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How Institutions Interact with Exchange Rates After the 2024 US Presidential Election: New High-Frequency Evidence

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ABSTRACT

This paper is a case study of the exchange rate adjustments during the first week following the swapping US election results. We compute three measures of exchange rate depreciation: the maximum depreciation during the 1st trading day after November 6 UTC 0:00 to capture the reaction on the FOREX immediately after the news for our sample of 73 currencies against the USD, practically all currencies depreciated sharply at the news. Second, the depreciation after 4 days to capture the reaction of monetary authorities and the global markets to the news; third, the depreciation 1 week after the shock to observe whether some countries have experienced a further depreciation or a return to the pre-shock exchange rate level. 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. We also find that the correlation between the depreciation rate after a week from the initial news and the ICRG institutional score is positive and significant at the 1 percent level. A multivariate regression for exchange rate movements indicates that after a week, the bilateral trade surplus with the US, and better institutional scores are associated with stronger depreciations. Exchange rate interventions have helped to stabilize the currencies at all time horizons. The exposure to policy changes, measured by EIU's Trump Risk Index, seems to be at play after 4 days.

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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), the Australian Dollar (AUD per USD), and the New Zealand Dollar (NZD 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.

[1] In the text, we refer to high-frequency movements for the exchange rate as we rely 15-minute data to compute the depreciation rates at different time horizons.

Figures 1a-1g High-frequency exchange rate movements around the 2024 US election of the EUR, GBP, JYP, CHF, CAD, AUD, NZD

Figure 1a

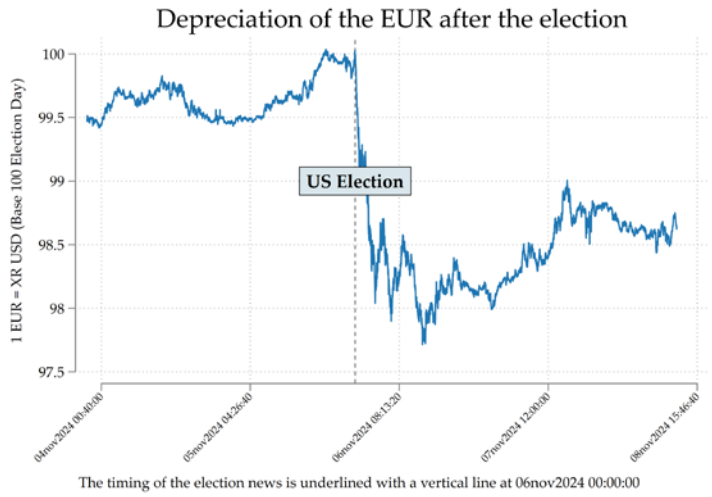


Figure 1b

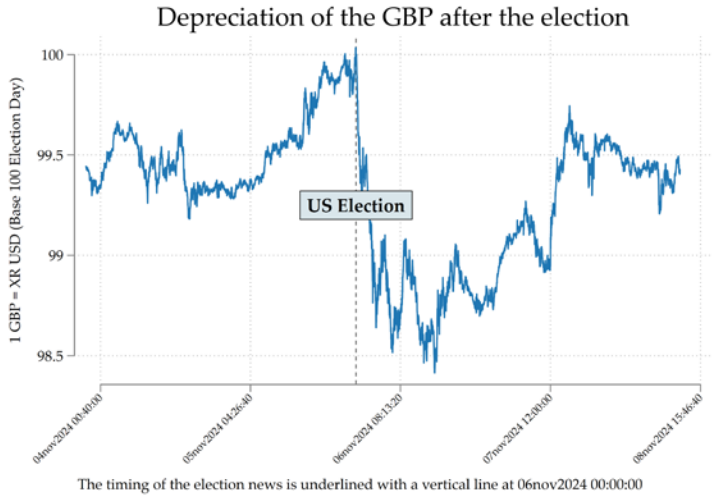


Figure 1c

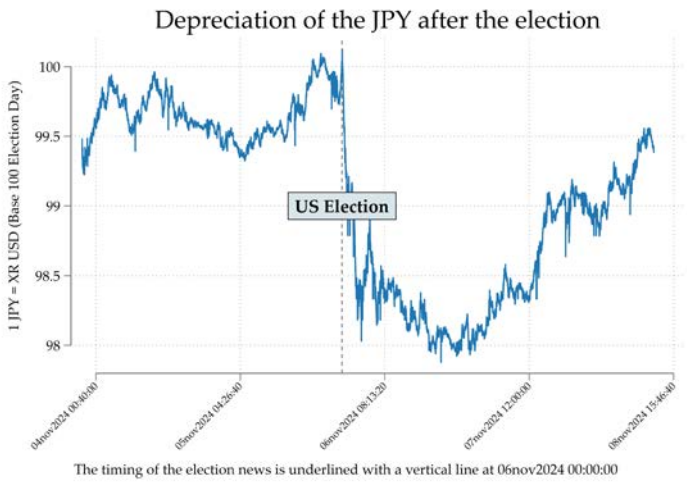


Figure 1d

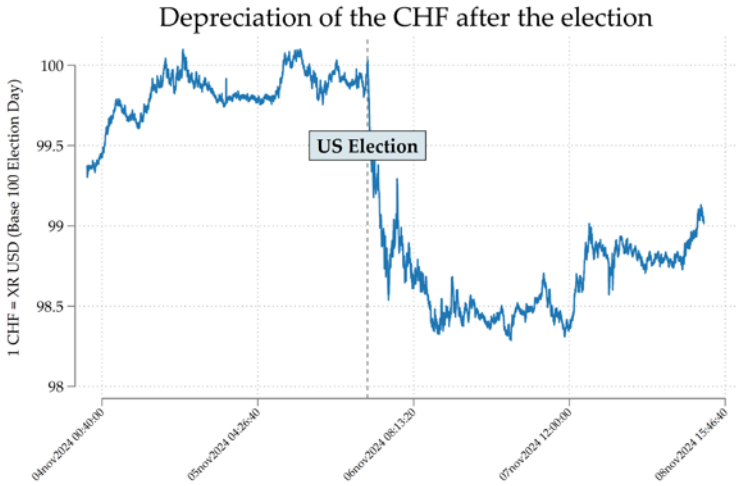


Figure 1e

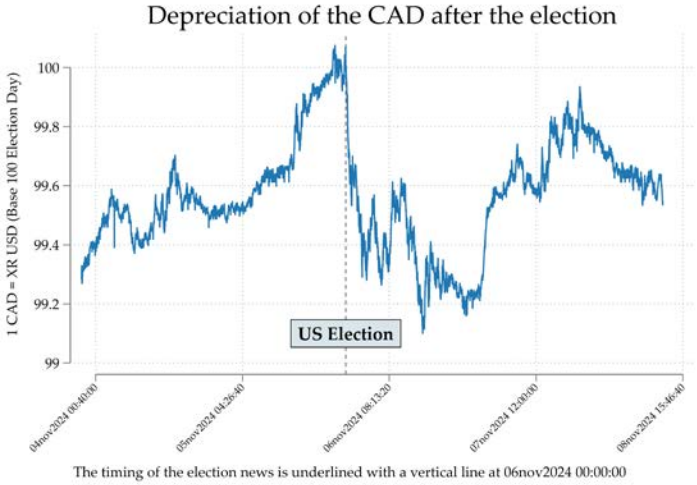


Figure 1f

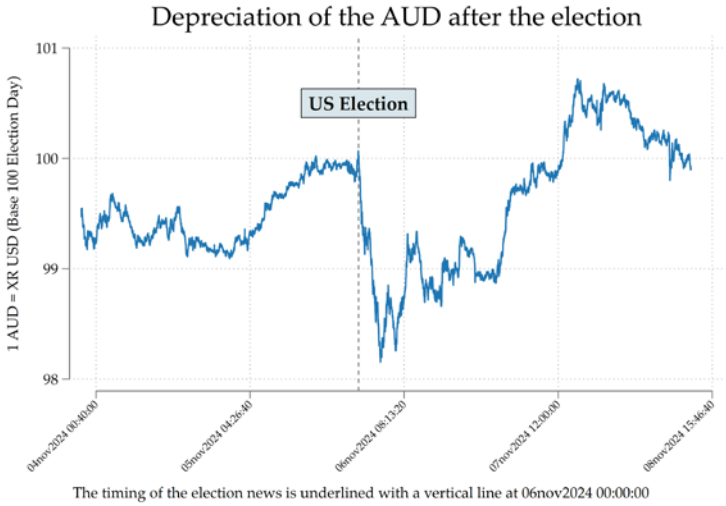
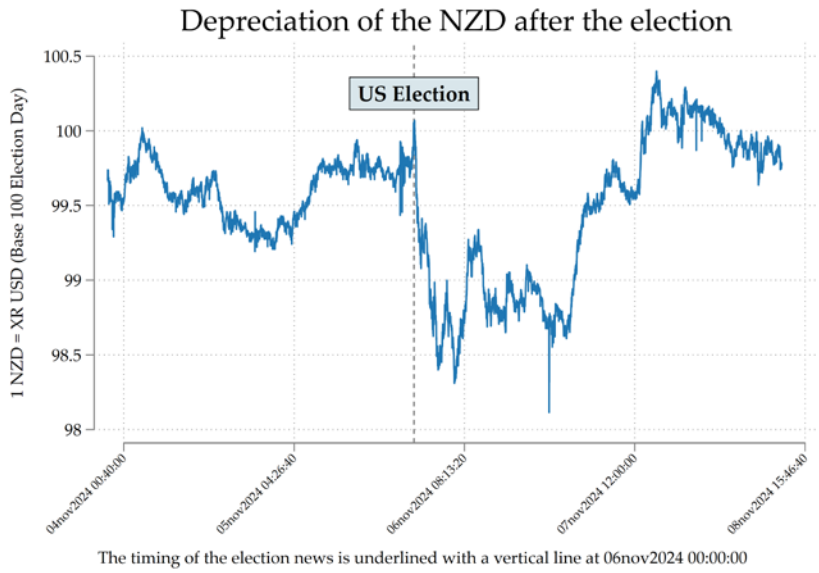


Figure 1g



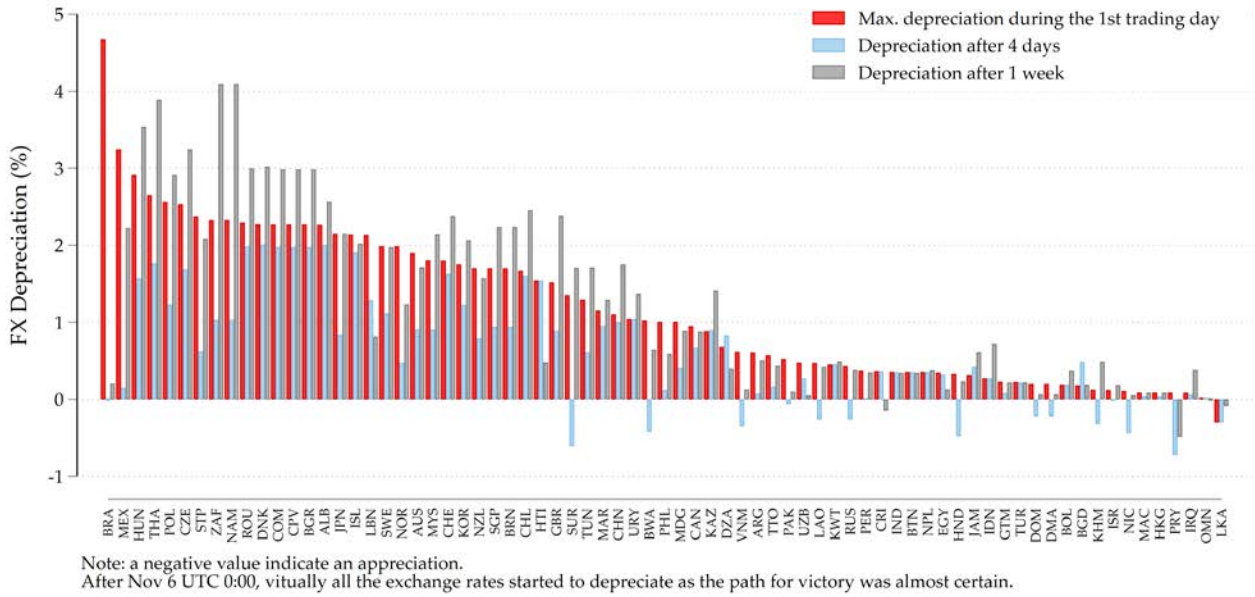
Source: authors' calculations. We select the most traded currency pairs and a two-day window around 6th November 0:00 GMT.

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; 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 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 can quote South Africa, Thailand, Hungary, Czech Republic, Romania, Bulgaria, and Poland, as the countries with the largest

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

differences. These movements are at the heart of policymakers' discussions, as they create instability, especially for emerging markets.[3]

Figure 2. Exchange rate movements in the aftermath of the 2024 US election[4]



Source: authors' calculations. One week after the information shock, the depreciation was even in 26 countries out of a sample of 73 bilateral exchange rates against the US Dollar.

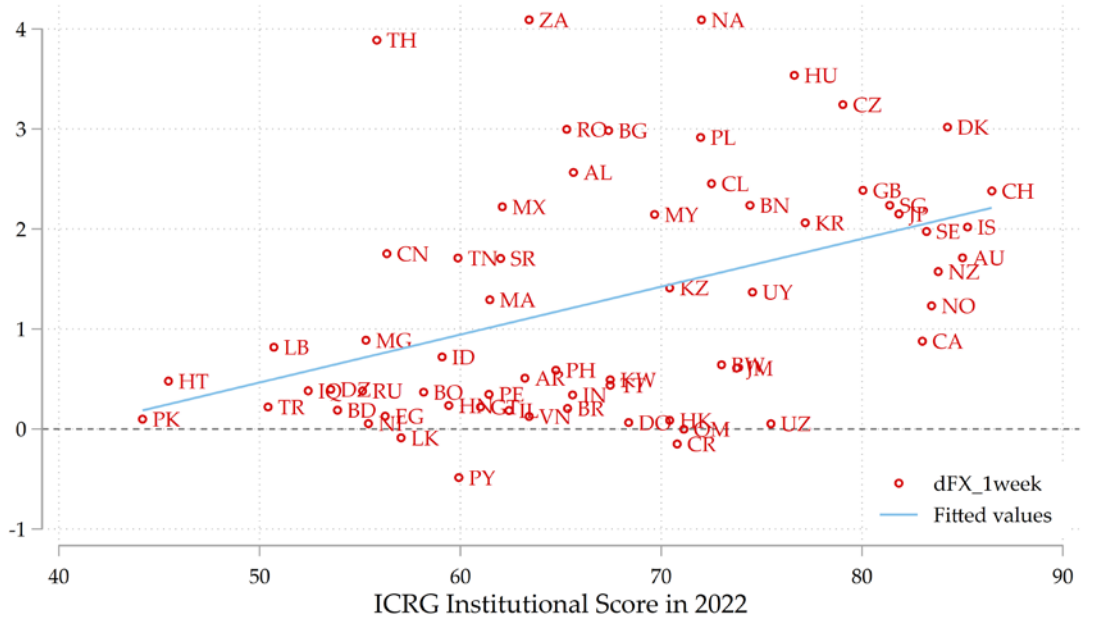
The outcome of the 2024 US election offers us a very well-suited quasi-natural experiment to test the resilience of countries to exchange-rate market pressures. Indeed, due to the nature of the Republican platform and thanks to the use of high-frequency data, we can identify the factors that explain the cross-sectional differences in currency returns against the US Dollar. Preliminary graphical evidence reveals an important piece of evidence. In Figure 4, we plot the exchange rate movements against the USD 1 week after the news against the ICRG institutional score, a broad measure of the

[3] Financial Times, https://www.ft.com/content/8aecd4a8-5f24-4899-999b-8e93ac2f67b6, consulted on 16 November 2024.

[4] 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.

quality of institutions created and maintained by the PRS group.[5] 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.[6]

Figure 3. Correlation between institutions and exchange rate movements



Note: a negative value indicate an appreciation.
At Nov 6 UTC 0:00, vitually all the exchange rates started to depreciate as the path for victory was almost certain.
dFX_1week is the depreciation after 1 week.

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

How do we interpret these preliminaries? This correlation indicates that countries with better institutions have experienced the largest depreciation. Due to the nature of the shock, we can infer that the market expects that the new US administration will be more favorable or at least more neutral *vis-à-vis* countries with political regimes that are less cautious about several dimensions of institutional

[5] We focus on the political risk rating component of the IGRG index that include 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.

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

development, like the respect of property rights, the central bank independence, the transparency of monetary and fiscal policy, democratic accountability of the economic policy decisions and so on. The rest of the paper will try to provide further evidence about this conjecture. 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). Thus, in Section 2, we present the implemented methodology and provide a brief overview of the related literature. In Section 3, we present and discuss the empirical results. We conclude in Section 4.

2. Empirical methodology

Our empirical methodology relies on the cross-sectional regression analyses of Eichengreen and Gupta (2015), Ahmed et al. (2017), Ahmed (2020), Ahmed et al. (2024), Aizenman et al. (2024) and Aizenman and Saadaoui (2024).[7] We can briefly consider a simple two-period setup in the spirit of differences-in-differences to provide some insights about our approach:

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

where p_{it} is the log of the exchange rate *vis-à-vis* the USD for country i in period $t \in \{0,1\}$. Period 0 denotes the period before the dollar appreciation began and Period 1 denotes the treatment period of dollar appreciation. Country and time-fixed effects are given by γ_i and δ_t, respectively. The vector X_i' contains a set of *ex-ante* or pre-treatment values of country fundamentals and currency factors including institutional score, 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. Because our

[7] 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.

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:

$$\Delta p_i = \alpha + \boldsymbol{\beta} X_i + u_i, \qquad (2)$$

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 swapping results where Trump has full control of Washington with a 'trifecta',[8] and the ensuing US dollar appreciation that came with it.[9]

3. Results and discussion

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 between 43.75 for Pakistan to 86.56 for Australia.

[8] BBC news, Trump has full control of government - but he won't always get his way, https://www.bbc.com/news/articles/cn42dzejpjvo, consulted on November 16, 2024.
[9] The surprise is reflected in the ABC news last pre-election report UPDATED Nov. 5, 2024, at 6:00 AM. A similar uncertainty is found the latest update of The Economist forecasting model for the US election, UPDATED Nov. 5, 2024.

Table 1. Univariate regression for the exchange rate movements

	(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)
Constant	-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

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.

Table 2. Multivariate regressions for exchange rate movements

	(1) Maximum depreciation during the 1st trading day	(2) Depreciation after 4 days	(3) Depreciation after 1 week	(4) Maximum depreciation during the 1st trading day	(5) Depreciation after 4 days	(6) Depreciation after 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	0.364	0.450	0.359
RMSE	0.871	0.619	1.054	0.951	0.598	1.110

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 balances with 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 order 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 A2 of Appendix A. Table 2 offers multiple insights. First, the evidence presented in Figure 1 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)[10] 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 EIU's Trump Risk Index,[11] 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).

Robustness checks. We conduct two main robustness checks about the effect of relative GDP per capita of countries *vis-à-vis* the US, 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.

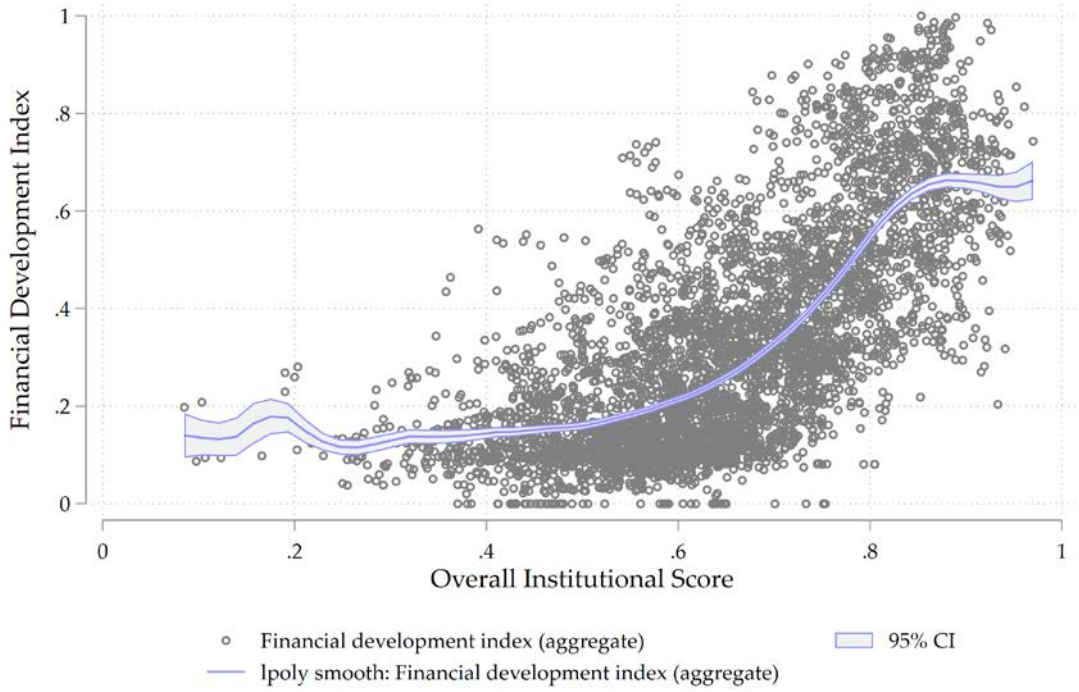
Relative income of countries *vis-à-vis* the US: The Balassa-Samuelson effect is traditionally a long run determinant of exchange rates (Bordo et al., 2017) important for developing economies (Hassan, 2016). Does it have a role in these short-run movements? When we add the relative income to the US, 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

[10] 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 conjecture that countries with fixed exchange rate regimes, before the event, are more likely to intervene on the currency markets during the event.
[11] This index is composed of three sub-components: 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.

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.

Figure 4. Institutional Development Precedes Financial Development



Source: authors' calculations. 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.

[12] We refer to these data on Exchange-traded derivatives statistics: https://data.bis.org/topics/XTD_DER/BIS,WS_XTD_DERIV,1.0/A.U.B.A.TO1.8A

These last results about liquidity are not surprising. In the Figure 5, 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 examples of countries that have weak institutions and, at the same time, developed financial markets accompanied by a liquid currency market.

5. Conclusion

This paper presents new evidence on the influence of institutional development and FX depreciation after the recent US presidential election. Using a broad cross-section of over 70 countries, we document statistically and economically significant estimates implying that better institutional scores are associated with stronger depreciation, reflecting the presumption of new orientation of US policies. Economic policies (currency interventions) and fundamentals (overvaluation and bilateral trade deficits with the US) influence the degree of exchange rate depreciation. Finally, the exposure to policy changes seems to be at play after 4 days. In the face of political instability, these results indicate that policymakers may limit the level of high-frequency currency movements by limiting the level of exchange rate misalignments and reducing trade imbalances.

[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.

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Appendix A

Table A1. 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

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

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.

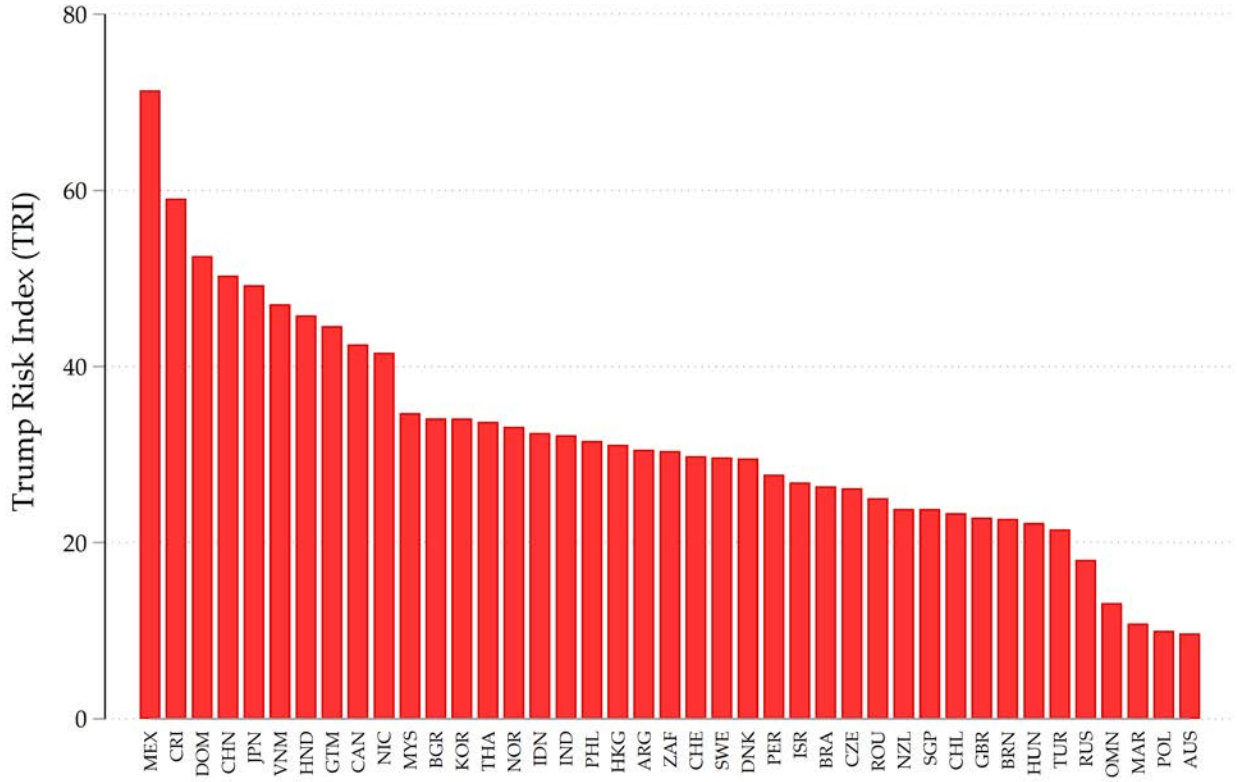
Number of countries, clarifications: We do not include the euro in the sample because the eurozone is composed of different sovereign countries. We have 73 currencies against the USD, but the sample is reduced to 64 in Table 1 because of the limited availability of institutional scores. There are 62 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 A2. 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 (15 minutes 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's database (Chinn and Ito, 2008), https://web.pdx.edu/~ito/Chinn-Ito_website.htm.
Exchange rate stability in 2020	Aizenman, Chinn and Ito's database (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 2014-2018, multiplied by 100, BRUEGEL, https://www.bruegel.org/.
Bilateral trade balance with the US in 2022	Bilateral trade balance with the US 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. In order to validate the empirical strategy, these explanatory variables have to be observed before the event, see Section 2.

Figure A1. 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.