

The role of global imbalances 10 years on

Ten years after the outbreak of the great global economic and financial crisis, the global economy is growing at levels close to 4% per year, a reasonably high rate. Most projections indicate a continuation of this trend in the medium term. Nevertheless, in this scenario of considerable growth, some well-known risk factors are once again rearing their heads. These include global imbalances.

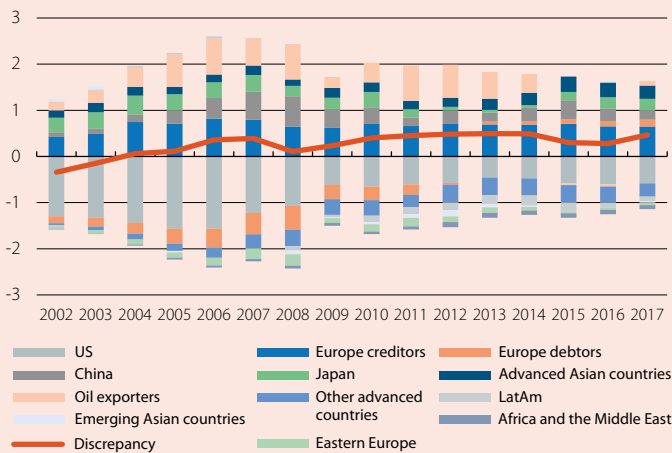
But what exactly do we mean when we talk about global imbalances? Generally speaking, we understand global imbalances as a situation of high and persistent current account deficits and surpluses, such that their existence can have global repercussions. The presence of current account deficits (and surpluses) is not cause for concern in itself, since they may be the result of optimal

movements of capital from countries with a low growth outlook (surplus) towards countries with a better outlook (deficit). However, if these deficits (and surpluses) arise, for example, as a result of heavily expansionary fiscal policies, excess savings (brought about by a scenario with high risk aversion) that are flowing to foreign countries with a well-developed range of safe assets, or mercantilism policies, they may well be cause for concern.

A combination of these factors is precisely what gave rise to some worrying global imbalances at the beginning of the millennium. Whereas in the early 2000s the sum of the current account deficits throughout the world represented no more than 1% of global GDP, in 2007 it was more than 2.5% (see first chart). This increase, of course, also occurred in the surpluses. In addition, this increase at both ends of the current account scale was concentrated in just a few countries. On the surplus side, there were sharp increases in Central Europe (led by Germany); in the oil-exporting countries, which benefited

Global imbalances: current account balances

(% of global GDP)



Source: CaixaBank Research, based on data from the IMF (WEO, April 2018).

from the sharp rise in the price of oil (going from just 30 dollars per barrel of Brent oil in 2000 to over 100 dollars in 2007); and in China, where the country's significant savings in search of safe assets and its neo-mercantilism policies in support of the exporting sectors were key drivers of the global imbalances.¹ On the other side of the scale, rising fiscal deficits in the US and in several countries of Europe's periphery were an important factor in the increase in global imbalances² (the twin deficits hypothesis, which suggests that excessively expansionary fiscal policies decrease their net national savings and increase external dependency, took on greater importance in that decade).³

This accumulation of imbalances during the early years of the 2000s exacerbated the impact of the 2008 financial crisis. The sudden breakdown of the international flows of capital that occurred following the collapse of Lehman Brothers forced those economies that were highly dependent on external savings (and, therefore, had a large current account deficit) to sharply cut their spending, thus depressing their economic activity. In addition, the strong global interconnection between the major economies through trade and financial flows led to the problem spreading on a global scale.

It should be noted that, following the outbreak of the financial crisis, many of the excessive deficits and surpluses were substantially corrected. Thus, the overall global current account deficit in 2012 stood at around 1.5% of global GDP. The reduction in the dispersion between countries' current account balances was also significant. Specifically, the largest economies with deficits reduced their combined external imbalance by half. By way of illustration, the US, which was the main country responsible for the large current account deficit, managed to reduce its deficit by 1 point of global GDP, while on the other side of the scale, China reduced its current account surplus by almost half a point of global GDP.⁴

1. The high level of savings in the emerging Asian countries is known globally by the economic term «savings glut».

2. See the article «From the Great Recession to today: the errors of monetary and fiscal policy» in this same *Monthly Report*.

3. See M. Chinn (2017), «The Once and Future Global Imbalances? Interpreting the Post-Crisis Record», Federal Reserve Bank of Kansas City's Jackson Hole Conference.

4. As a percentage of their respective GDP figures, the US went from a maximum deficit of 5.8% in 2006 to a minimum of 2.1% in 2013. China, meanwhile, went from a surplus of almost 10% in 2007 to 1.5% in 2013 (according to data from the IMF, WEO, April 2018).

In recent years, the current account imbalances have remained stable at around 1.5%, the same figure as in 2012. Although still above the levels seen in the early 2000s, this clearly lies below those seen in 2007. All in all, there are two elements that qualify this relatively reassuring view. The first is the major fiscal boost being carried out by the US Administration, with the tax cuts approved by Congress in December 2017 and the increase in projected expenditure for 2018 and 2019, which will widen the current account deficit. This increase will no doubt have a negative impact on global imbalances. Not in vain, the US remains the country with the highest current account deficit in the world: with a deficit of 449,141 million in 2017, it represented 51% of the total of all the countries in deficit put together.

Secondly, financial globalisation has added a layer of complexity to the international flows of capital, which current account balances do not capture. The global correction of current accounts following the financial crisis could well be masking international financial risks that remain significant or that may even be on the rise.⁵ On the one hand, the current account balance and, therefore, its counterpart in the financial account may have declined in net terms, but at the same time, the gross flows – i.e. capital inflows and outflows – are significant and their fluctuations could be a major source of instability. In 2008, for instance, while in the US the current account deficit dropped by 30 billion dollars, gross capital inflows into the country fell by 1.7 trillion. This decline mainly reflected the breakdown of inflows of European capital into the US and, to a lesser extent, the decline in flows from emerging Asian countries. This is a trend we would not have predicted simply by observing the current account balances, since the European region as a whole had a balanced current account, and it was Asia that had a significant current account surplus. The reason behind the different behaviour of Europe and Asia was that European banks were highly exposed to the American financial products backed by mortgages, while their Asian counterparts were not.

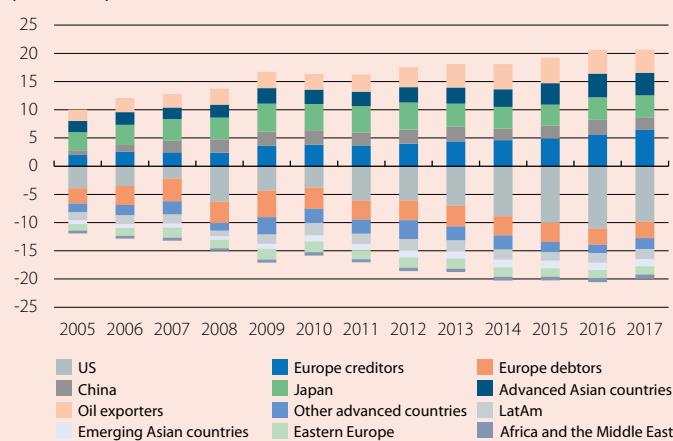
On the other hand, the significant expansion in countries' international asset and liability positions diminishes the importance of current account balances as a measure of macrofinancial vulnerability. A large stock of financial assets and liabilities leads to the change in economies' net international investment position (NIIP)⁶ being increasingly affected by net capital gains, while being less affected by current account balances. In the end, it is the NIIP that demonstrates these economies' capacity to meet their payment obligations in the medium and long term. In this regard, in recent years, the debtor and creditor positions (indicated by the NIIP) have not stopped growing, and according to the most recent estimates by the IMF, the gap will continue to widen. Without a doubt, this trend adds some pressure to the reassuring scenario implied by more contained current account balances (see second chart).

In short, the course of financial globalisation has led to highly complex international macrofinancial relationships. This requires an analysis of various indicators in order to more accurately gauge the levels of global macrofinancial stress. Therefore, although the reduction in global imbalances since the highs of 2007 is symptomatic of more controlled stress levels, the high external debtor positions of some economies, together with the significant gross flows of international capital, prevent us from taking an overly complacent view, since they suggest that some pockets of macrofinancial vulnerability have not yet dissipated.

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Net international investment position

(% of GDP)



Source: CaixaBank Research, based on data from the IMF (WEO, April 2018).

5. See M. Obstfeld (2012), «Does the Current Account Still Matter?», American Economic Review, 102(3), 1-23. See also C.E. Borio and P. Disyatat (2015). «Capital flows and the current account: Taking financing (more) seriously», BIS Working Paper.

6. The NIIP is defined as the difference between the stock of external financial assets and liabilities.