Common Trade Exposure and Business Cycle Comovement

JOURNAL OF INTERNATIONAL ECONOMICS
DOI:
https://doi.org/10.1016/j.jinteco.2024.103998
Publicado:
Miércoles, 28 Agosto 2024
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Clasificación JEL:
E32, F1, F41, F44
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Bilateral trade is considered a key driver of business-cycle transmission, as countries with higher bilateral trade have more correlated business cycles. We show, however, that when we account for the common trade exposure of a country pair to similar foreign cycles, the effect of bilateral trade on comovement falls sharply. Furthermore, common trade exposure is also a robust predictor of comovement. We conclude that trade is indeed a driver of business-cycle transmission, but often through common exposure to foreign cycles rather than just bilateral linkages. Finally, we consider the implications of these empirical results for the “trade-comovement puzzle.”