

Summary

**UBS Center Working Paper No. 15**

February 2016

# The Distributional Consequences of Large Devaluations

Javier Cravino, Andrei A. Levchenko

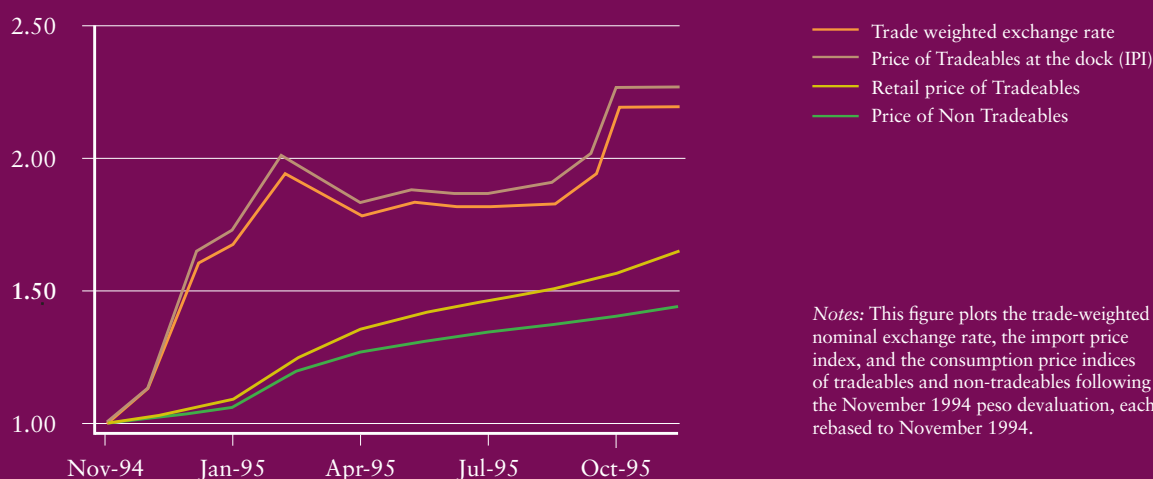


Large exchange rate devaluations are associated with dramatic changes in relative prices. In the aftermath of a devaluation, the price of tradeable goods “at the dock” moves one-for-one with the exchange rate, the retail price of tradeable goods increases, though less than the exchange rate, while non-tradeable goods’ prices are relatively stable. A clear illustration of such relative price movements is presented in Figure 1, which plots the evolution of these prices following the 1994 Mexican devaluation. The retail price of tradeables is much closer to the price of non-tradeables than to prices of tradeables at the dock, consistent with the importance of local distribution costs in retail prices. This paper studies the distributional consequences of such relative price movements.

Using the 1994 Mexican peso devaluation, the authors show that the distributional consequences can be large. In the two years following the devaluation, inflation of the consumption basket of those in the bottom decile of the income distribution was between 32 and 39 percentage points higher than

for the basket of those in the top decile. Differences in price changes within narrow product categories account for about half of this difference. The authors explore in detail one possible explanation for this result: the poor consume fewer non-tradeable goods. This manifests itself at all levels of product aggregation. Poorer households tend to spend a larger overall share of their income on tradeables. Across tradeable categories, the poor have higher expenditure shares in products with systematically lower distribution margins. Finally, within detailed product categories, the poor consume lower-priced varieties that contain relatively less domestic value added. Correspondingly, prices of goods with a smaller non-tradeable component rise more following a devaluation, leading to anti-poor distributional consequences. Another plausible mechanism that can drive the within effect is differences in markup elasticities with respect to exchange rate changes between higher- and lower-quality goods. The systematic consumption basket differences we identify are likely to occur in other countries and time periods, and thus the results for Mexico may be informative of the effects of other devaluations.

Figure 1: Price changes during the 1994 Mexican devaluation



**UBS Center Working Paper Series**  
The Working Paper Series is an academic publication series that features current research papers on topics that are of crucial relevance beyond academic research circles. These research papers touch on themes that are of both topical and fundamental importance for private and public sector representatives.

You can download the full version of the UBS Center Working Papers from our website anytime.  
[www.ubscenter.uzh.ch/en/publications](http://www.ubscenter.uzh.ch/en/publications)

UBS International Center of Economics  
in Society  
University of Zurich  
Department of Economics  
Schönberggasse 1  
CH-8001 Zurich  
Tel. +41 44 634 57 22  
[contact@ubscenter.uzh.ch](mailto:contact@ubscenter.uzh.ch)  
[www.ubscenter.uzh.ch](http://www.ubscenter.uzh.ch)

ISSN 2296-2778 (Online)

**Authors**  
Javier Cravino  
University of Michigan  
and NBER  
[jcravino@umich.edu](mailto:jcravino@umich.edu)

Andrei A. Levchenko  
University of Michigan  
NBER and CEPR  
[aalev@umich.edu](mailto:aalev@umich.edu)