As Europe and Asia hoard cash, economists see echoes of crisis

By Landon Thomas Jr.
October 24, 2016 – *The New York Times*

European and Asian investors have been rushing into the United States bond market, spurred by a global glut of savings that has reached record levels.

Running from near-zero interest rates at home, foreign buyers are piling into the booming market for corporate bonds, including high-grade debt securities issued by the likes of IBM and General Electric and riskier fare churned out by energy and telecommunications companies.

A growing number of economists are concerned that this flood of money may inflate the value of these securities well beyond what they are worth, potentially leading to a market bubble that eventually bursts.

More broadly, however, these economists fear that an excess of ready cash in Europe and Asia is on the rise, which could keep a damper on global growth prospects.

That is because the cash, instead of being spent on building bridges in, say, Germany, or individual shopping sprees in China and Japan, is accumulating and being recycled into global capital markets, keeping interest rates artificially low as investors chase after returns.

And again, economists say, the burden is placed on the United States, with its still fragile economy, to be the growth engine for the world.

"Asia and Europe keep exporting their savings to the rest of the world," said Brad W. Setser, an expert in global financial flows who worked at the United States Treasury from 2011 to 2015. "All this money sloshing around looking for a home is not healthy — it indicates a real lack of demand in other parts of the global economy."

The surge in flows echoes a wave of investment in the years right before the financial crisis, when mostly European investors snapped up billions of dollars of mortgage-backed securities before the American housing market imploded.

The current numbers are also arresting.

According to Mr. Setser's figures, about $750 billion of private money has poured into the United States in the last two years alone. About $500 billion, he calculates, reflects European and Asian investors buying United States Treasury securities, bonds issued by Fannie Mae and debt issued by American companies.

The rest comes from American institutional investors unloading their zero-returning European bonds and looking for some extra yield closer to home.

The culprit, Mr. Setser argues in a new paper for the Council on Foreign Relations, where he is a senior fellow, is the biggest global glut of savings ever, driven by cash-hoarding in counties like China, Taiwan and South Korea.

"There is a glut, and the glut isn't healthy," Mr. Setser said.

The philosophical grandfather of this global savings glut is Ben S. Bernanke, former chairman of the Federal Reserve, who coined the phrase in 2005, before he became chairman.

There are economic theories that daze and confuse, thanks to their opacity. And then there are a few that define a moment in time by explaining why asset markets overreach and implode.

In September 2007, as the financial crisis was beginning to take shape, Mr. Bernanke gave a speech in Berlin in which he warned of the

dangers that excessive global savings posed to the United States economy.

Mr. Bernanke cautioned that an accumulating cash pile in fast-growing countries like China was keeping global interest rates low and steering money into risky investments.

Within months, investment banks in the United States began their death march as the once-soaring market for mortgage securities collapsed.

Over time it became accepted in academic and policy circles that the global savings glut that Mr. Bernanke had described played a crucial role in the boom and eventual bust of the housing bubble in the United States.

Now, nearly a decade after Mr. Bernanke's warning, Mr. Setser and others are making the case that this cash pile is as large and dangerous as ever, driven by a persistent rise in excess savings in China and elsewhere in Asia, and in Europe, with Germany leading the way.

Not everyone subscribes to the savings glut theory, of course, especially not those nations that are sitting atop these piles of cash and facing pressure to take action, as Germany is.

Their opposing view holds that it has been the reckless money-printing ways of the global central banks (jump-started by Mr. Bernanke himself) that pose a threat to the global economy.

Still, the total sum of the savings glut is a stunning number — $1.2 trillion — a bit above what it was in 2007 when Mr. Bernanke warned about it. Three-quarters of it comes from China and other Asian dynamos.

The rest comes from large savers in Northern European countries like Germany and the Netherlands, replacing oil producers in the Middle East that have seen their cash piles erode with the decrease in oil prices.

In 2005, when Mr. Bernanke introduced the thought that there could be a downside to all this saving overseas, the American housing market was still robust and his remarks did not quite resonate.

It is easy to see why, given that the problem, as outlined by Mr. Bernanke, was not having too much debt, but having too much cash.

Past global blowups, like Mexico's in 1994, and Southeast Asia's in 1997 and 1998, were often stories of fast-growing economies running up debt and then running out of money.

Now, Mr. Bernanke was proposing, the danger was that these and similar nations were safeguarding cash by increasing exports and not investing as much as they should, with the result being a savings surge.

Recently, criticism has been directed toward large developed economies like Germany and other big savers in Europe like the Netherlands for allowing their current-account surpluses — essentially a country's cash on hand after investments — to increase more than fourfold since the financial crisis, to $488 billion today.

But Mr. Setser in his paper contends that the sharp upswing in East Asian surpluses has been less noticed.

That is because, he says, even with China's tremendous investment binge during recent years, its savings rate is still near 50 percent — which is just too high a level for the world economy.

"This is a big problem," said Nouriel Roubini, an economist at New York University who was recognized for his early warnings about the 2008 crisis. "There is no way to force those who are oversaving to spend more."

All of which hangs like a pall over the global economy, depressing interest rates and prospects for growth.

"Bernanke is even more right than he was in 2005 and 2007," Mr. Setser said.

While no one is saying yet that the flood of investment has created an asset bubble similar to that of 2008, market participants accept that

certain corners of the market, like junk bonds, have had a very nice ride of late.

Ken Monaghan, who oversees high-yield bonds for the global fund manager Amundi Smith Breeden, says that he is seeing a surge in interest from Asian and European insurance companies and pension funds — many of them conservative clients not known for dabbling in these sorts of securities.

“It has really caused spreads to move,” he said, using Wall Street jargon to describe what happens when the interest rates of these bonds decrease as investors pile in. “We are seeing institutional investors come to us and ask for levels of risk that they have never asked for before.”