Real Exchange-Rate Volatility, Third-Market Effect and Trade: Empirical Evidence from French Firm-Level Data*

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Preliminary version, all comments and suggestions welcome

Abstract

In this paper, we study how firm-level export performance is affected by Real Exchange Rate (RER) volatility and investigate the way this effect is shaped by firm size and the number of destinations. Taking into account third-market effects, we distinguish bilateral volatility from multilateral volatility - the latter capturing volatilities with respect to other destination countries served by the firm. Our empirical analysis relies on export data for French exporters over the 1995-2006 period. We confirm a trade-deterring effect of bilateral RER volatility on both intensive and extensive margins of trade, and we also provide evidence for strong third-market effects : bilateral exports and entry probability increase with RER volatility of other destinations. Finally, we find that both the number of destinations and firm size magnify the effect of both volatilities. These results provide micro-founded evidence suggesting that firms face a trade-off between hedging and optimal reallocation of exports, depending mainly on the number of destinations they serve.

Keywords: Exchange rate volatility, third-market effect, exports.

JEL classification codes : F14, F31, L25

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