PASS-THROUGH FROM EXCHANGE RATE TO PRICES IN BRAZIL
An Analysis using time-varying parameters for the 1980 – 2002 period

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The aim of the present paper is to analyze the pass-through from exchange rate to inflation in Brazil from 1980 to 2002. Initially, we developed a model of a profit-maximizing firm based on the pricing-to-market approach presented by FEENSTRA and KENDAL (1997). In order to adapt the model to the Brazilian reality, we considered the following aspects: (i) the firm sells its product both in the domestic market – where it has some pricing power – and in the foreign market – where it is a price-taker; (ii) costs are a function of the exchange rate; (iii) the degree of openness is included in the demand equation. Results show that the Kalman Filter yields better results than linear models with time-invariant parameters and that the inflationary environment and the exchange rate regime perceived by the agents affect the degree of pass-through to consumer prices. We can observe a reduction in the pass-through to consumer price indices (IPCA) or to indices with a consumer-price component (IGP-DI) after the implementation of the Real plan, and a more intense reduction after the adoption of the floating exchange rate regime in 1999. These results are in line with other estimates presented in the literature. The pass-through to wholesale prices, however, is relatively constant all over the period.

Key words: exchange rate, pass-through, Kalman filter

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