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Discussion of:
"Exchange Rates and Trade: Disconnect"
by Daniel Leigh, Weicheng Lian, Marcos Poplawski-Ribeiro, Rachel Szymanski, Viktor Tsyrennikov and Hong Yang

"Exchange Rates and External Adjustment" Conference

Zurich, June 24-25, 2016

Trade & exchange rate relationship: it's complicated!

- **Heterogeneity** across products (aggregation bias, Imbs and Mejean, 2015) and countries
- **Endogeneity** issues. The nature of the shocks matters (Bussiere, Lopez and Tille, 2015).
- **Omitted variable bias**. Numerous factors matter, such as macroeconomic and financial conditions.
- Possible **non-linearities** (Bussiere, 2013), esp. in the short run
- Structural changes: **GVC trade**, globalization
- **Statistical issues**, noisy trade data
- Methodological issues (micro versus macro, ECM, gravity), etc

➢ *Considerable differences in the magnitude of trade elasticities across studies + time varying coefficients*

A much needed exercise

- Exchange rate elasticities play a crucial role in the global economic environment
  - Currency wars, global imbalances, monetary policy, etc
- We need more papers that choose a specific angle and compare/combine results
- One of the key decisions:
  - either take a very narrow approach (but loss of generality)
  - or use a very broad dataset (hoping that errors will cancel out), which is the choice here
- Still, several important decisions to make

A very nice paper!!!

- The paper presents 3 sets of results
  - Reduced form regressions for individual countries using annual data; cross-country average is reported.
  - Analysis based on large depreciations à la Cerra & Saxena
  - Sectoral level data
- Very carefully executed; very clear
- Noteworthy and plausible results overall
  - The paper provides elasticities for XP, XV, MP, MV
  - There is no disconnect, ML conditions hold, elasticities are stable over time
- Still, a few questions…

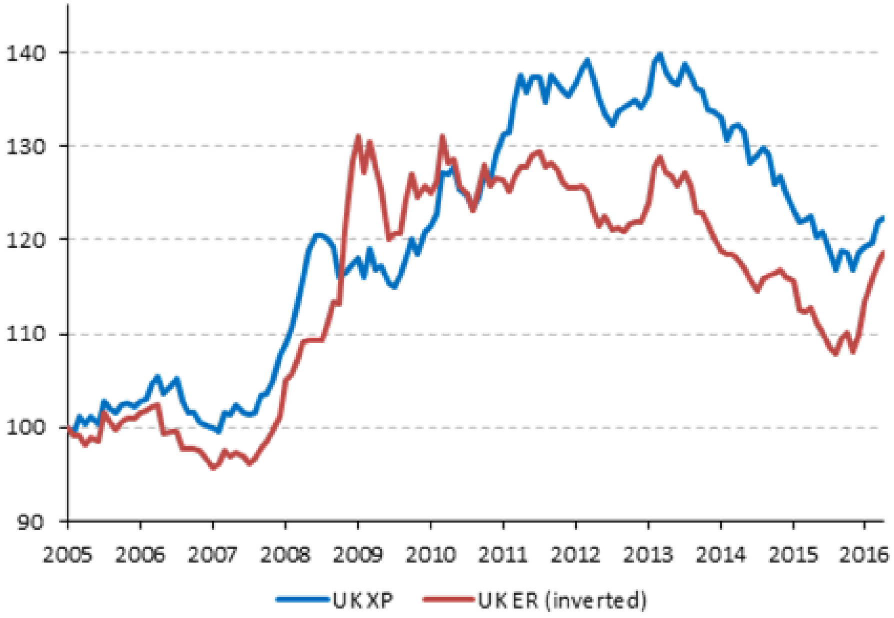
- Lots of very welcome features in the paper:
  - Focus on financial conditions and slack. More slack less exports following a depreciation?
  - Use of export prices (instead of CPI deflator as in Ahmed, Appendino, and Ruta, 2015)
  - Controlling for domestic and foreign input (and using IAD).
  - Focus on GVC trade (TBC). Prices react more, quantities less? (not so clear in the paper)
  - Check for cointegration
  - GEKS indices
  - Etc.

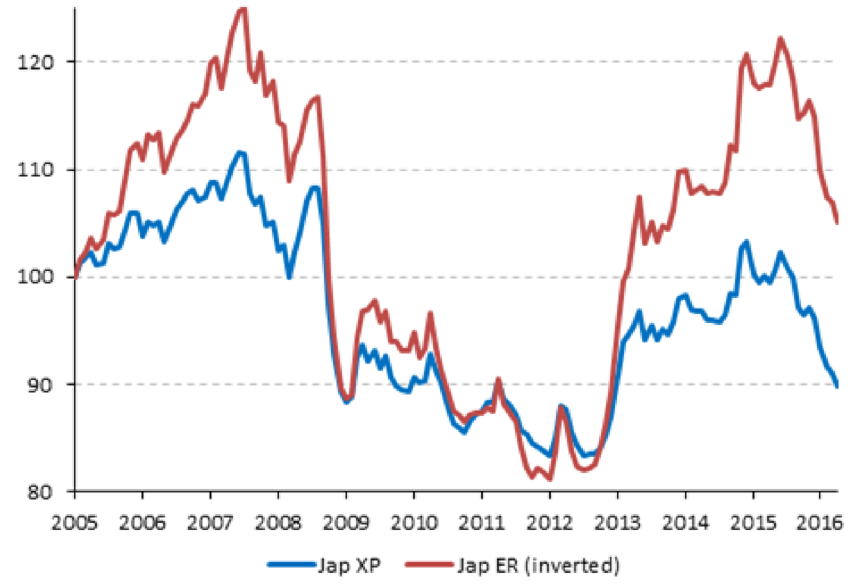
On the magnitude of the elasticities

- Minor point (exposition): the paper should flag their take-away results more clearly and clarify the units; clarify differences across methods
- The fact that ML conditions are accepted not a surprise. XP react strongly / incomplete pass-through. So the J-curve is no longer a J.
- Overall, elasticities in the first section are low
  - OK for prices at about 0.5 (more 0.4/0.6 but close)
  - For volumes 0.2 (to relative prices) is very low, even recalling that it is a macro elasticity (no disconnect?)
  - Own research more in the ballpark of 0.5 (Bussière, Gaulier and Steingress, forthcoming)

On the ML conditions

Strong reaction of XP to ER changes
(incomplete ERPT to MP)





To pool or not to pool? (the countries)

- **Key question**: should one use average estimates or individual estimates? There is a trade-off
  - Substantial heterogeneity across countries, even controlling for sectoral composition (BGS, 2016)
- Studies yield very clear differences across countries:
  - Clear for prices. ERPT is low in the US, high in some LatAm countries (AR), TU, RU, intermediate in European countries, etc. Sufficiently robust across different studies.
  - Perhaps less clear for volumes? Still…
- What should we do? Maybe depends how much you trust the individual country results; panel estimates a useful fall-back option.
- Country groupings? But not obvious which dimension

Further comments

- **Endogeneity** very hard to account for
- “historical episodes with large currency depreciations are more likely to be exogenous”: not sure!
- Understandable from the perspective of a foreign shock (contagion), but it is still a shock that affects trade and ER together
- Another problem is comparability:
  - Non-linearities
  - Problem with Twin crises (ER and banking), but even removing the latter. Note: this problem is esp. important for the effect on GDP
  - hard to infer elasticities “in normal times”

A complementary approach

- Bussière, Gaulier and Steingress (work in progress)
- Estimate for 50 systemically important countries the elasticity of export and import prices and volumes as well as the trade balance (BTW not reported in the IMF paper).
- Rely on detailed product level panel data across 190 trading partners covering 5000 products since 1995.
- Further analysis by means of fixed effects of the baseline results looking at 2 specific issues:
  - Time varying marginal costs (e.g. related to imported intermediate inputs)
  - Controlling for importer specific conditions (e.g. domestic demand shifter, supply or monetary shocks, etc.)

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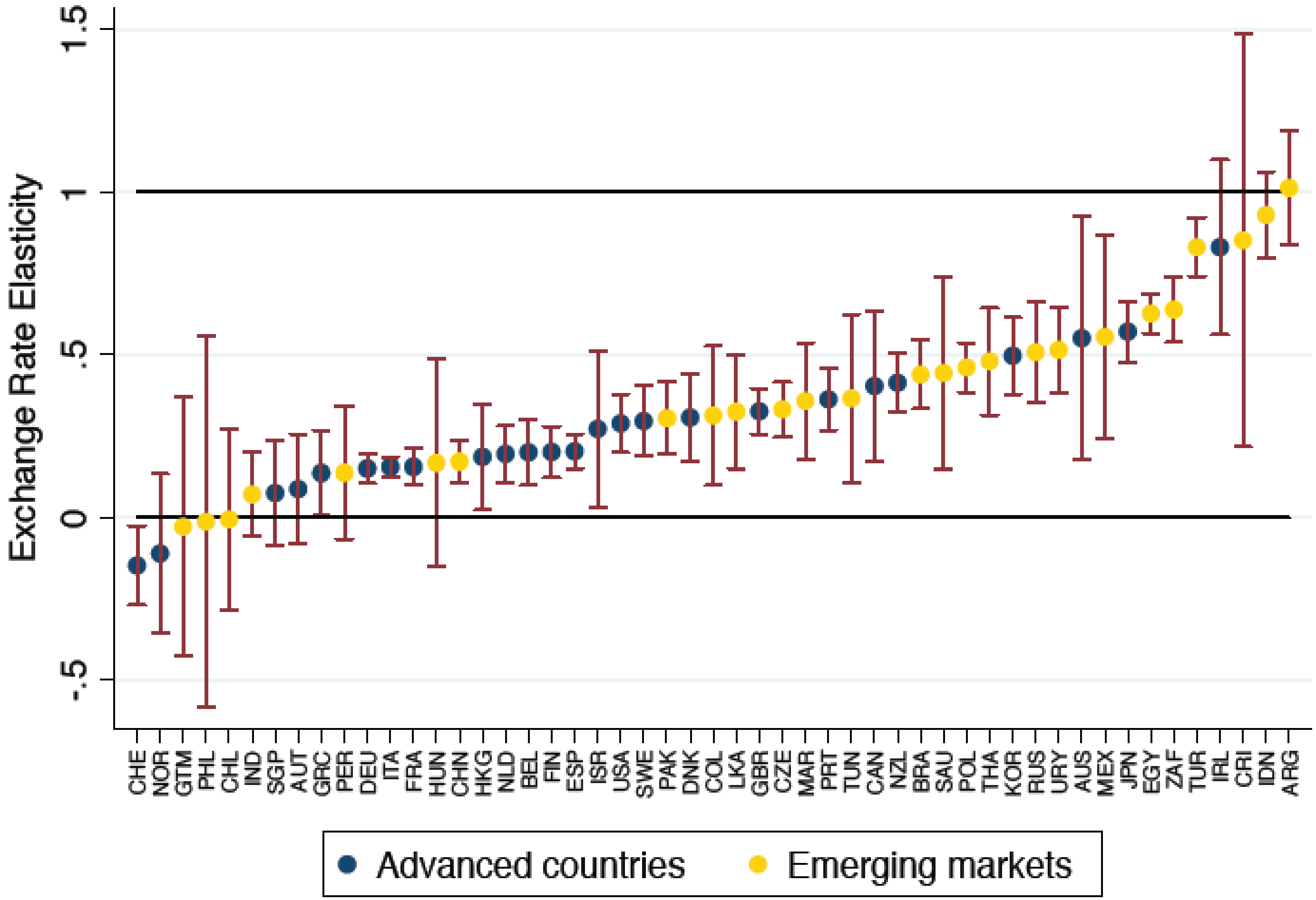
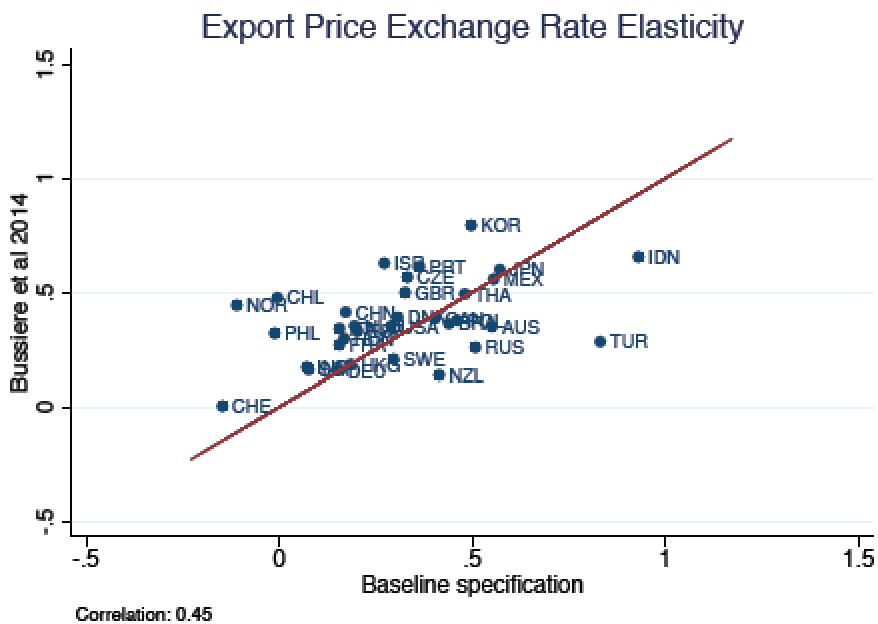
Baseline regression: export prices in exporter's currency



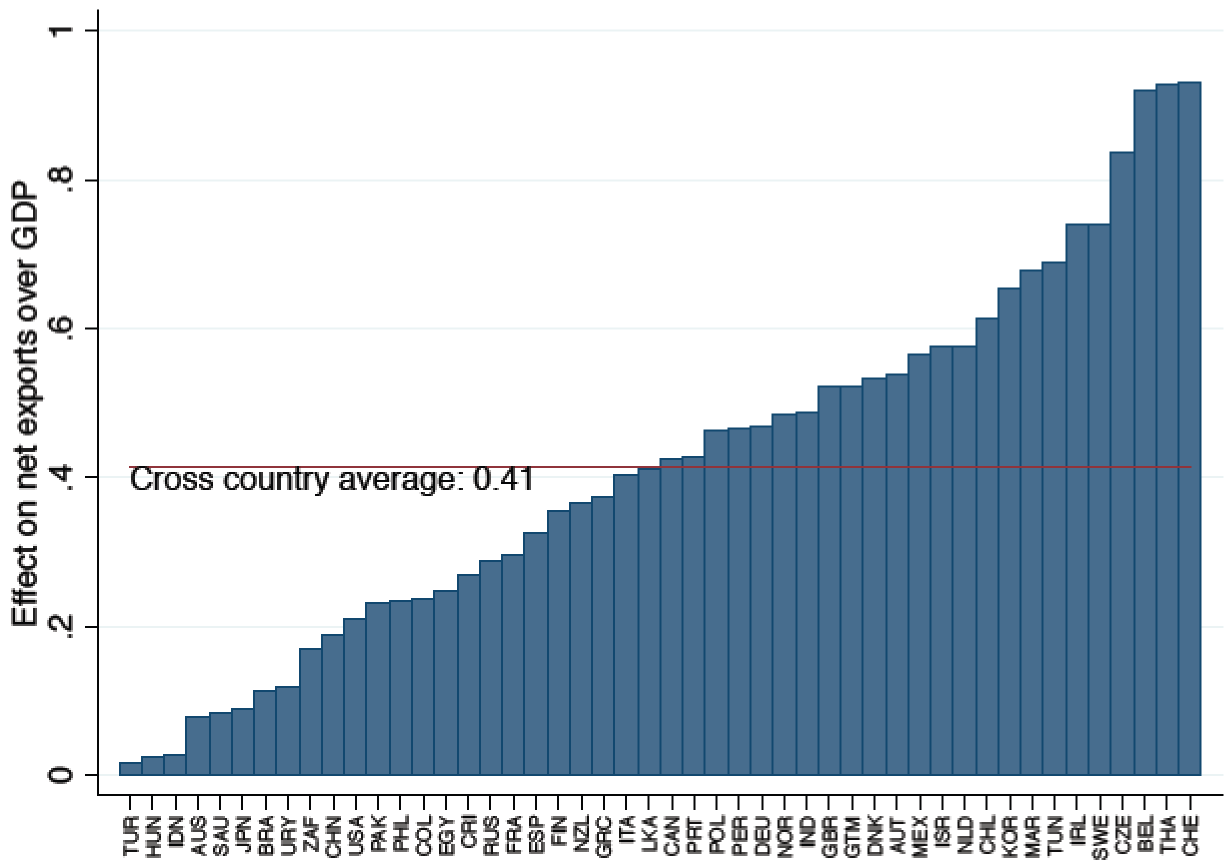
Bars represent 95% confidence interval

Baseline regression: export prices in exporter's currency
Correlation with previous study

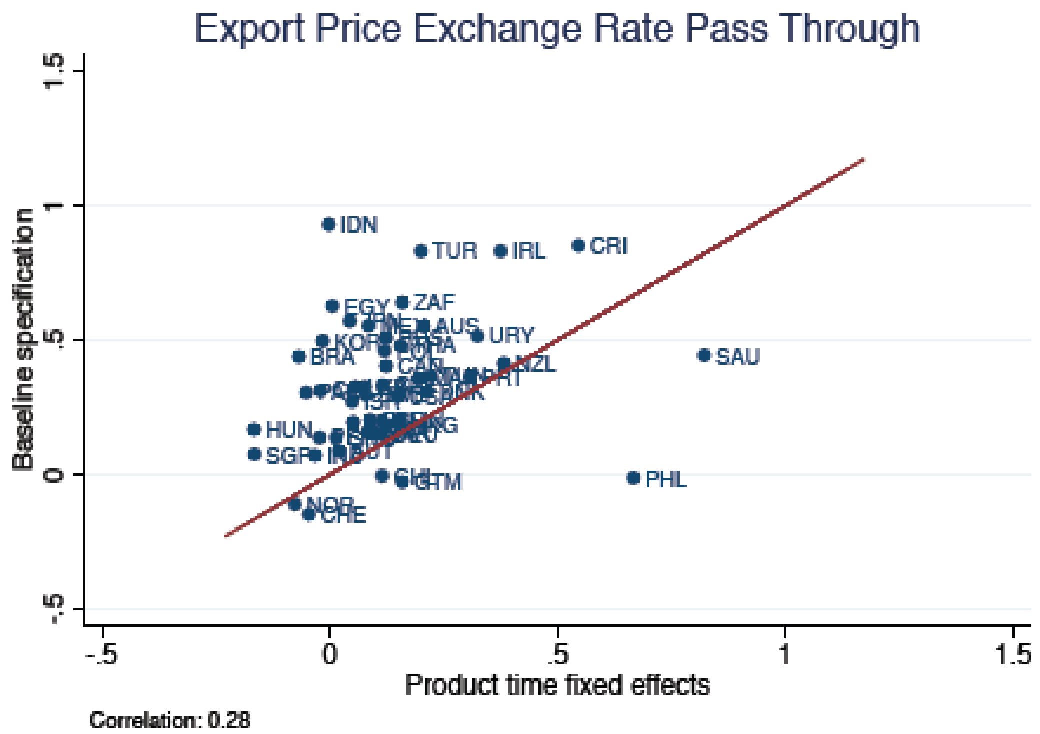


(a) Correlation is 0.45

Baseline regression: effect on the trade balance



Regression with exporter time-varying FE
Interpretation is that removing time-varying costs lowers the elasticity considerably



(c) Exports

To conclude

- Excellent paper: very careful, complete, transparent, convincing work
- The results will be useful to practitioners and should be of interest to academics as well
- Volume elasticities perhaps on the low side
- The question of whether to use average or individual country elasticities remains open
- Not the end of the story: other approaches should be used as a complement