Macroprudential Policy for Internal Financial Dollarization

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Contribution

- Novel empirical fact 3: FC deposits of households as a substitute for foreign loans to local firms
- Theoretical model of a small open economy with a financial friction where households use FC deposits as a hedge against currency risk
- Optimal macroprudential policy

Rationale for macroprudential intervention

- Overborrowing: entrepreneurs do not internalize the effect of their borrowing decisions today on the severity of their borrowing constraint in the bad state tomorrow, which exacerbates the Fisherian spiral
- De-dollarization of deposits: severity and likelihood of currency crisis vs. hedging opportunities provided by FC deposits
- Differentiated macroprudential taxes on FC and HC debt
    - discourage overall borrowing and saving
    - change the currency composition of debt owed by firms

Empirical fact 3

- How can one reconcile the two facts (as show on Figure 4) that, during sudden stops:
  - CA reverts
  - HH deposit dollarization rises
  - firm loan dollarization stays unchanged
- If the inflow of FC deposits of households offsets the outflow of foreign loans, then shouldn't the resulting effect of financial account be zero?

What delivers the results?

- Which ingredient of the model is critical for the results?
- General Epstein-Zin preferences vs. CRRA as a special case ($\zeta = \sigma$)?
- Tradable goods endowments to both types of agents, to one type only, to noone?
- Nontradable goods seem indispensable as they give rise to the exchange rate, which, being incorporated in the borrowing constraint, leads to pecuniary externality.
- The use of materials in production seems important for a meaningful calibration of the model.
- Else?

Endogenous production of nontraded goods

- In the model, labor is locked entirely in the T sector.
- If one endogenizes the production of N goods, then labor can migrate between the two sectors.
- Cross-sector allocation of labor at $t = 1$ should be state-dependent, and this presumably will reshape the cross-state profile of the exchange rate (the relative price of N) compared with the N endowment case.
- Any possible consequences for your results?