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An unexpected increase in the monetary policy rate generates a “Jcurve” pattern in the trade balance: in the short run, exports fall more than imports (the trade balance deteriorates), and in the medium term, imports fall more than exports (the trade balance improves).

Publication Date:
Thursday, 12 of February 2026

Approach

This study examines the effect of monetary policy on the trade balance, exports, and imports in Brazil, Chile, Colombia, Mexico, and Peru.
The author constructs monetary policy “surprises” as the difference between the central bank’s policy rate decision and the forecast made by analysts surveyed by Bloomberg prior to each monetary policy meeting; this difference isolates the unanticipated component of the policy rate. Using these surprises, the author estimates impulse–response functions through local projections for the period 1999–2024.

The magnitude of the transmission channels from monetary policy to external accounts is assessed by analyzing the response of the exchange rate and economic activity in each country. Additionally, the study examines the heterogeneity of the responses according to the type of exports and imports. A battery of robustness tests (changes in specification, exclusion of crisis episodes, and alternative measures of monetary shocks) confirms the main findings.

Contribution

Economic theory predicts ambiguous effects of a monetary shock on the trade balance, and the literature continues to disagree on the effects of monetary policy on exports. Exchange rate appreciation generated by a monetary contraction may reduce exports and increase imports, while a slowdown in domestic demand may reduce imports; the net effect depends on the relative magnitude of each transmission channel and on each country’s export and import structure.

This study provides empirical evidence to address this question in emerging economies, where identifying monetary shocks is more challenging due to the scarcity of highfrequency data. The researcher documents the dynamics of external adjustment following a monetary shock and explores the heterogeneity of this adjustment according to export composition (homogeneous vs. differentiated goods), the intensity of exchangerate appreciation, and the sensitivity of imports—particularly capital and durable goods—to interest rates. The results offer inputs for the optimal design of monetary policy.

Results

An unexpected increase in the monetary policy rate generates a “Jcurve” pattern in the trade balance.
In the short run, exports fall more than imports (the trade balance deteriorates), and in the medium term, imports fall more than exports (the trade balance improves).

The cumulative decline over 36 months in exports and imports following a onepercentagepoint monetary tightening is 4.5% and 5.9%, respectively. The exchange rate appreciates, and economic activity declines with a lag.

Effects vary across countries: in Brazil, the trade balance increases persistently; in Chile and Peru, the response is negative throughout the horizon; in Colombia and Mexico, the response is consistent with a Jcurve pattern. The author attributes this heterogeneity to the magnitude of exchangerate appreciation and the export/import structure: exports of homogeneous and highly substitutable products are more sensitive to exchangerate fluctuations than exports of differentiated goods. Imports of capital and durable goods are more sensitive to interest rates. Robustness tests confirm the main findings.