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Nota di contenuto

Contents; I. Introduction; II. The Model; III. Numerical Examples and Illustrations; Tables; 1. The Euro-Denominated Debt Spread, Face Value, PD, and the Cost of Credit Risk as a Function of Correlations; IV. Credit Spreads and Modigliani and Miller Propositions; Figures; 1. Spreads on Foreign-Currency Bonds and Correlations; 2. Betas of Stocks and Foreign Currency Bonds for Various Correlations; 2. The Expected Return on Stock (y_S) as a Function of the B/S Ratio; V. Implications and Conclusions; 3. The Expected Return on Stock y_S as a Function of the B/S Ratio and Correlation Coefficient
4. FE as a Function of F
Appendixes; I. Determination of the Face Value of Debt in the Foreign Currency; 5. FE as a Function of F; II. Firm Value, Exchange Rates, and Inflation; References

Sommario/riassunto

The paper shows how-in a Merton-type model with bankruptcy-the currency composition of debt changes the risk profile of a company raising a given amount of financing, and thus affects the cost of debt. Foreign currency borrowing is cheaper when the exchange rate is positively correlated with the return on the company's assets, even if the company is not an exporter. Prudential regulations should therefore differentiate among loans depending on the extent to which borrowers have "natural hedges" of their foreign currency exposures.
