Demand Propagation Through Traded Risk Factors

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Discussion by

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4th CEMLA/Dallas Fed Financial Stability Workshop

Global Financial Spillovers and the Role of the U.S. Dollar

San Antonio, Texas, November 24, 2025

Overview of the Paper

- This is a widely presented and maturing paper.
- The focus is on weekly returns in FX markets and how demand shocks are transmitted from one asset price to others, including non-FX asset prices.
- Leveraging changes in net positions among FX market intermediaries, it identifies three traded risk factors (Dollar, Carry, and a novel Euro-Yen Residual) in the cross section of FX returns.
- A novel related instrument-variable analysis allows the paper to estimate each factor's demand price sensitivity.
- The results indicate that factor prices increase 5-30 bps per $1 billion of added net demand.
- The paper also estimates spillover effects onto several non-FX asset prices following FX demand shocks.

Robustness and Sources of FX Flows and Returns

- In Figure 1, cumulative flow and return series for the Dollar, Carry, and Euro-Yen Residual factors are shown based on all 17 currencies.
- As a robustness check, I suggest to run the analysis using just the G10 currencies.
- In Figure 1, I would then overlay those G10 cumulative flow and return series for the 3 traded risk factors.
- I suspect that most of both flows and returns are from the G10 currency markets.
- On a separate note, DKK, HKD, and SGP do not have meaningful independent variation, so their elimination should be inconsequential.

The Execution Price of the Traded Risk Factors

- I think it would interesting to see what it would cost to trade the traded risk factors at the weekly frequency examined in the paper.
- More specifically, what “risk-free” bonds are you buying in each market? And what are their trading costs?
- What are the bid-ask spreads of the involved FX contracts?
- This could speak to the realism of your constructed traded risk factors: How tradable are these factors?

The Instrument — Bond Auction Announcements

- On one hand, the paper does not want the bond auction announcements to contain any major new information about government debt or fiscal policy.
- At the same time, the paper wants them to be important enough that foreign investors increase their ***demand*** for the local currency.
- Phillot (2025) and Bi et al. (2025) use high-frequency Treasury futures price changes around U.S. Treasury auction announcements and interpret them as exogenous shocks to U.S. Treasury ***supply***.
- Using local projections, Bi et al. (2025) quantify the impact of these shocks on Treasury yields, credit spreads, and relevant macroeconomic variables.
- Is Wachtel and Young (1990) still a relevant reference?

Bond Auction Outcomes

- Given that the auction announcements are made 8-10 days ahead of the auctions, do you control for the U.S. Treasury demand effects documented in Somogyi et al. (2025) and Krohn et al. (2025)?
- Supply surprises have been positive on average (Bi et al. 2025), and demand at the auctions has surprised to the upside as well (Somogyi et al. 2025).
- Do these persistent patterns and the outcomes of the auctions in general play a role for your analysis?
- Specifically, are the reported mean-reversion effects within one month flowing from the original auction announcements? Or are they reponses to the outcome announcements?

U.S. Treasury Auction Announcements

- Do U.S. Treasury auction amounts meaningfully vary?
- Based on a quick random sampling, the individual auction announcements seem very similar month after month.
- Recently, the amounts for 10-year notes are 42 billion, 39 billion, and 39 billion – SOMA purchases significantly affect the actual volume issued at the auctions.
- For 2-year notes, the amount has been 69 billion for more than a year.
- Some discussion of this would be helpful in terms of better understanding what it is investors learn through these announcements.

Demand Shocks and Their Price Effects

- What is a demand shock versus a liquidity shock?
- While a demand shock may not reflect new information, it may still be driven by a change in expectations about the future.
- If so, it would be likely to affect multiple asset classes simultaneously.
- Do you isolate pure demand shocks? Do you see the shock propagate across time from the initial asset price to other asset prices?
- The paper's phrasing entails a causality interpretation, although most results merely reflect a correlation.
- The analysis is using weekly data. How do you control for events (FOMC etc.) and macroeconomic releases?

Conclusion

- Interesting paper that combines returns and transactions data from FX markets.
- If the results are really about G10 currencies, sharpen the paper's focus accordingly.
- Traded risk factors appear in the title, so some discussion of their tradability would seem warranted.
- Some uncertainty about the interpretation of the instrument variable.
- The results for the non-FX assets are hard to interpret as the propagation can run in either direction. Thus, maybe consider leaving out this part.
- I look forward to reading future versions.