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Margins of Imports, Forward-Looking Firms, and Exchange Rate Movements *

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Abstract

This paper presents theory and evidence on firm's import responses to *current* and *future* exchange rates along both intensive and extensive margins. The paper first builds a dynamic heterogeneous-firm model to study how firms adjust their import decision by taking into account of both current and future exchange rates. In the model, individual firms pay a fixed sunk cost and face a probability of failure when searching for foreign intermediate suppliers. The impact of future exchange rate on import is different from that of current exchange rate: spot exchange rate appreciation would increase both the intensive margin (import value of individual firm) and the extensive margin (the number of importing firms), while future exchange rate appreciation increases the extensive margin rather than the intensive margin of imports. The model predictions are strongly supported by an empirical analysis using disaggregated data on China's imports from the United States and forward rates between US Dollar (USD) and Chinese Yuan (CNY) on the non-deliverable exchange market.

JEL: F31, F14, F12, F41

Keywords: Import, Future exchange rate, Extensive margin, Intensive margin

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