Global Flight to Safety, Business Cycles, and the Dollar

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Focus of the paper

- The role of global flight to safety for the dynamics of the global economy and the dollar

- Two country DSGE model
  - Home (US) and Foreign (RoW)
  - Asymmetric modelling of household sector
    - Households in both countries can hold safe bonds, but only US bonds are traded internationally
    - Global flight to safety (GFS) shock: US and Foreign households both want to hold more US bonds
  - Rest of the economy is modelled fully symmetric

- Linear approximation of the model estimated with Bayesian methods

Main result

Figure 1: The Role of the GFS Shock in World GDP Growth
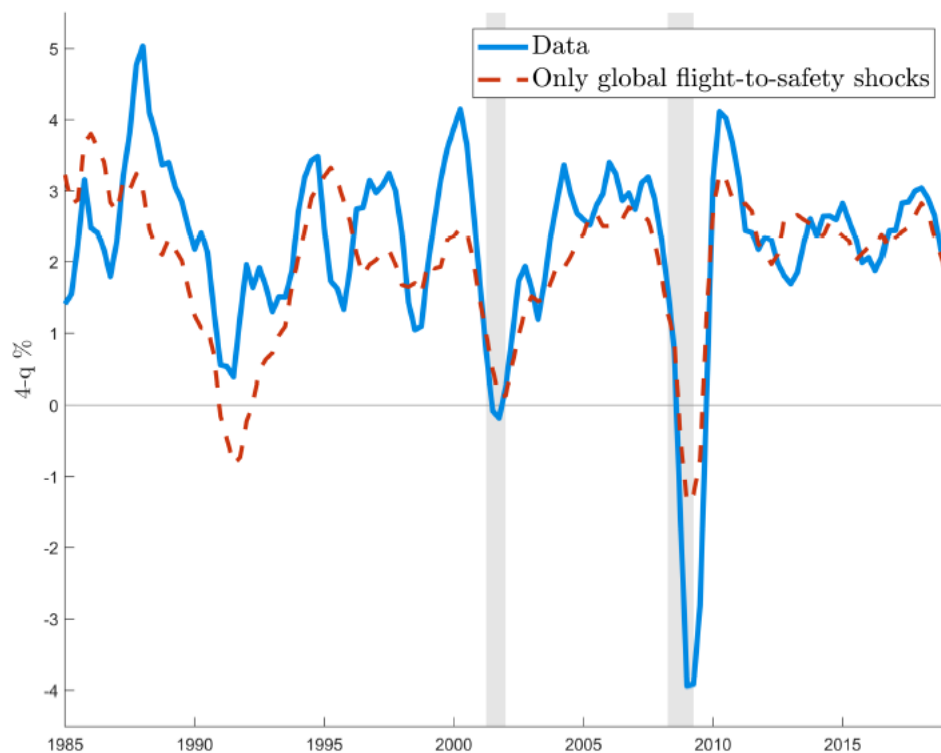
Comment 1: What is driving the results?

- GFS shock is the central driver of global GDP growth

- But what are the drivers of this result in the model?

- GFS shock enters the Euler equations

$$\hat{c}_t = c_1 \hat{c}_{t-1} + (1 - c_1)\mathbb{E}_t[\hat{c}_{t+1}] - c_2 \left(\hat{r}_t - \mathbb{E}_t[\pi_{t+1}] + \zeta_t^{RP} + \zeta_t^{GFS}\right)$$

$$\hat{c}_t^* = c_1 \hat{c}_{t-1}^* + (1 - c_1)\mathbb{E}_t[\hat{c}_{t+1}^*] - c_2 \left(\hat{r}_t^* - \mathbb{E}_t[\pi_{t+1}^*] + \zeta_t^{RP*} + \zeta_t^{GFS}\right)$$

$$c_2 \equiv (1 - b)/(1 + b)$$

- It would be useful to have a more detailed discussion of the model mechanisms that generate the result and of why the result makes sense

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# Comment 2: US MP is irrelevant for the foreign economy?

- Variance decomposition suggests that all US shocks, including MP, explain close to nothing of foreign macro-financial dynamics

Table 6: Variance Decomposition, Foreign Variables

	Global flight-to-safety	All U.S. shocks	UIP	Foreign home bias	Foreign risk premium	Foreign monetary	Foreign government	Foreign markup	Foreign inflation target
Foreign GDP growth	24.1	1.7	0	1.5	1.8	23.8	14.9	8.2	1
Foreign consumption growth	29.5	1.4	1.4	0.4	3.7	25.5	0.7	8.6	1.2
Foreign investment growth	29.4	3	2.7	0.4	0.1	15.9	0.2	6.7	0.5
Foreign spread	73.6	0.3	0.2	0	0.5	7	0.1	1.4	0.4
Foreign inflation	1.5	1.6	1.5	0.4	0	1.1	0	27.2	55.4
Foreign policy rate	13.7	0.5	0.2	0.2	0.1	14.9	0.2	5.4	57.6

Comment 2: US MP is irrelevant for the foreign economy?

- Global spillovers of US monetary policy are well established

- E.g., empirical evidence suggests that US monetary policy shocks have been main driver of secular trend in long-term bond yields globally
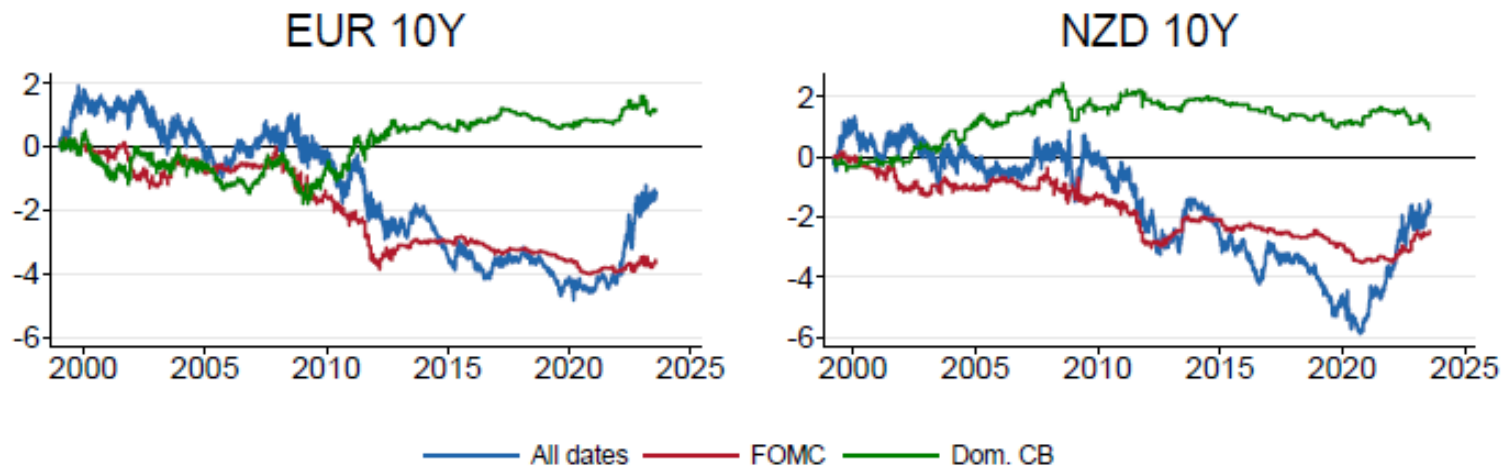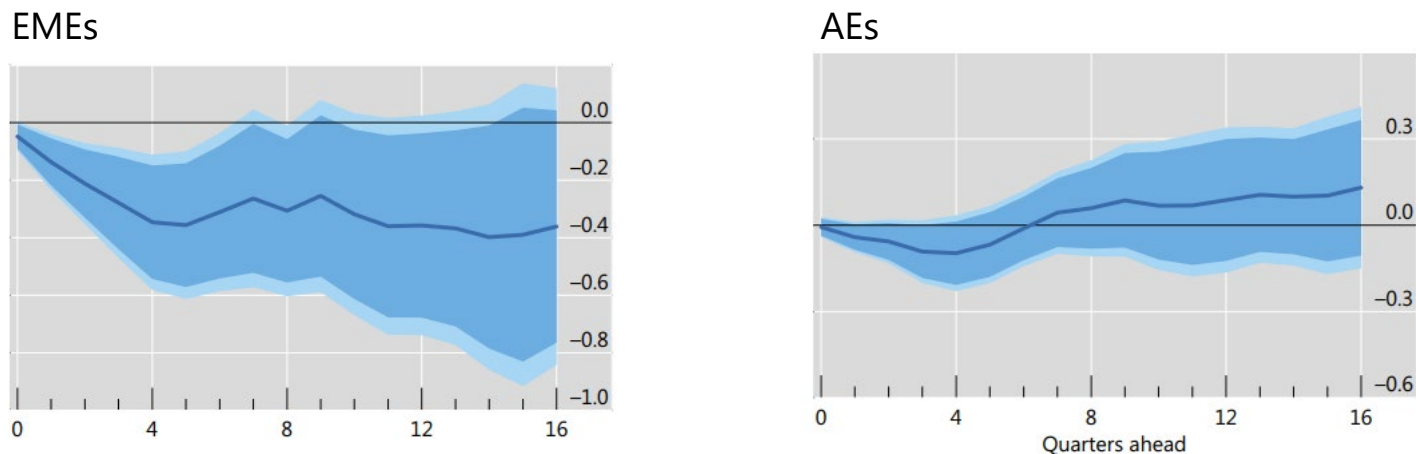

Source: Hofmann, Li and Wu (2025)

Comment 3: The foreign economy

- Foreign economy represents the RoW comprising advanced economies and emerging market economies

- But AEs and EMEs are impacted very differently by GFS shocks

Impact of US dollar appreciation shock

Source: Hofmann and Park (2020)

- EMEs: Financial channels of exchange rate matter for GFS shock propagation
  - Original sin: FX mismatch
  - Original sin redux: Borrowing in local currency from foreign investors
  - These channels could make the effects of GFS shocks even larger!

Comment 4: The dollar and global flight to safety

- GFS shock plays only moderate role in US dollar dynamics

Table 5: Variance Decomposition, U.S. Variables

	Global flight-to-safety	All foreign shocks	UIP	U.S. home bias	U.S. risk premium	U.S. monetary	U.S. government	U.S. markup	U.S. inflation target	Banking friction	U.S. Investment	U.S. TFP and labor supply
U.S. GDP growth	11.5	10.2	0	5.6	11.6	12.6	19.9	5.5	0.5	0.2	10.7	11.6
U.S. consumption growth	5.4	11.6	7	1.5	37.3	14	2	3.7	0.5	0	3.3	13.7
U.S. investment growth	0.5	4.4	6.7	0.9	1.2	3.6	0.2	6.3	0.1	1.3	72.8	2.4
U.S. spread	56.1	0.5	1.6	0.2	7.5	7.1	0.3	2.4	0.3	9.4	11.9	2
U.S. inflation	2.7	22	7.1	1.6	1.1	2.1	0.1	15	31	0.1	3.6	15.9
U.S. policy rate	14.1	1.5	0.9	0.9	8	13.8	0.6	9.2	39.5	0.1	1.8	12.1
U.S. hours	22.9	16.5	1.2	6.8	9.8	6.7	2.7	7.9	0.2	0.1	18.2	6.6
U.S. real exchange rate growth	8.6	26.5	37.3	8.3	3.5	7.9	0.3	4.1	0.4	0	1	2.4
U.S. import growth	1.1	2.9	1.9	54.4	0.9	3.2	0.5	5.9	0.1	0.5	26.3	2.7
U.S. export growth	11.5	54.3	18.7	4.5	2.3	3.5	0.2	2	0.2	0.1	1.2	1.4

- Obstfeld and Zhou (2022): "A direct indicator of low investor risk appetite, the excess bond premium (EBP) …. turns out to be the most reliably influential correlate of dollar movements in our estimates."

- How can we square this?

Thank you

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