

GLOBAL REBALANCING

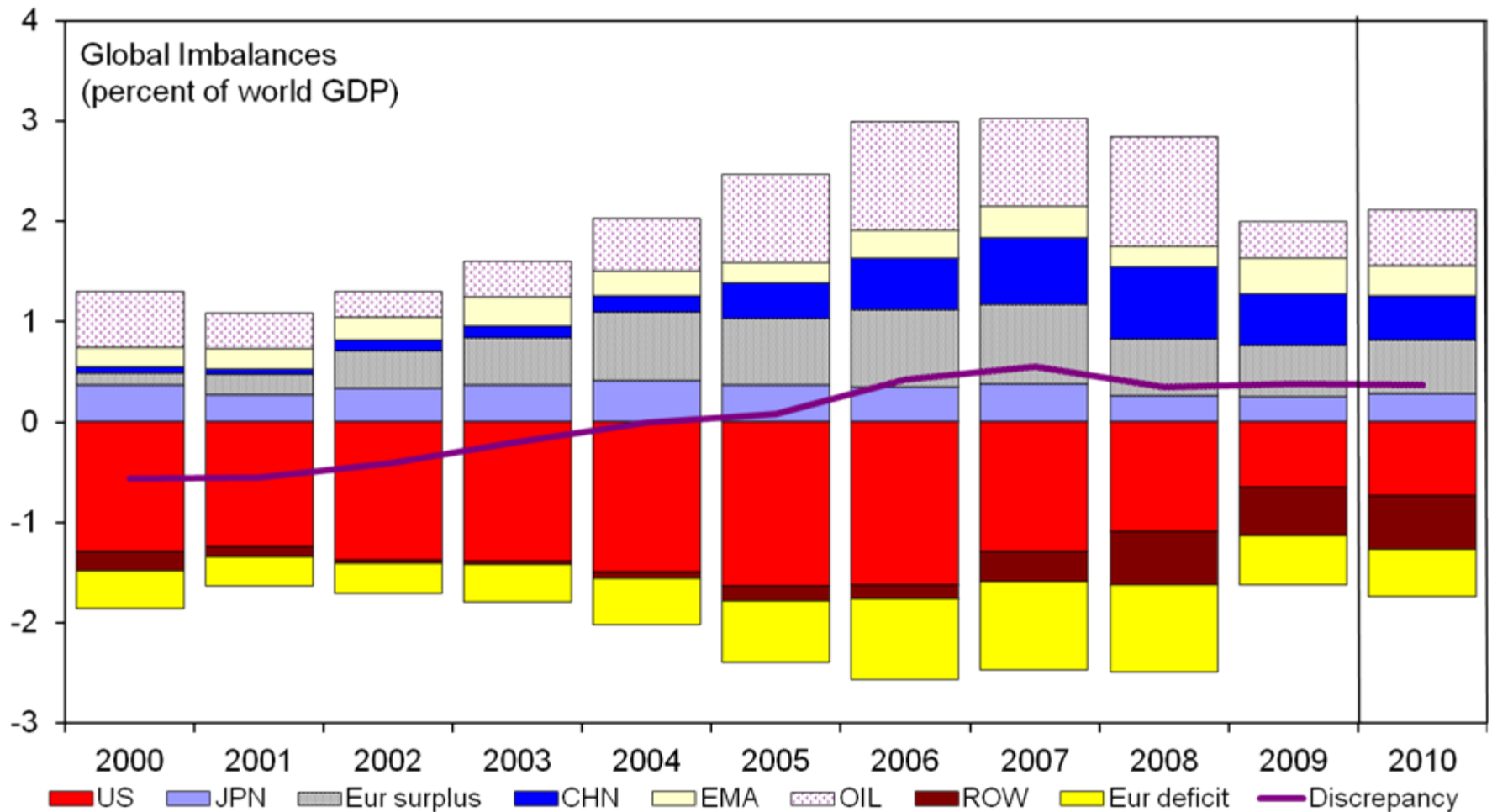
Gian Maria Milesi-Ferretti
International Monetary Fund
Research Department

Views expressed are mine and do not necessarily represent those of the IMF or IMF policy

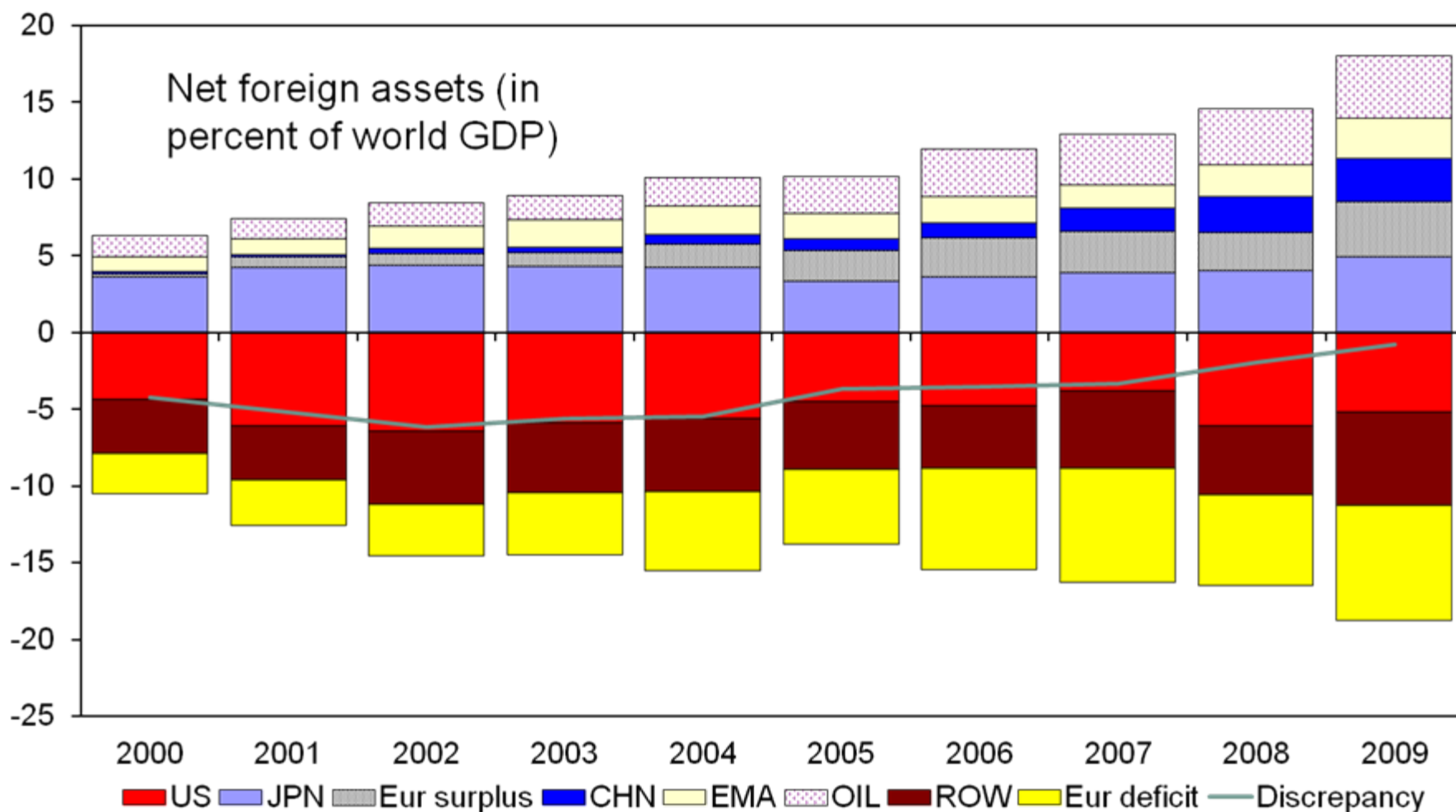
Global Imbalances: a look ahead

- Much debate about role of imbalances in crisis...
- ...but theme of this presentation is forward-looking
- Should we still worry about imbalances?
- If yes, what should we do about it?

Where do we stand on current account imbalances?



External positions have widened as well (but not always in synch with CA)

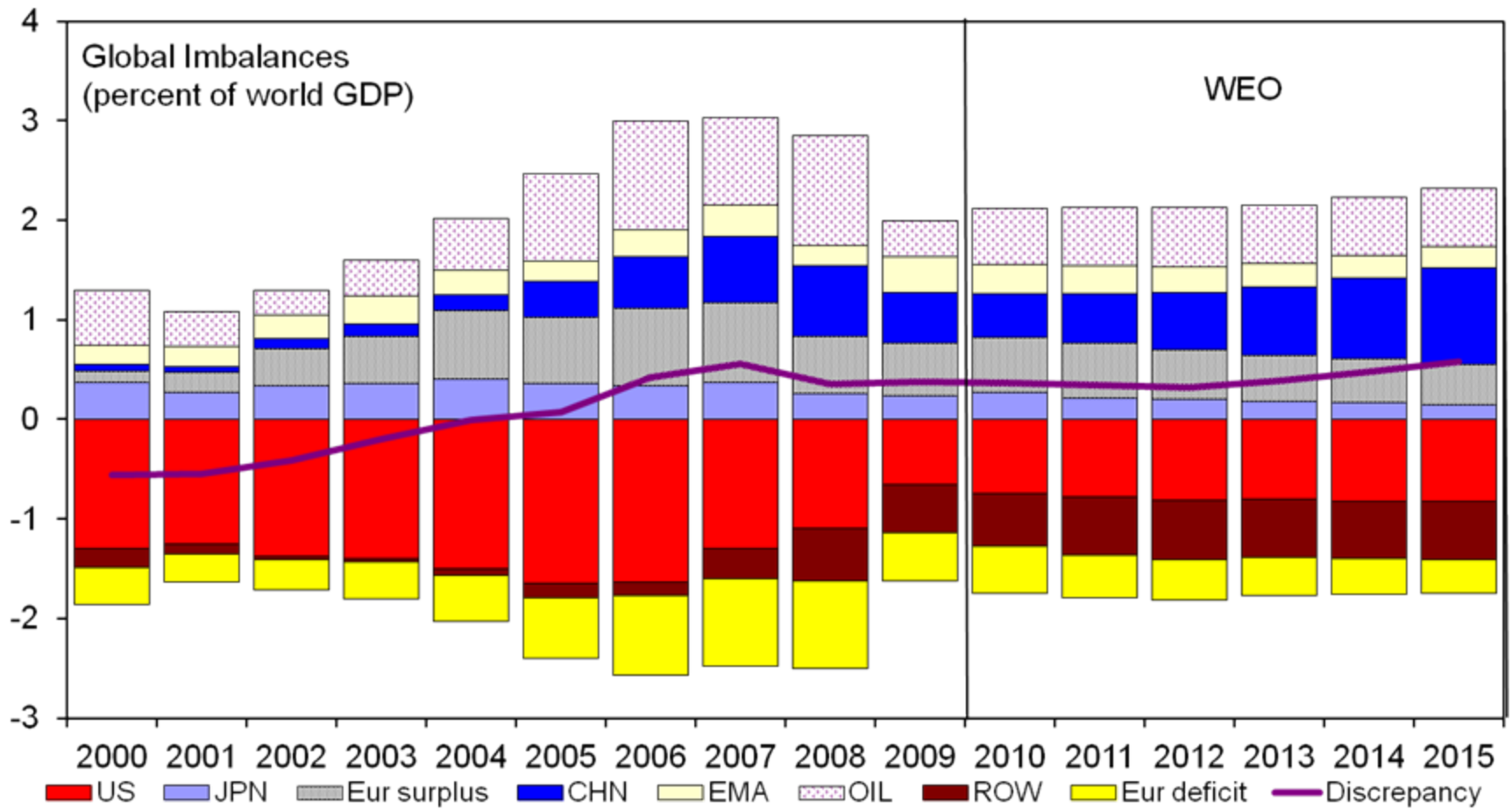


Why should we worry about imbalances?

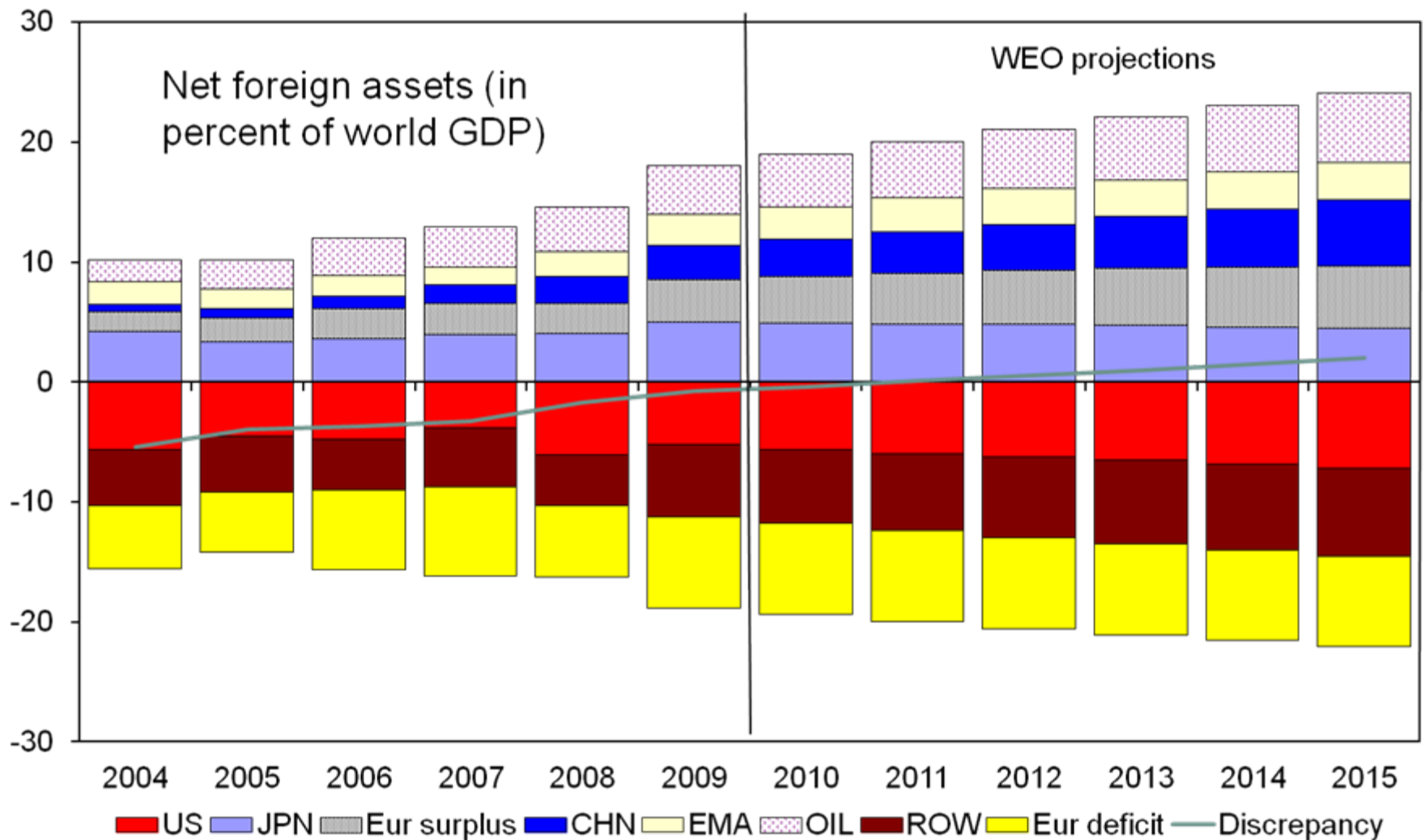


- They are a threat to the world recovery
- Divergent asset and liability positions are ultimately unsustainable, and can be a source of instability

At current exchange rates and current policies, current account imbalances would widen again...



.. And net creditor and debtor positions would continue to diverge



Imbalances and the world recovery

- Two rebalancing acts needed for sustained world recovery:
 - ▣ From public sector to private sector demand in advanced economies (AE) as stimulus spending fades and fiscal adjustment starts
 - ▣ From external demand to domestic demand in several emerging markets (EMs) and from domestic to external demand in (mostly) AE with large CA deficits

If this does not happen....

- Increased risk of stalled recovery in the US and some other advanced economies
 - ▣ *Consumption weak because of households balance sheet repair*
 - ▣ *Investment weak because of construction, prospects of weak demand, and incomplete process of financial system repair*
- Stronger protectionist pressures amidst lack of international coordination of policies

Policy actions needed

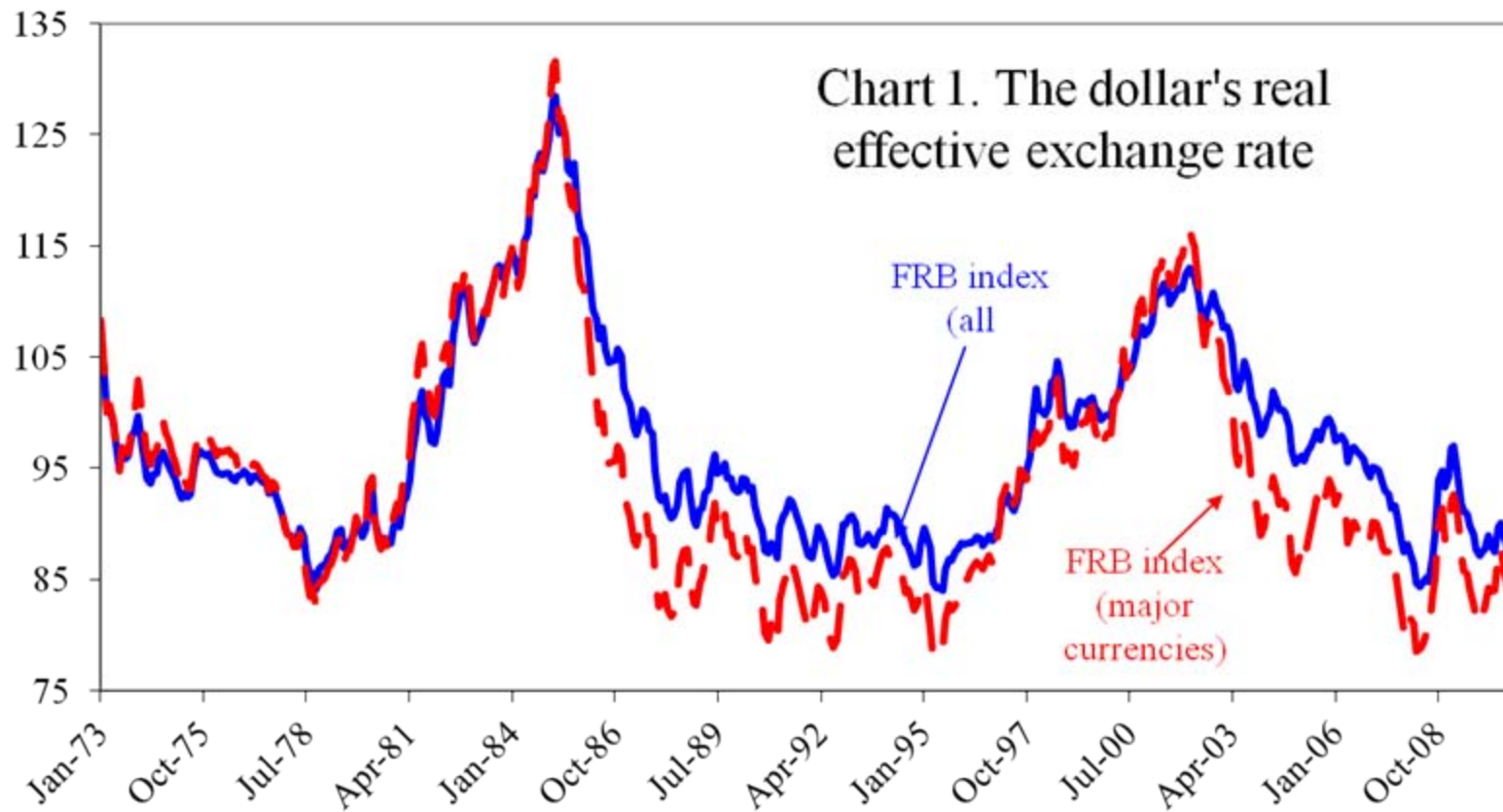
- Expenditure-switching: adjustment in exchange rates
 - ▣ *Appreciation in China and some other EMs, esp. in Asia*
 - ▣ *Some further weakening of the USD [possibly euro?]*

- Policies to sustain domestic demand in surplus countries. For example, address distortions that keep private consumption low (China) or stifle investment (other countries in emg Asia)

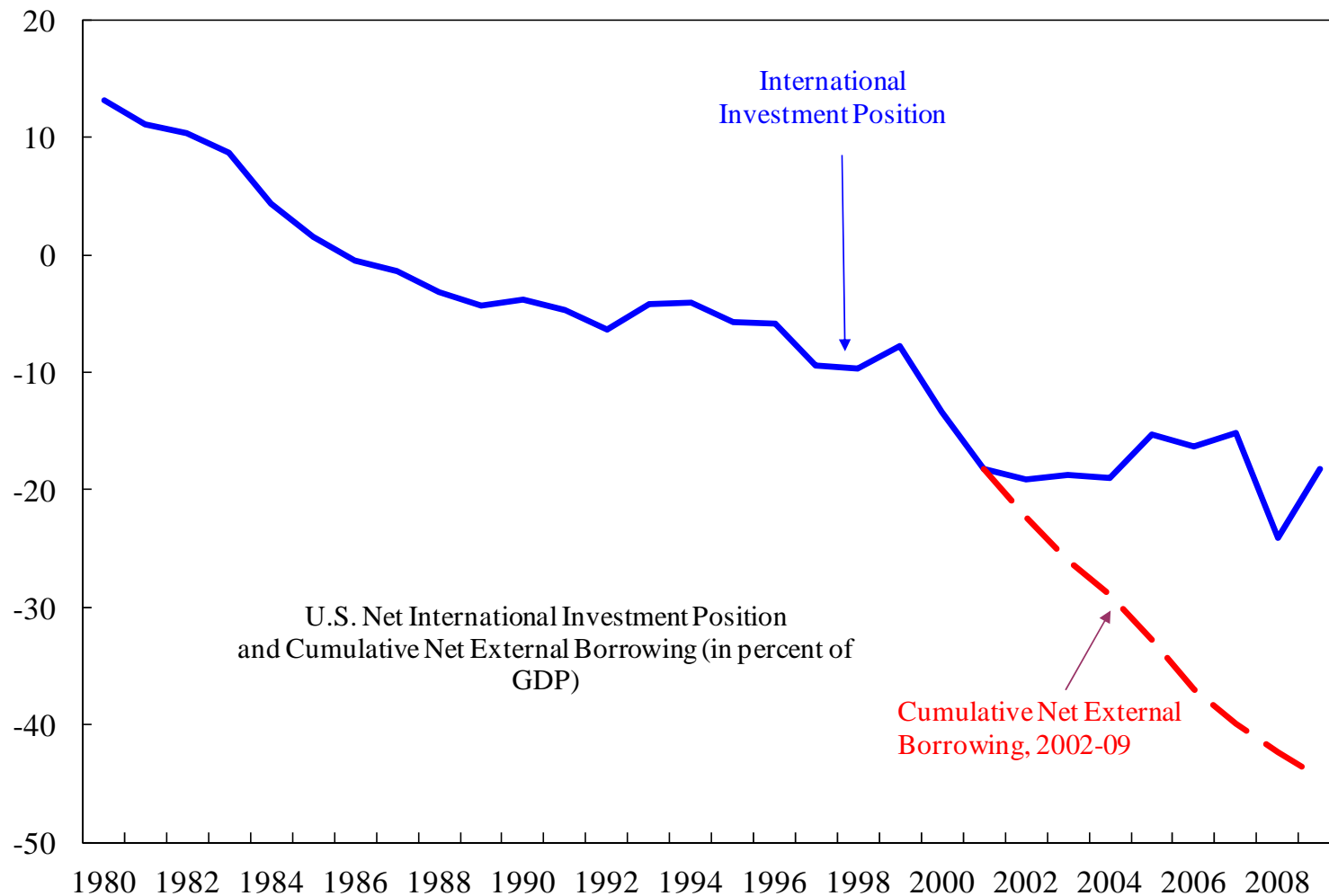
- In deficit countries,
 - ▣ Policies to address M-T fiscal challenges
 - ▣ Financial sector reform
 - ▣ Other structural reforms to sustain L-R growth

The puzzles: (I) US

- CA balance projections suggest future weakening of the USD
- ...but USD is close to a post-BW-minimum in real terms

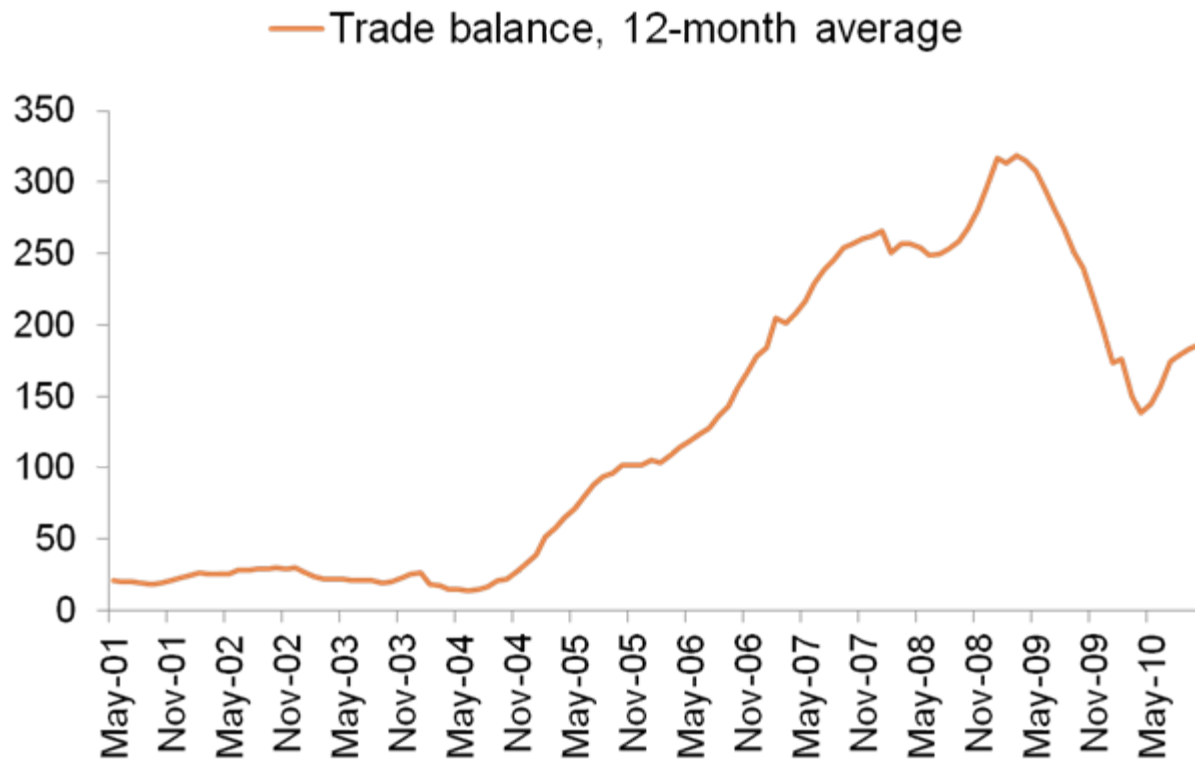


Based on CA deficits since 2001, US NFA should approach -50% of GDP. It is instead -20%



The puzzles: (II) China and emerging Asia

- What is the extent of global rebalancing underway?
- China is not a “small open economy”...
- ...but hard to assess the length of transition



The puzzles (III)

Imbalances in Europe

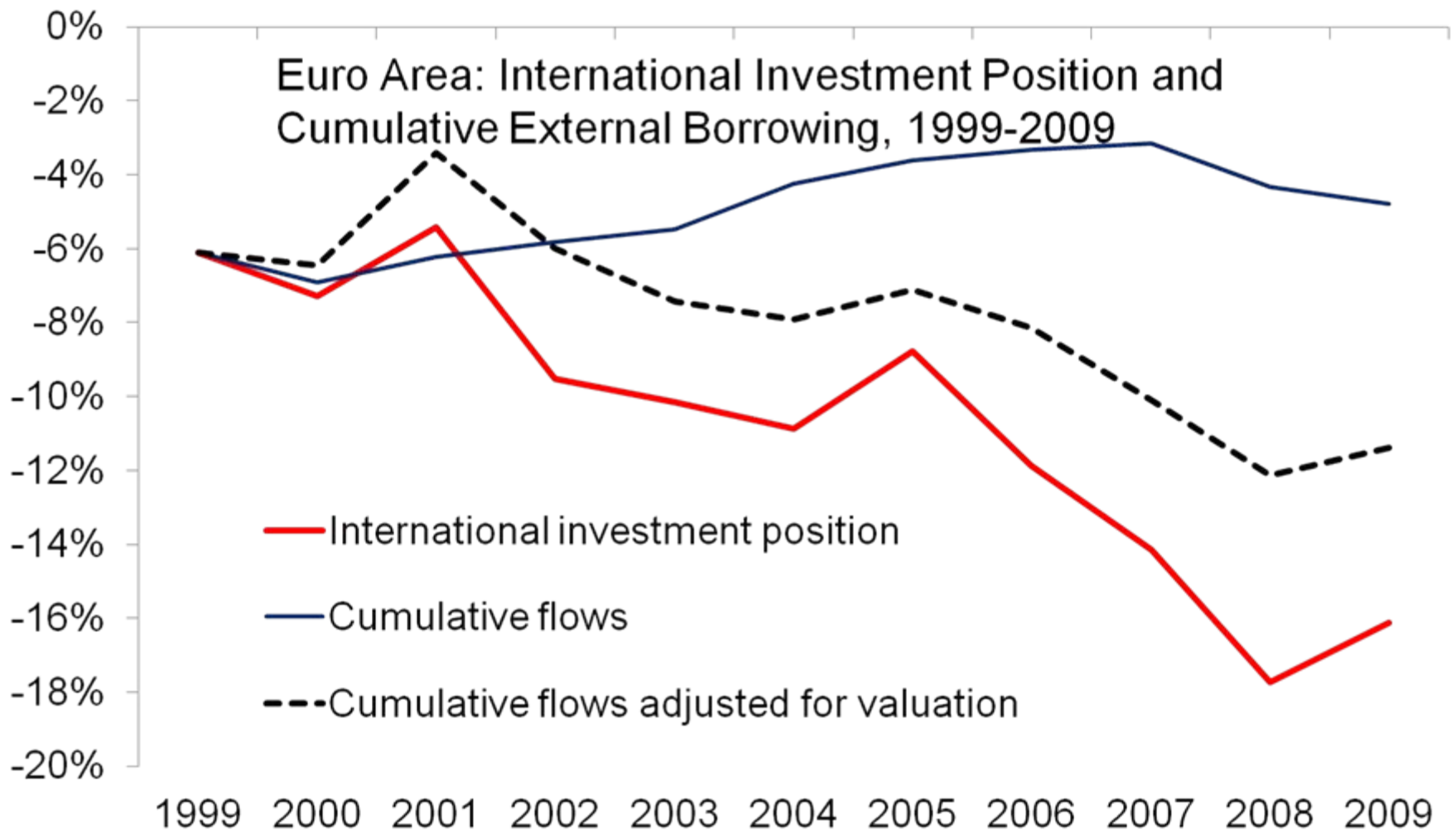
- Issue mostly neglected prior to crisis
- Real appreciation: inflation differentials vs euro appreciation
- Differential impact of external shocks on “North” vs “South”
 - China
 - Oil and commodity exporters
 - Emerging Europe
- Trade versus finance
 - Significant trade with countries outside euro area
 - Financing of “peripheral deficits” mostly internal to the euro area

The puzzles (III)

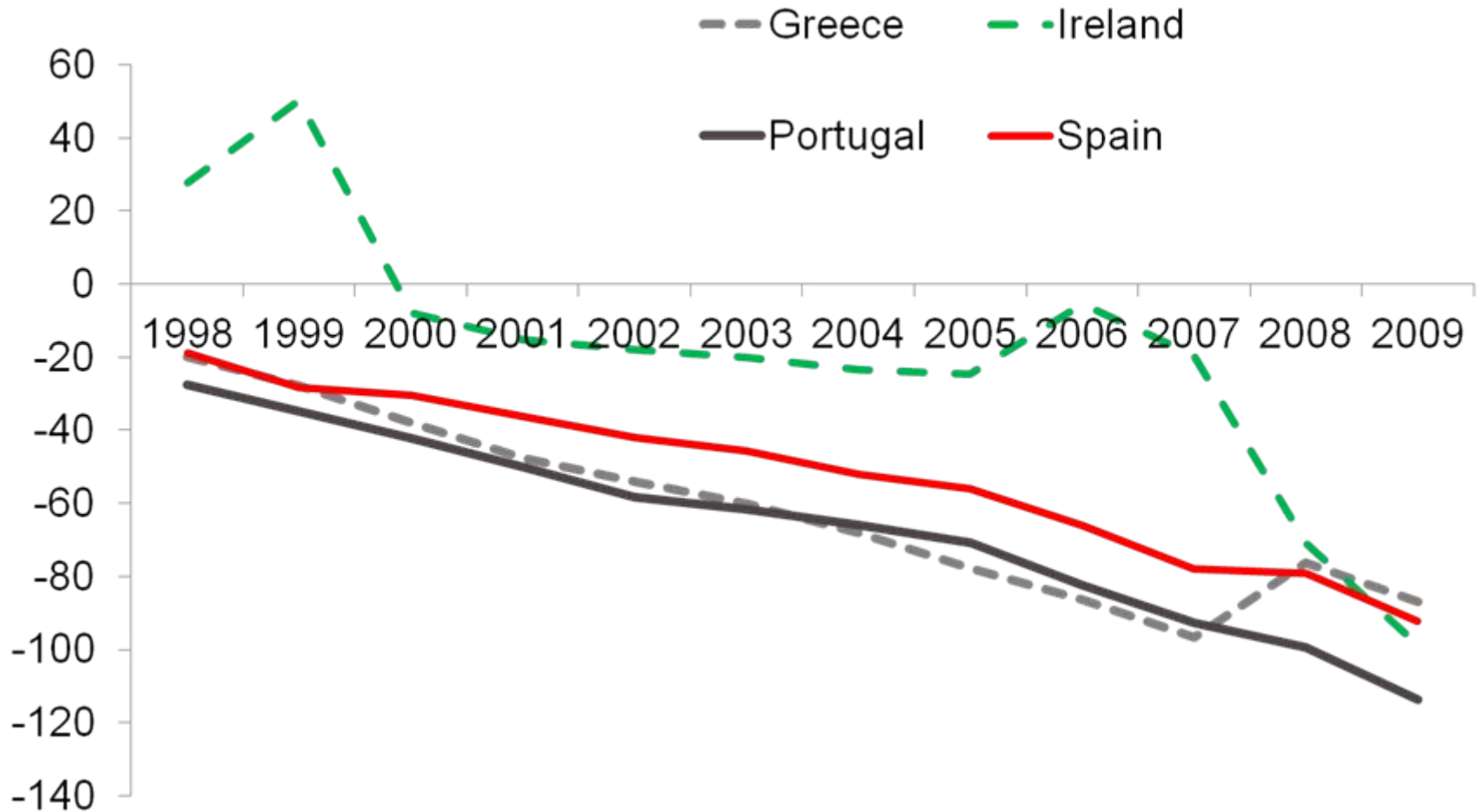
Imbalances in Europe

- How can adjustment work?
 - ▣ Compression of domestic demand in debtor countries
 - ▣ Costs of a strong euro?
 - ▣ What about the “North” in the euro area?
 - Emerging market demand for goods strong
 - ...but some impact of weaker demand within the euro area
 - Portfolio effects? Bilateral financing of “South” comes mainly from “North”
 - Tension between “safe haven” role of North and worries about debtor countries

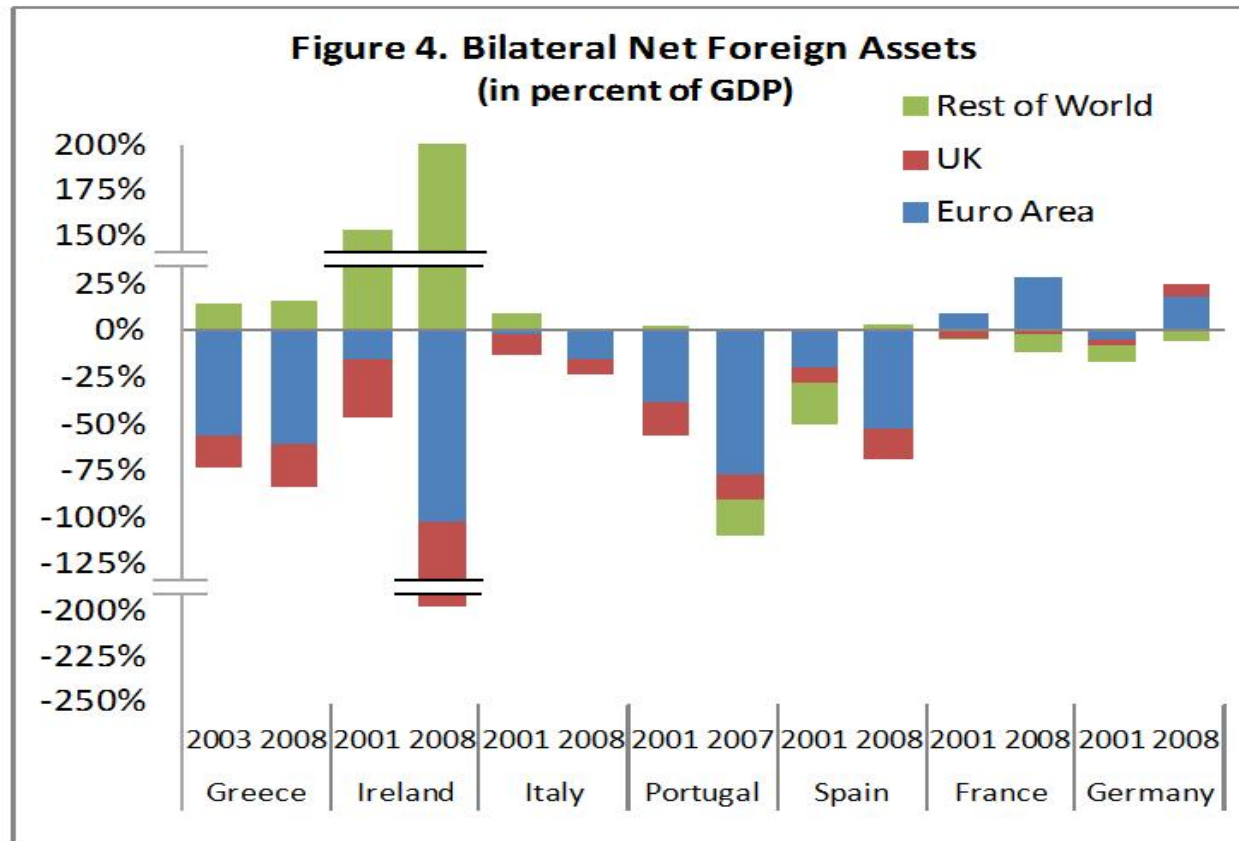
The external position of the euro area



Debtor positions have increased...



...financed primarily by the rest of the euro area



Sources: IMF Staff calculations based on OECD, BIS, and CPIS data

Portugal FDI data only available through 2007.

Greece Other Investment data only available from 2003.

Thank you!

