

The Global Dollar CYcle

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The Paper & The Discussion

The paper:

- ▶ Nominal dollar effective exchange rate related to global financial conditions
- ▶ Financial panics, dollar funding squeeze, dollar appreciation
- ▶ Associated with poor real performance of emerging economies in aftermath
- ▶ Discusses policies to smooth the dollar cycle

The discussion:

- ▶ What do we know about the importance of markets in setting exchange rates
- ▶ New and old policy instruments

Gross Positions Have Become Much Bigger

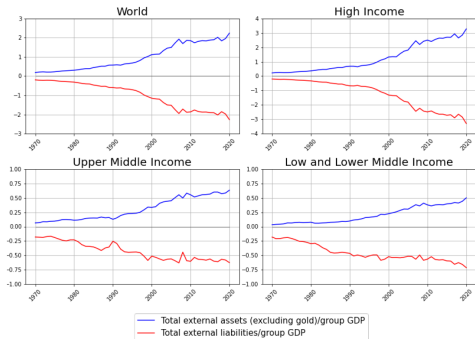


Figure 1: External asset and liability ratios to GDP across country groups, 1970-2020

- ▶ Currency composition of Assets and Liabilities is varied
- ▶ Dollar important in both A and L
- ▶ These are large currency portfolios!

Who Intermediates These Portfolios?

- ▶ A shift in these portfolios is a large currency demand/supply imbalance
- ▶ Who absorbs the risk in the medium run? World financial institutions
- ▶ They demand compensation to absorb this risk
- ▶ This force an important determinant of exchange rates
- ▶ Dollar is central to this story:
 - ▶ Big in terms of global capital flows, even when US is not involved
 - ▶ Most financial institutions fund themselves in dollar
- ▶ Paper takes the “financial determination of exchange rates” view
- ▶ Stresses that the dollar is crucial

Some History of the Global Policy Consensus

A caricature of the traditional stance:

- ▶ Washington consensus: no capital controls, no foreign exchange intervention
- ▶ Ex-post interventions
- ▶ Devaluation is expansionary

Post 2007-08 a rethink of the policy framework. e.g. IMF policy:

- ▶ First, moved stance on capital controls
- ▶ Now moving on FX intervention
- ▶ Strong recognition of centrality and far reaching effect of the dollar
- ▶ Devaluation effect on the economy....it depends

Some questions/suggestions for the authors as academics

- ▶ Asset markets are very correlated across the globe, risk premia are time varying, and the dollar is a safe currency
- ▶ To what extent is the dollar cycle a way to consolidate these facts? Or an independent phenomenon?
- ▶ The relationship with future economic growth is always tricky to assess. What are the channels? Are we sure the dollar is causing this?

Some questions for the authors as policy markers

- ▶ New concepts have to be evaluated empirically
- ▶ Little or no hard evidence on the effectiveness of policies like FXI and capital controls
- ▶ In this sense policymakers still flying blind but implementing new policies
- ▶ Reasonable concern: tools introduce to mitigate dollar cycle, especially capital controls, could be prone to abuse
- ▶ How much should countries smooth the cycle and with which tools?

Conclusion

- ▶ A useful piece of work on the importance of the dollar
- ▶ Brings together a number of recent advances, provides new evidence
- ▶ Much remains to be done in this space