Foreign Currency Debt and Expectations

Abstract

This paper contributes to a better understanding of the sources of corporate foreign currency (FC) borrowing by highlighting an expectation channel. Our model shows that, if agents have an informational advantage on the state of the economy, a certain degree of foreign currency borrowing might be observed if the fundamentals are strong relative to what public signals suggest to foreigners. In these situations, international markets tend to overestimate future currency depreciations, which increases the cost of borrowing in peso relative to borrowing in dollar and pushes domestic agents to denominate their debt in foreign currency. We provide empirical evidence for this phenomenon, using sovereign ratings as our measure of public signals. Controlling for fundamentals, we show that poor ratings predict positive domestic currency excess returns and are associated with more FC borrowing.

This paper is joint work with Isabella Blengini (Ecole hôtelière de Lausanne, HES-SO) and Ouarda Merrouche (University Paris-Nanterre)

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