Gold, Stock Price, Interest Rate and Exchange Rate Dynamics: An MS VAR Approach

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Abstract

Holding on gold as an asset has been considered a traditional safe haven for risk averse investors even though holding gold has no yield other than capital asset, especially during the volatile economic periods. Under the Breton Woods agreement the exchange rate is fixed by agreement and the price of gold has become volatile and steadily has been increasing against all of the major currencies. In this study, it is investigated that whether the relationship between gold, interest rates, exchange rates and stock market yields vary depending gold oil ratio. A two state time varying transition probability Markov switching (MS) process to the vector auto regression (VAR) estimation of macro financial variables. The switching between the states of the Markov process is linked to the volatility of gold and the macro financial variables to understand the transition dynamics between states. Results indicate that the interrelationships between the macro financial variables and gold prices are state dependent and volatilities of the variables have a statistically significant effect on the transitional dynamics of gold prices between the states.

Keywords: Gold Price, Gold Oil Ratio, Stock Price, Interest Rates, Exchange Rates, Time Series Analysis, Markov Switching Regimes

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