

Cycles and Trends in Commodity Exporting Economies: A Bayesian Investigation

Carlos A. Yépez*

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Abstract

Recent literature has documented a prominent role for commodity price shocks in driving fluctuations in emerging markets (Dreschel and Tenreyro 2018, Fernandez et al. 2018.) Our study adds to this literature by considering the case of advanced commodity exporting economies, as well as asking how important are commodity shocks for understanding the high observed volatility of real exchange rates.

Specifically, we carry out a quantitative examination of the well-known sources of business cycles in small open economies, with emphasis on commodity exporting countries. We estimate a standard open economy model with Bayesian methods for the cases of Mexico and Canada -two oil producing countries. We measure the relative contribution of both trend and transitory components of productivity, interest rate shocks, and commodity price shocks to the volatility of macroeconomic variables.

We find that transitory shocks to productivity along with commodity price shocks explain a sizeable share of the volatility of macroeconomic aggregates as well as the real exchange rate. Our results are thus suggestive of the importance of commodity prices for the conduct of stabilization policy in these economies.

Keywords: Business Cycles, Exchange Rates, Commodity Exporting Economies, Small Open Economy.

JEL codes: E32, F31, F41

*Department of Economics. University of Manitoba. Rm. 644 Fletcher Argue Bldg., Winnipeg, Manitoba. Canada R3T 5V5. E-mail: Carlos.Yepez@umanitoba.ca