Discussion on ”Signaling with Debt Currency Choice” by Egen, Malamud, and Zhou

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Currency of debt is important

Currency in which firms borrow has important implications for:

- Response to exchange rates shock; Aguiar (2005), Kim et al. (2015)
- Passthrough of monetary policy;
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1. UIP deviations. Salomao & Varela (2022), Bruno & Shin (2017)
2. Currency matching. Alfaro, Calani & Varela (2023)
3. Access to financial markets. Eichengreen & Hausmann (1999), Caballero & Krishnamurthy (2001)

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4. Signaling quality.

The Paper

Using data on emerging countries, document three empirical facts:

1. Costlier to issue debt in foreign currency.
2. $Cov\,(\text{Debt in FC, Firm quality}) > 0$
3. Covariance is still positive for firms in nontradable sector.

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What is the cost of debt?:

- Currency of debt matters for hedging against downturns.
- FC debt is a worse hedge against economic downturns.
- Therefore, FC debt is costlier in this dimension.

Model: borrowing in FC as signaling

- Firm quality is private information.
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Empirics

$$\frac{\text{EBIT}_{i,t+1}}{\text{Assets}_{i,t+1}} = \delta \text{FC share}_{i,t} + \beta X_{i,t} + \alpha_i + \lambda_{c,s,t} + \varepsilon_{i,t+1}$$

- Include country-industry-time FE.
- Firm controls: Ebit-to-assets ratio, market value, stock return, firm FE, ...
- Model prediction: $\delta > 0$.

Empirical results are consistent with signaling hypothesis

Table 3: Signaling channel of foreign-currency debt (levels): Full panel

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
				nontradable	domestic	domestic and pos. fc	
VARIABLES	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	$\frac{EBIT_{f,t+1}}{Asset_{f,t+1}}$ (%)	log(capex)$_{f,t+1}$
foreign currency share$_{f,t}$ (%)	0.006***			0.010***	0.006***	0.004*	0.0004
	(0.002)			(0.003)	(0.002)	(0.002)	(0.0002)
hard currency share$_{f,t}$ (%)		0.007***					
		(0.002)					
fc share$_{f,t}$ (bank loan, %)			0.004**				
			(0.002)				
EBIT$_{f,t}$ / Asset$_{f,t}$ (%)	0.373***	0.373***	0.374***	0.350***	0.379***	0.314***	0.0203***
	(0.014)	(0.014)	(0.015)	(0.028)	(0.014)	(0.017)	(0.0018)

- Coefficient is between 0.004 and 0.01.

Alternative model: heterogeneous access to foreign lenders

- Firms differ in their ability to borrow from foreign lenders.
- Firms borrow from multiple lenders.
- Probability of finding a foreign lender increases with size and quality.
    - Fixed costs, interest to the lender, ...

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- There are UIP deviations that make borrowing in FC cheaper.
  - For most of the countries in the sample, cheaper to borrow in USD on average.
- Only top managers are aware of these differences or know how to use hedging strategies.
- Top managers are matched with high productivity firms.

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Alternative model: supply side

- Households want to make deposits in FC for hedging reasons.

  Christiano, Dalgic, and Nurbekyan (2022)

- Banks want to create assets in FC to solve currency mismatch.

- Firms want to borrow in HC for hedging reasons.

- This implies that borrowing in HC is too expensive due to shortage of HC funds.

- High-quality firms take advantage and borrow more in FC from foreign lenders.

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Main challenge

No direct test of the hypothesis.

- Covariances are consistent with the signaling model.
- But they are also consistent with a number of other models.

How to address this?

- Need a shock to information availability.
  - Adoption of IFRS standards;
  - Financial liberalization and entry of foreign lenders...
- Analysis conducted within lender type: foreign vs. local.

Concluding thoughts

- Interesting and thought-provoking paper on an important issue.

- Proposes a new explanation for an old fact.

- Can still refine the empirical test of the hypothesis.