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Global imbalances, saving glut and investment strike

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The present state of the global economy is characterised by persistent and increasingly polarised current account imbalances, in a context of historically low long-term interest rates, which stand below the equilibrium levels proxied by potential growth and trend inflation. A comprehensive analysis by Ben Bernanke[1] attributes those two phenomena to one common cause: a global saving glut outside the United States.

The approach below is more pessimistic than the global saving glut theory as far as the diagnosis is concerned, as the most striking feature of the present state of the global economy is not so much a saving glut as an investment strike, in spite of low long-term interest rates.

This also affects the US economy where corporate investment remains subdued relative to profits, adding to the gradual loss in its tradable productive capacity, possibly to the benefit of large foreign direct investment outflows. So far, such a model could be seen as sustainable. Indeed, in spite of an increasingly large deterioration in the US net international investment position, the balance of income has remained positive owing to a favourable yield spread between assets and liabilities. However, the tipping point, beyond which net investment income turns negative and therefore becomes a levy on domestic resources, seems to be near.

This may lead to serious foreign debt sustainability issues and reinforces the "steep exchange rate adjustment" exit scenario with all its potentially harmful side effects. Recently, some optimistic assessments of exchange-rate-led adjustment have focused on valuation effects, through which a large amount of the US net foreign debt could be wiped out by a US dollar depreciation. We suggest that such an exchange rate shock would be likely to trigger an increase in US interest rates, which makes an exchange rate shock not as painless as it seems for the US economy. Besides, such a shock could be potentially more harmful than previous episodes of sharp US dollar adjustment from the perspective of the global economy, as the ratio of foreign-owned assets in the United States to the world GDP has tripled since the mid-1980s.

However, as far as the other exit strategies are concerned, the approach below is more optimistic: since economic policies had a significant influence on the run-up to the current situation of low interest rates/global imbalances, reorienting economic policies may successfully address the issues at stake, leading to a gradual policy-driven resolution process which could be less disruptive than a market-led adjustment.

The note is organised as follows: section 1 provides a brief summary of the mechanisms and implications of the "saving glut hypothesis"; section 2 discusses the accuracy of the saving glut hypothesis by looking at savings and investment behaviour in various economic regions; section 3 focuses on the saving/investment balance in the corporate sector, particularly in the United States, and the shift to the rent economy hypothesis and finally section 4 outlines various possible adjustment mechanisms of the global imbalances/low interest rates combination.

[1] *"The Global Saving Glut and the US Current Account Deficit"; remarks by Governor Ben S. Bernanke at the Sandridge Lecture, Viginia Association of Economics, Richmond, 10 March 2005.*