Highlights of "Through the Looking Glass: A WARPed View of Real Exchange Rate History"

- Following the seminal work of Fahle, Thomas, and Marquez (2008), who introduced a new RER index called "Weighted Average Relative Prices" (WARP) to correct an index numbers problem in extant indices, and produced it for the US from 1970-2006, I have produced WARP indices for **154 countries** for the period 1950-2011 using the last three versions of the Penn World Tables.
- I have also produced an historical WARP index for the US, from **1820 to 2011**. I find that in the early 2000s, during the collapse in US manufacturing, the US price level had not been that high relative to trading partners since the worst year of the Great Depression.
- I propose making a productivity adjustment to WARP to adjust for the observed "Penn Effect", and also produce Penn Effect-adjusted WARP indices for 154 countries over the period 1950-2011.
- As the IMF's Relative Unit Labor Cost index also suffers from the same index numbers problem (which I call the "trading-partner substitution bias" problem), and uses fixed, outdated trade weights that do not include China, I propose a new Weighted Average Relative Unit Labor Cost index (WARULC) which solves these problems. I produce this index for a handful of major economies.
- For the US, I show that the WAR indices seem to do a better job predicting trade flows and declines in manufacturing employment than do previous RER indices, and that these indices have better in-sample fit and out-of-sample predictive power (particularly the P-WARP index).