Economics 390
Topics in Macroeconomics
(11/4/2013)

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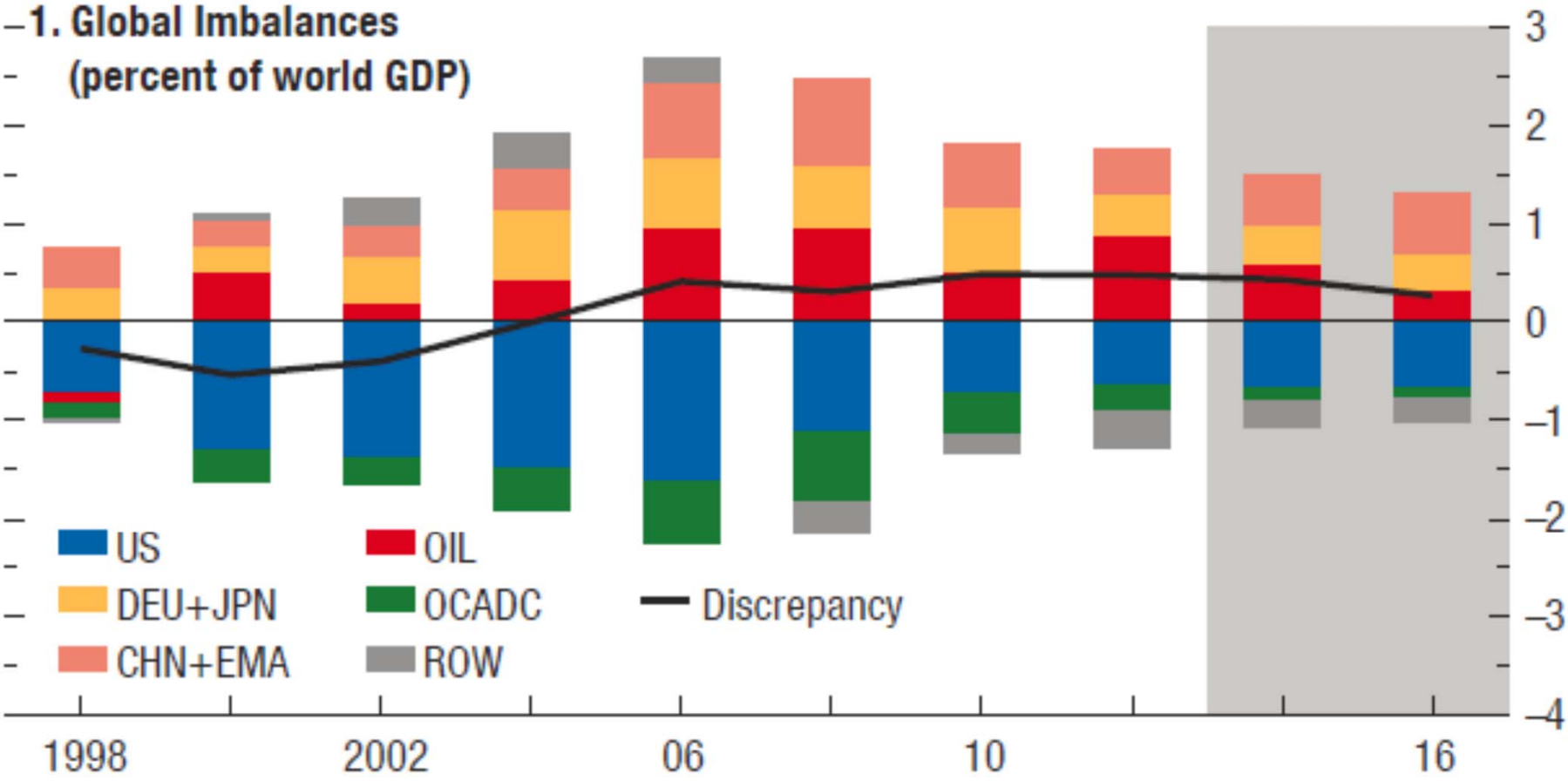
“The Saving Glut”

“*… some of the key reasons for the large U.S. current account deficit are external to the United States, ... Providing assistance to developing countries in strengthening their financial institutions … could … increase both the willingness of those countries to accept capital inflows and the willingness of foreigners to invest there. … Thus, we probably have little choice except to be patient as we work to create the conditions in which a greater share of global saving can be redirected away from the United States and toward the rest of the world - particularly the developing nations.*”

Bernanke (2005)

Current Account Imbalances



Source: IMF, *WEO*, October 2013, Figure 1.14

Theories of the Current Account

- Determinants of national saving and investment (demographics, public sector)
- Intertemporal approach (expectations of growth)
- Mercantilism
- Global saving glut/financial development and Bretton Woods II
- Distorted financial markets

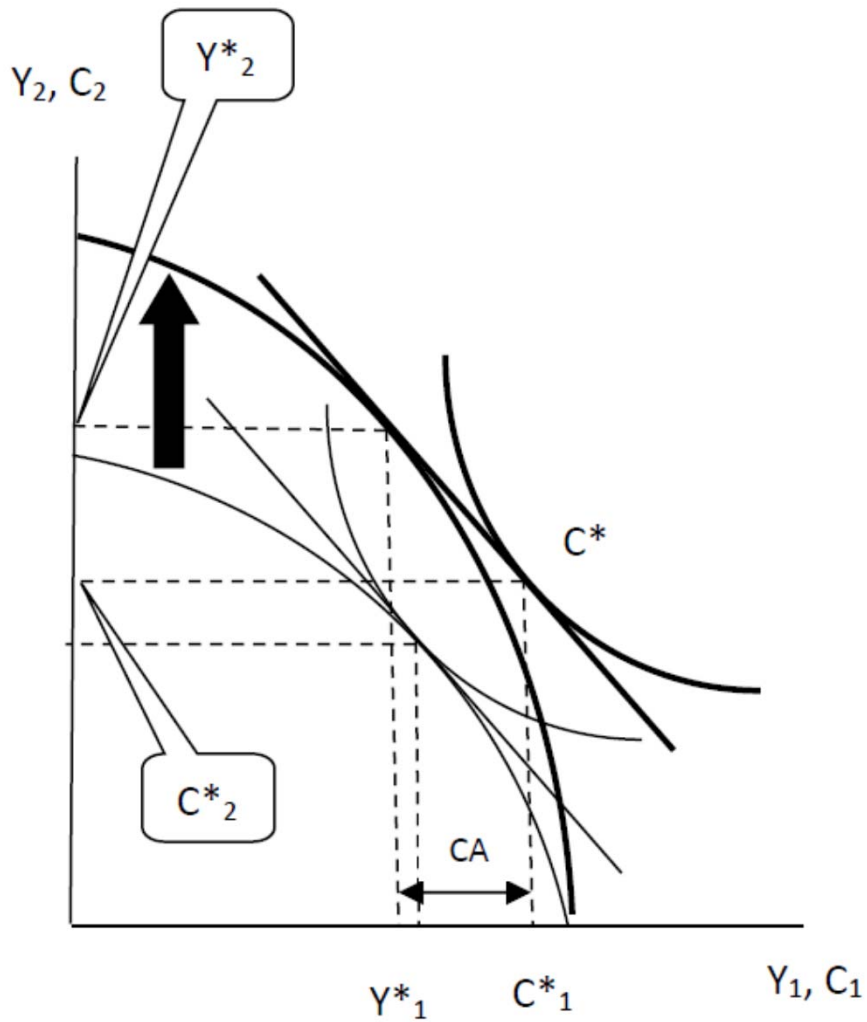
National Savings Approach

$$CA \equiv (T - G) + (S - I)$$

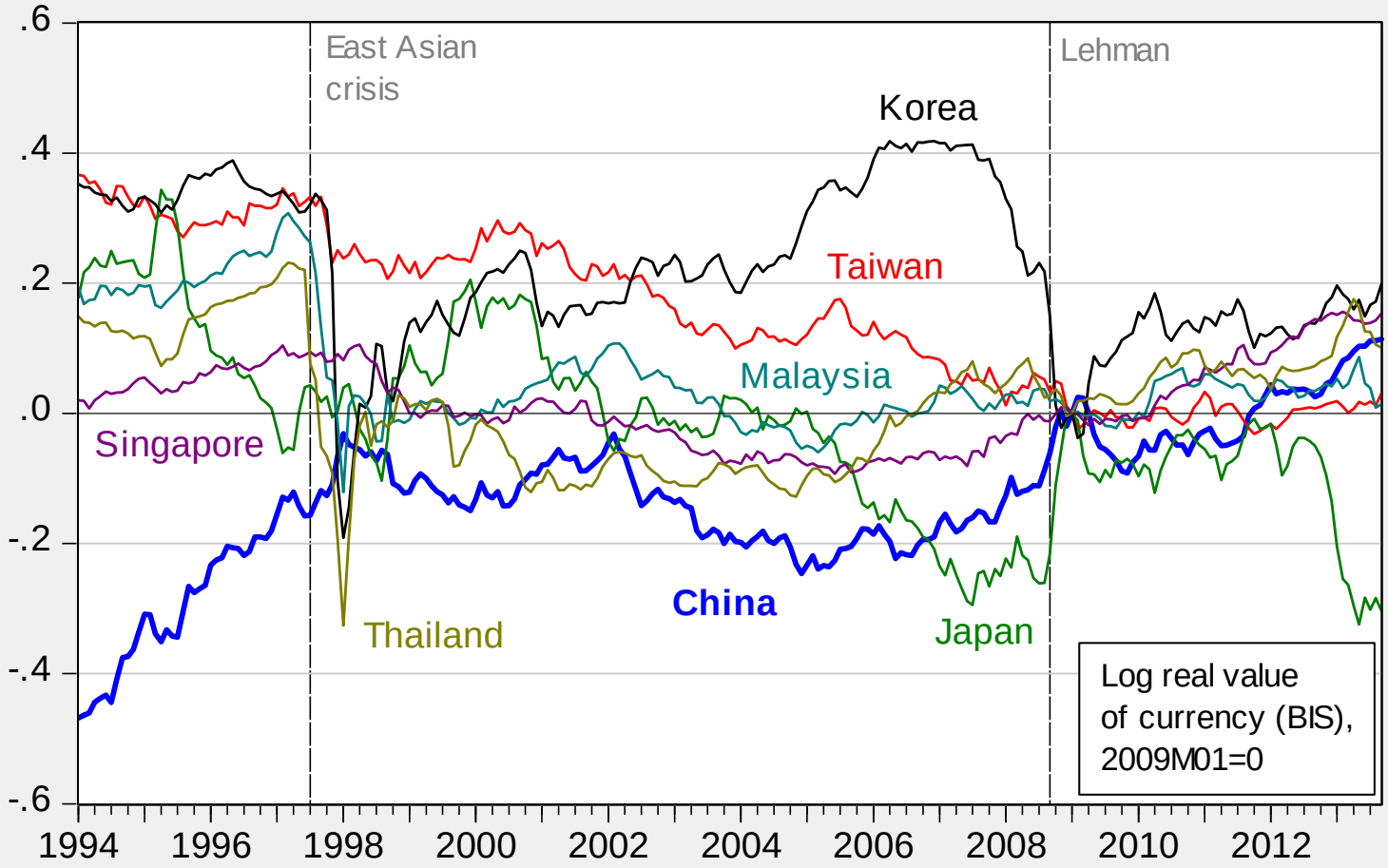
- T-G is the budget balance
- S depends on demographics, income volatility, per capita income, financial development
- CA depends on trade, financial openness
- Treats each country as independent from each other

Intertemporal Approach

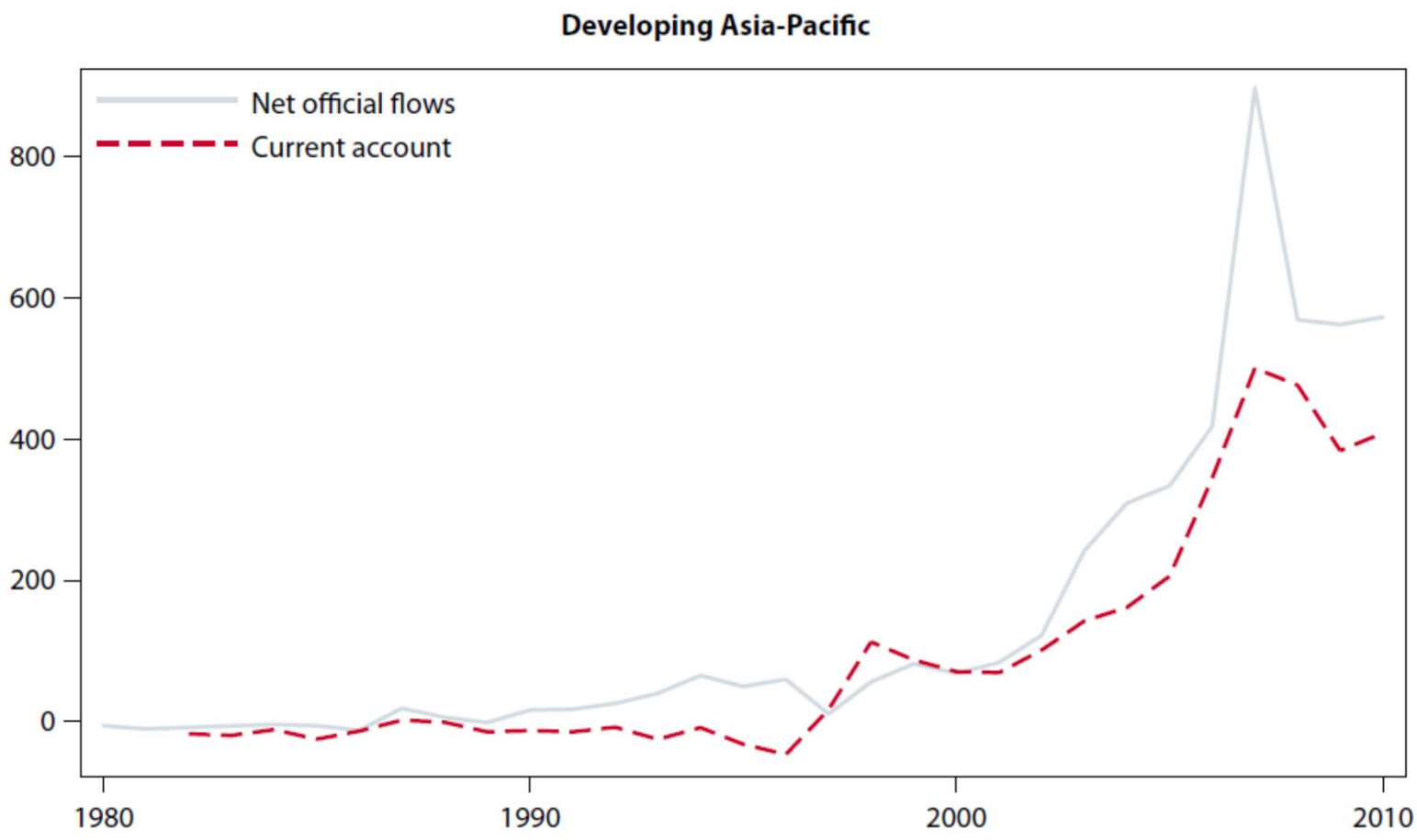
- Assume a future productivity shock
- Move from initial balance to deficit
- $CA = Y^*_1 - C^*_1 < 0$



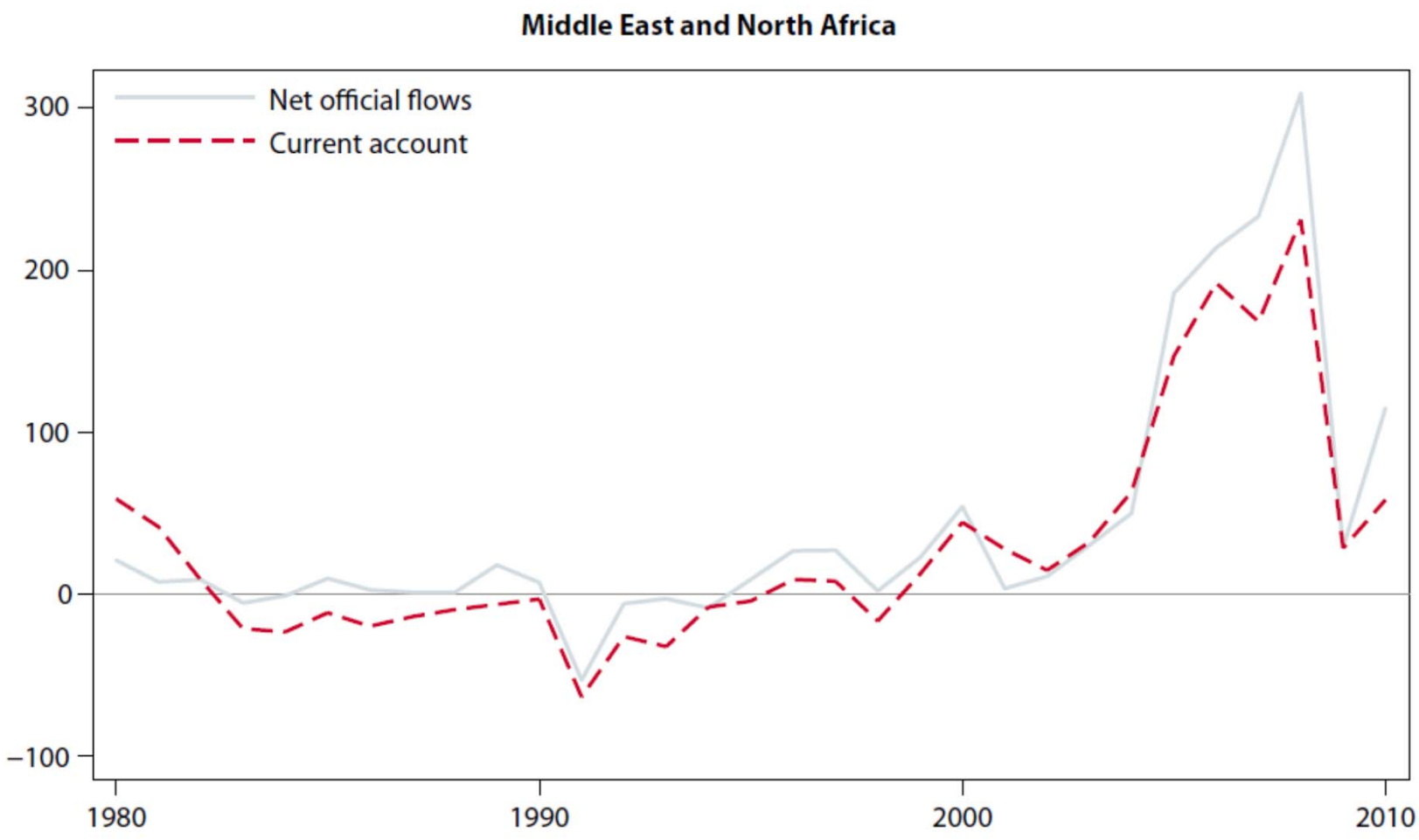
Mercantilism: Exchange Rates



Mercantilism: Intervention



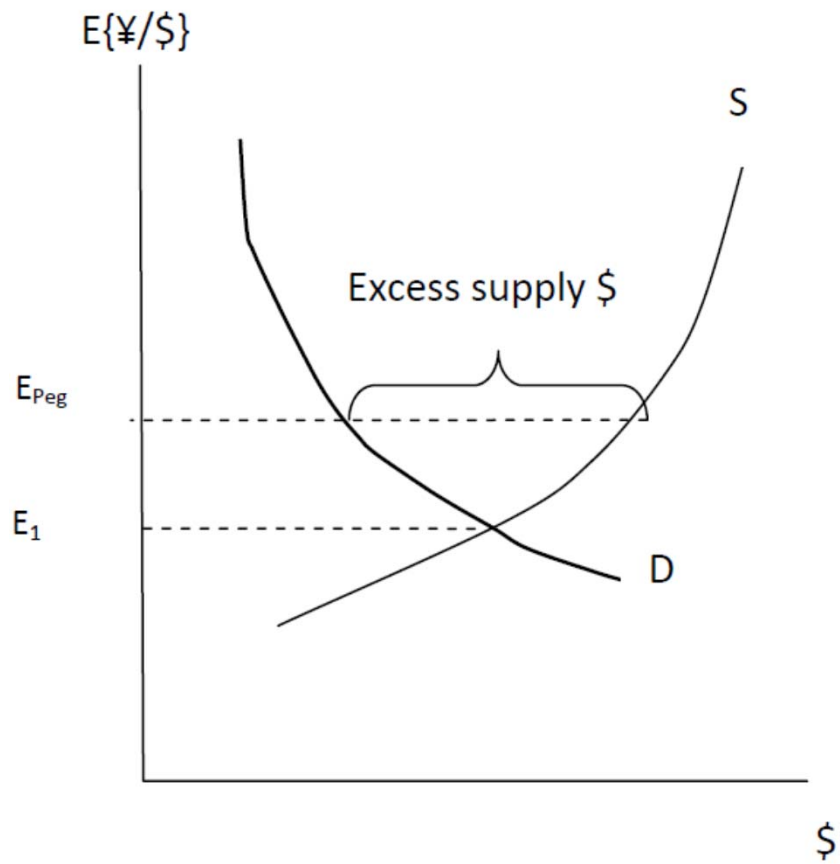
Mercantilism: Intervention



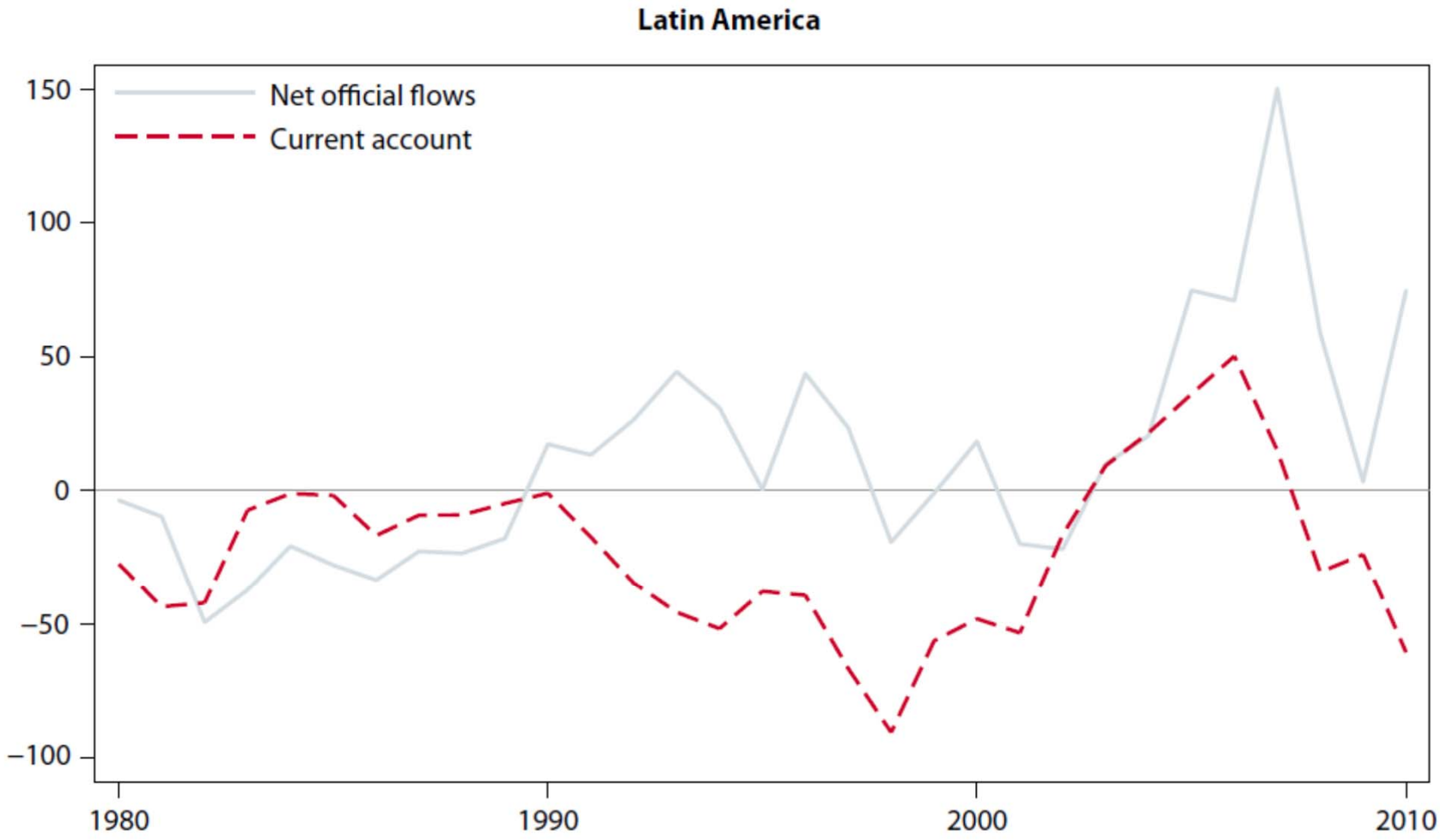
Mechanics

$$CA + (KA + ORT) \equiv 0$$

- Up is depreciation
- Peg or target at E_{peg}
- Hence undervaluation
- Excess supply must be made up



Mercantilism: Counterexample



Saving Glut

- Financial market development determines where saving flows to.
- This means countries with low financial development will tend to have capital flow to countries with high financial development.
- Sometimes this is called a safe-asset shortage.

Market Distortion

- How does one measure financial development?
- A standard approach is private credit as ratio to GDP.
- But China has almost all lending from state-owned banks.
- Bond markets, stock markets, derivatives markets indicate US at the top
- How to explain 2008?