

Discussion on *Sovereign Default and Global Financial Shock*
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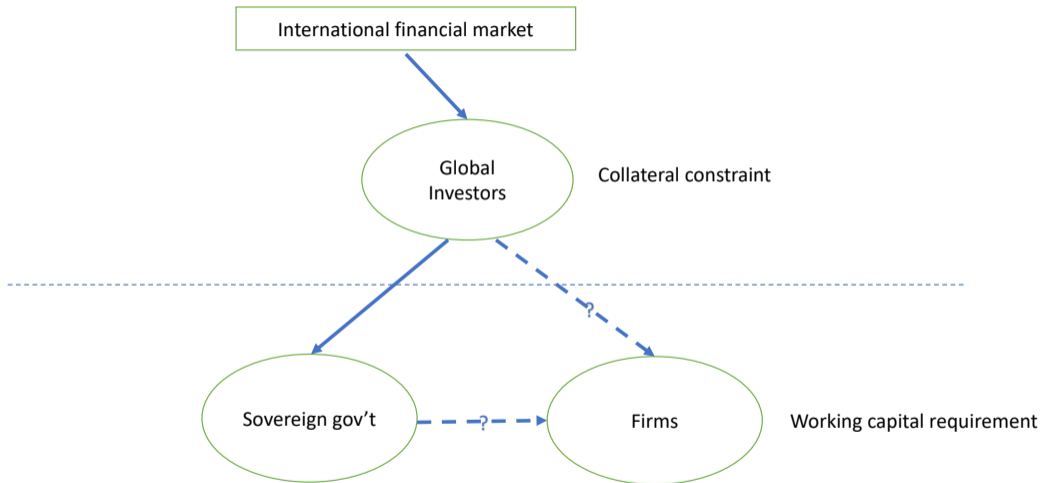
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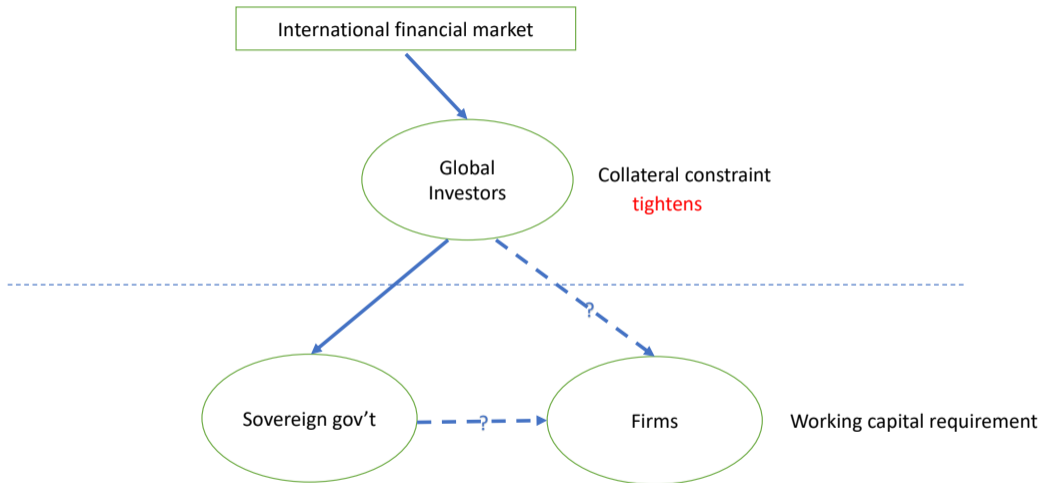
A short summary

- ▶ This paper focuses on how global financial shock affects emerging markets' sovereign spreads and economic activities.
 - ▶ global financial shock: unexpected ↓ in investors' funding capacity
- ▶ Disruptions of the production side; sovereign risk transmits to private sector & feedback loop between private sector and the sovereign.

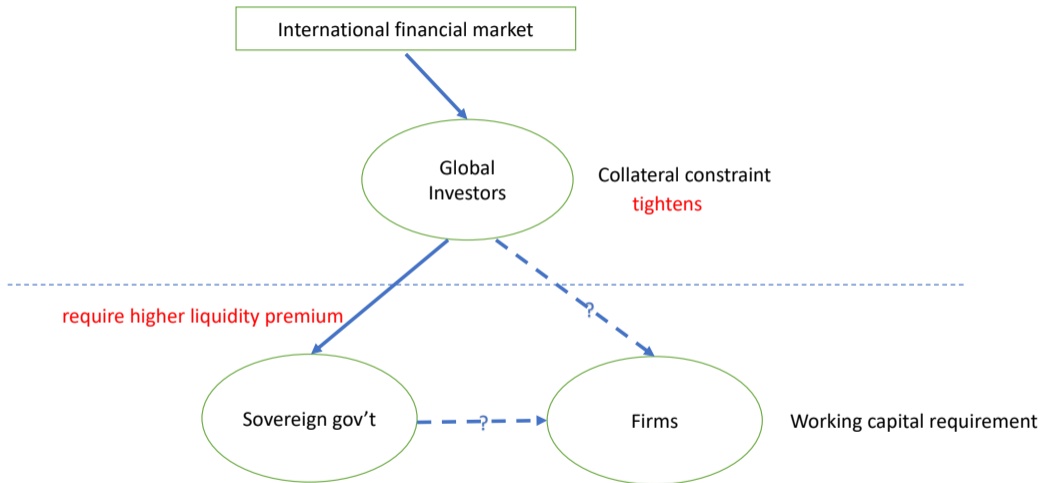
Main mechanism



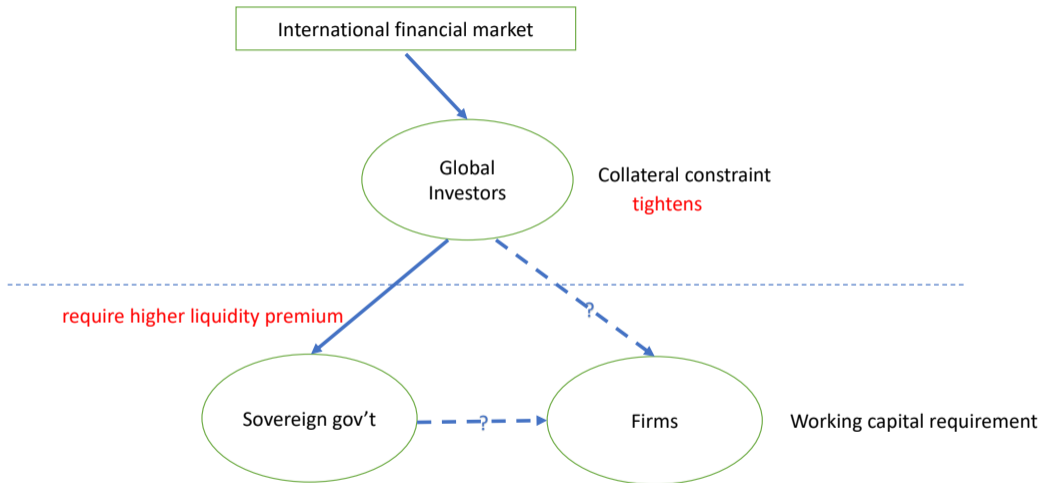
Main mechanism



Main mechanism



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In the paper, interest rate on working capital loan = interest rate on sovereign debt, so **borrowing cost for firms increases**, hindering production, further increasing default risk

Linkage between sovereign and firms

- ▶ In the paper, firms face interest rate equals to sovereign debt interest rate. Firms borrow from whom?
- ▶ Would like to see more characterization of the linkage.
- ▶ In the data, firms don't face the same interest rate as sovereign bonds. [▶ Figure](#)
- ▶ Firm heterogeneity: Arellano et al. (2019); Large and low-leverage firms are less affected for intangible investment, even benefit from GE effect that intangible investment price collapses (Deng, Liu (2020)).

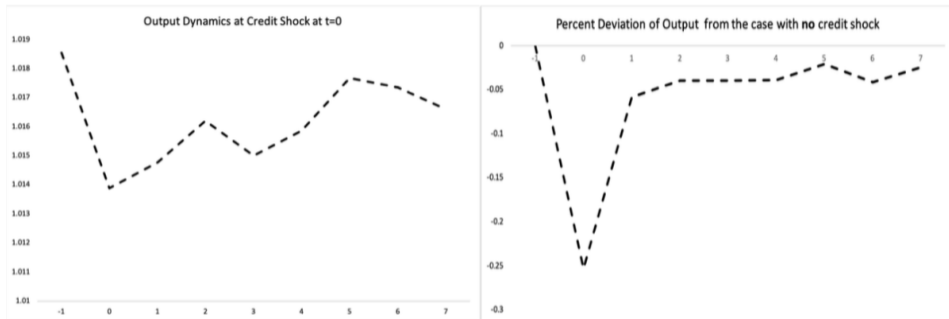
Linkage between sovereign and firms

Potential ways to model the linkage between the sovereign and the firms:

- ▶ Balance sheet channel: e.g. Sosa-Padilla (2015), Arellano et al. (2019)
- ▶ Crowding-out channel: public debt generates a crowding-out of private lending, reducing loanable funds available to firms e.g. Broner et al. (2014), Acharya et al. (2018), Becker and Ivashina (2018), Rojas (2020)
- ▶ Credit relationship channel: matching frictions of firms and lenders e.g. D'Erasmus et al. (2019)
- ▶ Fiscal policy channel: tightening in fiscal policy increases firm borrowing cost e.g. de Ferra (2018)
- ▶ ...

Output losses from sovereign default risk

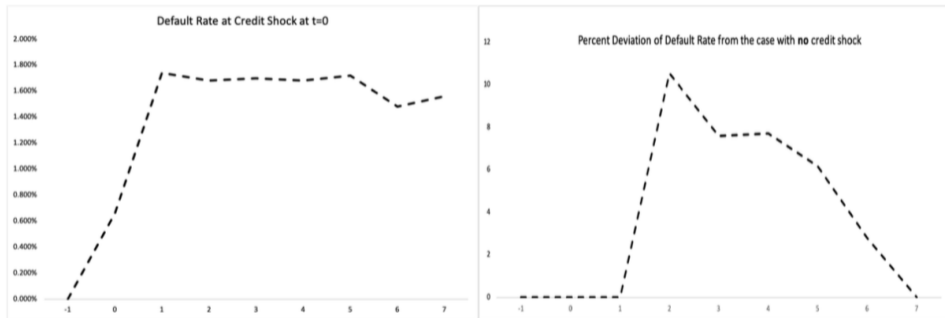
Figure 3.3: Output Dynamics around Financial Crises



- ▶ At the time of credit shock, the output on average decreases by around 0.5% from 1.018 to 1.013. The loss is not only from working capital channel, it also reflects the mechanical productivity decline

Output losses from sovereign default risk

Figure 3.4: Default Rate around Financial Crises

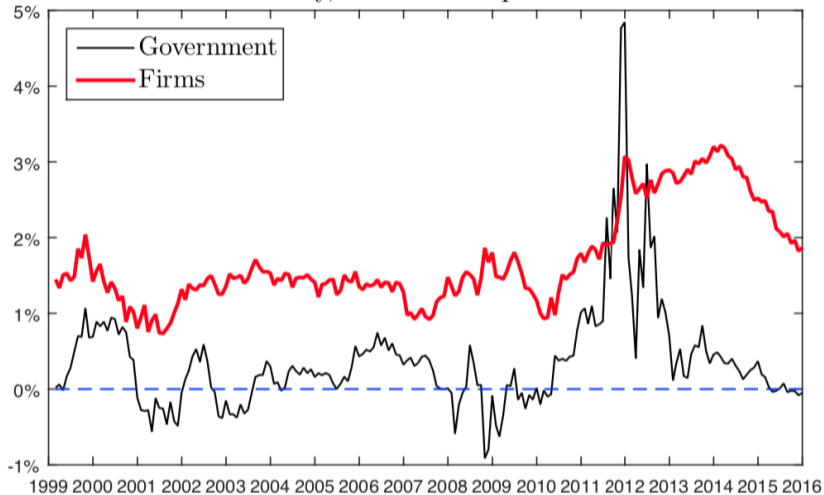


- ▶ would be useful to plot the simulation series conditional on not defaulting as well

Final remarks

- ▶ Interesting topic
- ▶ Open avenue for further research
 - ▶ Interactions between countries
 - ▶ Endogenize the spillover from the center of crisis to emerging markets
 - ▶ Quantitative analysis: how much this global financial shock contributes to the sovereign spreads and economic decline? glad to see more results

Italy, Interest rate spreads



Source: de Ferra (2018)