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“Global Current Account Imbalances and Exchange Rate Adjustments”

*Brookings Papers on Economic Activity 1:2005*, pp. 67-123

We develop a three-region economic model to assess how a significant reduction in global current account imbalances might impact dollar, euro, and Asian real exchange rates under alternative scenarios. Sizable exchange rate shifts appear to be a necessary corollary of adjustment even under otherwise relatively benign scenarios where appropriate policy actions are taken (for example, to raise U.S. national saving or to make Asian exchange rates more flexible). Our baseline estimate suggests that a halving of the U.S. current account deficit would entail nearly a 20 percent appreciation of Asian real exchange rates versus the dollar and a slightly smaller rise in European currencies. Although an adverse scenario is not the most likely outcome, the risks appear to be significantly higher than they were five years ago.

JEL codes: F11, F32, F37, F41