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.

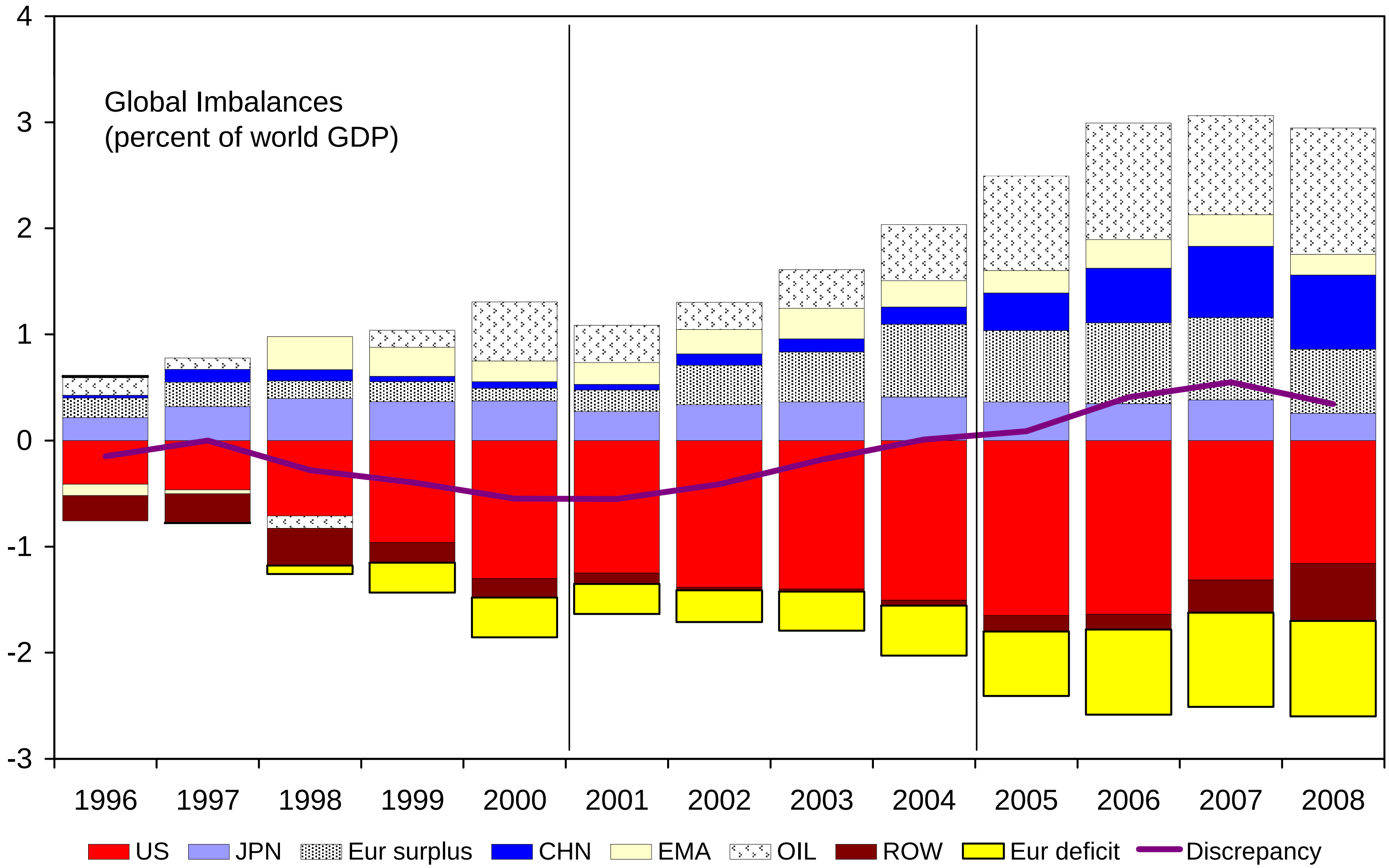
A Timeline for Global imbalances

- 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



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)

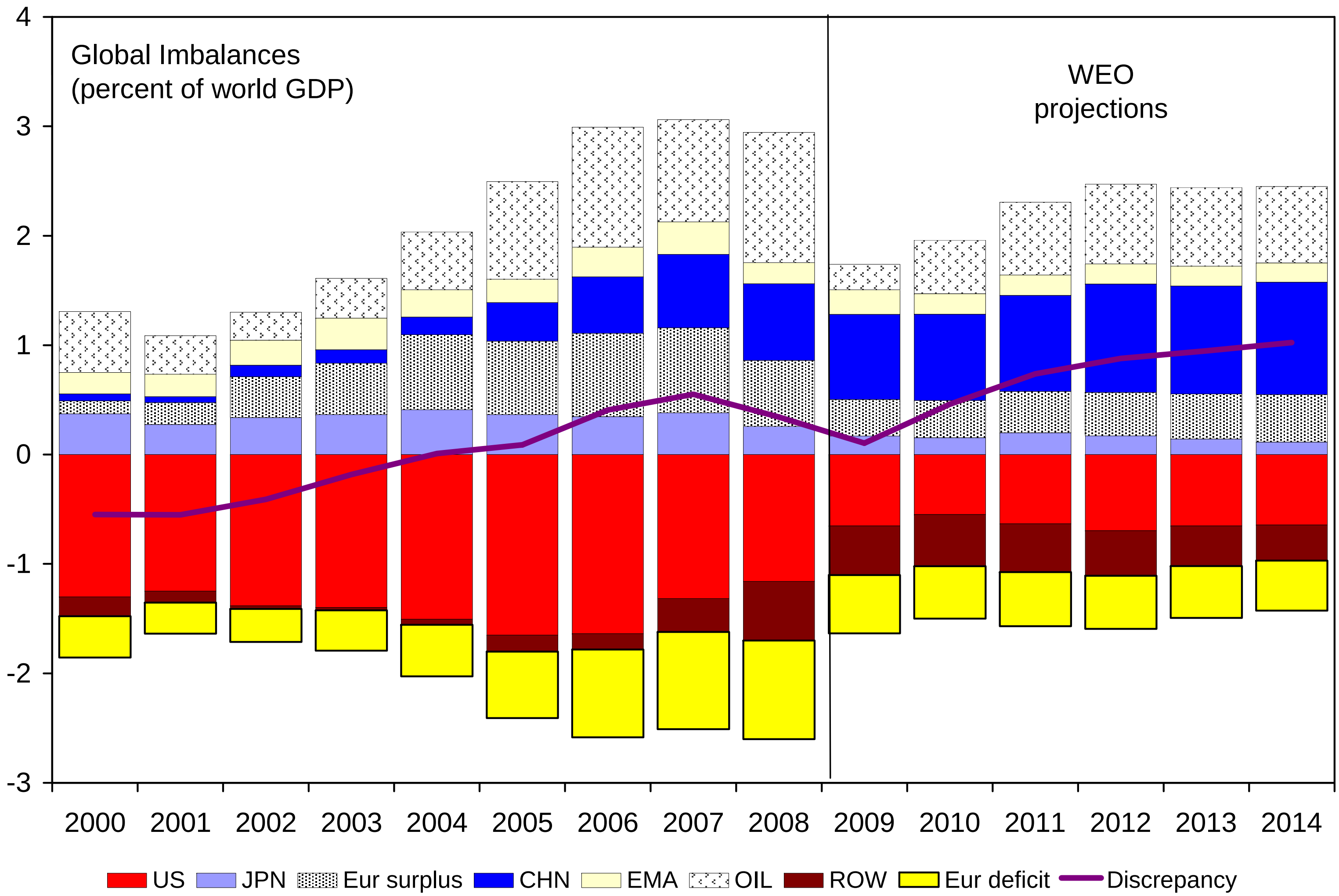
Temporary factors

- 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

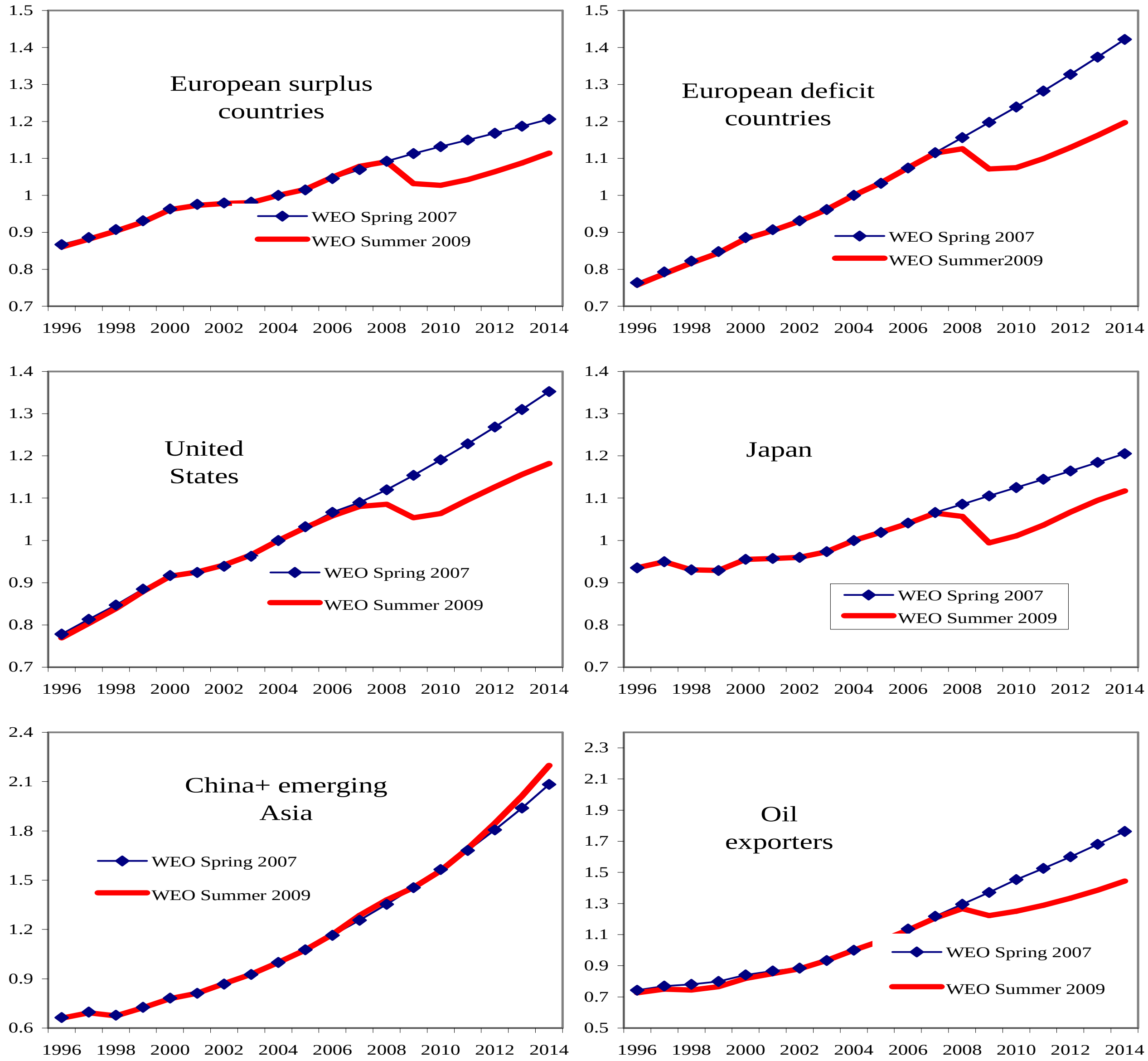
Persistent Factors

- 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



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.

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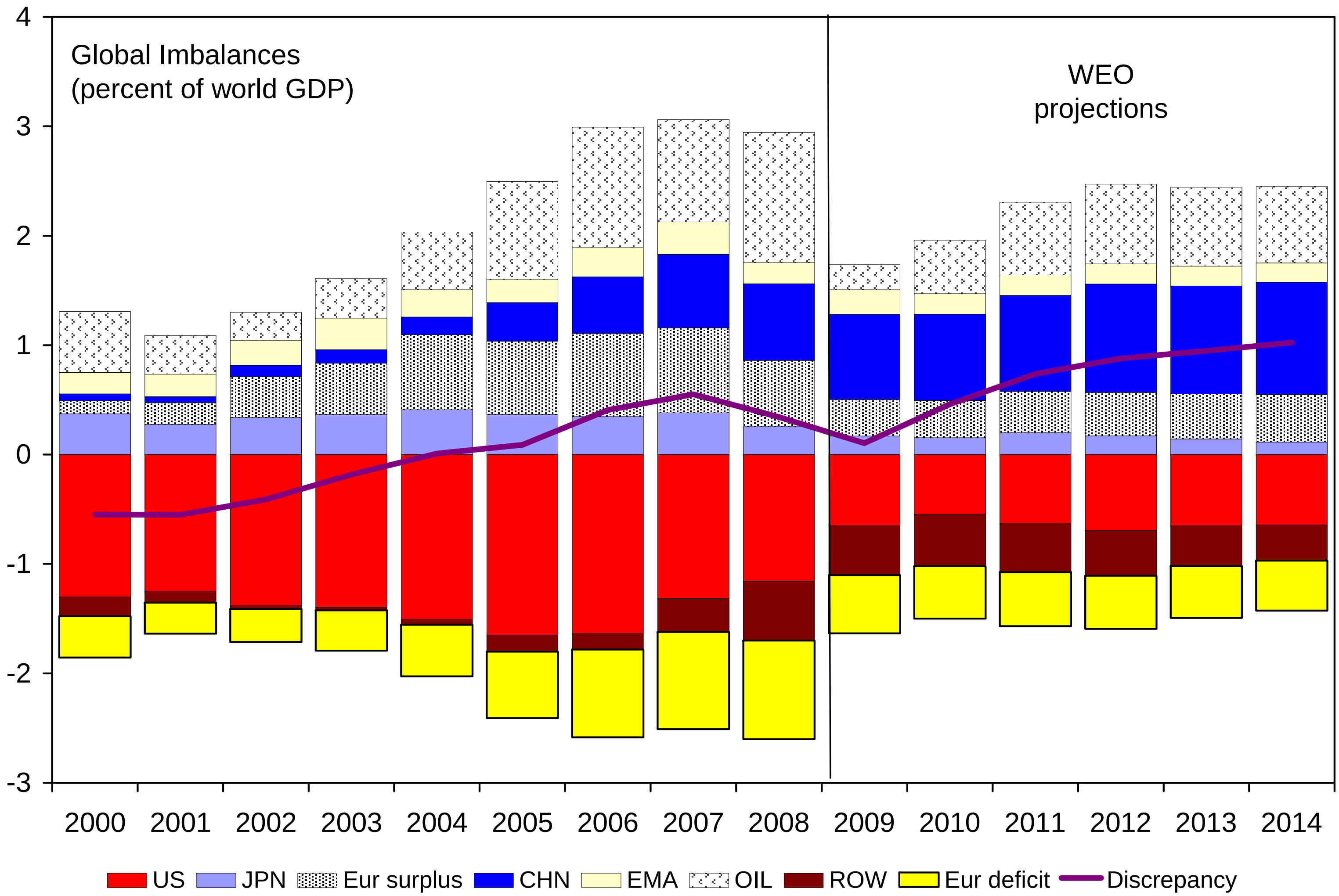

What if it does not happen?

- 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.