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SUERF-BAFFI Bocconi-OeNB event on "How to raise r*?" (virtual)
Session: Long-term trends, structural policies and r*: future scenarios and policy implications
*15 September 2021*

Based on:

- Work stream on globalization (2021), "The implications of globalisation for the ECB monetary policy strategy", ECB Occasional Paper Series, forthcoming.

- Kataryniuk, I. (2021), "How globalisation affects long-run interest rates? A panel cointegration approach", Working Paper Series, Banco de España, forthcoming.

r-STAR FOR SELECTED ECONOMIES
PERCENT

Legend: US, Canada, Euro area, UK, Brazil, Japan
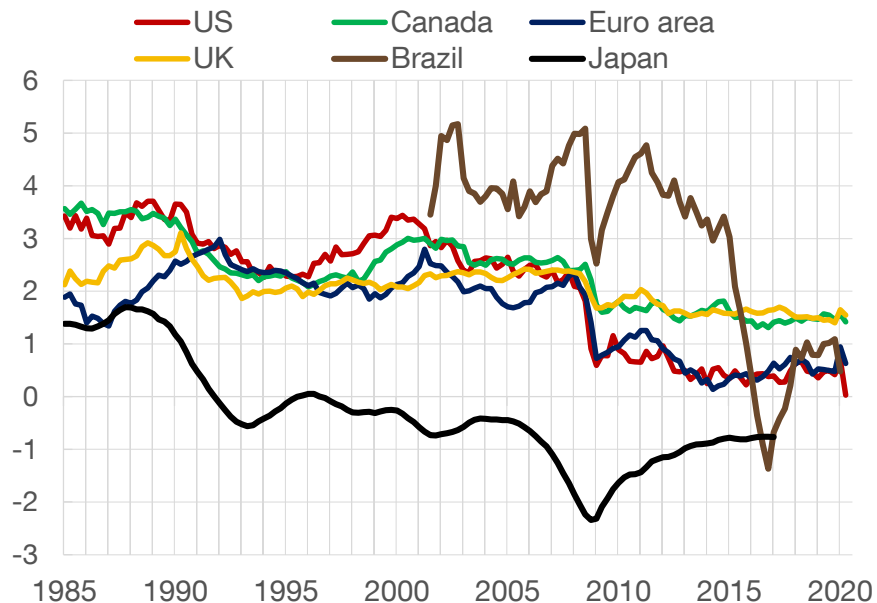
Source: Holston et al (2019), Wynne and Zhang (2018), Banco de España (2017) and own calculations.

REAL INTEREST RATES
AVERAGE ACROSS 17 COUNTRIES
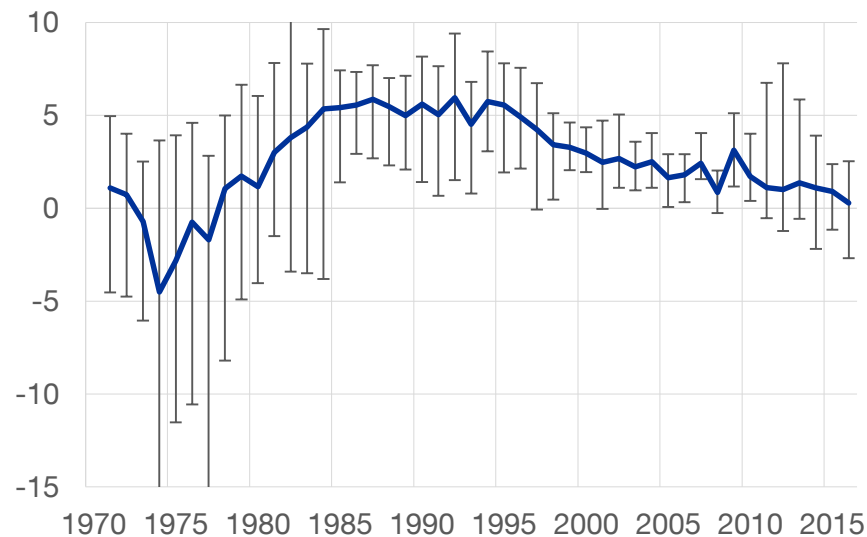
Source: Jordá, Schularick and Taylor Macrohistory Database and WB. Average, maximum and minimum across 17 countries: AU, BE, CA, DK, FI, FR, DE, IT, JP, NL, NO, PT, SP, SW, CH, UK and US

GIVEN THAT IT IS A GLOBAL PHENOMENA – ROLE OF GLOBALISATION?

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Rachel and Smith (2015) review six potential determinants:

Demographics

Inequality

Lower government investment

Country-specific, with similar trends

Price of capital

Savings glut

Spread between risk free rate and cost of capital

Common trends, influenced by globalization

+ Productivity

Country-specific, but driven by global trends

- Financial globalization (might) contribute to lower r and r*, and to higher cross-country correlation between natural interest rates
 Caballero et al., 2008 and 2016, Borio et al., 2017, Eichengreen, 2015, Bean et al., 2015, Rachel and Smith, 2017, Lunsford and West, 2017, Glick 2019; …

  - Increasing global supply of savings ('savings glut'), increasing safe asset demand (Del Negro et al., 2018, Caballero et al 2016, Caballero et al 2017)
  - Natural interest rates share a global factor
  - Foreign influence on domestic financial markets, global financial cycle

- Trade openness is linked to productivity growth

  - Productivity-enhacing resource reallocation within and across countries - Bernard et al. (2006)
  - Global production through GVCs, reducing costs, lower markups - Comin and Johnson (2020)

- Globalization might induce more market power (Natal and Stoffels, 2019), putting downward pressure to interest rates.

- Negative relationship between the accumulation of reserves in emerging economies and long-run interest rates (Grab et al., 2019, Busetti and Caivano, 2018)

- Positive relationship between the supply of safe assets and global rates (Caballero et al. 2016; Glick, 2019; Ferrera and Shousha, 2020)

- Ambiguous relationship between trade globalization and long-run interest rates (Busetti and Caivano, 2018)

FROM THEORY TO EMPIRICS (II)

Variable	Theoretical effect	Empirical effect
Young age share in population	Positive	Positive
Term spread	Negative	Negative
Global savings	Negative	Negative
Trade openness	Ambiguous	Positive

DETERMINANTS OF REAL INTEREST RATES IN ADVANCED ECONOMIES
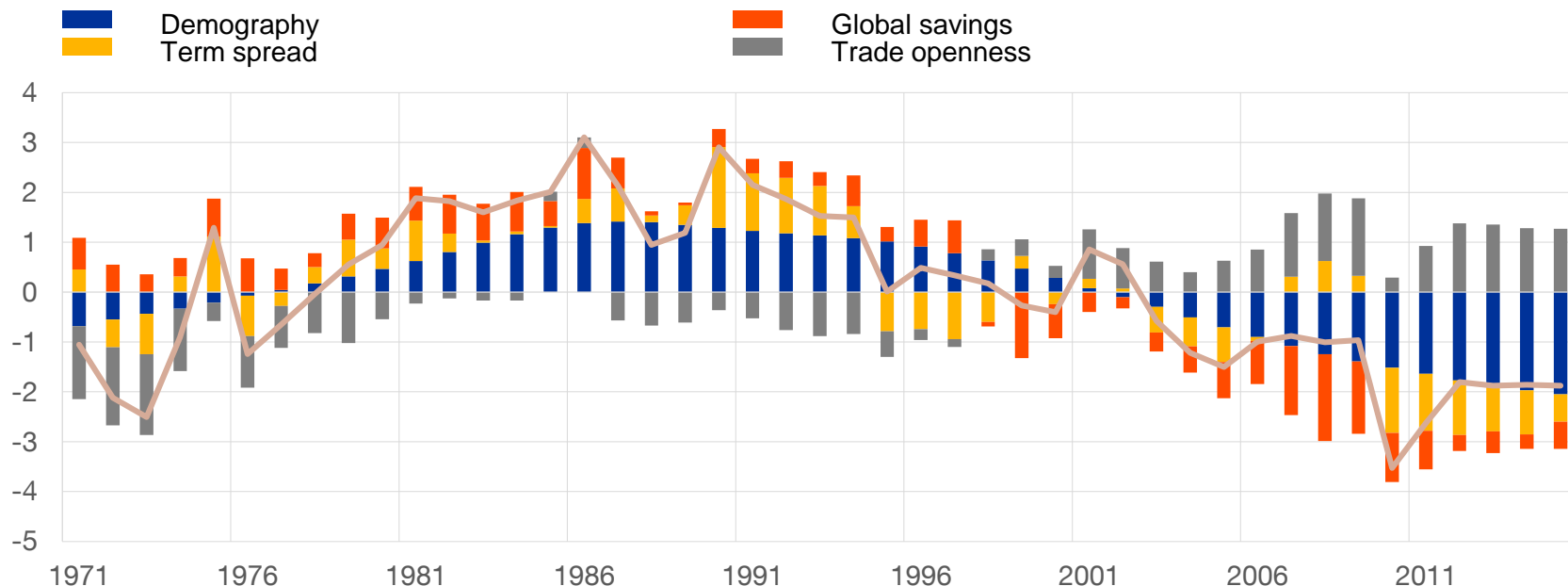
Source: Jordá, Schularick and Taylor Macrohistory Database, WB, Lane and Milesi-Ferretti EWN Database and own calculations. The line represents the (demeaned) natural rate estimated by the panel error-correction model. The contributions are the simple average of 17 countries: AU, BE, CA, DK, FI, FR, DE, IT, JP, NL, NO, PT, SP, SW, CH, UK and US

ECB (2021) and Kataryniuk (2021): follow Brand et al (2018) and Fiorentini et al (2018) - estimate a panel error-correction model to link traditional determinants (demography, risk) with globalization variables (trade openness, current account balance in Asian economies) - estimation using dynamic fixed-effects and pooled mean group estimators.

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- **Trade openness** seems to be positively related to long-run interest rates

- **Global excess savings** are negatively related to long-run interest rates

- **Both factors interact:** more openness (but balanced) can put upward pressure to r*, less openness (but imbalanced) can put downward pressure

- **Pre-COVID vs. Post-COVID dynamics?**