Comments on Foreign Currency Borrowing and Knowledge About Exchange Risk

Elisabeth Beckmann and Helmut Stix

Fernando N. de Oliveira
Central Bank of Brazil
XII Emerging Markets Workshop
Finland December 2014

What the Paper Does

- Study whether the demand for foreign currency loans is driven from lack of knowledge about the exchange rate risk emanating from such loans
- Employ household micro data from eight central and eastern european countries with information about knowledge of exchange rate risk
- Uses Heckman (1979) sample selection model

Main Results

- Majority of respondents are aware that depreciations incrase loan installments
- Exchange rate risk exerts a strong impact on he choice of loan currency

Data

- Household survey of eight Central European Countries
  - Bosnia, Herzergovina, Bulgaria, Croatia, Hungary, Poland, Romania, Servia and Former Yugoslavia, Macedonia
- Financial decisions and economic expectations of households
- Borrowing
  - Existence of loan
  - Loans plans
  - Currency composition
  - Attractiveness of foreign currency loans vis-a-vis local currency loans

Contribution of the Paper

- Provides evidence for eight different countries of foreign exchange risk and compares it with other measures of financial literacy
- Assess whether the demand for foreign exchange currency loan is casually driven by lack of knowledge of exchange rate risk
- Uses a comprehensive household level information on monetary and financial expectations

General Comments, Suggestions and Questions

- Nice paper
- Well written
- Clear contributions
- Original database
- Sound Econometrics

General Comments, Suggestions and Questions

- Brazil
  - Foreign exchange loans of individuals is ilegal
- However firms can take them
  - And they demand it very often
    - Demand has been increasing throughout time
    - All sectors of the economy
    - Nowadays, some firms are using foreign subsidiaries to take the loans
      - This may become a problem for the Central Bank of Brazil in the near future

General Comments, Suggestions and Questions

- Firms hedge (or speculate) foreign exchange risk
  - Foreign exchange swaps
  - Future Contracts
- Oliveira and Novaes (2007)
  - Information of foreign exchange swaps between 1999 and 2002
  - Hedging was done mainly by firms with foreign exchange debt
  - Speculation was done by commodity firms

General Comments, Suggestions and Questions

- Now concerning Beckmann and Stix paper and with the experience of Brazil in mind some questions come to my mind
  - Can individuals in some of these countries use derivatives to hedge (or even speculate) with these non domestic loans?
    - One of your control variables is earnings received in euros
      - Does this work as a natural hedge?

General Comments, Suggestions and Questions

- It seems to me that the survey questions do not address the possibility of hedging
- Is there a market for foreign exchange derivatives in these countries?
  - If not, why has it not developped yet?
    - With all these foreign exchange denominated loans it should be natural for this market to become very important

General Comments, Suggestions and Questions

- Are individuals in these countries able to choose the currencies that they are taking the loans?
  - OK, I understand that you control for a country fixed effects
    - But maybe you could do as a robustness tests an empirical analysis for each country to see what will happen

General Comments, Suggestions and Questions

- You state that some countries create more diffiulties than others for individuals to take these loans
  - I wonder what kind of dificulties would these be
  - How do you treat this fact in your empirical analysis?
    - Controlling for a country fixed effects is enough?

General Comments, Suggestions and Questions

- Maybe you could comment on the policy implications of your results
  - As Central Bankers we are very much interested in these implications for
    - Monetary policy
    - Financial system stability

General Comments, Suggestions and Questions

- Minor final comments
  - You should discuss more your database on your data section
  - You do not need to put the error (u) in your model
    - There are better ways to write down your model
  - I think you should discuss a little bit more about the survey
    - In particular, possible biases in the answers

Thank You!