

## DO TERMS OF TRADE DRIVE REAL EXCHANGE RATES? COMPARING OIL AND COMMODITY CURRENCIES

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### NON-TECHNICAL SUMMARY

Commodity terms of trade, defined as commodity prices deflated by the unit value of manufactured exports, were on a downward trend over several decades, before rising since the start of the 2000s. This overall trend is observed on average, even if developments are fairly different between oil and non-oil commodities. This paper investigates whether terms of trade have an impact on real exchange rates for two country samples: commodity exporters and oil exporters. More specifically, we ask two questions. Firstly, is the effect of terms of trade on the real exchange rate different in oil-exporting countries compared to other commodity producers? Secondly, to what extent exchange rate misalignments are linked to exchange rate regimes and to the anchor currency?

To answer these questions, we estimate two long-term relationships for the real effective exchange rate: the first relationship takes into account various economic fundamentals, including commodity terms of trade, while the second involves terms of trade alone. We use panel cointegration techniques over the 1980-2007 period, for our two samples of countries: 52 commodity exporters and 16 oil exporters.

Several findings emerge from our analysis. Firstly, real exchange rates co-move with commodity prices in the long run, as they are cointegrated, confirming results in previous studies. We also highlight the same type of relationships for oil-exporting countries, even if the response of their real exchange rates to oil price is somewhat smaller. Secondly, we identify common patterns in the real exchange rates of commodity and oil exporters. As most commodity prices were on a downward trend in the 1980s and the 1990s, commodity currencies tended to depreciate. This is also true, though to a lesser extent, for oil-currencies. Thirdly, we find that pegged currencies are highly dependent on the behaviour of their anchor. USD-pegged currencies were dragged down by the dollar fall and appear undervalued at the end of the period, whereas EUR-pegged currencies were being pushed upwards by the euro appreciation. Fluctuations in anchor currencies have been so wild that they may have dwarfed the impact of economic fundamentals on pegged exchange rates.

*Keywords:* commodities, oil, terms of trade, equilibrium real exchange rates, anchor currencies, panel cointegration.

*JEL:* C23, F31, O13.