Explaining large current account surpluses

China and Germany

Analyzing External Imbalances

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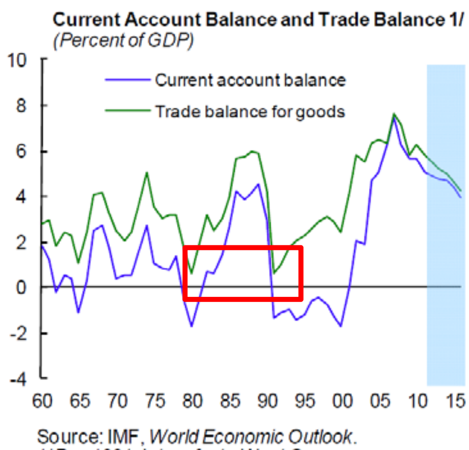
Germany:
long-run surpluses, trending upwards

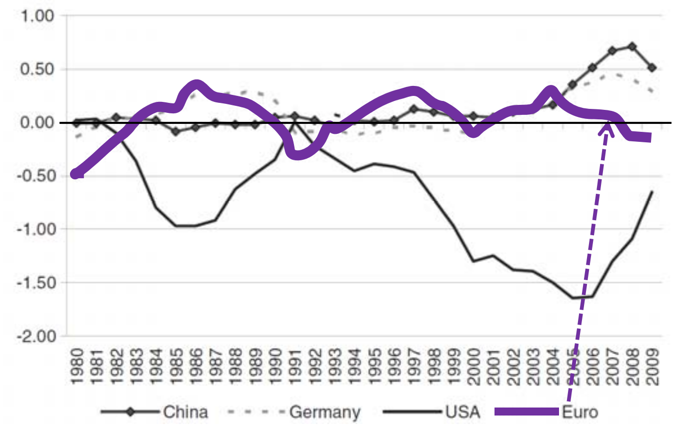


Source: IMF, *World Economic Outlook*.
1/ Pre-1991 data refer to West Germany.

- Germany has been running current account surpluses for decades.
- The exception - Germany's unification in the 1990s provided the impetus for deficits.
- These surpluses trended upwards until the global crisis.

Curiously, the current account of the euro block, on average, has been close to zero

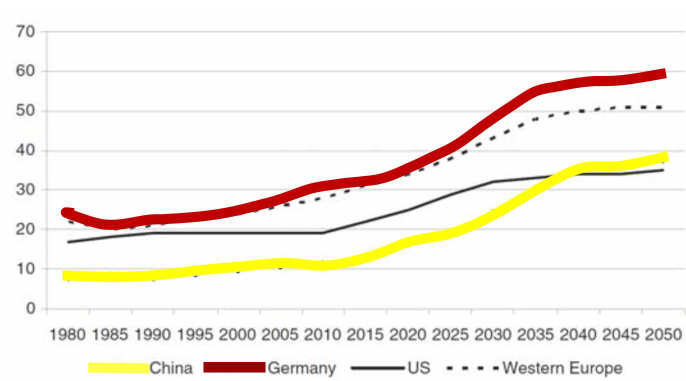
Current account balance as percentage of World GDP



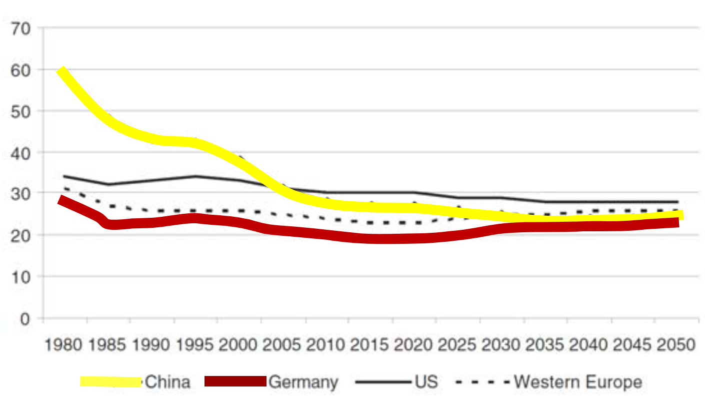
Possible interpretations

- German surpluses were and are part of the European dynamics.
- The Euro crisis acts to mitigate Germany's surpluses.
- The aging of Germany's population may explain the overall high and increasing saving rate of Germany.

Aging and demographic transitions will mitigate Germany's and China's surplus



Projections of % dependency ratios (Old)

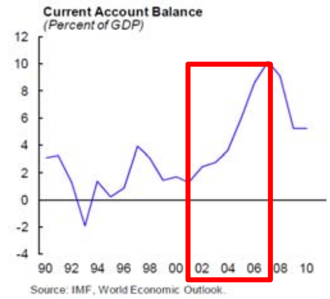


Projections of % dependency ratios (Young)

China: relative mild surpluses during the 1990s, unsustainable exponential acceleration during 2000-7

An Interpretation: Commitment to maximize growth, adopting a wide spectrum of policies.

- The 1997-8 crisis seemed to solidify this commitment.



- The sum of these policies amounts to massive financial repressions aimed at maximizing growth and job creation [financial controls, a low saving interest rate, the functioning of the SOE].
- Chances are that China has reached the end of the phase where a large current account/GDP is sustainable, and where export led growth plays a key role in job creation.

Growing headwinds against the export led growth and a large Current Account strategy

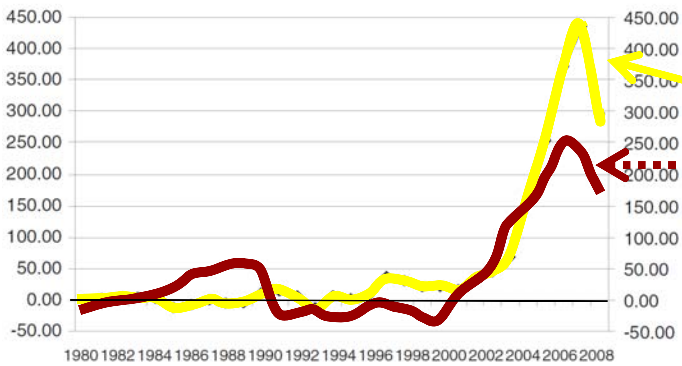
- Size effects and the global slowing down induce greater global resistance against the China's export-led growth strategy.
- Competitive pressure increases productivity and capital intensity in manufacturing and traded goods, reducing employment per unit production.
- Productivity growth in the traded sector mitigate the employment gains associated with export. Employment gains in China could be obtained from growth in domestic demand [Feenstra & Hong (2010)].
- The days of cheap labor in China may be over.
- Demographic trends in China imply rapid aging.

On the unsustainable 2000s

- In the mid 2000s, China reached an unprecedented configuration for a large economy: the Chinese GDP growth rate and current account/GDP reached 10%.
- This is an unsustainable configuration:

i. The sum of all current accounts adds up to zero,

ii. China's surpluses/global GDP increased from 0.05% in 2001 to about 0.7% before the global crisis (> Germany's).



Current account balance, USD billions

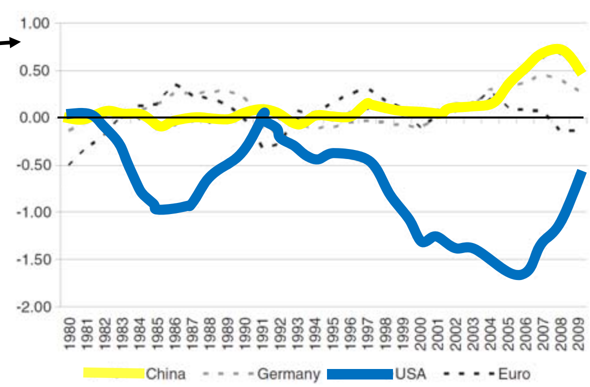
China and

Germany

On the unsustainable 2000s

Current account as a % of World GDP.

Excluding the US, the length of current account deficit spells is negatively related to countries' relative GDP size [Aizenman and Sun (2010)].

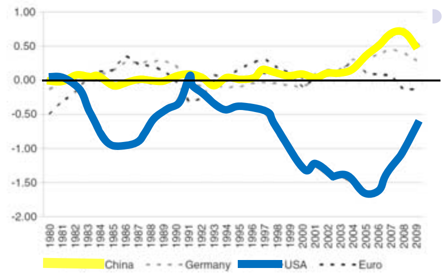


The fast GDP growth of China, while maintaining large current account/GPD surpluses, will be constrained by the limited sustainability of the current account deficits/GDP of countries that grow at a much slower rate.

- Short of the emergence of a "new demander/s of last resort," the Chinese growth path will be challenged by its own success [Aizenman and Sun (2010)].
- The continuation of China's fast growth will require Chinese demand and supply switching.

In an asymmetric world, size matters

Current account balance as a percentage of World GDP



- The global imbalances before the crisis were dominated by the US-China duo. Germany played a minor role, as it's surpluses were balanced overtime within Europe.
- The mutual willingness of the US and China to endure these imbalance in the 2000s, and the presumption of some observers that this was a win-win for both parties, provided the illusion of sustainability.

The pre-crisis global imbalances are not sustainable

- It worked 'OK' as long as the US and Europe were close to full employment, and China was smaller.
- A common rationale for Chinese policies has been the 'learning by doing' (and by exporting) positive externality.
- To the degree that this externality holds, there is also the 'dis-learning by not-doing' (i.e., importing) negative externality.
- China has reached a size where the continuation of its large surpluses may backfire, inducing Europe and the US to invoke retaliatory domestic policies .

On the needed adjustments

- The crisis gives the illusion of progress by scaling down global imbalances, yet it's premature to ascertain if the internal adjustments of the US and China are adequate (chances are that not).
- Short of the emergence of new "demanders of last resort," one hopes for a harmonious trajectory towards lower global imbalances.
- Even if new demanders of last resort arise, it is not clear if this will be good news for the global economy:
- Large gross and net positions may lead to greater turbulences down the road [Obstfeld (2010)].

The debate over the proper Yuan/$

- The debate over the proper Yuan/$ rate has been probably misguided, as the effect of a Yuan/$ appreciation can be mitigated by domestic export subsidies and administrative barriers impacting imports.
- The focus on the Yuan/$ is because of it's transparency, unlike the relative opacity of domestic policies.
- One should look at the total package of all policies and adjustments, in both the US and China.
- Demographic trends in China and Germany may facilitate part of the adjustment, though not in the US.

Thanks for you attention
Background references

- Aizenman J. and Y. Sun, 2010, "Globalization and the sustainability of large current account imbalances: Size matters," *Journal of Macroeconomics.*

- Aizenman J. and R. Sengupta 2011 "Global Imbalances: Is Germany the New China? A Skeptical View," *Open Economy Review*.

- Feenstra R. and C. Hong, 2010, "China's Exports and Employment," in *China's Growing Role in World Trade* (2010), University of Chicago Press.

- Obstfeld M., 2010, "The immoderate world economy," *Journal of international Money and Finance*.