

Macro Roundup Article

Headline: [Thoughts On The Crash](#)

Article Link: <https://www.grumpy-economist.com/p/thoughts-on-the-crash>

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Tweet: John Cochrane argues that the yen carry trade was not the cause of the August 5 stock market crash: "The most natural 'carry trade' is to borrow in Japan and invest in US short-term fixed income, not equities."

Summary: The stock market reaction is clearly way out of proportion to any of the alleged news events. One story being told is the unwinding of the "Japanese carry trade." Interest rates in Japan have been very low. So, investors borrow in yen (near 0%) to invest in dollars (5%), or dollar stocks (5% plus equity premium). That strategy makes a lot of money until the yen rises. Losers then sell their US stocks to repay the loans, pushing prices down more. Nice story. Does it hang together? This "currency carry trade" has been around for decades, produces steady returns from the lower interest rate in the borrowing country than the lending country, and ends with an occasional crash when the exchange rate moves. On a market level, the story has a few holes. Bonds are easier to use as collateral, and are less risky. You can harvest the 5% difference in interest rates with a lot less risk. So when the music stops, you'd expect investors to be selling US bonds at least as well as stocks, not to rotate from US stocks to bonds.

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