Discussion of Araujo and Leão

**OTC Derivatives: Impacts of Regulatory Changes in the Non-Financial Sector**

*Sixth BIS CCA Research Conference*

*Banco de Mexico*

13-14 April 2015

*Michael Moore*

*Warwick Business School, UK*
OTC Derivatives: Impacts of Regulatory Changes in the Non-Financial Sector

• Why this paper is important

• What this paper does

• What this paper does well

• What this paper could do even better
Why this paper is important...

• New literature on macroprudential use of international capital controls

• Welfare gains in terms of preventing asset price bubbles are clear

• Is there a downside for the real sector?
• **Natural experiment**

• **On September 16\textsuperscript{th} 2011, Brazil imposed a tax on FX derivatives short positions only**

• **Authors have access to database of all non-deliverable foreign exchange forward contracts**
What this paper does... Theory

- Assume non-financial firms long USDBRL forward positions are offset by short taxable positions by banks.

- Cost of bank’s position measured on transparent, liquid USDBRL futures market.

- Compare futures and forward prices before and after tax.
What this paper does...Testable Propositions

- For long NDF positions (=short bank futures market positions), forward-futures spread should widen because of tax

- For short NDF positions (=long bank futures market positions), forward-futures spread should be unaffected by tax
Controlling for bank and form characteristics along with variables that affect the FX market:

- For long NDF positions the spread rises by 52%
- For short NDF positions there is no significant effect
What this paper does well

- Very convincing experiment
- Unique data set
- Very clear result

- Importing firm faces a penalty when it needs to hedge a future payment in dollars i.e. needs a long USDBRL position.
What this paper could no better... econometric techniques

• **Difference-in-differences**

• **Endogeneity of control variables**
What this paper could no better...equation specification

- Control variables e.g. Spot FX rate, FX volatility, FX asymmetry need to be motivated in more detail
- Instead of fixed effects for banks and firms, it might be better to use measures of firm or bank size
- Though the results are always significant, estimates depend on exact specification of control variables
Conclusion

• Very important contribution

• Law of unintended consequences

• Capital controls at the very least cause gross welfare losses