

# Discussion of “Capital Flow Management Measures and Dollarization”

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# Background and Summary of the Paper

- EMEs use reserve requirements ( $RR$ s) as a macro-stabilization tool
  - For countries w/ high fin. dollarization: differential  $RR^{FC}$
- $\uparrow RR^{FC}$  when USD funding is cheap,  $\downarrow$  banks incentives to lend in USD.
  - Also: higher buffer to reduce vulnerability to flow reversal

## This paper:

1. **Empirics:** rich bank data from Peru.
  - a.  $RR^{FC}$  successful at  $\downarrow$  credit boom after funding shock
  - b. Response is heterogeneous on the ex-ante exposure to USD funding
2. **Model:** SOE + fin frictions + fin. dollarization + bank heterogeneity
  - Study effect of  $RR^{FC}$   $\rightarrow$  consistent w/ data

## Comment 1: USD deposits in the data and the model

- **Model:** USD deposits are 100% from abroad.
- **Data:** most certainly domestic investors play a non-trivial role
  - Consistent with history of high inflation, hysteresis
  - Suspect foreign USD funding is more bond based and more long term
- I understand this is a useful shortcut. Does this matter for the model predictions?

## Comment 2: CES aggregation of different credit

Producers (borrowers) aggregate different loans (peso/USD; from low/high exposure banks) using a CES

$$S_t = \left[ \sum_{i,j} (\omega_i^j)^{1/\sigma_s} (S_{i,t}^j)^{\frac{\sigma_s-1}{\sigma_s}} \right]^{\frac{\sigma_s}{\sigma_s-1}} ; \quad i \in \{h, \ell\} , j \in \{p, USD\}$$

*1 USD from a low-exposure bank is diff. from 1 USD from a high-exposure bank*

- It's like a shortcut for a deeper theory of how firms borrow.
  - Keep balanced portfolios of liabilities
- May be rationalized by a deeper model w/ relationship lending, or rollover risk (fickle lenders), or a mix of both.

## Comment 3: Validation for the model mechanism

### So far:

1. Here are a model and a mechanism for why the effect is heterogeneous across bank USD exposure, and
2. These are consistent w/ empirical findings

### Next/Want:

- How can we discard alternative mechanisms?
- What are other testable implications of the theory that wouldn't be shared by alternative stories?

# Conclusion

- I've seen this paper before, I like how it's shaping up!
- Very convinced by the empirical results. Model is still a bit behind.
- Potential to deliver useful policy recommendations about the interaction of *RR* and financial dollarization.
  - Not there yet, but soon.
- Looking forward to the next iteration!