

Responsiveness of Trade Flows to Changes in Exchange rate and Relative prices: Evidence from Nigeria

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Abstract

This paper examines the long-run and short-run impacts of exchange rate and price changes on trade flows in Nigeria using exports and imports functions. The bounds testing (ARDL) approach to cointegration is applied on a quarterly data from 1980Q1 to 2007Q4. The results indicate that in both the short-run and long-run Nigeria's trade flows are chiefly influenced by income- both domestic and foreign-, relative prices, nominal effective exchange rates and the stock of external reserves. The results also reveal that in the long-run, devaluation is more effective than relative prices in altering imports demand at both baseline and augmented models. The reverse is, however, the case for exports demand. Furthermore, the sum of the estimated price elasticities of export and import demand in Nigeria exceeds unity indicating that the Marshall-Lerner (ML) condition holds thus implying that a devalued naira might hold considerable promise as the panacea to rising trade deficits.

Keywords: Trade flows, Exchange rate, Relative prices, Autoregressive distributed lag

JEL classification: F13, F31, C32

1. Introduction

An increasingly integrated world economy has brought an admixture of both good and adverse consequences for developing countries. While international trade, especially in goods and services and capital, appears to have brightened prospects for economic growth and eventual development on the one hand, severe macroeconomic problems such as balance of payments disequilibrium, exchange rate misalignment and huge trade deficits seem to be counteracting factors on the other. From a theoretical standpoint,

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