“Firms’ Debt: Currency Choice and Exchange Rate Pass-Through” by Anna Burova (BoR), Konstantin Egorov (NES), and Dmitry Mukhin (U Wisconsin)

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NES and Bank of Russia Workshop on Financial Dollarization

24 February 2021

Paper

- Theory: fraction of FC debt is positively related to
  - the interest differential between FC and HC debt
  - correlation between operating profits and the exchange rate
- Evidence:
  - Firms that borrow in FC tend to have a positive and statistically significant correlation between profits and the exchange rate.
  - For firms with no FC-denominated debt this correlation is not statistically significant and quantitatively small.

Comments

- The exchange rate pass-through to profits as captured by the slope coefficient on exchange rate β is assumed to be uniform across firms, which might be a too strong restriction:

$$\pi_{it} = \alpha_i + \beta \Delta e_t + \ldots + \varepsilon_{it}$$

- Think of two firms, one with 90% of its revenues coming from export sales, and the other with only 10%.
- Empirical counterpart of π in the model: operating profits or EBIT?

Comments (cont.)

- Is non-bank debt denominated in FC accounted for?
- The share of bank debt denominated in FC in liabilities might reflect binding constraints imposed on banks by prudential regulation rather than firm's optimal choice of currency composition of debt.
- Namely, banks are required to assign higher risk weights to loans granted to borrowers with insufficient share of FC revenues in total sales.

Comments (cont.)

A more direct way to test the prediction of the model might be the following:

- Allow for firm-specific slope coefficient on the exchange rate – β_i instead of β.
- Use the *overall* (syndicated loans from foreign banks, FC-denominated bonds) – rather than bank debt only – share of FC-denominated debt in liabilities as the dependent variable or, alternatively, a dummy for non-zero share of FC-denominated debt in liabilities.
- Run OLS (logit/probit) of the share of FC-denominated debt in liabilities (the FC-denominated debt dummy) on firm-specific betas from the pass-through regressions and Home-Foreign interest rate differential.