

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

Theory

- 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

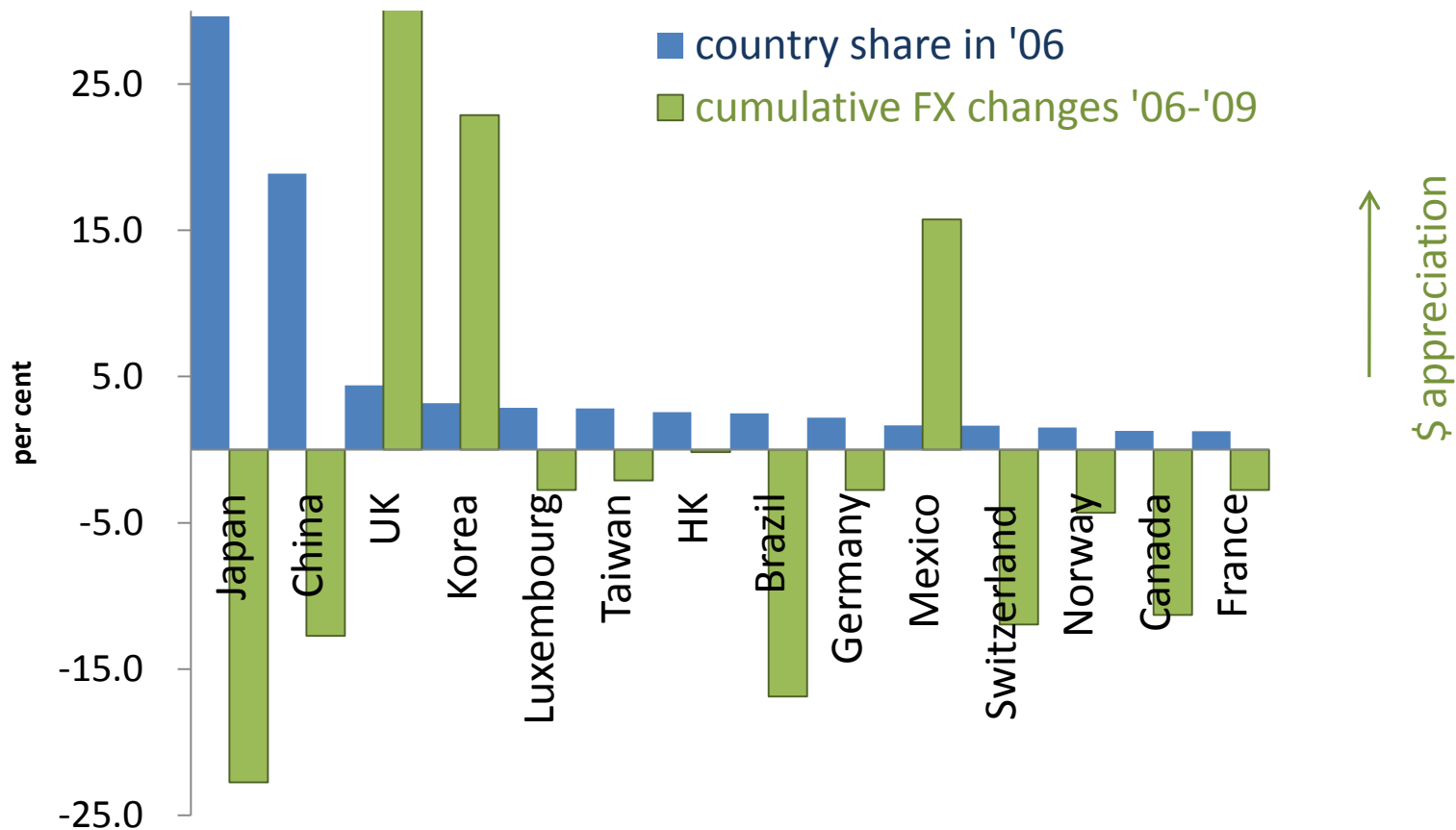
Insurance to the rest of the world?

- Insurance in the paper = consumption smoothing



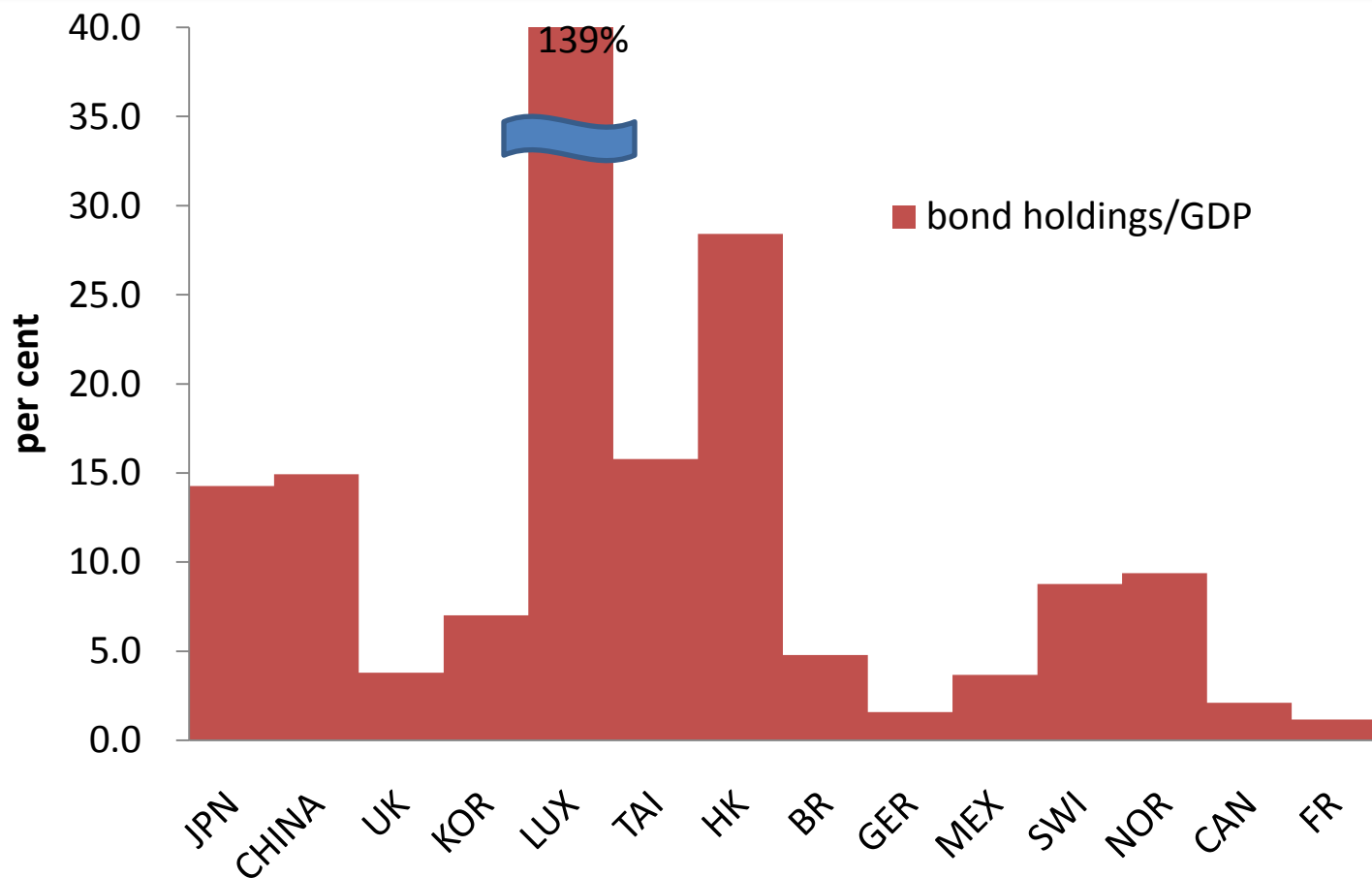
- Were US bonds useful for smoothing consumption? How to test?
- In this discussion, preliminary look at US gov't bonds

Major holders of US gov't bonds



- Total share 76% of foreign holdings
- Major holders may suffer capital loss due to \$ depreciation. Wealth transfer?

Importance of US gov't bonds



- 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

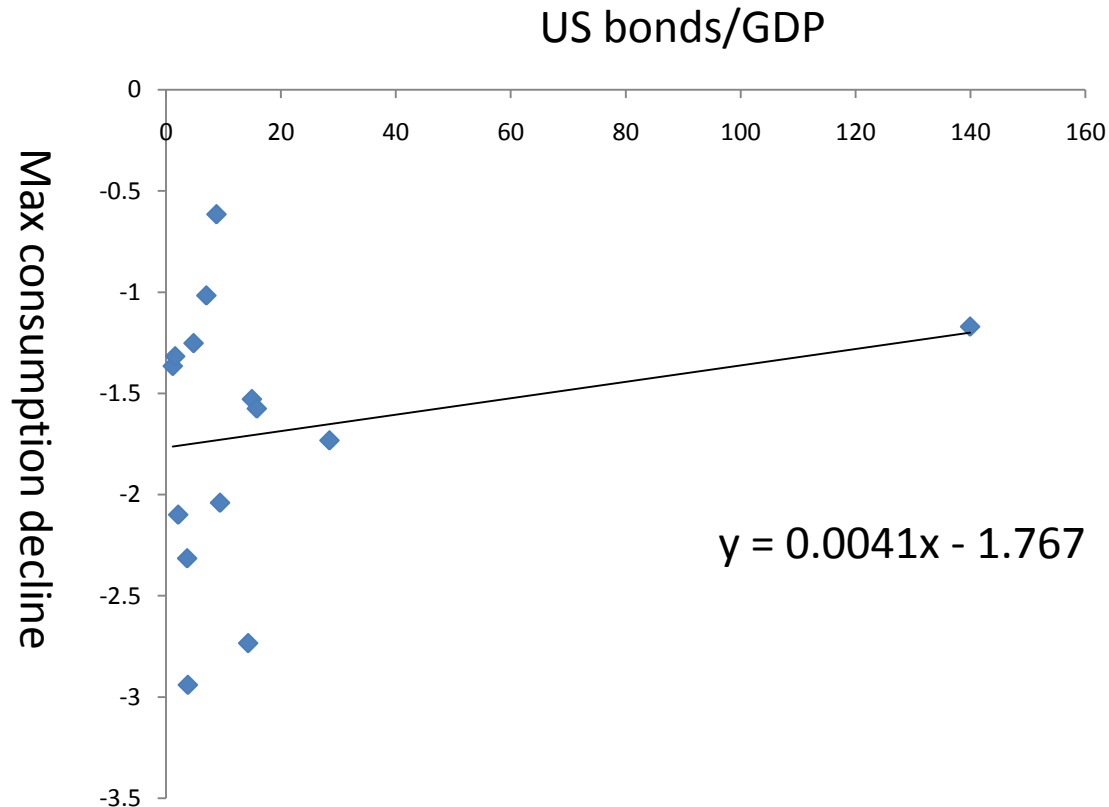
question: more US bond holdings/GDP

➔ more wealth transfer from US

➔ consumption smoother in crisis?

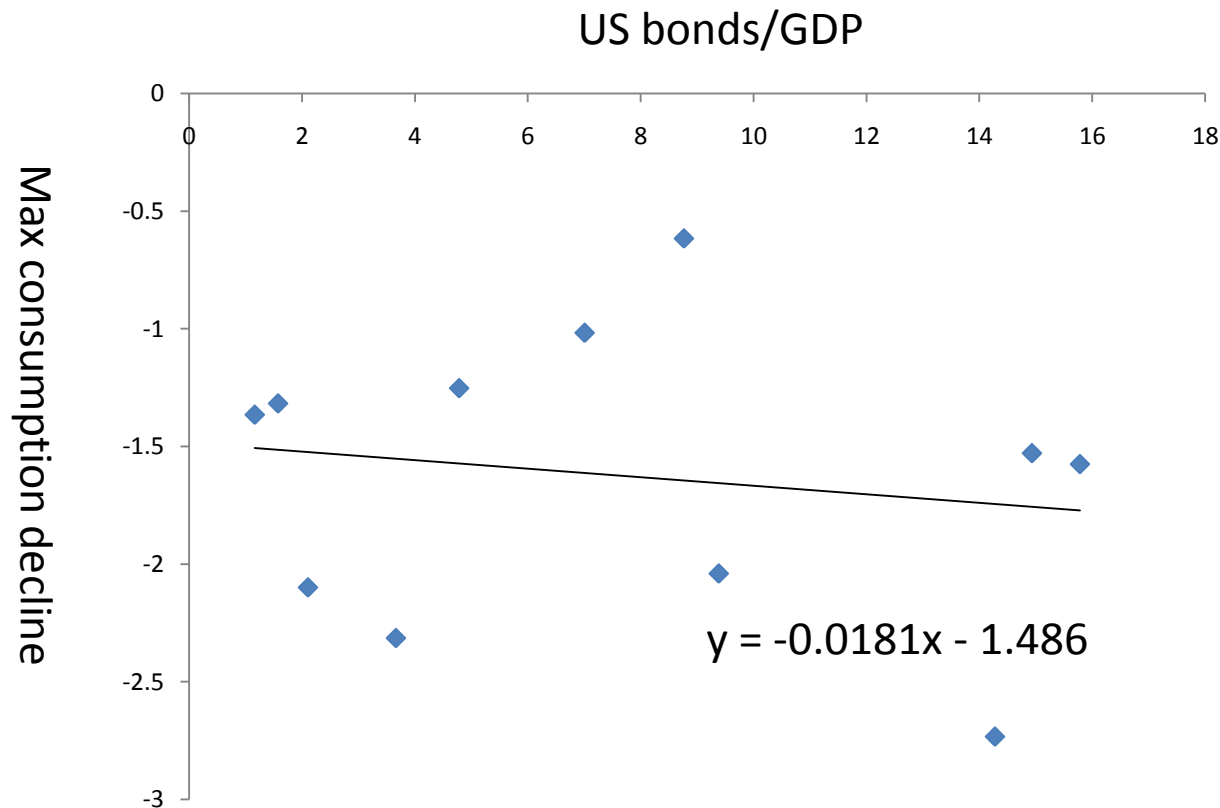
- Consumption deviation from trend: =
normalised deviation of consumption from HP
trend, 1996Q1-2009Q4

Max. consumption decline from trend: 08-09



- US bonds useful for consumption smoothing?

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

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

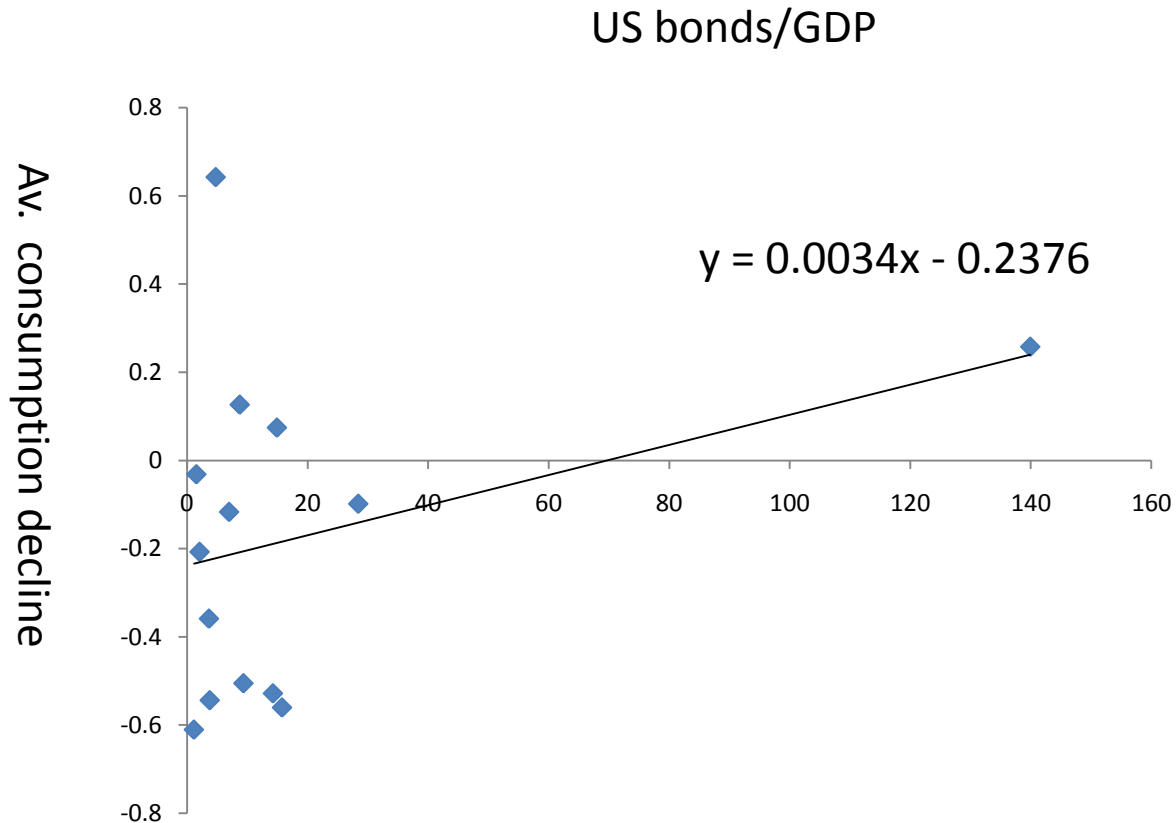
- Real return of nominal bonds affected by MP
 - $\text{Corr}(\text{real return}, \text{inflation}) = -0.49$ in US
- New source of international policy spillover
 - Traditional: terms of trade
 - This paper: foreign hedging demand for domestic assets
- Does it justify deviation from price stability?

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



Av. Consumption decline from trend excl. UK, Lux, HK

