Discussion - The Demand for Liquid Assets, Corporate Saving, and Global Imbalances

by P. Bachetta and K. Benhima

Discussion : Nicolas Coeurdacier (SciencesPo Paris and CEPR)

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What is it about?

Over the last two decades, unprecedented developments in the global economy:

- Fast growth in Emerging Asia

- An increase in private savings in Emerging Asia (faster than investment)

- Emergence of Global Imbalances - Capital Flows (liquid assets) from Asia to Developed Countries (US in particular)

Reconcile these features in a dynamic open economy macro model where demand for liquidity is a complement of fast growth (and building capital stock) if firms face borrowing constraints.
Fast Growth in Emerging Asia

Emerging Asia and Developed Countries Growth Experience

Source PWT
An increase in (private) savings in Emerging Asia
Global Imbalances

Current Account Imbalances (% of World GDP)

- Current account balance in Advanced Economies (% of World GDP)
- Current account balance in Middle East (% of World GDP)
- Current account balance in Emerging Asia (% of World GDP)

Source: WEO
Why is it theoretically puzzling?

Following a permanent increase in productivity, standard models would predict:

- A rise in investment and a fall in savings in the fast growing country

- A current account deficit in the fast growing country

- A rise in world interest rates

- Savings across countries respond in a similar way to changes in world interest rates as tied down by the Euler equation

Illustration in a two country OLG model with production (Diamond (1965))
Why is it theoretically puzzling?

To account for recent developments, one needs to:

(i) dampen the neoclassical effects regarding the response of savings and investment in response to growth episode

(ii) break down the standard Euler equation

This is what the paper does.
**Main Intuition**

(i) dampen the neoclassical effects regarding the response of savings and investment in response to growth episodes in emerging markets

Borrowing constraints reduce the investment response: entrepreneurs cannot borrow as much as implied by the MPK. Needs to accumulate liquid assets to finance wage bill in the interim period: raise in corporate savings

(ii) break down the standard Euler equation

Borrowing constraints for entrepreneurs generate a wedge in the Euler equation: harder to transfer consumption across periods (reduces wealth effect) and generates excess savings
The good news

Savings “glut” story (Bernanke (2005)). Savings seem to be the driving force of global imbalances at least for the last decade.

Saving stories based on precautionnary motives might not survive to growth

Mendoza, Quadrini and Rios-Rull (2009)

Ranciere and Jeanne (2006), Jeanne and Caroll (2009)

But is the right channel?

(note: see also Coeurdacier, Guibaud and Jin (2011))
Corporate savings driving global imbalances?

Lack of direct evidence in the paper.

Focus on China. Savings rate have increased from 39% of GDP in 1990 to 54% in 2008

Conventional view: corporate savings have risen tremendously over the last 15 years. From roughly 10% of GDP in 1990-1992 to 20% in 2005-2007

Martin Wolf: "The frugality of Chinese households is not the chief explanation for China's surplus savings ..., the principal explanation is China's huge corporate savings"

Corporate savings puzzle in China?
Corporate savings driving global imbalances?

Savings have increased but as share of GDP: share of corporate incomes/profits has doubled, so corporate savings rates have not increased as much (if at all).

To the contrary, household savings rate have increased a lot (and are diverging between OECD and China)

Why do corporate savings over GDP increase in China? Fast growth together with liquidity constraints or simply a raise in profitability together with low dividend payouts of SOEs?
Source: IMF
Source: OECD and Household Surveys for China
Are corporate savings in China so different?

Corporate savings/GDP have increased across the world (+4% since 1990) (at a slightly higher rate in Asia though).

Bayoumi et al. (2010) compared (gross and net) savings rate across the world using firm-level data (listed companies though, thus less likely to be constrained).

Contrary to conventional wisdom, no significant differences for Chinese firms compared to other countries.
Corporate savings and net lending in OECD countries

Source OECD
Other comments: Business cycle implications

- Comovements: fast growth in liquidity constrained economy generate expansions in developed countries. Evidence?

  Counteracts the standard neoclassical effects where capital flows towards its most productive use.

- Procyclical current account balances in liquidity constrained economies. Opposite in developed countries. Evidence?
Conclusion

Very nice paper!

Elegant model - makes sense of important recent developments in the global economy that contradicts standard models. Role for liquidity

Explains a part of global imbalances but needs more direct empirical evidence to quantify how much of the data their mechanism can explain.