Discussion of “Bond Convenience Yields and Exchange Rate Dynamics” by Rosen Valchev

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Summary-UIP Puzzle

- Short run (3-year): higher domestic interest rate and appreciation of domestic currency.
- Medium horizon (4-7 years): higher domestic interest rate and excess depreciation of domestic currency.
- UIP holds in the long-run.
- Complicated version of “delayed overshooting”, as in Engle (2016) on the real exchange rate .
- Very robust cyclical dynamics.

Summary-Theory

- Generates a endogenous time-varying convenient yield on holding forgiven and domestic bond.
- Explores the role of “fiscal policy” in determining the exchange rate dynamics beside the monetary policy.
- Very nice discussion and provide a novel explanation for the UIP puzzle.

Comments on Empirical Analysis I

- Interest rate differential is based on CIP. CIP is systematically and persistently violated since the great recession (Du Du, Tepper, and Verdelhan (2017)).
- Data since 2007 may be separated in the empirical evidence in section 2.
- Convenient yield is related to financial regulations. UIP puzzle has similar patterns before and after 2007?

Comments on Empirical Analysis II

- Section 7 incudes US corporate spread as a proxy for US convenience yield, but no proxy for the foreign convenience yield.
- Ratings on the sovereign debts are related to the convenient yield?
- Gap in 3-month tbill: home-Foreign
- 3-month Libor rate.

Comments on Empirical Analysis III

- UIP violation dynamics is more prominent for currency with more independent monetary policy
- 5 major global currencies, and 18 countries
- A country with strong and independent monetary policy inclines to be the one with global currency.
- The UIP cyclical patterns hold within global currencies or between global and non-global currencies?

Comments on the model I

- Model assumes bonds are issued in local currency. Does currency to issue bonds matter for the convenient yield?
- For emerging markets, the optimal choice of government to issue bond involves allocations between local or US dollar?

Comments on the model II

- Convenient yield is more related to High quality debt vs. high liquid debt?
- The US and another country (Canada) both issue bonds in US dollars with same maturity, the spread measures the convenient yield?

Comments on the model III

- The interaction between monetary and fiscal policies is very important here. Anything related to optimal policy
- The mechanism here can also help explain the disconnection between exchange rate and fundamentals.