



BANK FOR INTERNATIONAL SETTLEMENTS

Discussion of
Global Safe Assets

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Monetary Policy in an Interconnected Global Economy

Bank of Thailand and International Monetary Fund

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The views expressed are my own and do not necessarily reflect those of the BIS

Three good papers for the price of one

Inside liquidity

- Dominance of private-label assets

Prophylaxy

- The no-bubble equilibrium

Lender of last resort

- Mario Draghi is right

Inside liquidity

- Its dominance
 - Less safe into more safe, less liquid into more liquid
 - Demand stems from frictions, supply shifts with redefinitions
 - Importance of credible official commitment
- An example of redefinition within financial sector
 - Tri-party contract leads to growth in repo market
 - Eligible collateral includes CDOs, risky debt
 - Run in 2008 with good collateral redefined as only OMO

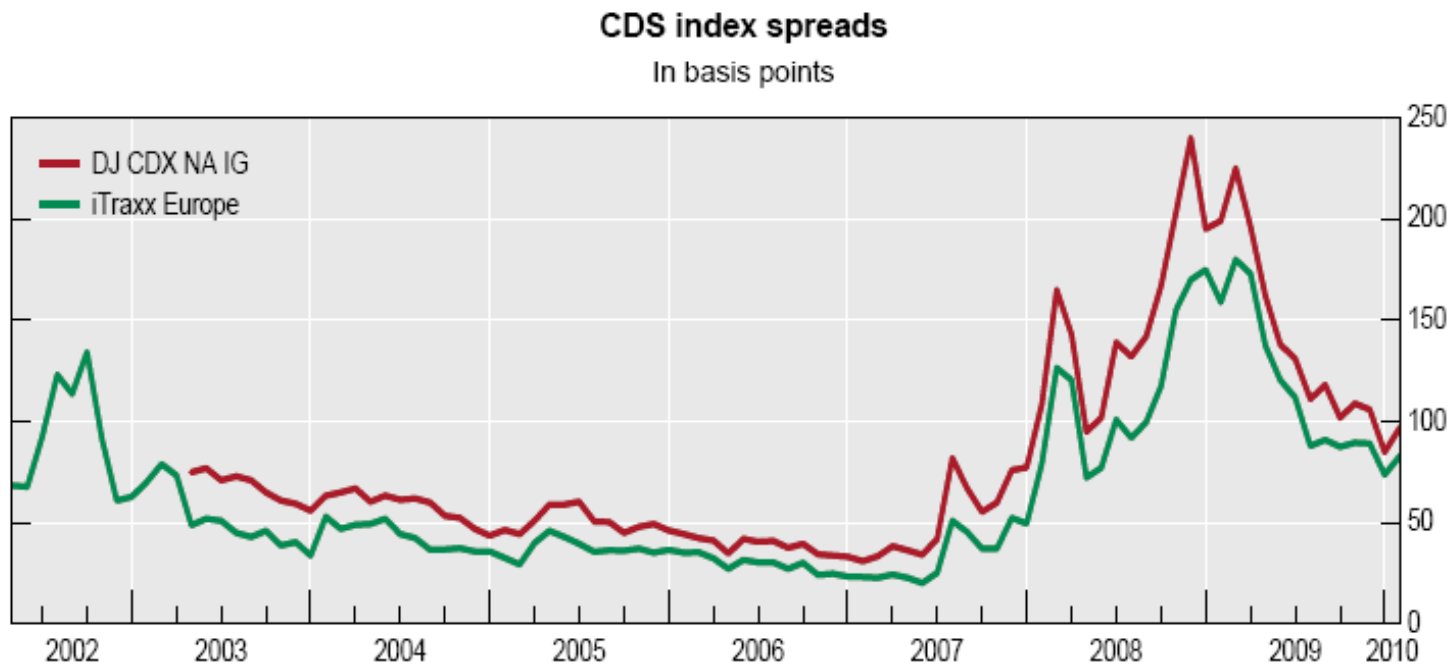
Prophylaxy

- The no-bubble equilibrium

V such that $\alpha < \theta\delta$.

- How to map into real world?
 - Initially, low δ leads to more private-label bubbles
 - In crisis, collapse of bubbles raises α
 - Role of central bank -- maintain supply of safe asset

The global credit market bubble of 2002-07



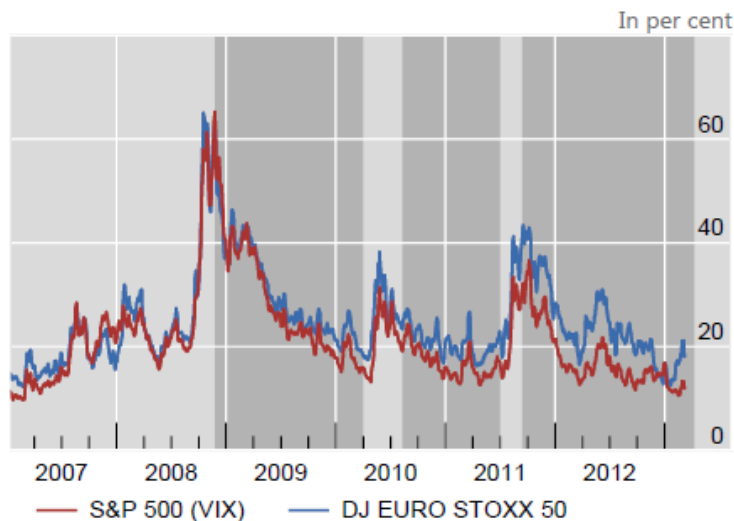
Five-year on-the-run CDS spreads.

Source: JPMorgan Chase.

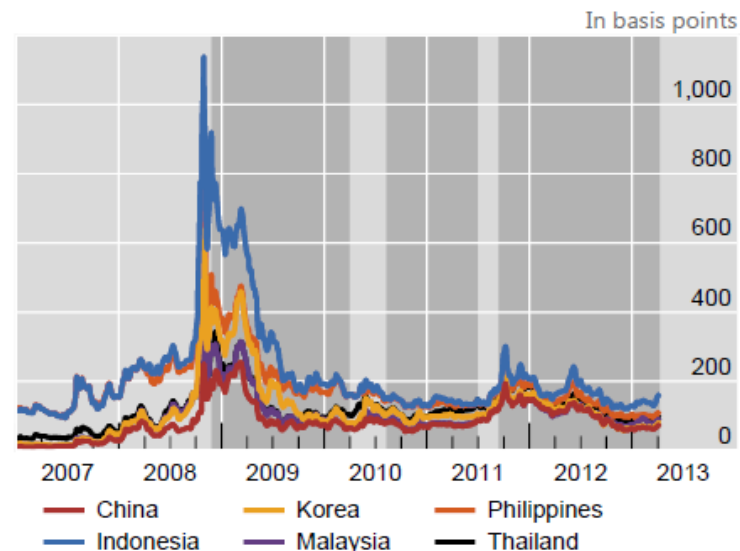
Risk appetites in three rounds of asset purchases

Implied volatilities in major equity markets, sovereign CDS spreads in Asia

Implied volatilities in major equity markets



Sovereign CDS spreads



Lender of last resort

- A model of two risks
 - Roll-over risk in government debt; inflation risk of monetizing debt
 - Monetary dominance -- central bank with strong operational independence
 - Good equilibrium and bad
 - Monetary backstop justified; moral hazard not a big deal
- Lessons from the ECB
 - August 2012 OMT, “as much as it takes” – announcement effect sufficient
 - Moral hazard and conditionality