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 ▸ show figure

- 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)
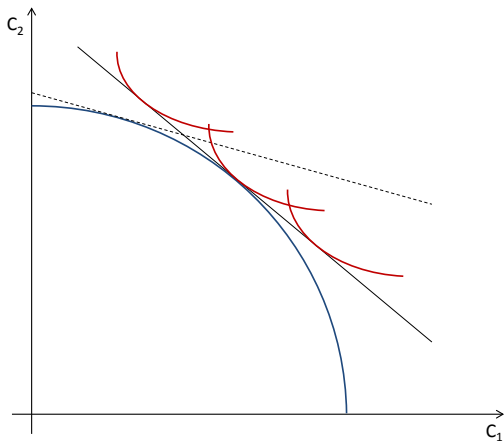 - — Quantitative analysis

Mechanism in a nutshell

- Neoclassical benchmark (representative agents)
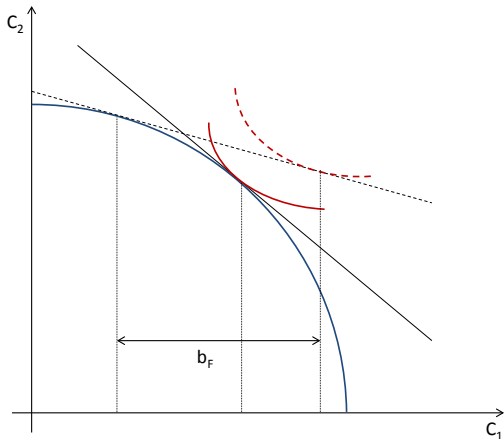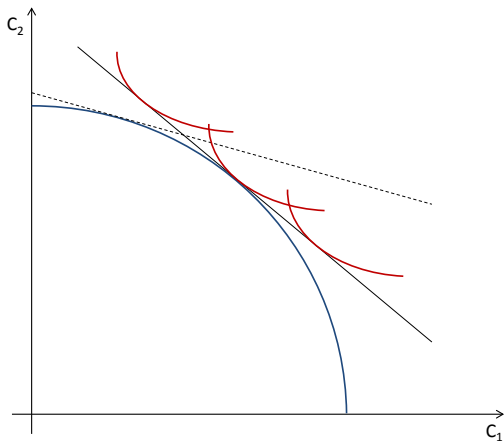
Mechanism in a nutshell

- Add heterogeneity

Mechanism in a nutshell

- Add heterogeneity

- Add a lot of (realistic) ingredients:
  - — Bewley-Aiyagari dynamic production economy
  - — Life-cycle OLG model
  - — Housing sector

Comments

**❶** 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)

❷ 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)

Comments

③ Calibration of the process for NFA:

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

$$\bar{b} = 15\%, \qquad \sigma = 1.5\%, \qquad \rho = 0.95$$
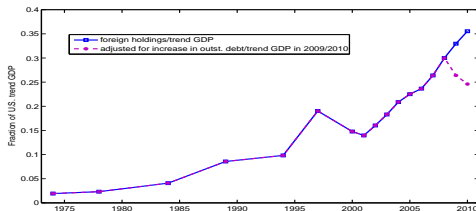
④ No government response function to b_F shocks
  — no Ricardian equivalence ⇒ role for gov't portfolio choice (venture capitalist)
  — gov't policy function ("sterilization")
  — also maximize the rents on safe assets (Bolton and Jeanne)

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

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

B. World and US real interest rates