Exchange Rate Movements and Fundamentals: Impact of Oil Prices and China's Growth

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Summary

This paper identifies five factors that can capture 95% of the variance across 39 US dollar exchange rates based on the principal component method. A time-varying parameter factor-augmented vector autoregressive (TVP-FAVAR) model is used to analyze the determinants of movements in these exchange rates, revealing that impact of global oil prices and China's growth has increased significantly since 2008. In particular, shocks to these two fundamentals drive the movements of both commodity and non-commodity currencies recently. The impact of monetary policy shocks on the currency pairs is comparatively small.