



SDI Review Form 1.6

PART 1:

Journal Name:	British Journal of Economics, Management & Trade
Manuscript Number:	MS: 2013_BJEMT_3232
Title of the Manuscript:	CURRENT ACCOUNT AND EXCHANGE RATE DYNAMICS IN PRESENCE OF RISK AND ECONOMIC SHOCKS.

General guideline for Peer Review process is available in this link:

(<http://www.sciencedomain.org/page.php?id=sdi-general-editorial-policy#Peer-Review-Guideline>)

- This form has total 9 parts. Kindly note that you should use all the parts of this review form.



SDI Review Form 1.6

PART 2: Review Comments

	Reviewer's comment This paper does not contribute to the research question that is implied by its title. The authors use exclusively static regressions with MA errors. The econometric method is not adequate for the research question, it can be regarded as outdated. It is not possible to investigate dynamics using static regression equations. The motivation of the project is unclear. I surmise authors are interested in investigating the effects of oil price shocks on the U.S. current accounts. As authors state in the first paragraph of Section 1, such a shock may have direct (immediate) effects and indirect effects that need a longer time span to materialize. A static regression can only find immediate effects, and it is unable to discriminate effects from the regressors to the dependent variable and the reverse direction, as it is basically just a multiple correlation analysis. For example, the regressions in Tables 1 and 2 essentially analyze the same relationships between the variables 'exchange rate' and 'current account', conditional on some covariates. The study of dynamic effects would require dynamic modeling, with lags of variables included among the regressors. The attempted autocorrelation	Author's comment <i>(if agreed with reviewer, correct the manuscript and highlight that part in the manuscript. It is mandatory that authors should write his/her feedback here)</i> Although we have used the U.S. data to examine the recent behaviour of the current account balance and have tried to shed light on the dynamics of the exchange rate (see our response below) our model provides a general structure for such analysis for other countries.
--	--	---



SDI Review Form 1.6

	adjustment by a GLS variant does not assist in this aim. The theoretical discussion of Section II is only loosely related to the empirical results. A rudimentary overlapping-generations model would mainly imply that current account deficits and surpluses may follow each other over time. This is what equation (11) appears to say, even though it is slightly incorrectly derived from the line above, omitting the discount factor $(1+r)$. The succeeding comparative static analysis in graphs is not very helpful in motivating the completely static statistical models in Section III.	We made the model dynamic by adding lag variables of the P_{oil} in eq. (14) and we added to more columns in Table 2, where we show the results from the dynamic effects. In this paper we have used a simple two period model to provide the analytical foundation. Such intertemporal models are routinely used as the basis for dynamic analysis. We corrected the typo and included the omitted discount factor in our derivation. The main result regarding the relationship between CAB of period 1 and CAB period 2 remains unchanged.
--	---	---



SDI Review Form 1.6

--	--	--



SDI Review Form 1.6

<u>Compulsory</u> REVISION comments	Dynamic models should be estimated, their results should be carefully evaluated. The monthly data used in this manuscript appears to be good and adequate for this purpose.	See Table 2 for the new estimations (the 2 columns are highlighted in yellow colour).
<u>Minor</u> REVISION comments	1. At the beginning, it is often unclear whether the statements refer to the world or to an oil-importing country or to the United States. I surmise that the U.S. situation is targeted from the very start. 2. It is unclear why a rise in the price of oil immediately and directly causes a depreciation of the U.S. exchange rate. There is a direct effect on the <i>real</i> exchange rate, with home goods suddenly cheaper than imported goods, i.e. a real depreciation. All substitution effects take time. 3. I is unlikely to denote real investment, it may mean 'fixed investment'. Note that 'wL' and 'qN' refer to nominal aggregates that reflect prices 'w' and 'q'. Maybe prices are meant to be relative prices, but this is not stated. 4. In line 182, E_1 ad E_2 may refer to A_1 and E_1. 5. Note that the Durbin-Watson statistic measures first-order autocorrelation only. Correlation across three months appears to be strong, a DW value of 1.786/1.729 does not suffice for indicating that the regressions in the second columns of Table 1/2 are correctly specified. At least, a Q test or Breusch-	5. In addition to the D-W statistic, we did a cointegration test (See Table 3) that show a stationary linear combination exists for



SDI Review Form 1.6

	Godfrey should be used. Even then, the regression model remains silent on all dynamic effects. 6. All standard errors in Table 1 are in the wrong positions. 7. The main effect by current accounts on the exchange rate undergoes a sign change when OLS is replaced by GLS, and it becomes insignificant. This effect is not commented in the text. 8. If the exchange rate is really defined as the price of the dollar in euro, an increasing exchange rate means an appreciation not a depreciation, at odds with statements in the text. 9. The phrase 'people were invested' does not sound reasonable to me.	both eqs. (13) and (14). Also we did a Q test and a Breusch-Godfrey test. The results are highlighted in the text in yellow colour. 6. We shifted the standard errors in Table 1 to the right position. 7. The Current account does not have significant effect on the spot rate. 8. The exchange rate is defined as \$/€. An increase in exchange rate means depreciation of the dollar. (Direct quotations for the U.S. or in American terms).
<u>Optional/General</u> comments		Thank you for your comments.