

# Abstract

Euro and the Effect on Bilateral Trade: Gravity Model Analysis

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The purpose of this thesis is to estimate the impact of common European currency on bilateral trade. Using data from 1993 to 2015, we employ structural Gravity model of trade on the sample of 19 European Monetary Union members and 25 developed countries. In our analysis, we use two different methods to account for the endogeneity, country-pair fixed-effects and Baier and Bergstrands (2009) specification of the Gravity model estimated by OLS. In order to examine the effect of missing observations, we employ Poisson Pseudo-Maximum-Likelihood estimator. Last, we focus on the adoption of the Euro as a reason behind the effect of trade diversion. The results of all three models show that the creation of the EMU had statistically insignificant effect limiting to zero. In the case of fixed-effects and OLS, the estimated effect is negative, while in the case of the PPML, we found a positive impact. In addition, the results of our analysis show that the adoption of the Euro did not cause a trade diversion.