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HOW INSTITUTIONS INTERACT WITH EXCHANGE RATES AFTER THE 2024 US PRESIDENTIAL ELECTION: NEW HIGH-FREQUENCY EVIDENCE

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How Institutions Interact with Exchange Rates After the 2024 US Presidential Election: New High-Frequency Evidence
Joshua Aizenman and Jamel Saadaoui
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ABSTRACT

This paper investigates how institutional quality shaped currency responses to the 2024 U.S. presidential election, using high-frequency exchange rate data for 73 countries. We document that virtually all currencies depreciated against the U.S. dollar immediately following the election result, which markets had not anticipated. Surprisingly, countries with stronger institutional quality, typically considered more resilient, experienced larger and more persistent depreciations. We interpret this through the lens of a geopolitical realignment: the election marks a structural break in the U.S. role as guarantor of a rule-based international order. Under the new administration's more transactional and bilateralist orientation, strong institutional alignment with liberal democratic norms may have increased perceived exposure to U.S. policy uncertainty. Our findings reveal how political regime shifts in leading economies can reconfigure the global distribution of financial risk premia.

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1. Introduction

The outcome of the 2024 US presidential election has resonated all around the world. On the exchange rate markets, virtually all the exchange rates depreciated around midnight of November 6, 2024, when the outcome of the election was certain. The US dollar to Mexican peso exchange rate moved from 20.15 Mexican pesos per US dollar to 20.77 Mexican pesos per US dollar in a couple of hours. These high-frequency exchange rate movements[1] reflect the expectations linked to the future orientations of US policy in terms of trade, immigration, capital flows, security, and foreign affairs. Mexico is expected to be among the first countries that will be impacted by these new policies. To some extent, the depreciation of the Mexican peso is driven by these expectations.

Beyond the striking example of the Mexican peso, Figure 1 presents the evolution of high-frequency exchange rate movements around the 2024 US election using one-minute data. We can observe a global pattern of appreciating currencies before November 6, 2024, and depreciating currencies after, especially for the freely floating currencies. The euro (EUR per USD) currency pair appreciated by 0.5 percent before the election and depreciated by more than 2 percent after the election. A very similar pattern is observed for the Great Britain Pound (GBP per USD), the Japanese Yen (JPY per USD), and the Swiss Franc (CHF per USD).

For the nontraditional reserve currencies (Arslanalp et al., 2022), like the Canadian dollar (CAD per USD) and the Australian dollar (AUD per USD), we also observe a similar pattern, albeit the depreciation was smaller, around 1 percent. Overall, this pattern is global and indicates that the US election was uncertain until the very last moment.

After this information shock, it is worthwhile noting that the depreciation occurred for virtually all countries around the world, as shown in Figure 2. We compute three measures of exchange rate depreciation, namely: first, the maximum depreciation during the first trading day to capture the reaction on the FOREX immediately after the news; second, the depreciation after 4 days to capture the reaction of monetary authorities and financial markets to the shock; and third, the depreciation 1 week after the shock to observe whether some exchange rates experienced a further depreciation or a return to the pre-shock exchange rate level. The overall assessment is that the exchange rate

[1] In the text, we refer to high-frequency movements for the exchange rate as we rely on one-minute data to compute the depreciation rates at different time horizons.

movement observed immediately after the 2024 US election has not been reversed one week later. In 26 countries out of a sample of 73 bilateral exchange rates against the US dollar, the depreciation after 1 week was even more pronounced than just after the election.[2] Among them, we have the currency pairs of South Africa, Thailand, Hungary, the Czech Republic, Romania, Bulgaria, and Poland as the countries with the largest differences. These movements are at the heart of policymakers' discussions, as they create instability, especially for emerging markets.

The outcome of the 2024 US election offers us a very well-suited quasi-natural experiment to test the resilience of countries to exchange-rate market pressures. Indeed, due to the nature of the Republican platform and thanks to the use of high-frequency data, we can identify the factors that explain the cross-sectional differences in currency returns against the US dollar. One of the primary conditions for our identification process is that the outcome of the 2024 US presidential election surprised global markets. Figure 1 unequivocally supports this supposition. We can see steady or rising trends in currencies before November 6 and dramatic falls in nearly all exchange rates within minutes after the outcome was realized. Its timing and universality, close to 0:00 GMT on election night, suggest that the event was unexpected to market participants. This would make the outcome of the election a good exogenous shock, allowing us to make causal inference credibly in differences-in-differences style methodology.

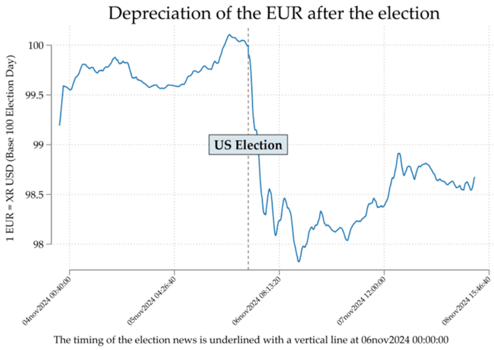
Preliminary graphical evidence reveals an important piece of evidence. In Figure 3, we plot the exchange rate movements against the USD 1 week after the news against the ICRG institutional score, a broad measure of the quality of institutions created and maintained by the PRS group.[3] For our sample of 73 currencies against the USD, we show that the correlation between the depreciation rate and the institutional score is clearly positive around 40 percent and significant at the 1 percent level.[4] The surprising result, that countries with stronger institutional quality experienced sharper currency depreciations, can be understood through the lens of a broader geopolitical realignment.

[2] The difference between exchange rate regime will be controlled in the multivariate regressions with the 'Exchange Rate Stability' variable, ensuring reliable estimates without losing any observations.

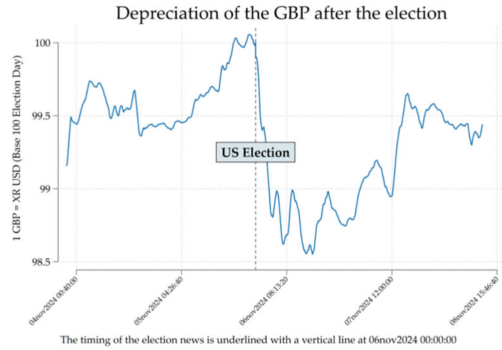
[3] We focus on the political risk rating component of the ICRG index that includes twelve dimensions related to government stability, corruption, democratic accountability, religious tensions, ethnic tensions, rule of law, quality of the bureaucracy, and so on. These institutional features will impact the perception of financial markets during information shocks, like the 2024 presidential US election.

[4] The correlation around 37 percent and significant at the 1 percent level for the other two measures of exchange rate depreciation.

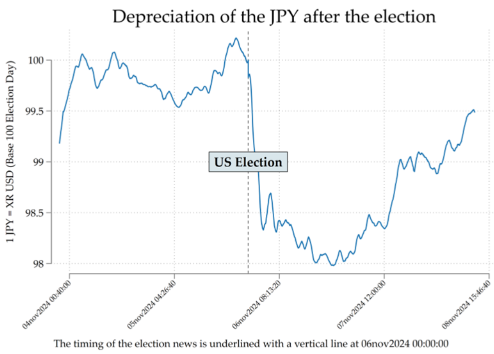
Figure 1: High-frequency exchange rate movements around the 2024 US election.



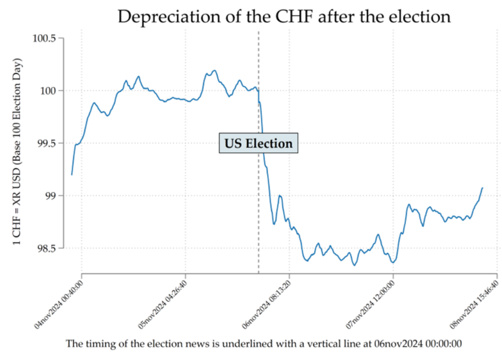
(a) EUR/USD currency pair



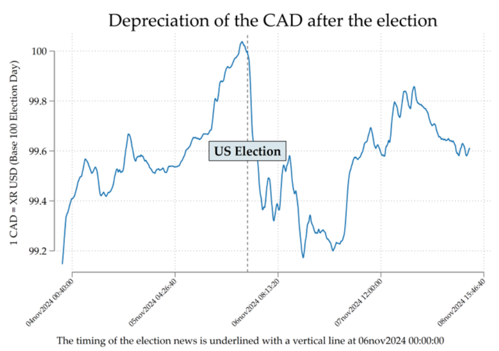
(b) GBP/USD currency pair



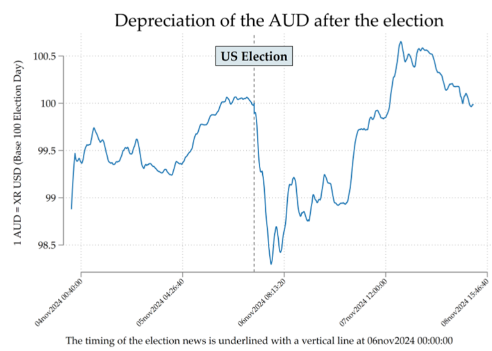
(c) JPY/USD currency pair



(d) CHF/USD currency pair



(e) CAD/USD currency pair



(f) AUD/USD currency pair

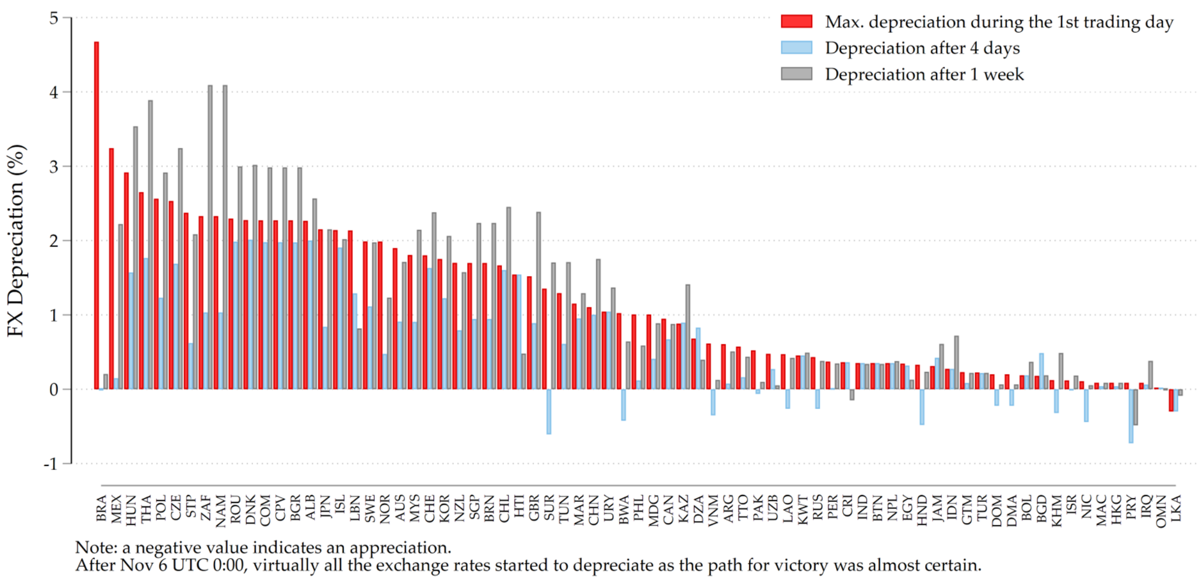
Note: We select the most traded currency pairs and a two-day window around 6th November 0:00 GMT. We use a moving average of the previous 60 minutes to smooth random fluctuations.

The 2024 US presidential election represents an inflection point in the global order,[5] where the US is no longer perceived as the anchor of a rule-based, democracy-oriented international system. Instead, there is a growing expectation that the new administration will adopt a more transactional, bilateralist, and possibly authoritarian-friendly foreign policy (as shown by the negotiations around the tariffs). This shift introduces a new form of uncertainty for well-institutionalized democracies

[5] The 2016 US Presidential Election was different in that respect.

that had previously benefited from alignment with US-led globalization. In this context, market participants may anticipate a withdrawal of preferential treatment, support, or policy coordination with these countries, triggering sharper depreciations. Conversely, countries with weaker institutional profiles, once considered riskier, may now be perceived as relatively insulated from reputational or strategic downgrades under the new US posture. Thus, the observed currency movements reflect not only economic fundamentals but also a realignment of political risk premia in response to an uncharted global trajectory.

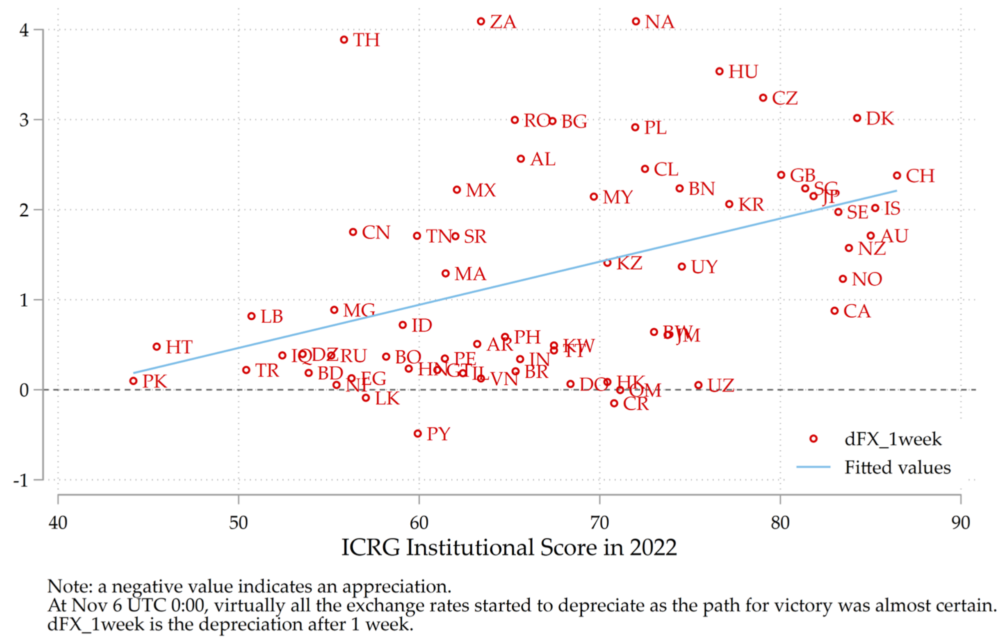
Figure 2: Exchange rate movements in the aftermath of the 2024 US election.



Note: One week after the information shock, the depreciation was even greater in 26 countries out of a sample of 73 bilateral exchange rates against the US dollar. We do not include the euro in the sample because the eurozone is composed of different sovereign countries. We have 73 currencies against the USD, but the sample is reduced to 64 in Table 1 because of the limited availability of institutional scores. There are 62 in the first three columns of Table 2 due to the availability of the other control variables. In Table 3, it is reduced to 40 due to the limited country coverage of the EIU's Trump Risk Index.

We study three event horizons that map to distinct stages of market adjustment after the 2024 United States election. The measure just after the election records the maximum depreciation during the first trading day after 0:00 UTC on November 6, 2024, which isolates the unanticipated information shock and the initial price discovery before policy responses or cross market feedback can materialize. The four-day horizon runs from 0:00 UTC on November 6 to 0:00 UTC on November 10 and is designed to capture early rebalancing across the first three complete global trading sessions and the first round of official communication and intervention, while limiting contamination from unrelated macroeconomic news. The one-week horizon extends to 0:00 UTC on November 13 and tests persistence versus reversal once weekend closures have passed and hedging and portfolio repositioning have worked through. As defined in Appendix A, these anchored windows ensure cross-country comparability, and ex-post evidence shows that the initial movement was not reversed one week later and was larger in 26 of 73 currencies, which underscores the value of measuring outcomes at the weekly horizon.

Figure 3: Correlation between institutions and exchange rate movements.



Note: Countries with higher ICRG institutional scores have experienced a stronger depreciation, suggesting that markets' participants expect that these countries will be impacted by the changes in the US policy.

The testable assumptions in this study are the following: first, the 2024 US presidential election constitutes a structural break in the international economic order (Stokes, 2018). This new context implies that the role of the quality of institutions in shaping the financial markets reaction will evolve. The United States is no longer the leader of the rule-based globalization. Thus, we can infer that the market expects that the new US administration will be more favorable or at least more neutral towards countries with political regimes that are less cautious about several dimensions of institutional development, like the democratic accountability, rule of law, corruption.

The second testable assumption that we are going to test relates to the different dimensions of the ICRG institutional score. To identify the economic, institutional, and political channels, we are going to test the 12 different dimensions of the ICRG score. In this way, we will be able to pinpoint the different dimensions that shaped the reaction of market participants. Thirdly, the financial development and liquidity may also have played a role in the dynamics of exchange rates all around the world. The third testable assumption is to estimate the influence of liquidity/financial development on these high-frequency movements.

This study contributes to the literature on the determinants of exchange rate dynamics around elections (Stein et al., 2005; Bonomo and Terra, 2005; Quinn et al., 2023). Indeed, Frieden and Stein (2001), together with Stein and Streb (1998, 2004) find that voters punish leaders who devalue when the currency was already undervalued. Steinberg (2015) finds that they are more likely to welcome a weak currency in countries where the manufacturing sector is powerful. These insights are not new. In his seminal contribution, Nordhaus (1975) predicted that exchange rate movements may be affected by elections, especially in emerging markets. Nordhaus wrote, "It *is predicted that the concern with loss of reserves and balance of payments deficits will be greater in the beginning of electoral regimes, and less toward the end… The basic difficulty in making intertemporal choices in democratic systems is that the implicit weighting function on consumption has positive weight during the electoral period and zero (or small) weights in the future*."

Thus, in Section 2, we present the implemented methodology. Section 3 provide an overview of the related literatures and our contribution. In Section 4, we present and discuss the empirical results and the robustness checks. We conclude in the last section, the Section 5.

2. Empirical framework

Our empirical methodology relies on the use of cross-sectional regression analyses following the works of Ahmed et al. (2017), Ahmed et al. (2023), Aizenman et al. (2024), and Aizenman and Saadaoui (2024).[6] We can briefly consider a simple two-period setup in the spirit of differences-in-differences to provide some insights about our approach:

$$p_{it} = \mu + \gamma_i + \delta_t + \boldsymbol{\beta}' X_i D_t + \epsilon_{it} \quad (1)$$

[6] In the set of related literature, we find Eichengreen and Gupta (2015) and Ahmed et al. (2017) that investigate the determinants of exchange rate changes over the 2013 Taper Tantrum period. Ahmed (2020) examines cross-sectional exchange rate changes of oil exporters and importers following an unexpected oil supply shock in 2019. Ahmed et al. (2023) and Aizenman et al. (2024) examine the determinants of resilience during US monetary cycles. Aizenman and Saadaoui (2024) extend these two last papers to the resilience of CESEE countries during ECB's monetary cycles.

where p_{it} is the log exchange rate vis-à-vis the USD for the country i in period $t \in \{0, 1\}$. Period 0 denotes the period before the dollar appreciation and period 1 denotes the treatment period of dollar appreciation; the country- and time-fixed effects are given by γ_i and δ_t, respectively. The variable vector X_i contains a set of ex-ante or pre-treatment values of country fundamentals and currency factors including FX reserves, and D_t denotes an indicator equal to 0 in the pre-event period and equal to 1 in the treatment period. The vector of coefficients of interest $\boldsymbol{\beta}$ captures the relationship between country i's ex-ante country fundamentals and its ex-post depreciation vis-à-vis the dollar. As our setting involves two periods, the specification can be expressed in a simpler form by taking differences of the dependent variable to consider the exchange rate return over the treatment period:

$$\Delta p_i = \alpha + \boldsymbol{\beta}' X_i + u_i \tag{2}$$

where $\Delta p_i = p_{i1} - p_{i0}$, $\alpha = \delta_1 - \delta_0$, and $u_i = \epsilon_{i1} - \epsilon_{i0}$. Therefore, our empirical specification takes the form of a cross-sectional regression of the percent depreciation of currency i over the treatment period. Identification is achieved under the assumption that these countries did not anticipate the unexpected results where Trump has full control of Washington with a 'trifecta',[7] and the ensuing US dollar appreciation that came with it.[8]

3. Related literature

This paper contributes to four strands of research at the intersection of international finance, political economy, and institutions. We study an information shock around the 2024 United States presidential election using one minute exchange rate data for a broad set of countries and we show that currencies of countries with stronger institutional quality depreciated more and for longer. This empirical pattern motivates a reinterpretation of how institutional alignment interacts with geopolitical risk and dollar strength.

[7] BBC news, "Trump has full control of government - but he won't always get his way," BBC, consulted on November 16, 2024.
[8] The surprise is reflected in the ABC News last pre-election report (Nov. 5, 2024, at 6:00 AM). A similar uncertainty is found in the latest update of The Economist forecasting model for the US election.

A first strand analyzes how elections and political incentives shape exchange rate outcomes. Nordhaus (1975) introduced the political business cycle, highlighting systematic policy variation over the electoral calendar. Building on this insight, Stein and Streb (1998, 2004) and Stein, Streb, and Ghezzi (2005) document recurrent devaluations around elections in settings with weak nominal anchors, while Bonomo and Terra (2005) and Frieden and Stein (2001) emphasize the political calculus behind exchange rate choices. Sectoral interests and voter preferences also matter. Steinberg (2015) shows that manufacturing intensity increases political support for weaker currencies, and Quinn, Sattler, and Weymouth (2023) provide evidence that exchange rate movements influence electoral behavior in democracies. Our event centered design complements this literature by focusing on an exogenous shift in United States policy orientation that was not priced in before election night and by tracing the heterogeneous currency response across institutional profiles.

A second strand studies international financial spillovers and the global dollar cycle. Ahmed, Coulibaly, and Zlate (2017) quantify how country fundamentals shape the transmission of external financial shocks to emerging markets, and Eichengreen and Gupta (2015) show that even expectations of a change in United States monetary policy can trigger capital flow pressures and currency depreciation. More recently, Aizenman, Park, Qureshi, Saadaoui, and Uddin (2024) and Aizenman and Saadaoui (2024) examine resilience across monetary cycles, while Ahmed, Aizenman, Saadaoui, and Uddin (2023) assess the effectiveness of foreign exchange reserves during the 2021 to 2022 tightening. Our findings add a new channel to this literature. They point to a geopolitical source of spillovers in which institutional alignment with a rules-oriented order, typically seen as stabilizing, can increase perceived exposure when investors expect a more transactional policy stance by the issuer of the leading reserve currency. This mechanism is consistent with the view of an evolving international order discussed by Stokes (2018) and with evidence on the rise of nontraditional reserve currencies reported by Arslanalp, Eichengreen, and Simpson Bell (2022).

A third strand links institutions, openness, and financial development. Acemoglu, Johnson, and Robinson (2005) argue that institutions are a deep driver of long run income. Chinn and Ito (2006) show that capital account openness and institutional quality jointly condition financial development, while Ju and Wei (2010) highlight how weak domestic institutions can induce a bypass of domestic financial systems. The Financial Development Index of Svirydzenka (2016) provides a broad measure of market depth and access, and it has become standard in cross country studies. In our application, stronger institutions are usually expected to lower risk premia. The opposite cross-sectional pattern we document after the 2024 election suggests that institutional strength can increase exposure when investors price a reordering of alliances and policy coordination. The result does not overturn the long run benefits of institutions for development, but it shows that the sign of the short run risk channel can change when the geopolitical anchor shifts.

A fourth strand concerns measurement and identification with high frequency data. Event study designs are well suited to isolate the immediate response of asset prices to information shocks. Ahmed (2020) provides high frequency evidence on commodity currency dynamics, and Larson and Madura (2001) discuss overreaction and underreaction in foreign exchange markets. Our approach combines an event window at the minute level with a difference in differences logic implemented in cross section, where *ex ante* country fundamentals and institutional characteristics are used to explain ex post depreciation against the dollar. This strategy builds on established practice in the literature on international spillovers and on the use of country level indexes of policy frameworks and market development. We rely on the exchange rate stability index of Aizenman, Chinn, and Ito (2008), the capital account openness measure of Chinn and Ito (2006), and a measure of real effective exchange rate misalignment computed from Bruegel data, together with the Trump Risk Index from the Economist Intelligence Unit to proxy exposure to policy reorientation in trade, migration, and security.

Within these literatures our contribution is threefold. First, we provide high frequency evidence that the 2024 election acted as a quasi-natural shock that was not anticipated by markets, as seen in the synchronous turning point across major currency pairs around midnight of November 6 in coordinated universal time. Second, we show that stronger institutional quality is associated with larger and more persistent depreciation after the shock, a result that runs counter to the conventional resilience narrative and that we interpret as evidence of a revaluation of political risk premia under shifting geopolitical expectations. Third, we document that these results are robust to controls for exchange rate management, external balances, capital account openness, and exchange rate misalignment, and that they do not hinge on financial market liquidity, while specific institutional subcomponents such as corruption, military in politics, and socioeconomic conditions play a prominent role in explaining the cross-country pattern. These findings connect the political economy of exchange rates with the literature on international spillovers and the institutional foundations of financial development, while underscoring the importance of event time identification when the global policy regime is in transition.

4. Results

In Table 1, we can see that the coefficient for the institutional score is positive, fluctuating around 2.6 and 4.8 percent, significant at the one percent level for a sample of 64 usable observations. As you can see in Appendix A in Table A1, the institutional score ranges from 43.75 for Pakistan to 86.56 for Australia.

Variable	**(1) Maximum depreciation during the 1st trading day**	**(2) Depreciation after 4 days**	**(3) Depreciation after 1 week**
ICRG Institutional Score	0.035***	0.026***	0.048***
	(0.008)	(0.008)	(0.009)
Intercept	-1.102*	-1.086*	-1.931***
	(0.581)	(0.550)	(0.635)
Observations	64	64	64
R-squared	0.140	0.142	0.183
RMSE	0.930	0.677	1.093

Table 1: Univariate regression for the exchange rate movements.

Note: Robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1. Authors' estimates. Countries with better institutional scores have known a stronger depreciation, as they are expected to be more impacted by changes in the US policy.

To achieve reliable causal estimates, we also control for a vector of relevant confounding variables in Table 2. The definition and sources of the variables are given in Table A.1 of Appendix A. Our covariate set follows standard open economy macroeconomic theory and the political economy of exchange rates, while tailoring the channels to an information shock centered on United States policy. The ICRG institutional score is the central explanatory variable because it captures the depth and credibility of domestic rules and enforcement, which ordinarily lowers risk premia but can raise perceived exposure when a geopolitical realignment threatens the payoffs to alignment with a rules-based order. Exchange rate stability, measured before the event, proxies for the regime and the capacity and willingness to smooth currency movements through intervention or credible commitments, which should dampen the pass through of global shocks to the bilateral rate. Real effective exchange rate misalignment captures the valuation gap with respect to fundamentals and therefore the scope for error correction after the shock. Capital account openness conditions the speed and amplitude of transmission by governing the ease with which cross border positions can be rebalanced. The current account balance summarizes net external financing needs and external resilience, so countries with stronger net saving positions should experience less forced adjustment in the immediate aftermath. The bilateral trade balance with the United States is included to capture direct exposure to prospective changes in tariffs, procurement, and supply chain policy that are central to the post-election narrative. The Trump Risk Index provides an ex-ante measure of vulnerability to policy shifts in trade, migration, and security, and therefore serves as a direct proxy for the intensity of the information shock across countries. In robustness, international reserves and short-term interest differentials are considered because standard asset pricing and intervention frameworks imply that larger reserve buffers and favorable carry cushions can stabilize the currency on impact. Measures of financial size and market liquidity are used to test whether depth and trading frictions condition the response, and relative income to the United States is added to probe the relevance of Balassa Samuelson fundamentals in the short run. Together, these variables allow us to separate valuation, policy regime, external balance, openness, and direct exposure channels in a cross-sectional difference in differences logic that is appropriate for a quasi-natural event.

Table 2 offers multiple insights. First, the evidence presented in Figure 2 and Table 1 is confirmed at all time horizons. The countries with better institutions have known a stronger depreciation. Second, ex-ante exchange rate stability scores (a possible proxy for currency interventions)[9] have helped to stabilize the currencies at all time horizons. Third, the misalignment of the real effective exchange rate contributes to the exchange rate depreciation only after 4 days. This coefficient can reflect an error-correction mechanism, as overvalued currencies are expected to depreciate in the future. Fourth, the bilateral trade deficit contributed to the depreciation after 4 days. Higher exposure to the risk linked to expected changes in the US policy, measured by the

[9] The exchange rate stability is computed using annual standard deviations of the monthly exchange rate between the home country and the base country. We may reasonably conjecture that countries with more fixed exchange rate regimes, before the event, are more likely to intervene on the currency markets during the event.

EIU's Trump Risk Index,[10] contributes to limiting the depreciation after 4 days. This possibly reflects the observation that most exposed economies have experienced the largest movements immediately after the shock (Larson and Madura, 2001).

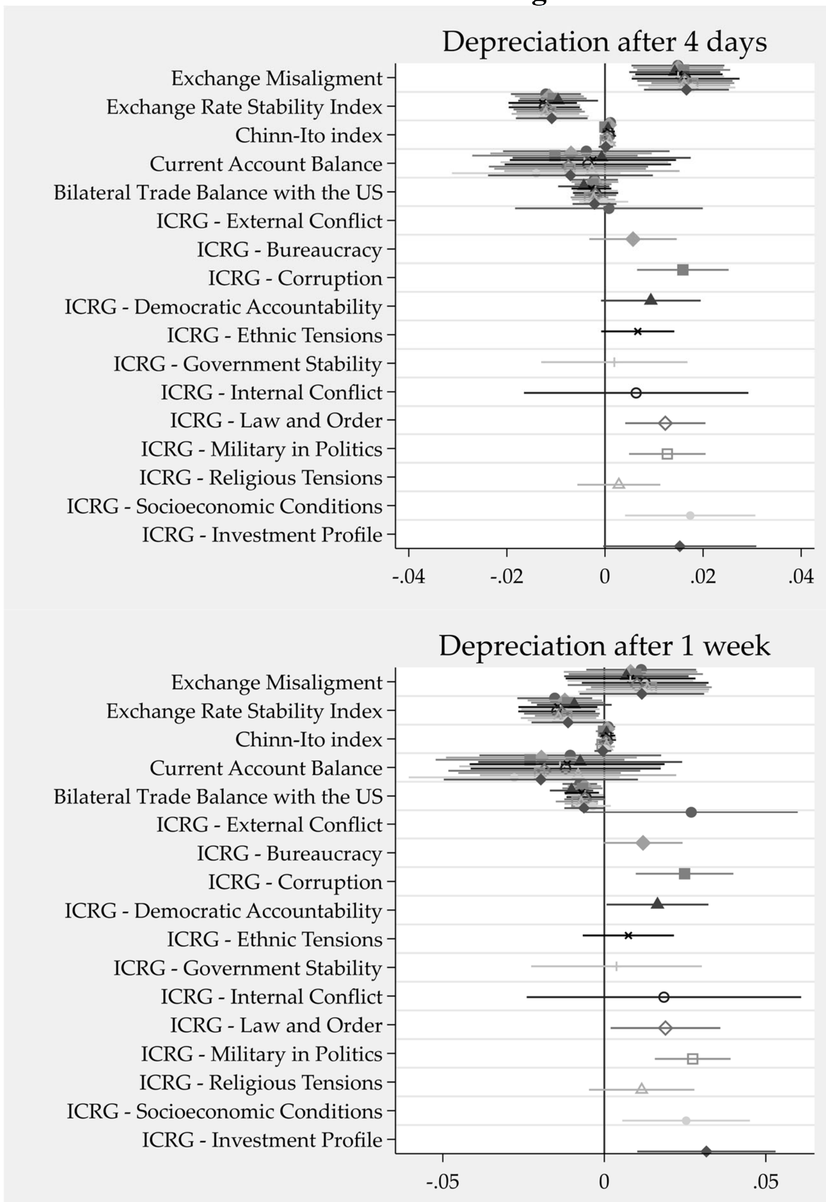
	Maximum 1st day	4 days	1 week	Maximum 1st day	4 days	1 week
ICRG Institutional Score	0.045***	0.031***	0.065***	0.059***	0.038**	0.057**
	(0.013)	(0.011)	(0.016)	(0.021)	(0.015)	(0.026)
REER Misalignment	0.015*	0.019***	0.017	-0.007	0.025**	0.043*
	(0.007)	(0.004)	(0.010)	(0.029)	(0.011)	(0.023)
Exchange Rate Stability	-0.014***	-0.011***	-0.012**	-0.015**	-0.008*	-0.019**
	(0.004)	(0.003)	(0.005)	(0.006)	(0.004)	(0.008)
Capital Account Openness	-0.079	-0.025	-0.133	-0.178	-0.032	-0.117
	(0.114)	(0.068)	(0.132)	(0.153)	(0.100)	(0.210)
Current Account Balance	-0.017*	-0.006	-0.018	-0.016	-0.017	-0.023
	(0.009)	(0.008)	(0.013)	(0.014)	(0.012)	(0.019)
Bilateral Trade with the US	-0.402	-0.240	-0.685**	-0.225	-0.577**	-0.715
	(0.399)	(0.227)	(0.294)	(0.412)	(0.245)	(0.484)
Trump Risk Index				0.004	-0.015**	-0.014
				(0.015)	(0.006)	(0.015)
Constant	-2.572**	-2.838***	-4.185***	-1.365	-3.498**	-5.311**
	(1.202)	(0.878)	(1.379)	(2.924)	(1.376)	(2.389)
Observations	62	62	62	40	40	40
R-squared	0.314	0.356	0.313	0.354	0.450	0.359
RMSE	0.871	0.619	1.054	0.951	0.598	1.110

Table 2: Multivariate regressions for exchange rate movements.
Note: Robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1. Authors' estimates. The coefficients for the control variables have the expected signs. More overvalued currencies have known stronger depreciation. Currencies with more exchange rate stability (as a proxy for currency intervention), higher current account surpluses at all the horizons, larger trade surpluses on the US, and with larger exposure to Trump policy changes are associated with stronger depreciation, signaling an over-reaction after the election (see, Larson and Madura, 2001). Ex-ante interest differentials with the US policy rates have been tested but are not significant at any horizon. Similarly, ex-ante levels of international reserves are not significant.

In Figure 4, it appears that the positive and significant coefficient on the ICRG index in the earlier results is driven by corruption, military involvement in politics, and socioeconomic conditions across the three horizons of depreciation. Additionally, law and order is significant for depreciation after 4 days and 1 week, while investment profile and democratic accountability are significant for the initial depreciation and after 1 week. The definitions of the different dimensions of the ICRG index are provided in Appendix B. The empirical analysis of our second testable assumption reveals that countries that have more corruption, have more military involvement in the government, and have worse socio-economic conditions have known less depreciation.

[10] This index is composed of three subcomponents: security, trade and immigration. A score is given to a cross-section of 70 countries, where a higher value means a greater exposure to risk. Mexico is the most exposed economy to the changes in the US policy. Saudi Arabia is the least exposed country, with a score of 9.4.

Figure 4: Correlation between institutions and exchange rate movements.



Note: The following code snippet produces the estimates, plots the coefficients for 12 different models, and makes the table for these 12 different models. The left-hand-side variable is the cumulative exchange rate depreciation after the election of Donald Trump. Please note that the coefficients have been normalized to have a similar magnitude in the figures. The normalization has no effect on the statistical significance but requires being careful on the interpretation of the magnitude of the US trade balance coefficient.

Now, we discuss the empirical results of our third testable assumption, namely, the role of liquidity and financial development. We check whether more liquid markets experienced more depreciation using IMF data on financial market size.[11] We introduce an interaction term between the institutional score and the financial size in the regressions of Table 2. The interaction terms are

[11] Financial markets depth, access, and efficiency is defined in Svirydzenka (2016).

never significant, with very high p-values. This shows that our results are not driven by liquidity effects.

Robustness checks in the Tables of Appendix C. We conduct three main robustness checks about the effect of relative GDP per capita of countries vis-à-vis the US and of the GDP size in PPP US dollars, using data from the World Bank, and about the role of liquidity of the different currency pairs, using data from the Bank for International Settlements and from the IMF. First, the relative income of countries vis-à-vis the US: The Balassa-Samuelson effect is traditionally a long-run determinant of exchange rates (Bordo et al., 2017) important for developing economies (Hassan, 2016). Does it have a role in these short-run movements? When we add the relative income to the US, the regressions in the first three columns of Table 2 barely change. The coefficients of the ICRG institutional score are still significant at the conventional levels, and the coefficients of the relative GDP per capita are never significant and provide any improvement in the regressions. This is not a surprising result, as institutions are a fundamental driver of wealth (Acemoglu et al., 2005).

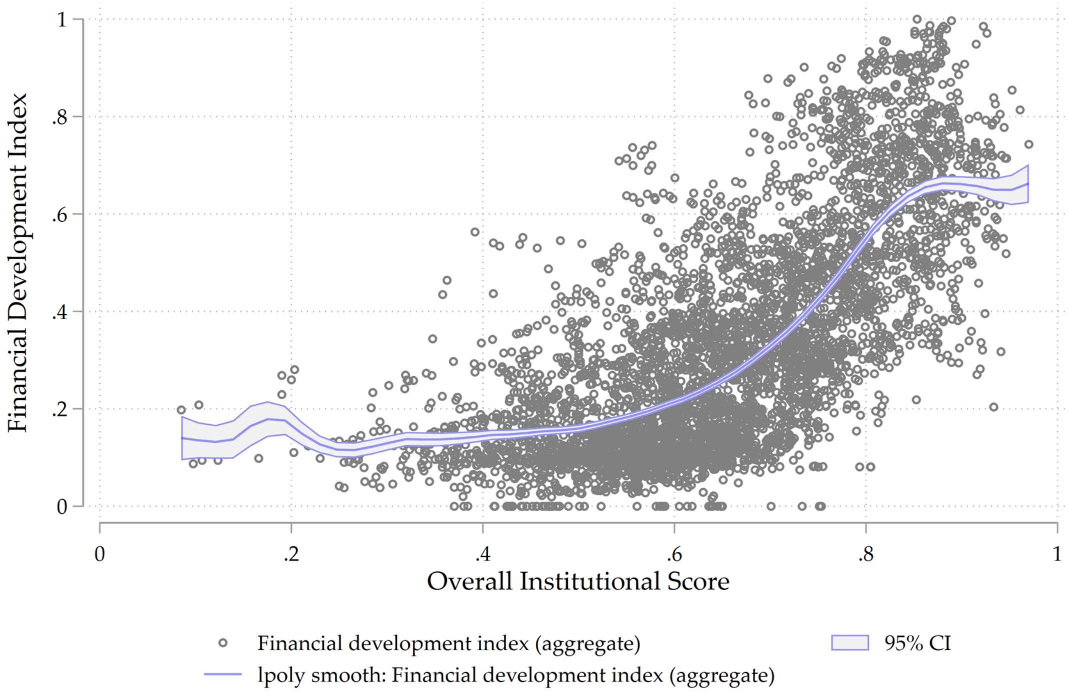
Role of liquidity of the different currency pairs: Our results may be driven by the different degrees of liquidity on the foreign currency markets. The most liquid currencies may have experienced stronger depreciations. We create a dummy for the most liquid currencies following the tracked currency pairs on the BIS website.[12] Again, the regressions in the first three columns of Table 2 barely change. The liquidity dummy has a p-value of 10.5 percent for the first column of Table 2. We can safely conclude that our results are not driven by liquidity. Besides, we use an interaction term between the financial market development and the institutional score. This second robustness check about liquidity show that our results are not driven by liquidity heterogeneity.

These last results about liquidity are not surprising. In the Figure 4, we use kernel regressions to show the transition between two steady states for a sample of 4808 observations (132 countries from 1984 to 2022).[13] The first steady state is the weak institutions/low financial development state. The second steady state is the strong institutions/high financial development state.[14] There are no

[12] We refer to the BIS data on exchange-traded derivatives statistics.
[13] The data for the financial development comes from the IMF (Svirydzenka (2016)).
[14] Ju and Wei (2010) provide a theoretical model explaining the interaction between domestic institutions and capital flows.

examples of countries that have weak institutions and, at the same time, developed financial markets accompanied by a liquid currency market.

Figure 5: Institutional Development Precedes Financial Development



Note: To estimate this kernel-weighted local polynomial regression, we use the 'lpoly' command of Stata 19 with the Epanechnikov kernel and a bandwidth equal to 0.3.

5. Concluding remarks

Our findings suggest a turning point in the global risk architecture. Where institutional quality has traditionally served as a buffer against market volatility, the 2024 U.S. election reversed this logic: alignment with now-deprioritized democratic norms may have amplified uncertainty. This paper thus documents not just a one-time market reaction, but a broader revaluation of institutional exposure under geopolitical disruption. In doing so, it highlights how even the most robust fundamentals can become a source of financial vulnerability when the global hegemon realigns its strategic commitments. Future research should explore whether this inversion persists beyond this episode, and how other large-country regime shifts, past or emerging, similarly rewire financial market expectations.

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Appendix A. Descriptive statistics and variable definitions.

Table A.1: Descriptive statistics

	(1) Count	(2) Mean	(3) SD	(4) Min	(5) Max
Maximum depreciation during the 1st trading day	73	1.19	1.00	-0.30	4.68
Depreciation after 4 days	73	0.61	0.74	-0.73	2.01
Depreciation after 1 week	73	1.26	1.20	-0.49	4.09
Current account balance in 2022	117	-1.72	11.90	-42.68	34.50
Capital account openness in 2021	117	0.38	1.50	-1.93	2.30
Exchange rate stability in 2020	116	54.50	31.87	3.86	100.00
ICRG Institutional Score in 2022	85	66.06	10.26	44.17	86.46
REER misalignment in 2020	116	99.27	14.27	56.82	198.55
Bilateral trade balance with the US in 2022	112	-0.04	0.18	-1.64	0.08
Trump Risk Index in 2024	46	31.89	13.44	9.44	71.37

Country list: 1 Albania; 2 Algeria; 3 Argentina; 4 Australia; 5 Bangladesh; 6 Bhutan; 7 Bolivia; 8 Botswana; 9 Brazil; 10 Brunei; 11 Bulgaria; 12 Cambodia; 13 Canada; 14 Cape Verde; 15 Chile; 16 China; 17 Comoros; 18 Costa Rica; 19 Czech Republic; 20 Denmark; 21 Dominica; 22 Dominican Republic; 23 Egypt; 24 Guatemala; 25 Haiti; 26 Honduras; 27 Hong Kong; 28 Hungary; 29 Iceland; 30 India; 31 Indonesia; 32 Iraq; 33 Israel; 34 Jamaica; 35 Japan; 36 Kazakhstan; 37 Kuwait; 38 Laos; 39 Lebanon; 40 Macao; 41 Madagascar; 42 Malaysia; 43 Mexico; 44 Morocco; 45 Namibia; 46 Nepal; 47 New Zealand; 48 Nicaragua; 49 Norway; 50 Oman; 51 Pakistan; 52 Paraguay; 53 Peru; 54 Philippines; 55 Poland; 56 Romania; 57 Russia; 58 Sao Tome and Principe; 59 Singapore; 60 South Africa; 61 South Korea; 62 Sri Lanka; 63 Suriname; 64 Sweden; 65 Switzerland; 66 Thailand; 67 Trinidad and Tobago; 68 Tunisia; 69 Türkiye; 70 United Kingdom; 71 Uruguay; 72 Uzbekistan; 73 Vietnam.

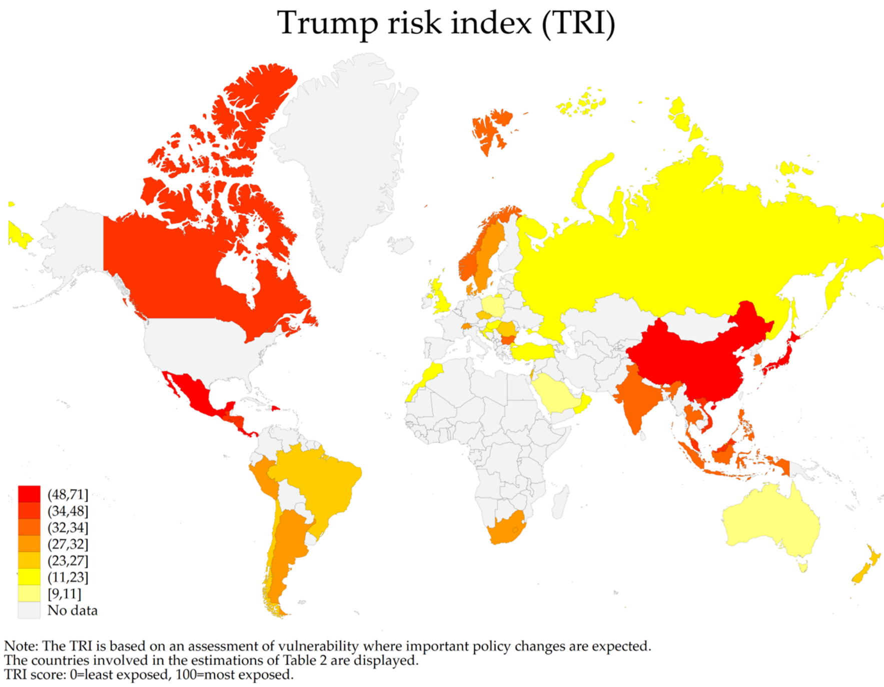
Number of countries, clarifications: We do not include the euro in the sample because the eurozone is composed of different sovereign countries. Heterogeneity across euro members is important. It should be studied with outcomes that vary at the national level within the monetary union, such as changes in sovereign bond spreads, credit default swap spreads, or relative equity returns around the event. We have 73 currencies against the USD, but the sample is reduced to 64 in Table 1 because of the limited availability of institutional scores. There are 62 in the first three columns of Table 2 due to the availability of the other control variables. In Table 3, it is reduced to 40 due to the limited country coverage of EIU's Trump Risk Index.

Table A.2: Data sources

Variable	Definition
Maximum depreciation during the 1st trading day	Maximum depreciation of the bilateral exchange rate against the USD during the 1st trading day (one-minute data), source: xe.com.
Depreciation after 4 days	Depreciation of the bilateral exchange rate against the USD between Nov. 6 UTC 0:00 and Nov. 10 UTC 0:00, source: xe.com
Depreciation after 1 week	Depreciation of the bilateral exchange rate against the USD between Nov. 6 UTC 0:00 and Nov. 13 UTC 0:00, source: xe.com.
Current account balance in 2022	World Development Indicators, World Bank, BN.CAB.XOKA.GD.ZS.
Capital account openness in 2021	Chinn and Ito (2006), https://web.pdx.edu/~ito/Chinn-Ito_website.htm.
Exchange rate stability in 2020	Aizenman et al. (2008), https://web.pdx.edu/~ito/trilemma_indexes.htm
ICRG Institutional Score in 2022	The sum of the political risk score components in the ICRG dataset, https://www.prsgroup.com/.
REER misalignment in 2020	The ratio between the real effective exchange rate in 2020 and the average value between 2014 and 2018, multiplied by 100, BRUEGEL, https://www.bruegel.org/.
Bilateral trade balance with the US in 2022	US Bilateral Trade Balance in Percent of GDP, World Bank, https://wits.worldbank.org/.
Trump Risk Index in 2024	An overall risk score is based on an assessment of vulnerability across three areas - trade, immigration, and security - where important policy changes under the Trump administration are expected, The Economist Intelligence Unit, https://www.economist.com/.

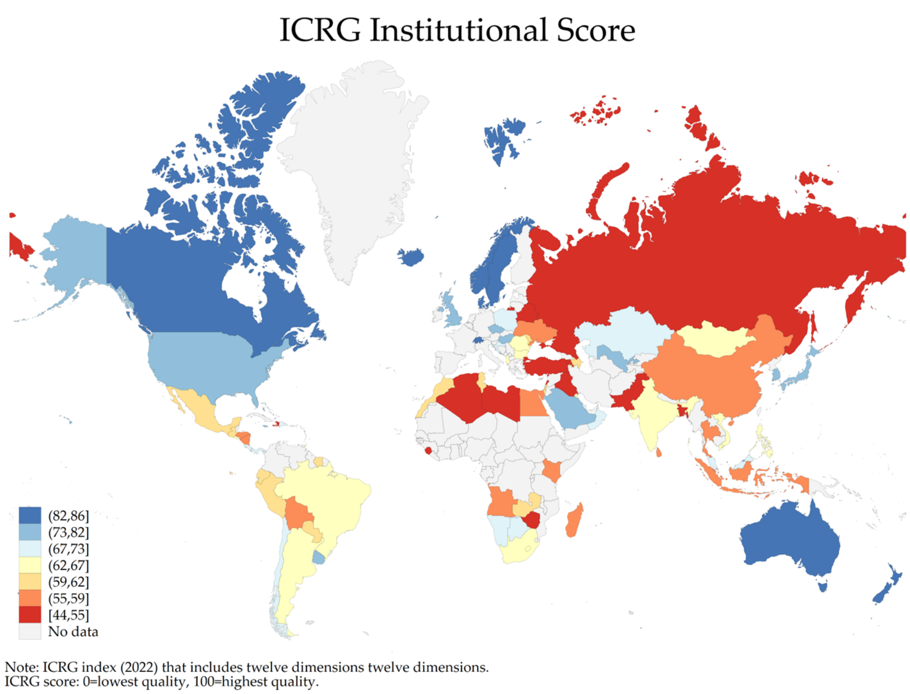
Note: we use the latest data available for the explanatory variables. To validate the empirical strategy, these explanatory variables have to be observed before the event; see Section 2.

Figure A.1: Exposure to changes in the US policy measured with TRI.



Note: authors' calculation based on the Economist Intelligence Unit's data. With a score above 40, Mexico, China, Japan, and Canada are expected to be strongly impacted by the policy changes.

Figure A.2: ICRG Institutional Score.



Note: ICRG index that includes twelve dimensions related to government stability, corruption, democratic accountability, religious tensions, ethnic tensions, rule of law, quality of the bureaucracy, and so on.

Appendix B. ICRG institutional score dimensions.[15]

- Government Stability

This is an assessment both of the government's ability to carry out its declared program(s) and its ability to stay in office. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to very low risk, and a score of 0 points to very high risk.

The subcomponents are *government unity, legislative strength, and popular support.*

- Socioeconomic Conditions

This is an assessment of the socioeconomic pressures at work in society that could constrain government action or fuel social dissatisfaction. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to very low risk, and a score of 0 points to very high risk.

The subcomponents are *unemployment, consumer confidence, and poverty.*

- Investment Profile

This is an assessment of factors affecting the risk to investment that are not covered by other political, economic, and financial risk components. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to very low risk, and a score of 0 points to very high risk.

The subcomponents are *contract viability/expropriation, profit repatriation, and payment delays.*

- Internal Conflict

This is an assessment of political violence in the country and its actual or potential impact on governance. The highest rating is given to those countries where there is no armed or civil

[15] Reproduced from the ICRG methodology note.

opposition to the government and the government does not indulge in arbitrary violence, direct or indirect, against its own people. The lowest rating is given to a country embroiled in an on-going civil war. The risk rating assigned is the sum of three subcomponents, each with a minimum score of 0 points. A score of 4 points equates to very low risk, and a score of 0 points to very high risk. The subcomponents are *civil war/coup threat, terrorism/political violence, and civil disorder.*

- External Conflict

The external conflict measure is an assessment both of the risk to the incumbent government from foreign action, ranging from non-violent external pressure (diplomatic pressures, withholding of aid, trade restrictions, territorial disputes, sanctions, etc.) to violent external pressure (cross-border conflicts to all-out war).

External conflicts can adversely affect foreign business in many ways, ranging from restrictions on operations to trade and investment sanctions, to distortions in the allocation of economic resources, to violent change in the structure of society. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to very low risk, and a score of 0 points to very high risk.

The subcomponents are *war, cross-border conflict, and foreign pressures.*

- Corruption

This is an assessment of corruption within the political system. Such corruption is a threat to foreign investment for several reasons: it distorts the economic and financial environment; it reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability; and, last but not least, it introduces an inherent instability into the political process.

The most common form of corruption met directly by business is financial corruption in the form of demands for special payments and bribes connected with import and export licenses, exchange controls, tax assessments, police protection, or loans. Such corruption can make it difficult to conduct business effectively, and in some cases may force the withdrawal or withholding of an investment.

Although our measure takes such corruption into account, it is more concerned with actual or potential corruption in the form of excessive patronage, nepotism, job reservations, 'favor-for-favors,' secret party funding, and suspiciously close ties between politics and business. In our view, these insidious sorts of corruption are potentially of much greater risk to foreign business in that they can lead to popular discontent and unrealistic and inefficient controls on the state economy and encourage the development of the black market.

The greatest risk in such corruption is that at some time it will become so overweening, or some major scandal will be suddenly revealed, as to provoke a popular backlash, resulting in a fall or overthrow of the government, a major reorganizing or restructuring of the country's political institutions, or, at worst, a breakdown in law and order, rendering the country ungovernable.

- Military in Politics

The military is not elected by anyone. Therefore, its involvement in politics, even at a peripheral level, is a diminution of democratic accountability. However, it also has other significant implications.

The military might, for example, become involved in government because of an actual or created internal or external threat. Such a situation would imply the distortion of government policy to meet this threat, for example by increasing the defense budget at the expense of other budget allocations.

In some countries, the threat of military takeover can force an elected government to change policy or cause its replacement by another government to be more amenable to the military's wishes. A military takeover or threat of a takeover may also represent a high risk if it is an indication that the government is unable to function effectively and that the country therefore has an uneasy environment for foreign businesses.

A full-scale military regime poses the greatest risk. In the short term a military regime may provide a new stability and thus reduce business risks. However, in the longer term the risk will almost certainly rise, partly because the system of governance will be become corrupt and partly because the continuation of such a government is likely to create an armed opposition.

In some cases, military participation in government may be a symptom rather than a cause of underlying difficulties. Overall, lower risk ratings indicate a greater degree of military participation in politics and a higher level of political risk.

- Religious Tensions

Religious tensions may stem from the domination of society and/or governance by a single religious group that seeks to replace civil law with religious law and to exclude other religions from the political and/or social process; the desire of a single religious group to dominate governance; the suppression of religious freedom; or the desire of a religious group to express its own identity, separate from the country as a whole.

The risk involved in these situations range from inexperienced people imposing inappropriate policies through civil dissent to civil war.

- Law and Order

"Law and Order" form a single component, but its two elements are assessed separately, with each element being scored from zero to three points. To assess the "Law" element, the strength and impartiality of the legal system are considered, while the "Order" element is an assessment of popular observance of the law. Thus, a country can enjoy a high rating – 3 – in terms of its judicial system, but a low rating – 1 – if it suffers from a very high crime rate if the law is routinely ignored without effective sanction (for example, widespread illegal strikes).

- Ethnic Tensions

This component is an assessment of the degree of tension within a country attributable to racial, nationality, or language divisions. Lower ratings are given to countries where racial and nationality tensions are high because opposing groups are intolerant and unwilling to compromise. Higher ratings are given to countries where tensions are minimal, even though such differences may still exist.

- Democratic Accountability

This is a measure of how responsive government is to its people, on the basis that the less responsive it is, the more likely it is that the government will collapse, peacefully in a democratic society, but possibly violently in a non-democratic one.

The points in this component are awarded on the basis of the type of governance enjoyed by the country in question. For this purpose, we have defined the following types of governance: alternating democracy, dominated democracy, de facto one-party state, de jure one-party state, and autocracy.

- Bureaucracy Quality

The institutional strength and quality of the bureaucracy is another shock absorber that tends to minimize revisions of policy when governments change. Therefore, high points are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services. In these low-risk countries, the bureaucracy tends to be somewhat autonomous from political pressure and to have an established mechanism for recruitment and training. Countries that lack the cushioning effect of a strong bureaucracy receive low points because a change in government tends to be traumatic in terms of policy formulation and day-to-day administrative functions.

Appendix C. Robustness Checks

	(1) Maximum 1st day	(2) 4 days	(3) 1 week
ICRG Institutional Score	0.0390**	0.0242*	0.0651***
	(0.0172)	(0.0127)	(0.0208)
REER Misalignment	0.0137*	0.0177***	0.0167
	(0.0078)	(0.0050)	(0.0102)
Exchange Rate Stability	-0.0137***	-0.0108***	-0.0121**
	(0.0040)	(0.0036)	(0.0054)
Capital Account Openness	-0.0932	-0.0427	-0.1339
	(0.1108)	(0.0710)	(0.1311)
Current Account Balance	-0.0209**	-0.0109	-0.0185
	(0.0096)	(0.0094)	(0.0134)
Bil. Trade with the US	-0.3909	-0.2259	-0.6848**
	(0.4126)	(0.2159)	(0.2951)
GDP per capita	0.0032	0.0039	0.0001
	(0.0044)	(0.0041)	(0.0056)
Intercept	-2.1843	-2.3621**	-4.1670***
	(1.4671)	(0.9988)	(1.5355)
Observations	62	62	62
R-squared	0.32	0.37	0.31
RMSE	0.88	0.62	1.06

Note: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. The GDP per capita data come from the World Bank.

Table C.1: Controlling for the GDP per capita.

	(1) Maximum 1st day	(2) 4 days	(3) 1 week
ICRG Institutional Score	0.0448***	0.0311***	0.0653***
	(0.0132)	(0.0107)	(0.0161)
REER Misalignment	0.0153**	0.0191***	0.0166
	(0.0071)	(0.0043)	(0.0106)
Exchange Rate Stability	-0.0136***	-0.0113***	-0.0122**
	(0.0040)	(0.0039)	(0.0050)
Capital Account Openness	-0.0793	-0.0252	-0.1332
	(0.1146)	(0.0689)	(0.1325)
Current Account Balance	-0.0177*	-0.0064	-0.0182
	(0.0093)	(0.0082)	(0.0132)
Bil. Trade with the US	-0.2834	-0.2334	-0.7174*
	(0.5328)	(0.2780)	(0.3650)
GDP size	0.0355	0.0019	-0.0096
	(0.0940)	(0.0621)	(0.0951)
Intercept	-3.5939	-2.8932	-3.9091
	(2.6037)	(2.0444)	(2.7800)
Observations	62	62	62
R-squared	0.32	0.36	0.31
RMSE	0.88	0.62	1.06

Note: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. The GDP in PPP US dollar come from the World Bank.

Table C.2: Controlling for the GDP size (the log of the GDP in PPP US dollar).

	(1) Maximum 1st day	(2) 4 days	(3) 1 week
ICRG Institutional Score (ICRG)	0.0386**	0.0310**	0.0743***
	(0.0171)	(0.0154)	(0.0220)
REER Misalignment	0.0138*	0.0191***	0.0172
	(0.0076)	(0.0045)	(0.0106)
Exchange Rate Stability	-0.0127***	-0.0115***	-0.0112**
	(0.0041)	(0.0037)	(0.0050)
Capital Account Openness	-0.0766	-0.0266	-0.1156
	(0.1111)	(0.0700)	(0.1379)
Current Account Balance	-0.0208**	-0.0060	-0.0190
	(0.0102)	(0.0081)	(0.0126)
Bil. Trade with the US	-0.1673	-0.2740	-0.4789
	(0.5590)	(0.2632)	(0.4227)
Financial Market Development (FMD)	0.9310	-0.2812	2.9634
	(2.9770)	(2.4930)	(4.0883)
ICRG*FMD	-0.0043	0.0029	-0.0379
	(0.0366)	(0.0330)	(0.0520)
Intercept	-2.3105	-2.8084**	-4.9546***
	(1.4366)	(1.2218)	(1.7411)
Observations	62	62	62
R-squared	0.33	0.36	0.32
RMSE	0.88	0.63	1.07

Note: Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. The Financial Market Development (FMD) data come from the IMF.

Table C.3: Controlling for the liquidity (Financial Market Development).