Foreign Exchange rate Dynamics and Trade Balances of Agriculture, Mining and Manufacturing sector: Empirical evidence from Eastern Africa Panel Data

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Abstract
This paper examines and compares the effect of foreign exchange rate on agriculture, manufacturing and mining trade balances using ten East African countries annual panel data over the period 1980-2013. The study uses autoregressive distributed lag cointegration procedure. The results based on the bounds testing procedure confirm the existence of stable long run relationship among variables. In all three sectors error correction model is found negative and statistically significant, this shows that in long run trade balance deviation adjusted towards equilibrium. The empirical estimations show that in the response of devaluation of real effective exchange rate, trade balance of all three sectors deteriorates in the short-run. In long-run real effective exchange rate has a positive effect on trade balances of manufacturing and mining sectors but the inverse effect for agriculture trade balance. However, after foreign exchange liberalization, depreciation has a positive impact on trade balance of each sector but the elasticity of real effective exchange rate on agriculture sector trade balance is very low. The effect of real income pronounces more than foreign exchange rate. The policy implications of our findings are that East African countries are suggested to practice the systematic type of devaluation complemented with other policy packages including further liberalization of foreign exchange regime that makes trade balance more elastic, especially the agriculture sector. Moreover, policies that aim at improving trade balance on region should focus on internal production of both exportable and importable goods, and utilizing the full capacity of traditional products, diversification and gradually escape from traditional exports.

Key Words: ARDL, Eastern Africa, Exchange Rate, Sectorial trade balance

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