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Does Gold *Liquidity* Learn from the Greenback or the Equity?

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Highlights

► We elucidate shifts of gold, dollar, and stock market liquidity, both before and after the 2008 financial crisis.

►We document the negative relationship between gold and dollar returns but also between equity and gold.

► We also identify the predictability role of liquidity proxies of dollar and equity on gold liquidity even after accounting for macroeconomic variables known to predict the business cycle.

► During periods of high volatility gold liquidity becomes highly affected by dollar liquidity movements through a nonlinear smooth transition framework.

► The chief observation we make is that the recent financial crisis has changed the behavior of gold in terms of returns and liquidity.

Abstract

This paper seeks to understand and elucidate shifts of gold, dollar, and stock market liquidity, both before and after the 2008 financial crisis. The relationship among these assets is examined by allowing for nonlinear dynamics in the speed of adjustment to the equilibrium. The findings document the predictability role of liquidity proxies of dollar and equity on gold liquidity even after accounting for macroeconomic variables, suggesting that liquidity of both assets maintains an influence on gold behavior. During periods of high exchange-rate volatility between currencies, gold liquidity becomes highly affected by dollar liquidity movements through a nonlinear smooth transition framework. Yet evidence reveals that to fully understand the movements of gold and dollar it is necessary to factor in stock market liquidity as well.

Keywords: Liquidity, Flight to liquidity, Economic growth, Commodity, Gold, the Dollar, Granger causality, Nonlinear cointegration, STAR.

JEL Classification: F31, F3, D4, C15, G10, G11, G12, G15, G20, G30, G32, C52, C61.