Global imbalances: past, present, and future

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Imbalances had many causes and players

- **Saving behavior**
  - Decline in U.S. private saving since 2001
  - Dramatic increase in the saving rate in China over the past decade.

- **Investment behavior**
  - U.S. productivity boom and stock market increase in late 1990s
  - Investment boom in “peripheral” Europe, particularly since 2005.

- **Policy choices**
  - Accumulation of reserves to strengthen external position
  - Choice by many EM countries to pursue policies of export-led growth
  - US fiscal deterioration 2000-onwards
Imbalances had many causes (II)

- **Commodity prices**
  - Gyrations in oil and other commodity prices since the early 2000s

- **Attitudes towards risk**
  - Decline in risk aversion in the 2000s, triggering capital flows towards fast-growing countries in Southern, Central, and Eastern Europe
  - Dramatic increase in risk aversion during the crisis, and increased demand for U.S. Treasury securities.
A Timeline for Global imbalances

1996-2000
- US investment boom, Asian investment bust.
- US financing through FDI, equity flows
- Surpluses in emerging Asia, Japan

2001-2004
- US fiscal deficits
- Financing through US bonds (incl. foreign central banks)
- Surpluses in Germany and other Ctr-Nort. Europ. countries, oil exporters

2005-2008
- Stable/declining deficits in US, large deficits in peripheral Europe
- Boom in surplus in China, oil exporters, Central-Northern Europe
Global imbalances 1996-2008
An evolving story

Global Imbalances (percent of world GDP)

US  JPN  Eur surplus  CHN  EMA  OIL  ROW  Eur deficit  Discrepancy
Imbalances: good or bad?

- In principle imbalances can be optimal...
  ...but in practice they can also reflect problems:

  - Domestic problems or distortions
  - Problems with the international monetary system and exchange rate regimes.
  - Imbalances may themselves lead to domestic problems
  - With large imbalances and liquid K-flows, systemic problems: the risk of "disruptive adjustments"
Concerns about imbalances: policy advice

- Multilateral consultations
  - raise private consumption and increase exchange rate flexibility in China
  - increase private and public saving in the United States
  - increase domestic demand and growth in Saudi Arabia
  - implement structural reforms to spur productivity growth, particularly in the non-traded goods sector, in both the euro area and Japan.
The crisis and its aftermath: imbalances disappearing?

- Imbalances were not the direct trigger the crisis
- But they reflected some of the “financial excesses” and were clearly unsustainable
- Imbalances narrowing sharply in 2009
  - Declining oil prices
  - Asset price busts in several deficit countries leading to lower domestic demand
  - Investment decline—smaller surpluses in K-goods exporters (Germany, Japan)
Temporary factors

- Large output gaps will eventually disappear

- Sharp increase in private saving may be partly temporary (as uncertainty declines and income and asset prices increase)

- Fiscal stimuli will have to be phased out
Persistent Factors

- Potential output projected to be lower than expected before the crisis, esp. in deficit countries with disrupted fin. system.

- Private saving projected to be higher than before the crisis. (even as output returns to its potential level, asset prices and wealth may not return to pre-crisis levels any time soon.

- Investment rates may be lower in a number of deficit countries (lower construction, higher cost of capital)

- Risk premia on capital inflows to many debtor countries have risen

- Crisis may lead deficit countries to accumulate higher reserves
Global current account projections

Global Imbalances (percent of world GDP)

WEO projections

US JPN Eur surplus CHN EMA OIL ROW Eur deficit Discrepancy
Growth projections (surplus and deficit countries)
So should we stop worrying?

- No. Previous policy advice still relevant. For example:
  - Domestic distortions still keep the saving rate in China too high
  - In many EMs crisis has shown risks of the export-led growth model.
  - Problems with the international monetary system still persist
  - Risks of disruptive adjustment could materialize again in a different guise, in light of the large fiscal deterioration in several advanced economies
  - And…
New reason for addressing imbalances

- The new configuration of saving and investment raise a new and important issue: the sustainability of the world recovery itself.
Policy agenda

- Need for a double re-balancing act

  - From public to private demand as fiscal stimuli are unwound

  - From external to domestic demand in surplus countries, and from domestic demand to external demand in deficit countries
Problem in deficit countries

- Higher private saving
- Investment not higher, likely lower
- ZIF on monetary policy
- For given public spending, need higher net external demand
- Where is external demand likely to come from?
Rebalancing in surplus countries and elsewhere

- **China**: scope higher private consumption, lower corporate saving, more appreciated RMB
- **Rest of emg Asia**: scope for higher investment, lower precautionary saving, some REER appreciation
- **Central/Northern Europe**: limited room to lower saving given demographics. Scope for higher productivity and investment, esp. in NT sector
- **Japan**: similar argument
Rebalancing in surplus countries and elsewhere (II)

- **Oil exporters:** some increase in C and I if oil prices stay high

- **Rest of the world** (including large EM such as Brazil, India, Mexico etc): scope for higher investment, lower precautionary saving if international financial architecture strengthened
Will it happen?

- To some extent. For example:
  - China is undertaking policy initiatives to strengthen social insurance, which will increase consumption.
  - Crisis has refocused attention on need to develop alternatives to reserve accumulation as a form of insurance. However, unlikely to happen in the short run.

- WEO forecasts
  - Based on “current policies” and constant REERs
  - Partial rebalancing, and thus of a relatively weak recovery.
  - Projections show a substantial world CA surplus, suggesting excessively optimistic assumptions about export growth in a number of country forecasts.
Global current account projections

Global Imbalances (percent of world GDP)

US JPN Eur surplus CHN EMA OIL ROW Eur deficit Discrepancy

What if it does not happen?

- Anemic recovery
- In US, increased political pressure to extend fiscal stimulus
- Resurgence of protectionist pressures
- Various scenarios
  - political pressure may be resisted, the fiscal stimulus phased out, and U.S. recovery would then be very slow.
  - high fiscal deficits leading to concerns about debt sustainability, falling demand for U.S. government bonds, a sharply weaker dollar
Thank you.