
Impact of Real Exchange Rate on Trade Balance: A case of Pakistan

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Abstract—This research paper aims at analyzing the impact of real exchange rate on trade balance of Pakistan. We have utilized Johansen co-integration test to examine the co-integration; while Vector Error Correction Method (VECM) technique has been used to test long-run relationship between the real exchange rate and trade balance. The annual data on variables is obtained from World Development Indicator (WDI), which ranges from 1976 to 2010. The results indicate that there exists a positive long run relationship between exchange rate and trade balance. We have also researched the existence of Marshall-Lerner (ML) condition and J-curve. The impulse response function has been used to test the existence of J-Curve. The results confirm the partial existence of J-curve by using impulse response function.

Keywords— real exchange rate (RER), trade balance (TB), Marshal-Lerner condition, co-integration analysis, J-curve