5 December 2016

Addendum to "The dollar, bank leverage and the deviation from covered interest parity"

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Avdjiev, Du, Koch and Shin (2016)[1] showed the existence of a "triangular relationship" between a stronger dollar, slower cross-border bank capital flows in dollars and wider deviations from covered interest parity. The sample in Avdjiev et al ended before the US presidential election on 8 November 2016. The recent appreciation of the dollar presents an opportunity to put the main predictions to an out-of-sample test. This addendum reports the findings.

The evidence from the post-election sample confirms the original findings in Avdjiev et al (2016). As shown in Table 1, the broad dollar index of the Federal Reserve rose by 3.9% between 8 November and 29 November. During the same period, the cross-currency basis widened for all G10 currencies. The largest movement was for the yen, with the basis widening from –70.3 basis points to –90.5 basis points.

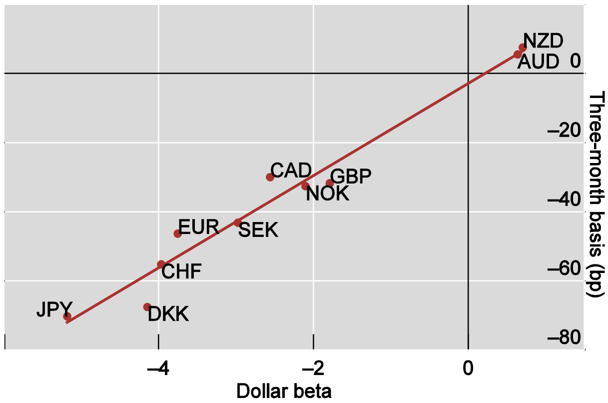
For the post-election period, the "dollar beta" is defined as the ratio of the change in the cross-currency basis (in basis points) over changes in the broad dollar index (in percentage points). In line with the findings in Avdjiev et al (2016), the dollar beta is highly correlated with the basis itself. The correlation coefficient is 98%.

Table 1 The dollar and cross-currency basis since the US election

Changes in the broad dollar index and three-month cross-currency basis since the US election

Currency	8/11/ 2016	29/11/ 2016	change	dollar beta[1]
Broad dollar	122.8	127.6	4.8 (3.9%)	
AUD	5.5	8.0	2.5 bps	0.64
CAD	–30.0	–40.0	–10.0 bps	–2.56
CHF	–55.3	–70.8	–15.5 bps	–3.97
DKK	–67.5	–83.7	–16.2 bps	–4.14
EUR	–46.4	–61.0	–14.7 bps	–3.75
GBP	–31.8	–38.8	–7.0 bps	–1.79
JPY	–70.3	–90.5	–20.3 bps	–5.18
NZD	7.5	10.3	2.8 bps	0.70
NOK	–32.6	–40.8	–8.2 bps	–2.10
SEK	–43.2	–54.9	–11.6 bps	–2.98

Cross-currency basis vs dollar beta[2]



[1] The dollar beta is calculated as the ratio of changes in the three-month cross-currency basis over changes in the broad US dollar index between 8 and 29 November 2016.
[2] The vertical axis shows the three-month cross-currency basis expressed in basis points on 8 November 2016, while the horizontal axis indicates the dollar beta.

Sources: Board of Governors of the Federal Reserve System; Bloomberg; BIS calculations.

[1] S Avdjiev, W Du, C Koch and H S Shin, "The dollar, bank leverage and the deviation from covered interest parity", *BIS Working Papers*, no 592, November 2016.