Devaluations, Deposit Dollarization, and Household Heterogeneity

Ferrante & Gornemann (2024)

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Brief recap

Depreciation of local currency

- Currency mismatch causes:
  - Erosion of banks' net worth that depresses credit supply and economic activity.
- Larger currency hedging by wealthier households:
  - Deepens the recession, magnifying the negative spillovers for poorer agents.
- FX intervention in depreciation:
  - Welfare gains if large financial dollarization.

Novelties

Depreciation and FX deposits

- Leveraged constrained banks:
  - Endogenous spread (saving - borrowing rates).
  - Borrowing channel.
- Heterogenous households:
  - Real income declines.
  - Labor income channel.
- Foreign currency deposits held by wealthier households:
  - Impact adversely on poorer households (with no exposure to FX risk).
  - Amplify output cost of a depreciation.

Comments on assumptions

Need to expand(?)

- Elegant sequential building of model:
  - Standard assumptions + novel ingredients.
  - Captures sytlized facts of emerging markets.
- Firms borrowing in foreign currency:
  - Banks concentrate on trading intermediation.
- Non-resident investors:
  - Large swings in net positions.

What to discuss

Hedging FX risks

- Macro prudential regulation on FX risks.
- Hedging strategies for FX risks.
  - Learned from experience.
  - Banks' structural net FX positions.
  - Derivative hedging from firms.
- Benefits from financial dollarization (?)
  - How much of a " bad thing"?
  - Access to international capital markets.
  - Output fluctuations (in an appreciation?)

FX Intervention

Alternative strategies

- Spot intervention:
  - Sterilyzed intervention
- Derivative intervention:
  - Depreciation expectations
- Deposit dollarization threshold
  - Reduce excessive FX volatility
  - How much intervention?
  - How much dollarization?

Concluding remarks

Policy implications

- Non-financial firms: Risk management.
- Financial firms: Macro prudential regulations.
- FX intervention: Market analysis.