

Real Exchange Rates, Saving, and Growth: Terms of Reference

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This paper is motivated by the observation that both currently as well as in the recent past, several countries that have achieved sustained high growth rates have simultaneously exhibited depreciated real exchange rates and high domestic saving rates. China is the current example, but over the previous couple of decades the association between depreciated real exchange rates and high saving rates has also been observed in high-performing Asian economies such as Korea, Malaysia, and Thailand, as well as in Chile. The opposite constellation of outcomes -- an appreciated real exchange rate, low domestic saving, and low growth -- has also been apparent in the international experience, for example in the case of pre-1994 Mexico. This raises the question of whether there is a systematic macroeconomic relationship between the real exchange rate and the saving rate. Some observers, for example, have speculated that exchange rate management may affect private saving behavior, perhaps through the effects of a depreciated real exchange rate on the domestic distribution of income.

The objective of the paper is to investigate the following aspects of this potential relationship:

1. Aside from the episodic evidence just mentioned, is there an association between high saving rates and either the exchange rate regime or a depreciated real exchange rates and in the international experience?

This question can be addressed using the Penn World Table data, which contain both measures of national price levels that can be (and have been) used to measure the extent of real exchange rate depreciation across countries, as well as data on national saving rates.

2. Does the existing literature interpreting the experience of high-growth countries in East Asia suggest an analytical connection between depreciated real exchange rates and the saving rate?

There is a large body of literature that has identified high saving rates and relatively depreciated real exchange rates as two of the characteristics of the high-growth economies in East Asia. The intent is to review this literature to examine the extent to which these phenomena have been linked analytically or empirically.

3. Aside from any mechanisms suggested by that literature, what does theory suggest about the possible causal relationships between high saving rates and depreciated real exchange rates?

In principle, the comovement between these variables could reflect causation from real exchange rates to saving rates, from saving rates to real exchange rates, or from third factors to both saving rates and real exchange rates. The paper will attempt to identify factors that could drive causation in each of these potential directions, and informally assess their plausibility for the case of the rapidly-growing economies in East Asia.