Glut punch

Global imbalances, a pre-crisis scourge, are back

East Asia and Europe are running massive surpluses with the rest of the world

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he Council on Foreign Relations, is the author of a new discussion paper looking at "the return of the East Asian savings glut". A summary of his paper begins in arresting fashion:

> *"The combined savings of China, Japan, Korea, Taiwan, and the two city-states of Hong Kong and Singapore is about 40 percent of their collective GDP, a thirty-five-year high."*

Prior to the financial crisis, many economists fretted about the problem of global imbalances. Measurement error aside, global trade balances; surpluses in some countries offset deficits in others. Yet the magnitudes of those surpluses and deficits can be small or large. In the early 1990s, surpluses and deficits were each around 0.5% of global GDP. They expanded rapidly therefore, to about 2% of global GDP on the eve of the crisis. After shrinking dramatically during the crisis and global recession, imbalances have begun to rebound and are now back to about 1.5% of GDP.

Why do such imbalances matter? They can create problems in a few ways. Large surpluses can be a side effect of very high savings rates, for example. The large imbalances of the 2000s seemed to reflect unnaturally high savings, which contributed to a "global savings glut" that depressed interest rates and encouraged reckless borrowing. Large imbalances can be unhealthy for countries on both sides of the zero; the deficit countries consuming more than they produce risk accumulating unmanageably high debts, while surplus countries can suffer from economic distortions associated the policies (like currency intervention and other means of surpressing consumption) that boost net exports. These sorts of problems still apply in some circumstances.

Yet another worry has grown more salient in the post-crisis period: the demand drain imposed on the global economy by surplus countries. A rising surplus in one country implies a rising deficit in another. That deficit represents a demand drain; spending that might otherwise have taken place within the economy flowing abroad into another economy. That drain is not a terribly big deal when the deficit economy can easily use monetary or fiscal policy to step on the accelerator and boost domestic spending: from the government, for instance, or through increased domestic investment. When interest rates are near zero and political constraints prevent governments from using active fiscal policy, the demand drain is dangerous: it generally results in weaker demand, and slower growth.

Imbalances today look slightly different than they did a decade ago. Then, America accounted for nearly all of the global deficit, while China and oil-exporting economies were responsible for most of the surplus. Oil balances are less important now, since America produces much more oil domestically than it used to, and since global oil prices have fallen. Instead, the surplus countries are high-saving goods exporters in Europe and East Asia. The big deficit economies, somewhat strikingly, are now America, Australia, Britain and Canada. These economies are all of a type: English-speaking, of course. Rich. But they are also highly financialised economies which specialise in the export of high-value services (and safe assets, in the form of both government securities and land). The split is a weird one which deserves more investigation.

The tricky matter is to work out what will happen next to global imbalances. Mr Setser notes that East Asian surpluses are rising partly because rates of domestic saving are high, but also because investment rates in countries like China and Korea have been falling—and there is good reason to think that China's extraordinarily high rate of domestic investment will need to fall much more in the near future. Meanwhile, Japan continues to run a rather large budget deficit; were it not for that, it's current-account surplus would likely be larger. And in Europe, recovery has been built atop large and growing current-account surpluses. Depending on how Brexit unfolds, Britain, which had been a rather generous contributor to global demand thanks to its whopping current-account deficit, might find itself pushed rather roughly by financial reality toward a more balanced current account—as the tumbling pound forces Britons to cut back on imports, for example.

All of which implies more pressure on the remaining sources of global demand. Rising imbalances do not necessarily mean another crisis is inevitable, lurking right around the corner. It does suggest a growing vulnerability across the global economy to any future shocks to demand, from a sharp China slowdown, for instance, or excessively rapid increases in American interest rates. The news, in other words, could be better.

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