The Dominant Currency Financing Channel of External Adjustment

Casas, Meleshchuk and Timmer

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Summary of Paper

Big picture: How do exchange rate shocks affect output?

- Literature proposes different mechanisms: (i) expenditure switching, (ii) real income, and (iii) balance sheet channel.
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Big picture: How do exchange rate shocks affect **trade through firms**?

- Literature proposes different mechanisms: (i) expenditure switching, (ii) real income, and (iii) balance sheet channel.
- Most papers are theoretical. Empirical identification is tricky!
- This paper provides **empirical test of the balance sheet channel.**
- It proposes the 2014-15 Colombian peso depreciation as a pseudo-natural experiment.
- Main hypothesis: firms with a larger share of foreign denominated debt experience a larger decline in production.
- It exploits the maturity structure of foreign debt to overcome endogeneity of currency choice.

Main Specification & Findings

$$ln\,(1 + Y_{ft}) = \beta\, x\, FCE_f\, x\, Post_t + controls_{ft} + \epsilon_{ft}\,,$$

where $Post_t = 1$ if $t > 2014Q3$ and FCE_f stands for

1. FCL_{ft}: outstanding amount of debt in foreign currency as a share of assets in 2014 Q1.
2. $LS_{ft,t'}$: change in repayment value of foreign denominated debt that is due before t' as a share of assets.
3. $WS_{ft,t'}$: change in repayment value of all foreign denominated debt as a share of assets.

- Main result: $\beta < 0$ only for imports.
- Results driven by non-exporters $\rightarrow$ exporting as a natural hedge.
- Dynamic version of regression: effect accumulates over time.
- Rest of paper: robustness and further evidence of financial frictions.

Some Remarks

Great paper: very important question, detailed data & smart identification strategy.

Summary of my comments

1. Unclear what the liquidity shock truly captures.
   - Timing and role of expectations.
2. This is a paper about foreign currency financing.
   - The emphasis on dominant currency is unnecessary.
3. Other minor comments.

Comment I: Constructing the Liquidity Shock

$$LS_{ft,t'} = \frac{\sum_{i \in \Lambda^F_{f,t}} 1_{T(i) \leq t'} \, L_i \, \Delta e_{t,T(i)}}{A_{ft}},$$

where $t = 2014q1$ and $t' = 2015q3$.

- Shock is interacted with $Post_t \rightarrow$ change in value only starting in 2014q3.
- Arbitrary choice of t': Colombian peso keeps depreciating until 2016q1.
- Is perfect foresight a good assumption? What about heterogeneity of expectations?

Comment II: why frame it as a DCP paper?

- This is a paper about **foreign** currency financing.
- No need for DCP in the model.
  - In fact, model does not feature nominal rigidities.
  - Real exchange rate shocks also generate the balance sheet effect.
- In the data, US is by far Colombia largest trading partner.
  - In the aggregate, closer to LCP for imports, PCP for exports.
- DCP weakens exporting as a natural hedge.
  - Depreciation leads to a negligible impact on export quantity.

Other minor comments

- Foreign currency borrowing is overall small in Colombia (Table 2).
  - Results driven by few very large firms?
  - Positive correlation between LS and firm size (Table 3).
- What share of total imports do imported intermediate inputs represent?
- Preferred placebo test: use share of imported intermediate inputs as dependent variable.
- Is there evidence that firms with higher shares of exports contract less? Potential to exploit the intensive margin too.
- In Figure 2, 2014q1 is significantly different than zero while 2014q3 and q4 are not.
- Quantification exercise is purely speculative.