

# Trade Intensity as Return Predictor

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## **Abstract**

We show that trade intensity across two countries is a good predictor for future returns. Future supplier-country returns are predicted by the combination of the trade intensity with the customer-country, alongside the realized returns of the customer country.

# 1 Introduction

This paper contributes to the literature on information diffusion and propagation of the economic shocks via trade network. Network of trade links can transmit relevant economic information (Acemoglu, Carvalho, Ozdaglar, and Tahbaz-Salehi (2012)). Menzly and Ozbas (2010) also show that information gradually diffuses along the supply chain. This notion can be applied in an international market sense.

Specifically, we investigate whether cross-country trade linkages allow for fundamental information diffusion. Lagged returns of customer countries can predict the future returns of the focal countries, beyond the predictive power of lagged focal country's return. A one standard deviation increase in customer countries realized return is associated with a 0.2 standard deviation increase in supplier country return.

Our paper is related to studies showing how economic information travels through production networks. Gofman, Segal, and Wu (2020) show that upstream firms have higher returns. Ahern (2013) shows

that central industries command a higher premium.

## **2 Conclusion**

Our results support the idea that information slowly upstream diffuses via global trade.

## References

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