

The PhD is progressing well with a projected finish date of late 2019.

Most recently I was at the European Central bank advising on exchange rate forecasting and finishing up a working paper. The paper shows that exchange rates and interest rate differentials are mean-reverting but at different speeds. The discrepancy arises because of an exchange rate risk premium – the covariance of which, w.r.t interest rate differentials, is time-varying. We show that the required sign change discussed in Engel can be generated using stationarity (due to purchasing power parity) as a risk factor. We also document the stability of the relationship of exchange rates and interest rates historically and explain differences since the financial crisis.

This project led to follow up work with a coauthor at the Bank of England which I now visit regularly. We show that explanatory regressions of exchange rates can be greatly improved upon using yield curve factors. We are then able to further decompose the aforementioned covariance into a risk-neutral measure covariance and a term premium. We show that the former provides covariances which are not statistically significant.

Finally, my thesis is also progressing well. I highlight two theoretical findings. Firstly, sovereigns issuing reserve (safe) assets face a dilemma. Households enjoy improved terms of risk sharing (higher allocations of tradable goods) but higher levels of unemployment due to an exchange rate appreciation. This rationalises recent political and popular discourse on protectionist measures and financial retrenchment. Secondly, I highlight the nexus between international market power and domestic financial depth. An important corollary of this is that financial autarky at the country level brings with it the hidden cost of loss of domestic financial market depth.