

**MODELLING THE IMPACT OF EXCHANGE RATE RISKS ON
IMPORTS**

BY :

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Dengan hormatnya perkara di atas adalah dirujuk.

2. Sukacita dimaklumkan pihak Kementerian Pengajian Tinggi melalui surat JPT.S(BPKI) 2000/011/010 Jilid. 4 (4) telah meluluskan cadangan penyelidikan Y. Bhg Prof/Prof. Madya/Dr./Tuan/Puan untuk di bayai di bawah Skim Geran Penyelidikan Fundamental (FRGS) Fasa 02/2010.

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4. Untuk tujuan mengemaskini, pihak Y. Bhg. Prof/Prof. Madya/Dr./Tuan/Puan adalah di minta untuk mengisi borang setuju terima projek penyelidikan dan menyusun perancangan semula bajet yang baru seperti yang diluluskan. Sila lihat lampiran bagi tatacara tambahan untuk pengurusan projek.

Sekian, harap maklum.

"SELAMAT MENJALANKAN PENYELIDIKAN DENGAN JAYANYA"

Yang benar


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Original Title as Proposed:

MODELLING THE IMPACT OF EXCHANGE RATE RISKS ON IMPORTS

Improved/Enhanced Title:

Original Objectives as Proposed:

The objectives are:

- (1) To theoretically examine how exchange rate risks affect imports
- (2) To ascertain the extent to which exchange rate risks affect imports in the short run and long run
- (3) To determine which exchange rate risk is more dominant – volatility or misalignment?
- (4) To find out whether the effect of overvaluation and undervaluation is asymmetric
- (5) To gauge the impact of exchange rate risks on imports in the events of shocks

Improved/Enhanced Objectives:

- (1) To analyze whether or not exchange rate influences imports
- (2) To develop a theoretical model that examines how exchange rate risks affect imports
- (3) To gauge the extent to which exchange rate misalignment i.e. overvaluation and undervaluation affects imports
- (4) To find out whether the effect of overvaluation and undervaluation on imports is asymmetric
- (5) To ascertain the impact of institutional risks such as political, financial, and economic risks on imports

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5. Report

5.1 Proposed Executive Summary

Risks arising from the exchange rate can be divided into two major categories – exchange rate volatility and exchange rate misalignment. The primary reasons why exchange rate risks are of interest to policymakers are due to the fact that: (1) Risks emanating from exchange rate volatility may increase or reduce the cost of imports and, (2) Exchange rate undervaluation may result in higher cost of import and overvaluation of the exchange rate may suppress costs of imports. Existing studies focus on the impact of exchange rate volatility on imports (see for example Koray and Lastapes, 1989; Klein, 1990; Cushman, 1988) but to the best of our knowledge, the impact of exchange rate misalignment on imports has yet to be studied.

The prime objective of this study is to develop a theoretical model, which explains the relationship between exchange rate risk and imports. Subsequently, the impact of exchange rate risks on imports will be examined using this model. We also examine whether exchange rate risks affects the performance of imports at both aggregated and disaggregated level. Both short and long run behavior will be examined using the estimation method proposed by Pesaran et al. (2001). The impact of shocks in exchange rate risks on imports will be simulated based on the impulse response and variance decomposition techniques.

We expect the results to support our hypothesis that exchange rate volatility depresses import activities. Exchange rate misalignment in the form of undervaluation is expected to increase the cost of imports hence discourages imports and overvaluation is expected to confer an opposite effect i.e. reduces the cost of imports hence promote import activities. Asymmetries in the events of overvaluation and undervaluation are also suspected. That is, the magnitude of percentage increase (decrease) in imports as a result of exchange rate overvaluation (undervaluation) is expected to differ.