Macro Roundup Article

Headline: What Determines Cross-Country Differences in r*?

Article Link: https://www.gspublishing.com/content/research/en/reports/2024/08/11/5c46ab2c-91e7-49c4-a307-04c18c2ba287.html

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Publication	Goldman Sachs
Publication Date	August 12, 2024

Tweet: Kevin Daly notes that r* tracks US/Global r*, while cross-country variation is driven by GDP per capita, inflation, and current account and government balances.

Summary: Developments in EM and DM neutral real rates over the past 25 years have mostly been driven by changes in US/global r*, which have an almost one-for-one impact on other economies. Country-specific spreads have remained largely stable in aggregate, falling in some economies but rising in others.In the latest five-year period (2020-24), the neutral real rate spread vs. the US has ranged from negative in some DM economies (notably Japan, the Euro area and Switzerland) to more than 10pp in some high-yield EM economies that have experienced major currency weakness (Turkey and Egypt).We find that most of the cross-country variation in neutral real rates is accounted for by three factors: GDP per capita levels, inflation, and current account balances (the latter are a more important factor for EMs than DMs). A 10pp convergence in GDP per capita lowers neutral real rates (r*) by 12bp (all else equal), 1pp higher average inflation raises r* by 33bp, and a 1pp improvement in the current account balance lowers r* by 7bp (and by 20bp in EM economies). We find no independent role for a range of other factors, including GDP growth, government balances, and government debt levels.

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