Comments on

'How Do Exchange Rate Regimes Affect Firms' Incentives to Hedge Exchange Rate Risk?'

by Herman Kamil

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Nice paper on an interesting question with important policy implications for the de-dollarization debate.

Research question

Do flexible exchange rate regimes imply that firms match better the currency composition of their income and liabilities?

Firm-level data

"*One element surprisingly lacking in the study of currency mismatches, since these mismatches are ultimately generated at the micro level, is firm level data with which to examine the phenomenon.*" (IDB, 2004)

Unique dataset (cross-country balance sheet and income information on firms' currency exposure); 7 Latin American countries (Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Uruguay); 2200 non-financial firms; 1992-2005.

1. Comment: How much in % of GDP account these firms for?

Results

Liability dollarization during fixed exchange rates: ranges from 7% (Colombia) to 86% (Uruguay).

Liability dollarization during flexible exchange rates: ranges from 4% (Colombia) to 60% (Peru).

Coverage ratio during fixed exchange rates: 50% (Chile) to 10% (Peru).

Coverage ratio during flexible exchange rates: 160% (Mexico) to 40% (Peru).

$\Rightarrow$ Firms borrow smaller proportion of dollar debt in flexible exchange rate regimes.

$\Rightarrow$ Match between currency composition of income and liabilities is better in flexible exchange rate regimes.

Econometric methodologies: pooled panel regression, event study, quantile panel regressions.

Results confirm statistical significance of the fact that currency match better in floating regimes, after controlling for firm-, country-, and year-specific factors and several robustness checks.

2. Comment: Concentrate only on pooled and quantile panel regressions.

Omitted variables?

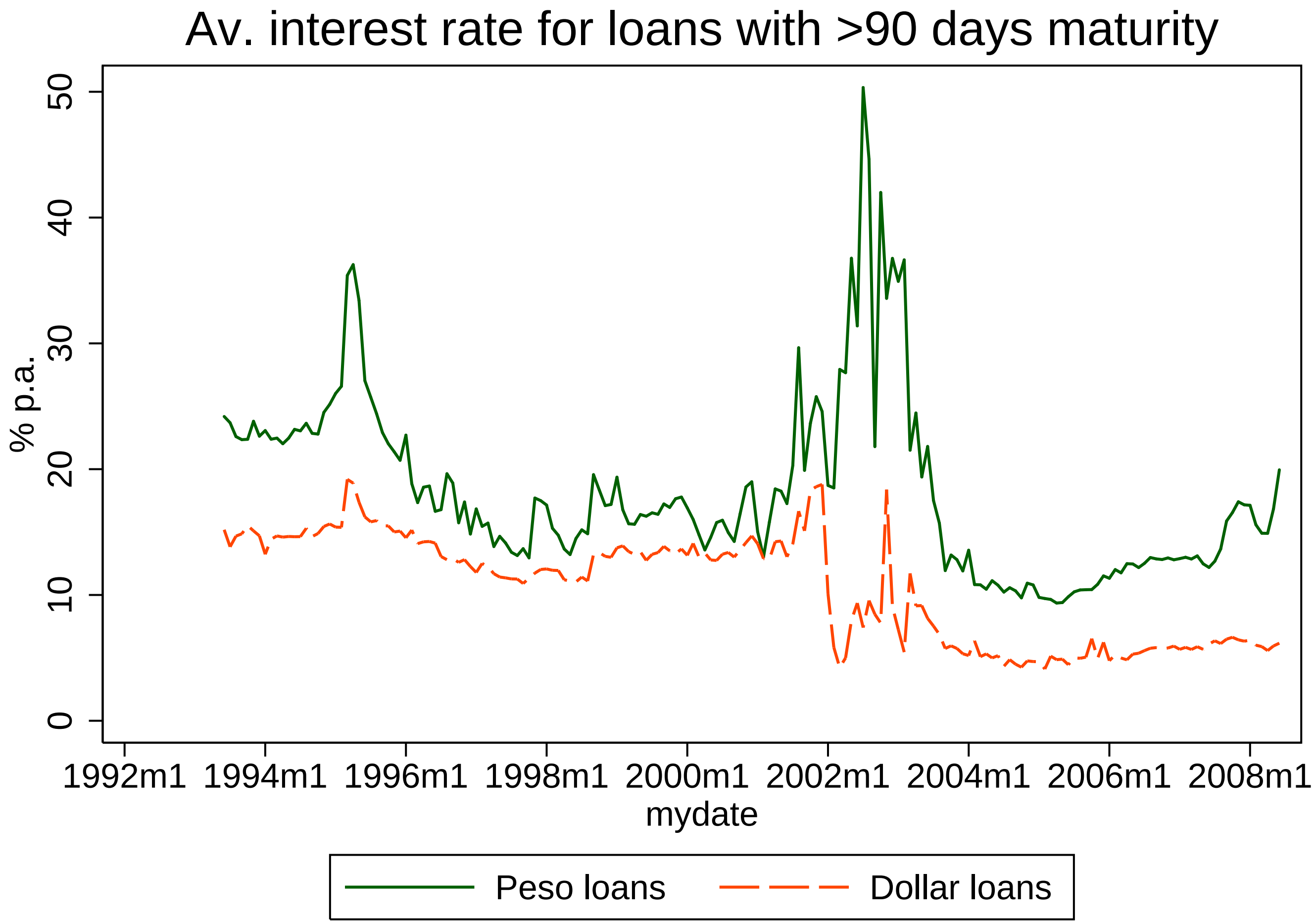
Why do firms borrow in dollars?

Because firm is an exporter.

Domestic funds are not available. External funds usually in dollars (original sin).

Domestic banks unwilling to lend in pesos at reasonable prices, because savers unwilling to deposit in pesos (domestic liability dollarization).

When this is coupled with the authorities' commitment to a fixed exchange rate and the allowance of the authorities to lend in dollars, all firms' will borrow in dollars in anticipation of a large bail-out program in the case of an unanticipated devaluation (moral hazard).



Av. interest rate for loans with >90 days maturity
% p.a.
0
10
20
30
40
50
1992m1
1994m1
1996m1
1998m1
2000m1
2002m1
2004m1
2006m1
2008m1
mydate
Peso loans
Dollar loans

I'm not sure whether the decrease in dollar borrowing, or in firms' currency mismatch, can be fully accounted for by firms' behavior.

Rather, I think that, similarly, changes in banks'/creditors' behavior and/or *bank regulation* implied that banks/creditors care more about the credit risk arising from currency mismatches of borrowers ('implicit currency risk').

Evidence: Financial crises in Latin America have given rise to changes in bank regulation, as it became apparent that dollar debt in the non-tradable goods sector was a key factor of banks' financial vulnerability.

Bazerque, Mailhos, Sander, and Vallcorba (2008)

$\Rightarrow$ Argentina, Colombia, Peru, and Uruguay introduced measures that limit banks' capacity/willingness to lend in foreign currency.

3. Comment: Control for changes in bank regulation.
If possible, also for foreign ownership, foreign currency assets, leverage, or macroeconomic conditions (interest rate differential).

Thank you for your attention.