

Prices, Markups, and Exchange Rates

Natalie Chen

Abstract :

Using highly disaggregated data for Colombian manufacturing firms during a large depreciation episode, we decompose firm-product prices into marginal cost and markup components to document new stylized facts about how exchange rate changes impact domestic prices. First, by weakening the intensity of import competition, a depreciation increases markups and therefore prices. Second, a depreciation raises marginal costs, but the resulting price increases are more modest because firms use their market power to partially offset the cost increases by reducing markups. These empirical patterns can be predicted by trade models featuring subconvex demand systems. They are important to understand how exchange rate fluctuations affect domestic prices and, in turn, inflation.