General Discussion of 'Gaining and Losing US Government Funding Advantage'

One participant noted that the periods during which US Treasuries lost their funding advantage coincided with unanchored inflation expectations, and it was generally agreed that inflation expectations are a key driver of Treasury market prices. One participant suggested that many of the 'puzzles' documented in the literature stem from the periods when inflation expectations became unanchored.

The discussion turned to the nature of the 'trilemma' faced by governments. It was noted by one participant that the trilemma could be considered a dilemma, given the strong preference of governments to avoid disruptions to the financial sector. Other participants noted, however, that government bailouts of the financial sector are a relatively recent phenomenon, with widespread banking failures having occurred in the past.

The discussion concluded on the lessons for policy provided by the 19th and 20th centuries, including differences in the funding advantage during the First World War and Second World War. It was noted that the First World War coincided with the end of the National Banking Era and the establishment of the Federal Reserve, which was not initially intended to hold government debt, thereby contributing to a weaker funding advantage. In contrast, during the Second World War, the Federal Reserve and US Treasury actively stabilised bond prices, encouraging the banking sector to hold large quantities of US Treasuries and strengthening the funding advantage. Similarly, it was conjectured that the collapse of Bretton Woods may have reduced the funding advantage by removing the requirement for international banks to hold US Treasuries.