

State Dependent Effects of Monetary Aggregates on Real Exchange Rate Volatility: MS-EGARCH Approach

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Abstract

The present study, in the form of a state-dependent model and during the period 2001:6-2019:12, investigates which of the components of monetary aggregates has the greatest impact on real exchange rate volatility of Iran. In order to achieve this goal, the variables of money, quasi-money, liquidity and monetary base are considered as monetary aggregates and in order to avoid multicollinearity between monetary aggregates, four Markov Switching Exponential GARCH models with fixed transition probability are estimated. The findings of the study also indicate that in both low and high regimes of real exchange rate volatility, monetary aggregates have a positive and significant effect on real exchange rate volatility and the effect of monetary aggregates in low regime of real exchange rate volatility is different from the high regime, so monetary variables have an asymmetric effect on real exchange rate volatility. In addition, in both the low and high regimes of real exchange rate volatility, the monetary base had a greater effect on real exchange rate volatility than other components of monetary aggregates. Therefore, controlling the components of monetary aggregates, given the

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importance of each in the up and down state of real exchange rate regime, can be considered as a strategic point by economic policymakers.

Keywords: Monetary Aggregates; Real Exchange Rate Volatility; Markov Switching Exponential GARCH Model; Asymmetric Effect.

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