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REAL EXCHANGE RATE MISALIGNMENT AND TRADE FLOWS IN NIGERIA (1960-2013)

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Abstract

The paper examined the effects of real exchange rate misalignment on trade flows in Nigeria between the year 1960 and 2013. Trade flows were divided into export flow, import and trade balance. The paper employed the behavioural equilibrium exchange rate (BEER) approach to obtain the equilibrium real exchange rate for Nigeria and a single equation co-integration approach to determine the effect of exchange rate misalignment on trade flows. It was observed that Nigeria's real effective exchange rate appreciated in most periods between 1960 and 1985 and depreciated in most periods between 1986 and 2013. The result of the study further indicates that real exchange misalignment has no significant effect on the volume of export but it has a significant depreciating effect on import and trade balance in the country. The study recommends a flexible exchange rate system to reduce real exchange rate misalignment and diversified export products to enable volume export responds to real exchange rate movements in the country.

Keywords: Real exchange rate, trade flows, export, import, misalignment DOLS.
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1. Introduction

Real exchange rate has been identified by various policy-makers as a major key factor in ensuring both the internal and external balances of the developing countries' economies. However, in the past two decades, this particular price has been observed to be out of equilibrium in most parts of the developing countries. This misalignment of exchange rate, as stated in the work of Auboin and Ruta (2011) can have a strong effects on the economy, as they affect the structure of output and investment. The distortion can lead to an inefficient allocation of resources and the incentive to engage in trade. As a result of this perceived problem, developing countries are encouraged to conduct their policy correctly in order to minimize the extent at which the actual real exchange rate deviates from the ideal rate over time.