

## **Assessing real exchange rate misalignment in the EU**

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Exchange rate assessment is becoming increasingly relevant for economic surveillance in the EU. The reduction of interest rate spreads and the persistence of different productivity dynamics among euro-area countries after the introduction of the euro were matched by widening current account imbalances and divergent dynamics in real effective exchange rates within the euro area. Abundant capital inflows into transition countries were often coupled with conspicuous current account deficits and price competitiveness losses.

Including in light of the above mentioned developments, DG ECFIN of the European Commission has been putting in place and using a battery of analytical tools for the detection of cases of exchange rate misalignment. These analytical tools are broadly similar to those used by Consultative Group on Exchange Rate Issues (CGER) of the International Monetary Fund. Approaches based on information about current account balances are considered together with methodologies producing estimates directly from information on relative prices (both real effective exchange rate and gaps between nominal and PPP parities).

This paper reviews and illustrates the methodologies employed to assess exchange rate misalignment and discusses results for EU countries. In doing that, it aims at pursuing a threefold objective.

First, it aims at clarifying the meaning and limitations of different approaches for the estimation of equilibrium rate misalignment.

Second, the paper aims at identifying the key features and properties of misalignment estimates according to the different approaches.

Finally, the paper analyses the relations among different misalignment measures. Should one expect different misalignment measures to normally point in the same directions? If yes, especially under what circumstances? Are different misalignment measures driven by the same underlying phenomena?

On the basis of results on the above questions, the paper aims at enucleating a series of principles and recommendations on how to come to an overall assessment and how to use the different measures.