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Gravity in FX R-Squared: Understanding the Factor Structure in Exchange Rates

Hanno Lustig & Robert J. Richmond

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We relate the risk characteristics of currencies to measures of physical, cultural, and institutional distance. The currencies of countries which are more distant from other countries are more exposed to systematic currency risk. This is due to a gravity effect in the factor structure of bilateral exchange rates: When a currency appreciates against a basket of all other currencies, its bilateral exchange rate appreciates more against the currencies of distant countries. As a result, currencies of peripheral countries are more exposed to the systematic variation than currencies of central countries. Trade network centrality is the best predictor of a currency's average exposure to systematic risk.

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SlidesBackground materials on mediationImai, Kosuke, Dustin Tingley, and Teppei Yamamoto. (2013). "Experimental Designs...

A blue banner for a panel discussion. On the left, three circular headshots of the panelists: Oleg Itskhoki, Paul Krugman, and Linda Tesar. To the right of the photos, the text reads: "International Trade and Macroeconomics, Summer Institute 2025", "Panel on The Future of the Global Economy", "Oleg Itskhoki, Harvard University and NBER", "Paul Krugman, City University of New York and NBER", "Linda Tesar, University of Michigan and NBER", and "July 8, 2025".

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1050 Massachusetts Avenue

Cambridge, MA 02138

[617-868-3900](tel:617-868-3900)

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