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Volume 20, 2013 - Issue 4

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Price discovery in commodity markets

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Pages 397-403 | Published online: 02 Aug 2012

Cite this article https://doi.org/10.1080/13504851.2012.709590

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Abstract

This article investigates the long-run relationship between spot and futures prices for corn and soybean. We apply cointegration methodology, allowing for the presence of potentially unknown structural breaks and then study the causality relationships between spot and futures prices within each specific subperiod identified with the aim of analysing the price discovery. Empirical estimates highlight (i) multiple breaks exist in the cointegrating relationship between prices and (ii) subperiods consequently identified express different dynamics in the causal relationship between spot and futures prices and support the idea that fundamentals are important in explaining the 2007/08 food price increase.

Keywords:

commodity | futures markets | price discovery | cointegration | structural breaks

JEL Classification:

C32 G13 G14 Q11

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Acknowledgements

We are grateful for useful comments by the discussants Dirk Baur, Sambit Bhattacharyya, Matthieu Stigler and conference participants. Financial support from the Università degli Studi di Milano for research in finance is gratefully acknowledged.

Notes

A preliminary version of this article was presented in Dublin at the Infinity Conference on International Finance, 13–15 June 2011, and in Zurich at the European Association of Agricultural Economists Congress, 30 August–2 September 2011.

[1] See Irwin et al. (2009) for a comprehensive explanation on the misunderstanding of the role of speculation in commodity price boom.

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