Summary of Chapter IV: *Awash with Cash: Why Are Corporate Savings So High?*

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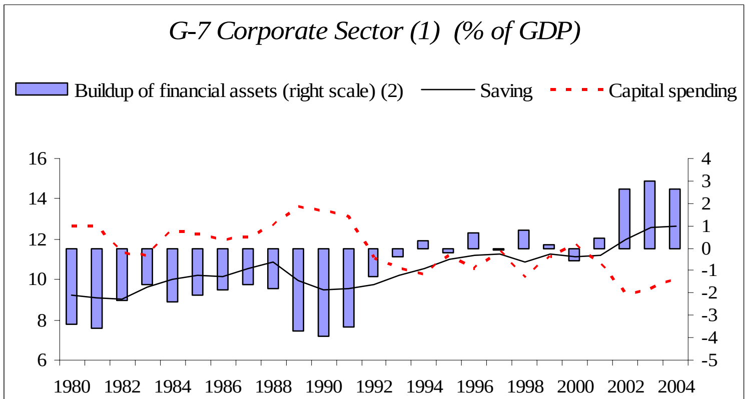
Prepared by Roberto Cardarelli
(Senior Economist, Research Department)

Corporates have been building up their financial assets at a record pace, which is a key factor behind the current low long-term global interest rates (see the Figure). During 2003-04 (the latest year for which data is available), corporates in the G7 countries accumulated $1.3 trillion of financial assets. This was more than twice the size of current account surpluses of emerging market and developing countries in the same period, which has famously been labeled a global "savings glut" by Fed Chairman Ben Bernanke.

In Chapter IV, the IMF investigates the reasons for this new found thriftiness among companies, and concludes that it is unlikely to continue going forward. This is because with the degree of excess capacity in the G7 countries narrowing, companies are likely to begin investing more in plant and equipment, while some of the factors that have driven recent strong corporate profits are likely to wane. Therefore, long-term interest rates will rise, unless there is an increase in household and government saving to offset changing corporate behavior.

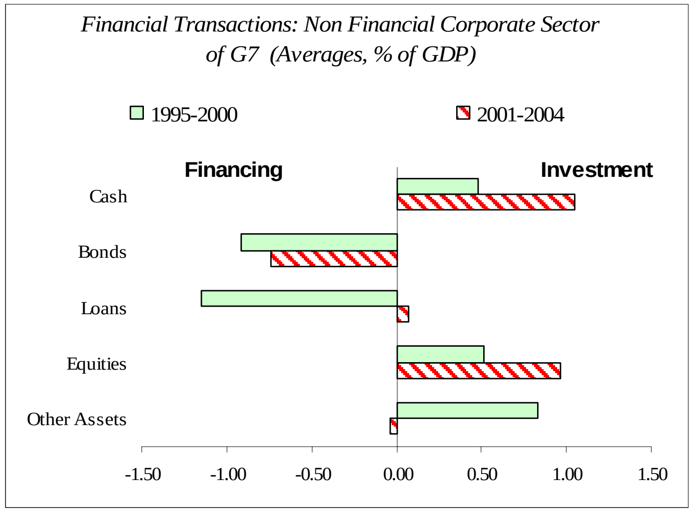
Why have corporates been saving so much, and is this is a temporary or permanent phenomenon? One commonly held view is that the increase in corporate savings is mainly a reaction to the excess debt and physical capital that was accumulated in the 1990s, and it is therefore temporary. Once these excesses have been worked out, the corporate sector will again become a net borrower.



(1) GDP weighted average of G-7 countries, excluding Germany.
(2) Diffrence between Saving (undistributed profits) and Capital Spending.

The Fund's analysis, however, suggests that the story is not as simple. Indeed, debt repayment has not been the primary reason for companies' savings (see the Figure), and even if net borrowing has declined in all the G-7 countries since the late 1990s, corporate debt ratios remain close to their late-1990s levels—with the exception of Canada and Japan. So the answer to questions surrounding the nature of the high corporate saving lies elsewhere in the form of both temporary (such as high profitability) and permanent (such as increased uncertainties in the operating environment facing firms) factors.

In particular:



- **Corporate profits have been strong primarily because of low interest rates and reductions in corporate tax payments, rather than abnormally high operating profits**. In Japan and the United States, where operating profits have accelerated sharply, the increase does not appear to be out of line with previous cyclical episodes.

- **Weak capital spending has at least partly reflected lower relative prices of capital goods**. Ongoing technological change has reduced the relative price of capital goods, and lowered the nominal spending needed to achieve a given *volume* of capital.

- **Companies have been shifting resources from domestic capital accumulation to the purchase of assets abroad**. Rather than investing in physical capital at home, companies have pursued strategies of expansion that involved acquiring existing or new fixed assets abroad.

- **The desired level of cash holding has increased**. This partly reflects the more uncertain operating environment faced by companies, the increasing role of intangible assets (which usually require more internal financing), and possibly the uncertainties associated with how they will be asked to meet currently unfunded pension liabilities.

As such, while corporate savings may remain higher than during the 1980s and 1990s, they will likely decline from their current historically high level over the next several years.