Comments on:

Firm Dollar Debt and Central Bank Dollar Reserves: A Case of Moral Hazard
by Rajeswari Sengupta

6th NIPFP-DEA Conference
March, 2010

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*The views expressed herein are those of the authors and should not be attributed to the IMF, its Executive Board, or its management.
Paper in a Nutshell

- Relatively novel dataset (from the IADB) on nonfinancial firms’ FX exposure
- Controls for firm specific and macro factors
- Author finds that hoarding of reserves encourages firms to borrow in FX (note the causality)
Where does this paper fit?

- Paper contributes to important strands international finance:

- Fear of Floating (why do central banks smooth exchange rate volatility?)

- Why do firms borrow in FX?
  
  - Corporate finance considerations aside, how are borrowing decisions affected by the exchange rate regime (FX volatility, central bank reserves, etc.)
  
  - Two Views:
    
    - Moral hazard
    
    - Incomplete markets (hedging instruments)
Detour and back to paper findings

- Moral hazard view:
  - CB’s FX intervention => low FX volatility (signal of government guarantee) => increased FX borrowing by firms
  - Recall the causality!

- Incomplete markets view:
  - Limited hedging opportunities => some firms (large corporates in emerging markets) will borrow too much in FX
    - How much is too much? Don’t know, but FX borrowing (unhedged FX exposure) should not depend on FX volatility

- Paper finds evidence in favor of Moral Hazard View
More on the Paper

- Cleverly applies pooled Tobit (censored) to address large fraction of firms with zero dollar debt
- Controls for firm-specific and macro factors (more on this soon)

\[
FX \text{ debt/ total debt } = F \left( res/GDP, FX \text{ vol}, \text{ firm\_size}, \text{ export sales}, \ldots \right)
\]

- Author finds that coefficient on res/GDP (or res/M2) is positive and coefficient on FX volatility is negative
- Paper shows that findings are robust (but how robust would the findings be to different measures of FX exposure? )
Unresolved Issues/Questions

- Given that degree of market completeness changed tremendously (exogenously?), how can one be sure about causality?
  - Could the author zoom in and focus on a country with limited or no change in availability of hedging instruments?
  - I read footnote 14 on lagged regressors: is it enough to address endogeneity?

- What to make of the magnitude of the coefficients?
  - Why is the coefficient on FX volatility small (or is it?)
  - Why is the coefficient on $r - r^*$ small and insignificant in the case of net debt/debt?
  - Why is the effect of reserves not significant for Brazil? (How significant were the changes in the availability of hedging instruments?)

- Could the author look at alternative measures of FX exposure to assess the robustness of the results?
More Issues and Policy implications

- What are the implications for FX intervention policy? Are central banks accumulating too much reserves?
- => Paper seems to suggest yes, CB does not internalize cost of “excessive” borrowing
- But then Reserves have shielded some countries from the worst of the recent crisis...
- Should the paper focus more on FX volatility?
  - After all some countries (including two countries in the sample) have had reserve accumulation programs while allowing the exchange rate to “float”
Concluding Remarks

- Nice paper: interesting question, clever use of technique, good data set, interesting results
- As with any good paper: interesting questions remain unanswered
- Policy implications are less clear (but to be fair not the objective of the paper!)