Axel A Weber: What imbalances after the crisis?

Speech by Professor Axel A Weber, President of the Deutsche Bundesbank, at the International Symposium of the Banque de France: Regulation in the Face of Global Imbalances, Paris, 4 March 2011.

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1. Introduction

Ladies and gentlemen,

Over the past several decades, the economies of the world have become increasingly integrated. With the removal of barriers to the worldwide flow of ideas, services, goods and capital, a global economy emerged. This has brought about a large increase in welfare and still harbours huge potential for further economic growth and prosperity. During the past years, growth in the world economy has become increasingly unbalanced, however. A visible expression of these imbalances are divergences in current account positions. Although these imbalances were not the ultimate cause of the financial crisis, they did play a role in the build-up of unsustainable structures. This sparked public debate regarding the options to rebalance the world economy and secure sustainable long-term growth. Let us first take a look at recent developments with regard to global imbalances and then discuss some policy options to address these imbalances.

2. Global rebalancing: recent trends and perspectives

Over the past two and a half years we have witnessed a partial correction of current account imbalances which was mainly driven by external adjustments in deficit countries and by lower surpluses in commodity exporting countries. However, the IMF forecasts a renewed divergence of current account positions. While the current account of the euro area as a whole will remain broadly in balance, future trends in global imbalances will be determined mainly by the United States on the deficit side and by Emerging Asia and oil-exporting countries on the surplus side.

According to these forecasts, the current account deficit of the United States will increase slightly until 2015, while the Chinese current account surplus is expected to increase more sharply. The medium-term outlook, however, is uncertain as the Chinese government has outlined a new plan to raise domestic demand. Current account surpluses in oil-exporting countries have not returned to pre-crisis levels, but given the recent hike in oil prices the surpluses might increase faster than initially expected. To sum up, current developments suggest that global imbalances will grow again and remain uncomfortably large over the coming years, albeit at below pre-crisis levels. Thus, there is good reason to further discuss policy options to rebalance the world economy.

3. Policy options to reduce global imbalances

In principle, current account surpluses or deficits are not a problem in themselves. However, the ones we have been observing at the global level are an expression of underlying barriers to sustainable growth and, at the same time, add an element of instability to the global economy. The US current account deficit, for example, has reflected a general decline in saving. Despite an ageing population and foreseeable increases in health and age-related expenditures, public saving has deteriorated. At the same time household savings have declined due to increased borrowing against rising house values. The counterpart to the US current account deficits were surpluses in emerging markets such as China and some oil-exporting countries. For the latter group of countries, the surpluses can partly be explained by an increase in oil prices. Nevertheless, current account surpluses were also caused by exchange rate policies that some countries pursued to artificially support their export sectors.

Given the malign nature of these persistent differences in current account positions the term global imbalances is indeed justified, and it is necessary to address them. However, when designing relevant measures, it is imperative not to underestimate the complexity of the problem. A country's current account position is driven by a very diverse set of underlying factors from within and outside its borders. Consequently, any sensible approach to reducing current account imbalances should not aim at steering them directly. Instead, the objective should be to create circumstances in which current account positions are determined by efficient and unbiased market decisions. In this context, the question of which countries have to act to correct the global imbalances can only be answered by taking into account their ultimate causes.

In general, emerging economies with high current account surpluses as well as oil-exporting countries should remove structural distortions that limit the expansion of domestic demand. In countries with an undervalued currency, for example, more flexible exchange rates would strengthen purchasing power and thus help to redirect growth from exports to domestic demand. This, however, is not a panacea and should be supplemented by structural reforms. In China, for example, such reforms might include measures to improve social security, which would reduce precautionary household saving, strengthen domestic demand and ultimately lead to a more balanced current account.

Economies with persistently large current account deficits, on the other hand, should adopt measures to support saving. This requires a sizeable decline in domestic absorption – the income levels and growth rates which prevailed before the crisis are no longer the appropriate benchmarks. Governments have to stabilise the public deficit, while households have to reduce their debt which had grown rapidly during the housing bubble. In addition, measures to strengthen export sectors, while maintaining open markets, would also help to reduce current account deficits.

The G20 recently made an attempt to address the problem of imbalances at the political level: in September 2009 the "Framework for strong, sustainable and balanced growth" was launched. This framework includes a pledge to "promote more balanced current accounts". As a general objective, this certainly points in the right direction and the framework could indeed usefully support the process of restoring more balanced global growth. It is backed by all the major stakeholders and is driven at the highest level by the G20 leaders. Moreover, a Mutual Assessment Process forms part of the framework. This process could provide an opportunity for exerting peer pressure among members to undertake the required structural reforms. Regarding the design of the relevant supervisory mechanism some progress was made during a meeting of the G20 in mid-February. Though difficult negotiations still lie ahead I am confident that they will eventually lead to viable results.

4. Conclusion

Ladies and gentlemen, there is no question that the problem of global imbalances has to be addressed. However, to be successful, it is essential that efforts do not focus on symptoms but rather are directed at the structural causes of the imbalances. To be more specific, as current accounts reflect a very complex set of determinants, any attempt to steer them directly within more or less arbitrary limits would overburden the relevant authorities. Similar objections apply to attempts to stabilise major exchange rates around some purported equilibrium target values. Such attempts at macroeconomic fine-tuning raise public expectations that economic policy cannot live up to; rather, they risk creating new frictions that require further interventions. Instead, it is up to the national authorities to implement the necessary structural reforms to allow for a market-based and lasting reduction of imbalances.