One Way Bets on Pegged Exchange Rates
by
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Comments by
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Basic Idea

- Measure “currency exposure” by regressing equity return of industry against exchange rate change, holding constant “market” return
- Details: “innovations” in exchange rates and market return uncorrelated with ex rate innovations
- Apply to India– daily data, many industries
- Results: latter periods (large reserve accumulation) more likely to have negative correlation b/t equity return and depreciation

General Comments

- Sophisticated econometric application to India
- Careful with data and econometrics
- Clearly written
- Interesting results, consistent with hypothesis that one-way bets drive currency exposure in recent years
- Possibly related to exchange rate regime

Questions

- What are implications for currency exposure positions?
  - Other studies generally find no correlation, and interpret this as hedging currency position
  - If Indian firms generally gain by INR appreciation against dollar, they must be short dollars
  - How can so many sectors in India be short dollars (net dollar liabilities) on such a large scale?
  - “Finance” approach– firms are location of assets; other approaches– firms produce things over time and have firm-specific qualities. Are all firms acting like financial enterprises?

Questions

- Consistent with other hypotheses?
  - Issue with all studies of this nature
- What other factors are correlated with exchange rate changes?
  - Fundamental causes of exchange rate appreciation
    - Strong domestic demand
    - New markets, new opportunities, new products
    - All correlated with strong returns, and maybe not in market index

Questions

- Omitted variables problem
- Should other idiosyncratic factors or common factors enter the equation in addition to the exchange rate?
- An exchange rate movement will have a different effect on different firms, depending on their market structure, hedging, etc. Are there other common variables that would also have asymmetrical effects that should be included?

Questions

- Are developments in some industries affecting exchange rate?
  - Logic is that individual firms are not (contrary evidence in Japan), but industries?

- Equity return change is NPDV of change in profit stream for all periods; Are India firm's hedged for a long time horizon? Can this really offset loss of export markets with INR appreciation?

Comments

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Small Points

- It would be useful to review the Tesar and Dominquez results, to see what the “state of the art” is in this literature.
- Does taking exchange rate surprises follow the literature?
- Are their any problems with (by construction) making the market index to be uncorrelated with exchange rate surprises
- pg. 12, can’t explain Swedish industry results (lack of exposure) because of floating exchange rates;

Overall

- Very nice paper
- Clear results, consistent with one hypothesis
- My concern: are the results consistent with other hypotheses?
- Are Indian firms/industries really so short on dollar positions!
- Or are other common shocks leading to strong correlations between exchange rate surprises and stock returns?
- Policy conclusions too far reaching for my taste, at this stage of the research!