

# Global Risk and the Dollar

Discussion of Georgiadis, Müller and Schumann (2022)

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Bank of England

December 2022

The views expressed here do not necessarily reflect the position of the Bank of England.

# This Paper

## What role does US dollar appreciation play for macroeconomic adjustment in response to global risk shocks?

Clearly a timely question:

### *The Dollar Is Strong. That Is Good for the U.S. but Bad for the World.*

The Federal Reserve may have no choice but to wage a relentless inflation fight, but countries rich and poor are feeling the pain of plunging currencies.

New York Times, Sept 26 2022

### *The Mixed Blessing of a 'Strong Dollar'*

While a dollar doesn't buy much in the United States, our columnist writes, the currency's international strength has been on display — in ways that aren't entirely beneficial.

New York Times, Oct 7 2022

# What The Paper Does

#1 Empirics identifying **causal** impact of 'global risk shocks' on dollar and macroec.

- *Approach*: Bayesian Proxy SVAR [Arias et al., 2021]
- *Identification*: High frequency gold-price surprises [Bloom, 2009; Piffer and Podstawski, 2018]

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Idem magistratus ite domum

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  - **[IN PROGRESS]** *Convenience*: Dollar safe-asset demand [Du et al., 2018; Corsetti et al., 2022...]
- #3 Counterfactual exercise for “what if the dollar didn’t appreciate?”
  - Very punchy numbers!

# Punchy Numbers: Too high?

*Without dollar dominance contractionary effect of global risk shock reduced by 50%*



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Equally high?

# My Comments and Suggestions

Two disclaimers:

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What's to come?

#1 How Much Should I Care About the Shock?

#2 Convenience Yields in the Empirical Setup

#3 Why Are Convenience Yields Interesting? How Could You Model Them?

# #1. How Much Should I Care About the Shock?

- Extensive discussion about what the ‘unified global risk’ shock captures:
  - Other safe-haven currencies (JPY) appreciate, while non-safe-haven (GBP!) depreciate
  - Increase in (short-term) US Treasury convenience yield
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  - Helpful to put empirics into context...
  - ...but also arguably necessary to taking punchy counterfactual numbers seriously given that role of dollar appreciation in macro transmission is shock-specific



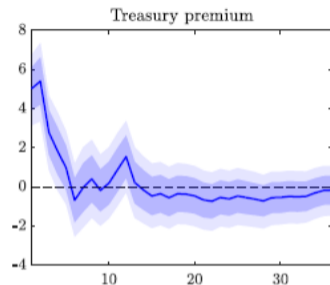
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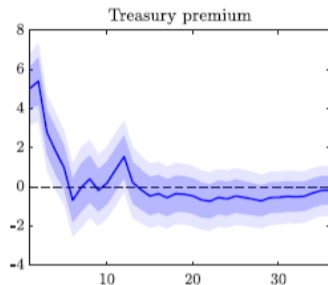


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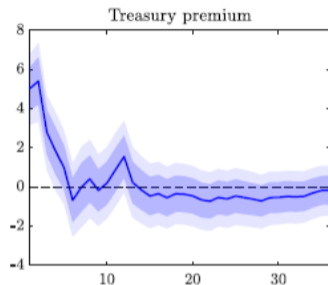


**Question:** Does setup allow for feedback from the conv. yld. to macro outcomes?

- US conv. yld.  $\Rightarrow \downarrow R_{US}$ , *cet. par.*  $\Rightarrow$  global expansionary effects
- But could  $\uparrow\uparrow R_{US}$  if dollar shortages arise in flights-to-safety [Cesa-Bianchi et al., 2022]

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**Suggestion:** Bring convenience yield into baseline specification

- May also provide scope for more refined counterfactuals

### #3. Why Are Convenience Yields Interesting For This Paper?

Current Version, *DCP*<sup>2</sup>:

- *Shock*: Global Risk Aversion
- *Mechanisms*:
  - *DCP in Trade*: appreciation hurts RoW, in spite of some scope for expenditure switching
  - *Dollar Financing*: appr. hurts RoW by ↓ net worth of RoW banks (what if US a debtor?)

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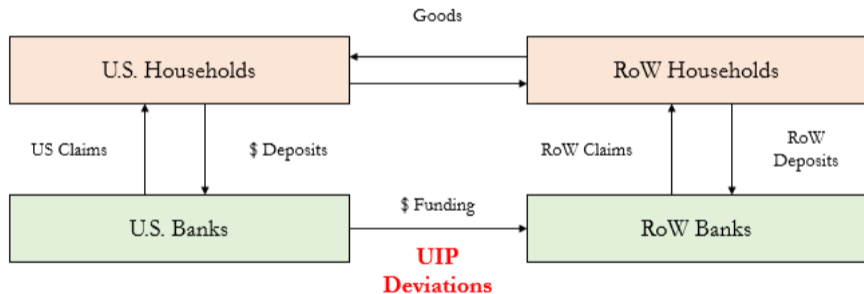
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Where It's Going?  $DCP^3$  with Shock Unchanged:

- *New Mechanism*:
  - *Dollar Safe Assets*: shadow value to holding US assets in crises ⇒ scope for more nuance in mechanism ( $\downarrow R_{US}$  outside of crises, welfare benefits to holding dollars...)

### #3 How Could You Model The Convenience Yields?

Is current setup rich enough to capture everything?

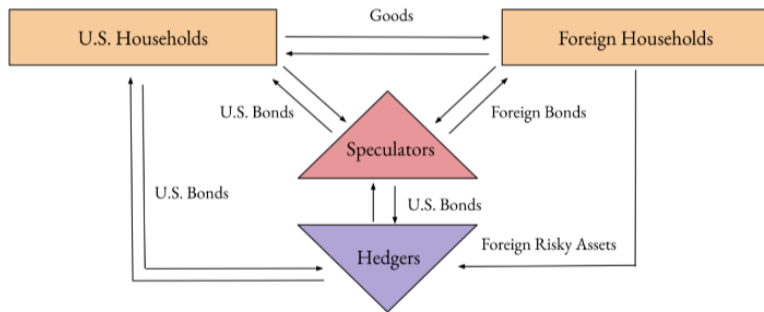


Dollar funding + Moral Hazard  $\Rightarrow$  UIP deviations

What about the CIP deviations?

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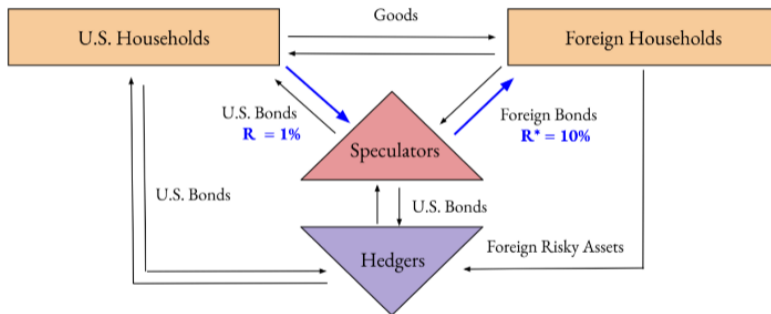


Setup of Ostry (2022), building on Gabaix and Maggiori (2015) and Jiang (2021)



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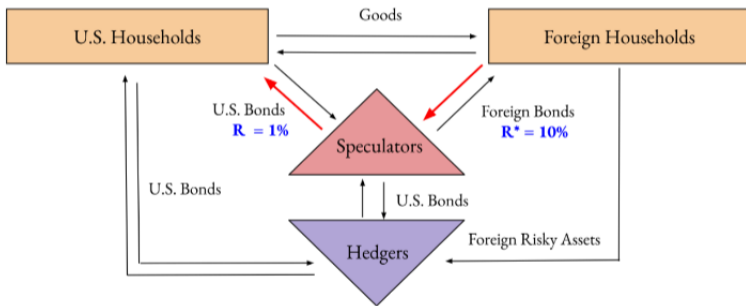


Ostry (2022)

Normal times: speculators perform carry trade (long high-yield) and require excess return (UIP deviation) for holding FX risk

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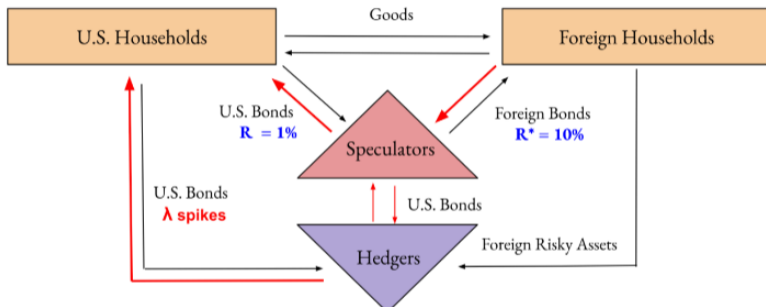


Ostry (2022)

Disaster state (cf. global risk aversion shock): speculators forced to shrink balance sheet

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Ostry (2022)

Hedgers endowed with risky Foreign assets, so hedge with US dollar bonds, but in 'disasters' hedgers fly to dollars and generate CIP deviation

## To Sum Up

- ★ Timely analysis of determinants of role of US dollar in macroeconomic adjustment
- ★ Transition from  $DCP^2$  to  $DCP^3$  a welcome step, that *should* open more doors
  - How important is the shock? Empirically, but also for counterfactual results?
  - Scope to make convenience yields more prominent in empirical analysis?
  - How to go about modelling convenience in your setup?