
Kodjovi M. Eklou

WP/23/111

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IMF Working Paper
Asia and Pacific Department

Dollar Exchange Rate volatility and Productivity Growth in Emerging Markets: Evidence from Firm Level Data
Prepared by Kodjovi Eklou*

Authorized for distribution by Lamin Leigh
May 2023

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ABSTRACT: This paper examines the impact of Dollar exchange rate volatility on firm productivity in Emerging Markets economies (EMs). Using firm level data covering 16 EMs over the period 1998 -2019, the paper shows that dollar exchange rate volatility reduces firm productivity growth. Exploring channels, its finds that the results are driven by countries with low level of financial development, high dollar invoicing, high bilateral trade with the US, high collective bargaining coverage and open capital account. Exploring the role of policy, it finds that Foreign Exchange Interventions (FXI) dampen this impact on firm productivity. Further, exploiting firm level data, the paper shows that dollar exchange rate volatility operates also through the financial friction channel, reducing contemporaneous investments, especially at firms with low liquidity buffers and weak balance sheet (high leverage). The role of financial frictions is confirmed through the finding that younger firms, more likely to face financial constraints, are also found to be more vulnerable to dollar exchange rate volatility. In addition, we also find evidence of a large and persistent effect on firms with highly irreversible investment, lending support for the real option channel of uncertainty on the dollar exchange rate. These findings are robust to a battery of tests, including controlling for uncertainty, financial crises and using an instrumental variable strategy exploiting US monetary policy shocks as an exogenous source of variation in dollar exchange rate volatility.

JEL Classification Numbers: C36; D24; E44; F31; F41; F43; O4.

Keywords: Dollar exchange rate; volatility; Productivity growth, Investment, Firm heterogeneity and spillovers.

Author’s E-Mail Address: keklou@imf.org

* The author(s) would like to thank, Alasdair Scott, Camila Casas, Christian Ebeke, Dmitry Plotnikov, Julia Faltermeyer, Melih Firat, Tidiane Kinda, Lamin Leigh, Margaux MacDonald, Modeste Some, Racha Moussa, Richard Varghese, and other participants to IMF seminar for helpful comments.
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¹ "The author(s) would like to thank" footnote, as applicable.
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