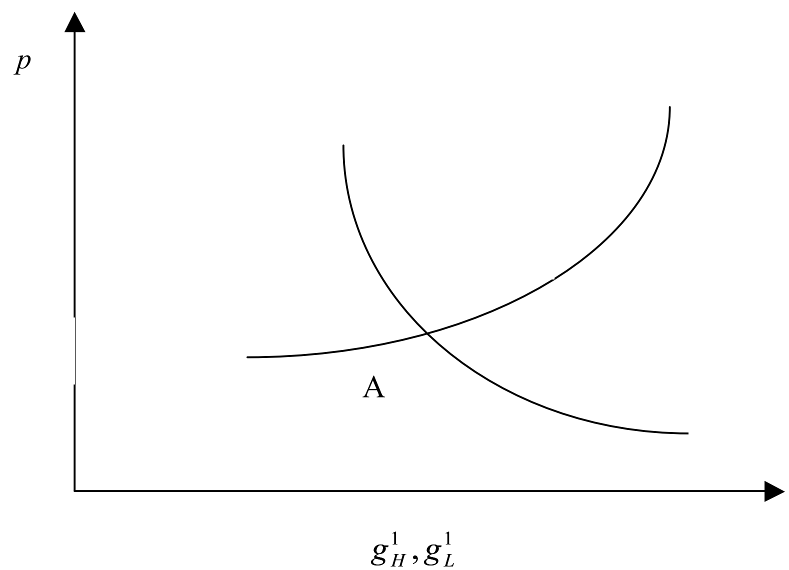
- Historically, the collapse of investment in the Asian crisis is the source of the savings glut.
- The fear of another crisis was instrumental in running trade surpluses and building up reserves in Asia.
- Reserves have now outlived their usefulness for Asian countries.
- Once and if domestic spending rises in Asia, the saving glut ends a glut of dollars ensues.

$$[X - M] = [T - G] + [S - I]$$

$$[M - T] = [G - T] + [I - S]$$

- Think of the world economy as comprising two sectors, situated respectively in the advanced and newly industrializing countries (NICs), producing respectively *smart* and *dumb chips*.
- Advanced countries import from NICs standardized, lower technology ‘commoditized’ inputs (*dumb chips*), while the NICs buy high tech goods (*smart chips*) as capital inputs from advanced countries.

- The growth rate of high tech goods in the advanced countries is related positively, and that of low-tech goods negatively, to the price ratio of high tech goods over low-tech goods, expressed in terms of the advanced country's currency. The point at which the two schedules intersect gives the price ratio (p) for which the two growth rates are in balance – however defined.

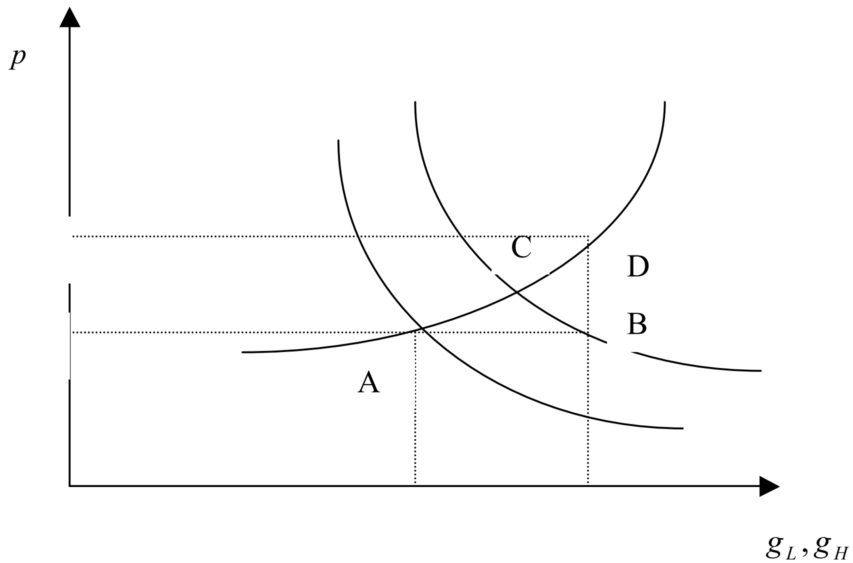


p
A
g_H^1, g_L^1

- In the abstract, the equilibrium of the two growth rates can be thought of as stable. If the price ratio is higher than its ‘equilibrium’ value the production of high tech. goods grow faster than that of low-tech goods, giving rise to an excess supply of high tech goods which pushes down the relative price of high tech goods in terms of low tech goods. Likewise, if the *p* is less than its equilibrium value, the price ratio is pushed up by an excess supply of low-tech goods.

- Liberalized capital flows prevent a stabilizing price adjustment that would close a gap that might emerge between the respective growth rates.

- the capital inflow to developing countries has two effects. On the one hand, it expands the potential supply of output by expanding the industrial capacity in the recipient countries. This can be thought of as causing an upward shift in the growth rate schedule for low tech goods. On the other hand, the capital inflow also fuels an asset price bubble and a currency appreciation, which prevents a smooth upward adjustment in relative prices in terms of the advanced country currency.


p
C
D
B
A
g_L, g_H

- Thus, rather than smoothly moving to the new equilibrium point at C, we end up at B, i.e. which indicates a global overaccumulation of low tech. goods.
- The currency meltdown during the Asian crisis can be thought of a belated price response that overshoots, indicated as an abrupt jump from point B to D in Figure 1.
- the higher growth rate in advanced countries, which the jump to point D implies in our diagram, is fuelled by the deflationary trend in the NICs.

- Mechanism of endogenous credit which makes global liquidity increasingly divorced from monetary policy in the US. Credit creation is now instead a function of global imbalances: reserve build up + petrodollars + carry trade, all recycled through the US and (increasingly ?) Western Europe.

- fear of a currency crisis is no longer as important a constraint on spending in Asia (and the rest of the South), and thus building up reserves of dollars there appear to have outlived their usefulness.

- Once domestic spending rises in Asia the savings glut comes to an end and a dollar glut ensues.

$$[X - M] = [T - G] + [S - I]$$

$$[M - T] = [G - T] + [I - S]$$

Rising inflationary pressures due to falling dollar and the greater difficulty of attracting foreign savings to finance the current acct deficit imply higher and rising interest rates in the US, causing a significant curtailment of private consumption because of problems of household indebtedness.