Panel Discussion
Conference on Exchange Rates and Prices

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December 7, 2007
At FED NY
The distribution chain to explain PT
Chain of distribution, PTM, and PT

Exporters

Exporter mark up decision (PTM) As a function of exchange rate

Exchange rate

Currency invoicing

Nakamura, Alessandria, et al.

Importers

Importer mark-up decision

PM=(1+t)PX/s

PM(1+mm)

Border

Retail price

PM(1+mm)+dM

Local costs; sales tax

Gopinath, et al.

C+dx

Domestic prices

Takatoshi Ito

Pass-through

C

PX=C(1+mx)

Bergin-Feenstra.

LOP? Crucini-Telmer

Crucini-Telmer

Nakamura, Alessandria, et al.

Schmitt-Grohe, et al.

Berger, et al.

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C

PX=C(1+mx)

Bergin-Feenstra.

Gopinath, et al.

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How to measure an entire PT?

• All papers explain only pieces of the pass-through
  – Can we see a whole picture? Exchange rate to retail price
    • Profit margin of exporters
    • Profit margin of importers
    • Profit margin of distributors of importing countries
  – Do we know dynamics?
    • Short-run and medium-run responses
    • Temporary vs permanent exchange rate changes
Pass-through (PT) Questions

• (1) Why is PT an important question?
  – Effects of exch rate changes on trade balances (J-curve)?
  – Will exch rate changes help global imbalances to disappear?
  – Comparison of the past/current episodes

• (2) What Determines the PT magnitude
  – Micro: Exporters’ behavior; Importers’ behavior
  – Macro: Composition imports effects on import prices
  – Micro/Macro: Will LOP hold?

• (3) Implications to Monetary/ExRate policies
  – Macro: Will devaluations cause inflation?
  – Macro: Should inflation (due to devaluation) be accommodated?
(1) Why is PT an important question?

- **Effects of exch rate changes on trade balances (J-curve)?** Will exch rate changes help global imbalances to disappear?
  - Bergin and Feenstra, China factor (China share increase lowers PT and J-curve)
  - Alessandria, et al. Lumpy trades (faster than J?)

- **Comparison of the past/current episodes**
  - Krugman, trade structure has changed and that may change PT; old trade theory may be more relevant now, while new trade theory was in 1980s.
(2) Determinants of PT magnitude

- **Micro: Exporters’ behavior; Importers’ behavior**
  - Alessandria, et al. Lumpy Trade (Importers’ inventory management)
  - Nakamura, Coffee (markups are adjusted)
  - Berger et al. (Border prices and Retail prices)

- **Macro: Composition imports effects on import prices**
  - Bergin and Feenstra, China factor
  - Krugman, trade compositions matters for PT(?)

- **Micro/Macro: Will LOP hold?**
  - Crucini and Telmer, challenging a conventional wisdom (real exch rate volatility = nominal exch rate volatility)
(3) Monetary/ExRate policies

- Macro: Will devaluations cause inflation?
- Macro: Should inflation (due to devaluation) be accommodated?
  - Takatoshi Ito and Kiyotaka Sato, “Exchange Rate Pass-Through and Domestic Inflation: A Comparison between East Asia and Latin American Countries”
- Macro: Currency denominations matter?
  - Gopinath, et al. (Currency choice matters for PT)
Policy Implications: Low PT

• [True?] Low PT due to commodity effect?
• [Resilience] Companies (or a country) diversify sources of production and destination of sales, thanks to globalization. No need for intervention?
• [Good] The central bank does not have to worry about the exchange rate fluctuations (devaluation => inflation)?
• [Bad] Large exchange rate changes are needed to correct (accompany) global imbalances?
  – Large exchange rate changes needed if PT is low
  – China’s $-peg slows the adjustment over not only Chinese but other (Mexican) goods—China factor
  – Large devaluation would cause import collapse (Lumpy Trade, Krugman’s $ Plunge)