CIFREM SEMINARS

Firm heterogeneity, financial integration and the impact of exchange rate volatility on international trade

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Via Inama, 5 - TN

This paper develops an open economy firm-heterogeneous model where the combination of market rigidities and exchange rate uncertainty acts like a barrier to trade and modify firm's optimal choice in terms of production and pricing. The existence of price and labor rigidities, coupled with imperfect financial integration and exchange rate uncertainty, separates incumbent firms into domestic producers, exporters setting the price in national currency and most productive exporters setting the price in foreign currency. The model predicts that only where financial integration is limited, a reduction in exchange rate uncertainty raises firm's profit, lowers prices, induces new firms to export. Fully financially integrated countries results perfectly insulated from exchange rate risk.

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