Discussion of Rey and Stavrakeva's "Interpreting Turbulent Episodes in International Finance"

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Outline

- Theory
- e Empirics
- Trump tariffs and exchange rates

- Outline the kind of theory that one could have in mind when thinking about the paper's question
- Question: what is the exchange rate impact of changes in dollar investors demand for local currency assets
 - changes driven by investors' appetite for risk (Global Financial Cycle)
- Consider an increase in the dollar value of dollar investors' holdings of local currency asset

$$\frac{Q^{\$,\ell}P^\ell}{S^{\ell/\$}}\nearrow$$

with
$$Q^{\$,\ell} + Q^{\ell,\ell} = Q$$

 $Q^{\$,\ell} \nearrow, P^{\ell} \nearrow, S^{\ell/\$} \searrow$

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- Let's start with **short-term bonds** (an asset not considered by Rey-Stavrakova)
- The local currency price of short-term bonds is pinned down by monetary policy

$$P^{\ell} = \frac{1}{1+i^{\ell}}$$

- \bullet Hence an increase in $Q^{\$,\ell}P^\ell/S^{\ell/\$}$ must be accommodated by
 - a currency appreciation $S^{\ell/\$}\searrow$
 - sale of short-term bonds by residents $Q^{\$,\ell}
 earrow$
- Sale of short-term bonds by the central bank is a foreign exchange intervention (Itzkhoki and Mukhin, 2023)
- In financially developed economies, most of the ofsetting is done by the private sector (Avdjiev et al, 2022; Jeanne and Sandri, 2023)

- Next, consider the case of long-term bonds
- The price P^ℓ is not pinned down by monetary policy because of the term premium (Gourinchas, Ray and Vayanos, 2024)

• under expectations theory, P^{ℓ} determined by $(E_t i_{t+s}^{\ell})_{s>0}$

- Again, the exchange rate impact should be small if local investors sell long-term bonds
- Next, consider increase in foreign demand for local equity with no offsetting local sale $(Q^{\$,\ell}\to)$
 - local investors see an increase in the dollar value of their local equity holdings
 - this spills over into an increase in dollar value of their local bond holdings
 - the exchange rate impact is the increase in the dollar price of short-term bonds

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Tentative takeaways

- Price impact of foreign investors demand shocks depend on presence of offsetting home investors
- Natural buffering by home investors that operate on the same margins as foreign investors but do not have the same preference shocks
 - importance of financial development, and sequencing of capital account liberalization
- Foreign exchange interventions can help but the source of shocks could matter
 - do FXI work when the source of shock is in equity markets?
 - perhaps counterveliling equity interventions by sovereign wealth funds would be more efficient?

Empirics

Empirics

- Rey-Stavrakeva (RS) measure the causal impact of changes in foreign demand for local equity or long-term bonds on the exchange rate
 - why not consider short-term bonds?
- Question: when foreign investors's dollar holdings of local assets increase by 1%, what is the impact on $S^{\ell/\$}$ and P^{ℓ} ?
 - \bullet I would like to see more about $Q^{\$,\ell}$ and $Q^{\ell,\ell}$
- In their IV estimation, RS use growth in outstanding shares of country-specific ETFs
 - they use component orthogonal to VIX, reflecting country-specific news
 - but isn't it what one wants to avoid in a measure of global financial shocks?
 - why not consider the growth in outstanding shares that is explained by VIX and other global financial factors?

Empirics

Results for Brazil



Figure: Brazil: impact of 1% increase in fc holdings of foreign investors

- Countries with smallest exchange rate impact of equity shocks are Taiwan, China, Singapore and HK
 - so FXI work after all to offset equity shocks?
- Financial development seems to make little difference
 - euro area between Thailand and Philippines in Figure 8

Trump tariffs

- US tariffs appreciate the dollar through trade channel (Jeanne and Son, 2024)
- But trade disintegration leads to financial disintegration (Obstfeld and Rogoff, 2001), so US tariffs could lead foreigners to sell US assets



Figure: Source: Hartley and Rebucci (2025)

THANK YOU!

Olivier Jeanne (JHU) Discussion of Rey and Stavrakeva's "Interpreting Turbulent Episodes in Intern

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