TRADE PATTERNS AND ROLE OF VEHICLE CURRENCY IN INDIA-ITALY TRADE: A COMMODITY LEVEL STUDY

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ABSTRACT:

The Indian rupee has shown a depreciating trend over the past decades. According to the J-curve theory, a currency's depreciation initially worsens the trade balance in the short run but improves it in the long run as trade prices adjust. While many studies have tested this effect across countries, the role of a vehicle currency particularly the US dollar has received limited attention. Given that over 80 percent of global trade is invoiced in US dollars, its influence on bilateral trade, even between non-US countries, can be significant. This paper investigates how India's bilateral trade balance with Italy is affected by the invoicing currency, comparing the euro (EUR-INR) and the dollar (USD-INR) as exchange rate indices.

Using monthly data from January 2009 to January 2024 for 30 commodities at the HS4 level (ITC-HS classification), the study applies the ARDL model for symmetric and NARDL model for asymmetric effects. The linear ARDL results for the euro-rupee exchange show significant short-run effects for six commodities and long-run effects for nine, with two supporting the J-curve. The NARDL model reveals short-run asymmetries for 17 commodities and long-run effects for three, two of which align with the J-curve. For the dollar-rupee exchange, only the NARDL model is used. It finds short-run effects in 13 commodities and long-run significance in 17. Notably, rupee depreciation against the dollar worsens the trade balance for 18 commodities. Overall, the analysis shows stronger and more asymmetric effects under the dollar-based exchange, highlighting the US dollar's dominant influence on India's commodity-level trade with Italy.