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Pass-through of Competitors' Exchange Rates to US Import and Producer Prices☆

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Abstract

This paper shows that in theory and BLS microdata, the prices of imported goods respond to the exchange rates (ER) of the producer's foreign competitors. In contrast, standard models have no role for competitors' ERs. Excluding the effects of competitors' exchange rates typically biases upwards estimates of bilateral exchange rate pass-through because competitors' ER and bilateral ERs are positively correlated. A multi-country version of Atkeson and Burstein's (2008) industry aggregation model is able to explain a sizable proportion of pass-through of competitors' exchange rates to import prices, and also predicts pass-through of foreign competitors' prices and pass-through of competitors' ERs to US producer prices — both of which are supported in the data. The results suggest that pass-through will be larger for ER movements shared by a greater fraction of foreign competitor countries.

Keywords: Exchange Rate Pass-through, Import Prices, Producer Prices.
JEL: E31, F12, F14, F31

1. Introduction

Standard empirical and theoretical models focus on the bilateral exchange rate (between exporting and importing countries) as the key international macroeconomic variable determining prices. However, since the 1980s (e.g. Dornbusch 1987) it has been appreciated that competitors' *prices* will be an important determinant of international prices in models where firms price strategically. In

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