Exchange Rate Impact on FDI Inflows in Sweden

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The study of FDI flows has been a growing field of research for decades. In this era of globalization, FDI has become an increasingly important component of both economic development and economic growth. The impacts of firm- and industry-specific variables have traditionally dominated the explanation of FDI trends in academia, but in recent years, there has been a shift to examine the importance of spatial aspects on FDI. These spatial aspects include macroeconomic qualities, like exchange rates and trade openness. It is necessary to study these macroeconomic variables because changes in government policy can influence these variables and potentially attract greater inflow of FDI in the host country.

This research examines the influences of national government policy on FDI inflows, specifically by analyzing the effect of Sweden's changing exchange rate regime on inward FDI between 1988 and 2018. Sweden provides an appropriate case study given the dynamic nature of both Swedish FDI and exchange rate in the past few decades. This research paper demonstrates to what extent the systematic exchange rate changes and typical exchange rate fluctuations account for inward FDI flows in Sweden by examining both Ordinary Least Squares (OLS) multivariate regression models and a Fully Modified Ordinary Least Squares (FMOLS) model.

The dependent variable is Sweden's FDI inflow recorded in millions of USD (*FDI*) and the focus independent variable is the Swedish Exchange Rate in terms of krona/US dollar (*ERATE*). The following control variables are included: real GDP (*RGDP*), interest rate (*IRATE*), trade openness (*OPEN*), lagged trade openness ($OPEN_{t-1}$), and lagged inward FDI (FDI_{t-1}). These control variables were chosen by reviewing previous literature and establishing a group of factors that consistently were found to be statistically significant in predicting inward FDI flows. In this research it is hypothesized that a depreciation of the Swedish exchange rate will lead to an increase in inward FDI flows.

The models deliver statistically significant results that support the original hypothesis. Specifically, the negative relationship between the real exchange rate and FDI inflows. Thus concluding that a depreciation of the Sweden exchange rate does in fact attract inward FDI flows. These findings suggest that both the wealth effect and relative production cost effect are contributing to foreign investors FDI decisions.