"Global Risk and the Dollar"

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Discussion by:

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What does this paper do?

- How does global risk impact real economy and financial markets?
- Examine systematically how **exogenous innovations to global risk** affect the economy and financial market (for both US and Rest of World "RoW") in a VAR framework;
- Examine a counterfactual environment that **shuts down** the risk channel through the **dollar**.

Bayesian proxy structural VAR

- Following Arias, Rubio-Tamirez and Waggoner (forthcoming, *JoEconometrics*):

$$\begin{bmatrix} \boldsymbol{y}_t' \\ \boldsymbol{m}_t' \end{bmatrix} \tilde{\boldsymbol{A}}_0 = \begin{bmatrix} \boldsymbol{y}_{t-1}' \\ \boldsymbol{m}_{t-1}' \end{bmatrix} \tilde{\boldsymbol{A}}_1 + \tilde{\boldsymbol{\epsilon}}_t', \tag{1}$$

$$E[\boldsymbol{m}_t \boldsymbol{\epsilon}_t^{*\prime}] = \boldsymbol{V} \tag{2}$$

$$E[\boldsymbol{m}_t \boldsymbol{\epsilon}_t^{0\prime}] = \boldsymbol{0} \tag{3}$$

Endogenous variables y:
(1) US dollar nominal effective exchange rate (NEER)
(2) US IP, US CPI, RoW IP
(3) VXO, excess bond premium
(4) 1-year Tbill, RoW policy rates
(5) Integration channels: US real export, US real import, crossborder bank credit
Additional: EMBI spread, RoW Equity, other risky index...

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Exogenous instruments m:
(1) Intradaily changes in price of gold (Piffer & Podstawski, 2018): percentage variation in the price of gold around uncertainty events (Bloom, 2009) when an event occurred; 0 otherwise
(2) “Pure” monetary policy surprises (Jarocinski & Karadi, 2020)

Main findings

- **A positive global risk shock:**
  (1) US dollar nominal effective exchange rate (NEER) – Appreciation
  (2) US IP, US CPI, RoW IP – Contraction
  (3) VXO, excess bond premium – Increase
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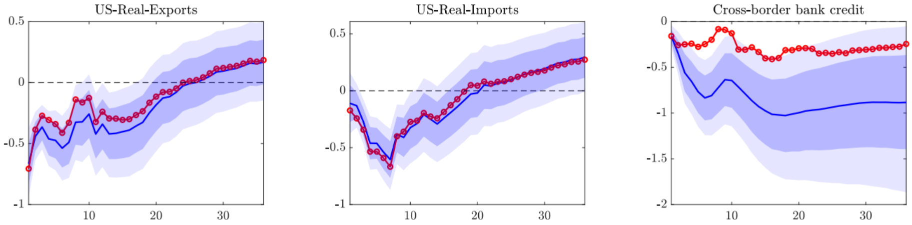
- **Counterfactual environment with no "(1) global risk → dollar appreciation"**
  (1) **weak risk effect** on **real trade** through dollar appreciation
  (2) **slightly stronger risk effect** on **financial channel** through dollar appreciation



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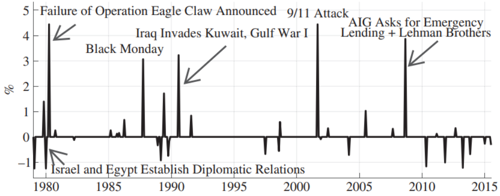

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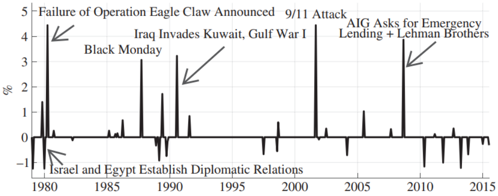

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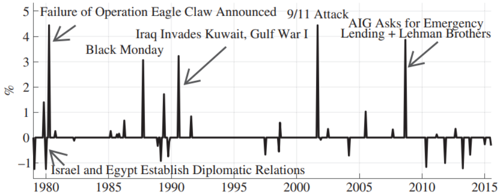

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Advantages:

⇒ Focus on gold price movements only related with uncertainty/risk events

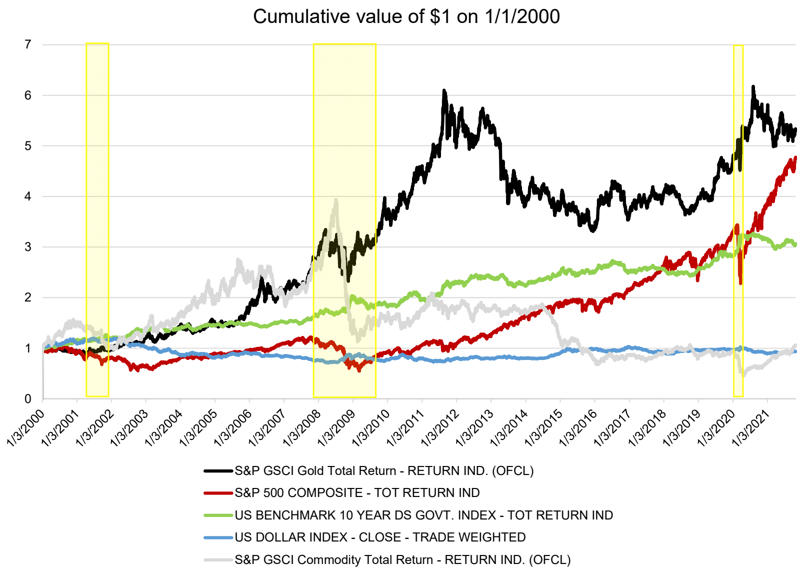
Potential disadvantages:

⇒ Less continuous; depend on the choice of “risk” events

⇒ Doesn’t really capture/allow for asymmetry

⇒ Strong assumption that “gold indeed behaves as safe” during risk episodes

#2 "Gold is safe": Conventional wisdom vs. Empirics



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- What might have been considered a safe haven in **one market crisis** might not be in the next, and it’s hard to know ex-ante which assets will behave as safe havens in **future market crises**. (What is a good risk proxy?)

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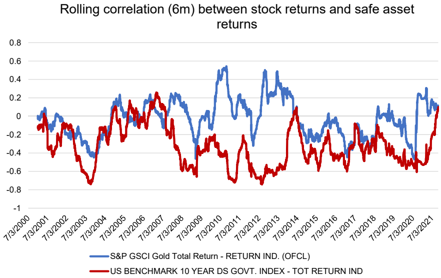
- Correlation among daily changes (2000-2021)

	Gold	**US** GovBond10yrs	**EMU** GovBond10yrs	**IT** GovBond10yrs	**FR** GovBond10yrs	**Commodity**	**DOLLAR**	**USD to GBP**
S&P500	-0.010	-0.358	-0.227	0.063	-0.157	0.272	-0.085	0.128
VIX	0.011	0.279	0.182	-0.102	0.095	-0.225	0.060	-0.092



#3 Microscope comments

- The BPSVAR model now includes VXO as a y variable and event-based gold prices as the m variable. One can also imagine doing the opposite, whereas volatility index may be viewed more of a "market risk gauge" by design.
- Can the paper report some results on the MP shock? **Is Global Financial Cycle in fact a Global Risk Cycle** (Bekaert, Hoerova, Xu, 2021) **or Global Policy Cycle** (Miranda-Agrippino & Rey, 2020)?
- Exhibition:
  - $\Rightarrow$ I feel that Section 3.4 (exogenous instrument) should come a bit earlier, as that is one of your contributions;
  - $\Rightarrow$ A time series plot of the risk and MP shock may be useful;
  - $\Rightarrow$ I agree that the choice of a risk shock and a MP shock are probably enough as exogenous shocks; BHX2021's Appendix A derives a simple habit-based model to motivate this choice.

Conclusion

- **I highly recommend this paper! Great idea, intuitive findings, and the execution and the writing are very carefully done**
- **My main comment:**
  When we think about "global risk", its measuring is still an ongoing debate, and worth discussing and exploring a bit more options. Has gold really been exhibiting safe asset properties in the recent years?

Thank You!

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