

LONG-RUN INTEREST RATES: PAST, PRESENT, AND FUTURE

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Medium and Long-Run Trends
in Interest Rates – Causes and
Implications for Monetary Policy

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“It is utterly impossible [...] for the rich to save as much as they have been trying to save, and save anything that is worth saving.”

Marriner Eccles, former Chair of the US Federal Reserve

This paper provides a structural explanation for the persistent global rise in debt and declining long-run interest rates since the 1980s. Figure 1 shows the long-run evolution of two key financial variables in the post-WWII period for the United States: the total credit-to-GDP ratio and 10-year real interest rate, as published by the Cleveland Federal Reserve.¹ Total credit includes both public debt issued by the federal government and private debt taken on by households and the nonfinancial corporate sector. After remaining relatively stable in the post-WWII years, total debt relative to GDP almost doubled since 1980. The situation is remarkably similar across the world as well, with global debt relative to GDP accelerating sharply since 1980.² The large rise in debt globally after the 1980s was accompanied by a fall in interest rates—that is, the price of debt. The ten-year real safe rate declined steadily from a high of around six percentage points in the early 1980s to zero in the post-2008 era, before rising in recent years.

Is there a unified explanation for the rapid and persistent rise in debt and the fall in interest rates that started in the 1980s? Why is it

This article is based on the keynote speech given at XXVII Annual Conference of the Central Bank of Chile in 2024. I thank the conference participants for many helpful questions and comments, and Amil Mumssen for superb research assistance.

1. The real interest rate series starts in 1982, as the very volatile inflation rate environment before that makes it difficult to construct a reliable series.

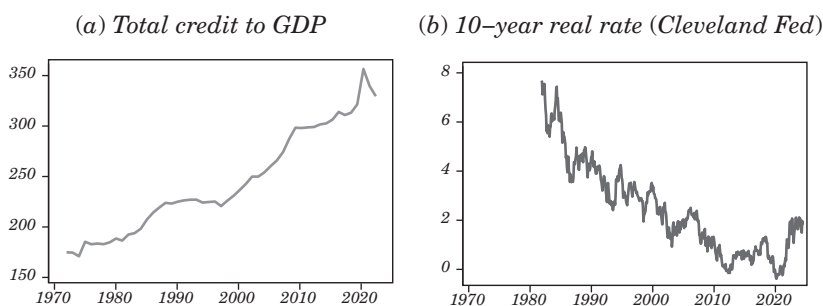
2. See International Monetary Fund (2024).

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that, despite rising debt that posed significant economic risks—such as contributing to the Great Recession of 2008—the total debt-to-GDP ratio continued to rise? In this article, I will argue that there is a possible structural explanation for this: the rise in extreme inequality and the rise in “financialization” after the breakup of the Bretton Woods system. As I explain, these structural shifts have led to a debt-dependent economy. Even the severe 2008 crisis, rooted in excessive borrowing, failed to reduce total debt levels. Instead, overall debt continued rising, as sovereign public debt increasingly replaced private debt growth after 2008. Today, public debt has reached alarming new heights worldwide, notably in the United States, the world’s largest economy. The rise in total debt, the fall in interest rates, the shift from private to public debt after 2008, and the current fiscal crisis in the United States and beyond can all be connected by a single structural explanation: the rise of extreme inequality and financialization.

The world seems “addicted” to debt. Today, there is twice as much debt for each dollar of global income as in 1980. Because income ultimately services debt, this sharp rise in debt relative to income naturally raises concerns about debt sustainability and fragility. What factors drive this global surge in debt? One approach to addressing this question is to determine whether the increase stems primarily from demand-side or supply-side forces in credit markets.

Figure 1. Credit-to-GDP Ratio and 10-Year Real Rate



Sources: IMF Global Debt Database, Federal Reserve Bank of Cleveland.

The left panel of Figure 1 illustrates the growth in total US debt-to-GDP ratio over time, showing an increase from 187 percent in 1980 to 329 percent in 2022, consistent with global trends. This total debt comprises private household debt, private nonfinancial corporate debt, and public government debt. In turn, the right panel of the figure presents the average cost of debt, proxied by the 10-year real interest rate on government bonds provided by the Federal Reserve Bank of Cleveland. The 10-year real rate fell from 8 percentage points in 1980 to zero by 2020, before rising in the wake of the pandemic. An eight-percentage-point decline in the real rate is extremely large. Together, the two panels in Figure 1 offer critical insights into whether supply-side or demand-side factors predominantly drive the observed debt dynamics.

All else equal, if the credit-to-GDP expansion had been driven by increased demand, interest rates would have risen. Instead, interest rates have experienced a substantial and persistent decline from 1980 to 2020. The combination of rising debt and falling interest rates strongly indicates that the primary factor behind increased debt is an expansion in credit supply. Furthermore, because these dynamics have persisted over decades, they imply that structural shifts in the economy underpin the growth in credit supply.

1. DEBT AND INEQUALITY: THE SAVING GLUT OF THE RICH

What factors drove the sustained increase in credit supply? A critical structural shift coinciding with accelerated credit growth is the dramatic rise in extreme inequality, both in the United States and globally. In the United States, the income share of the top 1 percent rose from 10 percent in 1980 to 20 percent in 2023—a 10-percentage-point increase in national income share. Similar trends are evident in other major advanced economies. Between 1980 and 2023, the top 1 percent income share rose by 7 percentage points in the United Kingdom, 4.5 percentage points in France, 1.5 percentage points in Germany, 9 percentage points in China, and 2.9 percentage points in Japan.

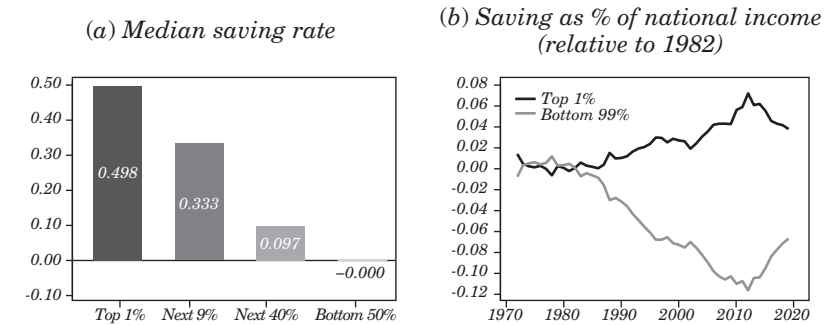
The global rise in extreme inequality significantly boosts the availability of savings because the wealthiest households save at much higher rates than the rest of the population. The left panel of Figure 2 shows median saving rates by wealth-percentile groups in the United States, derived from the Survey of Consumer Finances for nationally representative households tracked from 1983 to 1989. It reveals stark disparities: the bottom 50 percent of households essentially live

hand-to-mouth, with zero savings. Households in the 51st–90th percentile save at a rate of 9.6 percent, and those in the 91st–99th percentile save at 27.9 percent. In contrast, the saving rate for the top 1 percent reaches 41.7 percent, over six times higher than that of the rest of the population.

The substantial gap in saving rates between the top 1 percent and everybody else means that as income distribution shifts toward the wealthiest households, the savings supply from this group significantly expands. This is precisely what occurred in the United States, beginning in the 1980s. The right panel of Figure 2 illustrates the ten-year moving average of total savings contributed by the top 1 percent as a share of national income, with values normalized relative to 1983 levels. These annual savings figures for the top 1 percent are derived from tax-filing data using the imputed wealth methodology developed by Mian and others (2020).

Between 1963 and 1983, savings contributed by the top 1 percent as a share of national income remained stable. However, precisely as inequality began to rise, these savings significantly increased. At their peak, annual savings from the top 1 percent alone rose by more than 6 percent of national income. We label this substantial rise the “Saving Glut of the Rich”. The annual savings flow from the top 1 percent increased by 3.4 percentage points of national income on average after 1982. In 2024-dollar terms, this represents an additional savings flow coming from the wealthiest top 1 percent of over \$800 billion every year from 1982 onward.

Figure 2. Saving across the Wealth Distribution



Sources: US Federal Reserve System, Distributional National Accounts, Survey of Consumer Finances.

Importantly, the rise in the Saving Glut of the Rich did not stem solely from rising inequality; the savings rate of the top 1 percent itself climbed further over the last three decades, amplifying their total contribution to national savings. In particular, the top 1 percent savings rate rose from 42.9 percent during 1963–1982 to 53.6 percent afterwards. An increase in the savings flow of such magnitude coming from the very rich must be absorbed elsewhere in the economy. So, where did these additional savings from the top 1 percent flow to?

Let θ_{top1} and θ_{bot99} represent total private savings from the top 1 percent and the bottom 99 percent, respectively. The national accounting identity linking these variables is given by:

$$\theta_{top1} + \theta_{bot99} = I^n + F - S^g$$

where I^n denotes net investment, F the current account, and S^g government savings. This identity must hold every year. While private savings rapidly increased as a share of national income, net investment as a percentage of national income remained flat or even declined. Additionally, the United States consistently ran a current account deficit, and government deficits did not expand significantly until after 2008. This raises the question: Where did the increased savings from the top 1 percent ultimately go?

The right panel of Figure 2 provides the answer. The increased savings from the top 1 percent were absorbed by the bottom 99 percent through borrowing (and thus dissaving). In fact, the rise in dissaving by the bottom 99 percent exceeded the additional savings from the top 1 percent, as the lower-income group also absorbed the expanding US current account deficit driven by the global saving glut.

A crucial insight emerges from this analysis: rising extreme inequality generated substantial surplus savings from the wealthiest households. Importantly, these savings did not fuel increased real investment. Instead, they financed borrowing and dissaving by other households. The financial sector facilitated this process, and it remains an open and important question why it directed these surplus savings into debt-driven consumption rather than productive investment.

2. THE INDEBTED DEMAND FRAMEWORK

Mian and others (2021) provide a theoretical framework explaining how the high saving propensity of the wealthy leads to increased debt and declining interest rates as income concentration among the top 1

percent grows. A crucial component of their model is non-homothetic preferences in saving decisions, represented by explicitly incorporating wealth into the savers' utility function. As inequality deepens and a larger portion of national income flows to households with strong wealth-driven saving preferences, the credit supply expands and drives equilibrium real interest rates downward.

This increased supply of credit from the wealthy reduces interest rates, which in turn inflates asset prices. Higher asset values enhance collateral, which enables the broader population to borrow more and increase consumption, thus creating debt-driven "indebted demand." However, this debt-driven demand expansion is unsustainable in the long term, as growing interest burdens gradually suppress future demand. Consequently, maintaining indebted demand necessitates a continual decline in the long-run equilibrium interest rate, or r^* . In short, rising extreme inequality expands the supply of credit coming from the top 1 percent. These increased savings have not gone into more productive investment, but rather toward borrowed consumption. However, borrowed consumption—or indebted demand—puts downward pressure on future interest rates as indebted consumers try to service their debt burdens. The indebted demand framework thus offers an integrated explanation for rising inequality, growing dependence on debt-driven consumption, and persistently falling interest rates.

The central insight of the indebted demand framework is illustrated in Figure 3, which plots the long-run equilibrium between the demand for and supply of savings. The intersection of these curves determines the long-run natural interest rate, denoted by r . Holding other factors constant, a decrease in r increases the demand for debt, thus rendering the demand curve downward-sloping, as is standard in most economic models.

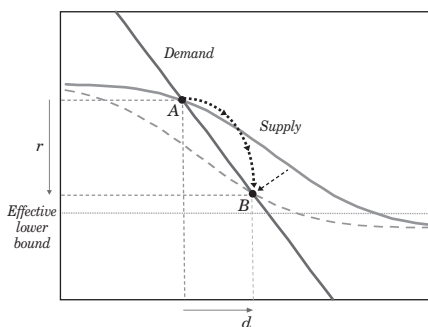
Notably, the supply curve for savings also slopes downward. This occurs because, at lower levels of wealth—when aggregate asset and debt holdings are relatively small—the economy behaves similarly to a traditional Ramsey model, where the interest rate is anchored by a relatively high average discount rate. As the economy grows richer, however, households desire to save a larger fraction of their permanent income due to non-homothetic preferences. This preference-driven increase in desired savings reduces the effective discount rate, which leads the long-run equilibrium interest rate along the savings supply curve to decline.

Consequently, the savings supply curve is downward-sloping in an economy characterized by high savings rates among the wealthy. The initial long-run equilibrium, denoted by point A in Figure 3, can be thought of as representing conditions around 1980. Now consider a permanent increase in income inequality, specifically an increase in the income share captured by the top 1 percent.

With non-homothetic preferences, rising inequality shifts the long-run savings supply curve inward. For any given level of total assets (equivalently, total debt, since debt is the sole asset in this simplified economy), higher inequality reduces the effective discount rate because a larger share of income accrues to households inclined to save more. This inward shift of the supply curve moves the long-run equilibrium from point A to point B. The black boxes depict the short-run transitional dynamics as the economy adjusts between these steady states. Thus, the indebted demand framework effectively explains the key long-run correlation observed since 1980, rising debt accompanied by declining interest rates.

Another significant structural shift beginning in the 1970s, following the collapse of the Bretton Woods system, was the increased financialization of the global economy. Financial markets experienced rapid liberalization during the 1980s, as numerous countries transitioned to flexible exchange rates and reduced barriers to cross-border capital flows. Concurrently, the United States underwent substantial financial deregulation, including bank-branching liberalization, making capital markets increasingly central. Consequently, financial institutions began to rely more heavily on capital markets through practices like securitization and wholesale financing.

Figure 3. Rise in Inequality



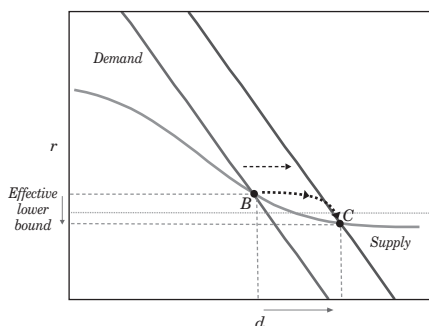
Source: Author's calculations.

A major effect of this financialization was the emergence of easier access to credit. Borrowers could more readily obtain loans, particularly by leveraging assets such as homes and automobiles. Unsecured credit also expanded notably with the proliferation of credit cards and related financial products. From a macroeconomic perspective, financialization can be conceptualized as shifting the long-run demand curve for credit outward, thus enabling borrowers to pledge a larger share of their future income.

Figure 4 shows the effects of this shift in credit demand, starting from equilibrium point B in Figure 3. Remarkably, increased financialization produces the same long-run effects as heightened inequality— a permanent rise in credit demand elevates the steady-state level of borrowing and simultaneously *lowers* the long-run equilibrium interest rate. The intuition that increased credit demand reduces the long-run equilibrium interest rate may seem counterintuitive, yet it is fundamental to the indebted demand framework.

Initially, higher credit demand raises interest rates due to increased borrowing—a conventional short-run response depicted by the black boxes in Figure 4, which illustrates the economy's transition from point B to the new equilibrium C. This short-term interest-rate increase reflects the immediate stimulative effect of additional borrowing and spending. However, increased borrowing eventually constrains future demand as borrowers repay loans at higher interest rates. Because creditors typically represent wealthier individuals with higher savings rates, debt repayments redistribute income toward households less inclined to spend, thereby reducing aggregate demand. The redistributive drag on demand ultimately dominates and thus drives the long-run equilibrium interest rate downward. The economy settles into a new equilibrium C characterized by elevated debt-to-GDP ratios and lower equilibrium interest rates.

Central to the indebted demand dynamic—which drives credit upward and interest rates downward amid rising inequality or rising financialization—is the reality that the private borrowing rate R^{priv} typically exceeds the economic growth rate G . Both macroeconomic models and empirical evidence confirm that households consistently borrow at rates higher than the growth rate of average incomes. This fundamental imbalance makes increasing indebted demand inherently unsustainable unless interest rates continuously decline.

Figure 4. Rise in Financialization

Source: Author's calculations.

But what happens if rising inequality and consequent debt dependency drive the equilibrium interest rate below the effective lower bound (ELB)³ This is illustrated in Figure 4 with the equilibrium interest rate in C being below the effective lower bound for the economy. Under such conditions, the economy falls into a liquidity trap and experiences a demand-driven recession. Crucially, this liquidity trap becomes persistent—as long as high inequality and substantial savings among the top 1 percent continue to exert downward pressure on interest rates, the economy remains trapped indefinitely in a debt-driven liquidity crisis. Thus, unlike typical Keynesian models, the liquidity trap in an indebted demand world is permanent.

3. FISCAL POLICY: THE GOLDBLOCKS CONUNDRUM

Can fiscal policy help an economy that has hit the effective lower bound and becomes trapped in a permanent liquidity crisis? If governments were forced to borrow at the same interest rates as private households, the answer would be no. However, governments in advanced economies typically borrow at significantly lower rates than private entities, even after adjusting for credit risk. The lower cost that the government enjoys is often referred to as *convenience yield*.

Mian and others (2025) demonstrate that if the government's borrowing rate is sufficiently low—specifically, $R^{gov} < G$ —then running large and persistent primary deficits can effectively lift

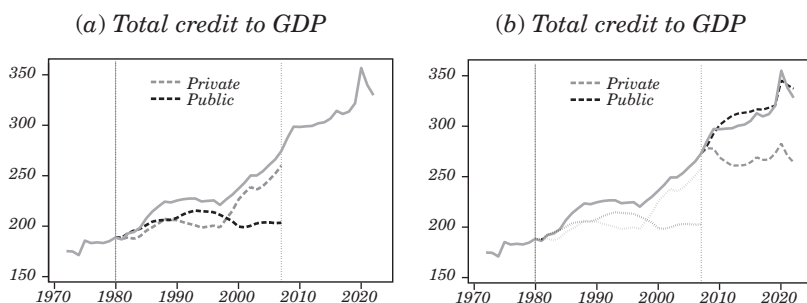
3. The ELB can be the traditional zero lower bound (ZLB) on the short nominal rate set by a central bank.

the economy out of the liquidity trap. When private debt no longer generates sufficient demand, fiscal policy can step in by maintaining sustained primary deficits. Figure 5 illustrates precisely this scenario, highlighting how the US government significantly expanded deficits following the 2008 financial crisis as private households faced pressure to deleverage and interest rates hit zero.

The left panel of Figure 5 decomposes the growth in total US credit since 1980 into private credit (household and nonfinancial corporate) and public credit (government). The graph shows that, between 1980 and 2008, it was private sector borrowing that primarily drove credit expansion. However, the right panel of Figure 5 shows that after the onset of the Great Recession—when the heavily indebted private sector could no longer sustain borrowing—large government deficits stepped in to maintain demand. Indeed, all credit growth since 2008 has been due entirely to rising government debt.

The sharp reliance on government debt to generate demand after the Great Recession is evident in the data. Between 1980 and 2006, the US government maintained a nearly balanced primary budget, averaging a primary deficit of only 0.02 percent of GDP. In sharp contrast, from 2007 onward, the government's average primary deficit increased dramatically to 4.3 percent of GDP. This sudden, substantial rise in primary deficits reflects the structural economic necessity to generate debt-driven demand.

Figure 5. Credit-to-GDP Ratio Decomposition by Private and Public



Source: IMF Global Debt Database.

When $R^{gov} < G$ in an economy constrained by the effective lower bound, governments have the capacity to run fiscal deficits without the need to finance these deficits in the future, thanks to the expansionary impact of government spending. However, this borrowing capacity is not unlimited. Governments face a downward-sloping demand curve for their debt, characterized by the semi-elasticity of borrowing costs with respect to amounts borrowed, denoted as ϕ .

While the convenience yield grants governments a low cost of borrowing, the increasing borrowing relative to GDP eventually raises overall financing costs, with incremental costs determined by ϕ . Extensive empirical research has measured this elasticity in advanced economies. Mian and others (2025) demonstrate that once a government accumulates sufficient deficits to escape the liquidity trap, any additional debt will push up interest rates. Specifically, governments can theoretically maintain primary deficits as long as $R^{gov} < G - \phi$, without incurring future fiscal adjustments through increased taxes or reduced spending. However, beyond this threshold, even if $R^{gov} < G$, the condition $R^{gov} < G - \phi$ implies that governments again face conventional trade-offs due to rising deficits.

In a world characterized by indebted demand and constrained by the effective lower bound, governments face a “Goldilocks zone” on fiscal deficits, in which deficits must be sufficiently large to avoid the effective lower bound, but not so large as to necessitate painful structural fiscal adjustments in the future. Figure 6 illustrates the Goldilocks zone in a debt-deficit diagram. The locus of the arc refers to all debt-deficit combinations that are sustainable in the long run, given the possibility of $R^{gov} < G$. For moderate permanent primary deficits, the government can sustain a constant debt-to-GDP ratio (which is the x-axis in the figure). This reflects the “free lunch” that opens up due to the presence of the convenience yield.

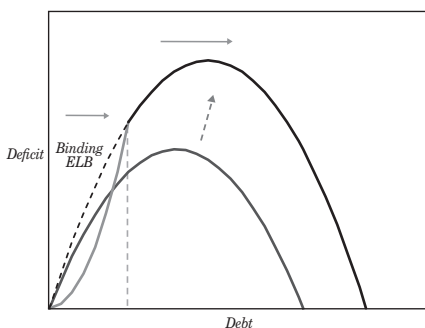
However, because the government faces a downward-sloping demand curve, it cannot run too large a primary deficit forever. The maximum primary deficit is denoted by the maximum height of the arc, which reflects the maximum permanent primary deficit and an interest rate on government borrowing given by $R^{gov} = G - \phi$. Any primary deficit above it is unsustainable in the long run. Figure 6 also shows how a rise in inequality expands fiscal space and makes the presence of the effective lower bound more likely. Since government bonds are held by the rich in equilibrium, an increase in inequality expands the demand for government debt, thus raising the convenience yield and making it easier for governments to fund deficits.

The debt-deficit locus thus expands outwards as inequality rises. At the same time, for reasons already mentioned, increasing inequality pushes aggregate demand down, which opens up the possibility of liquidity traps. Thus, fiscal policy is *required* to run sufficiently high deficits in order to prevent the economy from dipping into the ELB environment. This is reflected by the red kinked line in the debt-deficit diagram: fiscal policy must maintain deficits above the gray line to avoid the liquidity trap.

Our calibration using recent US data indicates that the United States may have exceeded this optimal range in recent times. The current combination of borrowing costs and deficit levels suggests the US economy is now incurring tangible risks from maintaining excessive deficits. The data suggest that the United States will eventually have to undergo some fiscal adjustment, through a combination of higher revenues and reduced spending.

This reliance on debt-driven demand thus introduces a new type of economic fragility: fiscal policy must navigate a narrow path. On one hand, very small deficits risk plunging the economy into recession and hitting the effective lower bound. On the other hand, deficits that become excessively large raise borrowing costs and heighten debt-sustainability concerns, which potentially trigger self-reinforcing financial pressures.

Figure 6. Deficit-Debt Diagram – Rise in Inequality



Source: Author's calculations.

Even if a government carefully calibrates fiscal policy to remain within the Goldilocks zone, external factors can shift its boundaries, triggering the need for continuous adjustments. For instance, increased inequality could expand fiscal space by raising demand for government bonds. Conversely, if top-income savers scale back or inequality decreases, demand for bonds might weaken and push interest rates upward while narrowing fiscal capacity. Moreover, the convenience yield itself can fluctuate due to speculative market forces; asset prices are known to deviate from their long-term fundamentals—a phenomenon known as the “excess volatility puzzle”.

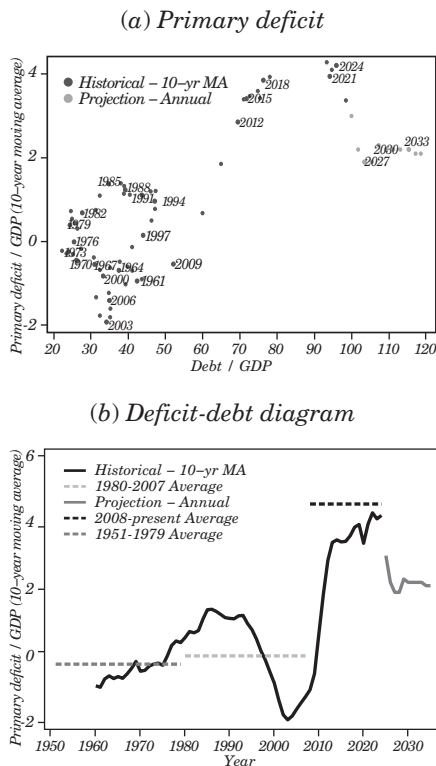
Governments seeking to remain within the Goldilocks range must thus be prepared to adjust fiscal policy proactively in response to potentially adverse market shifts. Fiscal policy management will need to be highly adaptive and nimble. However, doing so effectively is very difficult in practice. In reality, fiscal policy decisions are not made by technocrats in isolation; they are deeply influenced by political dynamics. Political gridlock, disagreements, and delays in policy decisions are common, and it is typically easier for governments to expand fiscal deficits than to adopt the often unpopular measures required to reduce them.

The upper panel of Figure 7 plots the ten-year moving average of primary deficit-to-GDP ratio for the United States. This country has had a primary balance *on average* in the post-WWII period until 2008. However, there has been a massive rise in primary deficits since then. The United States has run an average primary deficit of 4.5 percentage points of GDP since 2008. While the Congressional Budget Office (CBO) projects long-run primary deficit to settle at around 2 percentage points of GDP under current law, there is considerable uncertainty around it.

The lower panel of Figure 7 plots the deficit-debt diagram for the United States since WWII. It highlights the unusual current fiscal position for this country. Both the primary deficit-to-GDP and debt-to-GDP ratios are at historic highs and, as our calibration suggests, quite likely outside of the sustainable long-run path.

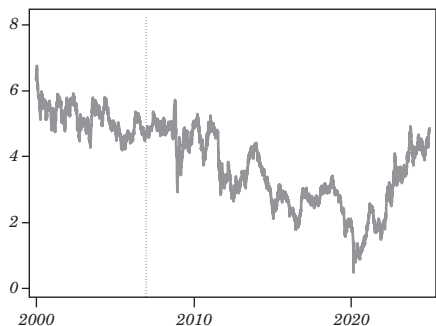
The bottom line is that relying on fiscal policy to address structural problems linked to rising inequality carries substantial risks. Indeed, there are compelling reasons for heightened concern about fiscal sustainability now. A sustained primary fiscal deficit exceeding two percent of GDP may pose significant debt sustainability risks for the United States. In recent years, the US deficit has consistently surpassed this threshold even amidst a relatively tight labor market, thus prompting markets to raise long-term interest rate expectations.

Figure 7. Primary Deficit and Debt



Source: Congressional Budget Office.

Figure 8. 7–10 Forward Rate



Source: US Federal Reserve System.

Figure 8 illustrates the 7–10-year forward interest rates for the United States from 2000 through early 2025. After declining for decades, long-term interest rate expectations reversed sharply following the substantial fiscal expansions during the Covid-19 crisis. These expectations have now risen to levels not seen since before the 2008 Great Recession. The surprise inflation shock after the pandemic, continued large deficits, and heightened political risks in the aftermath of the 2024 elections have all contributed to higher future interest rate expectations.

4. LOOKING AHEAD

A key concern is whether the United States will be able to maintain its exorbitant privilege, or convenience yield, on government bonds. Indeed, the recent “Liberation Day” tariff announcement coming from the Trump administration has sent shock waves around the world. The US dollar has weakened, and many are questioning whether the country will maintain its financial advantage. If this advantage diminishes—due to geopolitical tensions, war, climate-related events, or declining confidence among global investors—, real interest rates could rise further. This would in turn threaten the sustainability of current fiscal deficits as well as private debt. Governments may then resort to financial repression, implicitly taxing other economic sectors to create fiscal space, which would negatively affect long-term growth prospects.

While the indebted demand framework illustrates how public debt can substitute for private debt to sustain aggregate demand in low-interest-rate environments, several risks could disrupt this equilibrium. Erosion of convenience yields, severe external shocks, or even a reversal in extreme inequality could push real rates sharply higher, thus intensifying fiscal sustainability concerns and elevating debt burdens. Today, the global debt-to-GDP ratio is at an unprecedented high, and rising interest rates reflecting market anxiety about government fiscal stability pose significant risks for the world economy.

The global economy’s deepening addiction to debt—fueled by structural imbalances arising from extreme inequality—presents a profound and escalating long-term threat. Rather than confronting the root causes of unequal economic growth, policymakers have increasingly relied on debt-financed consumption to sustain demand. This reliance on debt-driven growth is fundamentally unsustainable

and leaves the world economy dangerously vulnerable. Until we directly address the underlying drivers of inequality, global economic stability will remain fragile and continuously exposed to the risks of a deeply indebted world economy.

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