

Exchange Rates and External Adjustment

Chapter 2 of the

2019 IMF *External Sector Report*

Discussion by
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Chapter 2 Conclusions

- Role of exchange rate in trade adjustment is little changed, at least over medium term.
- Real depreciation boosts trade balance in line with historical estimates.



Global Value Chain Implications

- GVCs raise import content of exports.
 - Depreciation directly raises export cost, reducing the ability to cut export price in foreign currency.
 - GVCs boost total exports and imports, thus raising the base on which exchange rates operate.
- GVCs create new margins for adjustment.
 - E.g., Toyota builds Camry in Japan, China, Russia, Thailand, and United States.
 - When dollar rises, the import price stays fixed in dollars, but Toyota shifts production outside the United States and increases imports.



Dominant Currency Pricing

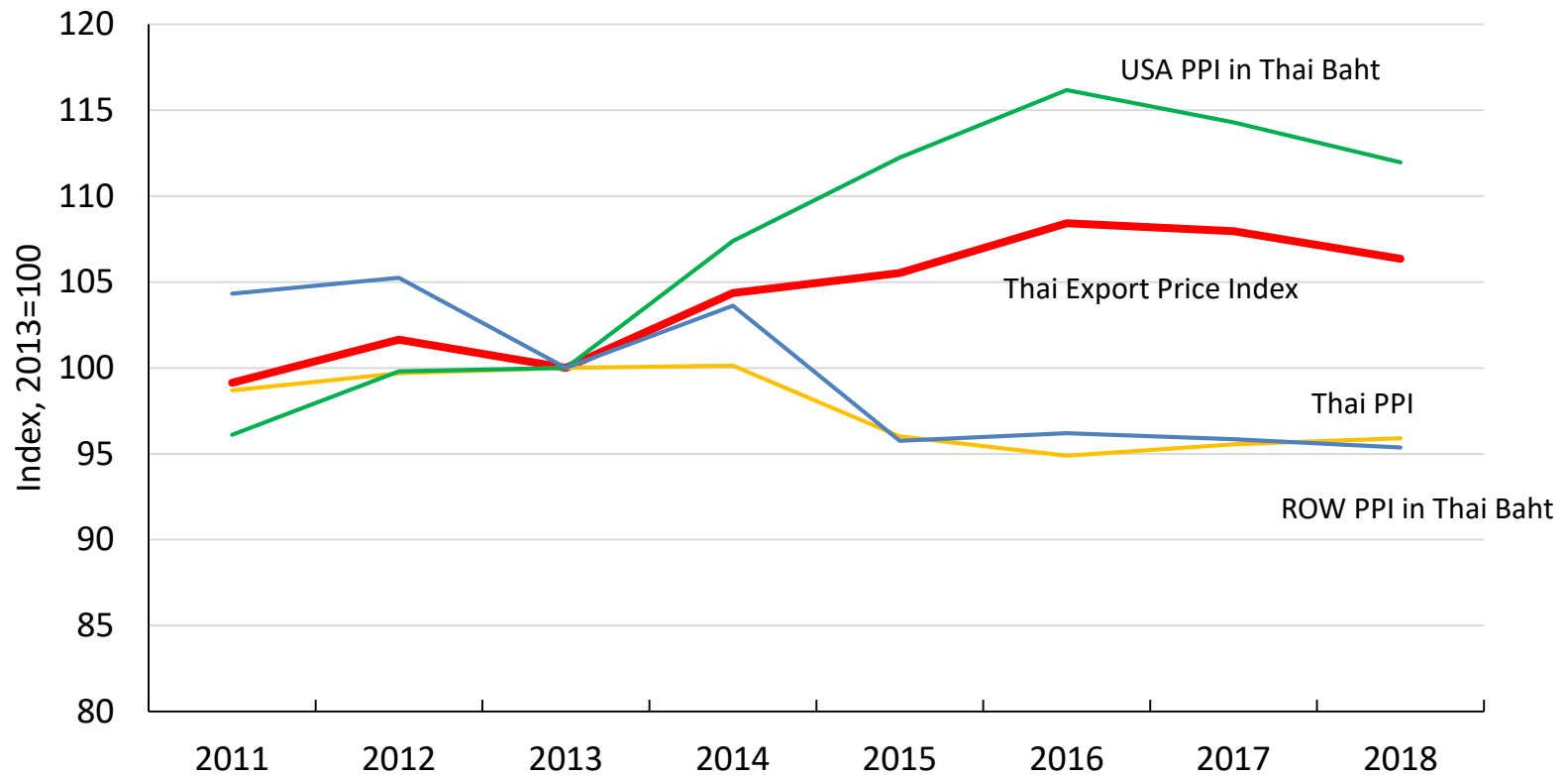
- Thai exports to, and imports from, Chile are priced in US dollars not baht or pesos.
 - Baht depreciation initially boosts Thai export and import prices.
 - Over the medium term, trade prices reflect combination of domestic and foreign prices.
- Research on dollar's dominant role overlooks an important alternative.
 - Trade prices may move with global average prices, not solely exporter, importer, or US prices.



Pricing Alternatives

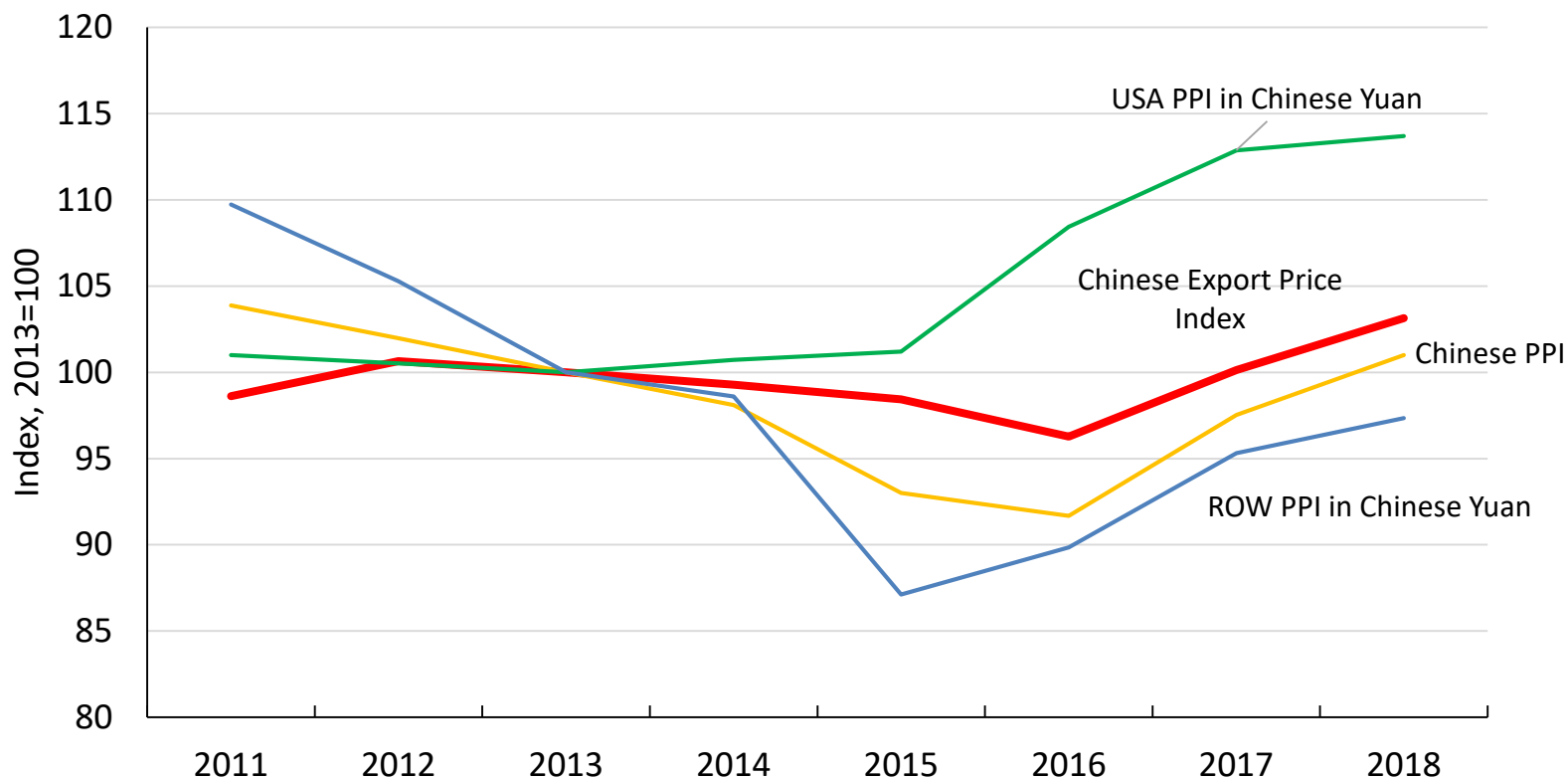
- Classic model: producer currency pricing
 - PX moves with exporter PPI
- 1990s model: destination currency pricing
 - PX moves with destination PPI
- Latest model: dominant currency (dollar) pricing
 - PX moves with US PPI
- Next model?: global currency pricing
 - PX moves with global PPI
- Truth may be a mixture of the above models

Export Prices and Recent Dollar Appreciation: Thailand



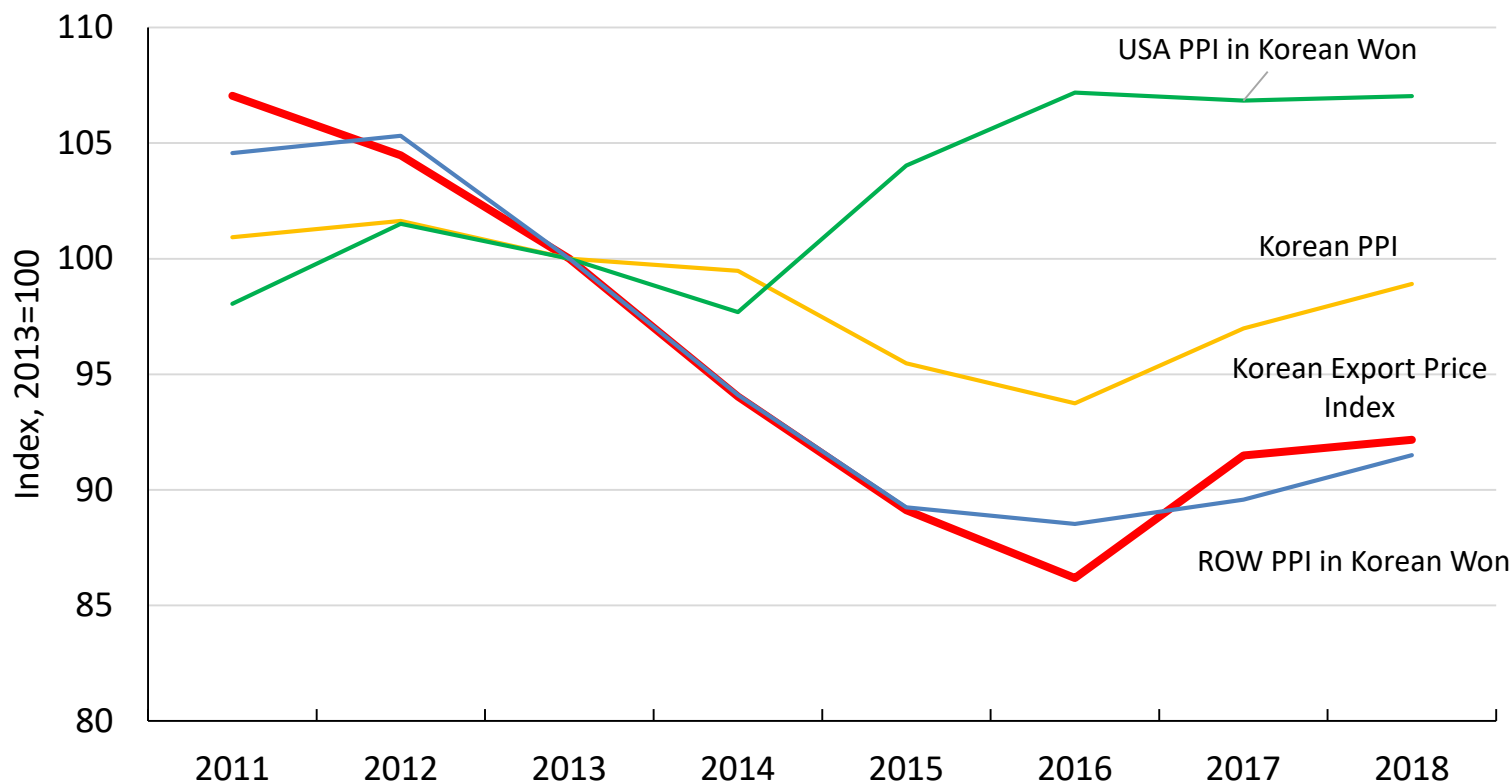
Note: ROW PPI is expressed in local currency based on JP Morgan's PPI-based real effective exchange rate.
Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.

Export Prices and Recent Dollar Appreciation: China



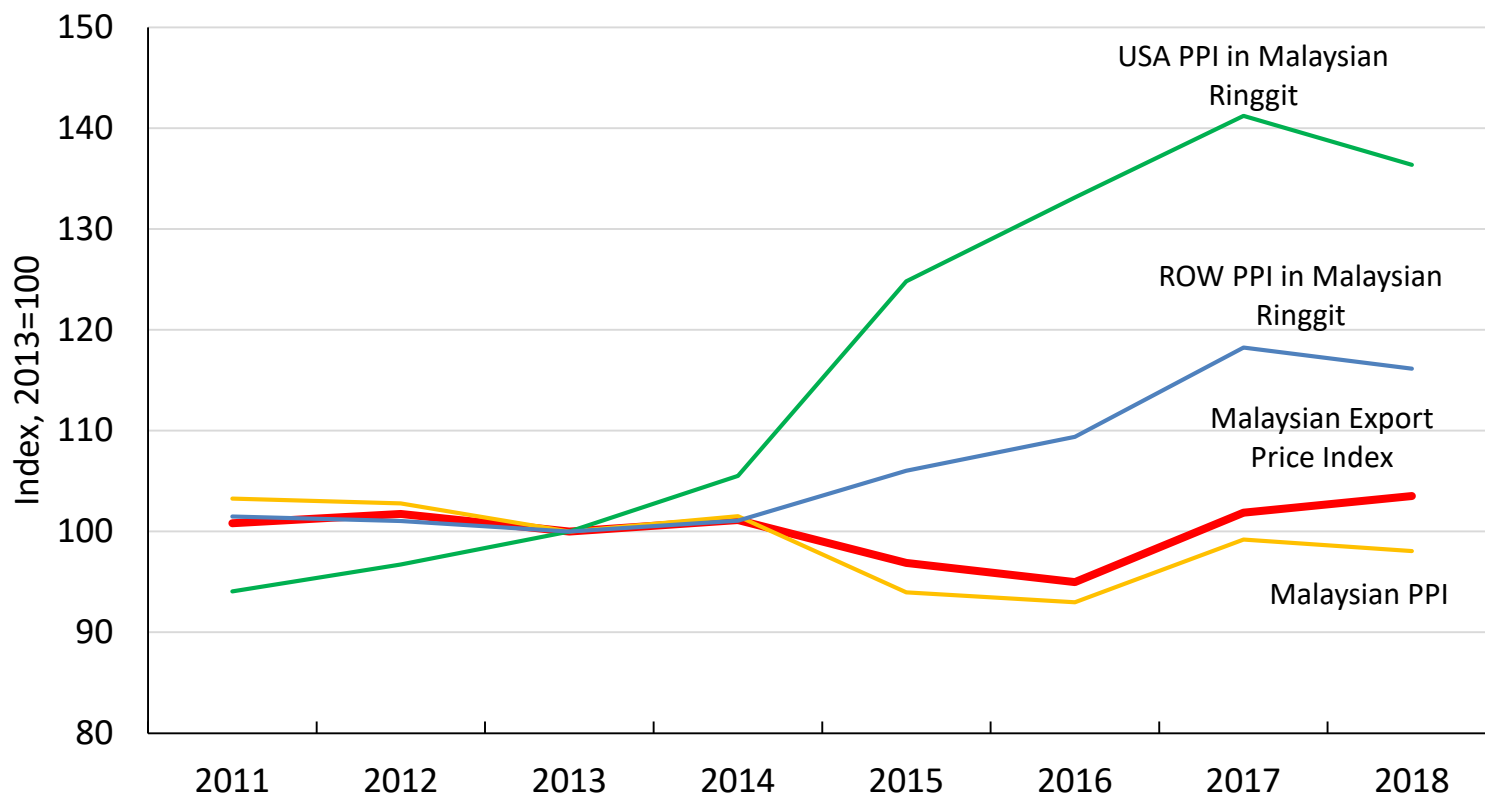
Note: ROW PPI is expressed in local currency based on JP Morgan's PPI-based real effective exchange rate.
Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.

Export Prices and Recent Dollar Appreciation: Korea



Note: ROW PPI is expressed in local currency based on JP Morgan's PPI-based real effective exchange rate.
Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.

Export Prices and Recent Dollar Appreciation: Malaysia



Note: ROW PPI is expressed in local currency based on JP Morgan's PPI-based real effective exchange rate.
Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.



Export Unit Value Correlations, 1994-2017: Averages Across 16 Countries

	USA PPI	ROW PPI	Exporter PPI
Short Run (1-year change)	0.59	0.74	0.64
Medium Run (4-year change)	0.54	0.78	0.73

Note: The US PPI is converted into local currency using the bilateral exchange rate. ROW PPI is expressed in local currency based on JP Morgan's PPI-based real effective exchange rate. Countries are Canada, China, Colombia, India, Indonesia, Israel, Korea, Malaysia, Mexico, Philippines, Singapore, South Africa, Sweden, Switzerland, Thailand, and Turkey.

Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.



With What Are Export Prices Most Correlated?

	USA PPI	ROW PPI	Exporter PPI
Short Run (1-year change)	Israel, Thailand	China, India, Indonesia, Korea, Malaysia, Mexico, Philippines, South Africa, Sweden, Switzerland, Turkey	Canada, Colombia, Singapore
Medium Run (4-year change)	Philippines	China, India, Israel, Korea, Mexico, South Africa, Sweden, Thailand, Turkey	Canada, Colombia, Indonesia, Malaysia, Singapore, Switzerland

Note: See previous slide.

Sources: World Bank WDI, International Monetary Fund IFS, JP Morgan/Haver, and author's calculations.



Conclusions on Pricing

- Research shows that the dollar plays a role in export pricing even after controlling for local costs and destination prices.
- However, the apparent role of the dollar may be overstated owing to omission of a global market factor.
- More research is needed.