



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

US and Chinese Imbalances: Causes, Prospects, Policies

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Presented at PIIE event: “International imbalances again? Still?
Forever?”

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Bayoumi, Tamim, and Joseph E. Gagnon, *The US Trade Deficit and Foreign Borrowing: How Long Can It Continue?* PIIIE Working Paper 25-14, July 2025.

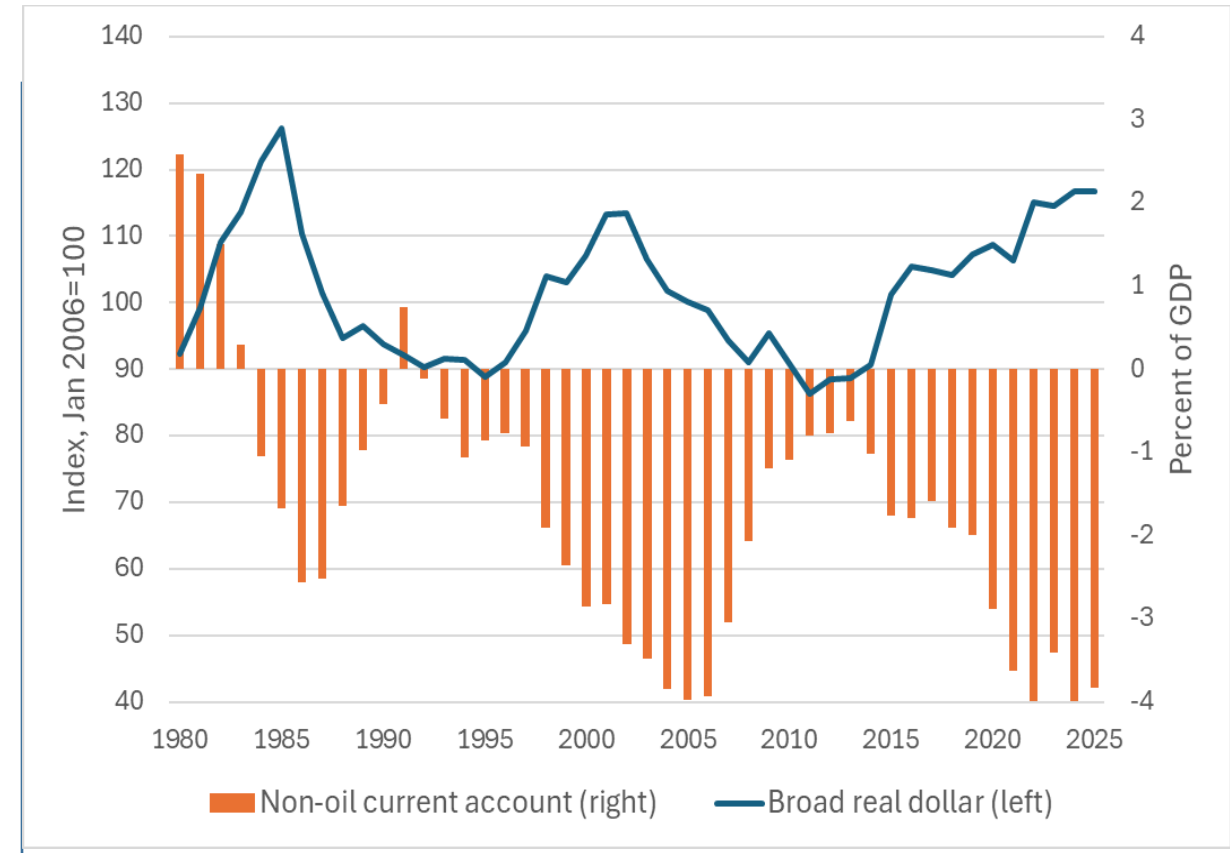
Bayoumi, Tamim, and Joseph E. Gagnon, *Prospects for Global Imbalances in 2026 and Beyond: Another China Shock?* PIIIE Working Paper 26-2, February 2026.

- The United States has had persistent current account deficits for 45 years.
 - The net international investment position is reported at -90% of GDP.
 - Correcting some measurement issues, it is nearly -70% of GDP.
- The main driver is the safe, large, and innovative US financial market, which excels at creating assets that are attractive to international investors.
 - The dollar's reserve currency role was important in 2003-13.
 - US fiscal deficits are important now, but were not a net driver for most of the past 45 years.
- China's rapid productivity growth and proliferation of new firms and products means that its real exchange rate needs to appreciate to keep trade balanced.
 - A previous attempt to hold down the RMB led to the first China shock in 2003-08.
 - Imbalance in net private flows keeps RMB weak now, driving a second China shock.

Strong dollar keeps US non-oil deficit large

- Non-oil current account deficit responds to dollar with a lag.
- Dollar did not appreciate further with tariffs but remains strong.
- Absent Iran war effects, non-oil deficit likely to narrow $\frac{1}{2}$ - 1 percent of GDP.
- High oil prices increase oil balance slightly, but widen non-oil deficit as they slow growth abroad, hurting US exports.

Sources: Bureau of Economic Analysis, Federal Reserve Board, and author's calculations.

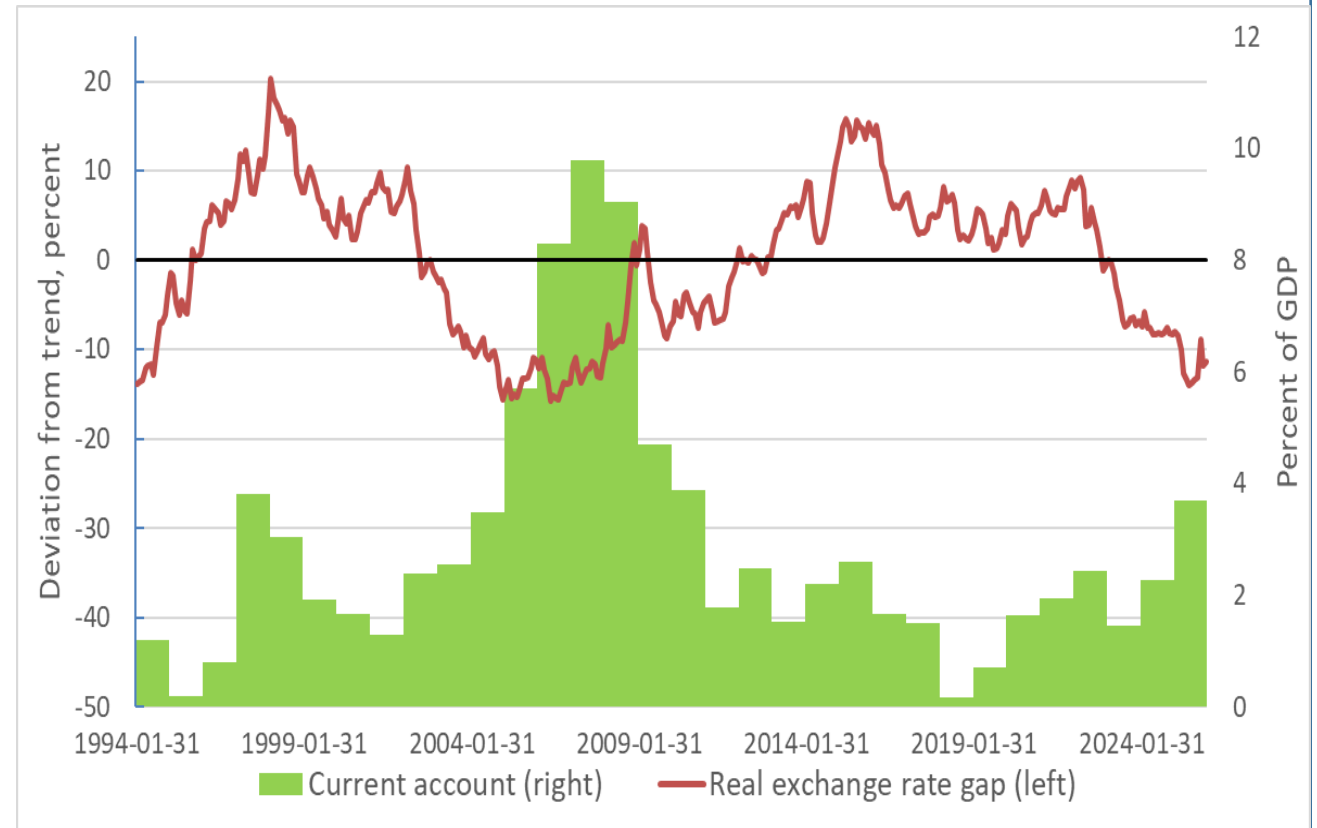


China's weak currency is increasing its trade surplus

- Rapid productivity growth in China requires trend real appreciation to stabilize current account.
- Real exchange rate below trend widens China's current account surplus with a lag.
- Absent Iran war, China's surplus likely to pass 6% of GDP next year.
- More expensive oil imports and slower world growth are a drag on China's surplus.

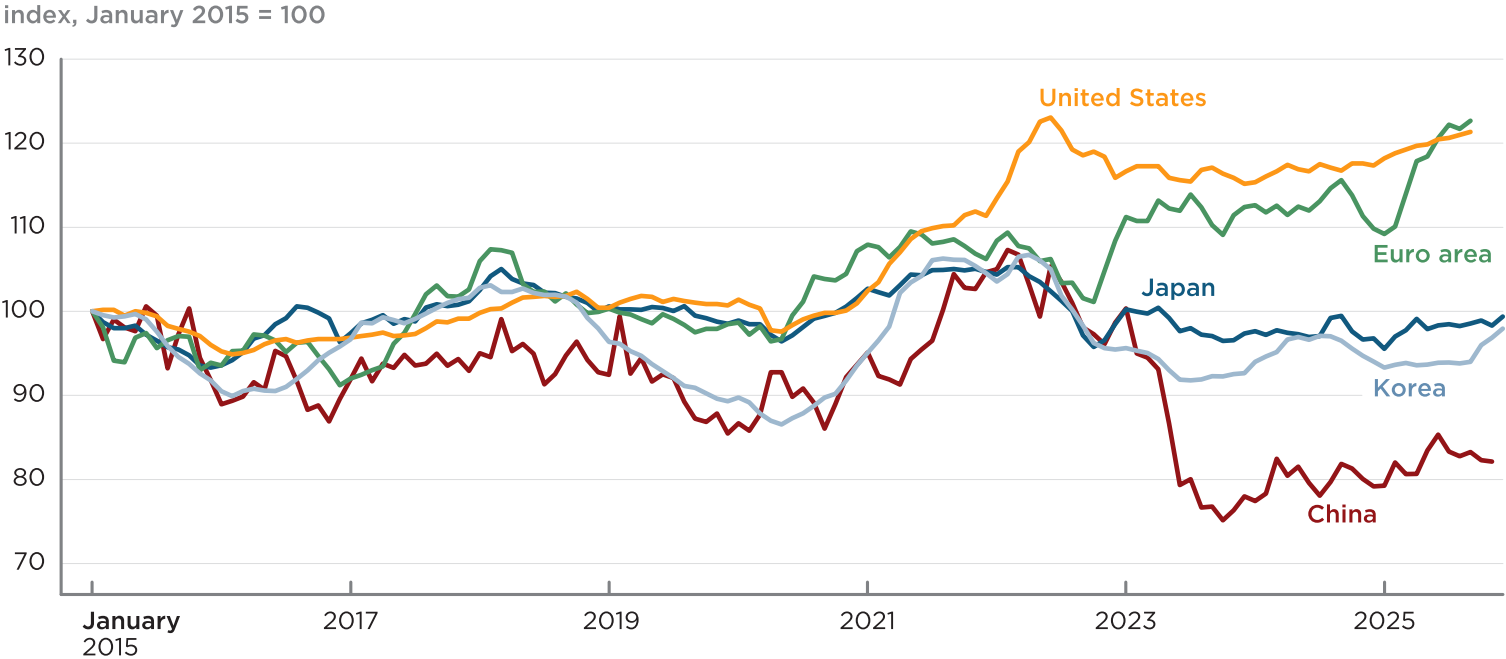
Note: Real exchange rate is fitted to a quadratic time trend. Trend growth rate is 2.7% in 1994 and 0.8% in 2025.

Sources: Bank for International Settlements, International Monetary Fund, and author's calculations.



Chinese manufacturing costs have fallen dramatically

Figure 4
Manufactured export price indexes in US dollars, 2015-25

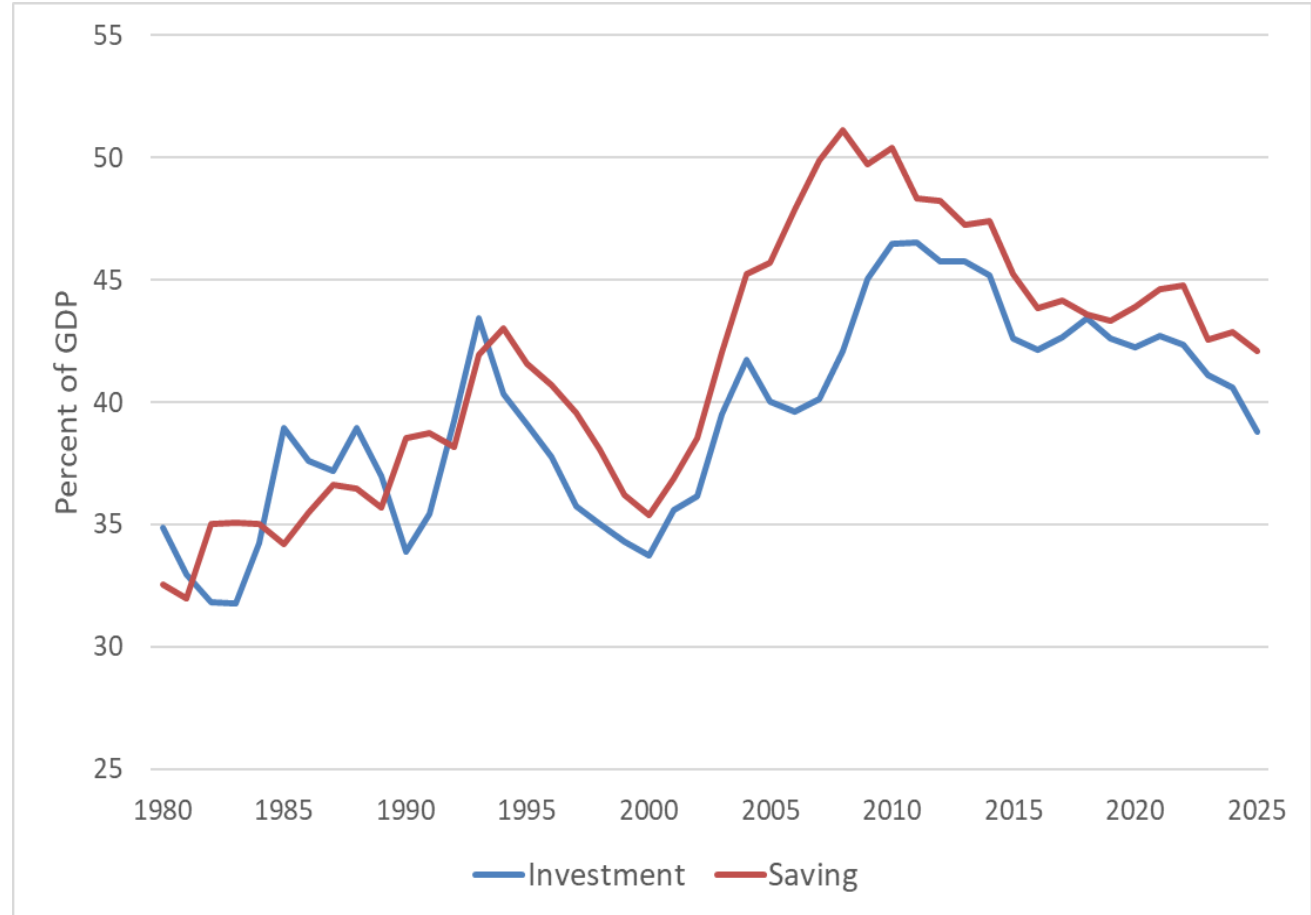


Note: Euro area index is producer price index for nondomestic (extra-area) sales of total industry excluding construction and energy. Japan index is corporate sector export price. Korea index is export price excluding food and energy.
Sources: National sources via Macrobond and authors' calculations.

China investment is falling faster than saving

- China's investment rate of 39% of GDP is far above US (21%), World (26%), and even India (33%).
 - Further decline is likely.
- Ongoing collapse of housing wealth will prop up saving for some time.
- Excess capacity in China's labor market and manufacturing sector drive further export growth, consistent with a growing gap between saving and investment.

Source: International Monetary Fund.



- The combination of a stable or slightly shrinking US deficit and a rapidly growing Chinese surplus is bad news for manufacturers elsewhere.
 - The second China shock will hit Europe and parts of Asia hardest.
 - Protectionism won't help Germany, Japan, and Korea much, as the main battleground is in third countries where Chinese exports displace German, Japanese, and Korean exports.
 - High oil prices shrink China's surplus, but this does not help Europe or Asia.
- China's leaders seem to understand the importance of boosting consumption, but measures planned to date are far too weak.
 - Expanding net exports is the path of least resistance for the time being.
 - One benefit is acceleration of the green transition (solar panels, batteries, EVs).
- A sudden end to the US AI boom could tip the US into recession, compounding the loss of export markets for Europe and Asia.



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