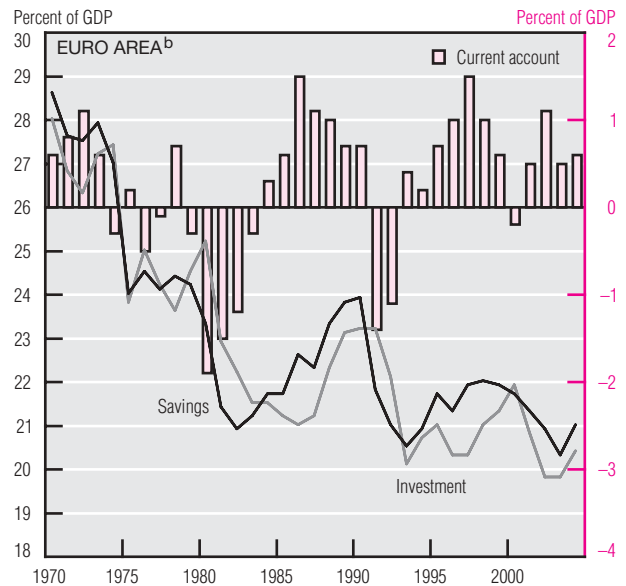
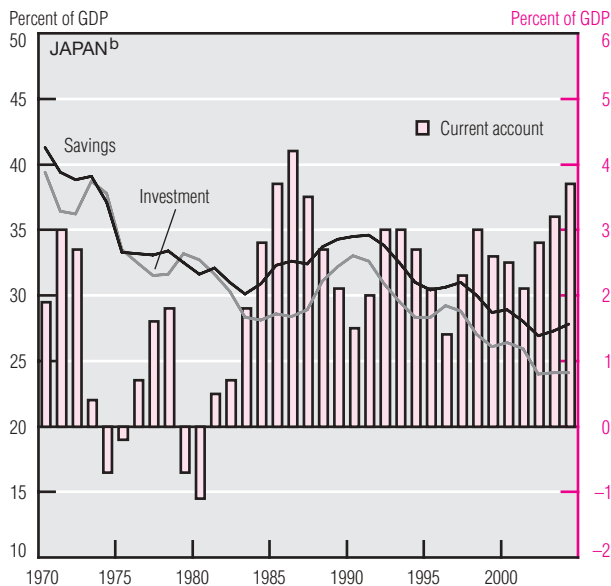
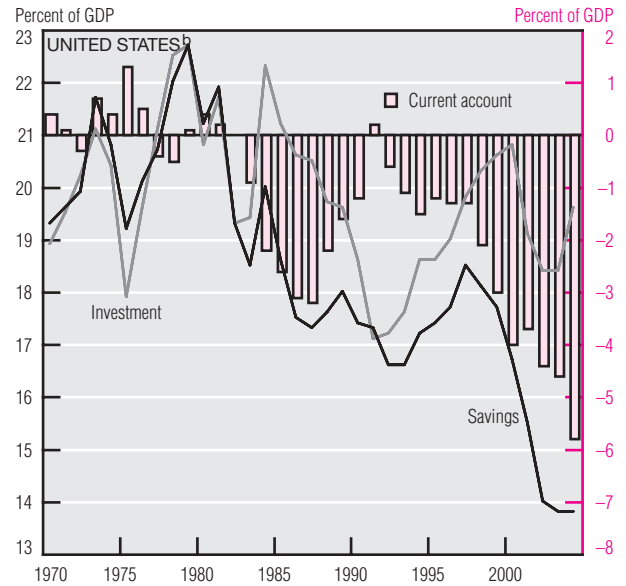
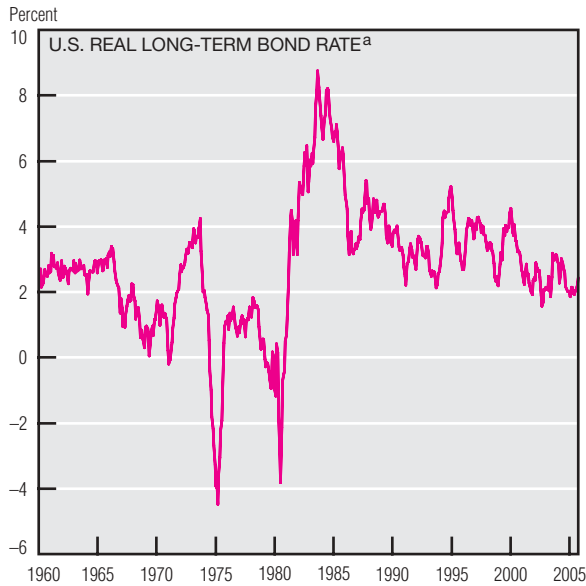


The Interest Rate Conundrum and the Savings Glut



a. Calculated using 10-year Treasury bond rate and 12-month change in CPI less food and energy.

b. IMF staff calculations. Original sources include the OECD Analytical Database; and the World Bank, *World Development Indicators*.

SOURCES: Federal Reserve Board; Bureau of Labor Statistics; and International Monetary Fund, *World Economic Outlook*, September 2005, pp. 91–124.

Two of the brightest blips on U.S. policymakers' radar screens are the low level of U.S. long-term interest rates and our large, expanding current-account deficit. Global saving and investment patterns go a long way toward explaining both of them.

Real long-term interest rates in the U.S. and elsewhere around the globe seem unusually low for the current state of the business cycle. A recent International Monetary Fund study of 46 countries (including industrialized, emerging-market, and oil-producing

nations) suggests that lackluster global investment helps explain real interest rates.

Expressed as a percentage of world GDP, global investment fell from 23% in 1997 to 21% in 2002. It recovered to approximately 22% in 2004, according to the latest available data. The current pace of worldwide economic recovery and recent declines in the cost of capital seem capable of supporting a higher level of global investment than we have recently seen.

Among industrialized countries, most of the investment decline was concentrated in the euro area and in Japan, where 15 years of subpar economic growth has taken a toll. On balance, investment in most other industrialized countries remained fairly flat between 2001 and 2004. In the U.S., however, fixed investment has recently been rebounding.

Investment in most East Asian countries fell precipitously after the Asian financial crisis in the mid-1990s. A notable exception is China, where

(continued on next page)

The Interest Rate Conundrum and the Savings Glut (cont.)



a. IMF staff calculations. Original sources include the OECD Analytical Database; and the World Bank, *World Development Indicators*.
SOURCE: International Monetary Fund, *World Economic Outlook*, September 2005, pp. 91–124.

investment has risen sharply. Among oil-producing nations and other emerging-market nations, investment has been unimpressive.

In the aggregate, savings must equal investment; not surprisingly, global savings have declined as a share of world GDP. Within any country or region, however, savings can—and typically do—differ from local investment. Divergences between nations' saving and investment patterns are mirrored in their current-account positions. Countries running current-account surpluses save more

than they invest, whereas countries experiencing current-account deficits invest more than they save.

In most countries and regions covered in the IMF study, savings closely paralleled—but slightly exceeded—local investment. Consequently, most countries and regions maintain small current-account surpluses.

There are, however, striking exceptions. As a consequence of federal budget deficits and low private savings, overall savings in the U.S. have fallen sharply since 1997 and remain well below our level of investment. In contrast, most East Asian countries

and oil-producing countries maintain savings substantially in excess of local investment. Inflows of savings from these emerging-market economies account for roughly two-thirds of the divergence between U.S. investment and savings. The pattern of their savings, currently at record levels, generally reflects many East Asian governments' wish to acquire foreign-exchange reserves as a buffer against future financial crises and as a consequence of relatively low returns in investment projects in these emerging economies.