

# International Consumption Risk Sharing Gains and Asset Returns\*

KAREN K. LEWIS<sup>†</sup>      EDITH X. LIU<sup>‡</sup>

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## Abstract

Although asset returns incorporate direct valuations of risk, international consumption risk sharing studies have largely ignored the counterfactual implications for asset pricing moments. In this paper, we consider modifications that generate more plausible asset return behavior and ask what they imply about international risk sharing gains. Persistent consumption risk is required to explain the mean and variance of equity returns, but this risk implies greater risk sharing gains than transitory risk alone. Moreover, the magnitude of these gains depends inversely upon the degree of correlation in persistent consumption risk across countries. We identify a high correlation of persistent consumption risk based upon the correlation of equity returns relative to consumption returns. This analysis suggests that countries have limited ability to diversify persistent consumption risk through international risk sharing.

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<sup>†</sup>University of Pennsylvania and NBER. E-mail: lewisk@wharton.upenn.edu

<sup>‡</sup>Cornell University. E-mail: edith.liu@cornell.edu