

Abstract

The real exchange rate has proven to be an important factor in international trade because it is expected that exports respond to real exchange rate movements with respect to the characteristics of the importing and exporting countries. Exchange rate volatility increases uncertainty of profits on contracts denominated in foreign currency and subsequently dampens trade and economic growth. This study investigated how real exchange rate volatility affected exports of key Kenyan commodities to the European Union and United Kingdom, namely; tea, coffee and horticulture to the European Union. The presence of exchange rate volatility was determined using the GARCH model. A Bounds testing and Autoregressive Distributed Lag model was used to establish the presence of a long run relationship between exchange rate volatility and commodity exports. Findings revealed that exchange rate volatility affected tea exports to the UK and horticulture exports to the European Union. Foreign income played an important role in explaining tea and coffee exports to the UK and EU respectively.