How Institutions Interact with Exchange Rates After the 2024 US Presidential Election: New High-Frequency Evidence

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Outline

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2. Research question
3. Methodology
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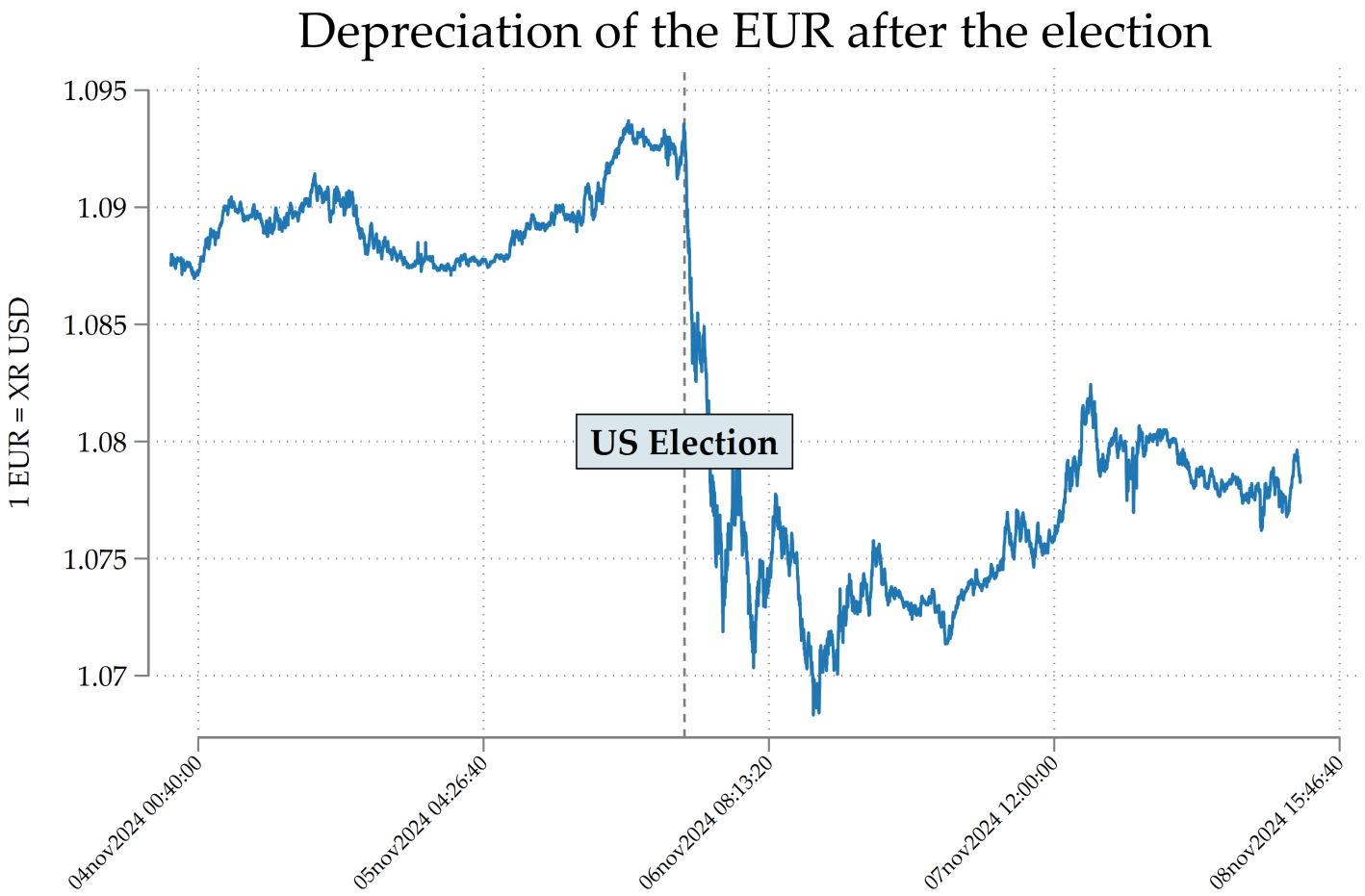
1. Motivation

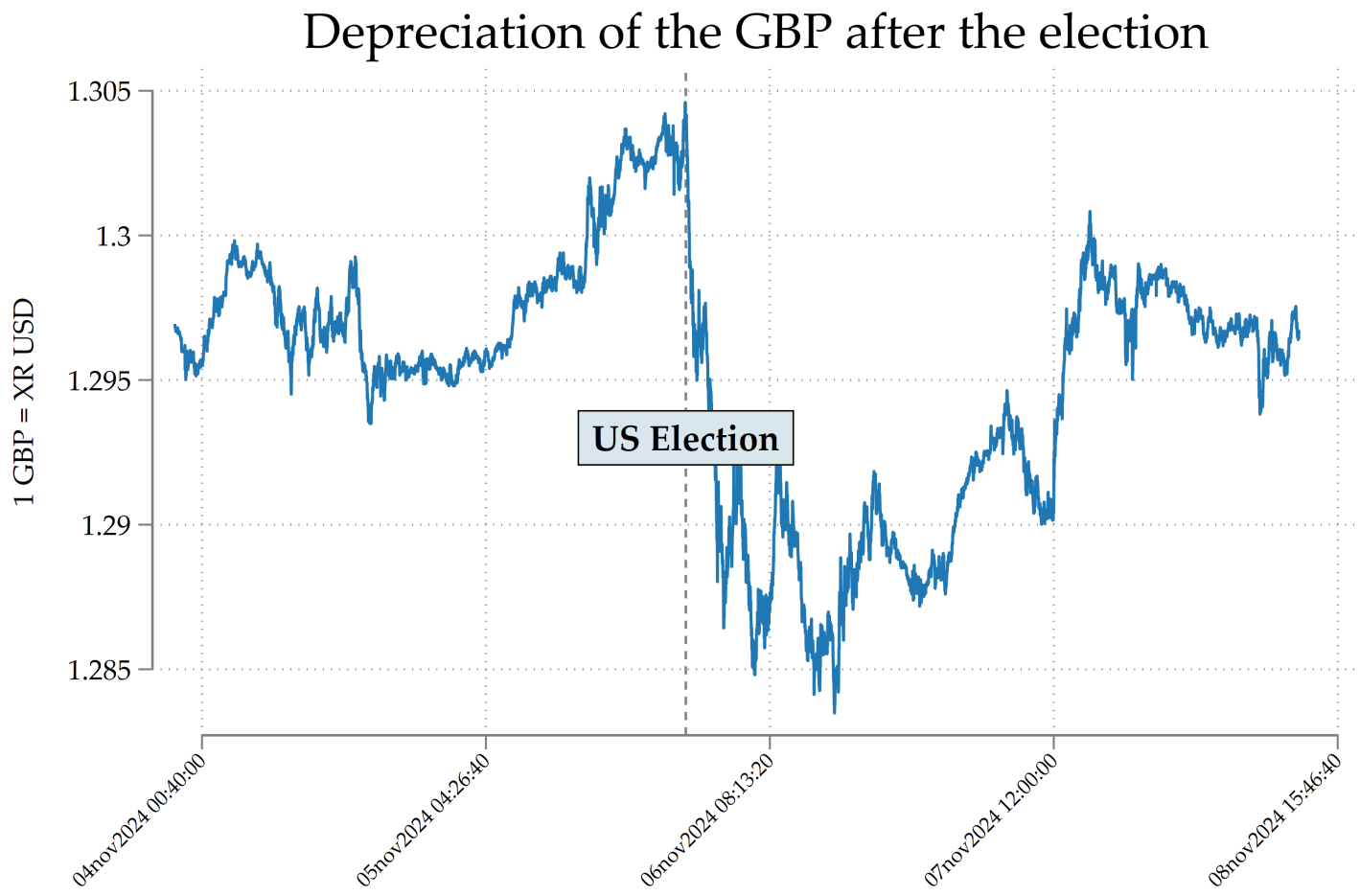
- When has the FOREX market received the information that Donald J. Trump will elected the 47th US president with certainty?
- The election was uncertain until the last day (Nov 5, 2024)
- How the market participants on the FOREX reacted to this information shock? Overreaction?

USD per EUR



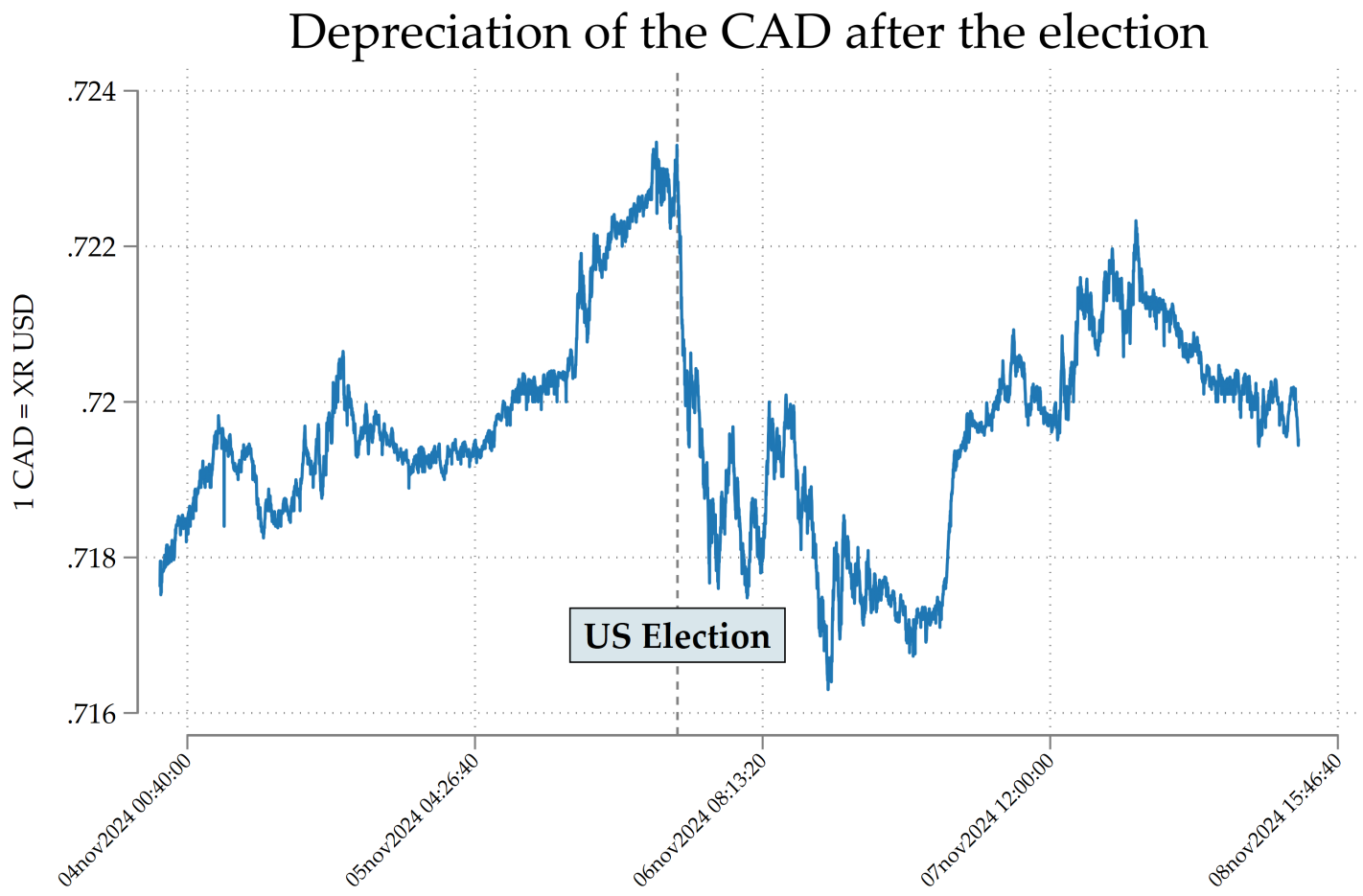
The timing of the election news is underlined with a vertical line at 06nov2024 00:00:00

USD per GBP



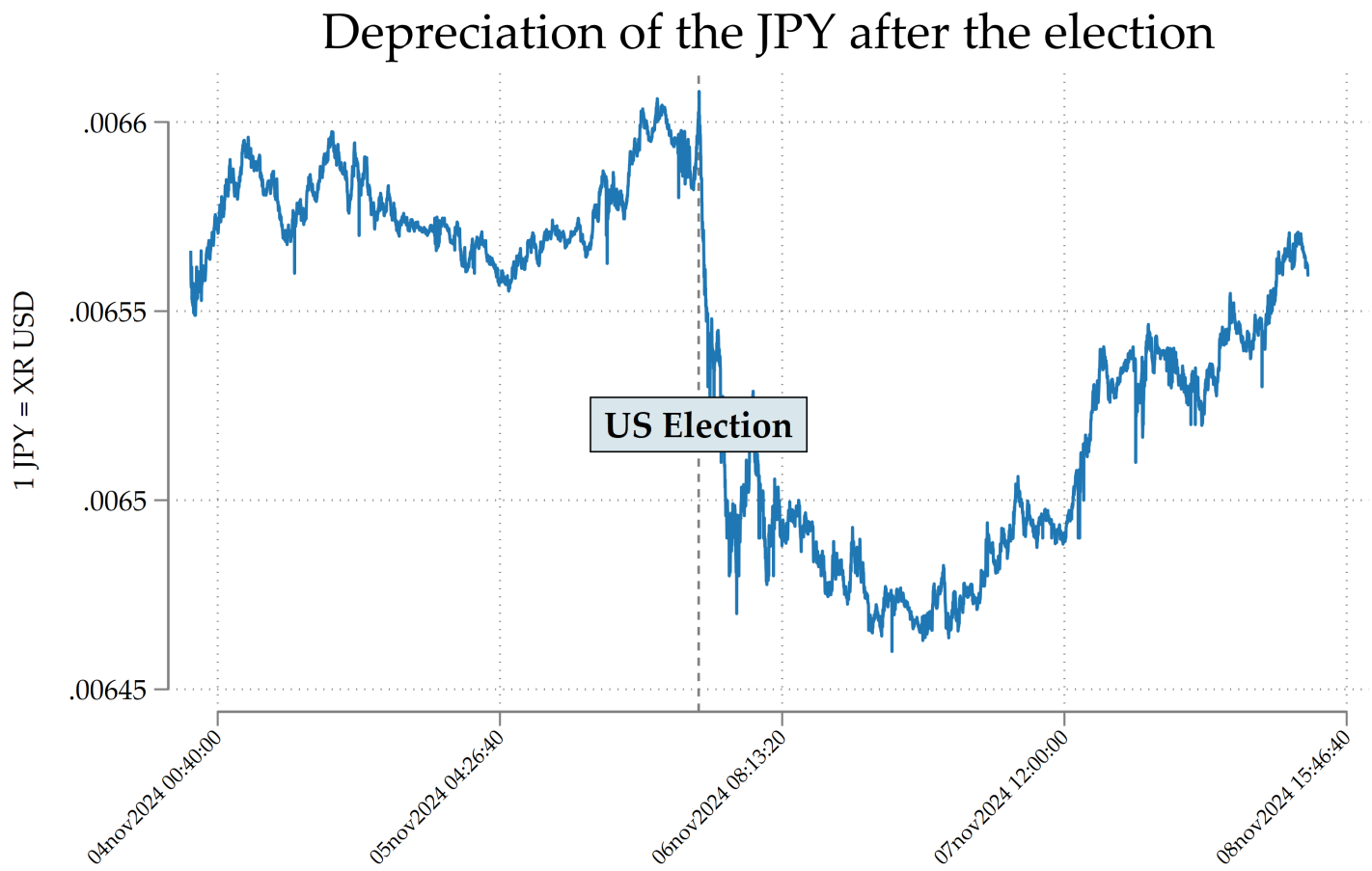
The timing of the election news is underlined with a vertical line at 06nov2024 00:00:00

USD per CAD



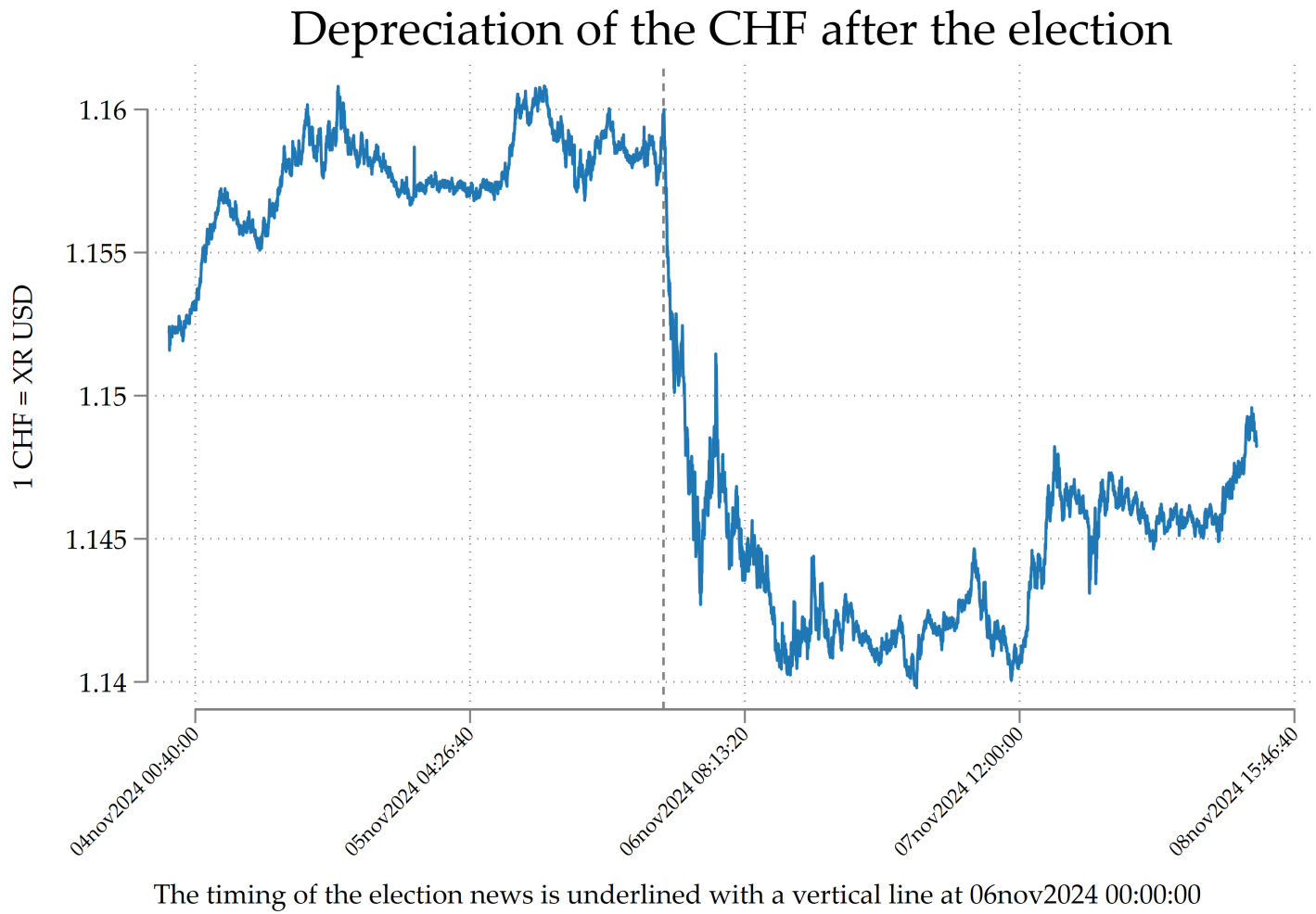
The timing of the election news is underlined with a vertical line at 06nov2024 00:00:00

USD per JPY



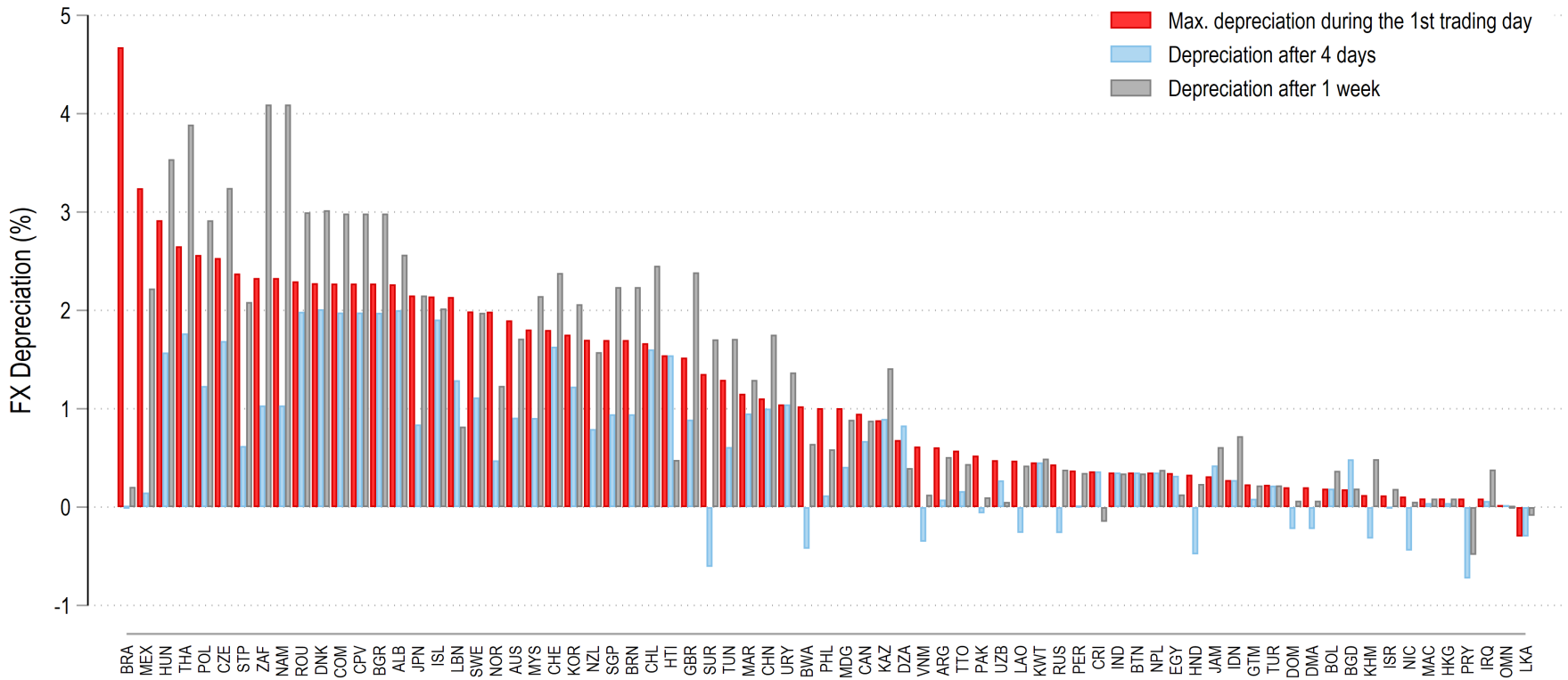
The timing of the election news is underlined with a vertical line at 06nov2024 00:00:00
1 USD = 1/0.0066 JPY = 151.51 JPY ; 1 USD = 1/0.00645 JPY = 155.038 JPY

USD per CHF



The timing of the election news is underlined with a vertical line at 06nov2024 00:00:00

FX Depreciation for the full sample



Note: a negative value indicate an appreciation.
After Nov 6 UTC 0:00, vitually all the exchange rates started to depreciate as the path for victory was almost certain.

A well-suited quasi-natural experiment

One week after the information shock, the depreciation was even in 26 countries out of a sample of 73 bilateral exchange rates against the US Dollar

The outcome of the 2024 US election offers us a very well-suited quasi-natural experiment to test the resilience of countries to exchange-rate market pressures

Indeed, due to the nature of the Republican platform and thanks to the use of high-frequency data, we can identify the factors that explain the cross-sectional differences in currency returns against the US Dollar

Preview of the results

An additional 10pp in the *ex-ante* ICRG institutional score were associated with 3.5-4.8% additional FX depreciation

- Stronger effect among after 1 week

Higher *ex-ante* exchange rate stability by 10pp were associated with 0.8-2% less depreciation

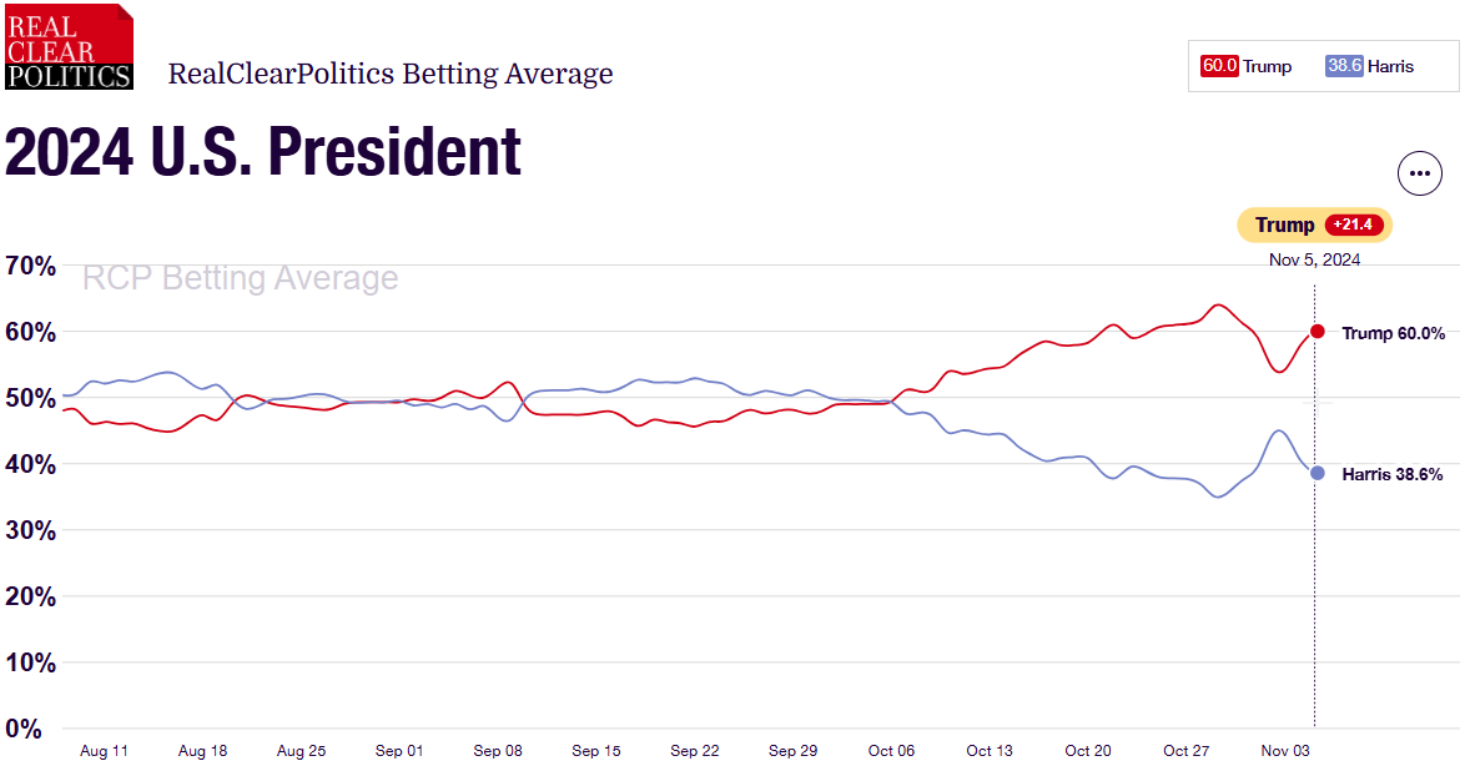
- Possible nonlinearities?

Larger depreciations also associated with:

- Higher quality institutions
- REER overvaluation

A well-suited quasi-natural experiment

BETTING ODDS	TRUMP	HARRIS
RCP Average - Last update: 8:00AM EST, Tuesday, November 5	**60.0**	**38.6**
BetOnline	62	38
Betfair	59	38
Bovada	61	40
Polymarket	59	38
Smarkets	59	39



A well-suited quasi-natural experiment

This news shock is a rise in the probability of having Trump as a president from about 50% to 100%, with the extra recognition that the US Senate flips to Trump.

If you look at the betting odds, the shock is a rise of the probability from 60% to 100%, still significant enough to move all non-fixed exchange rates.

Quality of institutions and FX depreciation

Note: a negative value indicate an appreciation.
At Nov 6 UTC 0:00, vitually all the exchange rates started to depreciate as the path for victory was almost certain.
dFX_1week is the depreciation after 1 week.

2. Research question

How do we interpret these preliminaries?

This correlation indicates that countries with better institutions have experienced the largest depreciation.

Due to the nature of the shock, we can infer that the market expects that the new US administration will be more favorable or at least more neutral vis-à-vis countries with political regimes that are less cautious about several dimensions of institutional development, like the respect of property rights, the central bank independence, the transparency of monetary and fiscal policy, democratic accountability of the economic policy decisions and so on.

Quality of institutions and FX depreciation

The rest of the paper will try to provide further evidence about this conjecture. This study contributes to the literature on the determinants of exchange rate dynamics around elections **(Stein et al., 2005; Bonomo and Terra, 2005; Quinn et al., 2023).**

3. Methodology

We follow the previous literature (**Eichengreen and Gupta (2015), Ahmed et al. (2017), Ahmed (2020), Ahmed et al. (2024), Aizenman et al. (2024) and Aizenman and Saadaoui (2024)**) and estimate cross-sectional regressions:

$$\Delta p_i = \alpha + \boldsymbol{\beta} X_i + u_i$$

Cross-sectional regression of the percent depreciation of currency i over the "treatment" period (from the reception of the news to a point in the future) on ex-ante quality of institutions and other fundamentals observed before the treatment period

Identification assumptions:

- Countries did not anticipate Trump's election **(OK)**
- Potential confounding variables are controlled for **(OK)**

4. Results

Why currencies with the best institutions have known the largest depreciation? Has the market overreacted this information shock?

We study country variation in FX depreciation after 2024 US presidential election

We focus on the buffering role of foreign exchange (FX) reserves

- Cross-country differences in policies and economic fundamentals also considered

Data

	(1) Count	(2) Mean	(3) SD	(4) Min	(5) Max
Maximum depreciation during the 1st trading day	73	1.19	1.00	-0.30	4.68
Depreciation after 4 days	73	0.61	0.74	-0.73	2.01
Depreciation after 1 week	73	1.26	1.20	-0.49	4.09
Current account balance in 2022	117	-1.72	11.90	-42.68	34.50
Capital account openness in 2021	117	0.38	1.50	-1.93	2.30
Exchange rate stability in 2020	116	54.50	31.87	3.86	100.00
ICRG Institutional Score in 2022	85	66.06	10.26	44.17	86.46
REER misalignment in 2020	116	99.27	14.27	56.82	198.55
Bilateral trade balance with the US in 2022	112	-0.04	0.18	-1.64	0.08
Trump Risk Index in 2024	46	31.89	13.44	9.44	71.37

Baseline results

	(1) Maximum depreciation during the 1st trading day	(2) Depreciation after 4 days	(3) Depreciation after 1 week
ICRG institutional score	**0.035*** **	**0.026*** **	**0.048*** **
	(0.008)	**(0.008)**	**(0.009)**
Constant	-1.102*	-1.086*	-1.931***
	(0.581)	(0.550)	(0.635)
Observations	64	64	64
R-squared	0.140	0.142	0.183
RMSE	0.930	0.677	1.093

Baseline results with controls

	(1) Maximum depreciation during the 1st trading day	(2) Depreciation after 4 days	(3) Depreciation after 1 week	(4) Maximum depreciation during the 1st trading day	(5) Depreciation after 4 days	(6) Depreciation after 1 week
ICRG Institutional Score	**0.045*** **	**0.031*** **	**0.065*** **	**0.059*** **	**0.038** **	**0.057** **
	(0.013)	**(0.011)**	**(0.016)**	**(0.021)**	**(0.015)**	**(0.026)**
REER Misalignment	**0.015***	**0.019*** **	**0.017**	**-0.007**	**0.025** **	**0.043***
	(0.007)	**(0.004)**	**(0.010)**	**(0.029)**	**(0.011)**	**(0.023)**
Exchange Rate Stability	**-0.014*** **	**-0.011*** **	**-0.012** **	**-0.015** **	**-0.008***	**-0.019** **
	(0.004)	**(0.003)**	**(0.005)**	**(0.006)**	**(0.004)**	**(0.008)**
Capital Account Openness	-0.079	-0.025	-0.133	-0.178	-0.032	-0.117
	(0.114)	(0.068)	(0.132)	(0.153)	(0.100)	(0.210)
Current Account Balance	-0.017*	-0.006	-0.018	-0.016	-0.017	-0.023
	(0.009)	(0.008)	(0.013)	(0.014)	(0.012)	(0.019)
Bilateral Trade with the US	-0.402	-0.240	-0.685**	-0.225	-0.577**	-0.715
	(0.399)	(0.227)	(0.294)	(0.412)	(0.245)	(0.484)
Trump Risk Index				**0.004**	**-0.015** **	**-0.014**
				(0.015)	**(0.006)**	**(0.015)**
Constant	-2.572**	-2.838***	-4.185***	-1.365	-3.498**	-5.311**
	(1.202)	(0.878)	(1.379)	(2.924)	(1.376)	(2.389)
Observations	62	62	62	40	40	40
R-squared	0.314	0.356	0.313	0.364	0.450	0.359
RMSE	0.871	0.619	1.054	0.951	0.598	1.110

Discussion

- This paper presents new evidence on the influence of institutional development and FX depreciation after the recent US presidential election.

- Using a broad cross-section of over 70 countries, we document statistically and economically significant estimates implying that better institutional scores are associated with stronger depreciation, reflecting the new orientation of the US policy.

- Economic policies (currency interventions) and fundamentals (overvaluation and bilateral trade deficits with the US) influence the degree of exchange rate depreciation. Finally, the exposure to policy changes seems to be at play after 4 days.

- In the face of political instability, these results indicate that policymakers may limit the level of high-frequency currency movements by limiting the level of exchange rate misalignments and reducing trade imbalances.

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