External Adjustments and Coordinated Exchange Rate Policy in Asia *

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In this paper, we estimate structural VAR models with contemporaneous restrictions based on neo-classical and Keynesian theories to investigate whether the cause of current account surpluses for East Asian economies is a “saving glut” or undervalued currencies. Analytical results show that the major determinant of the current account is the real effective exchange rate for all East Asian countries with the exception of China for which the major determinant is domestic GDP. Accordingly, the recently requested revaluation of the Chinese yuan may not be an effective policy for reducing the Chinese current account surplus, and may affect other Asian current accounts. We also investigate whether a Chinese currency revaluation would contribute to the improvement of current account imbalances in East Asia and find that a revaluation would *improve* the current accounts of Japan, Korea, Indonesia, and Thailand. Since the trade structures of major East Asian countries are substitutes with that of China, a Chinese currency revaluation might not lead to a decrease, rather that an increase, in East Asian current account surpluses. Coordination of currency policy among East Asian countries is, therefore, needed to solve the global current account imbalance.

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