Exchange Rate and Wage Adjustment

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Abstract

In this paper we rely on a representative panel of manufacturing firms and estimate the implications for firm-level wages of changes in the permanent component of the exchange rate. Similarly to the response of employment and hours documented in Nucci and Pozzolo (2010), the direction and size of wage adjustment are shaped by the external orientation of each firm on both the sale and cost side of the balance sheet. Through the revenue side, wages are shown to rise after a currency depreciation and the effect is estimated to be larger the higher is the firm's exposure to sales from exports. On the contrary, a depreciation induces a cut in firm's wages through the expenditure side and the effect is larger the higher is the incidence of imported inputs on total production costs. We show that, for a given degree of firm's external orientation, the sensitivity of wages to exchange rate movements is larger for firms with a lower market power. In accordance with the result of Goldberg and Tracy (2003) that exchange rate affects the wage premium or penalty associated with a job transition, we find that in firms with a higher job creation rate the impact of currency swings on wages is larger. We also show that other transmission channels provide a degree of difference in the wage response to exchange rate shocks. These include the degree of import penetration in the domestic market, the extent of input's substitutability in production and the composition by type of firm's employment.