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IMF Working Paper

Trade Uncertainty and Investment in the Euro Area

by Christian Ebeke and Jesse Siminitz

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I N T E R N A T I O N A L M O N E T A R Y F U N D

IMF Working Paper

European Department

Trade Uncertainty and Investment in the Euro Area¹

Prepared by Christian Ebeke and Jesse Siminitz

Authorized for distribution by Jeffrey Franks and Shekhar Aiyar

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Abstract

We analyze the impact of trade policy uncertainty on investment in the euro area. Our identification strategy assumes that countries that are relatively more dependent on global trade networks exhibit a higher sensitivity of investment with respect to trade uncertainty. We find that the investment-to-GDP ratio is on average 0.8 percentage points lower for five quarters following a one standard deviation increase in the level of trade uncertainty. We demonstrate that these results are unlikely to be driven by omitted variables and that they are robust to different measures of trade uncertainty and trade openness. Our analysis suggests that the detrimental effect of trade tensions goes beyond lower trade growth, as uncertainty can reduce investment and the economy's long-term growth potential.

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