The Shrinking of Global Imbalances*

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For a couple of years before the global financial crisis of 2008 erupted, there was already disquiet among economic analysts about the build-up of global imbalances. It should be noted that overall in the world economy, current account surpluses in some countries or group of countries has to be met by corresponding deficits elsewhere. Obviously, therefore, all economies together simply cannot expand on the basis of net exports, even though that seems to be the underlying strategy that is proposed for everyone.

In the 2000s before the crisis, some advanced economies were running large current account deficits and developing countries with much lower levels of per capita incomes were running surpluses. The global South was effectively subsidising the global North, not only through cheap exports but through net capital flows largely into the US. The US current account deficit had grown to enormous proportions, with its counterpart in the growing current account surpluses of economies like China, Germany and Japan. This was generally seen as unsustainable and there were fears of a "hard landing". It is true that the actual manifestation of it in the financial crash of 2008-09 proved to be even harder for many other countries than for the US, but several observers blamed the earlier imbalances for leading up to the crisis.

Since then, there does indeed appear to have been some substantial rebalancing, or reduction of these imbalances, at least for the major groups of economies. Chart 1 indicates how the current account balances of the advanced economies have been mirrored by opposing movements in the balances of all emerging markets and developing countries taken together. (All data are from the IMF World Economic Outlook of October 2015; the data for 2015 are projections.)

Chart 1: Global rebalancing has already occurred

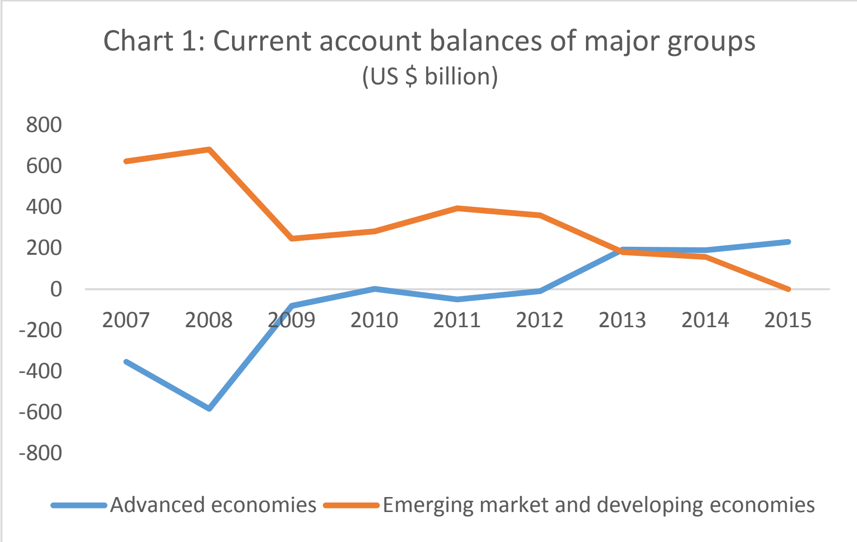


Chart 2: But the major economies still show large imbalances

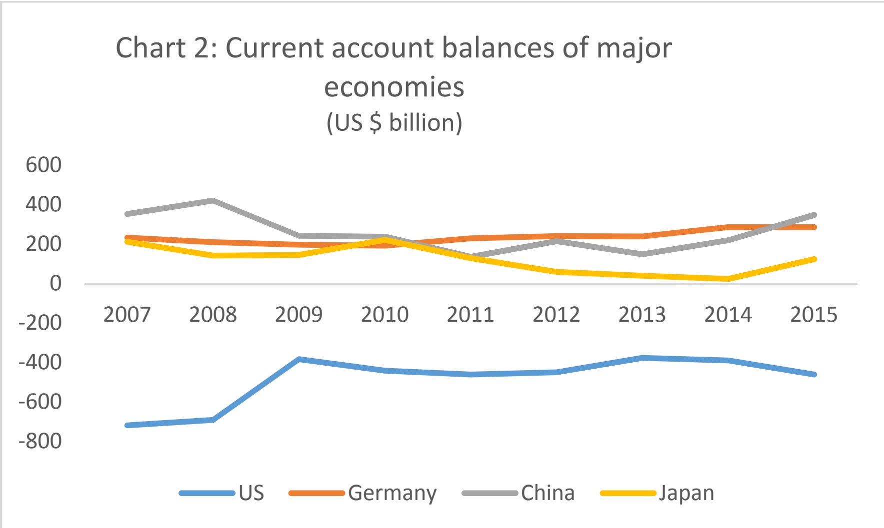
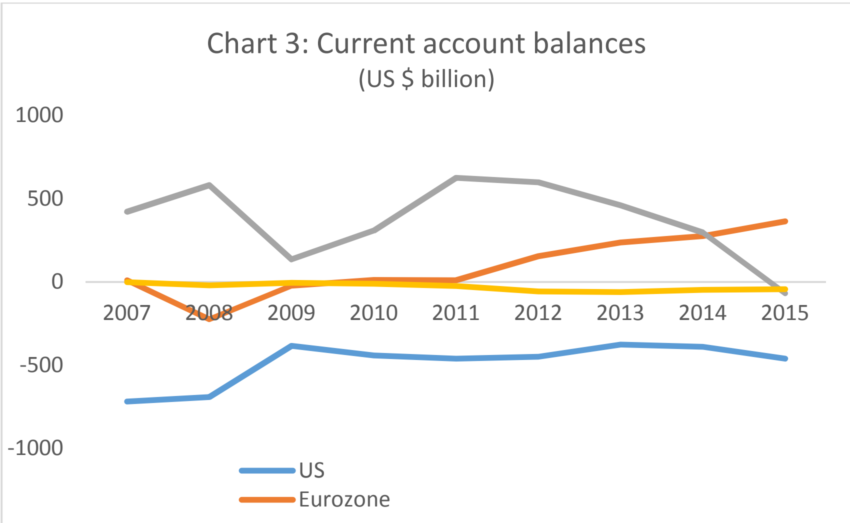


Chart 3: As the Eurozone becomes a surplus region and oil exporters go into deficit



The surpluses of the emerging and developing world came down sharply in 2009, but recovered a little bit over the next three years before they started declining again. In the current year (2015) the surplus has been eliminated and this group is now in net deficit. Meanwhile the deficits of the advanced economies were largest in 2008, but thereafter they have been reducing and these economies have shown net and rising surpluses from 2010, and particularly since 2013.

On the face of it, this is a desirable process. After all, developing countries are often described as having "structural deficits" in that their development project is still incomplete and so they would require additional external resources to boost their domestic investment. The current account surpluses of this group effectively amounted to a transfer of resources to the advanced economies, surely not something to be celebrated. The fact that these in turn were typically held in the form of reserves in US dollar or other major currency securities, generating net capital flows from South to North, further amplified this concern. So a rebalancing whereby they once again become slightly net deficit seems to be a good thing.

But the actual process is more complicated and less positive. As Chart 2 indicates, the big imbalances were those of certain countries: the United States running large deficits that were in effect countered by large surpluses of three economies in particular: China, Germany and Japan. Since the global financial crisis, US deficits have indeed come down, but still remain very large indeed, but only Japan shows a consistent decline in its current account surplus, with a slight rise again in the current year. In Japan's case, this has also been accompanied by a prolonged deflationary process, in which policy makers have struggled to generate some expansion of economic activity.

China's current account surplus also reduced somewhat after 2008, but has been rising again since 2013. In the most recent period, China's surpluses are rising for the wrong reason: exports are falling, but imports are falling even faster, generating recessionary impulses for its major trading partners. Meanwhile Germany's export surpluses show a slow and steady increase over much of this period, with only a very small decline in the current year.

So how does the aggregate balancing get achieved? Chart 3 points to the answer. There are two trends of note that show up here. The first is the dramatic decline in the surpluses of oil-exporting countries, to the point where they are now in deficit. Given the decline in prices of oil and the persistent stagnant demand for this as growth decelerates across the world, this is no surprise. Nor is the fact that non-oil primary product exporting countries have moved from balance to deficit as their exports have also faced lower prices. The other trend is more surprising: the Eurozone has moved from deficit to surplus and this surplus has risen consistently since 2011.

This shift in the eurozone's current account pattern is occurring in the midst of the ongoing crisis in the region and a slowdown in growth. The "peripheral" countries of the Eurozone are being forced to cut down their deficits or move into surplus through stringent adjustment measures including fiscal austerity, which have suppressed wage incomes and allowed little or no economic growth, and often record continuing declines. The surplus countries of the Eurozone have refused to run deficits to balance this, instead choosing to persistently rely on external demand by generating positive net exports. So the Eurozone as a whole has moved into surplus, which also imparts a net deflationary and recessionary impulse to the rest of the world.

What does all this suggest? It means that the rebalancing that has occurred has been of a most undesirable kind especially for developing countries, with recessionary impulses being transmitted across the world by advanced countries such as the eurozone as a whole. As long as everyone seeks to grow on the basis of external markets, the chances for global recovery are near zero and developing countries will face hard times ahead even if so-called “balancing” is achieved.

For those who would press for eliminating global imbalances in current account surpluses or deficits regardless of how this is done, there is a clear message in all this: be careful what you wish for.

*This article was originally published in the Business Line on November 9, 2015.