

Accepted Manuscript

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PII: S1059-0560(18)30216-8

DOI: [10.1016/j.iref.2018.03.007](https://doi.org/10.1016/j.iref.2018.03.007)

Reference: REVECO 1608

To appear in: *International Review of Economics and Finance*

Received Date: 31 January 2016

Revised Date: 17 March 2018

Accepted Date: 21 March 2018

Please cite this article as: Aziz M.N. & Ahmad A.H., Exchange rate hysteresis in the UK imports from the South Asian Countries, *International Review of Economics and Finance* (2018), doi: 10.1016/j.iref.2018.03.007.

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Exchange Rate Hysteresis in the UK Imports from the South Asian Countries¹M. Nusrate Aziz²

and

A. H. Ahmad³**Abstract**

We investigate and find evidence for the hysteresis hypothesis in UK imports from South Asian countries, using a monthly sample of data that covers 1999 to 2012. This paper finds evidence of the asymmetric effect of exchange rate volatility that ‘large’ depreciations significantly reduce UK imports from Bangladesh; however, ‘large’ appreciations do not increase the imports significantly. We also find a partial support for the hysteresis hypothesis in UK imports from India, Pakistan, and Sri Lanka. We find that hysteresis can be both country- and commodity-dependent, which is largely consistent with previous empirical studies. Theoretical literature suggests that hysteresis occurs due to the presence of sunk costs, however, we find that hysteresis occurs even beyond the sunk costs.

Keywords: Hysteresis hypothesis, Sunk costs, Exchange rates, Recursive estimate

JEL Classification: C22, F31, F32

¹ We are grateful to the editor and two anonymous reviewers for their very useful and constructive comments.

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