Overcoming "original sin" to secure policy space

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*The views expressed here are mine and not necessarily those of the Bank for International Settlements

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Fiscal policy has led the way in the policy response to the pandemic, giving rise to large budget deficits, both in advanced and emerging economies.

AEs = AU, CA, CH, DK, EA, GB, JP, NO, NZ, SE and US; EMEs = BR, CL, CN, CO, CZ, HK, HU, ID, IN, KR, MX, MY, PE, PH, PL, RU, SA, SG, TH, TR, TW and ZA.
Source: IMF, *World Economic Outlook*. 
Most emerging market governments have overcome “Original Sin” to borrow from global investors in domestic currency

![Currency denomination and holders of government debt securities](chart)

1 Issued on domestic and international markets (heterogeneous sources of data). Domestic bonds exclude money market instruments. Sources: S Arslanalp and T Tsuda, “Tracking Global Demand for Emerging market Sovereign debt”, *IMF Working paper*, no WP/14/39, March 2014; Dealogic; Euroclear, Thomson Reuters; Xtrakter Ltd; national data; BIS calculations.
Higher yields (in blue) reflect the higher risks in the eyes of investors, compounded by rolling social and political unrest in several EMEs.

1 JPMorgan EMBI Global index, stripped spreads.  
2 JPMorgan GBI-EM Broad index, yields on traded index.  
3 Flows to sovereign foreign currency bond funds.  
4 Flows to sovereign local currency bond funds.  
Sources: EPFR; JPMorgan Chase; BIS calculations.
Reflecting these trends, the share of domestic currency sovereign bonds held by foreign investors has fallen relative to recent highs.

Source: Institute of International Finance.
“Original Sin” has given way to “Original Sin Redux”
Currency mismatch has migrated from borrowers to investors, giving rise to “risk-on, risk-off” and high duration multiplier\(^1\)

\[ y = a - bx \]

where \( R^2 \) = 0.88

\[ y = a - bx \]

where \( R^2 \) = 0.58

\[ y = a - bx \]

where \( R^2 \) = 0.94

\[ y = a - bx \]

where \( R^2 \) = 0.70

\(^1\) Total return on bonds denominated in local currency as weekly change in JPMorgan GBI-EM principal return index in local currency and US dollar.

Sources: JPMorgan Chase; BIS calculations.
Duration multipliers tend to be well above 1 for some large EME borrowers\(^1\)

\[ y = -0.42 + 2.28x \quad \text{where } R^2 = 0.402 \]

\[ y = -0.194 + 2.04x \quad \text{where } R^2 = 0.53 \]

\[ y = -0.14 + 1.43x \quad \text{where } R^2 = 0.823 \]

\(^1\) Total return on bonds denominated in local currency as weekly change in JPMorgan GBI-EM principal return index in local currency and US dollar.

Sources: JPMorgan Chase; BIS calculations.
Duration multipliers for local currency government bonds

1 Slope of the fitted line for the US dollar returns on EME local currency government bonds against local currency returns.
Sources: JPMorgan Chase; BIS calculations.
Dollar beta as a cross-sectional risk factor that is priced

Source: BIS calculations.
Dollar and euro duration multipliers for EME local currency

1 Slope of the fitted line for dollar and euro returns on EME local currency government bonds against local currency returns. Sources: JPMorgan Chase; BIS calculations.
Dollar and yen duration multipliers for EME local currency$^1$

![Graph showing duration multipliers for different countries.](image)

$^1$ Slope of the fitted line for dollar and euro returns on EME local currency government bonds against local currency returns.

Sources: JPMorgan Chase; BIS calculations.