Technology Diffusion and Currency Carry Trades *

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This version: January 18, 2016

ABSTRACT

The paper identifies a unique dimension of currency carry trades that it is related to the intensity of technology transition across countries. Particularly, I show that technology diffusion is a fundamental determinant of currency premia. Technology spillovers are measured based on the R&D embedded in intermediate goods as well as the inflows of foreign direct investment (FDI) that are associated with domestic patents owned by foreign investors. Intuitively, carry traders require a risk premium for financing risky innovation in countries with *high* patent related FDI inflows. Similarly, a positive risk premium is obtained from countries with *high* concentration of technology transition as investment currencies are subject to the R&D of the funding countries.

Keywords: Technology Adaption, Comparative Advantage, Currency Risk premium.

JEL Classification: F31; G11; O32; O34.

* **Acknowledgements**: I thank Arie Gozluklu, Rong Leng, Dong Lou, Michael Moore, Vikram Nanda, Alessandro Palandri, Gordon Phillips, Vikas Raman, Mark P. Taylor, John Thanassoulis and Onur Tosun as well as seminar participants at the WBS brown bag Finance series for very useful comments. I would also like to thank the Economic and Social Research Council (ESRC) as well as the Warwick Business School for the financial support.

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