



# Overcoming "original sin" to secure policy space

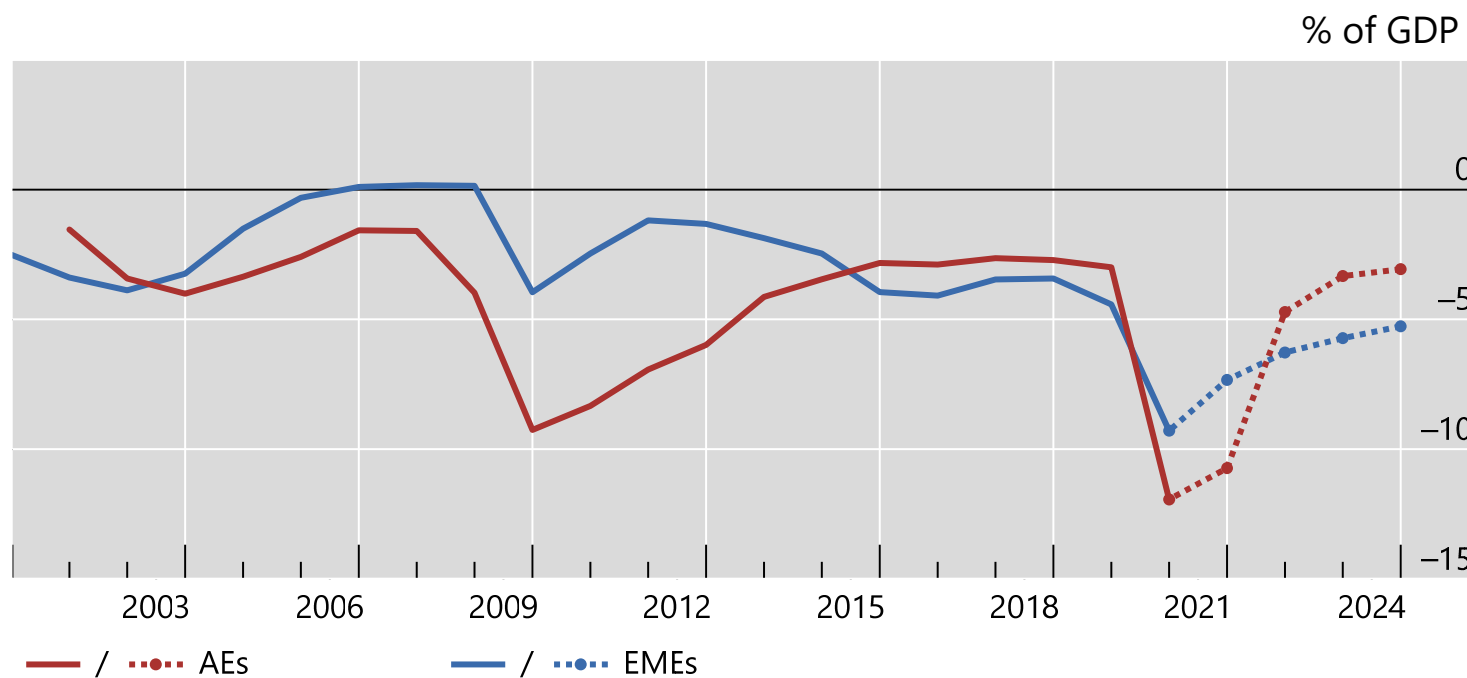
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"The Economics of the Covid-19 Pandemic"

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

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



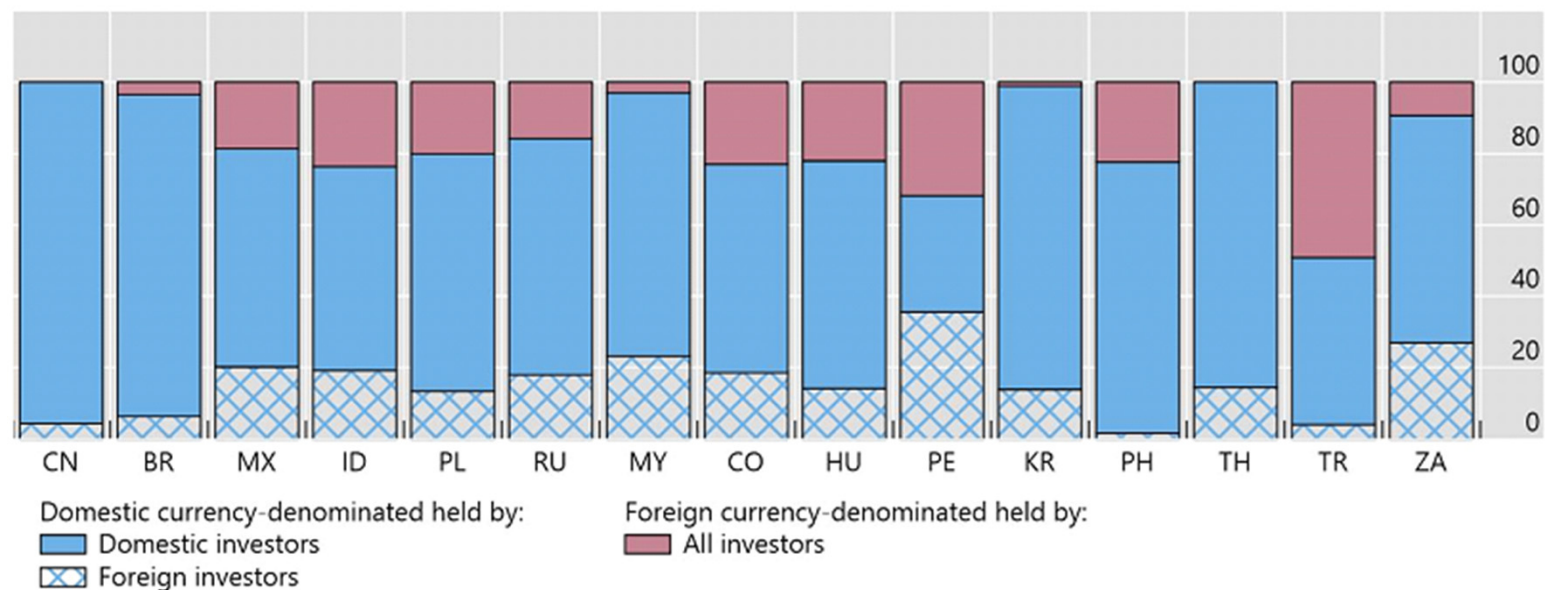
AEs = AU, CA, CH, DK, EA, GB, JP, NO, NZ, SE and US; EMEs = BR, CL, CN, CO, CZ, HK, HU, ID, IN, KR, MX, MY, PE, PH, PL, RU, SA, SG, TH, TR, TW and ZA.

Source: IMF, *World Economic Outlook*.

## Most emerging market governments have overcome “Original Sin” to borrow from global investors in domestic currency

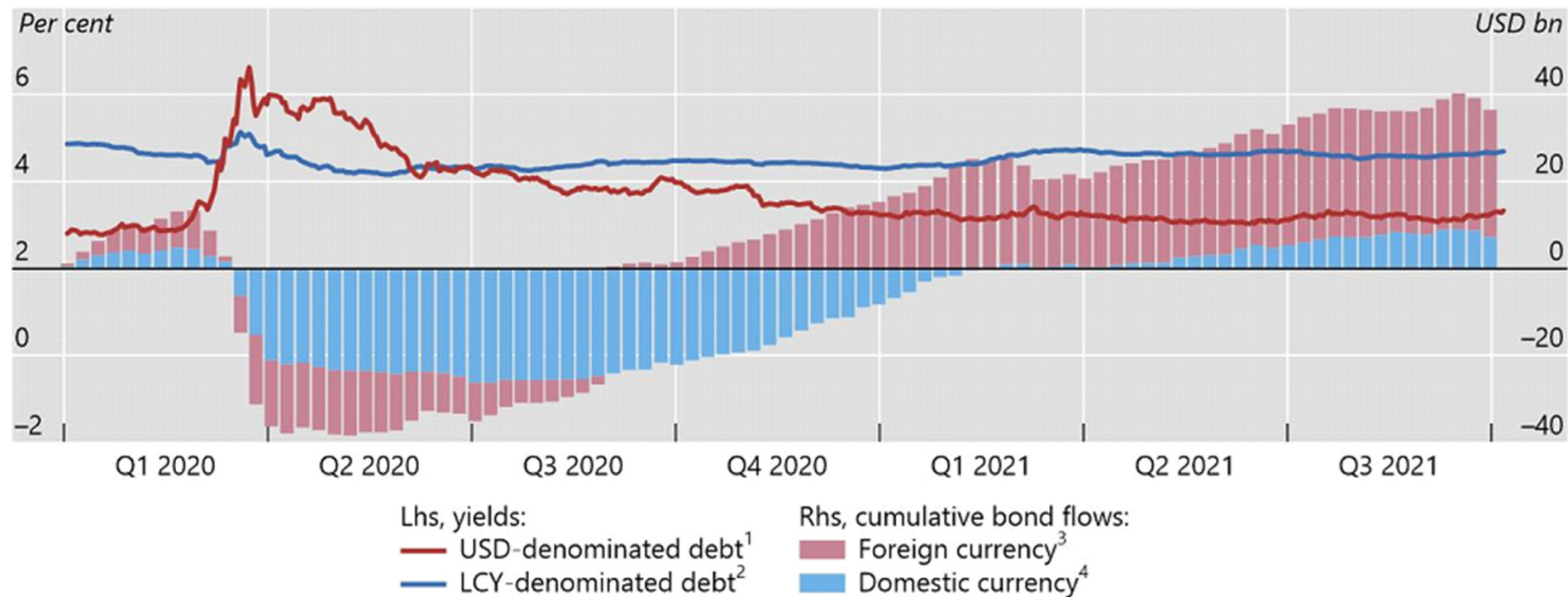
Currency denomination and holders of government debt securities<sup>1</sup>

As a percentage of total amounts outstanding, at end-December 2020



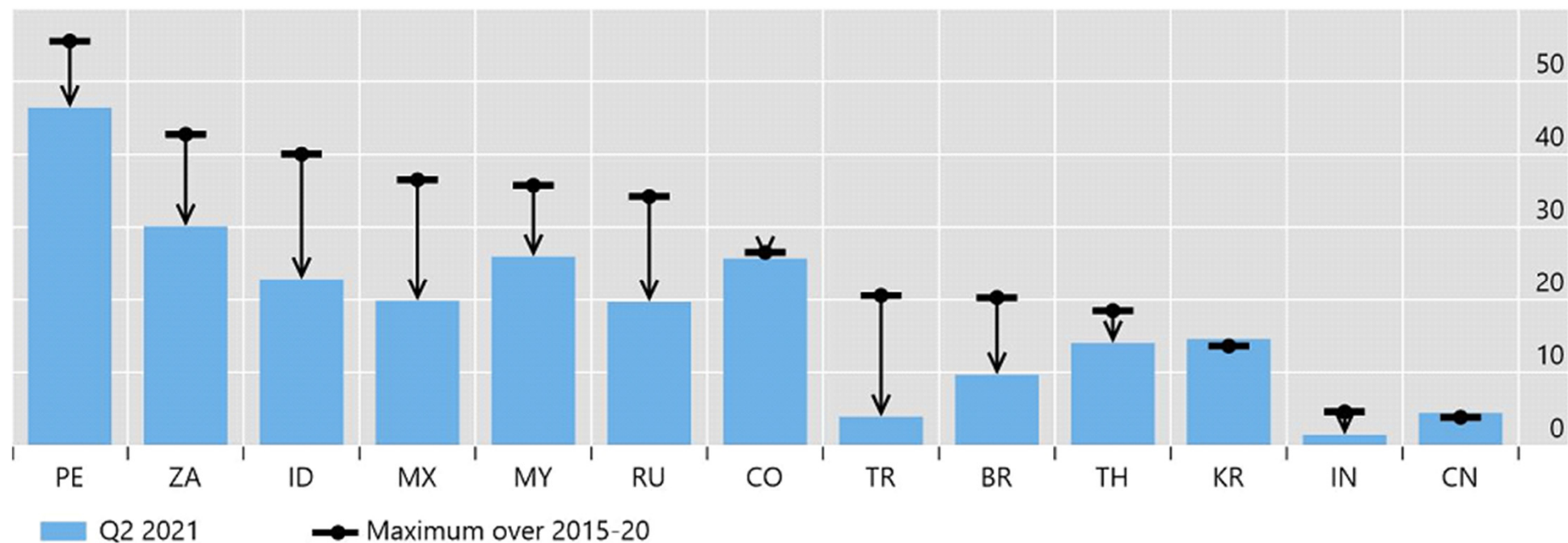
<sup>1</sup> Issued on domestic and international markets (heterogeneous sources of data). Domestic bonds exclude money market instruments. Sources: S Arslanalp and T Tsuda, “Tracking Global Demand for Emerging market Sovereign debt”, *IMF Working paper*, no WP/14/39, March 2014; Dealogic; Euroclear, 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



<sup>1</sup> JPMorgan EMBI Global index, stripped spreads. <sup>2</sup> JPMorgan GBI-EM Broad index, yields on traded index. <sup>3</sup> Flows to sovereign foreign currency bond funds. <sup>4</sup> 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

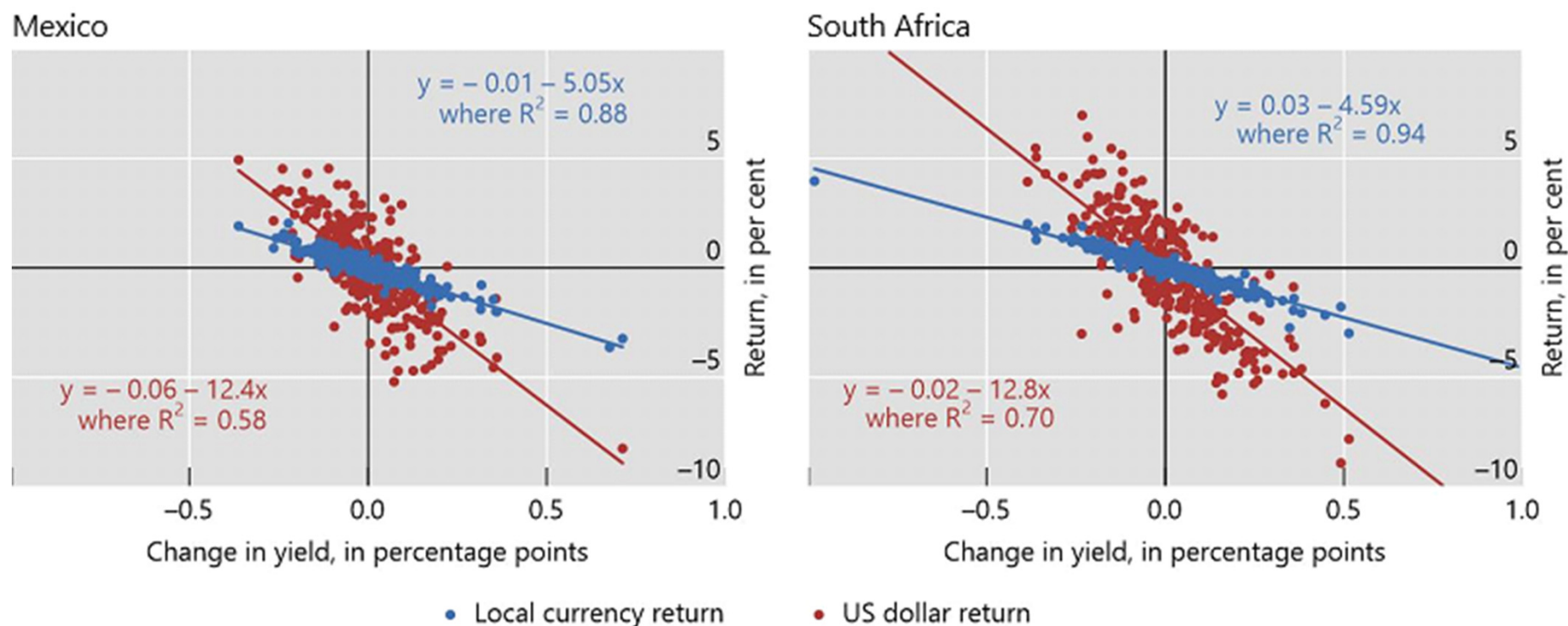


Source: Institute of International Finance.



## “Original Sin” has given way to “Original Sin Redux”

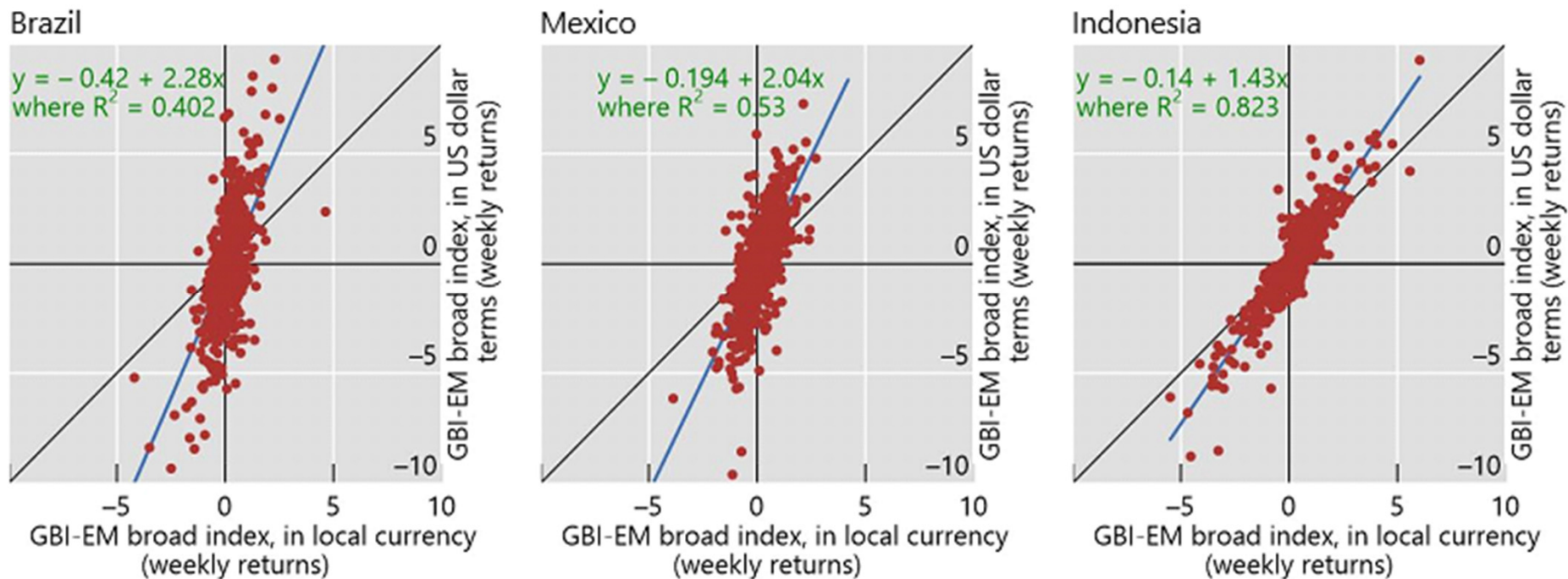
Currency mismatch has migrated from borrowers to investors, giving rise to “risk-on, risk-off” and high duration multiplier<sup>1</sup>



<sup>1</sup> 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.

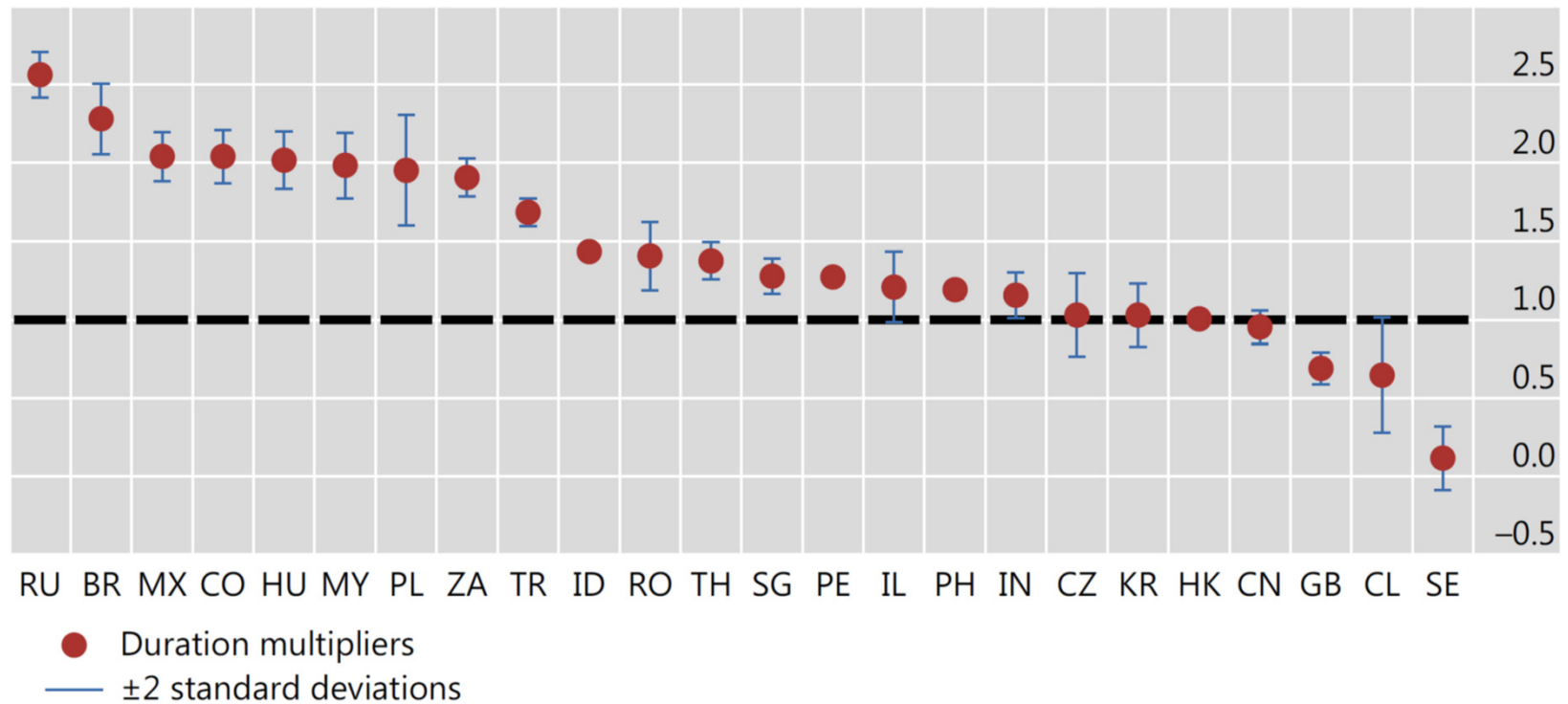
## Duration multipliers tend to be well above 1 for some large EME borrowers<sup>1</sup>



<sup>1</sup> 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<sup>1</sup>

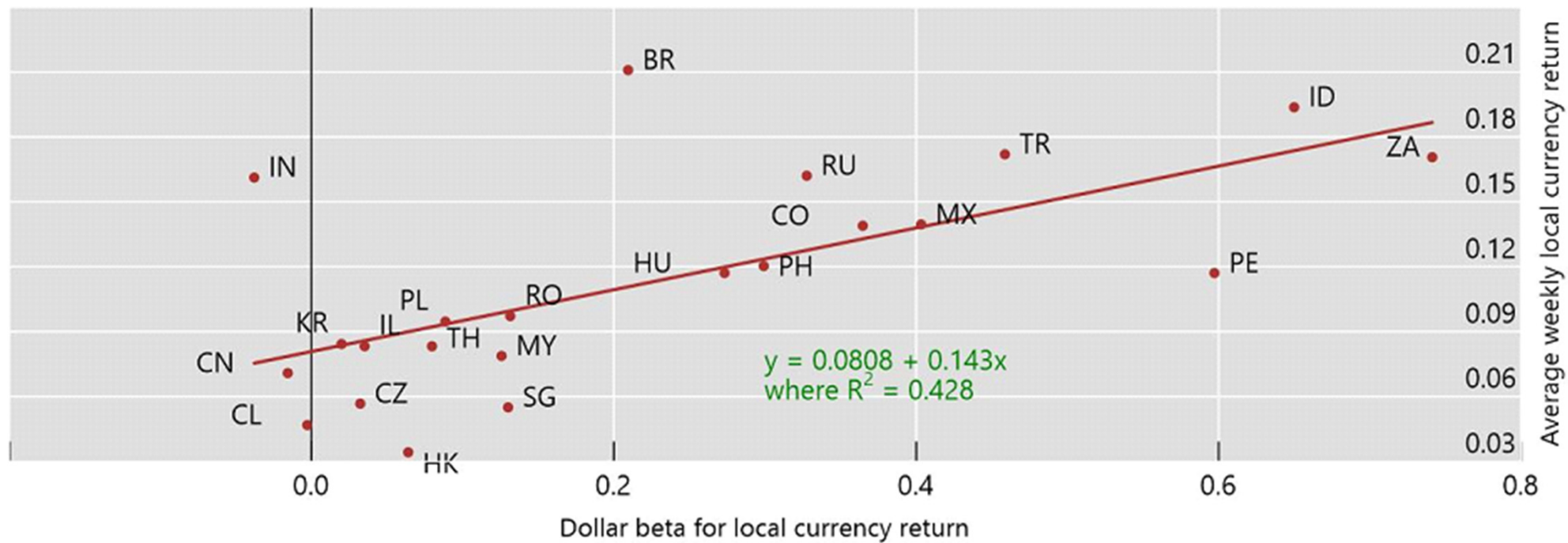


<sup>1</sup> Slope of the fitted line for the US dollar returns on EME local currency government bonds against local currency returns.

Sources: JPMorgan Chase; BIS calculations.

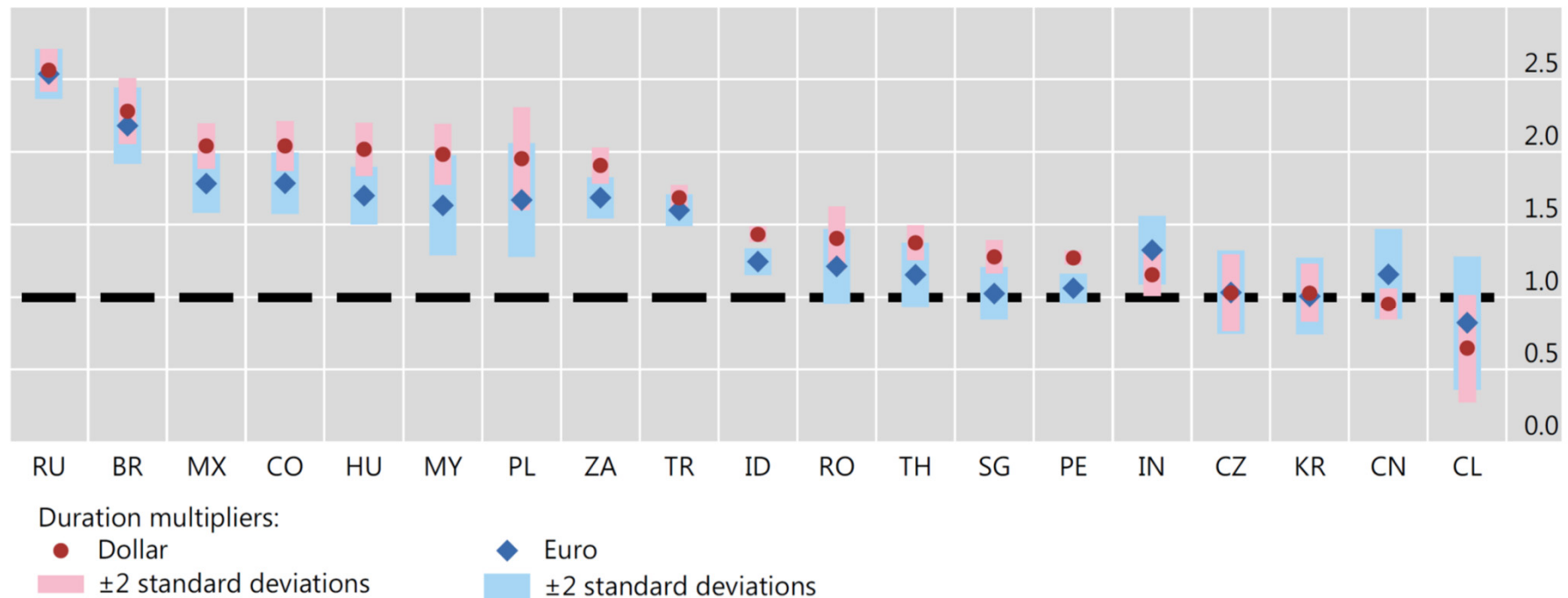


## Dollar beta as a cross-sectional risk factor that is priced



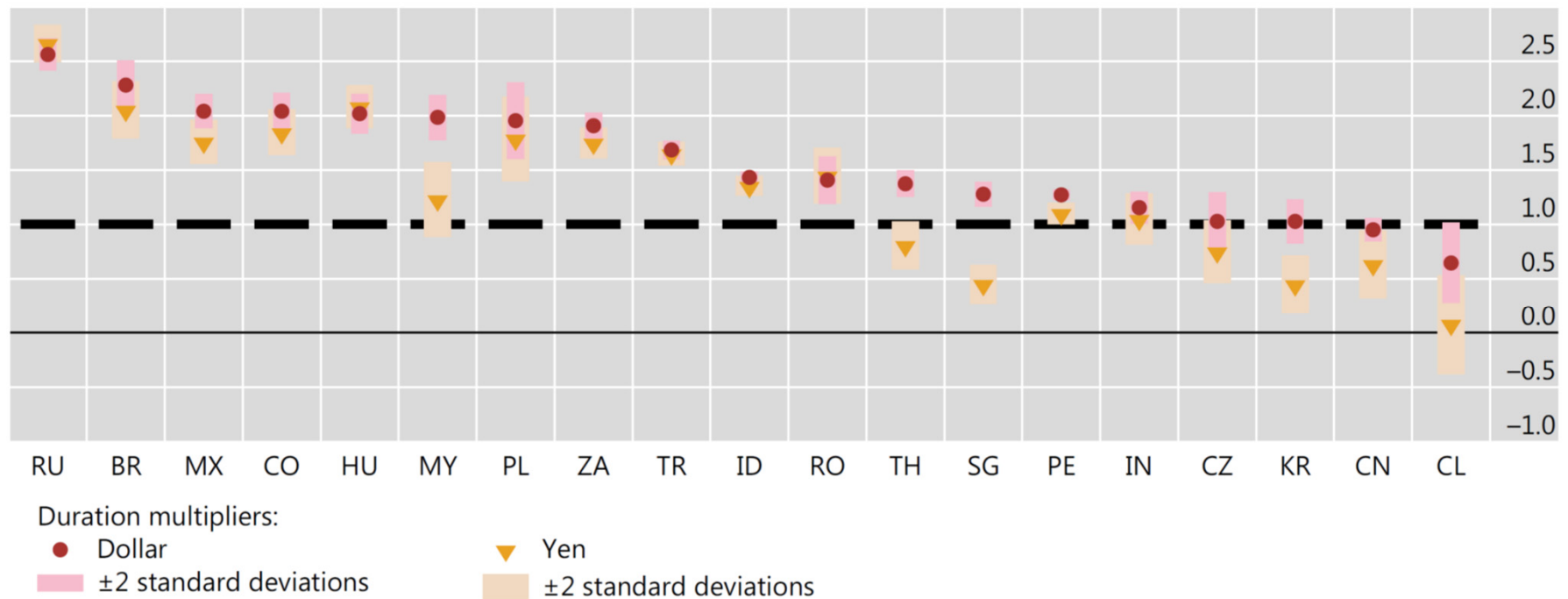
Source: BIS calculations.

## Dollar and euro duration multipliers for EME local currency<sup>1</sup>



<sup>1</sup> 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<sup>1</sup>



<sup>1</sup> 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.