



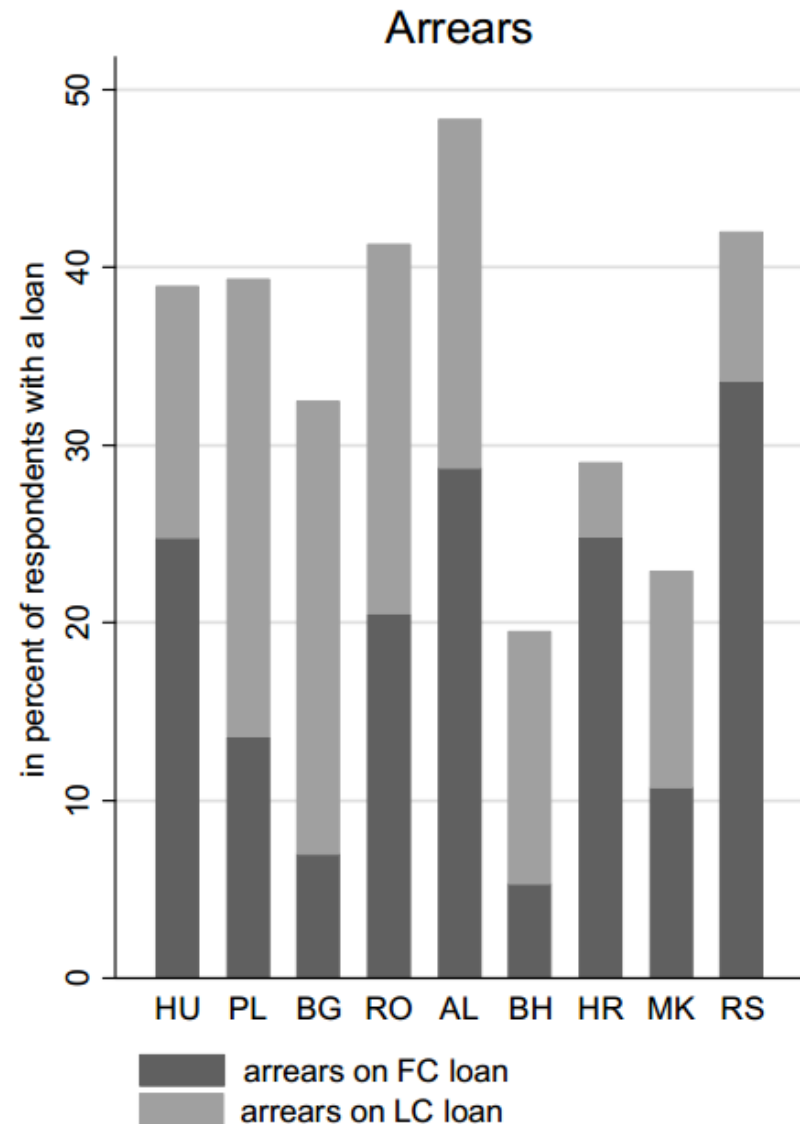
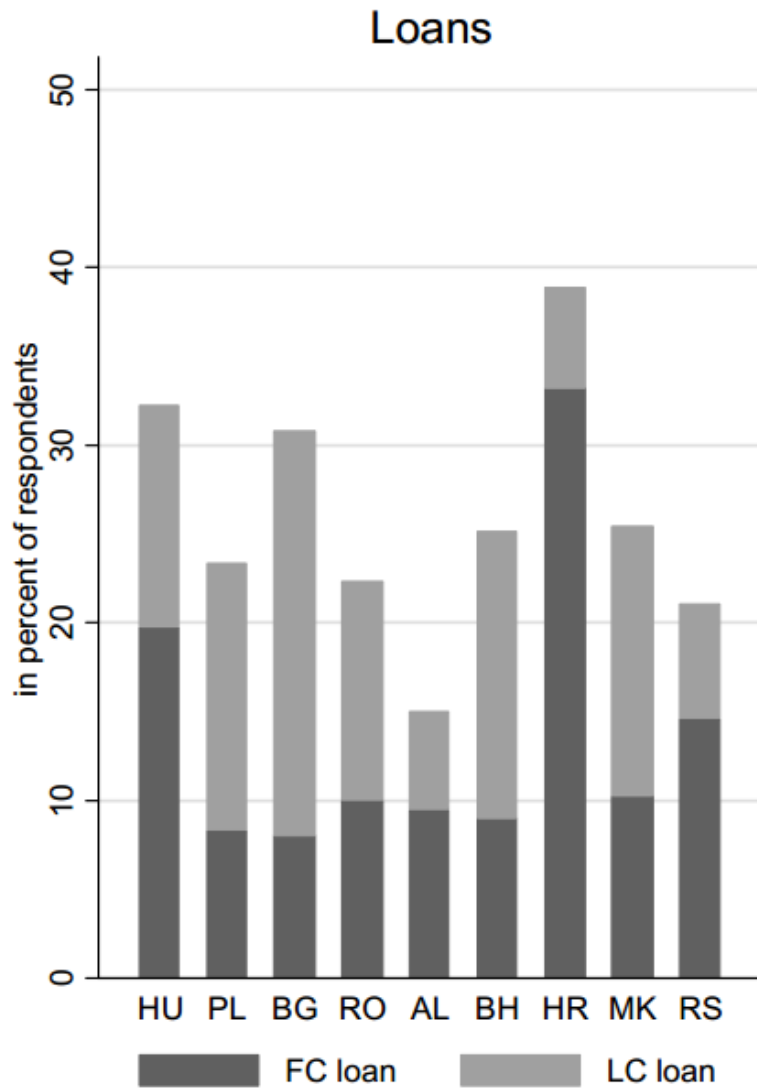
Foreign Currency Borrowing and Knowledge about Exchange Rate Risk

Discussion by Martin Brown
Swiss National Bank Workshop, November 2014

Research question, Methodology & Findings

- Is FX borrowing by households in South-East Europe driven by a lack of knowledge about exchange rate risk ?
- Relate household-level survey data on preferences for foreign currency loans to a new measure of exchange rate literacy
 - OenB Euro-Survey: 13'700 households in 8 countries in 2011/2013
- Find that exchange rate literate households are less likely to prefer FX loans ... especially if they expect a depreciation of the local currency

We want to understand why households take risky loans



Policy makers need to know whether literacy matters

ft.com > world > Sign in

Europe

Home World Companies ▾ Markets ▾ Global Economy ▾ Lex ▾
Africa Asia-Pacific ▾ Europe ▾ Latin America & Caribbean ▾ Middle East & North Africa ▾ UK ▾ U

July 4, 2014 1:42 pm

Hungary acts on foreign-exchange loans

By Kester Eddy in Budapest



Hungary's parliament passed a law on Friday that will force banks to compensate borrowers for what the government says were "unfair" conditions applied to mostly foreign-exchange denominated loans issued in the years up to the financial crisis.

The same day, shares in [Erste Group](#), the Austrian bank, fell as much as 15 per cent after it warned it would make losses of up to €1.6bn this year, partly because of the [foreign-exchange loans](#) made to Hungarian households.

The contribution of this paper

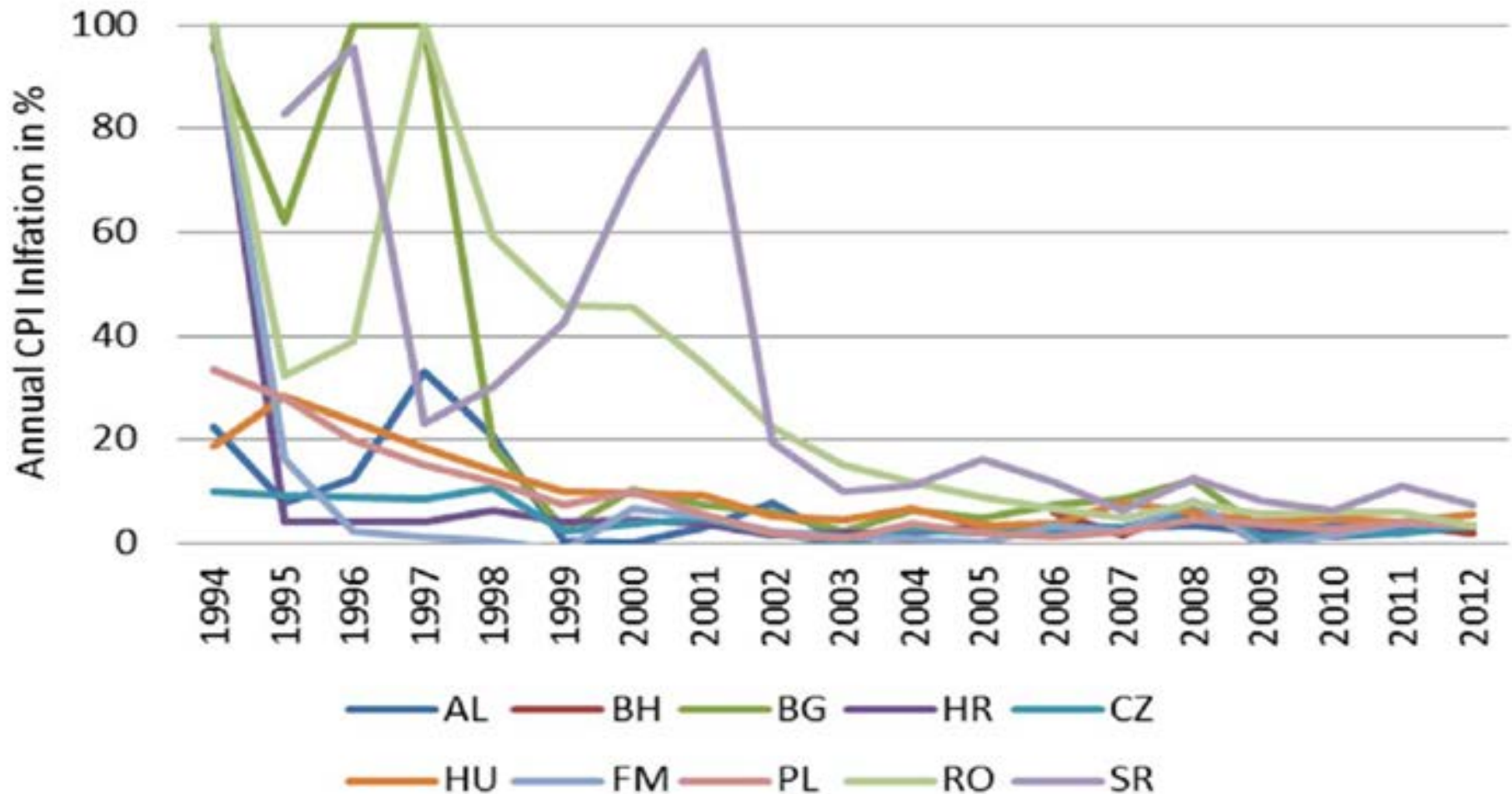
- First paper to document the degree of exchange rate literacy among households across Eastern Europe
- First paper to relate exchange rate literacy and individual exchange rate expectations to FX borrowing

..... and from the broader perspective of loan contract choice and household risk management

- First paper to document the interaction of financial literacy and monetary expectations on household choice of (risky) debt contracts

Comment 1: Exchange rate & Inflation literacy

- Expand the analysis of the relation between crisis experience, exchange rate literacy and inflation literacy



Comment 2: Characterize FX borrowers

- Households which understand FX risk and expect a depreciation are (much) less likely to demand FX loans

..... is this sufficiently informative for policy makers ?

- What share of FX borrowers are clueless about FX risk ?
- What share of FX borrowers understand FX risk
 - .. but are (over-) confident about the local currency
- What share of FX borrowers understand FX risk and don't trust the local currency
 - but are willing to take the bet because of low leverage
 - ... or high risk tolerance

Comment 3: Household risk management

- Numerous papers study household mortgage choice from the viewpoint of household risk management

e.g. Amromin et al. 2013; Ehrmann & Ziegelmeier 2014

- Individual monetary expectations (and knowledge about their impact on loan installments) play a key role in theory
... but i've not seen an empirical paper which can relate loan contract choice to individual expectations and literacy
- You have the potential for a more general contribution
 - but you would also need to discuss the interest rate risk attached to LC vs. FX loans...

Other comments

- Present bias vs. Financial literacy
- What about loan type and purpose ?
- Replicate the results using actual use of FX loans
- Do you need a selection model ?