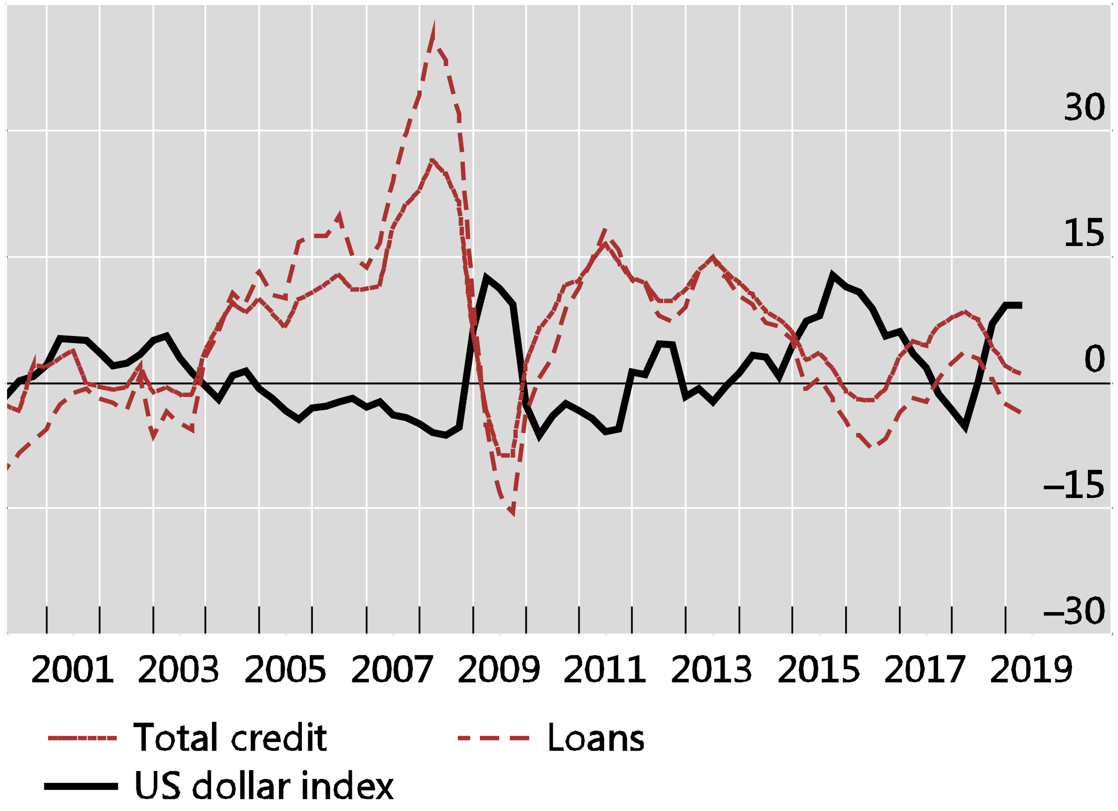
Discussion of “Global risk and the dollar”

by Jorgos, Gernot, and Ben

Valentina Bruno

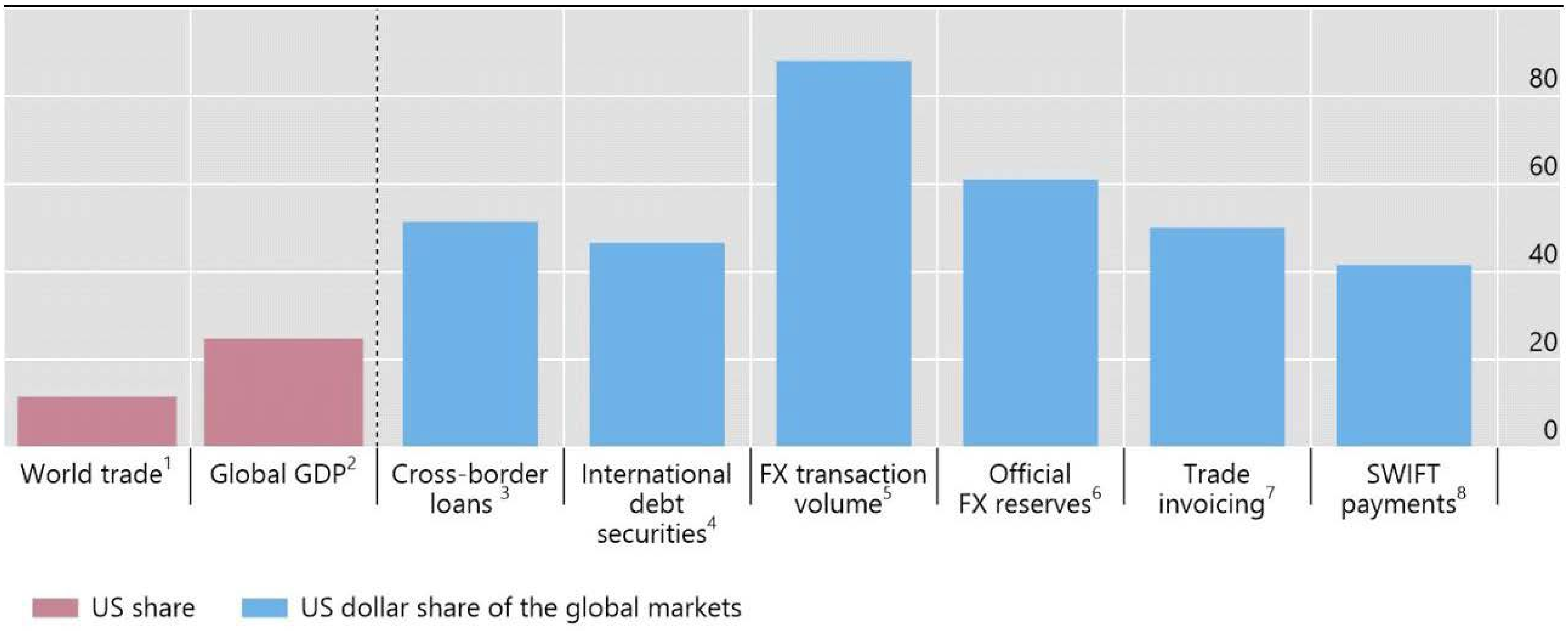
Facts

1) The US dollar is a barometer of global financial conditions: when the dollar appreciates, financial conditions tighten (and viceversa)



Facts

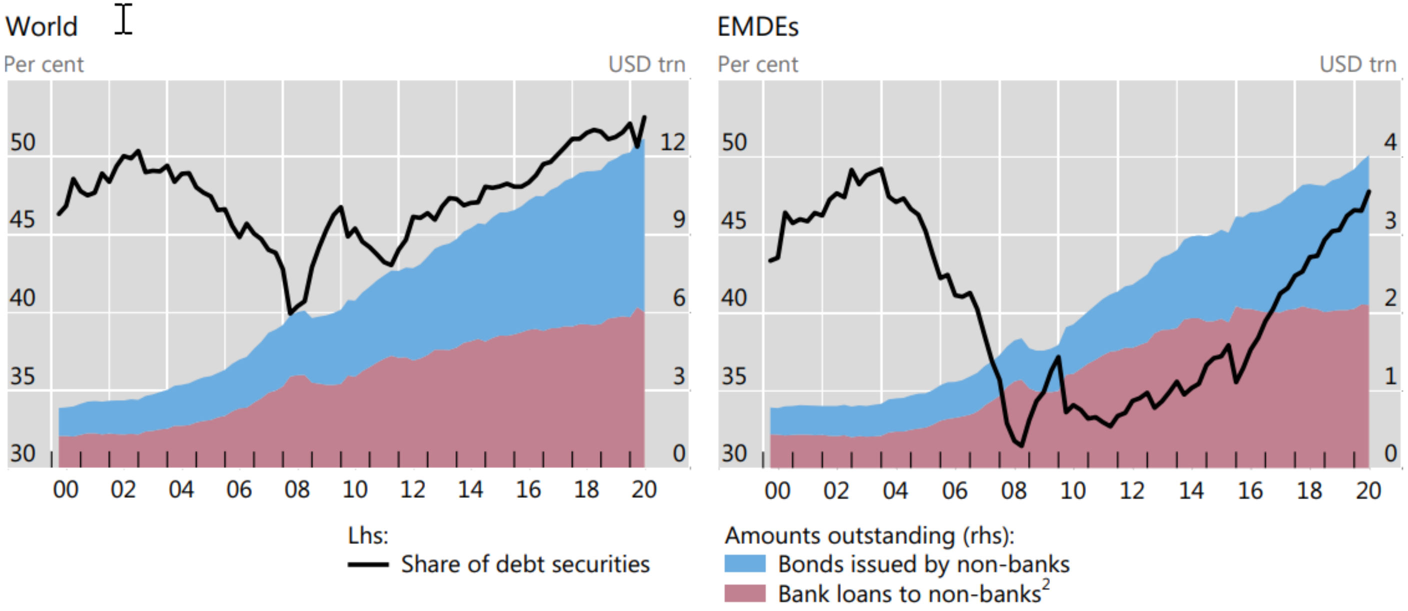
2) The US dollar is the dominant currency



Facts

3) Non-US firms are hungry of US dollars

US dollar-denominated credit to non-banks outside the United States[1]



Further information on the BIS global liquidity indicators is available at www.bis.org/statistics/about_gli_stats.htm.

[1] Non-banks comprise non-bank financial entities, non-financial corporations, governments, households and international organisations. [2] Loans by LBS-reporting banks to non-bank borrowers, including non-bank financial entities, comprise cross-border plus local loans.

Sources: Datastream; Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; national data; BIS locational banking statistics (LBS); BIS calculations.

This paper

- Model: two-countries (US and RoW), bringing together the role of the dollar in financial markets and trade
  - Financial channel + Invoicing channel in a unified framework

- Empirical Analysis: how a shock in the price of gold affects financial markets and the real economy in a VAR framework

Main message: the US dollar amplifies global risk shocks and has real effects

Comment #1: What I liked the most

- In the spirit, the model incorporates the **exchange rate effect** coming from the **financial channel** and the **role of trade invoicing** for the real economy.

Comment #1: What I liked the most

Bruno and Shin's Financial Channel (2015 REStud + 2022 forthcoming):

A stronger dollar sets in motion lender balance sheet effects that tighten credit supply, raise the cost of working capital of exporting firms, thereby dampening exports.

The financial channel may even outweigh the positive improvements predicted by the trade competitiveness channel

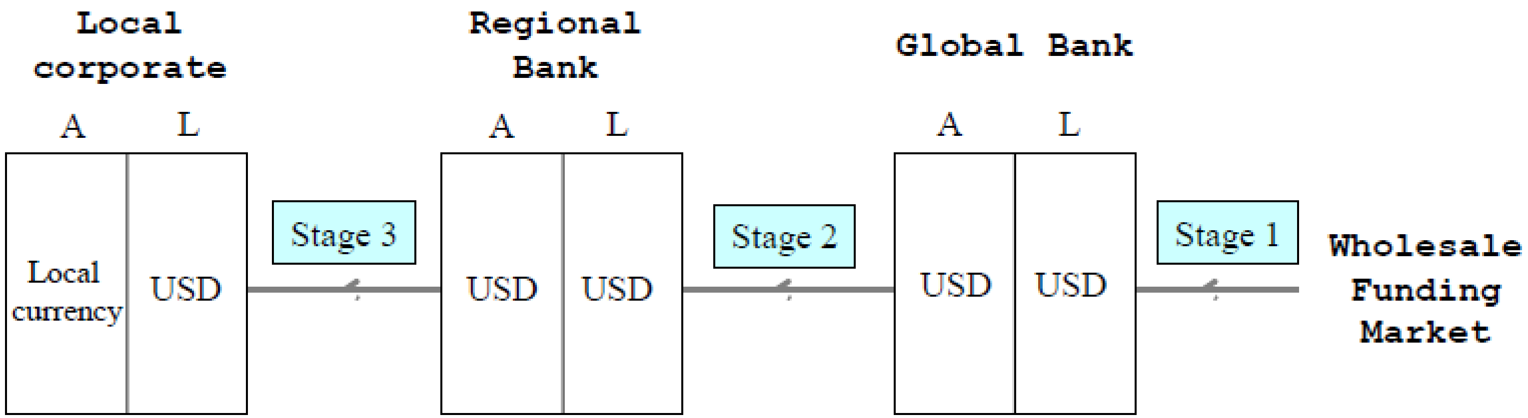


Figure 3. Cross-border bank lending in US Dollars

Comment #1: What I liked the most

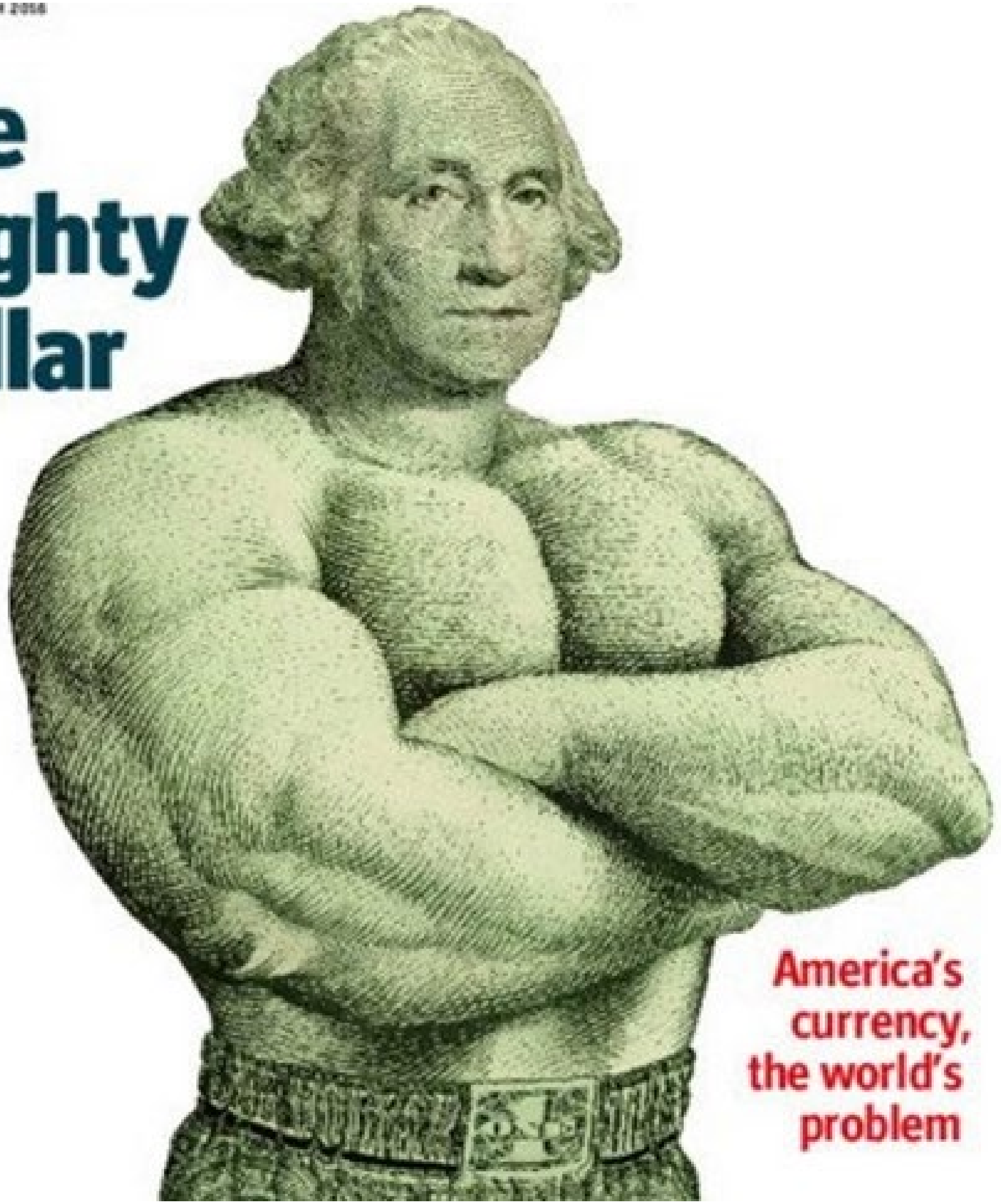
Goldberg and Tille (2008, 2009) and Gopinath et al. (2020) role of dollar invoicing

- The dollar is the dominant currency in trade invoicing
- Dollar appreciation leads to a contraction in trade volume in the rest of the world

Bruno & Shin +

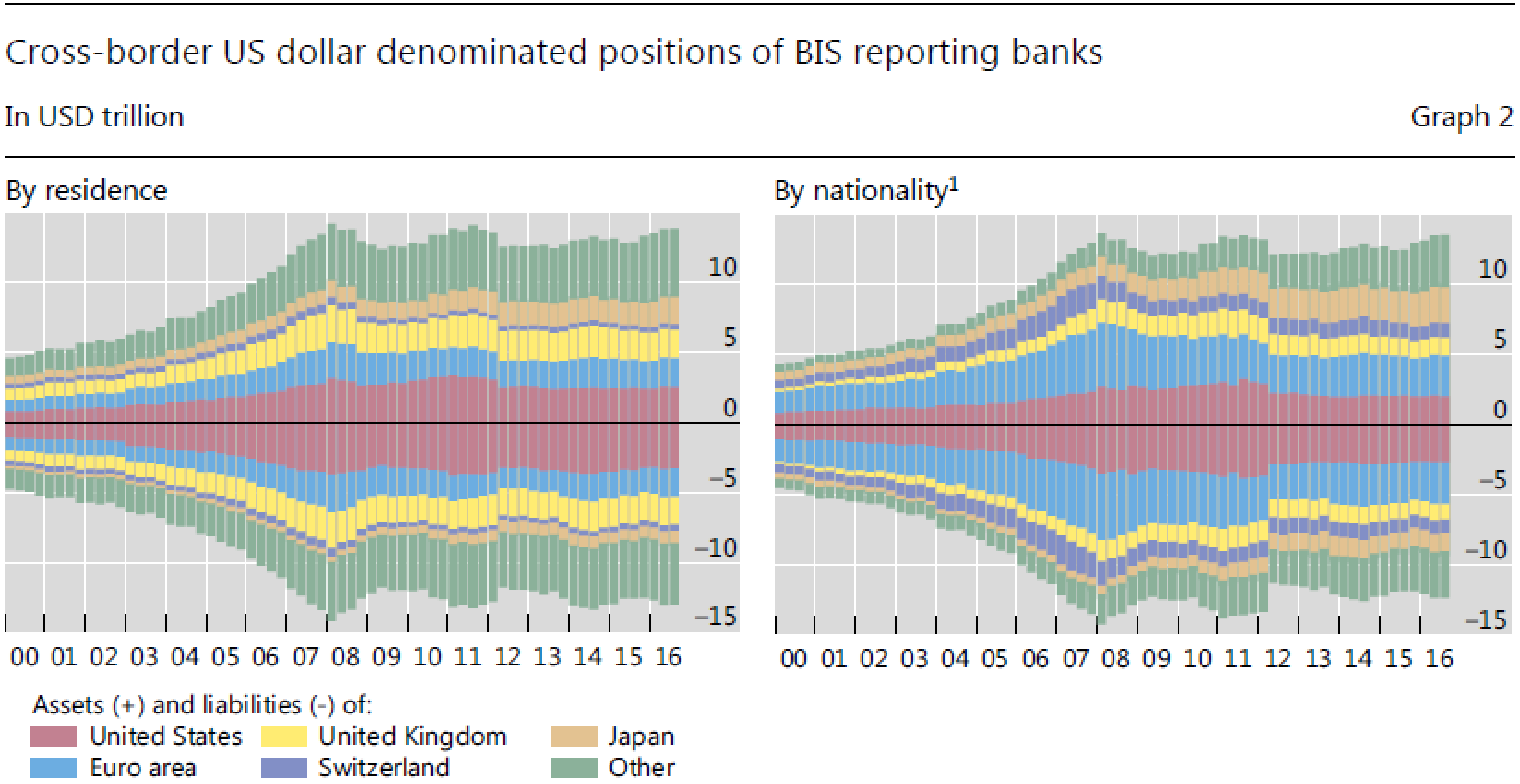
=

The mighty dollar



America's currency, the world's problem

Global economy as an intricate map of dollar flows. The domain of the currency (the dollar) extends beyond the borders of the currency's home country (United States).



The dollar is everywhere, not just to and from the United States.

Why DCP squared?

- Gopinath et al.’s channel is a trade channel where the USD has a contrary force to the bilateral exchange rate due to invoicing
- The USD in the financial channel is associated with tightening of global financial conditions

- DC~~P~~ squared

Comment #2: Empirical Evidence

- It is well-known that **what happens in financial markets does not stay in financial markets, but it affects the real economy.**
- As the dollar appreciates….
    - Firms' capital expenditures decline
    - Output and consumption decline
    - Exports decline
    - Domestic and cross-border credit decline
    - Sovereign debt spreads go up
    - Local currency returns go down

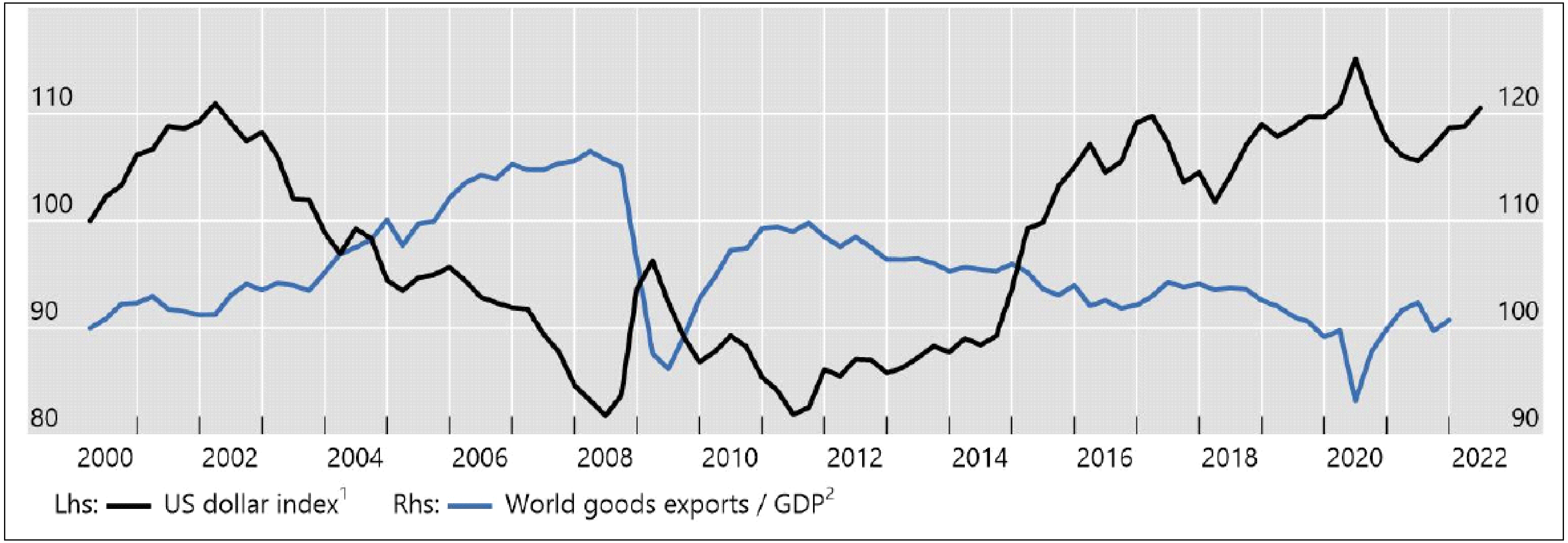
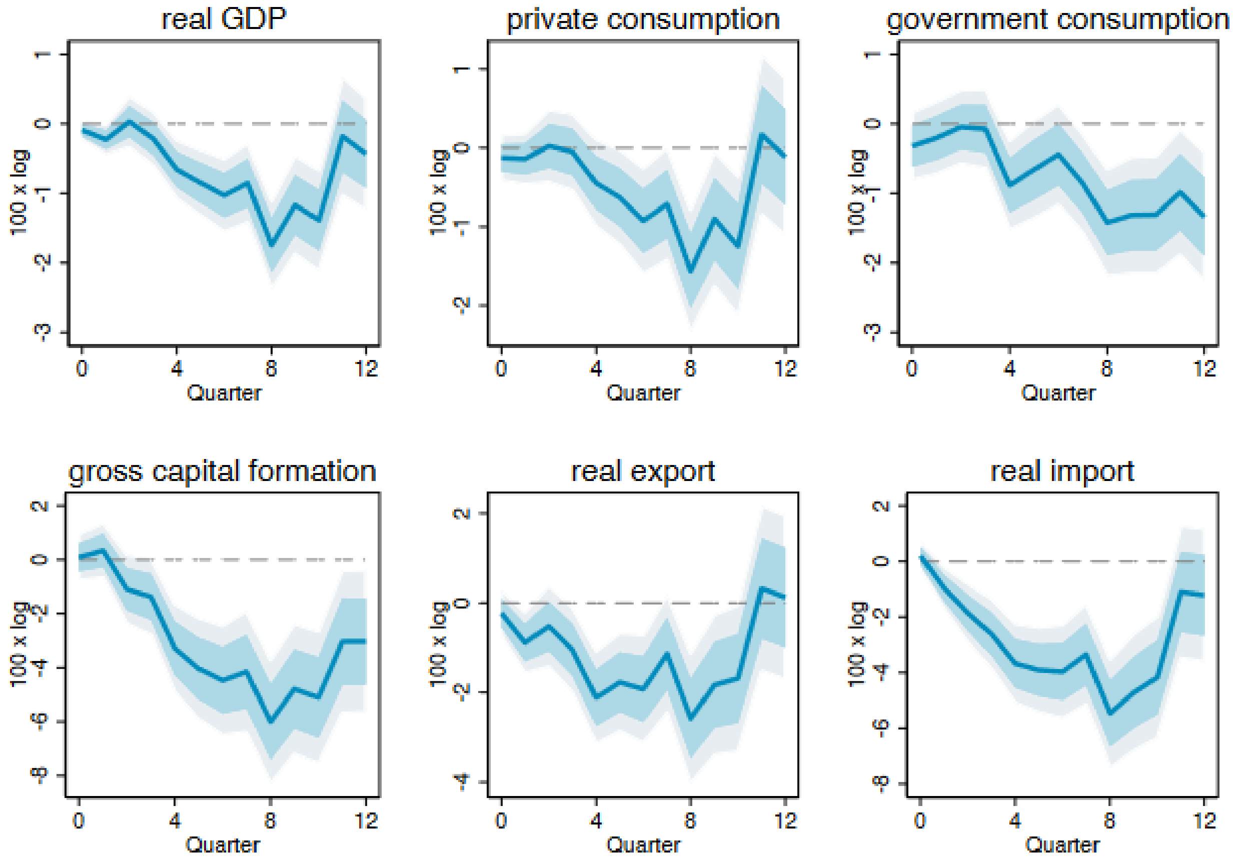


Figure 1

Global goods trade and the dollar. The figure shows the ratio of world merchandise exports to world output (right axis) and a weighted average of the foreign exchange value of the U.S. dollar against the currencies of a broad group of major U.S. trading partners, based only on trade in goods (left axis). Data are normalized as of Q1 2000. Sources: Federal Reserve Bank of St Louis, FRED; IMF, World Economic Outlook; World Trade Organization; Datastream; BIS calculations.

Dollar and Exports (forthcoming)

Figure 8: Impulse response: 10% appreciation of advanced economies dollar index



Obstfeld and Zhou (2022)

Comment #2: Empirical Evidence

- It is well-known that **what happens in financial markets does not stay in financial markets, but it affects the real economy.**

Bruno & Shin & co-authors (2015, 2018, 2019, 2020, 2022, and forthcoming)

Obstfeld and Zhou (2022)

di Giovanni, Kalemli-Özcan, Ulu, and So (2021)

Linda Goldberg Mundell-Fleming Lecture (2022)

Comment #2: This Paper

Methodology: *The shock we identify using the intra-daily gold-price surprises on narratively selected dates is intended to unify a broad class of shocks to risk that have been put forth in the theoretical literature.*

Gold as the ultimate safe asset.

While there are differences in structural conceptions, these shocks have in common that they are all associated with an exogenous increase in the demand for safe and liquid assets.

Comment #2: This Paper

Findings: The US dollar amplifies global shocks

The financial channel dominates the competitiveness channel

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Gold price shocks as an instrument

Gold spot price

Gold reference prices

From 1970-01-01 | To 2022-11-11 | PDF | PNG

6m | 1y | 3y | 10y | Max

Daily | Weekly | Monthly | Yearly

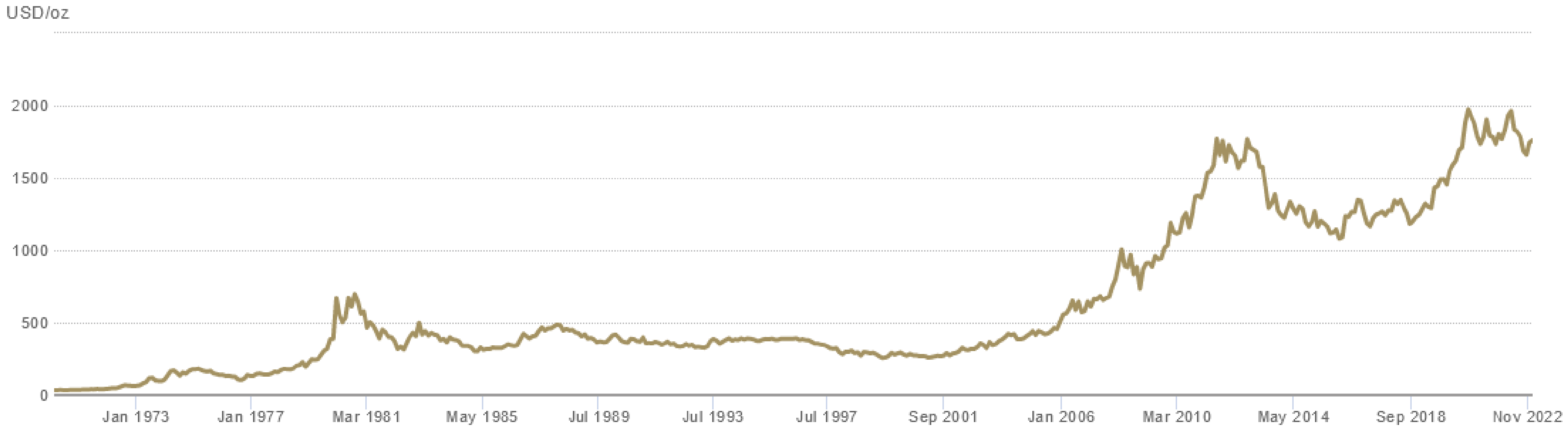
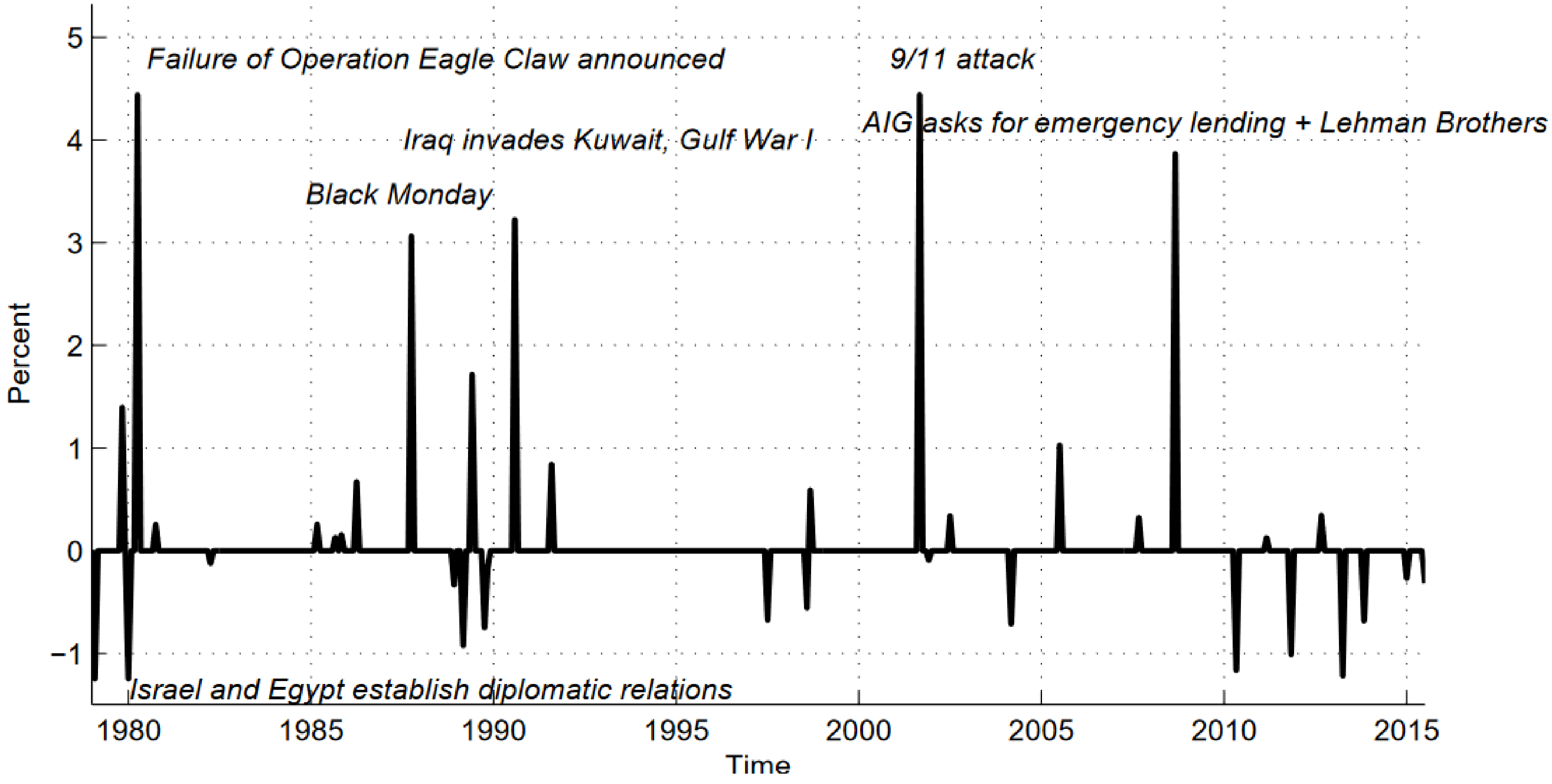
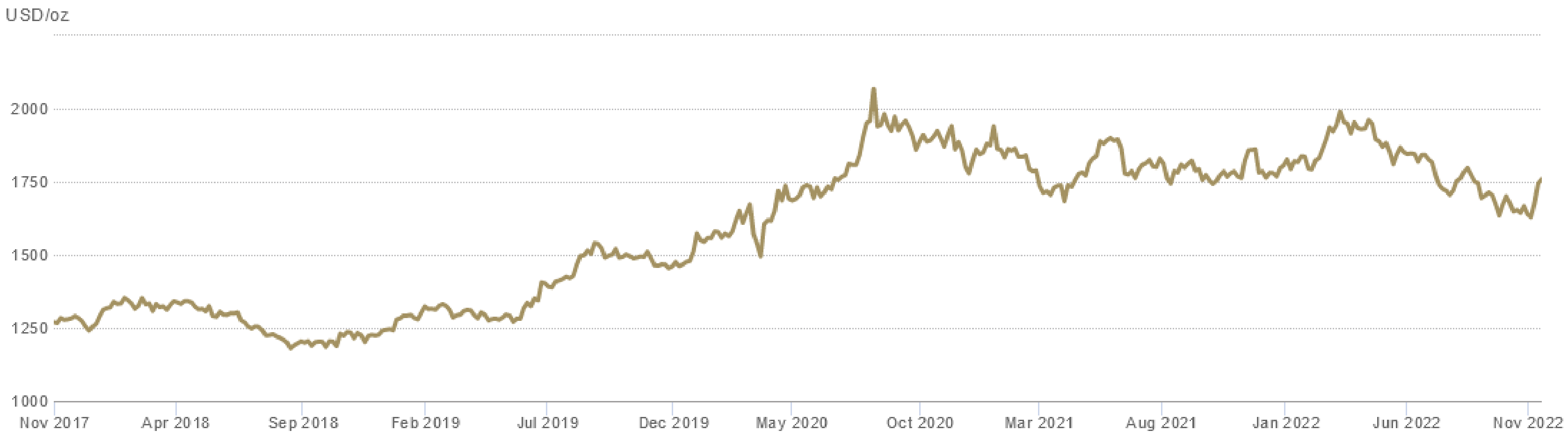


Figure 1: Proxy for uncertainty shocks: variations in the price of gold around events



Piffer and Podstawski 2018

Is gold = ultimate safe asset?



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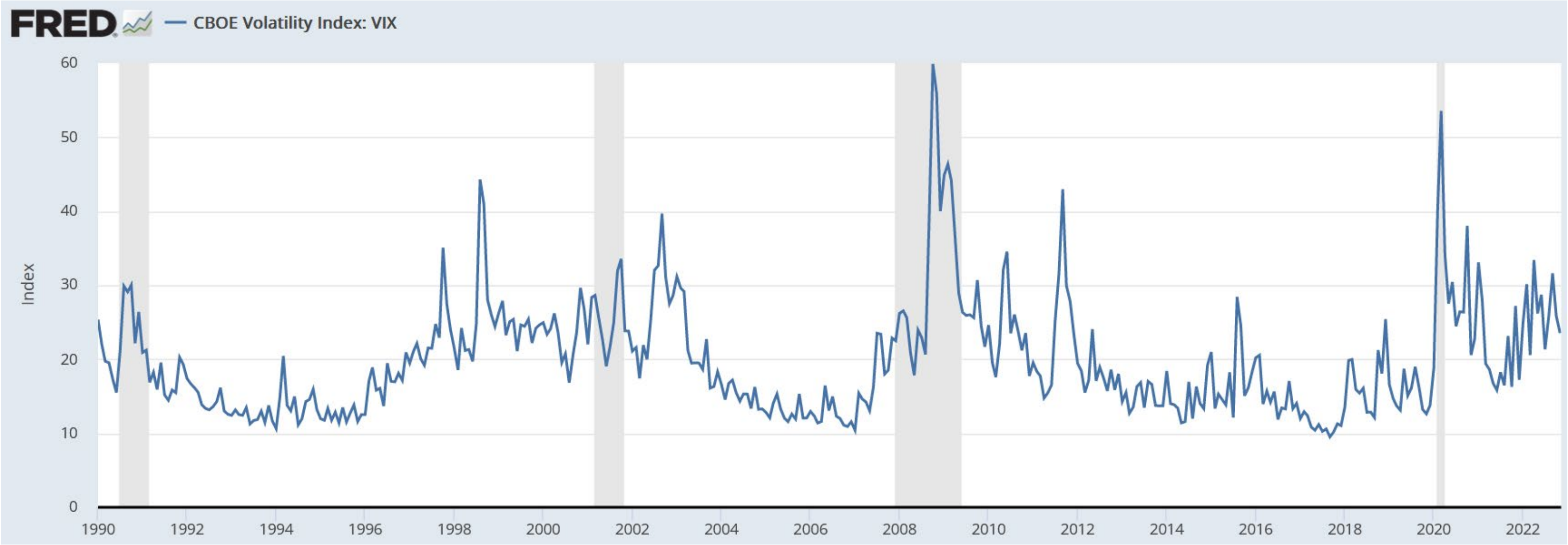

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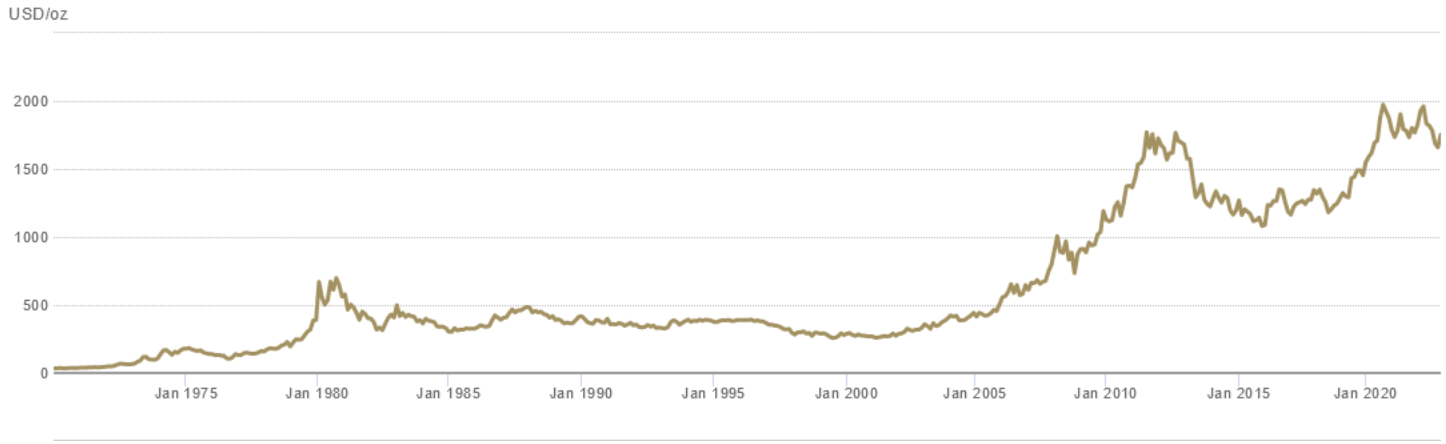
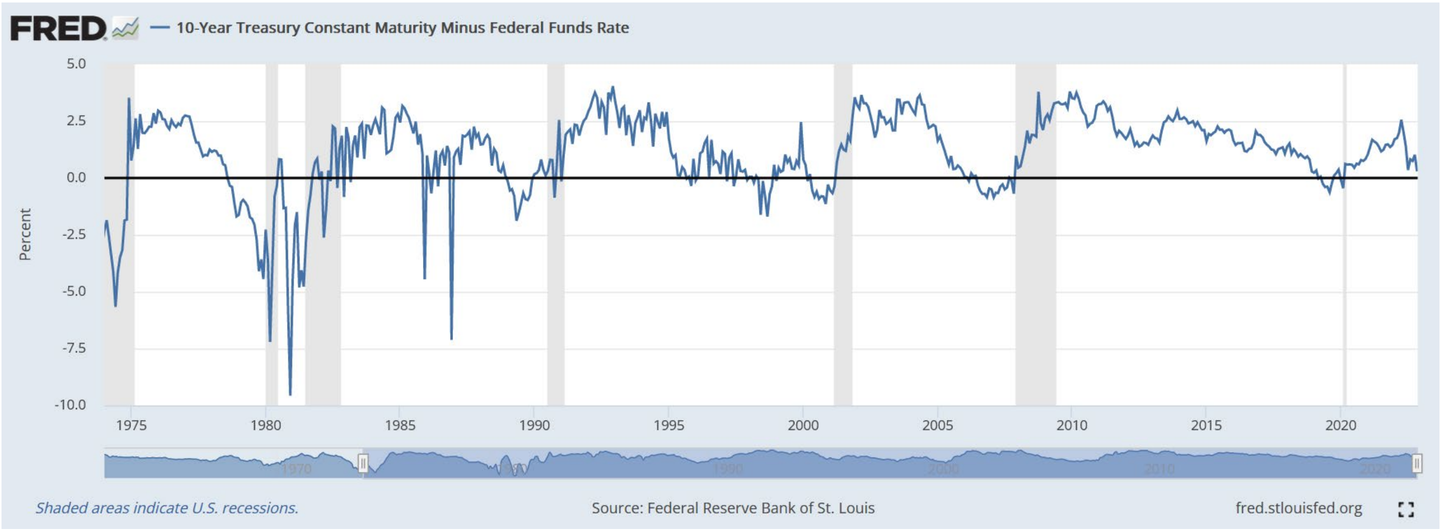
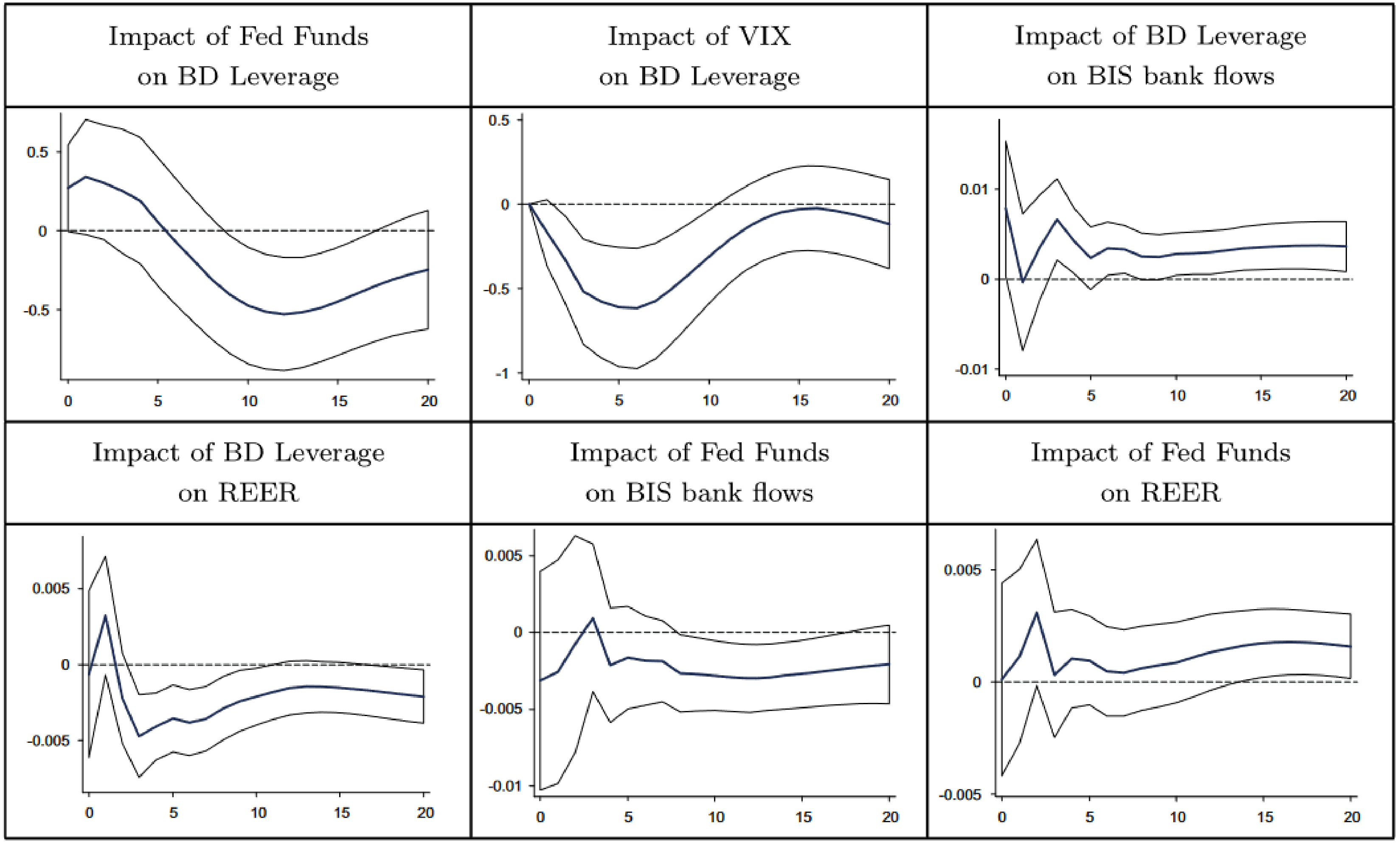




Is gold = ultimate safe asset?

- The paper validates the findings with gold prices by using surprises in Treasury yields or a geo-political risk as measures of risk

- Drilling down on one possible channel



The risk-taking channel of monetary policy impact capital flows and the US dollar exchange rate through the banking sector.

Concluding remarks

- The dollar is a barometer of global financial conditions
- It amplifies shocks given that non-US firms, banks, and investors are exposed to dollar fundings shocks
- Real effects in the economy
- “Safe Asset” can mean many things
- Risk-taking channel of US monetary policy, gold prices are *sometimes* a manifestation of it.