XXVII Annual Conference of the Central Bank of Chile
"Medium- and Long-Run Trends in Interest Rates: Causes and Implications for Monetary Policy"
Opening remarks by Rosanna Costa, Governor of the Central Bank of Chile
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1. Welcome Remarks

Good morning to all the speakers, discussants, the organizers of this event, **Atif Mian, Sofia Bauducco, Mariana García and Lucciano Villacorta,** and everyone who is here attending in person and to those following us via streaming. We welcome you to the twenty-seventh Annual Conference of the Central Bank of Chile entitled *"Medium- and Long-Run Trends in Interest Rates: Causes and Implications for Monetary Policy."*

Since 1997, the Central Bank of Chile (BCCh) has been convening prominent scholars and policymakers to this Conference to discuss major issues in central banking and their implications for emerging economies. Since its inception, this Conference has served as a bridge between academics and policymakers. This version is no exception: fresh and thoughtful research will support the discussion over the next two days on a topic that is very much front and center on the policy agenda. We will enjoy the presentations of seven authors, seven discussants, two keynote speakers, and a policy panel.

2. Motivation and context

This year's conference tackles a topic that is increasingly at the forefront of economic discussions: the future trajectory of long-run real interest rates, their potential determinants, and the implications for monetary policy. The timing of this topic couldn't be more relevant, especially in light of the sharpest and most synchronized monetary tightening we have seen in decades.

As we all know, central banks in advanced economies have recently started lowering their policy rates and in many emerging economies this normalization process has been under way for some time now. Even so, policy rates had risen significantly over the past two years from their record lows in decades. This shift has sparked a lively debate regarding the future of medium- and long-run trends in the real rates; specifically, whether policy rates will revert to their pre-pandemic lows or will settle at a higher level.

Opinions on this matter vary widely among experts and I think there is not a clear consensus on what the long run interest rates will look like in the future. On the one hand, there are reasons to believe that real interest rates are likely to revert to their historical lows, as the key factors that were mainly thought to have driven these rates down over the past forty years—such as demographic shifts, stagnant productivity growth, increased market power, higher risk aversion and sustained demand for safe assets—do not seem likely to revert sufficiently to produce a significant and lasting increase in real interest rates in the coming years.

On the other hand, recent market indicators suggest that equilibrium long-term real interest rates have risen. Also, some new estimates of the natural interest rate—defined as the "long-run" equilibrium rate after shocks have dissipated—indicates that this rate may have risen in several advanced countries in the past few years. As I will discuss in a while, this shift could indicate that at least some structural drivers of real interest rates have changed direction or that the natural interest rate is adjusting to a new economic environment possibly characterized by higher levels of public debt.

The future evolution of the natural interest rate has significant implications for monetary policy. Accurately assessing the long-run trend of the natural rate is essential for central banks, as this rate serves as a crucial reference point for monetary policy. The difference between the real interest rate and the natural rate provides valuable insight into a central bank's monetary stance and aids in evaluating various policy options.

However, the natural rate is an abstract concept, and its estimates often carry considerable uncertainty, particularly in the post-pandemic period. Since the natural rate is not directly observable, understanding its determinants has become vital for effective monetary policy. I am confident that the fruitful discussions we will have during this conference will deepen our understanding of these determinants and clarify where natural rates and other relevant interest rates may stand in the years ahead.

In these opening remarks, I would like to take a moment to briefly review the key empirical long run trends we have observed in interest rates, as well as the primary explanations put forth in the literature. Following that, I will walk you through the main agenda of the Conference.

3. Drivers behind the trends in interest rates

Over the past forty years (up to the Covid-19 pandemic in 2020-2021), we have seen a remarkable decline in nominal interest rates across the globe. For example, during the 1981 to 2020 period, nominal returns on U.S. Treasury bonds, both short and long term, dropped significantly. The 2-year Treasury Bills experienced a drop of around 14 percentage points, and 10-year bonds saw a decline of 13 percentage points. During this same period, inflation also fell, albeit to a lesser degree, leading to real rate declines of about 5 and 4 percentage points for the 2- and 10-year bonds, respectively, putting sovereign real interest rates close to zero and even in negative territory for some periods. The decline was not limited to sovereign bond rates; it was also present in the returns on other so-called "safe" assets. Importantly, this downward trend was not exclusive to the United States. Real long-term rates have declined by several percentage points since the early 1980s in both developed and emerging economies, so this appears to be a global phenomenon.

The global downward trend in observed risk-free rates over an extended period suggests a significant decline in the natural interest rate, often referred to as the “long-run” equilibrium rate. This secular decline has coincided with a relatively stable trajectory in the marginal product of capital, a stable trajectory on the returns on risky assets, and a stable trajectory in the investment rate, particularly in advanced economies. As a result, these patterns are often attributed to factors that have increased the overall supply of savings over the years, alongside factors that have redirected this excess in savings toward the demand for safe assets rather than productive investments.

In recent years, much of the literature has centered on the hypothesis of a "global saving glut." This theory suggests that a significant excess of savings from certain countries and affluent groups has led to a marked shift toward safe assets. Consequently, there has been a notable increase in the prices of these assets, accompanied by a decline in interest rates.

One contributor to this phenomenon was the increased savings from emerging economies, particularly since the 1990s. Factors such as robust economic growth, soaring commodity prices, and high risk aversion all fueled greater savings in these regions. As a result, these economies channeled substantial portions of their savings into global markets, with a significant impact on interest rates in developed countries.

Another contributor to this saving glut was the increasing savings rates among the wealthiest households in developed nations. As income inequality has risen, rich households have saved a larger share of their income, further contributing to the excess savings phenomenon. Research indicates that the savings of the top 1% in the United States is comparable to the savings generated by the excess from emerging markets, a trend the literature refers to as the "saving glut of the rich." This dynamic has profound implications for wealth distribution and economic stability.

Other mentioned explanations for the excess savings are linked to more structural factors, such as the secular stagnation hypothesis, which suggests a persistent decline in potential economic growth that limits investment opportunities, thereby driving savings toward safer assets. Additionally, demographic changes—including declining population growth and longer life expectancy—have influenced savings behavior across generations and regions.

Finally, rising risk aversion, the declining cost of investment goods, and the substantial increase in corporate power over recent years further explain why this increase in savings has been directed toward safe assets rather than productive investments.

Over the past 40 years, all these factors have shaped the dynamics of savings, investment, and, consequently, interest rates, each contributing with varying significance during different phases. Looking ahead, the trajectory of interest rates will heavily depend on the uncertain evolution of these drivers.

The outlook for these structural factors influencing real interest rates is mixed. On the one hand, several key factors behind the pre-pandemic decline in interest rates— such as low potential growth, rising inequality, increasing uncertainty, growing market power, and longer life expectancy— show no significant signs of changing direction. These forces suggest that real interest rates may revert to their declining pre-pandemic trend. On the other hand, additional factors could lead to a sustained rise in rates. These include a decrease in savings due to a growing inactive population, substantial fiscal deficits resulting in very high levels of debt, potential productivity gains from advancements in artificial intelligence, geopolitical risks and climate disasters affecting global savings, and significant investments in the green transition.

I hope our upcoming discussion will help clarify the direction of these drivers and enhance our understanding of where the natural interest rate may be headed in the future.

4. *Conference contents*

Let me now give a very brief overview of what we will be hearing today and tomorrow:

The Conference will start with the session "Interest Rates and Macroeconomic Policy" In this session, the paper by **Francesco Bianchi, Renato Faccini and Leonardo Melosi** examines the role of fiscal policy in shaping the future path of real interest rates. Then, the paper by **Gabriel Jiménez**, **Dmitry Kuvshinov, José-Luis Peydró and Bjorn Richter** will look at the links between the path of the monetary policy rate over time and the risk of banking crises from a historical perspective.

Then, we will continue with the first keynote speech, delivered by **Ricardo Reis**. He will address the implications of interest rate trends on inflation, as well as the subsequent effects of inflation on these trends.

We will then transition to our second academic session, which will focus on "Theories of Natural Interest Rates." The natural interest rate, an abstract concept, is defined as the interest rate that prevails in long-term equilibrium once economic shocks have dissipated and prices are fully flexible. As a latent variable, understanding its determinants and refining its measurement is of paramount importance.

This session will begin with a paper by **Ozge Akinci, Gianluca Beningno, Marco del Negro, and Albert Queralto**, who propose a complementary concept referred to as the Financial (In) Stability Real Interest Rate. While the natural interest rate is typically associated with macroeconomic stability, this new concept emphasizes the critical importance of financial stability. Following this presentation, **Galo Nuño** will discuss three theories concerning natural interest rates. Traditional theories often highlight structural drivers such as technological advancement and demographic changes. However, Galo's paper will challenge this conventional view, exploring how factors such as public debt, household inequality, the zero lower bound, and persistent negative supply shocks may influence natural interest rates.

To conclude this session, we will hear from **Elías Albagli, Sofia Bauducco, Guillermo Carlomagno, Luis Gonzales, and Juan Marcos Wlasiuk**, who will discuss the potential impacts of climate change and escalating geopolitical tensions on long-term interest rates.

The second day will begin with the keynote speech titled "Long-Run Interest Rates: Past, Present, and Future" by **Atif Mian.** He will explore the interconnections between interest rates and both private and public debt over time. Atif will first address the role of inequality in explaining the simultaneous decline in interest rates and the rise in debt over the past few decades. He will then examine the dynamics of debt, discussing an appropriate constraint on interest rates to prevent explosive borrowing. Finally, he will focus on estimating future yields.

Next, we will tran**si**tion to the session titled "Interest Rates, Inflation, and Transmission to Emerging Markets." This session will open with the paper "U.S. Anti-Inflationary Policy and Emerging Economies: 1980 vs. 2020s" by **Drishan Banerjee, Galina Hale, and Harrison Shieh.** Their paper analyzes macroeconomic data from advanced and emerging economies in the 1980s and 2020s to highlight differences in how U.S. monetary policies have impacted emerging markets in these two distinct periods. The second paper in this session, by **Francisco Legaspe and Liliana Varela,** will show how country-specific risks, such as political uncertainty and risk on debt repayment explain excess returns from investing in local currency assets in LATAM countries. Finally, a policy panel featuring **Elias Albagli, Jean-Marc Natal, Boris Hofmann, and Ricardo Reis** will offer insights into the future of interest rates and their implications for monetary policy in emerging economies.

5. Acknowledgements

I would like to especially thank **Atif Mian** for being the external organizer of this Conference, as well as locals **Sofia Bauducco, Mariana García and Lucciano Villacorta** for putting together such a wonderful program. I also thank all the speakers and con**tri**butors and look forward to the Conference volume that we will publish in some months with its formatted **con**tents.

Let me finish by thanking **María José Reyes, Constanza Martinelli, Carolina Besa, Daniela Gaete, Daphne Guiloff, Pablo Barros,** and both the Public Affairs Department and the Economic Research Department of the Central Bank of Chile for all their invaluable help managing the logistics of organizing this Annual Conference.

I wish you a fruitful discussion over the next two days.

Thank you.