Real Exchange Rate Devaluations, Imports of Intermediates and Export Performance

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This paper turns to import dependence in intermediate inputs and proposes a relatively simple framework to examine how real depreciations affect firms' export decisions, their export performance, as well as aggregate trade flows. The model accommodates some well documented facts of the International Trade literature on the characteristics of exporters (firm heterogeneity, selection into exporting etc.) while taking into account trade in intermediate inputs which is a salient part of global trade flows. I contribute to the literature on real exchange rate movements and export performance by bringing attention to a rather intuitive mechanism that can account for the fact that several middle income countries are undergoing massive devaluations of their currencies without experiencing considerable gains in their export performance. The theoretical framework extends the seminal paper of Melitz (2003) by introducing trade in intermediate inputs and waiving the symmetry assumption, allowing countries to be different along several relevant dimensions. The main prediction of the model is that in the presence of trade in intermediate inputs, a country's relative dependence on imports of intermediates and the relative use of intermediates in the final production process arise as key determinants of the firms' export status and export performance. In this context, exchange rate fluctuations, or in general fluctuations of relative prices, may yield results that come at odds with the predictions of traditional theories. The model provides conditions for which depreciations don't enhance the relative cost competitiveness of a country leading to a loss of export revenue and a negative adjustment along the extensive margin of trade.