U.S. Populist Rhetoric and Currency Returns

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Summary

- **Research question**: How does U.S. populist rhetoric affect the cross-section of currency excess returns?
- **Main finding**: Currencies that perform badly (well) when U.S. populist rhetoric is high have higher (lower) expected excess returns
- U.S. populist rhetoric is priced in excess currency returns
- Key mechanism: currencies that perform badly are considered risky, investors require higher premium for holding these currencies

Overview of Comments

- Very important question
- Creative way of capturing U.S. populist rhetoric
- Given the importance of this question, it is even more important to understand what this measure captures and what the results imply

  Scope for improvement:

  1. Link between theoretical framework and the empirical analysis
  2. Construction of the populist measure
  3. Interpretation of results

Comment 1: Link between theory and empirical analysis

- Theoretical framework based on Pastor and Veronesi (2020) defines populism in a very specific way: aversion to globalization
- US agents less risk averse than agents in the RoW. They exhibit aversion to inequality
- Globalization leads to more output but also increases inequality. Populist policies: move to autarky reduces output, lowers inequality
- Two predictions of the model on asset prices:
  1. Move to autarky reduces consumption $\Longrightarrow$ higher marginal utility of consumption $\Longrightarrow$ bonds are more valuable as they provide future consumption
  2. Risk sharing only between US investors who are less risk averse $\Longrightarrow$ demand lower compensation for holding risky assets

Comment 1: Link between theory and empirical analysis

As a shift to populism is associated with a decrease in consumption/output for U.S. investors, their marginal utility increases in times of rising populism. Currencies with negative U.S. populist rhetoric beta yield low excess returns in times of rising U.S. populist rhetoric, hence they are considered relatively risky assets by U.S. investors. Therefore U.S. investors demand higher expected returns for holding currencies with low U.S. populist rhetoric beta*

- * true only if the populism measure captures only anti-globalization policies. The measure in the paper is much broader; captures both left- and right-wing populism
- Higher valuation of bonds in the model stems from the fact that bonds are risk-free and allow agents to share consumption risk (not state contingent)
- Currencies provide state-contingent consumption. Asset price implications driven by both prediction 1 and 2 from the model

Comment 2: The APR Index

- The index uses a dictionary of populist terms from presidential speeches between 1952 and 1996 (Bonikowski and Gidron (2015))
- The nature of populist rhetoric has been changing constantly
- Populist terms now may be very different from populist terms used more than 20 years ago. The set may be larger.
  - Should the word 'immigrants' or 'tariffs' be included in the dictionary to identify populist articles?
- Huge possibility of Type-I and Type-II errors
- The paper looks at the subset of articles from U.S. politics category. Trade policy (and other economic policies) can be driven by populist rhetoric, may not feature in the U.S. politics category

Comment 3: Isolating the effect of populism on currency returns

- What drives the cross-sectional differences in performance of different currencies?
- Does it truly reflect reaction to populism or to economic policy driven by populist sentiment? Or is it exposure to political risk in the US?
- Not easy to isolate, but control for these factors in the regression that estimate betas:

$$rx_{i,t} = \alpha_{i,t} + \beta_{i,t} PR_{t-1} + \gamma_{i,t} X_{t-1} + \epsilon_{i,t}$$

  where X could be an index of political risk, VIX, or economic uncertainty
- Populism is a slowly evolving phenomenon while asset prices change very quickly. Better to use event study approach?

Conclusion

- Interesting paper and important question
- More work needed to refine the theoretical framework and tie it better to the empirical analysis
- Sharpen the measurement of the APR
- Control for confounding factors that can drive the result
- Many avenues for future research