

Commodity Prices and AUD/USD Exchange Rate: A Regime Dependent Analysis

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The impact of export commodity prices, which are essentially exogenous, on the AUD/USD exchange rate is investigated. We use a Markov Regime Switching model to identify significant structural breaks endogenously. In this framework, the effect of four commodity sub-indices as generally favoured by the Reserve Bank of Australia is explored. These are Rural, Non-Rural, Base Metal and Bulk Commodities. The aim is to find, if any, state contingent explanatory power of these sub-indices on the changes in exchange rate. All the subindices have significant explanatory power during low volatility regime. But during high volatility regime only the first two subindices are significant. Further investigation reveals that a large jump in the Bulk Commodity sub index up or down may indeed be followed by a regime shift. The model also identifies the post GFC period as the high volatility state.

JEL Codes: C10; C51; C58; E52; E58; F31; G15.