Asset Purchases as Remedy for Original Sin Redux

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QE in Emerging Markets

• In March-April 2020 international capital market froze, and several EMs responded with QE (Rebucci et al., 2021)
• Several successful interventions: falling long rates and “appreciating” exchange rates
  • Puzzling given that standard models predict depreciation
  • Three alternative explanations:
    • Reflection of strength of Fed interventions
    • FXI new-found effectiveness
    • A different transmission mechanism in EMs, with QE alleviating domestic financial frictions (This paper)
Several open questions

• Home vs Foreign QE
• Spillovers from global-staggered adoption
• FXI vs QE
• Public vs Private QE
• Announcements vs Actual Purchases
• Persistence of financial market impact
• Effects on the real economy
• Side effects and preconditions
• Macroprudential roles of EM QE (Kolasa and Wesolowski, 2020)
This paper covers a lot of ground

• Home vs Foreign QE
• Spillovers from from global-staggered adoption
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Several Contributions

  - QE generates falling yields and appreciating exchange rate
  - Comparing QE stabilizing effects in response to both price and quantity shocks to foreign supply of funds to government
- Private vs Public QE interventions
- COVID-19 counterfactual
- Some results linking persistence of the financial market impact to size of the interventions
- Preconditions and some discussion of spillovers from foreign monetary policy shocks
Comments

• What this paper is not about

• Price and quantity shocks and FXI vs QE

• QE transmission to exchange rate and term premia
This paper is not about Original Sin Redux (Change title!)

- **OS** (Eichengreen and Hausmann, 1999): EMs cannot issue in domestic currency to borrow abroad or to borrow long term domestically, regardless of domestic policies and characteristics
  - Liquidity provision and LLR must be in dollars FXI main tool (Calvo)

- **OSR** (Carstens and Shin, 2019): Global portfolio investors evaluate their returns in dollar terms
  - There is no frictions on the foreign lenders in the model
  - Share of foreign investors in LC bond market has only a quantitative role
  - Unlike the OSR hypothesis, LC debt is critical otherwise no scope for QE
Price vs quantity shocks and FXI vs QE

• How does the quantity shock differ from price shock?
• Are these differences bearing onto the relative merit of QE vs interest rate responses?
  • Do quantity shocks justify QE adoption above the ZLB?
• FX exposure in banks vs firms: does it matter (Akinci and Queralto, 2020 say no)?
  • QE differs from FXI in that LC liquidity provision is potentially unlimited.
  • Here QE effectiveness stems from the fact that both firms and banks can fund themselves in LC, but in the data corporates borrow in FX.
  • Is QE still effective with large share of corporate dollar debt?
Mechanism

\[ q_t l_t + \omega_g q_t^g b_t^g - \omega_d d_t = \kappa_t n_t, \]

\[ \nu^*_t = E_t \left\{ \mathbb{E}_{t,t+1} [R_{t+1} - R^*_{t+1}] \right\}, \]

\[ \nu^*_t (1 + \mu_t) = \lambda \mu_t \omega. \]
How does QE appreciate the FX? Unclear
UIP deviations are larger the less distorted is the domestic financial system.
Other suggestions and comments

• Focus the paper on price vs quantity shock and mechanism through which QE compress yields and appreciates the FX rate
  • Develop a simpler two period model as in Akinci-Queralto (2020) deriving your UIP deviations and explaining them carefully against the data (e.g., Şebnem Kalemli-Ozcan and Varela, 2021)

• Need a two countries extension showing that advanced economies QE would compound effects on exchange rate under asymmetry in frictions

• Relate findings to model of QE transmission through term and FX premia--Gourinchas, Ray and Vayanos (2020) and Greenwood et al. (2020)

• Use quantitative model to discuss other issues such as Public vs Private, side effects and pre-conditions, effects at the zero lower bound

• Calibration to average of 13 economies is bound to be distorted by outliers. Either aggregate economy or a case study with a typical country.
Thank you