



## The Impact of Exchange Rate Fluctuations on the Balance of Payments in Selected MENA Countries

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### Abstract

The balance of payments, as one of the most important indicators of economic stability in each country, reflects its financial and trade interactions with the global economy. On the other hand, exchange rate changes in economies dependent on energy exports play a decisive role in the direction of the balance of payments. Therefore, the purpose of this research is to examine the impact of exchange rate fluctuations on the balance of payments in the MENA region countries during the period 1995-2024 using the autoregressive model with panel distribution lags (PMG). The research findings indicate that exchange rate fluctuations have had a negative impact in the short term and a positive and significant impact on the balance of payments in the long term. Other findings indicate that in the short and long term, the degree of openness of the economy and GDP has increased the balance of payments, while inflation has reduced the balance of payments. Therefore, governments and economic policymakers should be able to improve the balance of payments by predicting and implementing appropriate exchange rate policies. They should also stabilize the foreign exchange market by implementing proper foreign exchange and financial planning.

**Keywords:** Exchange rate, balance of payments, Panel ARDL, MENA.

**JEL Classification:** F31, F41.

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## 1. Introduction

This is why many countries implement exchange rate policies to reduce the effects of exchange rates on economic issues. The balance of payments is a document in which the transactions and exchanges of natural and legal persons residing in a country with foreign countries are regularly recorded for a period of one year. By examining the balance of payments, government officials can evaluate and analyze the country's economic situation in relation to domestic and foreign economic activities. In general, the balance of payments is a summary of all transactions of a country with other countries of the world during a certain period of time. Changes in the exchange rate affect the balance of payments in four ways, directly the price of exports and imports, indirectly the reaction of the volume of exports and imports to changes in relative prices. The dominance of the price effect over the effect of export and import quantity in the short term is a phenomenon that Magee called the J curve in 1973. In the short term, the volume of export and import does not change much, so that the effect of price dominates the effect of quantity, and this result leads to the deterioration of the balance of payments account in the short term. But after a time interval, the volume of exports increases and at the end of the adjustment of the balance of payments account, which was affected by the increase in the exchange rate, it is drawn as a J curve. According to the J curve, it is expected that the balance of payments will improve with the devaluation of the domestic currency in the long run (upward branch of the J curve); But in the short term, this trend will not be realized (the downward branch of the J curve).

## 2. Theoretical framework

The relationship between the exchange rate and the balance of payments is theoretically such that devaluation can have a positive effect on the balance of payments, and this policy is one of the ways to compensate for the trade balance deficit, but from an empirical point of view, in many cases, the relationship between the two contradicts economic theories and even It is ambiguous. When a country's currency depreciates, it affects the balance of payments through two channels. Price effect: with the decrease in the value of the country's currency, the export goods become cheaper in terms of foreign currency (our goods are cheap for foreigners) and the imported goods become more expensive in terms of national currency; Therefore, the price effect will increase the current account of the country in question. Quantity effect: As our goods become cheaper for foreigners, export demand increases, and as imported goods become more expensive, the volume of imports is lower, and as a result, the quantity effect improves the current account.

## 3. Methodology

The mixed group (PMG) method was developed by Pesaran et al (2001). In this

method, it estimates homogeneity coefficients for all sections in the long run. But in this method, the estimated short-term coefficients for each period are heterogeneous in order to adjust towards the long-term equilibrium. But in this method, the estimated short-term coefficients for each period are heterogeneous in order to adjust towards the long-term equilibrium. In this method, the error correction coefficient should be negative and the residual terms of the error correction model should be uncorrelated. In the fixed effects (DEF) method, similar to pooled between-group (PMG), the estimated long-term cointegration coefficients are the same for all sections. On the other hand, this method has a lower adjustment speed and its short-term coefficients are homogeneous, unlike PMG.

#### 4. Discussion

in the short run: The first lag in the balance of payments has had a positive effect on itself. In fact, the balance of payments in the current period has had a positive effect on the balance of payments in the previous period. So that a one percent increase in the first lag in the balance of payments has caused a 0.067 percent increase in the balance of payments. The exchange rate has had a negative effect on the balance of payments. So that a one percent increase in the exchange rate has reduced the balance of payments by -1.914. The first lag in the exchange rate has caused a decrease in the balance of payments. So that a one percent increase in the exchange rate has led to a decrease in the balance of payments by -1.916. The negative effect of the exchange rate on the balance of payments through the purchasing power parity theory and the Marshall-Lerner condition. The weakening of the national currency (an increase in the exchange rate) can cause an increase in the price of imports in domestic currency. If the import structure is inelastic and a country's imports are dependent on intermediate and essential goods, the exchange rate will lead to an increase in the value of the dollar and imports and an increase in the current account deficit instead of improving the trade balance. GDP has had a positive effect on the balance of payments. So that a one percent increase in GDP has led to a 0.472 percent increase in the balance of payments. The first and second inflationary hiatuses have had a negative effect on the balance of payments. So that a one percent increase in inflation in the first hiatus has caused a -1.44 percent dec.

#### 5. Conclusion and Suggestion

Therefore, governments and economic policymakers should be able to predict and implement appropriate foreign exchange policies to improve the balance of payments. They should also work to create stability in the foreign exchange market by implementing proper foreign exchange and financial planning.

## **6. Ethical Considerations**

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### **6.2. Author's Contribution**

The authors of the article, while observing the ethics of the research, participated in the preparation of the article with an equal share.

### **6.3. Conflict of Interest**

There is no conflict of interest.

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