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Real exchanges rates in commodity producing countries: A reappraisal[☆]

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Commodity price booms, as those recorded in the last decade, may have a significant economic impact in small, commodity exporting, developing countries. Whether the impact on output is positive or negative is still unclear. It depends on various factors, notably on the impact that commodity prices can have on the real exchange rate of the commodity exporting countries. Two recent papers show that the real exchange rate appreciates when commodity prices increase. Our analysis produces new estimates of this relationship by focusing on a large sample of developing countries which are specialized in the export of one leading commodity. By using non-stationary panel techniques robust to cross-sectional dependence, we find that the price of the dominant commodity has a significant long-run impact on the real exchange rate when the exports of the leading commodity have a share of at least 20 percent in the country's total exports of merchandises. Our results also show that the larger this share, the larger the size of the impact.

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1. Introduction

Many developing countries, gifted in natural resources, heavily depend on international commodity prices. Whether natural resources are a luck or a curse for these countries is still an open debate. Historical experience shows indeed that some countries have admirably well taken profits of their natural endowments, while others suffered countless economic difficulties. The “natural resource curse” literature, surveyed recently by Frankel (2010a), identifies several channels through which commodity prices can affect the economic performance of commodity producing countries. One important channel is the real exchange rate. Theoretical literature indeed shows that commodity price booms may cause an appreciation of the real exchange rate of commodity exporting countries. This appreciation in turn generates so-called “Dutch disease” effects, by altering the competitiveness of the non-commodity exportable sectors. In this paper, we explore this “real exchange rate” channel and we provide new empirical estimate of the relationship between commodity prices and real exchange rates for a large group of developing countries.

Recent estimates of the relationship that may exist between real exchange rates and commodity prices are provided by Chen and Rogoff (2003) and by Cashin et al. (2004). The former provides results for three developed countries (Canada, Australia and New-Zealand) and the latter for about sixty developing countries. Both use time-series cointegration techniques and find that commodity prices have a significant positive long-run impact on the real exchange rate of many countries. Our analysis is similar in spirit to those two recent studies. One main difference with them comes from the fact that we focus exclusively on developing countries whose exports are highly concentrated on one particular commodity. In their studies, Chen and Rogoff (2003) and Cashin et al. (2004) both look at the long-run dependence that may exist between a country's real exchange rate and a specific country-commodity price index constructed as a weighted average of the price of the different commodities that are exported by the country. In our study however, what we are interested in is to assess whether the price of the leading commodity exported by a country is an economically and statistically significant determinant of the long-run variations in their real exchange rate. The price variable in our cointegration analysis is therefore a single price rather than a constructed price index. We believe that this approach is particularly relevant given the numerous countries that are heavily specialized in the production and export of one natural commodity. This is clearly the case of most oil producing countries. This is also true for many countries exporting agricultural or mineral commodities, as for instance Central African Republic (cotton), Chile (copper), Colombia (coffee), Ivory Coast (cocoa), Ethiopia (coffee), Malawi (tobacco), Mauritius (sugar) or Niger (uranium). More formally, in a very recent paper, Easterly and Reshef (2010) show from a sample of 37 African countries that the cross-country mean share of the top export is about 48 percent of total export receipts (for the period 1994–2008), while the average share of the second top export is only 14 percent of total export receipts. Similar conclusions are drawn from the data reported by Cashin et al. (2004), which covers 58 developing countries.¹ It appears in particular that for 27 countries, the leading commodity accounts for more than 50 percent of total commodity exports, the cross-country mean share being about 75 percent.

For small countries specialized in the export of one main commodity, fluctuations in the (world) price of their leading commodity export can be an important source of macroeconomic instability. For that reason, the price of that commodity can play a key role in the macroeconomic management of these countries. It can for instance influence the design of exchange rate and monetary policies if policymakers are willing to reduce the undesirable “Dutch disease” effects caused by commodity price booms. On this matter, Frankel (2010b) reports that the 2003–2008 boom in world commodity markets put upward pressure on the currency of several Latin American commodity exporting countries and these countries intervened heavily on the foreign exchange market to dampen the currency appreciation. Colombia was one of these countries, as illustrated by Vargas (2005). Edwards (1986) also shows

¹ From the data reported by Cashin et al. (2004) in their Table 1 (pp.246–247), it appears that the top commodity export accounts on average (across countries and for the period 1991–1999) for 52 percent of all commodity exports. The average share of the second and third leading commodity is respectively about 18 percent and 9 percent.

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