Discussion of “Exorbitant Privilege and Exorbitant Duty” by Gourinchas, Rey and Govillot

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Main message of the paper

• US as an insurance provider to the world
• Collects insurance premium in normal time
  – Exorbitant privilege: excess return of gross assets over gross liabilities
• Pays insurance in crisis time
  – Exorbitant duty: wealth transfer from the US to the world (US NFA declines)
• Interesting and new insight
Exorbitant privilege: evidence

• Expand Gourinchas-Ray (2005, 2007)
• Excess return = 1.62-3.47% (1973-2009)
• Mainly due to within asset class differential
  – Ex. US bonds held by foreigners give lower return than foreign bonds held by US
• Comprehensive robustness analysis
Exorbitant Duty: evidence

• During the current crisis,
  – US bond prices more stable than foreign equity prices
  – Sharp decline in US Net Foreign Asset (NFA): wealth transfer from the US to the world

• Regression analysis
  – US NFA/GDP and financial market volatility negatively correlated
• Large: Bad times in US more likely to be bad times for the world (Hassan (2009))
  – US safe bonds are good hedge
  – then US pays lower return on its liabilities
• US less risk averse: US can bear more risk
• Disaster shocks: help the model match data
Insurance to the rest of the world?

- Insurance in the paper = consumption smoothing
- Were US bonds useful for smoothing consumption? How to test?
- In this discussion, preliminary look at US gov’t bonds
• Total share 76% of foreign holdings
• Major holders may suffer capital loss due to $ depreciation. Wealth transfer?
• JPN, China, Taiwan, Switzerland, Norway: significant US bond holdings compared with their GDP
• Lux and HK and UK need care (financial centre)
Consumption smoothing in major US bond holders

question: more US bond holdings/GDP
  more wealth transfer from US
  consumption smoother in crisis?

• Consumption deviation from trend: =
  normalised deviation of consumption from HP trend, 1996Q1-2009Q4
Max. consumption decline from trend: 08-09

- US bonds useful for consumption smoothing?

\[ y = 0.0041x - 1.767 \]
Max. consumption decline from trend: 08-09, excl. UK, Lux, HK

- No obvious evidence for insurance role?
- Similar results for average consumption decline, consumption growth

\[ y = -0.0181x - 1.486 \]
US bonds as insurance

• I showed just simple correlation, so results not conclusive.

• Analysis needed for consumption smoothing of the rest of the world and US bond holdings
Implications for monetary policy

- Real return of nominal bonds affected by MP
  - $\text{Corr}(\text{real return}, \text{inflation}) = -0.49$ in US
- New source of international policy spillover
  - Traditional: terms of trade
  - This paper: foreign hedging demand for domestic assets
- Does it justify deviation from price stability?
Central banking under globalisation

• Monetary policy and international portfolio choice
  – Devereux and Sutherland (2007, 2008)
  – MP can affect international risk sharing

• Is there any special role of CB of a large country? Exorbitant privilege and duty?
appendix
Av. consumption decline from trend: 08-09

US bonds/GDP

\[ y = 0.0034x - 0.2376 \]
Av. Consumption decline from trend excl. UK, Lux, HK

\[ y = -0.0113x - 0.1022 \]