Gauging the Safehavenness of Currencies

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Summary

This study assesses the 'safehavenness' of a number of currencies with a view to providing a better understanding of how capital flows tend to react to sharp increases in global risk aversion during periods of financial crisis. It focuses on how currencies are perceived by dollar-based international investors or, more specifically, whether they are seen as safe-haven or risky currencies. To assess the 'safehavenness' of a currency, we use a measure of risk reversal, which is the price difference between a call and a put option of a currency. This measures how disproportionately market participants are willing to pay to hedge against appreciation or depreciation of the currency. The relationship between the risk reversal of a currency and global risk aversion is estimated by means of both parametric and non-parametric regressions which allow us to capture the relationship in times of extreme adversity, i.e., tail risk. Our empirical results find that the Japanese yen and, to a lesser extent, the Hong Kong dollar are the only safe haven currencies under stressful conditions out of 34 currencies vis-à-vis the US dollar.