The Effect of Monetary Policy on Commodity Prices: Disentangling the Evidence for Individual Prices

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In this paper we study the effect of monetary policy shocks on commodity prices. While most of the literature has found that expansionary shocks have a positive effect on aggregate price indices, we study the effect on individual prices of a sample of four commodities. This set of commodity prices is essential to understand the dynamics of the balance of payments in Colombia. The analysis is based on structural VAR models, we identify monetary policy shocks following [Kim, 1999, 2003] upon quarterly data for commodity prices and their fundamentals for the period 1980q1 to 2010q3. Our results show that commodity prices overshoot their long run equilibrium in response to a contractionary shock in the US monetary policy and, in contrast with literature, the response of the individual prices considered is stronger than what has been found in aggregate indices. Additionally, it is found that the monetary policy explains a substantial share of the fluctuations in prices.

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