IMPACT OF EXCHANGE RATE VOLATILITY ON EXPORTS IN SRI LANKA

S. Shiyalini[1*], M.R.F. Rismina[2] and T. Vinayagathasan[3]
[1,2] Postgraduate Institute of Humanities and Social Sciences, University of Peradeniya, Sri Lanka
[2]Department of Economics and Statistics, University of Peradeniya, Sri Lanka
*shiyalini06@gmail.com

The exchange rate regime and foreign policy are important measures of macroeconomic management in order to develop the economy through improving the performance of export in the country. Many scholars pay attention to studying the impact of exchange rate volatility (ERV) on the export growth. Although the majority of the existing empirical studies have shown a negative relationship between exchange rate volatility and export performance, only a very few studies found significant relationships between them. After the implementation of the floating exchange rate regime in Sri Lanka, the exchange rate became highly volatile leading to negative repercussions on trade, investment and growth. Therefore, the purpose of this study is to investigate the impact of ERV on exports in Sri Lanka using quarterly data from 2000 to 2017. ERV was calculated using the moving average standard deviation method. This study employs the autoregressive distributed lag (ARDL) Bounds testing approach to analyze the data. Using the demand function of exports, a paper also considers the effect of real foreign income, relative price and the depreciation of real effective exchange rate (REER) on exports of Sri Lanka. ARDL Bounds test results confirms that a long-run co-integrating relationship exists between the selected variables. The findings of this study indicate that the ERV has statistically significant negative impacts on exports both in the short-run and long-run, implying that higher exchange rate fluctuation tends to reduce Sri Lanka's real exports. Besides, REER depreciation affects exports negatively in the short run, but positively in the long-run, consistent with the J curve effect. Moreover, the increase in real foreign income of Sri Lanka's major export trading partner countries has a statistically significant and positive impact on Sri Lanka's real exports in the long-run as well as in the short-run. In addition, relative price affects the real exports negatively and is statistically significantly in the long-run. These findings suggest some important policy implications in managing the exchange rate system and promoting exports of Sri Lanka.

Keywords: Exchange rate volatility, Real effective exchange rate, Real exports, ARDL Bounds test