CENTRE FOR MACROECONOMICS

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Dash for Dollars

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During the outbreak of the Covid-19 pandemic in early 2020, global corporate bond markets were under severe distress. As investors rushed to sell securities to meet sudden liquidity demands and to build cash buffers, corporate bond spreads widened dramatically, at a pace that was unseen since the 2007-08 Global Financial Crisis.

A defining -- but overlooked -- feature of the stress period was the divergent increase in spreads across bonds denominated in US dollars versus bonds denominated in other currencies: as the pandemic accelerated in early March, spreads of dollar bonds rose significantly faster than the spreads of non-dollar bonds. In this paper, we ask whether investors' sell-off of corporate bonds was more severe for dollar-denominated bonds and, if so, what are the reasons that can explain this pattern.

Relying on *within-firm* variation in bond spreads, to avoid selection issues, we show that US dollar-denominated bonds experienced a larger increase in spreads than bonds denominated in other currencies when the Covid-19 turmoil intensified. Our interpretation of this finding is that dollar bonds were disproportionately affected by selling pressures as investors "dashed for dollars". We confirm our interpretation by exploiting *transaction-level* data for a subset of investors: we show that selling volumes at the time were indeed larger for USD-denominated bonds. Moreover, we show that this behaviour was more marked for investors with large dollar-denominated liabilities.

These findings align with our hypothesis that the dominant role of the US dollar in the international monetary and financial system – and, in particular, its undisputed role as a funding currency – was driving the selling pressure which triggered the pronounced fall in dollar bond prices during the Covid-19 market stress.

Our empirical results and proposed interpretation have useful implications for policymakers and investors. As financial and real liabilities are widely denominated in US dollars, investors may choose to liquidate dollar-denominated assets in stress periods to obtain dollar cash. The yield spikes induced by this selling pressure, if unarrested, may ultimately limit the ability of firms to issue or roll-over dollar-denominated debt. To avoid such an adverse scenario, our findings emphasize the crucial role of Federal Reserve dollar swap lines as a policy tool. By reducing dollar funding strains, swap lines can effectively mitigate the severity of selling pressures in dollar-denominated securities.