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Commodity Price Shocks and Monetary Policy

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Abstract : We examine the role of monetary policy in the presence of commodity price shocks using a Dynamic stochastic general equilibrium (DSGE) model with price and wage rigidities. The model characterizes a commodity exporter by its degree of export diversification, and explores the following monetary regimes: flexible domestic inflation targeting; flexible Consumer Price Index inflation targeting; exchange rate peg; and optimal rule. An increase in the degree of diversification is found to mitigate responses to commodity shocks. The welfare comparison suggests that a flexible exchange rate regime under the optimal rule is preferred to an exchange rate peg. However, monetary policy provides limited stabilization effects in an economy with low degree of export diversification.

Keywords : business cycle, commodity price, exchange rate, global financial cycle
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