Are Global Imbalances Sustainable?
Post-Crisis Scenarios

The Long-Term Investments in the Age of Globalisation

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Outline

OUTLINE

- Global current account imbalances nearly halved after the global crisis after reaching a post-war high of over 5% of world GDP in 2008, but are widening again

- External positions of major economic areas are not unsustainable, but structural breaks occur from time to time

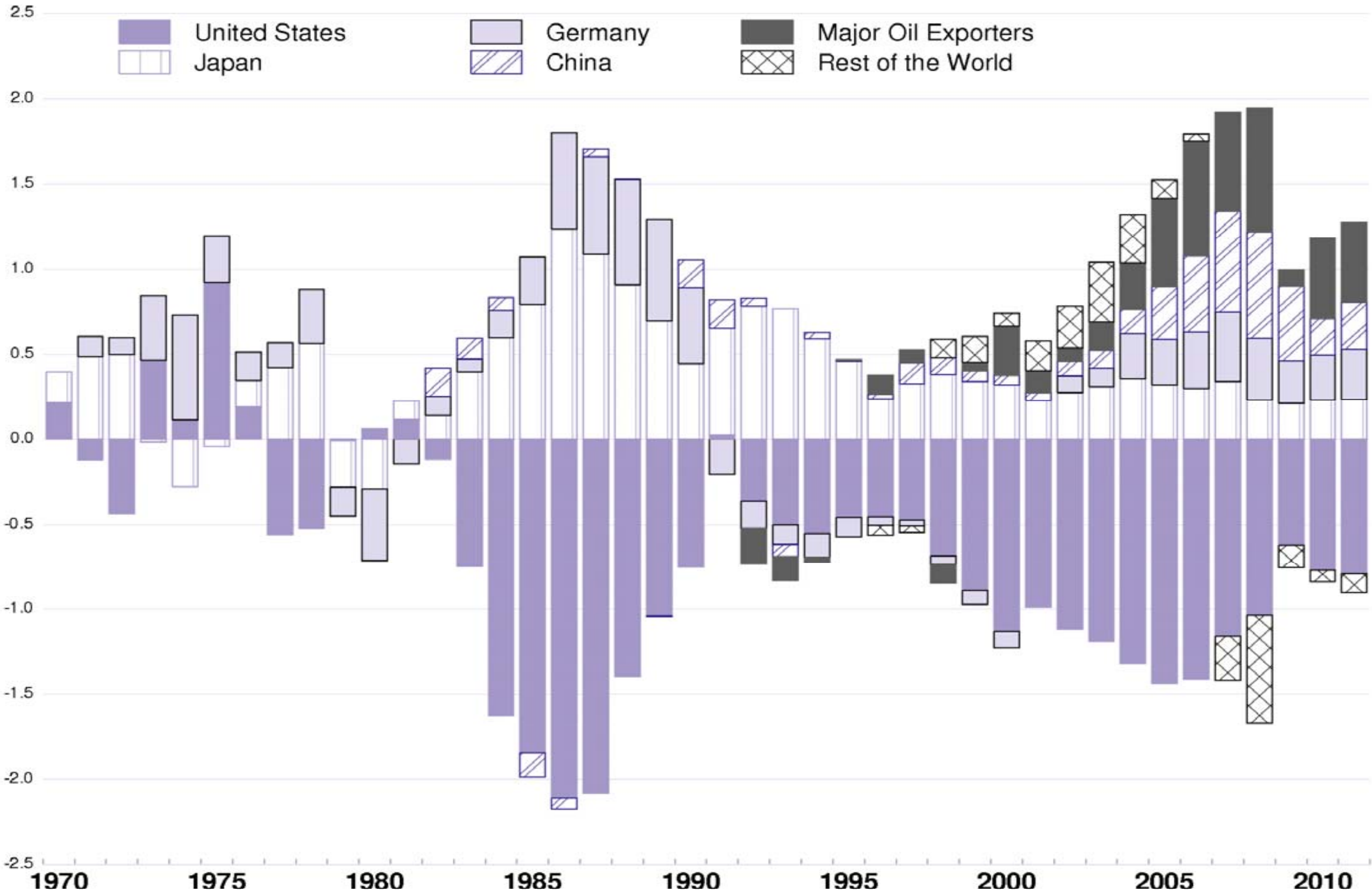
- Fiscal consolidation and structural reform are needed to reduce imbalances in the coming years

- Such policies may also have implications for intensity and composition of capital flows that will be financing imbalances

Global imbalances are widening again

GLOBAL IMBALANCES

Current account balances, in % of world GDP

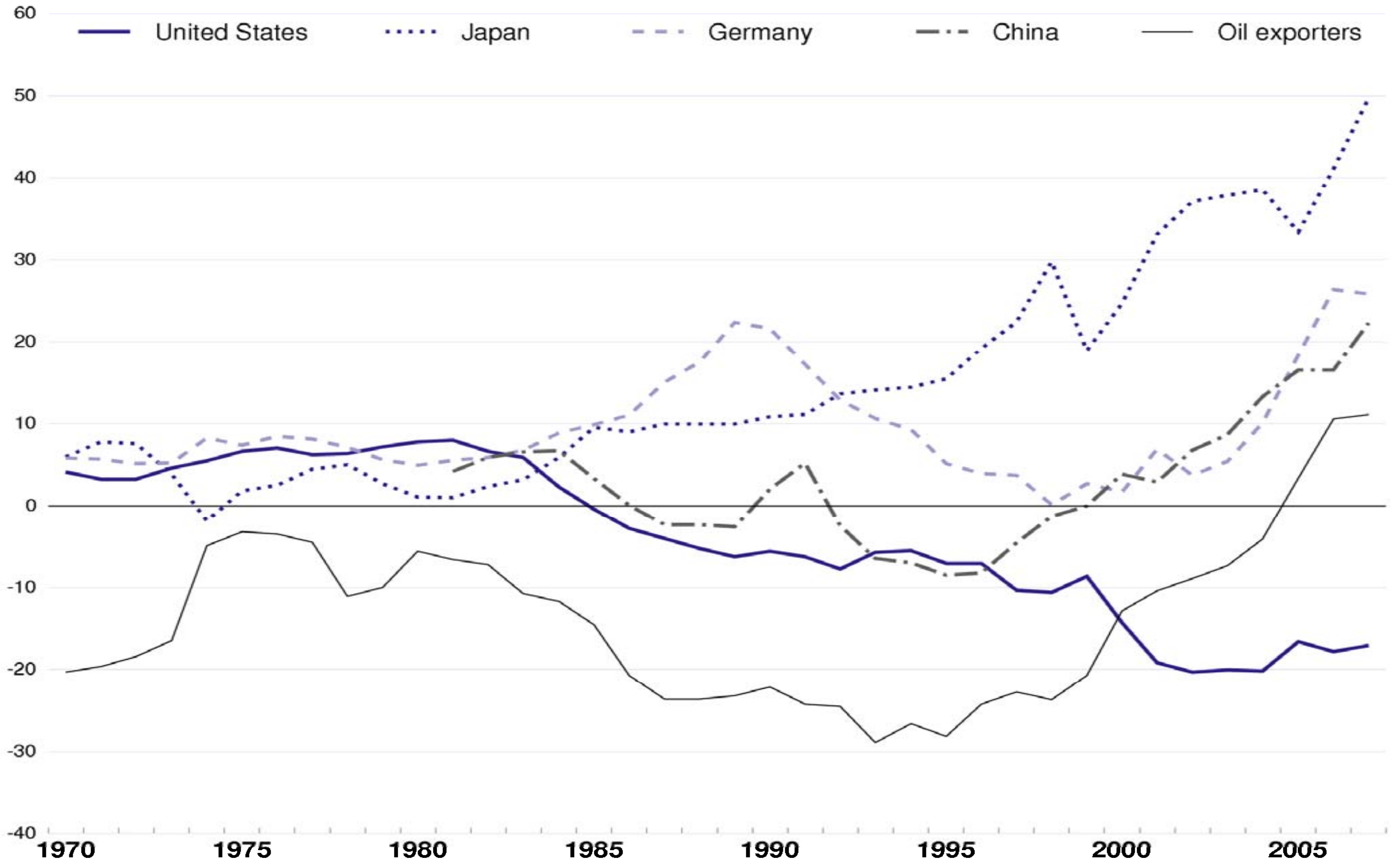


Source: OECD Economic Outlook EO87 database and national sources.

Consistent with current account trends, net foreign asset positions are widening in some countries

NET ASSET POSITIONS

In % of individual country GDP

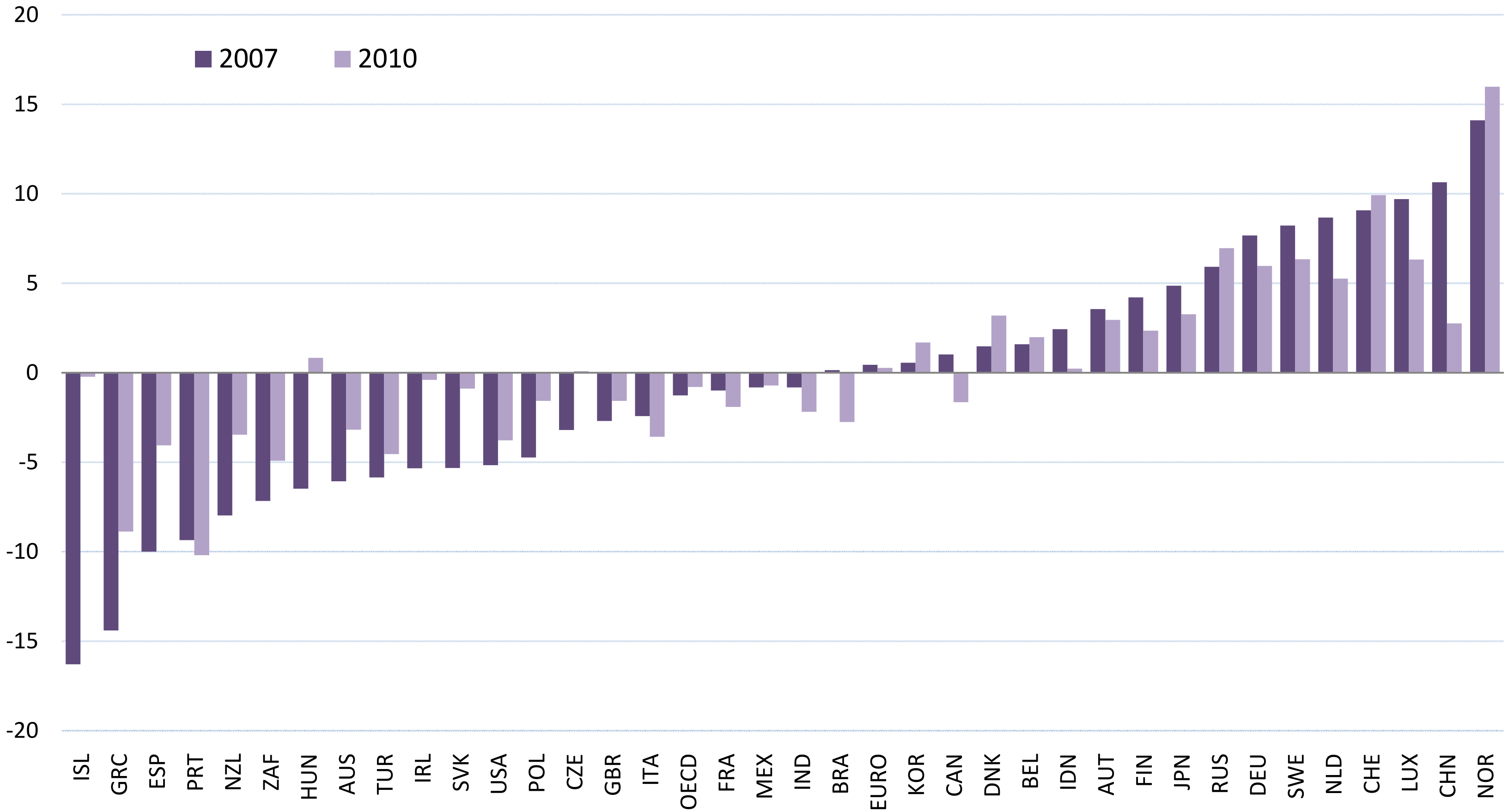


Source: Updated and extended version of the External Wealth of Nations Mark II database developed by Lane and Milesi-Ferretti (2007).

External positions have changed during the crisis

EXTERNAL POSITIONS

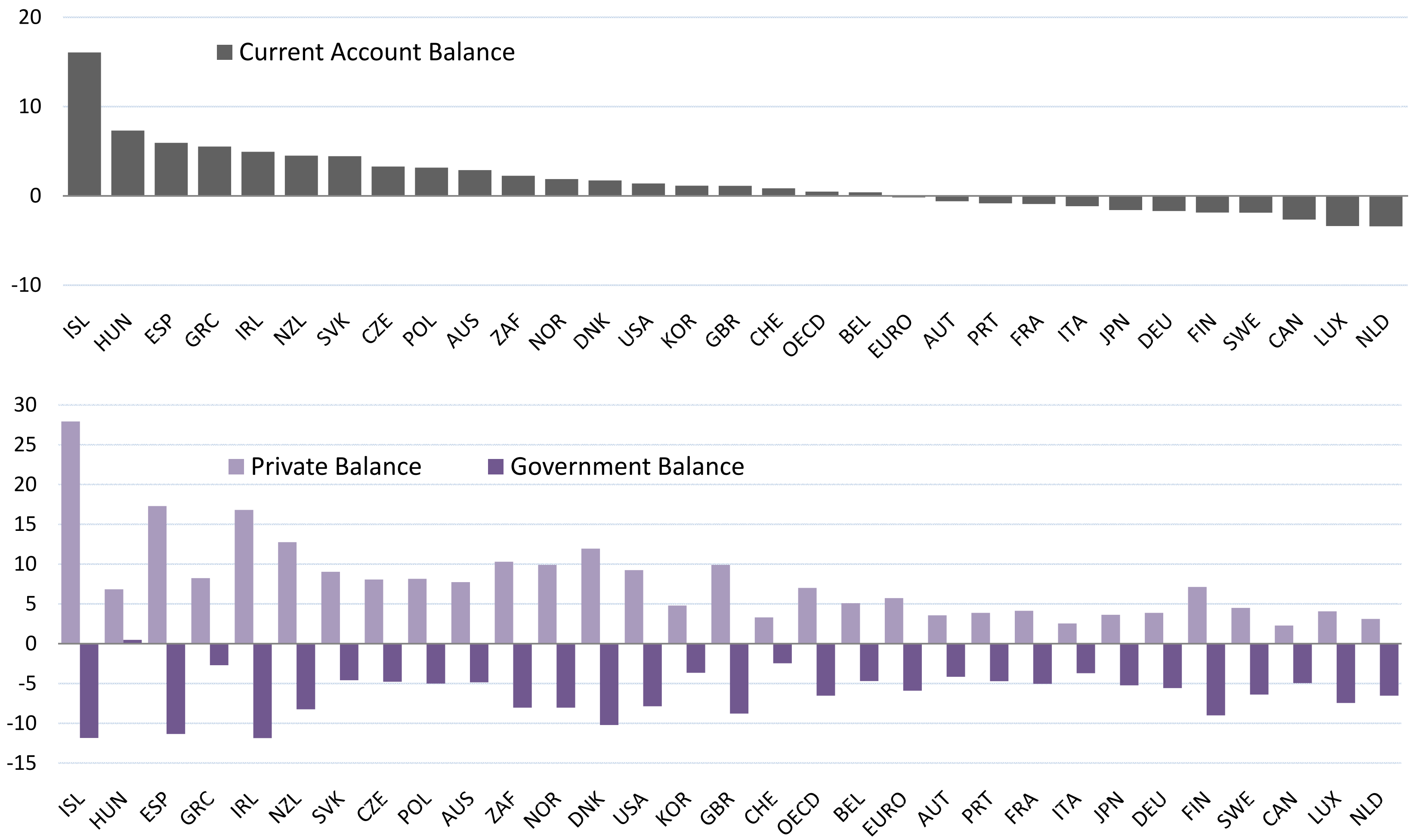
Current account balances in % of GDP



Source: OECD Economic Outlook EO87 database.

Changes in private balances have been large in some countries, to some extent offsetting public balances

Decomposition of changes in current account balances in % of GDP, 2007-10

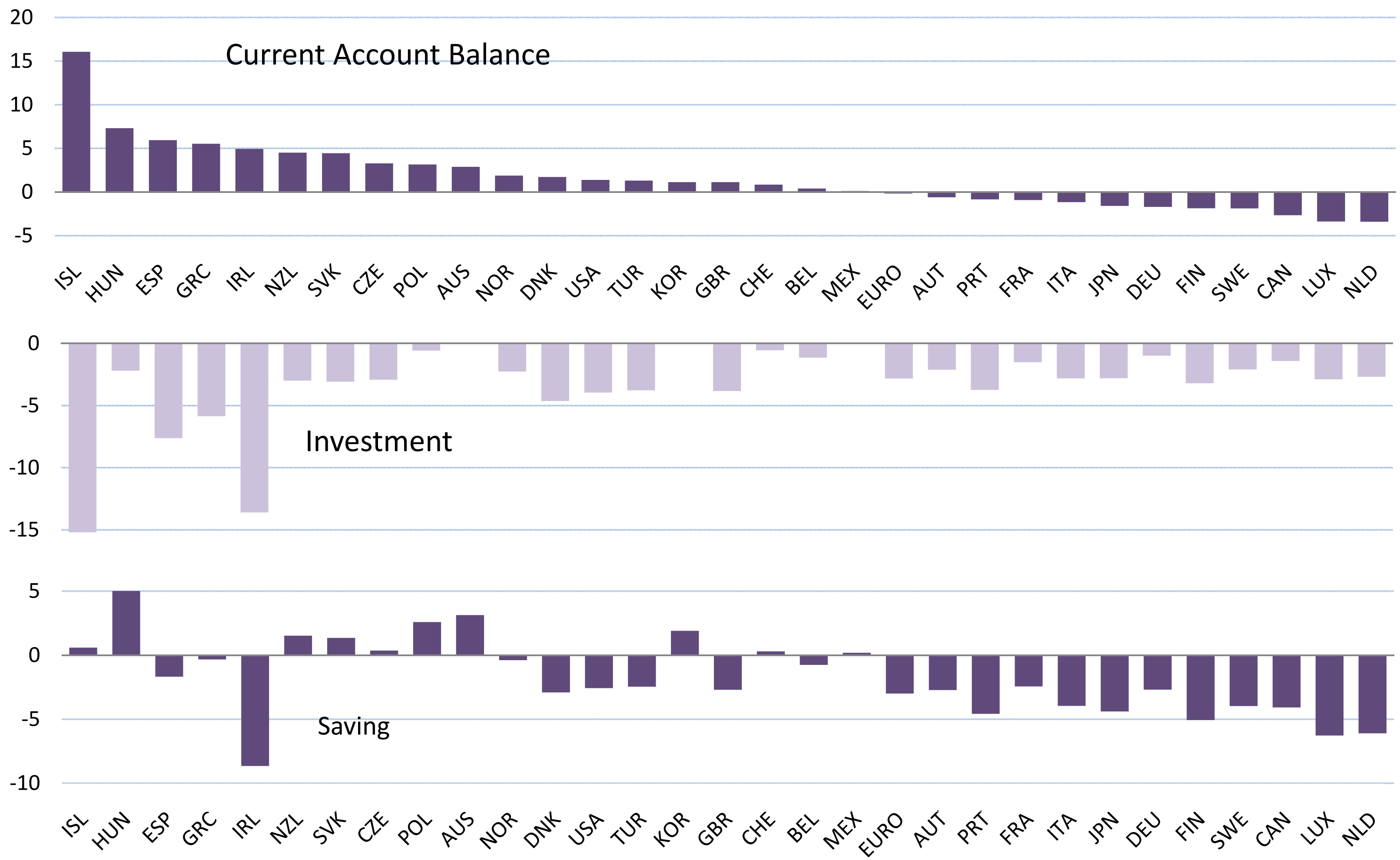


Source: OECD Economic Outlook EO87 database.

External adjustment has been due to falling investment in some countries (with consequences for growth)

SAVING AND INVESTMENT

Decomposition of changes in current account balances in % of GDP, 2007-10



Source: OECD Economic Outlook EO87 database.

Are current account imbalances sustainable?

- Our analysis suggests that current account balances are sustainable for periods of time but not indefinitely. Sooner or later structural breaks occur and current account reversals take place

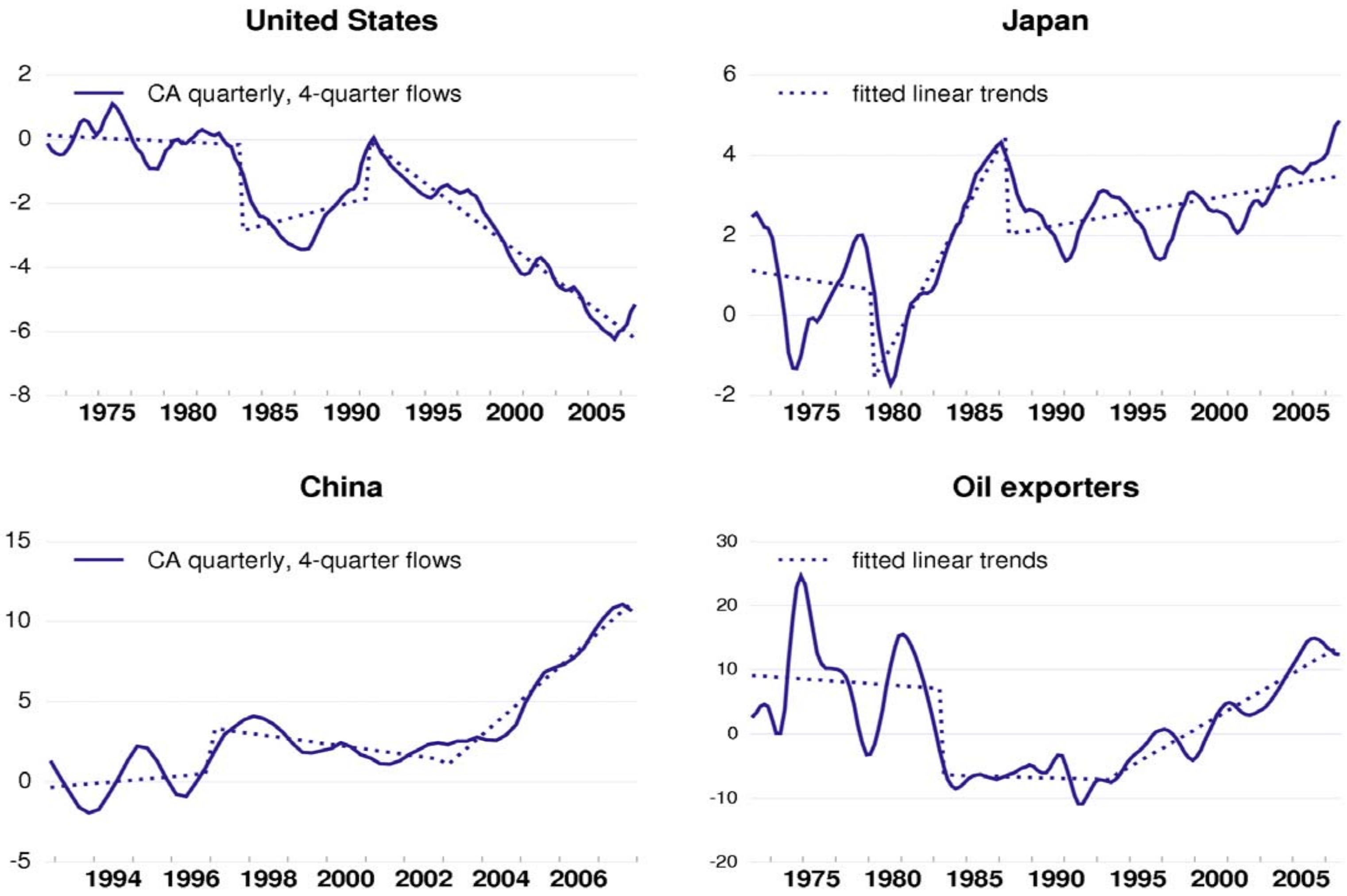
- It is important to investigate features and implications of such break points

- We look at changes in fiscal balances, exchange rates, potential growth

STRUCTURAL BREAKS

There have been breaks in current account trends

Current account balances in % of GDP



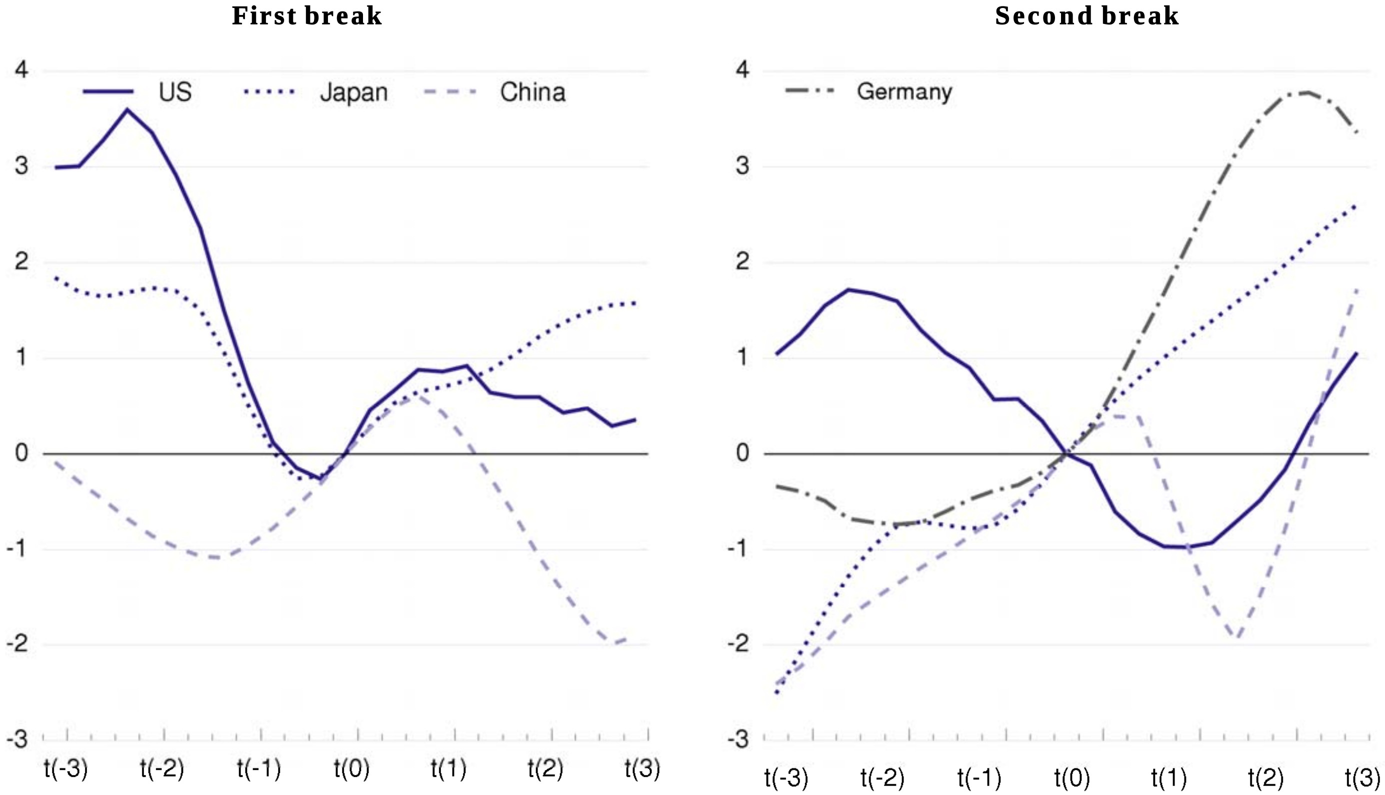
Note: Structural breaks identified on the basis of the Lee-Strazicich unit root tests.
Source: OECD Economic Outlook EO87 database and national sources.

EVENT ANALYSIS

Budget balances tend to improve after current account reversals

Budget balance, rescaled to 0 at t_0

First break: t_0 = 1983q4 for the United States, 1979q2 for Japan and 1997q1 for China
Second break: t_0 = 1991q3 for the United States, 1987q3 for Japan, 2003q1 for China and 2005q4 for Germany



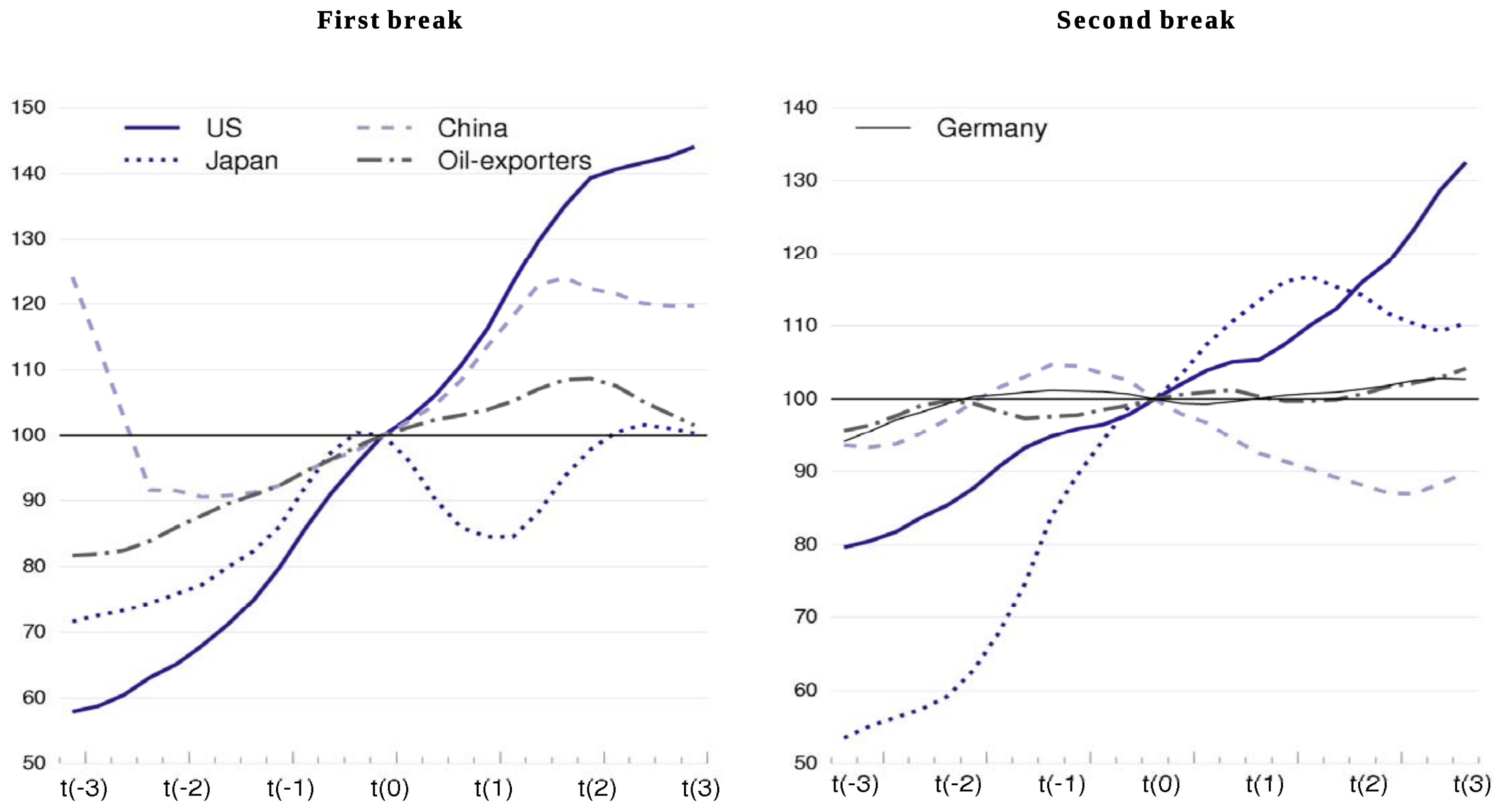
Source: OECD Economic Outlook EO87 database and national sources.

Exchange rates sometimes appreciate after current account reversals

EVENT ANALYSIS

Nominal effective exchange rate, rescaled to 100 at t_0

First break: t_0 = 1983q4 for the United States, 1979q2 for Japan, 1997q1 for China, and 1983q3 for the oil-exporting countries
Second break: t_0 = 1991q3 for the United States, 1987q3 for Japan, 2003q1 for China, 2005q4 for Germany and 1994q1 for the oil-exporting countries



Source: OECD Economic Outlook EO87 database and national sources.

EVENT ANALYSIS

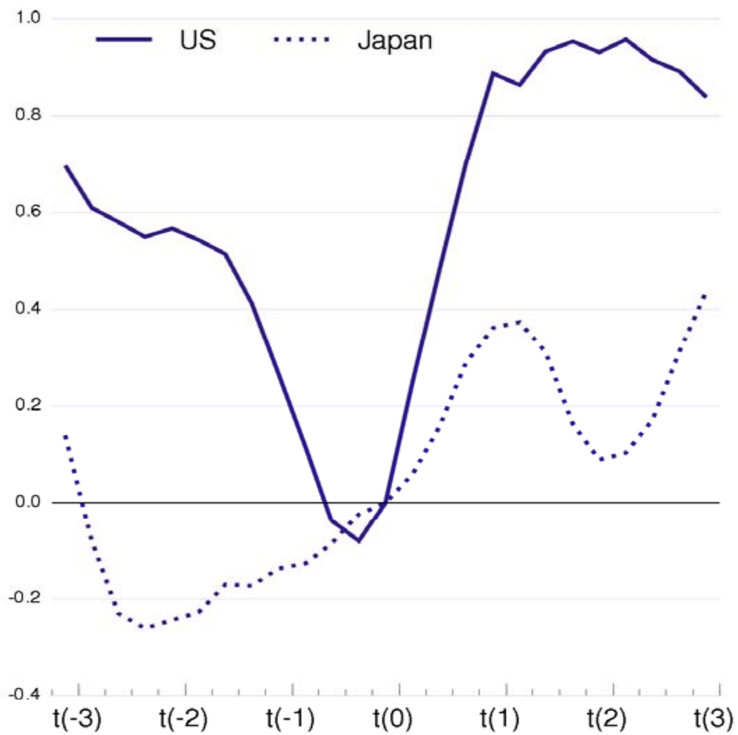
Potential output growth rises for a while after current account reversals

Potential output growth, rescaled to 0 at t_0

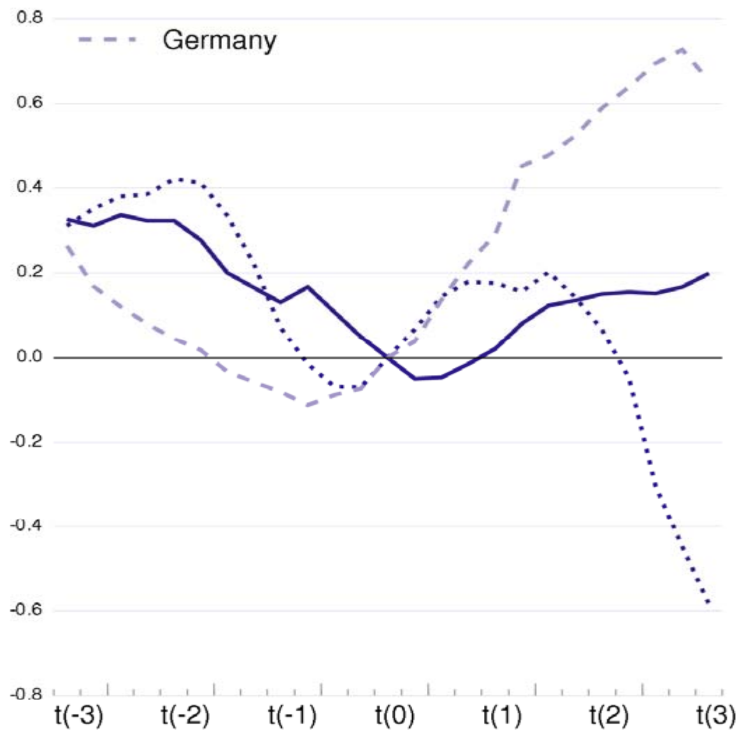
First break: t_0 = 1983q4 for the United States and 1979q2 for Japan

Second break: t_0 = 1991q3 for the United States, 1987q3 for Japan and 2005q4 for Germany

First break



Second break



Source: OECD Economic Outlook EO87 database.

POLICY IMPLICATIONS

Policy implications

- Dealing with global imbalances in the years ahead must be put in a broader perspective as most countries will have to undergo fiscal consolidation and adopt measures to sustain medium term growth
- Policy scenarios look at the implications on growth, fiscal consolidation, and imbalances

Looking ahead: What do we learn from policy simulations?

POLICY SIMULATIONS

- 3 different scenarios are considered:
  - ✓ Baseline (business as usual): limited fiscal consolidation and no structural reform
  - ✓ Fiscal consolidation: Debt-to-GDP ratios are reduced to pre-crisis levels (except for Japan) by 2025 and exchange rate effects are taken into account
  - ✓ Structural reform: measures are phased in to reduce (raise) savings in surplus (deficit) countries and to reduce structural unemployment in the euro area

✓ Simulations carried out using the OECD Global Model

REFORM OPTIONS

Which structural reforms?

- In the United States, large current account deficits reflect low savings, especially among households
  - ✓ Scrapping income tax deductibility for mortgage payments or shifting the personal income tax further to a consumption base
- In China, large external surpluses are associated with high domestic savings, among households and enterprises alike
  - ✓ Strengthening formal social safety nets and financial systems
- External imbalances are also large within the euro zone; sizeable surpluses in Germany reflect low investment
  - ✓ Policy action to boost investment in new sources of growth

POLICY SIMULATIONS

Structural reforms could prevent large global imbalances from re-emerging

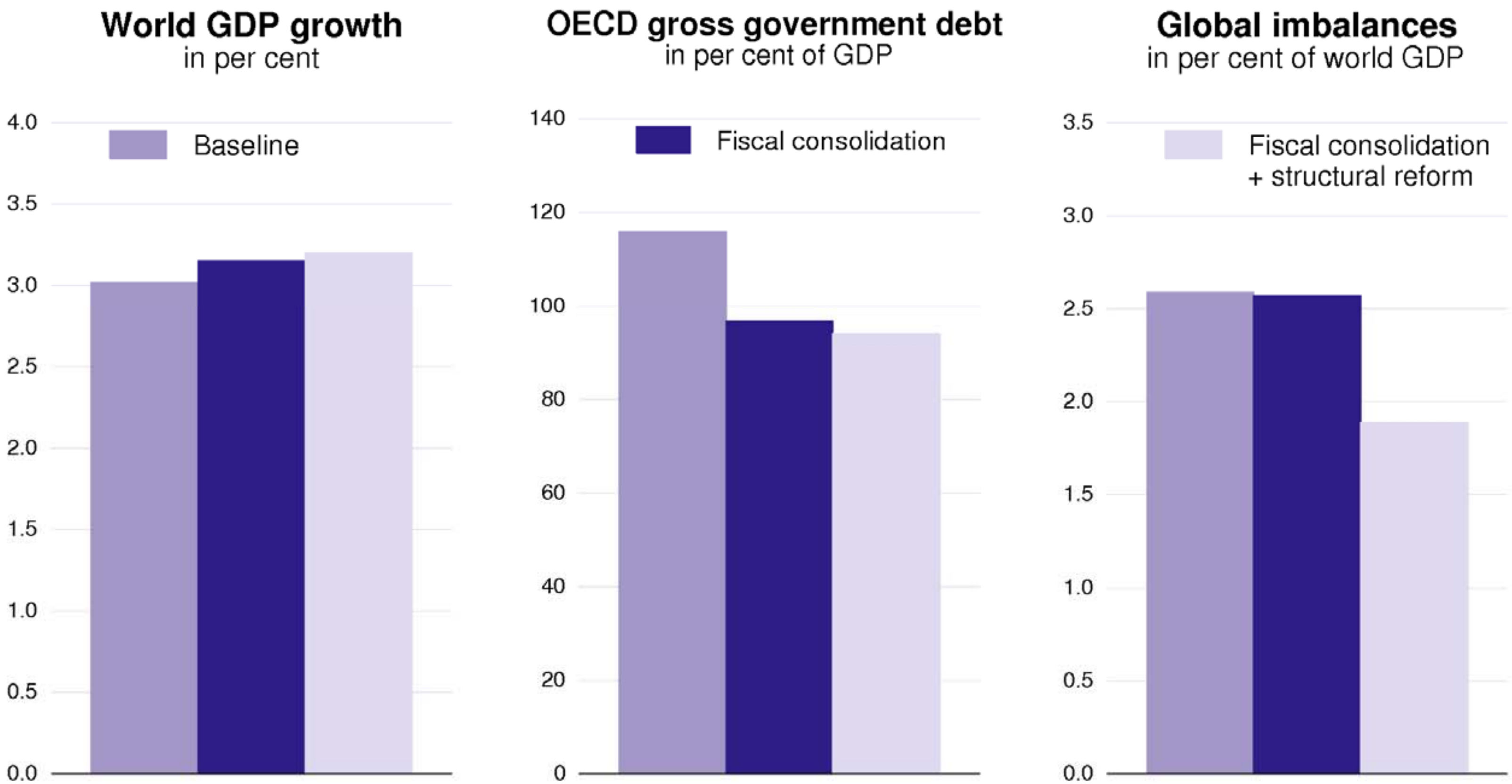
	Current account balance				Difference from baseline scenario		
	2008	2011	2015	2025	2011	2015	2025
United States							
Baseline	-4.9	-4.0	-4.1	-4.2	...	...	...
Plus fiscal consolidation	-4.9	-3.7	-4.0	-4.2	0.3	0.1	0.0
Plus exchange rate response	-4.9	-3.6	-3.6	-3.5	0.4	0.5	0.7
Plus structural reform	-4.9	-3.5	-2.8	-1.0	0.5	1.3	3.2
Japan							
Baseline	3.3	3.5	3.1	2.0	...	...	...
Plus fiscal consolidation	3.3	3.8	4.3	2.7	0.3	1.2	0.7
Plus exchange rate response	3.3	4.0	4.6	3.5	0.5	1.5	1.5
Plus structural reform	3.3	3.9	4.8	2.9	0.4	1.7	0.9
Euro area							
Baseline	-0.8	0.8	1.1	1.3	...	...	...
Plus fiscal consolidation	-0.8	1.1	0.4	1.4	0.3	-0.7	0.1
Plus exchange rate response	-0.8	1.1	0.7	1.7	0.3	-0.4	0.4
Plus structural reform	-0.8	1.2	0.7	1.8	0.4	-0.4	0.5
China							
Baseline	9.4	3.4	4.0	5.5	...	...	...
Plus fiscal consolidation	9.4	3.2	3.9	5.3	-0.2	-0.1	-0.2
Plus exchange rate response	9.4	2.8	3.3	4.7	-0.6	-0.7	-0.8
Plus structural reform	9.4	2.3	2.2	3.1	-1.1	-1.8	-2.4
Other non-OECD Asia							
Baseline	2.7	1.9	1.7	1.5	...	...	...
Plus fiscal consolidation	2.7	1.3	1.6	1.2	-0.6	-0.1	-0.3
Plus exchange rate response	2.7	1.5	1.3	0.7	-0.4	-0.4	-0.8
Plus structural reform	2.7	1.5	0.7	-0.7	-0.4	-1.0	-2.2

Source: OECD Economic Outlook EO87.

POLICY SIMULATIONS

Structural reform can do much to sustain growth and reduce global imbalances while pursuing fiscal consolidation

Policy simulations, 2016-25 average



Source: OECD calculations.

POLICY SIMULATIONS

Bottom-line of policy simulations

- Global imbalances would continue to widen in the baseline scenario
- Fiscal consolidation could narrow global imbalances but not by a large amount, in part because of the synchronicity of adjustment in many countries
- Structural reform would yield the largest payoff in terms of lower global imbalances

Implications of a reconfiguration of current account imbalances for capital flows

- Fiscal consolidation
  - ✓ A reduction in the supply of government bonds in (mostly advanced) countries that currently have high debt and/or budget deficits could lead to a rebalancing of capital flows towards corporate bonds, equity and/or foreign direct investment, which could be growth-enhancing
- Exchange rate flexibility
  - ✓ Because of greater exchange-rate flexibility, surplus countries whose currencies are currently pegged to the U.S. Dollar (China, oil-exporters) could decrease accumulation of international reserves in the form of U.S. government bonds

- Structural reform

  ✓ Structural reform to raise household savings in the United States would affect the size and composition of insurance and pension fund portfolios

  ✓ A liberalisation of entry restrictions in sheltered sectors in surplus countries, such as Germany and Japan, could create opportunities for foreign investment in those countries

  ✓ Reforms to reduce savings in some surplus emerging-market economies would increase the attractiveness of investing in such countries, thus limiting capital outflows towards advanced economies

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