Discussion of

Foreign Ownership of US Safe Assets: Good or Bad?

by Jack Favilukis, Sydney Ludvigson and Stijn Van Nieuwerburgh

Oleg Itskhoki
Princeton University

AEA Meetings, San Diego, 2013
Global Imbalances

- Persistent global CA imbalances:
  - US, UK versus China, Japan, Oil Exporters
  - Regional imbalances: Spain & Co versus Germany

- Large private net foreign liability positions (US, UK, Spain)
  — offset mostly by equally large government reserve positions (China, Japan, OPEC)

- Simultaneously a period of low world interest rates and low inflation

- Resource relocation towards non-tradables (in particular, housing) and appreciated real exchange rate
Place in the literature

- **Origin and sustainability of the US CA imbalance:**
  - Global risk-sharing: MQRR
  - US as a venture capitalist: Gourinchas and Rey
  - Demand for US safe assets: CFG, Blanchard et al.

- **Unsustainable US current account:**
  - Obstfeld and Rogoff: need for a large depreciation

- **This paper:**
  - Welfare consequences of global demand for US safe assets
  - In particular, distributional consequences (within US)
  - Quantitative analysis
Mechanism in a nutshell

- Neoclassical benchmark (representative agents)

\[ C_1 \quad b_F \quad C_2 \]
Mechanism in a nutshell

- Add heterogeneity

![Graph with axes labeled C1 and C2]
Mechanism in a nutshell

- Add heterogeneity

- Add a lot of (realistic) ingredients:
  - Bewley-Aiyagari dynamic production economy
  - Life-cycle OLG model
  - Housing sector
Relationship to the gains from trade literature:
— standard argument with representative agents (neoclassical benchmark)
— ability to compensate the losers (Dixit and Norman)
— possibility of losses from trade (Newbury and Stiglitz)

Decomposition of the gains (and losses):
— Standard terms-of-trade forces (i.e., those who need to borrow gain)
— Amplification through collateral constraints
— Amplification through housing and stock markets
  • Level of gains versus distribution (aggregation, redistribution)
Calibration of the process for NFA:

\[(b'_F - \bar{b}) = \rho (b_F - \bar{b}) + \sigma \eta, \quad \eta \sim iid \mathcal{N}(0, 1)\]

\[\bar{b} = 15\%, \quad \sigma = 1.5\%, \quad \rho = 0.95\]

No government response function to \(b_F\) shocks

— no Ricardian equivalence ⇒ role for gov’t portfolio choice (venture capitalist)
— gov’t policy function (“sterilization”)
— also maximize the rents on safe assets (Bolton and Jeanne)
Comments

5 Other sources of gains and losses:
   - US as a “venture capitalist”: capital gains on NFA (Gourinchas and Rey)
   - Dollar as reserve currency, low inflation
   - Loss of competitiveness and “Dutch decease”
   - Bubbles and volatility (sudden stop)

6 Other moments in the data:
   - Dynamics of interest rate
   - RER appreciation (and required depreciation)
   - Labor allocation across sectors (tradable vs non-tradable) and (static) terms-of-trade appreciation
Net Foreign Assets and Interest Rate

Figure 1. Three Stylized Facts

Sources:
(a) WDI and Deutsche Bank; (b) International Financial Statistics and Survey of Professional Forecasters; (c) World Development Indicators, Bureau of Economic Analysis, European Central Bank, Bank of Japan, and Authors’ calculations (see Appendix).

A. Current account by region (percent of world output)

B. World and US real interest rates