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Exchange-rate volatility, trade and "fixing for life" in Thailand

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Abstract

At the outset of the 1997 financial crisis, the quest to find a more suitable exchange-rate policy has become an urgent task facing the East Asian economies. One of the key policies agreed under Thailand's August 1997 Letter of Intent (LOI) with the IMF was the adoption of a more flexible exchange-rate policy. However, the country re-adopted its pre-1997 crisis rigid exchange-rate policy in early 1999. To grasp this "fixing for your life" phenomenon, we test the impact of the exchange-rate volatilities of Thailand's baht against the yen and the US dollar on the performance of the country's bilateral trades with the two key partners.

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Keywords: Thailand; Exchange-rate volatilities; Exports; Imports; Rigid and flexible exchange-rate regimes

1. Introduction

Most of the empirical works have confirmed that the rise in the volatility of exchange rate in general does have some consequences on the trade flows. Yet, despite the best efforts of economists, a basic paradox as to whether the exchange-rate volatility benefits or adversely affects trade flows remains unresolved (McKenzie, 1999).

Among the studies reported in Table 1, only Chowdhury (1993) and Caporale and Doroodian (1994) show consistently adverse consequences of exchange-rate volatility on exports and imports. Other studies such as Klein (1990), McKenzie (1998), Bailey et al.

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Table 1
Empirical studies of exchange-rate volatility and trade flow

Author	Country/sample period	The effect of ER volatility to trade
Hooper and Kohlhagen (1978)	Germany, Japan, United Kingdom, United States, Canada, France (bilateral trade) (1965.1–1975.4)	*X*: Significant negative relationship in 2 equations, significant positive relationship in 4 equations and insignificant in 26 equations
Rana (1981)	South Korea, Philippines, Thailand, and Taiwan (multilateral trade) (1960.1–1976.4)	*M*: Significant negative relationship in 4 equations and insignificant for 1 equation for the pegged period in Taiwan equation
IMF (1984)	United States, United Kingdom, France, Germany, Italy, Canada, and Japan (bilateral trade) (1965.1–1982.4)	*X*: Significant negative relationship in 3 equations, significant positive relationship in 11 equations and insignificant in 28 equations
Kenen and Rodrick (1986)	US, Canada, Japan, Belgium, France, Germany, Italy, The Netherlands, Sweden, Switzerland, UK (multilateral trade) (1975.1–1984.2)	*M*: Significant negative relationship in 4 equations and insignificant in 7 equations
Bailey et al. (1987)	Canada, France, Germany, Italy, Japan, UK, US, Australia, New Zealand, The Netherlands, Switzerland (multilateral trade) (1962.2–1974.4 and 1975.1–1985.3)	*X*: Significant negative relationship in 3 equations, significant positive relationship in 5 equations and insignificant in 34 equations
Thursby and Thursby (1987)	Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Italy, Japan, The Netherlands, Norway, South Africa, Sweden, Switzerland, United Kingdom, and United States (bilateral trade) (1974–1982 (annually))	*X*: Significant negative relationship in 10 equations
Cushman (1988)	US (bilateral trade) (1974–1983 (annually))	*X*: The 2 of the 6 equations have a significant negative effect and 1 has a significant positive effect; *M*: the 5 of 6 equations have a significant negative effect
Koray and Lastrapes (1989)	US with UK, France, Germany, Japan, and Canada (bilateral trade) (1959.01–1985.12)	*M*: Significant negative relationship in 41 equations, significant positive relationship in 16 equations and insignificant in 39 equations
Lastrapes and Koray (1990)	US (multilateral trade) (1973.03–1987.12)	*X and M*: Significant negative relationship in 6 equations and insignificant in 42 equations
Klein (1990)	US with The Netherlands, Canada, Japan, France, Italy, Germany (sectoral analysis in bilateral trade) (1978.01–1986.12)	*X*: Significant negative relationship in 4 equations, significant positive relationship in 7 equations and insignificant in 43 equations
Asseery and Peel (1991)	Australia, Japan, UK, US, West Germany (multilateral trade) (1972.1–1987.4)	*X*: Significant negative relationship in 1 equation, significant positive relationship in 2 equations and insignificant in 3 equations