Discussion
Shocks vs Structure: Explaining Differences in Exchange Rate Pass-Through across Countries and Time
Forbes, Hjortsoe and Nenova

Philippe Martin¹

¹Sciences Po and CEPR

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Main original results

Follow-up paper of "The Shocks Matter: Improving our Estimates of Exchange Rate Pass-Through": more countries,

Pass-through of ERs into prices depends on origin of shocks and on structural parameters (26 SOEs)

- **Shocks:**
  - Domestic monetary shocks: high positive pass-through (appreciation leads to lower CPI)
  - Domestic demand shocks: low negative pass-through (appreciation leads to higher CPI)
  - Domestic supply shocks: no pass-through
  - Global shocks: no-pass-through

- **Shocks vs structure**
  - nature of shocks: short term variations in ER pass-through
  - structural variables (inflation variability): long term variations in ER pass-through
Shocks and pass-through

- Monpol: Appreciation + Recession = lower prices (higher pass-through)
- Demand: Appreciation + boom (lower pass-through)

Figure 4. Cross-country averages and ranges for the correlation between exchange rates and prices, eight quarters after SVAR shock

Notes: The light blue range depicts the range of median consumer price responses corresponding to a 1% exchange rate depreciation caused by different shocks across the 26 countries. The first column shows the estimates after a domestic supply shock, the second after a domestic demand shock, the third after a domestic monetary policy shock and the fourth and fifth after permanent and temporary global shocks, respectively.
Monetary vs demand shocks

Identification for shocks that generate exchange rate appreciation:

- Contractionary monetary shock: low GDP, low CPI
- Positive demand shock: high GDP, high CPI
- Lower pass-through during demand driven appreciation than during monetary driven appreciation
Interpretation?

- If shock is: recession (monetary policy tightening) + ER appreciation
  - Both recession and ER appreciation push CPI down: observe high positive pass-through

- If shock is: boom (positive demand shock) + ER appreciation:
  - Boom and ER appreciation push CPI in opposite direction: observe negative or small pass-through

- Is this the right interpretation?
  - Should we be surprised that (+ +) > (+ -) ?
  - Would interacting the ER and GDP growth in the standard pass-through equation generate similar conclusion (although would not identify the source of GDP fluctuations)
Clarification of theory

Other paper: "The Shocks Matter : Improving our Estimates of Exchange Rate Pass-Through"

- Lower pass-through of ER movements for demand than for monetary shocks: why?
- Markups or marginal costs of exporters, importers, intermediates (wholesale, retail..)?
- Some exporters choose LCP but face sticky prices: but true for any shock
- Exporters are forward looking: if expect future marginal costs to increase (boom) then increase prices now
- Persistence of shocks? Demand induced ER movements are less persistent than monetary policy induced in theory
  - See Drozd and Nosal (2012): importers and retailers absorb more volatile and less persistent shocks because they need to explicitly build market shares by matching with their customers
  - If process is costly and time consuming: pass-through only when shocks are persistent enough (monetary policy induced)
  - But then: Why are demand induced ER movements less persistent than monetary policy induced?
Procyclical local distribution costs and wages

- Local additive distribution costs (independent of exchange rate)?
  Corsetti and Dedola (2005)

- \( p^c_i = p^X_i s_i \tau_i + \eta_i w_i \) (\( w_i \) wage in distribution sector)

- Exporters prices: \( p^X_i = \frac{\sigma}{\sigma - 1} \left( 1 + \frac{\eta_i w_i}{\sigma \tau_i w s_i} \right) \frac{w}{\varphi} = \mu_i m c^X \)

- Exporters increase markup when destination currency appreciates (\( s_i \) falls): pass-through falls

- \( \frac{d p^X_i}{d s_i} \frac{s_i}{p^X_i} = \frac{\eta_i w_i}{\sigma \tau_i w s_i + \eta_i w_i} \): exporters absorb in their markup more exchange rate movements when high destination wages

- Intuition: share of producer prices in consumer price falls, perceived elasticity of demand falls

- Demand driven boom associated with appreciation: \( w_i \) increase; exporters markups increase; less pass-through of exchange rate into import and consumer prices
Some interesting potential policy implications

- *Quantities?* If pass-through to consumer (import) prices depends on nature of shocks, logical implication: elasticity of trade balance to exchange rate should also depend on shocks
- Monetary policy induced depreciations should imply more reductions of import quantities than demand shock induced depreciations: could be checked by estimating trade elasticities conditional on shocks
- Suggests that exchange rate channel of monetary policy is maybe underestimated in SOEs
- Again, intuitive and interesting
- Recession + Appreciation (monetary induced): imports fall (high elasticity)
- Boom + Appreciation (demand induced): imports?? (low elasticity)