Macro Roundup Artcile

Headline: Political Risks to the U.S. Safe Harbor Premium

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Tweet: US financial assets benefit from a "Safe Harbor Premium" due to perceived lower risk. @ernietedeschi argues that US “shadow risk” increased 20-25 bps between 2016-20.

Summary: Expected Return on Equity Investment = Risk-Free Rate + Global Equity Risk Premium + Country Risk Premium. Even a relatively modest move in risk premia would have profound implications for the US. If the US country risk premium moved to that of the current UK level, after 10 years, real equity wealth per household would be $50,000 lower and real GDP 1% smaller. The erosion of safe harbor advantages could include more uncertainty and discontinuous risk, higher bond yields, and, ultimately, lower growth. Country risk analysis is a relative concept. Since the US is conventionally the benchmark for measuring global risk, by construct, US risk is often assumed to be 0%. Along several different dimensions, however, US political risk has risen over the last eight years: we estimate a “shadow” risk premium for the US that implies that US political and institutional risk is more consistent with a country risk premium of 25-35bps rather than zero. For context, this is roughly half of the UK’s premium in the immediate aftermath of Brexit. US shadow political risk was broadly falling over 2006-16 and has risen since by around 20-25bps. Most of this rise occurred from 2016-20.

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Primary Topic: Fiscal Deficits

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