Box 1: Characterization of recent Carry-Trade Strategy Indicators for Main Investment Currencies in Latin America - Financial Markets Report, First Quarter of 2026

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Carry trade is an investment strategy whose returns depend on the interest rate differential between two jurisdictions and on the evolution of their exchange rates. It consists of borrowing in a currency with low interest rates (funding currency) to invest in assets denominated in another currency offering higher returns (investment currency). Its return is mainly determined by i) the interest rate differential, insofar as the income generated by the assets exceeds the financing cost, and ii) exchange rate dynamics, given that a depreciation of the investment currency against the funding currency may reduce or even reverse the gains.

These strategies are highly sensitive to episodes of increased global risk aversion, during which their returns may deteriorate abruptly. In such scenarios, investors tend to unwind positions in higher-risk assets, including those associated with carry trades, which results in capital outflows from investment currencies and depreciation pressures on these currencies. This performance often coincides with increases in financial volatility indicators, such as the VIX.

The returns of these strategies exhibit pronounced asymmetry: gains tend to accumulate gradually, whereas losses, when they materialize, are abrupt and larger in magnitude, a phenomenon summarized by the expression “exchange rates go up by the stairs and down by the elevator” (Brunnermeier et al., 2008). In this context, carry trade is exposed to crash risk insofar as wider interest rate differentials tend to attract speculative positions but also imply a greater likelihood of abrupt depreciations in investment currencies. When risk aversion increases, the simultaneous unwinding of these positions amplifies exchange rate movements.

Fuente: https://www.banrep.gov.co/en/publications-research/financial-markets-report/box-1-first-quarter-2026