Working papers economics - Short vs Medium-Run: Exchange Rate Movements, Investment and the Currency Composition of Balance Sheets

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In contexts of sustained depreciation, firms face a trade-off between investing and engaging in financial hedging, suggesting the need for policies that improve the liquidity and accessibility of the derivatives market to reduce these costs and foster investment.

Publication Date: Monday, 25 of May 2026 **Focus**
This paper combines an empirical analysis with a theoretical framework to distinguish the short- and medium-term effects of exchange rate movements on firms' investment. It uses a detailed dataset of balance sheets and income statements of Colombian firms, together with information on financial derivatives, exports, and imports. Advanced econometric techniques are applied to identify the channels through which the exchange rate affects investment, taking into account both structural factors and transitory shocks.

Contribution
The paper's main contribution is to decompose the effects of the exchange rate into three channels: competitiveness, the nominal revaluation of export revenues, and balance sheet effects stemming from foreign currency debt. In addition, it identifies that financial hedging through derivatives—while protecting firms against exchange rate surprises—may constrain investment when the exchange rate remains depreciated for prolonged periods, due to higher costs and tighter financial constraints.

The study also shows that firms' borrowing and hedging decisions respond to their own characteristics, rather than being driven solely by inherited effects from exchange rate movements.

Results
Empirically, the results indicate that large firms tend to reduce their exposure to foreign currency debt and increase their use of derivatives during periods of depreciation, while exporting and foreign-owned firms increase their foreign currency borrowing and reduce their financial hedging. Firms' investment is found to be more affected by structural depreciations than by temporary exchange rate shocks.

Finally, the paper concludes that in contexts of sustained depreciation, firms face a trade-off between investing and engaging in financial hedging. This finding points to the need for policies aimed at improving the liquidity and accessibility of the derivatives market in order to reduce these costs and foster investment.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/publications-research/working-papers-economics/short-medium-run-exchange