PRESS POINTS FOR CHAPTER 3: EXCHANGE RATES AND TRADE: DISCONNECTED?
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Key Points

- Unusually large changes in the exchange rates of major currencies—in the 10–30 percent range in real effective terms—have kindled a debate on the likely effects of these changes on trade.

- Some suggest exchange rate movements are less relevant than they used to be for trade, which could complicate policymaking.

- Analysis in this chapter, based on data for advanced and emerging market and developing economies over three decades, finds that exchange rate movements still have sizable effects on exports and imports.

- A 10 percent real effective depreciation in an economy's currency raises real net exports by, on average, 1.5 percent of GDP, with substantial cross-country variation around this average.

- Little sign of disconnect between exchange rates and trade. Recent exchange rate movements imply substantial redistribution of net exports across economies. Exchange rates can still help reduce trade imbalances.

Recent currency movements have been unusually large. The U.S. dollar has appreciated by more than 10 percent in real effective terms since mid-2014, while the euro has depreciated by more than 10 percent since early 2014 and the yen by more than 30 percent since mid-2012. Large exchange rate changes have also occurred for a number of emerging market and developing economies.

There is a debate on the likely effects of these currency movements on trade. Some predict strong effects on exports and imports, based on conventional economic models. Others point to the limited changes in trade balances in some economies—in Japan, in particular—implying an apparent disconnect between exchange rates and trade. And some argue that the increasing fragmentation of production across different countries has reduced the relevance of exchange rates for trade.

Shedding light on this issue is important, as disconnect between exchange rates and trade could complicate policymaking. It could weaken a key channel for the transmission of monetary policy by reducing the boost to exports that comes with currency depreciation when monetary policy eases. It could also complicate the resolution of trade imbalances, such as when imports exceed exports, via the adjustment of relative trade prices.

The chapter's analysis suggests that exchange rate movements still have strong effects on trade (Figure 1). The analysis examines the experience of both advanced and emerging market and developing economies over the past three decades—a wider sample than is typically examined. It finds that a 10 percent real effective exchange rate depreciation comes with, on average, a rise in real net exports of 1.5 percent of GDP, with substantial variation around this average. Although it takes some years for the effects to fully materialize, much of the adjustment occurs in the first year.

Figure 1. Effect of a 10 Percent Real Effective Depreciation on Real Net Exports
(Percent of GDP)

Source: IMF staff calculations.
Note: Figure shows long-term effect on level of real net exports in percent of GDP based on country-specific import- and export-to-GDP ratios and the average producer price index–based trade elasticities reported in Table 3.1 for the 60 economies in the sample.

There is also little sign of a trend toward disconnect between exchange rates and trade. Some evidence indicates that the rise of global value chains, with different stages of production located across different countries, has weakened the relationship between exchange rates and trade in intermediate products used as inputs into other economies' exports. But global-value-chain-related trade has increased only gradually through the decades, and the bulk of global trade still consists of conventional trade. There is also little sign of a weakening in the responsiveness of exports to relative export prices, or in the effects of exchange rates on trade prices. A key exception to this pattern is Japan, which displays some evidence of disconnect, with weaker-than-expected export growth despite substantial exchange rate depreciation, although this weak export growth reflects a number of Japan-specific factors.

Recent currency movements thus imply a substantial redistribution of real net exports across economies (Figure 2). The currency movements since January 2013 point to a redistribution of real net exports from the United States and economies whose currencies move with the dollar to the euro area, to Japan, and to economies whose currencies move with the euro and the yen. (Beyond these direct effects, changes in exports and imports also reflect shifts in the underlying fundamentals driving exchange rates themselves, such as demand growth at home and in trading partners, and movements in commodity prices.) Among economies experiencing currency depreciation, the rise in exports is likely to be greatest for those with slack in the domestic economy and with financial systems operating normally.

For policymakers, a key implication of the results is that exchange rate adjustments can still help to reduce trade imbalances. Exchange rate changes also continue to have strong effects on export and import prices, with implications for inflation dynamics and the transmission of monetary policy.

Figure 2. Illustrative Effect of Real Effective Exchange Rate Movements since January 2013 on Real Net Exports
(Percent of GDP)

Greater than 1.5%
0.5 to 1.5%
0 to 0.5%
−1.5 to 0%
−1.5 to −3%
Less than −3%

Source: IMF staff calculations.
Note: The illustrative effects of CPI-based real effective exchange rate movements from January 2013 to June 2015 on real net exports in percent of GDP are based on the average consumer price index (CPI)–based estimates of the exchange rate pass-through into export and import prices and the price elasticity of exports and imports reported in Table 3.1. These average estimates are applied to all economies. Country-specific shares of exports and imports in GDP used in the calculation are from 2012.