

# The *Looming* Global Savings Drought

*Soon, Fed Chair Jerome Powell's job  
will become a lot more complicated.*

BY ROBERT DUGGER

**I**n the past twenty years, there have been many market surprises. Two, however, will force profound changes in monetary policy thinking. The first surprise was the declining trend in Treasury bond rates in the 2000s. The second was the rising trend of Treasury bond rates in 2022 and 2023. Both surprises marked large changes in investable world savings and the urgent need for U.S. deficit containment.

In 2005, U.S. Federal Reserve Governor Ben Bernanke attributed the first surprise to a world “savings glut.” Departing from much of the academic thinking at the time, he argued that excess savings outside the United States made interest rates—particularly long-term rates—lower than they would be otherwise. He wrote, “[O]ver the past decade a combination of diverse forces has created a significant increase in the global supply of saving—a global saving glut—which helps to explain both the increase in the U.S. current account deficit and the relatively low level of long-term real interest rates in the world today.”

These “diverse forces,” he explained, “transformed emerging-market economies from borrowers on international capital markets to large net lenders,” and he pointed out that, “virtually all economies today are open economies, and well-developed international capital markets allow savers to lend to those who wish to make capital investments in any country, not just their own. Because saving can cross international borders, a country’s domestic investment in new capital and its domestic saving need not be equal in each period. If a country’s saving exceeds

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its investment during a particular year, the difference represents excess saving that can be lent on international capital markets.”

Net savings as reported by the World Bank reflects the “excess savings” Bernanke referred to. The 1970 through 2005 portion of Figures 1 and 2 shows what Bernanke was seeing—nominal world net savings alone and as a percent of world GDP was rising almost without interruption. The Treasury Department had no trouble selling its bonds. Every issue was eagerly purchased by investors worldwide, mainly by private and public entities in high net savings economies such as Japan, South Korea, Middle East and Africa oil economies, and China.

However, as Figure 1 shows, nominal savings peaked in 2011. Thereafter, the GDP growth in Figure 2 could be accomplished only by increased public and private leveraging of available savings.

National net savings is a measure of a country’s total saving after accounting for depreciation of its capital

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*The flow of investable world savings for the past five years has been flat or trending down. But U.S. demand for savings is expanding.*

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stock and is the liquidity available to be invested worldwide. World net savings is the sum of the savings of 217 nations whose national income and product accounts are reported to the World Bank. Analyzing world savings flows using International Monetary Fund-reported current and capital account data is an alternative approach. A paper by Chicago Federal Reserve Bank economists Robert Barsky and Matthew Easton, “The Global Saving Glut and the Fall in U.S. Real Interest Rates: A 15-Year Retrospective,” lays this approach out. Because the World Bank data nets out capital stock depreciation, it more closely aligns with market perceptions of investable savings. Both approaches yield similar conclusions; however, net savings enables a direct supply/demand framing of  $r^*$  (the natural real rate of interest) and rates for the entire yield curve and facilitates

critically important fiscal sustainability debates, especially in the United States.

The topping out of world net savings growth was hidden by the clouds of massive fiscal and monetary covid stimulus. When the skies began to clear in 2022, those asset managers and central bankers who expected the relationships between official rates and long-term bond rates that prevailed during the savings glut years to continue were surprised.

They missed the fact that by 2017, the savings glut was conclusively over. Figure 3 shows the nominal amount of net savings of the ten highest-saving nations through 2020. As Figure 3 indicates, U.S. saving stalled in the late 1990s and then was surpassed by that of China in the mid-2000s. Next to the United States, the highest-saving nation in the late 1990s was Japan. As its savings declined in the early 2000s, it was replaced by China as the leading savings provider. However, China’s net savings peaked in 2018 and has been declining since.

Fed research on corporate profitability aligns with this chronology. In “End of an era: The coming long-run slowdown in corporate profit growth and stock returns” (2023), Fed economist Michael Smolyansky concludes, “[T]he decline in interest rates and corporate tax rates over the past three decades accounts for the majority of the period’s exceptional stock market performance. Lower interest expenses and corporate tax rates mechanically explain over 40 percent of the real growth in corporate profits from 1989 to 2019. In addition, the decline in risk-free rates alone accounts for all of the expansion in price-to-earnings multiples.”

By 2022, the world savings market had become much tighter, and longer-term rates were rising. In October 2023, U.S. Treasury Secretary Janet Yellen warned about weak foreign demand for U.S. securities. “We are worried about a loss of adequate liquidity in the market,” she said. In answer to a question, she suggested that buying back certain U.S. government securities is



*The 2000s and 2020s surprises will inevitably change how central bankers see themselves. In time, Fed Chairman **Jerome Powell** will not be able to talk about U.S. monetary policy solely in terms of U.S. conditions.*

a possibility. “It’s something a number of” other governments “have done from time to time.”

A week later, the Treasury Borrowing Advisory Committee said that “while there is still reasonable demand for U.S. Treasuries from many domestic and international market participants, it has not kept pace with the increase in supply.”

The following week, the Federal Open Market Committee meeting statement added “financial conditions”

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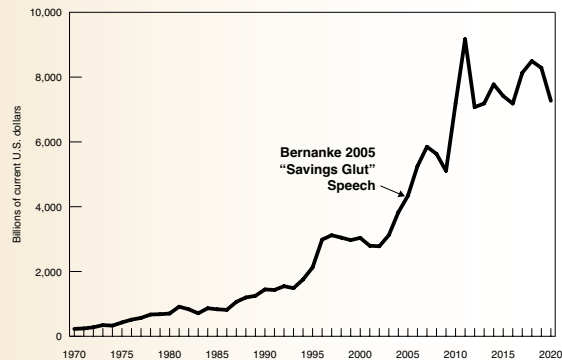
as a factor that “would weigh on economic activity, hiring, and inflation.”

The initial response from mainstream market participants and policymakers was to focus on estimating the “term premium”—the hard-to-measure additional yield that investors require for holding Treasury bonds to maturity to compensate for taking long-term risks. The focus was misplaced in the view of some east Asian investment managers with decades of experience allocating net savings from that region to the rest of the world.

As one manager commented, the focus on term premia “... enables Americans to avoid thinking about actual supply-demand conditions and how much more of the world’s savings they need than other nations.” He and his colleagues see interest rates simply as prices determined by supply and demand. For them, the flow of investable world savings for the past five years has been flat or trending down. But U.S. demand for savings is expanding and appears to be politically driven and intractable. The problem, they say, is evident in charts like Figures 4 and 5.

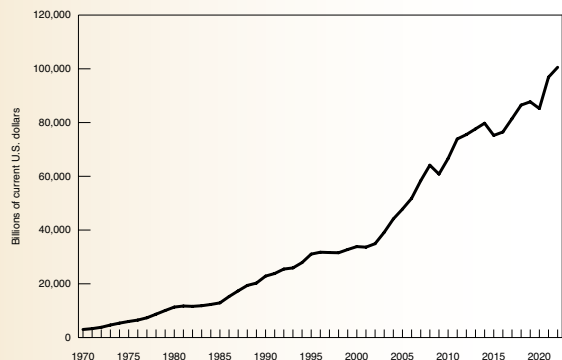
Figure 4 shows the portion of reported U.S. debt and equity liabilities owned by U.S. entities. Data below zero percent shows U.S. borrowing massively by selling debt and equities to non-U.S. entities after the mid-1980s when the U.S. current account balance went negative. The downtrend was required to enable the U.S. to support its consumption, continue to serve as global policeman, and keep voter support of the government. Figure 5 shows the net international investment position of major economies including the United States. It indicates that most of the world’s post-Great

**Figure 1 World Nominal Net Savings Since 1970**



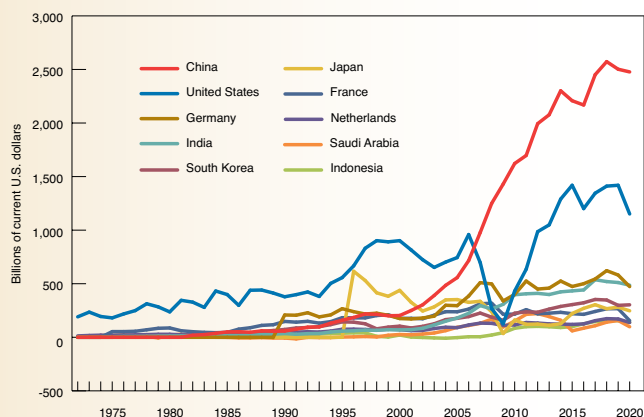
Source: World Bank.

**Figure 2 World Nominal GDP Since 1970**



Source: World Bank.

**Figure 3 Nominal Net Savings, 1972–2020, of Ten Highest-Saving Economies in 2019**



Source: World Bank.

Financial Crisis leveraging was done by the United States selling more than \$15 trillion of U.S. dollar debt and equities to foreign investors.

These Asian asset managers argue that the cost of investable capital worldwide is determined where the curves of world net savings supply and demand intersect. They refer to this cost as the “savings-market clearing rate” (SMCR). There is a yield curve of SMCRs ranging from hours to decades. In their view, the SMCR curve is the key determinant of national interest rates at all maturities and currency values worldwide. The SMCR for a given maturity is a function of the realized intersections of

the net savings supply and demand of hundreds of economies given their domestic rates and currency values, and expressed as a percentage rate in, say, dollars, euros, or their own currency.

Bernanke’s “excess savings” were invested at rates set by the SMCR yield curve. Because the supply curve was

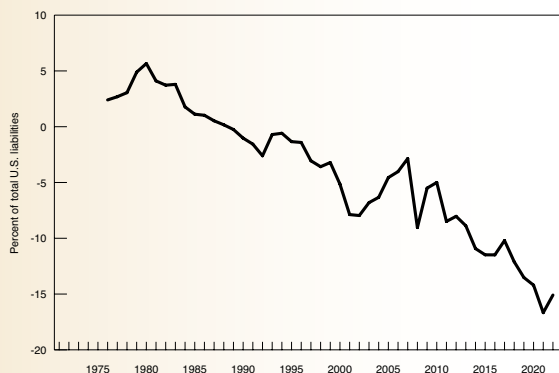
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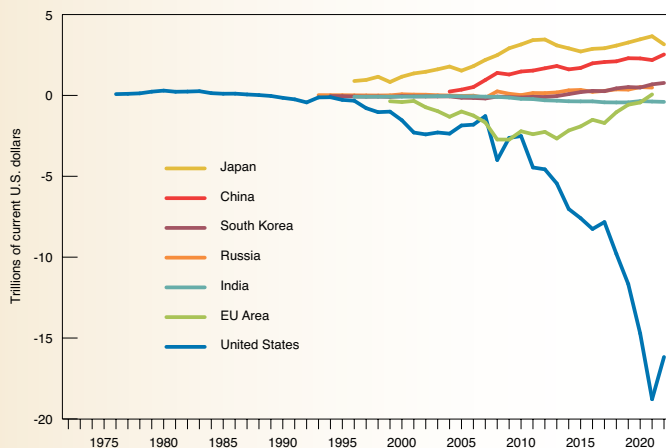
**Figure 4 U.S. Net International Investment Position**

Percent of total U.S. liabilities (debt plus equities)



Sources: International Monetary Fund, U.S. Federal Reserve, and Statista.

**Figure 5 Regions with largest net international investment positions in 2019, 1972–2022**



Source: International Monetary Fund.

expanding more than the demand curve during the “savings glut” years, SMCRs were falling, putting downward pressure on U.S. rates.

The SMCR’s effect on currencies depends on whether a country can afford to pay the higher rates. If they cannot, their currencies will fall in value as capital flows from their markets to the economies that can. This is the case for many developing economies now. Currencies of economies that can pay the higher rates, such as the U.S. dollar, will rise in value.

The slope of the supply and demand curves is crucial. Over a one-to-two-year period, the amount of net savings an economy can generate is likely to be relatively fixed. During that period, the world savings supply curve is probably nearly vertical (inelastic), and even small shifts in demand will cause the point of intersection to rise or fall significantly. If deficits are rising and asset managers and policymakers have out-of-date world net savings expectations, they will be surprised by how much their domestic interest rates rise—as they were in 2022 and 2023. If the United States cannot rein in its rising savings demand, supply inelasticity will be an aggressive threat to bond values.

The initial focus on term premia is now being replaced by deeper consideration of monetary policy in a closed world economy. In a July 2022 address, Bank of England Governor

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Andrew Bailey introduced a cost of capital concept similar to the SMCR. He talked about an upper-case  $R^*$  that is “driven by long-term structural factors”—an echo of Bernanke’s “diverse forces.” The key difference between  $R^*$  and SMCR is this: SMCR is simply a market rate.  $R^*$  in Bailey’s framing is the theoretical equilibrium real interest rate, which would “sustain output at potential and inflation at target.”

The broadly familiar lower-case  $r^*$ , Bailey said, “reflects the effects of cyclical shocks to both aggregate demand and supply and so can vary substantially over the short to medium term.” Upper-case  $R^*$ , he explained, is determined by “slow-moving but important structural changes, such as trends in population and demographics, technological changes (like increased automation and the rise of intangible capital), and environmental factors (like climate change and the transition to net zero)” that “shape policy decisions in the longer term.”

In their November 2023 paper, Bank of England economists Ambrogio Cesa-Bianchi, Richard Harrison, and Rana Sajedi echoed Bernanke and gave a nod to the SMCR concept when they wrote, “Over the long run,

when capital can move freely across countries, there exists a single interest rate that clears the global capital market. This global trend real interest rate, Global  $R^*$ , acts as an anchor for domestic interest rates in open economies, so that estimates of Global  $R^*$  are important inputs to longer-term structural analysis, including the design of policy frameworks.”

It is clear now that the 2000s and 2020s surprises will inevitably change how central bankers see themselves. In time, Fed Chairman Jerome Powell will not be able to talk about U.S. monetary policy solely in terms of U.S. conditions. Whether in a goldilocks growth moderation or an all-out financial crisis, he will get questions about global savings supply and demand and clearing rates, Fed monetary policy, and the U.S. and world economic outlooks.

Currently, Powell prefers to “stay in his lane” and not discuss fiscal policy. However, because the SMCR and ideas like  $R^*$  are directly affected by Congressional budget policy, he will have no option but to comment on the need for fiscal sustainability. When he does, it will mark the end of the beginning of Congressional resistance to fiscal reform. ◆