Testing the Short-and-Long-Run Exchange Rate Effects on the Trade Balance: The Case of Colombia

Hernán Rincón C. *

This paper examines the role of the exchange rate in determining the short-and-long-run trade balance behavior for Colombia testing the BRM and ML conditions, and the J-curve hypothesis. It uses a regression model formulation which includes income and money so that the monetary and absorption approaches to the balance of payments are also examined. The econometric procedure used is the Johansen and Juselius' approach to estimation of multivariate cointegration systems. The main result is that the exchange rate do play a role in determining the short-and-long-run behavior of the Colombian trade balance. Moreover, devaluation improves the trade balance, which is consistent with the BRM or ML conditions. The J-curve type of hypotheses are rejected. The results show also that the long-run effect of an exchange rate devaluation on the trade balance is enhanced if accompanied by reduction in the money stock and/or an increase in income. The findings with respect to income and money variables did not uniformly reject or accept hypotheses from the absorption or monetary approaches either for the short run or the long run.

JEL classification: F31; F32; F41; C32; C52

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