How does exchange rate volatility influence exports?

The debate about the influence of exchange rates volatility on trade is intensifying, as US President Donald Trump attempts to blame the People's Republic of China's exchange rate policy for the US current account deficit.

The link between exchange rates and trade is a complex one, and while there are several analyses of this relationship, none is considered definitive.

Some experts say exchange rate volatility increases the uncertainty of companies about potential export profit, leading them to reduce exports, but that is theoretical. Others say a significant proportion of companies will increase exports, aiming to offset the loss on each exported unit. This explanation is strongly contested.

A key number is gross trade, the figures for which are often misleading in relation to exchange rates. This is because of the prevalence of multi-country supply chains in the global production process, whereby a product finished in, for example, China and exported by China, may have been made from parts imported by China.

Value-added trade gives a much clearer picture, taking into account the fragmentation of the production process.

Exchange rate volatility has a strong impact on value-added trade and leads to a decrease of value-added exports. Remove foreign indirect inputs from the picture, and the effects of exchange rate volatility on manpower and investment costs are revealed.

To contain the effects of exchange rate volatility, governments need to coordinate monetary policies, or at least be transparent about them. Global production networks, with lower trade and investment barriers, would also be helpful.

Yizhe Daniel Xie is a PhD candidate at the Graduate School of Asia-Pacific Studies, Waseda University, and a non-resident fellow at the CSIS Pacific Forum.

Listen to podcast

- https://soundcloud.com/adbinstitute/how-does-exchange-rate-volatility-influence-exports

Read the blog post

- https://www.asiapathways-adbi.org/2017/04/how-does-exchange-rate-volatility-affect-value-added-and-gross-trade/