



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

International aspects of r^*

Maurice Obstfeld

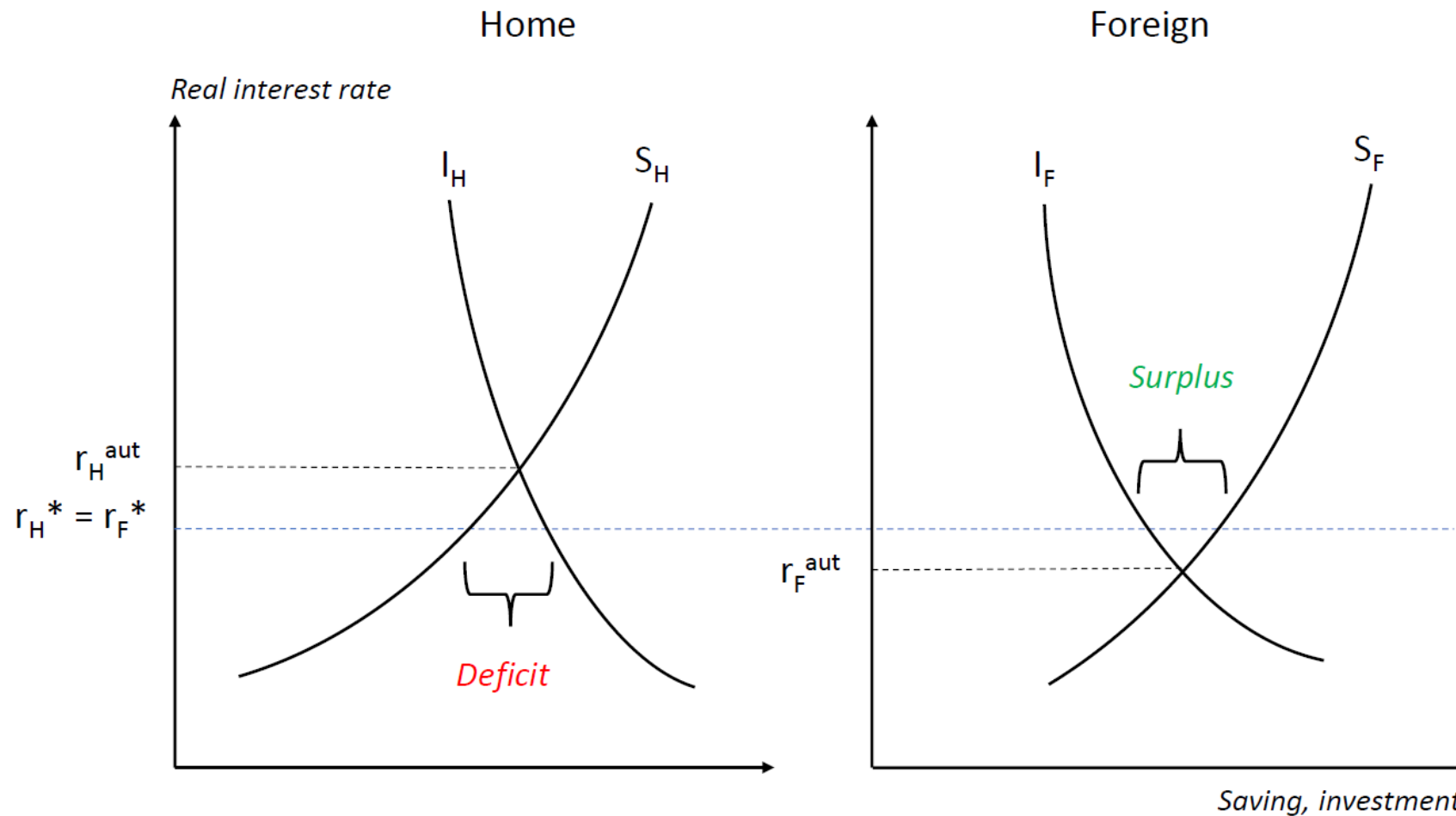
Conference on “Whither r^* ?”

Federal Reserve Bank of New York, March 28, 2025

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In an integrated capital market, r is global

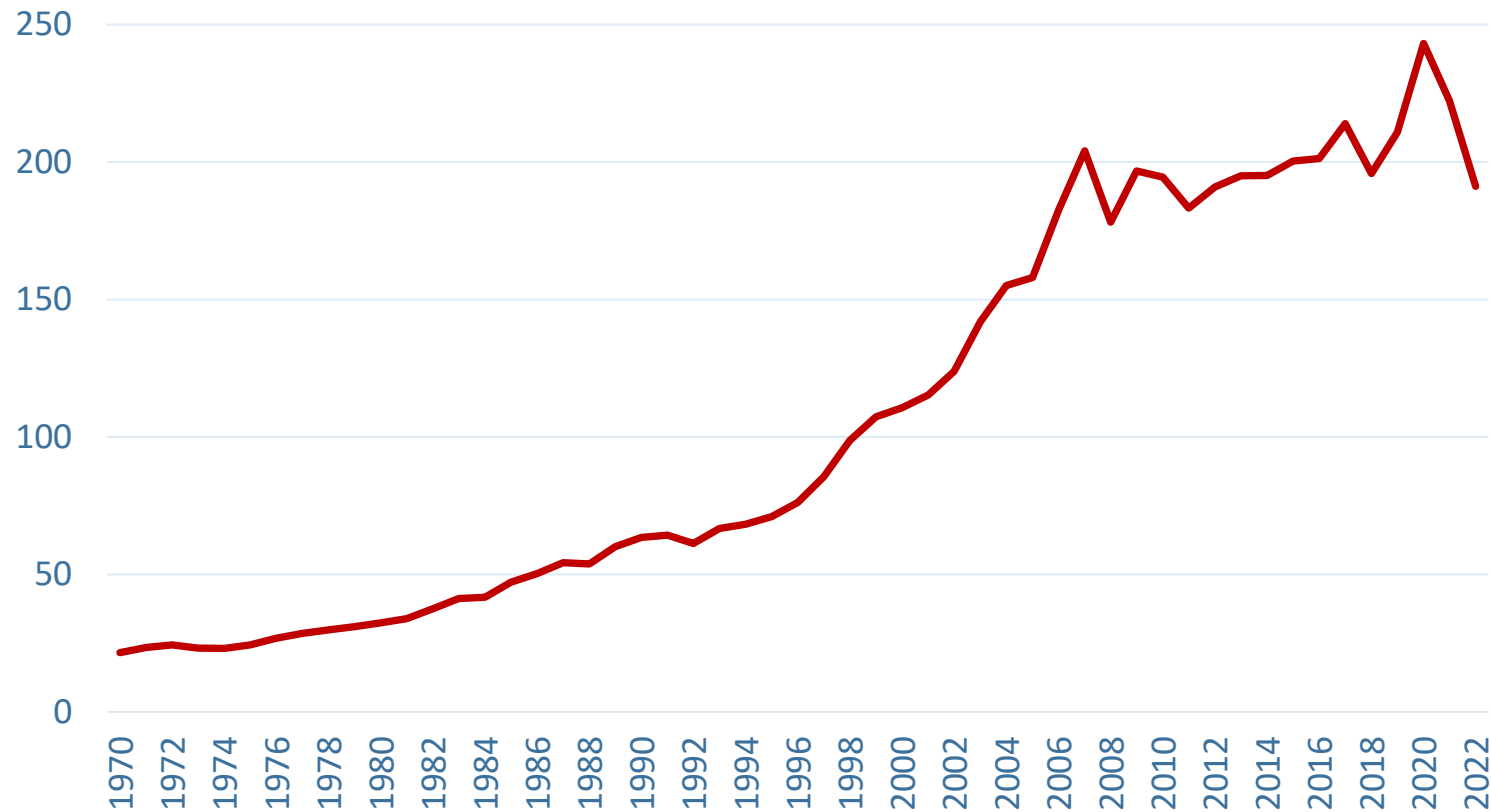
One-good model of Metzler (1968)



International financial integration is high

Average of external assets and liabilities, from G. M. Milesi-Ferretti, Brookings EWN database

Percent of world GDP



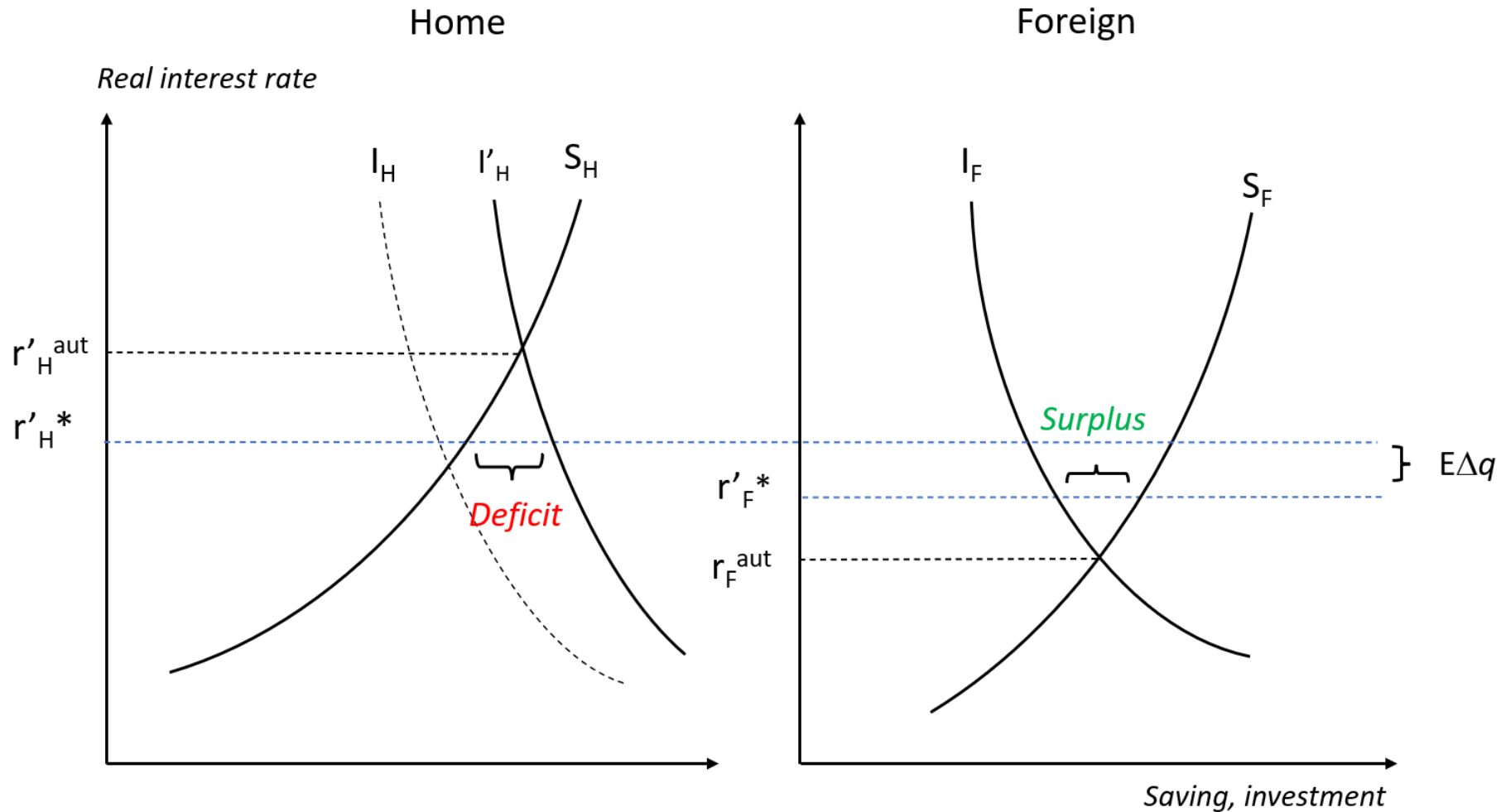
Real-world complications

$$r_H = r_F + E\Delta q + ?$$

- Interest parity: expected change in real exchange rate
 - Mean-reverting?
 - In part a reflection of *merchandise trade costs*
- Currency risk premium
- Term premium (at longer maturities, relevant for \bar{r})
- Liquidity premium
- Default risk in sovereign yields
- Tax treatment
- Barriers to cross-border capital movement

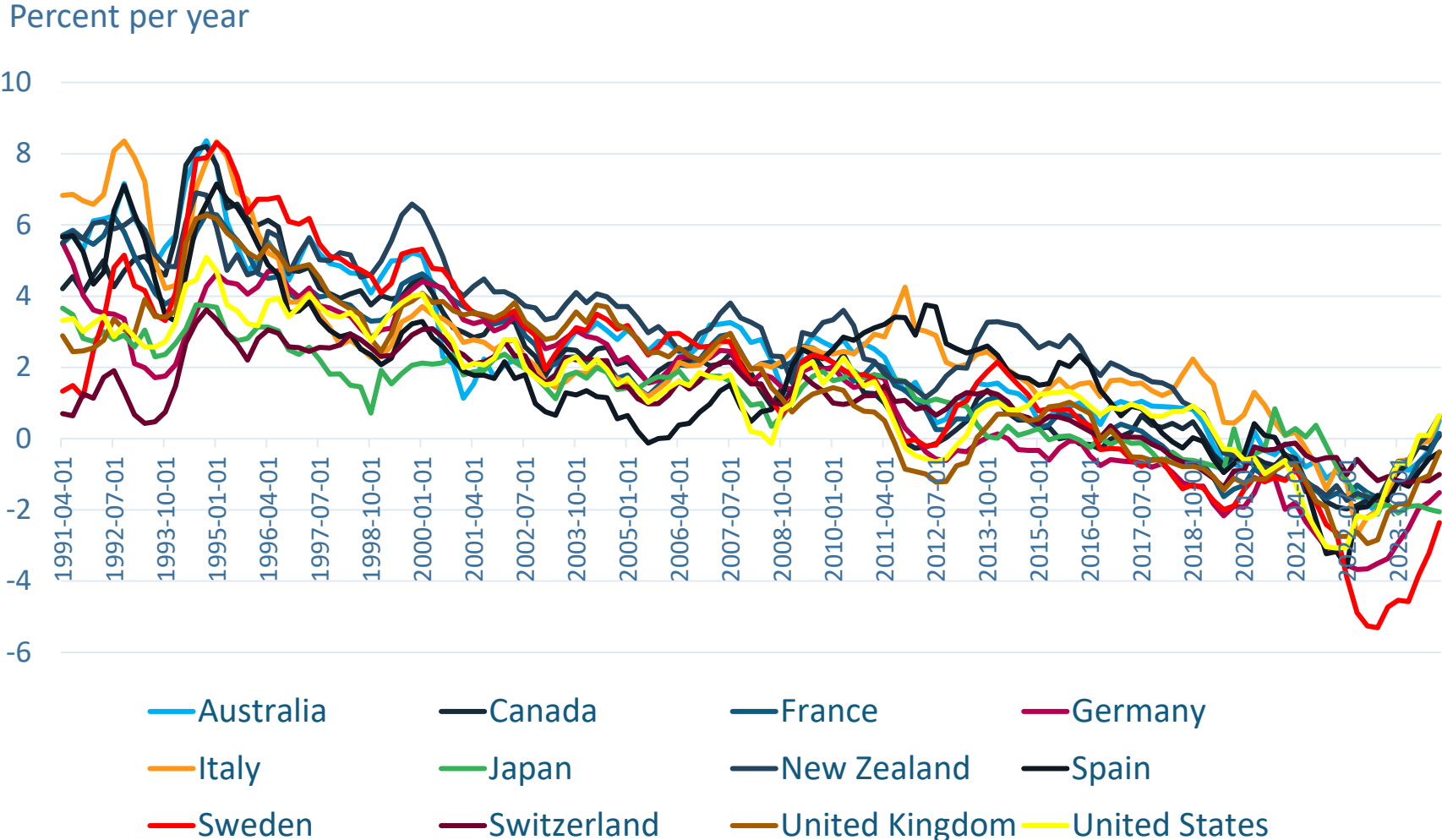
Role of real exchange rate

Upward shift in Home investment schedule



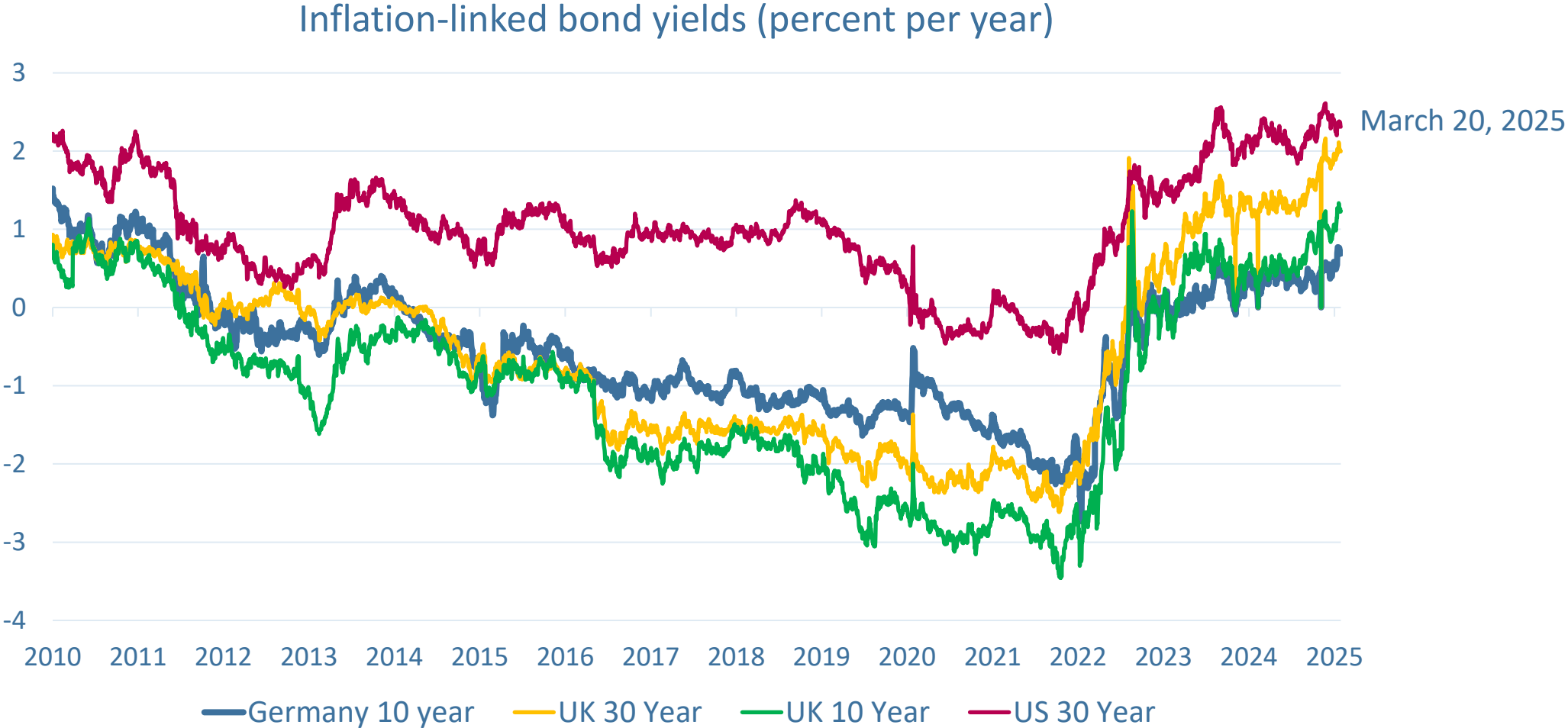
Advanced–economy real interest rates trend together

Partially ex post real rates on long-term government bonds



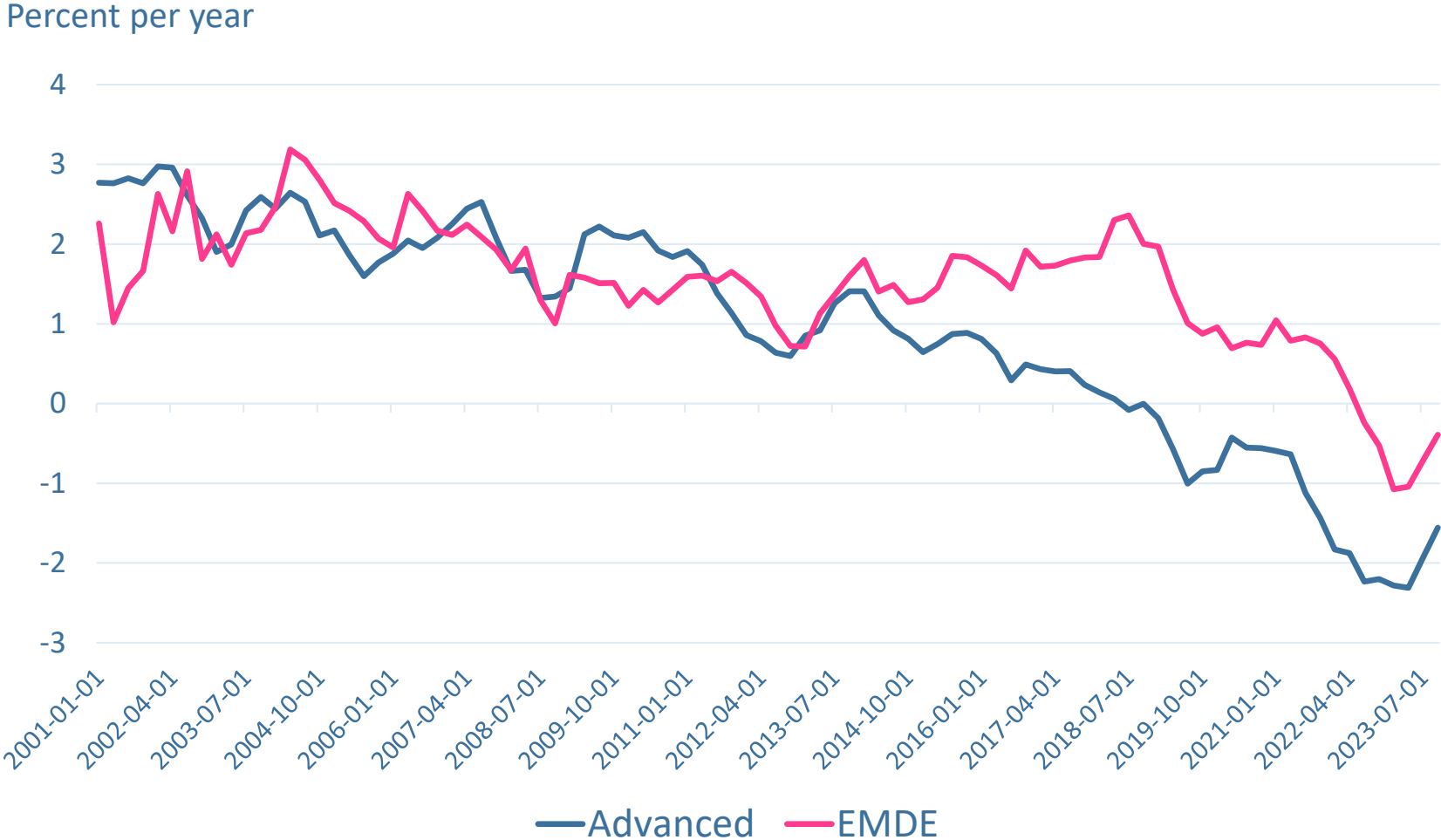
Long-term inflation-linked bond yields indicate higher expected r^* , global gaps

Source: Bloomberg



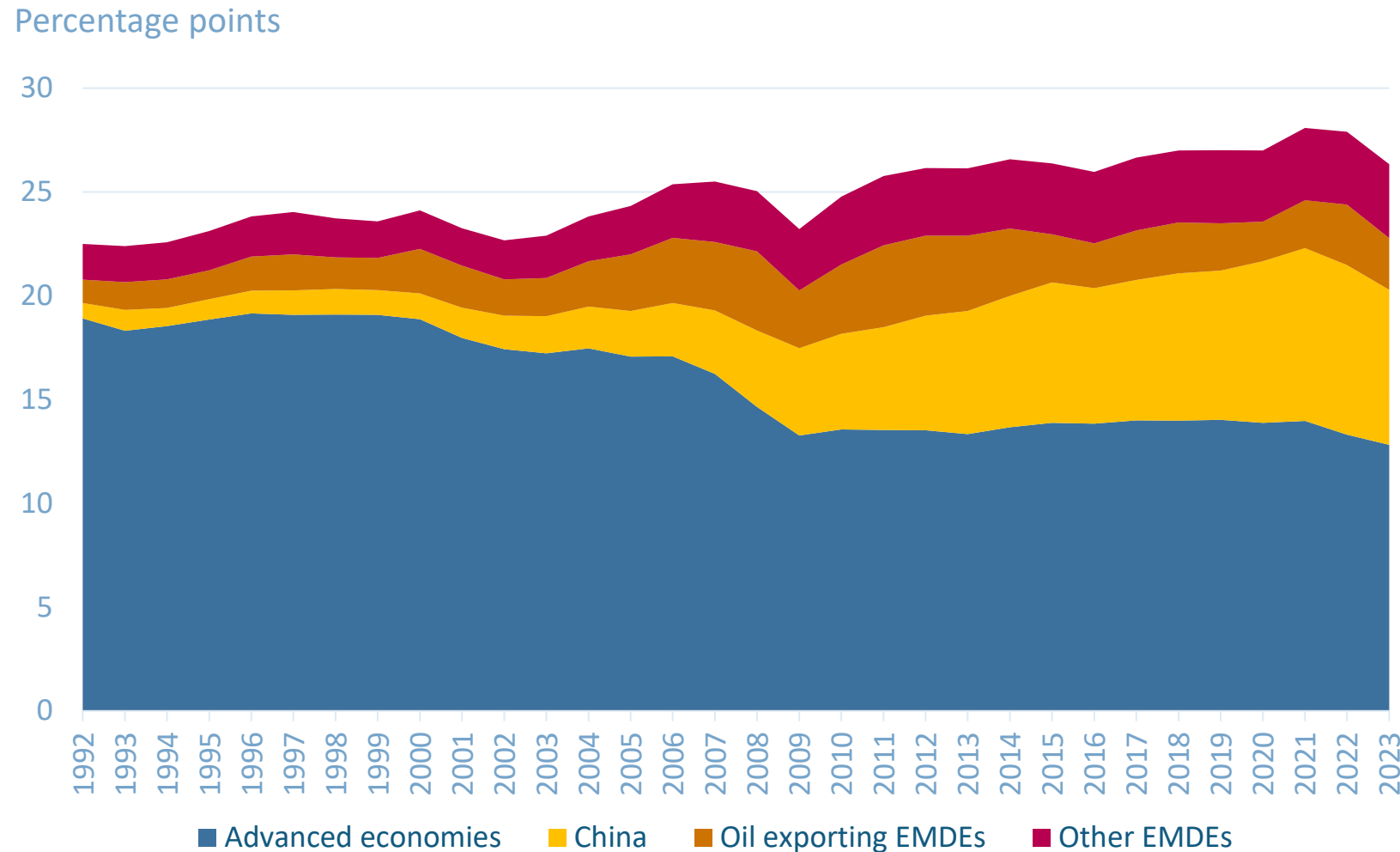
EM rates have been higher than AE rates since the GFC

Simple averages for 12 high-income and 23 middle-income economies



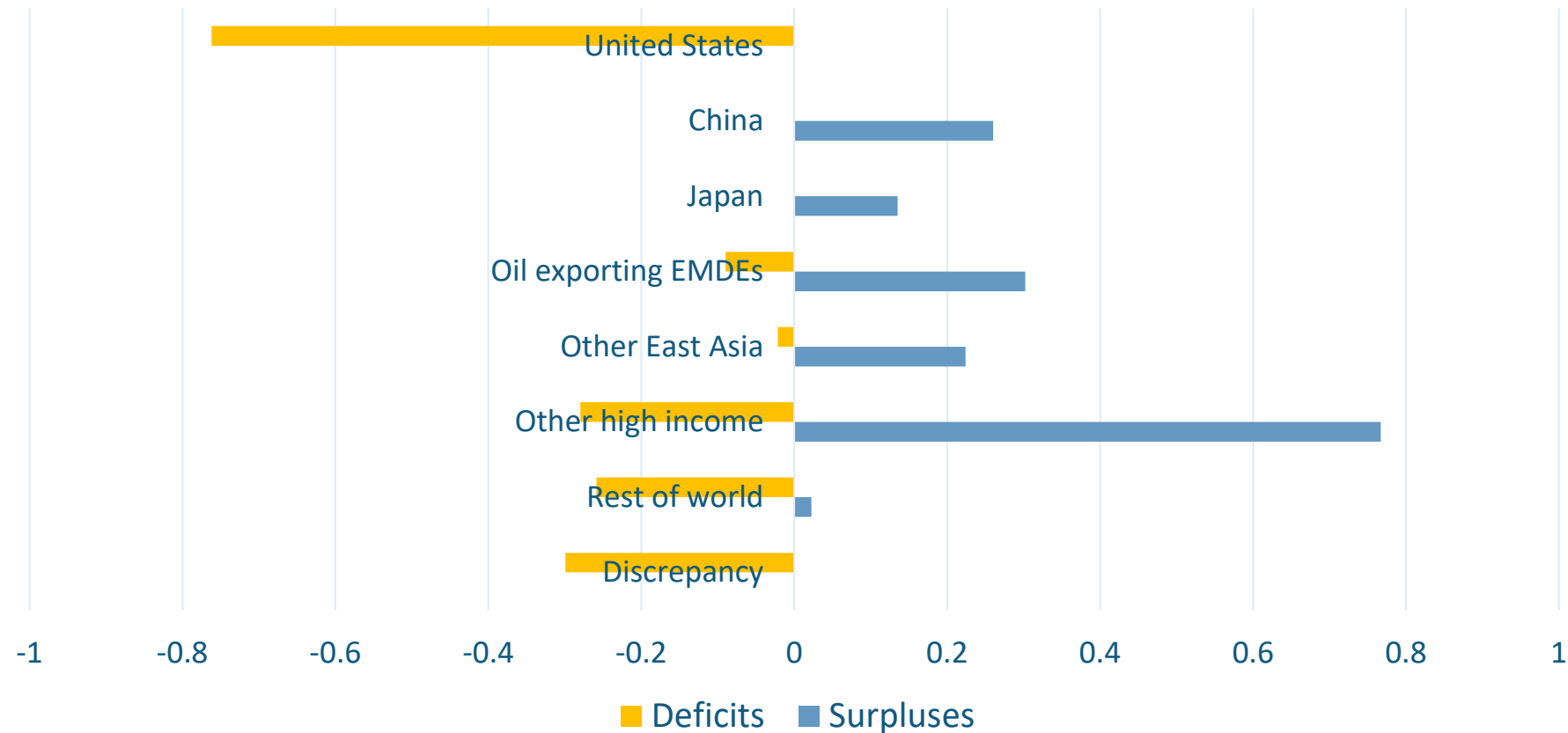
China is a substantial share of global saving (and investment)

Yet, it is imperfectly integrated
Into world capital markets



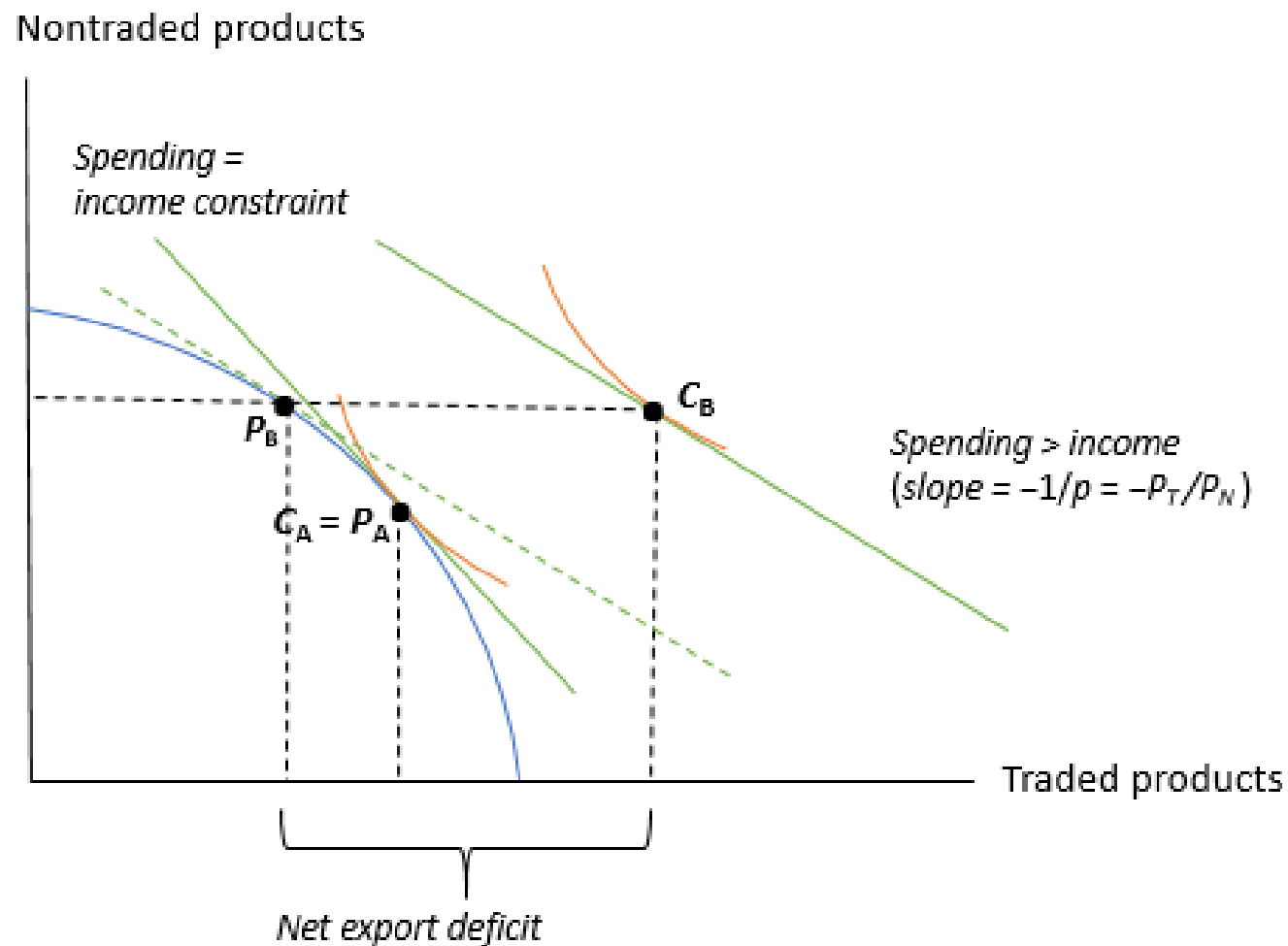
Global current accounts in 2023: High-income economies dominate for global real interest rates

Percent of world GDP



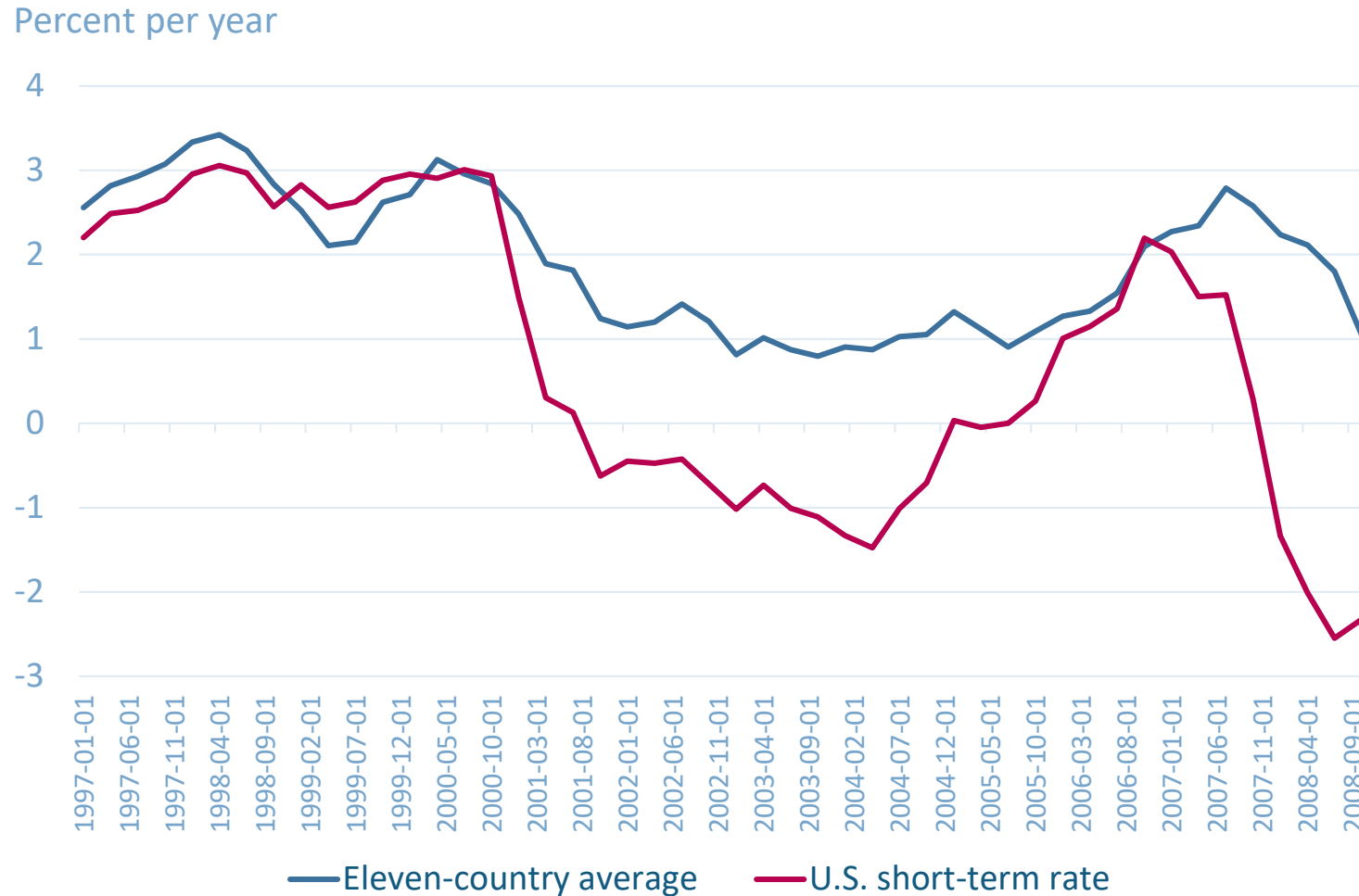
In open economies the trade balance and real exchange rate matter for r^*

The Australian model of a “dependent” economy (Salter-Swan-Corden)



r^* likely to be more variable across countries than \bar{r}

U.S. short-term real rate vs. average of 11 high-income countries, 1997-2008



Some takeaways

- Real rates, even at long term, aren't fully equalized across countries
- Even bigger divergences in real policy rates are possible
- But international capital markets have expanded markedly
- For high-income economies, real rates trend together (Del Negro et al., *JIE*, 2019)
- Indexed bond markets show long-term r gaps – something of a puzzle
- Emerging market rates have been persistently higher since the GFC
- Rates in high-income group largely determined by high-income factors
- Everywhere, global events influence domestic r^*
- The external trade balance (current account) matters for r^* , which depends on a real exchange rate that could be out of equilibrium in the short run – e.g., if the currency is stronger, r^* is lower



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Thank you.

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