



HAL
open science

Do commodity price volatilities impact currency misalignments in commodity-exporting countries ?

Cyriac Guillaumin, Salem Boubakri, Alexandre Silanine

► To cite this version:

Cyriac Guillaumin, Salem Boubakri, Alexandre Silanine. Do commodity price volatilities impact currency misalignments in commodity-exporting countries?. *Economics Bulletin*, 2020, 40 (2), pp.1727-1739. halshs-02935658

HAL Id: halshs-02935658

<https://shs.hal.science/halshs-02935658v1>

Submitted on 29 Sep 2020

HAL is a multi-disciplinary open access archive for the deposit and dissemination of scientific research documents, whether they are published or not. The documents may come from teaching and research institutions in France or abroad, or from public or private research centers.

L'archive ouverte pluridisciplinaire **HAL**, est destinée au dépôt et à la diffusion de documents scientifiques de niveau recherche, publiés ou non, émanant des établissements d'enseignement et de recherche français ou étrangers, des laboratoires publics ou privés.

Volume 40, Issue 2

Do commodity price volatilities impact currency misalignments in commodity-exporting countries?

Cyriac Guillaumin
University Grenoble Alpes

Salem Boubakri
Paris-Sorbonne University of Abu Dhabi

Alexandre Silanine
Paris-Sorbonne University of Abu Dhabi

Abstract

This paper aims to investigate the relationship between misalignments of real effective exchange rates and real commodity price volatilities in a sample of 46 commodity-exporting countries by considering financial development as the transition variable. We first estimate currency misalignments as deviations of the observed real effective exchange rates from their equilibrium values estimated using the behavioural equilibrium exchange rate (BEER) approach. Then, we rely on panel data and a smooth-transition regression model to estimate commodity price volatilities' non-linear impacts on currency misalignments. Our results indicate that the estimated coefficients are highly significant, and demonstrate that real commodity prices' volatility has a non-linear impact on currency misalignments depending on the country's degree of financial development.

We thank the French National Research Agency for financial support under Grant ANR-15-IDEX-02 "InnoFiRisk". We are grateful to Carmen Reinhart for useful comments on earlier drafts.

Citation: Cyriac Guillaumin and Salem Boubakri and Alexandre Silanine, (2020) "Do commodity price volatilities impact currency misalignments in commodity-exporting countries?", *Economics Bulletin*, Volume 40, Issue 2, pages 1727-1739

Contact: Cyriac Guillaumin - cyriac.guillaumin@univ-grenoble-alpes.fr, Salem Boubakri - salem.boubakri@psuad.ac.ac, Alexandre Silanine - silanine.alexandre@gmail.com

Submitted: March 19, 2020. **Published:** June 18, 2020.

1. Introduction

Financial investors deal with commodities as an asset category similar to equities or bonds. When investing in futures markets, financial investors should be adverse to different types of risks, such as portfolio or currency risk. In particular, a specific risk in an international context can involve fluctuations in exchange rates. For instance, fluctuations in the real effective exchange rate appear to be a crucial variable in determining trade capabilities and economic stability among countries with income primarily derived from commodity exports. Many empirical studies have proven that the real prices of commodity exports are the preponderant factor in determining commodity-exporting countries' real exchange rates (Amano & van Norden, 1998a; 1998b; Chen & Rogoff, 2003; Cashin et al., 2004; Cayen et al., 2010).¹ Therefore, policymakers and financial investors must fully understand the relationship between movements among commodities' real prices and fluctuations in real exchange rates. This paper aims to better capture the relationship between this volatility in real commodity prices and the real exchange rates of commodity-producing countries—in both the short- and long-term—by paying particular attention to the non-linearity impacts. Thus, we follow original works by Chen and Rogoff (2003) and Cashin et al. (2004), which demonstrate that commodities' real prices are a preponderant factor in determining the real exchange rates for commodity-exporting countries.

Since the oil shocks of the 1970s, commodity prices' movements have been attributed to fundamental factors linked to changes in supply and demand.² Recently, several investigations—including those by Irwin and Sanders (2010), Inamura et al. (2011), Céspedes and Velasco (2012), and Hong et al. (2015)—have highlighted the main factors that affect commodity prices: commodity demand growth fluctuations in such emerging markets as China and India, interruptions in oil production, demand elasticity, and the increased cost of biofuels. However, the multiple and rapid slumps and increases among all major commodity prices since 2002 suggest that many macroeconomic and financial factors must be considered to better understand recent commodity price movements (Mayer, 2009; Hong & Yogo, 2012; Cheng & Xiong, 2013).³ Further, since the 2008 global crisis it has become more difficult for policymakers and researchers to assess the reasons for, and impacts of, commodity price movements.⁴ A range of empirical studies—such as works by Büyüksahin and Robe (2011), Inamura et al. (2011), and Silvennoinen and Thorp (2013), among others—has emphasized the increasing correlation between commodities and financial markets, supporting the idea that financial investors affect commodity price movements.⁵ Recently, several such financial actors as investment banks, retail investors, hedge funds, and mutual and pension funds have invested in commodity futures, highlighting the relevance of the purported “financialization of commodities.” For example, Domanski and Heath (2007) highlighted the increasing

¹ See, for example, Coudert et al. (2015) or Boubakri et al. (2019) for a complete literature review.

² See, for example, Killian (2008) for a literature review.

³ See Henderson et al. (2015) for a literature review.

⁴ For example, prices in the oil sector increased from \$72 to \$160 in 18 months (from January 2007 to June 2008). Subsequently, they decreased from \$160 to \$50 in the next six months.

⁵ See, for example, Chari and Christiano (2017) and Cheng and Xiong (2013).

number of contracts in derivative commodity markets, which tripled between 2002 and 2005.⁶ Clearly, this ongoing financialization process must be developed to an extent that warrants the continuing supervision and regulation of commodity markets, as well as diversifying and reducing portfolio risks.⁷ For example, Baker and Routledge (2012) developed a dynamic model to demonstrate that dynamic risk-sharing can generate wide variations in both prices and risk premia in the commodity market.⁸

This paper's objective is twofold. First, it aims to interpret how real commodity prices interact under a new context of commodity market financialization. Second, it will evaluate the impact on currency misalignments by considering how financial markets are developed. The misalignment of real exchange rates is a primary pillar in commodity-exporting countries' trade strategies; specifically, undervaluing currencies reinforces commercial competitiveness, which stimulates domestic production and exports while reducing imports. A notable empirical example is that of the Chinese government, which has undervalued the yuan against the other major currencies for decades, and especially the US dollar.⁹ This effectively facilitated China's exports and its rapid economic growth (Cline, 2010). In contrast, an overvalued currency typically indicates an increased probability of a possible currency crash (Frankel & Rose, 1996). Additionally, persistent misalignments may distort the relative prices of traded versus non-traded goods, which may generate economic instability (Edwards, 1989).

This paper contributes to existing literature by demonstrating how commodity price movements affect currency misalignments among commodity-exporting countries by incorporating a new "commodity financialization" process in the analysis. We aim to capture commodity market volatilities' non-linear effects on exchange rate misalignments. Our empirical study is based on a sample of 46 commodity-exporting countries divided into four panels: food and beverages, energy, metals, and raw materials. We rely on the panel smooth transition regression (PSTR) model proposed by González et al. (2005) to consider the potential non-linear relationship between commodity price volatilities and exchange rate misalignments. Our main findings reveal that commodity price volatilities tend to slightly increase real exchange rate misalignments when a country is financially better developed. These findings also confirm a change in the relationship between commodity and currency markets that may be induced by increasing financial depth as well as the intensification of commodities' financialization in the post-2000 era.

The remainder of this paper is structured as follows: Section 2 presents our empirical methodology and describes the data in general, and its statistical properties in particular. Section 3 presents our results and their implications. Section 4 concludes.

⁶ Mayer (2009) demonstrated that the number of contracts for commodity futures and options markets increased more than threefold between 2002 and mid-2008. Moreover, Masters and White (2008) noted that commodity index investments increased between 2003 and 2008, from 13 to 370 billion USD.

⁷ For a literature review on the financialization of commodities, see Cheng and Xiong (2013) and Zarembalver and Neumann (2015).

⁸ See also Basak and Pavlova (2016) for a commodity-financialization model.

⁹ For example, Frankel (2005) found that the yuan was undervalued by 36% in 2000; Schröder (2013) also provides a review.

2. Empirical methodology and data description

2.1. The sample of countries, commodity price index, and financial development level

We consider monthly data, from January 1994 to December 2016, for a sample of 46 commodity-exporting countries divided into four panels: food and beverages, energy, metals, and raw materials.: Algeria, Argentina, Australia, Bahrain, Bolivia, Brazil, Cameroon, Canada, Chile, Colombia, Ethiopia, Ghana, Honduras, Iceland, India, Indonesia, Iran, Ivory Coast, Kenya, Kuwait, Malawi, Malaysia, Mali, Mexico, Morocco, Mozambique, Niger, Norway, Oman, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Saudi Arabia, Senegal, South Africa, Thailand, Togo, Tunisia, Turkey, Uganda, United Arab Emirates, Uruguay, Venezuela, and Zambia.

We select the commodity price index in accordance with the main type of commodity exported by each country. All price indices are extracted from the International Monetary Fund's (IMF) database (*Primary Commodity Prices*).

As previously mentioned when discussing the PSTR model, we introduced a financial transition variable to consider the commodity markets' increasing financialization, although the choice of the financial development variable must also be discussed. Indeed, different methods have been used to measure financial development.¹⁰ As demonstrated by, for example, Boubakri et al. (2016), de facto measures seem to be more appropriate. Regarding the de facto measure, we follow Levine et al. (2000)¹¹ and measure the degree of financial development by the ratio of M2 to GDP, taken from the World Bank database (*World Development Indicators*). We also use the ratio of private credit to GDP as an alternative indicator and as robustness checks of the financial development level. This ratio is taken from the World Bank database (*World Development Indicators*).

2.2. Empirical methodology

This study aims to assess the impact of real commodity prices' volatility on currency misalignments by considering the level of financial development as a transmission channel. We evaluate this relationship by considering the PSTR model proposed by González et al. (2005). We denote the dependent variable as $|MIS_{i,t}|$, with the monthly real effective exchange rate misalignments expressed as absolute values; thus, the PSTR model is as follows:

$$|MIS_{i,t}| = \alpha_i + \beta_0 \Delta ComPI_{i,t} + [\beta_1 \Delta ComPI_{i,t} * F(S_{i,t}; \gamma, c)] + \varepsilon_{i,t} \quad (1)$$

for $t = 1, \dots, T$ and $i = 1, \dots, N$, with t denoting time and i the country. Further, α_i denotes the country fixed effects and $\Delta ComPI_{i,t}$ represents the volatility of the real commodity price index, and is proxied by the absolute value of the monthly variation in the real commodity price index; it also corresponds to the exogenous variable that determines whether the transition function F is active; $S_{i,t}$ represents the transition variable, defined here as the level

¹⁰ For example, Ligonnière (2018) provides further discussion.

¹¹ Levine (2005) and Svirydzienka (2016) demonstrated that several indicators can be used to assess the financial development level, but the ratio of M2 to GDP seems to be the most common in literature.

of financial development; and $\varepsilon_{i,t}$ is an independent and identically distributed (i.i.d.) error term. The transition function $F(S_{i,t}; \gamma, c)$ is a continuous function of $S_{i,t}$ and is normalized to be bound between zero and one; these extreme values are associated with regression coefficients β_0 and $\beta_0 + \beta_1$. This transition function is given as originally noted by González et al. (2005):

$$F(S_{i,t}; \gamma, c) = \left(1 + \exp(-\gamma \prod_{j=1}^m (S_{i,t} - c_j))\right)^{-1} \quad (2)$$

where c_j ($j = 1, 2, \dots, m$) are the threshold parameters ($c_1 \leq c_2 \leq \dots \leq c_m$) and γ is the slope parameter of the transition function. According to González et al. (2005) it is usually sufficient in practice to consider $m = 1$ (logistic) and $m = 2$ (logistic quadratic). In the case of $m = 1$, the dynamics are asymmetric, and the two extreme regimes are associated with the transition variable's low and high values; the change is centered around the threshold (c_1). In the case of $m = 2$, the dynamics are symmetric and the transition function's minimum is at $(c_1 + c_2)/2$; it attains a value of one at both low and high values of the transition variable.

2.3. Equilibrium exchange rate and currency misalignments

Various concepts of equilibrium exchange rates exist, from the short-term market equilibrium to the incredibly long-term universal price convergence.¹² We account for the long-term relationship between the real exchange rate and its determinants by following the behavioral equilibrium exchange rate (BEER) methodology introduced by MacDonald (1997, 2000) and Clark and MacDonald (1998). For example, the IMF has adopted this approach (Isard, 2007), as it appears less normative than other methodologies—such as the fundamental equilibrium exchange rate (FEER)—and yields excellent empirical results.¹³ The BEER methodology's real effective exchange rate is expressed as a function of three fundamental variables:¹⁴

$$LREER_{i,t} = \mu_i + \theta_1 LBS_{i,t} + \theta_2 NFA_{i,t} + \theta_3 LTO T_{i,t}^{com} + u_{i,t} \quad (3)$$

where $LREER_{i,t}$ is the logarithm of the real effective exchange rate, $LBS_{i,t}$ is the country's productivity (the Balassa-Samuelson effect) expressed as a logarithm, $NFA_{i,t}$ denotes its net foreign asset position as a percentage of GDP, and $LTO T_{i,t}^{com}$ signifies its real commodity trade terms expressed as a logarithm; α_i accounts for individual fixed effects and $u_{i,t}$ is an i.i.d. error term.

Real effective exchange rates are provided by the Bank for International Settlements and Bruegel databases.

The Balassa-Samuelson effect, or productivity differential, is approximated by the GDP per capita, measured in purchasing power parity (PPP) relative to the trading partners. The GDP-PPP and GDP data variables are both extracted from the IMF's International Financial Statistics database.¹⁵

¹² For example, Bénassy-Quéré et al. (2010) or Bussière et al. (2010) provide further discussion.

¹³ For example, Driver and Westaway (2005) and Durand and Lopez (2012) provide further discussion.

¹⁴ For example, Clark and MacDonald (1998), Chinn (2005), and Ricci et al. (2008) provide further discussion.

¹⁵ As a robustness check, we also use Balassa-Samuelson effect data from the *EQCHANGE* database (Cepii). The results are available upon request from the authors, and are quite similar.

The *net foreign asset position* (NFA) refers to the value of the sum of foreign assets held by monetary authorities and deposit-money banks, less the value of foreigners' domestic assets; this is expressed as a percentage of GDP. The NFA series data are obtained from an updated, extended version of the dataset constructed by Lane and Milesi-Ferretti (2007) for the period from 1980 to 2015.¹⁶ We compute the variable for the last year (2016) by adding the previous NFA position to the contemporaneous current account, and we consider the variable as a percentage of GDP. Data on the current account and GDP (in US dollars) are taken from the IMF's World Economic Outlook database.

The *real commodity terms of trade* are calculated in the same way as in work by Cashin et al. (2004). Consequently, the real commodity terms of trade are a weighted average price of the country's three main exported commodities, deflated by the manufactured unit value.

The real exchange rate misalignment, noted as $MIS_{i,t}$, is computed as follows:

$$MIS_{i,t} = \hat{u}_{i,t} = LREER_{i,t} - LREER_{i,t}^{EST} \quad (4)$$

where $LREER_{i,t}^{EST}$ is the real effective (estimated) equilibrium exchange rate.

3. Results

We must use monthly data to investigate the long- and short-term relationships between real commodity price volatilities and exchange rate misalignments. Therefore, we reconstruct our variables of interest—relative productivity, net foreign assets, and the real commodity trade terms—at a monthly frequency using a typical interpolation procedure.¹⁷

3.1. The long-term relationship and currency misalignments

We first apply cross-section dependence and several panel unit root and cointegration tests, showing that our four series ($LREER$, $LToT^{com}$, NFA and LBS) can be considered as unit root processes and are cointegrated.¹⁸ We then estimate the cointegrating relationship in equation (3).

As ordinary least squares (OLS) estimates are biased and depend on nuisance parameters, we use the dynamic OLS (DOLS) procedure introduced by Kao and Chiang (2000) and Mark and Sul (2003) in the panel cointegration context. We also use the BKN estimation procedure proposed by Bai et al. (2009). The DOLS procedure involves augmenting the cointegrating relationship with the regressors' lead and lagged differences to control for endogenous feedback effects. While this approach accounts for a certain form of cross-sectional dependence through possible time effects, the procedure developed by Bai et al. (2009) specifically addresses this property. Further, the BKN technique captures cross-sectional dependence by introducing unobservable common factors in the errors. An iterative procedure jointly estimates the cointegration coefficient and these factors.

¹⁶ For more information, see <http://www.philiplane.org/EWN.html> and work by Lane and Milesi-Ferretti (2007).

¹⁷ We also use the proportional Denton method, which is both robust (Chen, 2007) and recommended in IMF or Federal Reserve Bank publications (Kinda, 2011; Liu et al., 2011).

¹⁸ To save space, complete results are available upon request from the authors.

We use the DOLS and BKN procedures to obtain estimation results for the cointegrating relationship, as Table 1 indicates.

Table 1: Results of the cointegrating relationship

	DOLS Method	BKN Method
LBS	0.119*** (7.439)	0.116*** (7.504)
NFA	0.081*** (17.711)	0.080*** (19.062)
LToT ^{com}	0.033*** (5.047)	0.046*** (7.016)

Notes: Estimation of equation (3):

$$LREER_{i,t} = \mu_i + \theta_1 LBS_{i,t} + \theta_2 NFA_{i,t} + \theta_3 LToT_{i,t}^{com} + u_{i,t}$$

t-statistics are given in parentheses. Significant coefficient at 1% (***), 5% (**) or 10% (*).

Regardless of whether the DOLS or BKN procedures are used, the three fundamental variables' estimated coefficients exhibit the expected signs and are significant at conventional levels. Subsequently, an increase in relative productivity, the NFA position, and commodity trade terms lead to an appreciation of the real effective exchange rate. The commodity terms of trade seem to be an important determinant of the real effective exchange rate, as Cashin et al. (2004) demonstrate. Moreover, the currencies among our commodity-dependent countries can be considered “commodities currencies,” as the long-term elasticity of the real effective exchange rate versus the (commodity) terms of trade is positive and significant. We also note that the estimated cointegrating coefficients' values are smaller when the BKN procedure is applied. Indeed, Bodart et al. (2012) demonstrated that when correcting for the bias induced by cross-sectional dependence, the considered fundamentals still have significant long-term impacts, but these are reduced compared to the effect obtained using the DOLS methodology. We then check whether our results for the entire panel might be masking some heterogeneity across countries following the types of commodity they export; first, we subdivided our panel into four groups depending on the nature of the main commodity each country exports: food and beverages, metals, raw materials, and energy. We then estimated the long-term relationship for these country sub-groups, and Table 2 presents the estimated coefficients. The findings confirm that commodity trade terms are a significant determinant of the real effective exchange rate for the four commodity panels, except for the energy panel, with mixed results for the relative productivity and NFA position. They are sometimes non-significant (*LBS* for raw materials and energy, and *NFA* for energy only). We use these estimated coefficients to calculate each panel's equilibrium exchange rates. Currency misalignments are then derived following Equation (6) as the difference between the observed real effective exchange rates and their equilibrium value.¹⁹

¹⁹ For brevity, we do not report figures that display the evolution of observed and equilibrium real effective exchange rates and their associated misalignments. These results are available from the authors upon request.

Table 2: Results of the cointegrating relationship for subgroups of countries according to the commodity classification

	Food and beverages	Metals	Raw materials	Energy
LBS	0.405*** (13.461)	0.325*** (4.277)	0.107** (0.042)	0.182** (0.023)
NFA	0.102*** (15.884)	0.145*** (7.983)	0.018 (0.448)	0.100*** (3.504)
LToT ^{com}	0.055*** (3.916)	0.033** (1.732)	0.051*** (0.008)	-0.052 (-1.561)

Notes: Estimation of equation (3):

$$LREER_{i,t} = \mu_i + \theta_1 LBS_{i,t} + \theta_2 NFA_{i,t} + \theta_3 LToT_{i,t}^{com} + u_{i,t}$$

This equation is estimated using only the DOLS procedure.²⁰ *t*-statistics are given in parentheses. Significant coefficient at 1% (***), 5% (**) or 10% (*).

3.2. The non-linear relationship: The PSTR estimation results

We now assess the short-term non-linear relationship between real commodity price volatilities and currency misalignments. However, studying non-linear relationship requires a specific modeling strategy. According to González et al. (2005), the modeling process involving panel data must first test linearity against the PSTR alternative. If linearity in our study is rejected, the real commodity price volatilities' impacts on currency misalignments differ depending on whether the financial development level (i.e. transition variable) is low or high.²¹ The results reveal that the null hypothesis of linearity is rejected in favor of the PSTR alternative with two regimes.²² These findings emphasize the volatility of real commodity prices, which differently impact the currency misalignments depending on the level of financial development. Table 3 displays the PSTR estimation results.

First, we use the de facto measure of financial development as the transition variable, measured by the ratio of M2 to GDP. The results are highly significant for all panels and indicate the following: (i) real commodity price volatilities significantly impact currency misalignments; and (ii) this impact is non-linear, and takes different signs depending on the level of the financial transition variable. Also, Table 3 reveals a significant heterogeneity between the four panels with thresholds (\hat{c}) varying from 0.272 (metals) to 0.408 (food and beverages). The threshold value - as connected with the level of financial development - reveals an important heterogeneity in terms of the dynamics and impacts between commodity price volatilities and currency misalignments. As the different countries in the four panels have heterogeneous levels of financial development, their real commodity price volatilities differently affect the currency misalignments.

We now focus on the estimated coefficient of our exogenous variable, which is real commodity price volatility. First, the estimated coefficient for the metals panel is positive for the periods when countries are financially less developed (regime 1). Consequently, when the

²⁰ Results using the BKN procedure are very similar and are available upon request from the authors.

²¹ To save space, results of linearity tests are not reported here but are available upon request to the authors.

²² The linearity test also provides the appropriate order m of the logistic transition function. The results indicate that the dynamic is asymmetric ($m = 1$) for all panels.

commodity price volatility rises, this will increase currency misalignments. Regarding the second regime, when a country has a better level of financial development, commodity price volatility negatively affects currency misalignments. This indicates that the commodity-exporting countries' financial development toward risk diversification can reduce currency misalignments when commodity prices are highly volatile.

Table 3: Estimation results of the PSTR model (full sample period: 1994-2016)

	Food and beverages		Metals		Raw materials		Energy	
	Regime		Regime		Regime		Regime	
	1	2	1	2	1	2	1	2
Transition variable: <i>M2/GDP</i>								
$\Delta ComPI$	-0.189***	0.488***	1.197***	-0.234***	-0.461***	0.146***	-1.425***	0.179***
\hat{c}	0.408		0.272		0.285		0.340	
$\hat{\gamma}$	1331.8		1223.7		3352.3		91.4	
Transition variable: <i>Private credit/GDP</i>								
$\Delta ComPI$	-0.061	1.781***	0.230***	-0.256***	-0.818***	0.082***	-0.629**	0.047***
\hat{c}	0.498		0.302		0.134		0.508	
$\hat{\gamma}$	27.9		3369.5		3498.7		103.7	

Notes: Estimation of equation (1):

$$|MIS_{i,t}| = \alpha_i + \beta_0 \Delta ComPI_{i,t} + [\beta_1 \Delta ComPI_{i,t} * F(S_{i,t}; \gamma, c)] + \varepsilon_{i,t}$$

$|MIS_{i,t}|$ stands for the misalignment expressed in logarithm (in absolute terms). $\Delta ComPI$ is the commodity price index volatility. \hat{c} represents the estimated threshold value, and $\hat{\gamma}$ is the estimated slope parameter of the transition function. Significant coefficient at 1% (***), 5% (**) or 10% (*).

Second, we observe different behaviors for the other three panels—energy, food and beverages, and raw materials—compared to the metals panel, as the exogenous variable's estimated coefficient is negative in the first regime and positive in the second. Therefore, the greater the real commodity prices' volatility for the periods when countries are poorly developed financially, the smaller the gap between the real exchange rate and its equilibrium value. Alternatively, the estimated coefficient is positive for the periods when a country is better developed financially (regime 2). For instance, in the energy panel's second regime, a rise of 10 percent in the commodity price volatility will induce an increase of 1.79 percent in currency misalignments. This result may be explained by the fact that the financial development process and commodity financialization can reverse this effect, and primarily during periods of high discrepancy in financial markets, which can accentuate these currency misalignments when commodity prices are more volatile. These results are consistent with those of Reinhart and Smith (2002) and Tille (2005),²³ which demonstrate that higher financial development can lead to highly volatile exchange rates and persistent deviations from an exchange rate equilibrium. Moreover, these three panels' results can be explained by the type of exchange rate regime, as a majority of raw materials- and energy-exporting countries have adopted pegged exchange rates, whether *de jure* or *de facto*, with bands of

²³ For example, Caporale et al. (2011) provide a literature review.

fluctuations allowed in some cases.²⁴ Even with high financial development, a fixed exchange rate cannot cushion a higher commodity price volatility. In this case, the exchange rate cannot be a shock absorber (Devereux, 2004). In contrast, and as Edwards and Levy-Yeyati (2005) demonstrated, a flexible exchange rate can be a shock absorber.

To test the robustness of our results, and based on the data set availability, we select another financial development indicator: private credit to GDP. This measure is defined as the credit issued to the private sector by banks and other financial intermediaries, divided by GDP, and constitutes a measure of general financial intermediary activities provided to the private sector. The lower part of Table 3 presents the PSTR model's estimation results following the same approach as previously. The results confirm commodity price volatilities' non-linear impact on currency misalignments. Indeed, the food and beverages, raw materials and energy panels reveal that this impact is negative in the first regime, then becomes positive when the transition variable reaches the threshold value (in the second regime). These results corroborate the previous measure (M2/GDP) and demonstrate our results' robustness. The results for the metals panel are also identical for both measures—the M2/GDP ratio and private credit/GDP ratio, as the impact is positive in the first regime and negative in the second. Our findings are consistent with previous studies (Fratzscher et al., 2014; Coudert & Mignon, 2016) and support the idea that the real commodity price volatilities impact the real exchange rate misalignments when considering the financial development level as an important transmission channel.

4. Conclusion

This paper investigated the relationship between commodity price volatilities and real effective exchange rate misalignments among 46 commodity-exporting countries between January 1994 and December 2016. In considering the commodity market's financialization process, it seems that a country's level of financial development may be important as a transmission channel from real commodity price volatilities to currency misalignments. Our results not only indicate that the estimated coefficients are highly significant, but also highlight that real commodity prices' volatility has a non-linear impact on currency misalignments depending on the country's degree of financial development. The results also demonstrate different dynamics based on the type of commodity the country exports and its level of financialization. Specifically, the PSTR specification revealed that the real price index's volatility is a significant driver of currency misalignments for all panels. In summary, our results highlight the importance of the financialization channel when analyzing real commodity price fluctuations' impacts on the currency misalignments across commodity-exporting countries. However, the impact intensity differs from one panel to another. One should not solely focus on a country's level of financial development when analyzing the relationship between real commodity prices and the real effective exchange rate. Indeed, other transmission channels may be tested as well, as for instance, trade capabilities among others.

²⁴ For example, Reinhart and Rogoff (2004) or Ilzetzki et al. (2017) discuss the classifications of exchange rate regimes.

References

- Amano, R., & van Norden, S. (1998a). Exchange rates and oil prices. *Review of International Economics*, 6(4), 683–694.
- Amano, R., & van Norden, S. (1998b). Oil prices and the rise and fall of the U.S. real exchange rate. *Review of International Economics*, 6(4), 683–694.
- Bai, J., Kao, C., & Ng, S. (2009). Panel cointegration with global stochastic trends. *Journal of Econometrics*, 149(1), 82–99.
- Baker, S., & Routledge, B. (2012). The price of oil risk. *Working paper 9-2011*. Carnegie Mellon University.
- Basak, S., & Pavlova, A. (2016). A model of financialization of commodities. *The Journal of Finance*, 71(4), 1511–1556.
- Bénassy-Quéré, A., Béreau, S., & Mignon, V. (2010). On the complementarity of equilibrium exchange-rate approaches. *Review of International Economics*, 18(4), 618–632.
- Bodart, V., Candelon, B., & Carpenter, J. F. (2012). Real exchange rates in commodity producing countries: A reappraisal. *Journal of International Money and Finance*, 31, 1482–1502.
- Boubakri, S., Couharde, C., & Raymond, H. (2016). Effects of financial turmoil on financial integration and risk premia in emerging markets. *Journal of Empirical Finance*, 38, 120–138.
- Boubakri, S., Guillaumin, C., & Silanine, A. (2019). Non-linear relationship between real commodity price volatility and real effective exchange rate: The case of commodity-exporting countries. *Journal of Macroeconomics*, 60, 212–228.
- Bussière, M., Ca'Zorzi, M., Chudik, A., & Dieppe, A. (2010). Methodological advances in the assessment of currency misalignments. *ECB working paper 1151*. European Central Bank.
- Büyüksahin, B., & Robe, M. (2011). Does paper oil matter? Energy markets' financialization and equity commodity co-movements. *Working paper*. American University.
- Caporale, M. G., Ciferri, D., & Girardi, A. (2011). Are the Baltic countries ready to adopt the euro? A generalized purchasing power parity approach. *The Manchester School*, 79(3), 429–454.
- Cashin, P., Céspedes, L., & Sahay, R. (2004). Commodity currencies and the real exchange rate. *Journal of Development Economics*, 75(1), 239–268.
- Cayen, J. P., Coletti, D., Lalonde, R., & Maier, P. (2010). What drives exchange rates? New evidence from a panel of U.S. dollar exchange rates. *Bank of Canada working paper 2010-15*. Bank of Canada.
- Céspedes, L. F., & Velasco, A. (2012). Macroeconomic performance during commodity price booms and busts. *NBER working paper 18569*. National Bureau of Economic Research.
- Chari, V. V., & Christiano, L. (2017). Financialization in commodity markets. *NBER working paper 23766*. National Bureau of Economic Research.
- Chen, B. (2007). An empirical review of methods for temporal distribution and interpolation in the national accounts. *Working paper 0077*. Bureau of Economic Analysis.
- Chen, Y., & Rogoff, K. (2003). Commodity currencies. *Journal of International Economics*, 60(1), 133–160.

- Cheng, I. H., & Xiong, W. (2013). The financialization of commodity markets. *NBER working paper 19642*. National Bureau of Economic Research.
- Chinn, M. (2005). A primer on real effective exchange rates: Determinants, overvaluation, trade flows and competitive devaluation. *NBER working paper 11521*. National Bureau of Economic Research.
- Clark, P., & MacDonald, R. (1998). Exchange rates and economic fundamentals: A methodological comparison of BEERs and FEERs. *IMF working paper 98/00*. International Monetary Fund.
- Cline, W. R. (2010). Renminbi undervaluation, China's surplus, and the US trade deficit. *Policy Brief 10-20*. Peterson Institute for International Economics.
- Coudert, V., & Mignon, V. (2016). Reassessing the empirical relationship between the oil price and the dollar. *Energy Policy*, *95*, 147–157.
- Coudert, V., Couharde, C., & Mignon, V. (2015). On the impact of volatility on the real exchange rate-terms of trade nexus: Revisiting commodity currencies. *Journal of International Money and Finance*, *58*, 110–127.
- Devereux, M. (2004). Should the exchange rate be a shock absorber? *Journal of International Economics*, *62*, 359–377.
- Domanski, D., & Heath, A. (2007). Financial investors and commodity markets. *BIS Quarterly Review*, *March*, 53–67.
- Driver, R., & Westaway, P. (2005). Concepts of equilibrium exchange rates. *Bank of England working paper 248*. Bank of England.
- Durand, C., & Lopez, C. (2012). Taux de change d'équilibre et mesure de la compétitivité au sein de la zone euro (The equilibrium exchange rate and measure of competitiveness in the Eurozone; in French). *Bulletin de la Banque de France (Bulletin of the Bank of France)*, *190*, 125–133.
- Edwards, S. (1989). *Real exchange rates, devaluation and adjustment: Exchange rate policy in developing countries*. Cambridge, MA: MIT Press.
- Edwards, S., & Levy Yeyati, E. (2005). Flexible exchange rates as shock absorbers. *European Economic Review*, *49*, 2079–2105.
- Frankel, J. A. (2005). On the renminbi. *CESifo Forum*, *6*(3), 16–21.
- Frankel, J. A., & Rose, A. K. (1996). Currency crashes in emerging markets: An empirical treatment. *Journal of International Economics*, *41*(3-4), 351–366.
- Fratzscher, M., Schneider, D., & Van Robays, I. (2014). Oil prices, exchange rates and asset prices. *ECB working paper 1689*. European Central Bank.
- González, A., Teräsvirta, T., & van Dijk, D. (2005). Panel smooth transition regression models. *Research paper 165*. Quantitative Finance Research Centre, University of Technology, Sydney.
- Henderson, B., Pearson, N., & Wang, L. (2015). New evidence on the financialization of commodity markets. *Review of Financial Studies*, *28*(5), 1285–1311.
- Hong, H., & Yogo, M. (2012). What does futures market interest tell us about the macroeconomy and asset prices? *Journal of Financial Economics*, *105*(3), 473–490.
- Hong, H., de Paula, A., & Singh, V. (2015). Hoard behavior and commodity bubbles. *NBER working paper 20974*. National Bureau of Economic Research.

- Ilzetzki E., Reinhart C., & Rogoff, K. (2017). Exchange rate arrangements entering the 21st century: Which anchor will hold? *Quarterly Journal of Economics*, 119, 1–48.
- Inamura, Y., Kimata, T., Kimura, T., & Muto, T. (2011). Recent surge in global commodity prices—impact of financialization and globally accommodative monetary conditions. *Bank of Japan Review 11-E-2*. Bank of Japan.
- Irwin, S. H., & Sanders, D. R. (2010). *The impact of index and swap funds on commodity futures markets* (OECD Food, Agriculture and Fisheries Working Paper No. 2). Retrieved from the Organisation for Economic Co-operation and Development.
- Isard, P. (2007). Equilibrium exchange rates: Assessment methodologies. *IMF working paper 07/296*. International Monetary Fund.
- Kao, C., & Chiang, M. H. (2000). On the estimation and inference of a cointegrated regression in panel data. *Advances in Econometrics*, 15, 179–222.
- Kinda, T. (2011). Modeling inflation in Chad. *IMF working paper 11/57*. International Monetary Fund.
- Killian, L. (2008). The economic effects of energy price shocks. *Journal of Economic Literature*, 46(4), 871–909.
- Lane, P., & Milesi-Ferretti, G. M. (2007). The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970–2004. *Journal of International Economics*, 73(2), 223–250.
- Levine, R. (2005). Finance and growth: Theory, evidence, and mechanisms. In P. Aghion, & S. Durlauf (Eds.), *Handbook of economic growth* (pp. 865–934). Amsterdam: Elsevier.
- Levine, R., Loayza, N., & Beck, T. (2000). Financial intermediation and growth: Causality and causes. *Journal of Monetary Economics*, 6(1), 31–77.
- Ligonnière, S. (2018). Trilemma, dilemma and global players. *Journal of International Money and Finance*, 85, 20–39.
- Liu, Z., Wang, P., & Zha, T. (2011). Land-price dynamics and macroeconomic fluctuations. *Working Paper 2011-26*. Federal Reserve Bank of San Francisco.
- MacDonald, R. (1997). What determines real exchange rates? The long and short of it. *IMF working paper 97/21*. International Monetary Fund.
- MacDonald, R. (2000). Concepts to calculate equilibrium exchange rates: An overview. *Bundeskank series 1 discussion paper 2000.03*. Bundesbank.
- Mark, N., & Sul, D. (2003). Cointegration vector estimation by panel DOLS and long-run money demand. *Oxford Bulletin of Economics and Statistics*, 65, 655–680.
- Masters, M. W., & White, A. K. (2008). The accidental Hunt brothers: How institutional investors are driving up food and energy prices. The Accidental Hunt Brothers Blog Special Report.
- Mayer, J. (2009). The growing interdependence between financial and commodity markets. *UNCTAD discussion paper 195*. United Nations Conference on Trade and Development.
- Reinhart, C., & Smith, R. (2002). Temporary controls on capital inflows. *Journal of International Economics*, 57(2), 327–351.
- Reinhart, C., & Rogoff, K. (2004). The modern history of exchange rate arrangements: A reinterpretation. *Quarterly Journal of Economics*, 119, 1–48.
- Ricci, L., Lee, J., & Milesi-Ferretti, G. (2008). Real exchange rates and fundamentals: A cross-country perspective. *IMF working paper 08-13*. International Monetary Fund.

- Schröder, M. (2013). Should developing countries undervalue their currencies? *Journal of Development Economics*, 105, 140–151.
- Silvennoinen, A., & Thorp, S. (2013). Financialization, crisis and commodity correlation dynamics. *Journal of International Financial Markets, Institutions and Money*, 24, 42–65.
- Svirydenka, K. (2016). Introducing a new broad-based index of financial development. *IMF working paper 16/5*. International Monetary Fund.
- Tille, C. (2005). The welfare effect of international asset market integration under nominal rigidities. *Journal of International Economics*, 65(1), 221–247.
- Zarembalver, A., & Neumann, B. (2015). *The financialization of commodity markets: Investing during times of transition*. New York: Springer.