Peterson Institute for International Economics

International imbalances again? Still? Forever?

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[00:00:22.21] - Maurice Obstfeld

I'm going to wait for, um,

[00:00:53.48]

Okay, good afternoon everyone. Please take your seats. Quiet down. It's my great pleasure to welcome you to this Peterson Institute panel on global imbalances in the Siegfried Bergstein Center. The title of the event is International Imbalances Again. Still forever. So I think that's quite appropriate, uh, given that, uh, we, we seem to go through cycles of attention to global imbalances. Uh, uh, we had the, uh, the, um, uh, the '80s, we had the, uh, the, uh, the 2000s, and now we're back again in a cycle. And we'll be hearing from our panelists, uh, what some of the issues are and what some of the reasons for that are and whether we should be concerned or, uh, or take a more relaxed view about global imbalances. Um, we really have an all-star panel of scholars and policymakers to discuss the issues. Um, uh, in alphabetical order, uh, we have Joe Gagnon, my colleague here at Peterson. A senior fellow who was the associate director in the Division of International Finance at the Fed before coming here, has served in roles at the Treasury Department, visited Berkeley, which is a huge qualification for anyone, and has worked in this field for literally decades on trade imbalances and current accounts.

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We have Elaine Rae, who will be the next chief economist at the BIS. Elaine, congratulations again. Elaine is the Lord Bagry Professor at London Business School. She's taught at Princeton, she's taught at the LSE. We tried to hire her at Berkeley unsuccessfully, unfortunately. And she has a very distinguished record both in pathbreaking economic analysis in finance and in policy advice. Alan Taylor, truth in advertising, a longtime collaborator of mine and student, dare I say, back in the day, is a professor of international and public affairs at Columbia. But he is also currently serving as a member of the Monetary Policy Committee of the Bank of England. Alan sort of straddles economic history, macro finance, econometrics, and has also done extensive writing on current accounts. And finally, but not least at all, Isabelle van Steenkest, Director General for International and European Relations at the ECB. Isabelle has worked there since 2022, has been Deputy Director in the Directorate of Monetary Policy and in the Directorate General of Economics. And she is also an important researcher in, international macro, applied macro, and monetary economics. She's been a visiting professor at the College of Europe. I'm going to proceed according to my instructions in the order Ray, Taylor, Van Steenkist, and Gagnon.

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Hélène has to return to London on a plane very soon to teach her class in the morning, so she will not join us on the panel afterward, but we will hear her remarks from the podium. So let me first welcome up Hélène.

[00:05:04.36] - Hélène Rey

Thank you very much, Maury, for this very generous introduction. And I have to say that I won't be able also to be here for the questions, but I fully delegate my answers to Maury. On the panel. So the presentation I'm going to be making today is based on a report that we have just finished for the French presidency of the G7. And my co-authors on this report are Chonggen Bai from Tsinghua, Gita Gopinath from Harvard, and Axel Weber from Frankfurt. And this report also benefited greatly from a CPR-Berlin-Paris report, which has been written also in the last months, and to which several very eminent economists collaborated. And in particular, we have had contributions here from, from Maury and from Gianmaria and many others. So building on this, I'm going to be Giving you, really, given my time, a few highlights of the report. The report is available on the website of the French presidency of the G7. As you can see here from this graph taken from the Paris report, and I believe from actually Maurice's chapter, we have seen in the recent past several instances where global imbalances defined as persistent and excessive current account imbalances have widened.

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We had the beginning of the 1980s, we had before the Plaza Accord, we had the first episode. We also had an episode obviously at the beginning of the 2000s, which ended up with a great financial crisis, and we currently are in another episode of global imbalances, where according to the IMF, The excess current account balances account roughly for two-thirds of a widening in 2024. So why are we concerned about global imbalances? Well, usually global imbalances, and that's what very much we learned from these historical episodes, are coming together with tensions on the trade side, so trade protectionism essentially, which we are currently also seeing, and also sometimes with financial risks. Again, that was very much the case in 2006-2007, and we might be also seeing some signs now. So this is why we are concerned about these episodes. Now, what are the causes of global imbalances? So here, we very much take the view that global imbalances reflect unbalanced growth models of various areas. The areas which are right now under the focus are the United States. You could see before that the US was pretty much the deficit country, actually, for all the episodes.

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China, on the other side, and Europe. So the kind of G3. And in the three cases, we have unbalanced growth models. So the macroeconomic nature expressed itself via savings and investment imbalances., and those are shaped by macroeconomic policies. So as I mentioned, the risk associated with those imbalances are well known from historical episodes. Now, we're also aware that besides global imbalances, there are also sectoral imbalances, which are conceptually very distinct. So by sectoral imbalances, we mean, for example, imbalances in the manufacturing sector, or for the case of the US, we have a very specific example, the energy sector, The energy sector in the US was under deficit while the US had a current account deficit. Now, the energy sector is in surplus in the US, and the US still has current account deficits. So these are very conceptually different notions. However, sectoral imbalances are also associated sometimes with protectionism, with financial and security risk, and may also reflect sometimes, again, non-market practices and choke points. So they are also important from a policy perspective, even though they are conceptually quite distinct. Now, in the report, we spent some time trying to dispel what we believe are common misconceptions in the discussion of global imbalances.

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In particular, so one has to do with a central role for exchange rates. We do not believe that exchange rates have a causal role or a very central role. We believe they are supporting role in the case of global imbalances. I won't have much time to develop, but as an example, if we look at the beginning of the 1980s, we had a very strong dollar. If we look at just before the Great Financial Crisis, very wide global imbalances, the dollar was actually depreciating. So there's no automatic co-movements between global imbalances and exchange rate movements. We also dispel the notion that tariffs can close imbalances. Another very important point on which actually Maury has written a fantastic piece recently is the fact that somehow because the US is issuing the global reserve currency, the US should be running current account deficits. This is not the case. If you are issuer of a reserve currency, what it means is that you might have a lot of gross liabilities that the rest of the world want to hold, for example, US Treasuries that are circulating in the rest of the world. However, facing these US Treasuries on the asset side, you might have— you don't have to have a trade deficit.

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You might have also some assets, some gross assets. So if you have gross assets, gross liabilities, they may balance. Indeed, you might have a current account surplus. And historically, that has happened for currency issuers. So again, I will refer you to the excellent piece that Maury has just written on that. Now, if global imbalances are essentially macroeconomic in nature, then we go into more detail for each of the three big areas here and spell out what are the unbalanced growth models that are giving rise to these global imbalances, and so what would be the relevant macroeconomic policies in order to rebalance, in order to correct them. And one thing we point out is that it's very much in the interest of— in the interest of individual areas to actually do this rebalancing, and as well as in their collective interests. So why is it of interest to the individual area? So let's take, for example, China. I think it's relatively clear that there are decreasing returns to the growth models of China in terms of excess investments in the traded goods sector, in terms of having a relatively atrophied non-traded sector, in particular vis-à-vis services, which is consistent with a very depreciated real exchange rate.

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And the size of the Chinese economy is such that exporting all these goods is more and more difficult, facing more and more tariff walls in the rest of the world, as well as giving rise in China to the so-called involution mechanism through which we have deflation in industrial prices. So there's a number of key macroeconomic levers that China could use in order to rebalance its economy. That would be in the interest of the Chinese economy, but would also be in the interest of the other countries, so the US and Europe, to do their rebalancing more or less simultaneously, so it's a very weak form of collaboration, weak form of cooperation. But if China rebalances, that would increase the real rate of interest, and if you are a deficit country, you would— if you actually rebalance at the same time, that's going to decrease your cost. Okay, so this is something that we point out, and we have some discussion about Europe,, and what should be done in the case of Europe, very much along the lines of Draghi, Letta, and now Noyé and Kukies' reports. Also, from the point of view of the US, here we talk about fiscal adjustment, and we also point out some risk in terms of financial stability and also the functioning of US Treasury markets.

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So these are the points of action that we spelled out in the report. Finally, since I also mentioned the necessity of thinking of sectoral imbalances as well as global imbalances, so global imbalances, we see very much still a central role for the Fund with this surveillance and monitoring mandate. So we have some suggestions regarding doing joint scenario analysis, doing a little bit more of in-detail work when the external report assessment focusing on the areas which are the most important ones for global imbalances, etc. But we also point out that there could be more fruitful collaboration between the WTO and the FSB who are dealing with the sectoral imbalances. So in particular for the WTO, these sectoral imbalances sometimes lead to trade surges, which are from a political economy point of view very difficult to take. And it turns out that the WTO in its framework has been built in order to deal with those issues. There are some safeguard clauses in the WTO, which are pretty much breathing spaces, which are there to ensure the political durability of trade, of openness to trade. And so what we recommend is that they should be a little bit more pragmatic and a little bit easier to use.

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They are being used, by the way, by a number of countries. Currently, but they could be made easier to use. So we have some recommendations for the safeguard clauses, the anti-dumping and countervailing duties clauses, and there was the national security clauses. And from a financial stability point of view, here there's very much a role for the FSB, collaboration with the Fund as well, with a lot of transparency work needed on data, as well with the BIS for cross-border exposures of NBFI. And essentially also the offshore places where there is also a lot of crypto activity, so regulatory arbitrage, as well as the design of system-wide stress tests, as started in particular by, for example, the Bank of England. And let me stop here.

[00:16:40.39] - Alan Taylor

Okay, good afternoon. Thank you for inviting me to be part of the discussion today, and thank you, Maury, for a kind introduction. So today I want to focus on a shift that's often underappreciated in debates on global imbalances. For decades, we've explained imbalances primarily through macrostructural forces like demographics, productivity differentials, fiscal positions, and saving-investment gaps. Those explanations still matter, but they may no longer tell the whole story. And what is new and what I want to emphasize is the growing role of industrial policy. Industrial policy at scale, along with other policy distortions, are now becoming important to understanding why at the macro level global imbalances have reemerged and why they may be proving so persistent. And this is a theme of new and ongoing research at the Bank of England led by Ambrogio Cesbianchi and other co-authors. And I encourage you to look at the underlying working papers. So I'm pleased to now present a short summary of that work so far, which might be a catalyst for discussion. So global imbalances are back. They've returned to levels we've only seen a few times in the past. But the novelty is not just their size, it's the mechanism behind them, I would argue.

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Traditionally, we would have attributed these imbalances to macro fundamentals. Like the population, aging, productivity gaps, fiscal positions, and so forth. And those forces still operate, and Alain emphasized those, but they may not be the whole story. And today's imbalances may increasingly be shaped in addition by micro-level policy choices, especially industrial policy, that alter incentives for firms, suppress household consumption, and redirect resources toward export-oriented sectors. These policies do not simply shift the composition of output, they reshape the entire domestic demand structure. An industrial policy may be especially powerful when combined with three reinforcing features: managed exchange rates, which prevent currency appreciation while increasing foreign reserve accumulation; capital controls, which limit outward investment and keep savings trapped domestically, a form of financial repression; and consumption-suppressing policies, which reduce household income shares or increase corporate savings and tilt the economy toward production rather than absorption. And this combination may be what makes the current episode different. Industrial policy is not operating in a vacuum. It is operating within a policy architecture that systematically pushes economies toward persistent external surpluses. And this is a bit of a departure from the classic macro story and may explain why imbalances today are more entrenched, more policy-driven, and more resistant possibly to traditional adjustment mechanisms.

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So this chart shows the long-run evolution of global imbalances, and what stands out is that the current period is not just another upswing in a familiar cycle. It may be a structurally different regime. In earlier eras, imbalances tended to unwind through exchange rate movements, interest rate adjustments, or shifts in domestic demand. But today, those mechanisms are maybe somewhat muted. And that's why even major shocks from the global financial crisis to the pandemic have not produced perhaps the standard sustained rebalancing because the underlying policy architecture is maybe designed to preserve those external surpluses. So perhaps macro forces are not sufficient on their own to explain the scale and persistence of today's imbalances. A complete explanation may also need to take account of the micro-level mechanisms embedded in industrial policy. And modern industrial policy is not simply about supporting strategic sectors. It often comes with lots of other ingredients like targeted credit allocation, subsidized capital for export-oriented firms, administrative guidance on investment priorities, restrictions on household borrowing for consumption, suppressed wage growth in tradable sectors. Now, these interventions shift the internal balance of the economy, raising production capacity faster than domestic absorption. And they channel resources into sectors that are structurally oriented towards external markets.

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And the macro policy context comes into play here, as I have argued in my own research work with Woojin Choi that recently appeared in the Journal of International Economics. Crucially, industrial policy interacts with exchange rate management. When a country prevents its exchange rate appreciating, the competitive— competitiveness gains from industrial policy can be locked in for much longer than would otherwise be the case, perhaps creating a self-reinforcing cycle. Industrial policy boosts exports, exports generate surpluses, surpluses put upward pressure on the currency, but the currency is then prevented from appreciating. And then capital controls and the domestic financial system become a closed loop. Savings cannot easily flow abroad, so they accumulate domestically, pushing down interest rates and maybe encouraging further investment in the same export-oriented sectors. Capital controls also limit foreign speculative investment that would put downward pressure on the exchange rate. So I see this as being an interesting lock-in, maybe a macro-micro fusion that is unusual in the current era. So industrial policy is now not just shaping the structure of production, it's shaping the structure of external balances. This chart illustrates how these dynamics may be playing out across major economies and that a portion of current account balances cannot be explained by traditional macro fundamentals.

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So this is an accounting exercise that the Bank of England team did. You can see here the US continues to run large deficits supported by global demand for dollar assets. But the more interesting story may be on the surplus side. China's surplus is no longer easily explained by demographics or productivity alone.. It may reflect parts of the policy mix like industrial upgrading, managed exchange rates, and a domestic demand structure that systematically favors production over consumption. And maybe too in parts of the euro area, particularly Germany and the Netherlands, exhibiting surpluses that exceed what macro fundamentals would predict. These surpluses may reflect sectoral specialization and institutional features that suppress absorption. So in all of these exercises, the unexplained component is large. And it may be that industrial policy is what explains the gap. And so a note on persistence. This scatterplot shows how persistent imbalances have become in the modern era by comparing the current account balance with its 5-year lag. And it shows how persistent imbalances have become in, in the modern era relative to a century ago or the interwar period or Bretton Woods. In the past, these imbalances were more responsive to shocks and policy changes.

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Today they are much more sticky. And I think one reason here might be that industrial policy creates capital-deep tradable sectors that are not easily unwound. We can think about both economic and perhaps political economy reasons for that. Once a country builds a globally competitive export machine supported by subsidies, credit allocation, and exchange rate management, it becomes structurally difficult to shift resources back towards domestic demand. And I think that's a key novelty, and industrial policy may thus create path dependence in external balances. To conclude, let me, uh, focus on some risks and policy implications. The political risks arising because industrial policy is inherently competitive. When one country subsidizes what is seen as a growth-promoting sector, others can feel compelled to respond to defend their own productivity. Or strategic interest. And the adjustment risks are asymmetric. Deficit countries face pressure to adjust, surplus countries do not. The old story. So industrial policy and macro distortions can amplify that asymmetry by locking in these export-oriented structures. There are also, as Alain pointed out, financial stability risks emerging from these large sustained external balance sheets interacting possibly with non-bank vulnerabilities., and perhaps industrial policy here could be exacerbating these risks by concentrating investment in specific sectors.

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To conclude, the policy path forward may require recognizing that industrial policy is now a driver of global imbalances— maybe not the only driver, but an important one. Surplus countries need to rebalance toward domestic demand, deficit countries need credible fiscal paths, and international institutions need to update their analytical frameworks to incorporate the micro-level mechanisms that help shape today's imbalances. Thank you.

[00:25:32.51] - Isabelle Vansteenkiste

Before I start talking, let me thank Peterson Institute for organizing this panel and for inviting me and for more —here. So I'm going to focus, coming from the ECB, on Europe and how Europe fits into the discussion on global imbalances. I'm going to call it a Schrödinger's déjà vu, like Schrödinger's cat. Is it, is it not? It is and it is not. So, and I'm going to start right away in giving you already my main points of my intervention. So when you look at global imbalances and then global policy debate, you have a bit of a déjà vu for those who were around in the 2000s. You see large imbalances, And we see them at the surface also in a highly financially integrated world, which makes us worried about when they unwind what may happen because spillovers could be severe. But if you look under the hood and if you look in particular for the euro area, it's quite— it's not so much of a déjà vu. At the time, for those who remember, we were worried about the deficit countries. We actually went through a sovereign debt crisis. There was quite some adjustments. And now actually the focus has shifted to a euro area surplus.

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And there's not much discussion anymore about concerns of a sovereign debt crisis, thankfully so. Now, if you look in today's world, the euro area is an important contributor to global imbalances. Actually, any large jurisdictions, as soon as it runs an imbalance, is going to be an important contributor. But that doesn't mean it's worrisome, right? And my point is we are not at the epicenter this time on the discussion on imbalances. We look at the surplus. Yes, there is a surplus, but it's already declining. And when you look at the policies across the countries, they're actually going in the right direction. It's not less evident— it's less evident when we look elsewhere. But of course, that doesn't mean that Europe should be rest assured. We can and should do more because in particular in Europe, the policies that would rebalance growth, and that's what Elena already said, are also those that support near-term and actually also long-term growth. So there's no trade-off between rebalancing policies and growth for Europe. That doesn't mean it's always easy to do because there's always vested interests that get you, in particular when we try to integrate in Europe, We all know it's a good thing, but that doesn't necessarily mean it has been easy to achieve.

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And my final point is, when we think about imbalances and why we're concerned about them being so high, is because we're thinking about disorderly unwinding. And there I come back to my déjà vu. So, you know, maybe the euro area is— in terms of the imbalance discussion now, it is not a déjà vu, but maybe there's some déjà vu after all for the euro area in case it unwinds. And maybe last time it went via the banking sector. Could it happen this time via the MBFIs. So in the next couple of slides, I'm just going to have some charts illustrating the points that I had. And the first one actually on the left, I borrowed from Alan the chart, so I don't need to discuss it very much, but it just shows that global imbalances are actually at very high levels. The chart on the right, I want to combine it with that, is that the world is still very financially integrated. And this is a chart from a Geneva report. One of my co-authors is in the audience, and he knows much better this data than I have. So if you have questions on the data, please Go to him, but this is a proxy for international financial integration, which is basically the sum of the stock of total gross external financial assets and liabilities.

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We haven't seen the world integrating further since 2008, but it remains at a very elevated level, right? And so that makes us concerned about imbalances. Now, as I mentioned, URA is an important contributor. I updated the data for the IMF VEO release this week, and actually for 2025, the URA current account surplus went further down. If you would have looked for €2024, area contributed around one quarter of the imbalances. That was on par with China. Actually, China, the surplus increased further, whereas for the euro area, it decreased somewhat. But still, we're like the second largest contributor on the surpluses side, surely because of also the size of the euro area. Now, as I mentioned, for Europe, the debate this time around is quite different. This just on the left-hand side shows the current account balances in 2007 and compares them to 2025. The 2007 is the dark blue bars and the light blue bars are 2025. So you can see in 2007 we had this group of countries that had very large deficits. They were a source of concern and the concerns unfortunately materialized. And we saw quite some adjustment by these countries. And so as a result, as the surplus countries didn't adjust and the deficit countries did, what you saw was your area current account as a whole basically shifted from, you know, balance to slight deficit.

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To surplus. Now, since 2017, what you can see is that we do see a gradual decline in that surplus again in the euro area, and partly because also we see some policies starting to being taken by the surplus countries. Now, as I mentioned, Europe is not at the epicenter, and there's many ways to skin a cat, right? So this is just one way, and it's partial, but it's just to illustrate a little bit like where do imbalances actually sit. These are just ratios, household consumption to GDP ratio and gross fixed capital formation to GDP ratio. Where you look basically on the left-hand side, you know, you see really two clear outliers, right? You see China, and there's a lot of discussion always about China. You know, consumption is very low. There's a variety of factors there. You know, we'd also say household savings is very high. That's just the other side of the coin. For the United States, basically you see very, very high consumption-to-GDP ratio. So two very different economies, and you have also two very different current account ratios there. On capital formation, you can also see there's one outlier, which is China.

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I sometimes think China doesn't have an export-led growth strategy, but they have a domestic classic production-led strategy, and then basically the collateral is that whatever you don't sell at home because consumption is depressed, you end up selling abroad. For the other countries, investment is much more range-bound, but I just wanted to show this also as a side remark that, you know, high investment, you know, of course it leads automatically to higher growth by, you know, accounting-wise, but it doesn't necessarily lead to higher TFP growth because the US has far higher TFP growth and China has rather low TFP growth, and if you look at the investment ratio of China, it's far above that of the US and the other European economies. As I mentioned, policy is going in the right direction. So for Europe, you see a lot of efforts actually to step up investment, and part of it is a bit of necessity on the defense side, but also on infrastructure. I have here just on the very right chart, you know, the expected additional spending for Germany. This is just from the Bundesbank's estimates basically. If you look at the other jurisdictions, if you look at the US, I have here the CBO projections.

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You see basically the federal debt as a ratio to GDP is not set to decline necessarily. It's actually set to increase further, right? And that doesn't bode well for the current account deficit. And if you look at China, there's no real signs that they want to move away from this kind of production-led and growth target kind of strategy that they have. So the direction at least of travel looks different for the other major jurisdictions.

[00:32:22.24] - Maurice Obstfeld

Jurisdiction.

[00:32:22.25] - Isabelle Vansteenkiste

Now, my final point that I want to raise, as I mentioned, well, your area, it is in a different situation, but it is not so after all when you start looking under the hood actually in terms of the linkages, right? So if you look at the banking sector linkages after the global financial crisis, banks learned their lesson by force, partly by regulation, but the exposures of the banks directly to the foreign jurisdictions has massively declined. But what we do see now is that banks have become increasingly exposed and are increasingly lending to MBFIs, and those are, for instance, then invested into the United States. So we see a risk if imbalance is in the wild that we see the spillover, but then through the back door via the MBFIs. And that really calls for enhanced monitoring, understanding better. That's also what Elaine was mentioning on the data, but also the regulatory side, right? Not just in the jurisdictions, but also global cooperation, which in a fragmenting world is becoming increasingly difficult. Thank you very much.

[00:33:30.19] - Joseph Gagnon

Okay, thank you. My talk today is jumping off from two papers I have written over the past year with Tam Bayomi, who's here today. The first one's on the US trade deficit and issues about sustainability. The second one is prospects in the near term. For Global Imbalances. They're both on the PII website. Some of the key points are that, as people in this room know, the

United States has had persistent current account deficits for 45 years, current account being the best measure of trade deficit. This means we've been borrowing from the rest of the world, and the net international investment position, which is our claims on the rest of the world minus their claims on us, is at negative 90% GDP, which is an astonishingly large number. We show in the paper there's some measurement issues. Probably a more realistic issue— value would be minus 70% of GDP. But that's still a pretty big negative number. We find the main driver throughout this 45 years is the safe, large, and innovative US financial market, which excels at creating assets that are attractive to international investors. But a little note on that is that you would think then that we would have more investment in the US, but as you just saw in the previous— Isabel's chart— we don't have more investment.

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What we have is that has pushed up asset prices, made American households feel wealthier and save less. So, it has driven us to save less. Two minor contributors are the dollar's reserve currency role. It's not a major contributor, but during the years 2003 to '13, it was for those years. Fred Bergsten and I wrote a book in 2017 in which we called that the decade of currency manipulation. The dollar was the main vehicle for that manipulation, and so, it— did impact our trade balance. US fiscal deficits are now important and have been for the past 5 years. They're a major contributor now. But over the previous 40 years, on average, the US fiscal deficit was very close to that in other countries, and so it couldn't have been a very big net contributor on average. China's— turning to China, China's rapid productivity growth and the proliferation of new firms and products means that its real exchange rate needs to appreciate over time just to keep trade in balance. And Alain mentioned sort of macro intervention in exchange rates. Well, the most prominent example is in the mid-2000s when the government of China held down its currency, kept it from appreciating, and that led to the first China shock of the mid-2000s.

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Currently, China does not appear to be doing a lot of intervention, but in capital flows, what's going on is that the rest of the world has completely lost its appetite for Chinese assets, and China's continued— China private sector has continued to want to buy foreign assets, and so that has allowed the current account to grow and the renminbi to be weak without so much intervention. So looking at the US, now Helene said exchange rates don't matter. I think what she meant was they're not a driving fundamental. But I do think they are the transmission mechanism for fundamentals to work. And so what I show here is the US value of the— real value of the dollar is the blue line here. And you see three waves of strong dollar. And we're currently in the third wave of a strong dollar. The orange bars are the non-oil current account balance for the US. I take oil out because it doesn't respond much to the dollar and it's had different movements lately. But what you see is that with a lag of 2 to 3 years, when the dollar is strong, then the current account is weak, and then when the dollar weakens, then the current account recovers.

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And this is— we're now in the third wave of this. Pattern. Going forward, the dollar is still strong at the end of that chart there, but it didn't appreciate anymore after the imposition of last year's tariffs, and standard macro models would have called for that to keep the balance constant. Well, since the dollar didn't appreciate, the tariffs probably will reduce imports a bit, and that's one reason I expect this current account might narrow a bit going forward. Another reason is that the US interest rates have declined and that reduces the net interest payments, which is part of the current account. So, absent the Iran war, I would have predicted a narrowing of that deficit by 0.5 to 1% of GDP, but high oil prices are a new factor. They actually improve the oil balance a bit because we're now an oil exporter, but that's a pretty small thing. They might hurt the non-oil deficit because our foreign markets are more likely to be hit negatively, growth negative hit from this than we are, which would hurt our exports. So we'll see. But the deficit will remain large even if it shrinks a little bit. In China, again, I'm showing the real exchange rate for China in the red line and the Chinese current account is the green bars.

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And again, you see when the— when renminbi is strong with a lag, then the current account shrinks, and when the renminbi is weak with a lag, the current account grows. Now, one difference here is that, as I mentioned before, because of the rapid productivity growth, you need to do this in a detrended real renminbi, but then it works pretty well. So, absent the Iran war, given the weakness of the renminbi, and other factors which I'll come to later, we would expect China's surplus to continue growing and to get to around 6% of GDP next year. But the war is going to change that. So at current prices in futures markets, energy imports to China might increase by 0.5% of GDP. That might hold down their growth. Plus there might be a slowdown in their foreign markets. That might hold down their growth. So that the rise in the current account may not be as much as it otherwise would, but it still will be, I believe, significant going forward. This chart just shows that another cut on China's price competitiveness. What you see is manufactured export prices, and during the COVID period in the United States and Europe, the yellow and green lines, prices rose, as you know, part of the overall inflation.

[00:40:27.10]

A year later, coming out of COVID China had a big manufacturing recession, and that caused their prices to actually fall. That's the red line, and there's a huge gap that's opened up in these tradable goods. So China's very competitive internationally. I don't have time to go through this chart, but the point here is simply that domestic imbalances inside China are moving in a direction that would support a growing external imbalance, i.e., a growing trade surplus. So to get to the final conclusions, the combination of a stable or slightly shrinking US deficit and a rapidly growing Chinese surplus is bad news for manufacturers elsewhere. And this second China shock's going to hit Europe and parts of Asia hardest. The US seems to be less exposed now. We've put up stronger barriers to China, and I think even in places where we haven't put up explicit barriers, Chinese companies are afraid to enter because of the fear that barriers will be put up. So this will probably deflect these, uh, shock elsewhere. Protectionism in Europe and Japan won't really help much if it can happen because the main battlegrounds are really third countries where Chinese exports will displace German, Japanese, and Korean exports.

[00:41:47.16]

True, as I said, higher oil prices actually shrink China's surplus, so it's not as bad. It will be growing, but not as strongly. But that's cold comfort if you're an exporter in Europe or Asia, because you're still going to face all those exports. China's leaders seem to understand the importance of boosting consumption, but the measures that have been planned to date are just far too weak given the size of the problem. And expanding net exports is clearly the path of least resistance. And that's sort of where China's clearly going to be heading until they get further pressure. One benefit of all this is the acceleration of the green transition, especially China's ability to sell cheap solar panels, batteries, and EVs around the world. Final risk is, could the US AI boom end a bit abruptly? My colleague Martin Trezempa in the previous session said, that's not a risk, it's not going to happen. I agree for 2026, but who knows for 2027? It could be like 2001 when the tech boom burst, and that could tip the US into recession finally and causing a big loss in export markets and making this all the more painful.

[00:43:02.07]

Thank you.

[00:43:36.31] - Maurice Obstfeld

Okay, I'm going to use my monopoly power over the podium to make two observations, then I'm going to ask a question to all of the panelists. But just two reflections sparked by the comments that the speakers have made. Back in 1980, there was a very famous paper written by Martin Feldstein and Charles Horioka about saving and investment rates across the world, and he showed that these were highly correlated. And he concluded from this that there was not much capital mobility in the world. What we saw in both Isabel and Alan's presentations was that the dispersion of current accounts has reached levels comparable to the gold standard. And in fact, in 1980, in a paper in the IMF staff papers, Tan Bayoumi entered this debate looking at data from the gold standard and said, well, indeed, the gold standard saving and investment rates are not highly correlated because countries did not target their current accounts. And so now if we look at these dispersions, we're back in the the situation with regard to capital mobility, which we were in under the gold standard and which was highly lauded, yet we're not happy, right? We— and that's because we think there are certain distortions that are driving these global imbalances.

[00:45:13.02]

Now, second observation, which was sparked by a comment of Joe's, is that So some of the actions that are doing this are on the international investment side, not just on the trade side. If we look at the Trump administration's attempt to make trade deals involving large foreign investment flows into the US, at least in the short run, those are going to worsen the US external position. Similarly, actions that discourage investment in China by U.S. firms and firms elsewhere, as Joe pointed out, are also going to tend to weaken the RMB and augment China's external surplus. So a lot of policies working in different directions and unclear what the, what the result will be, which brings me to my question for the panelists. If you go back to the 1980s, the Plaza Accord, big discussion about external imbalances, fundamental disagreements between the Europeans and the Japanese saying the imbalances were due to US fiscal deficits and the US saying they were due to low growth and market interventions abroad. And basically, it was resolved perhaps not so much by purposeful policies, but by things like German reunification, which was not a macroeconomic policy in intent. So my question for the panelists, and maybe we could go from left to right, is suppose we have today similar disagreements internationally about global imbalances.

[00:47:03.52]

The Chinese point to US deficits and they say the role of the dollar. The US points to Chinese subsidies and other industrial policies. Suppose indeed we are in a standoff and nothing happens and global imbalances don't shrink and continue to grow. How do you see the economics and the politics possibly dictating the outcomes? And I understand this is all very complicated by the the Mideast situation, but I'd like you to sort of spitball a little about this and tell the group what you think. Alan, left or right? My left.

[00:47:44.52] - Alan Taylor

Um, yeah, thanks. Uh, a great list of questions, not sure I can answer all of them. Um, very interesting to bring up Feldstein-Horioka, which I was mentioning actually in, in the discussion with Helen just as Isabel was going through her slides because it was striking that China's consumption ratio to GDP fell by 20%age points just as their investment ratio to GDP rose by 20%age points over that sort of longer run period. Totally consistent with Holstein-Harjo in the sense that that completely swamped the current account movements at large, as those are. But you reminded me of my research, blast from the past, many years ago on time series of current accounts and investment and saving, and I'd be curious to talk to Tam afterwards or Q&A. I think that was a period in the 19th century when these current account balances were at their most persistent, as we saw in that sort of persistence scatter plot, and we have kind of gone back to that, so it's maybe not such an unusual phenomenon. But over time, you know, there's, there's cointegration. You have to like obey the budget constraint. But it was— it seemed like the mobility there just took the form of you could have imbalances for longer even if on average you had to have saving equals investment.

[00:49:08.02]

I was going to throw a question back at you, which is in the slide that Ellen showed, but she attributed to you, we had a lot of discrepancies consecutive persistent discrepancies on the surplus side in, I think, the '70s and '80s, and they've all flipped to negative. So we've gone from missing surpluses to missing deficits. I wonder if that's part of the mystery of what's going on. Is there— has the dark matter flipped signs? And if so, so where is it? But on prospects for resolution, I'll go back to the sort of political economy point, and I guess I'm channeling my neighbor Jagdish Bhagwati, who was your neighbor back in who I see all the time because we live in the same building. And I just think about how with industrial policy, which is what I emphasized, you're veering off into sort of micro-level sectoral and industrial kind of distortions, which like trade policies are going to have lots of like dispersed interest groups. So if it's like, you know, we need to have a Plaza Accord, so you've got to talk about a lever which might be fiscal policy or another lever which might be exchange rate policy, you know, maybe it's easy to kind of get to some agreement or coordination on a few levers on some very big points.

[00:50:20.39]

But if you've got tons and tons of industries and sectors and interest groups and sort of resolving an imbalance problem that's inflected with lots of industrial kind of policy interventions as well, then instead of taking 1 or 2 years like a Plaza Accord, it'll be taking, I don't know, 10 or 15 years like Uruguay round, feels a bit different and maybe not so happy.

[00:50:51.00] - Isabelle Vansteenkiste

So picking up on if the imbalances are not being resolved, like say naturally, let's put it like that, and you need to reach some sort of agreement, I think if you look through history, that has been really hard. I mean, we refer to the Plaza Agreement, but even the Plaza Agreement, there was already some move in the right direction by the time that took place. And as you mentioned, there were other factors that led to the resolution. And I think the European Union has been maybe a nucleus also of showing how difficult it is to resolve imbalances because we had all the discussion of intra-EU imbalances and we had set up all kind of very complex processes, macroeconomic imbalance procedures, you know, so that, you know, there would have been an adjustment on the surplus countries and the deficit countries. It's really, really hard. So I can see in the current context, it will be very difficult As well, again, what, at least on the surplus side, and referring to what Alan was saying on these industrial policies, China is eating away the manufacturing lunch, not just of Europe, of the advanced world, but also in the emerging world.

[00:51:54.04]

And I can imagine that at some point, at least the global collectively come together and say, how do we resolve this? And ideally, that happens through WTO or reviewing the rules of the WTO. I'm not a trade expert, but there must be things that you can try there. At that level to do. Now, what I'm most concerned about, and as central bankers, we see risks, is that resolution will happen to a disorderly unwinding. And there, why we are different from 2008 is that the world is far more fragmented. 2008, you had the G20 getting together and basically acting very rapidly. Now, it's much more difficult to reach global agreements. At the time, money was flowing into the United States, although the source of the shock was the United States. If we're having an episode where markets react as in April last year to a shock, then we may see a very different and more difficult even unwinding of a mountain.

[00:52:48.46] - Joseph Gagnon

So I'd like to separate sort of current accounts caused by policy actions and current accounts that might be caused by private behavior. It seems that there's a growing sense that policy actions do cause some of these imbalances and that maybe there'd be a natural agreement that that's something that we should agree to counteract to some extent. Fred and I talked about the currency side of it some years ago, and that was sort of our conclusion. But then Alan's— the stuff you showed today shows that there's many more sides of it besides just holding your currency down. There's industrial policy of different types. And it gets very complicated. But there still is a sense that maybe we need to think about distortions that these things cause and counteract them. But it seems to— that's tough. That's tough enough. But what if we— my nightmare is that we're moving to a world in which maybe this is actually not going to be that important because it's especially with respect to China, it's going to be driven entirely by what private Chinese people want. Because I can very well imagine a world in which few foreigners want to buy assets in China, and hundreds of millions of Chinese households and companies want to buy foreign assets.

[00:54:13.04]

And that, it seems to me, can swamp any of the subsidies anyone has ever identified in China in terms of the amount of money that they could shift abroad and the current account it could support. The IMF and the US Treasury have said, we want a freely floating renminbi with no intervention. They might not be happy with what happens if that happens. And what should we do about it? I don't know.

[00:54:42.50] - Maurice Obstfeld

Yeah, I mean, interestingly, there's a counterpoint in the 1980s with the US-Japan relationship and the US efforts to get Japan to open financial markets, the yen-dollar agreement. And, you know, in the current geopolitical atmosphere and given the very different positions of China and Japan strategically nowadays, it's hard to imagine the Chinese being willing to engage in any such thing. And the leadership has been moving to a position of, you know, really greater autarky with response to— with regard to financial flows. So that is probably a worrisome development going forward. You know, coming back to what Isabel said about the, you know, the euro area, I have to recall a another Feldstein-Horioka paper, which was from the early 2000s after the euro came in. And my colleague Olivier Blanchard and Francesco Giovazzi had a Brookings paper on Europe, the end of the Feldstein-Horioka puzzle, you know, documenting the increase in capital flows, net capital flows among euro area members. And, you know, isn't this great? And The discussion was Pierre Olivier, the very young Pierre Olivier Gournay-Chasse, who had been doing some work on Latin American crises. And he kind of said in his discussion, well, not so fast.

[00:56:13.17]

But we saw how that worked out. OK, well, with that, I'm not going to take up the discrepancy because if I understood it, it wouldn't be a discrepancy. But I'll turn to the floor for questions. There's a mic in the middle. Jessica has mics. Please identify yourself before speaking, and the floor is briefly yours.

[00:56:50.27] - Alan Taylor

Good. Two brief comments. Slightly— quite different comments. So the first one is nobody said the words trade war, but it seems to me the second Chinese shock, if it does happen and if it really does undermine a lot of manufacturing sectors elsewhere, it's very difficult to see, especially if the AI boom becomes a bust, how you avoid a lot of trade me. That's— so that would be my shorter answer to that. On sort of fundamentally what's going on with imbalances, what strikes me is how long they've been around, right? The US deficit, 45 years. UK essentially on an identical number. China may be more like 30 years. Germany, if you take out the unification a long time. So then you have to shut your eyes and say, what's the fundamental thing which differentiates the surplus and deficit countries? And it strikes me that a very good candidate for this is different financial sectors. UK and the US have relatively disintermediated, relatively adaptable financial sectors, and, you know, Japan, the euro area, and China China are all basically bank-based. And maybe there are other things which the two groups have in common. But that strikes me as not a bad one.

[00:58:28.55] - Joseph Gagnon

By the way, that was my co-author, Tam Bayomi. He didn't introduce himself, but for the record. Patrick Honohan, Peterson Institute. If there's nobody else to ask at the moment, I would like to ask the following question. Maybe it's not the flows that we should be worrying about, but the accumulation of different types of asset and liability. And do we worry much less if these assets and liabilities are things like equities, FDI,, and much more if they're concentrated, maybe public sector debt liabilities.

[00:59:16.46] - Maurice Obstfeld

I think, well, you know, the definition of FDI and the measurement of the stocks is somewhat an inexact science, but in principle, you know, equity claims are self-liquidating. We should be worried about the debt claims. And, um, You know, for the US, those are still substantial, including substantial Treasury debt, which, you know, for me suggests one of the possible ways that imbalances could unwind in a disorderly fashion would be a set of events involving Treasury difficulties and refinancing, which possibly lead to Federal Reserve interventions from a, you know, perhaps less independent Fed that is inclined to see market functioning as an issue when it's really insolvency that's the issue. And, you know, that could, that could be one scenario. And I think, I think Tam is right that on the other side, the, the China imbalances, if not ameliorate it. And the Chinese leadership keeps saying they want a bigger service sector, they keep saying they want more consumption, they keep saying they want to end involution. It just doesn't seem to happen. But if those things don't happen, I do foresee an upsurge in anti-China protectionism around the world, and that could also be quite disorderly.

[01:00:50.50] - Joseph Gagnon

Just a factual If we take out all equities on both sides of the US position, which we think is minus 70% of GDP, I think we said the net— we found the net equity— I mean, the net debt, just pure debt assets and liabilities, is still a minus 50% for the US. So yes, it's a worrisome number, even if you only worry about debt.

[01:01:15.31] - Alan Taylor

Yeah, I agree with that point. I mean, the delta in the last few years has been a lot about equity valuations. Kristin Forbes made that point in the panel yesterday. I think of that as a Nokia problem, which back in the '90s, lots of foreigners owned Nokia, and so Finland's net international investment position went to sort of minus— not minus infinity, but it got very large and negative. It wasn't like anything harmful, so I think Patrick's quite right to point that out, and I think that has been a big delta in recent years. On the first question, I think trade diversion is kind of brewing. And so that tension just seems to be there, kind of quietly building up. But what it will lead to, I don't know. But I did want to ask a question about the financial assets and liabilities and how they balance out and try to set up an argument between Joe and Ellen. But unfortunately, Ellen's not here, so we have a one-sided argument. But Ellen's point was, well, you know, just because you've got all these liabilities building up, it would all cancel out if you could just acquire the assets.

[01:02:16.44]

But if you do, you know, rest of the world versus China or something, your argument is we've moved sort of structurally to a point where— or the future you lay out is no one wants to buy the Chinese assets. So that seems to be diametrically pushing back on Helene's argument. So maybe you want to speak to that.

[01:02:39.15] - Joseph Gagnon

Well, Helene said the thing which is true, which is that there's no— reason in principle why a reserve currency needs to run a current account deficit. And that's because they could invest in those countries. So you could issue your assets to those foreigners and in turn buy their assets. So no trade implications. And as you say, the problem just seems to be at least for a number of the surplus countries, most notably China, but also of some other oil exporters and such. You know, there really isn't a huge demand in the US to buy Saudi Arabian or UAE assets or Chinese assets or Singaporean assets. So in that world, I think the market equilibrium is going to lead you to a trade outcome, I think. And so even though she's right that it needn't be that way, I think it is being that way.

[01:03:42.40] - Maurice Obstfeld

I see Ted waiting to ask a question patiently.

[01:03:45.16] - Joseph Gagnon

Ted? Do you want another question, or do you want to end things?

[01:03:52.23] - Maurice Obstfeld

Whatever you want to say, Ted.

[01:03:54.21] - Joseph Gagnon

So an observation and a question. So as an old-timer, I am struck by the fact that 1971 was all about exchange rates and imbalances, right? And we now have a much broader sense of, at least economists have a broader sense of its underlying factors, other policies which you all have talked about in various ways. Not that exchange rates don't matter, but they tend to be reflective rather than driving. But the question I guess I have is this new concern about global imbalances So what's the concern? What are people worried about? Right? What do you expect to happen if nothing happens, so to speak, if policies don't change?

[01:04:48.40] - Maurice Obstfeld

Any panelists?

[01:04:53.08] - Isabelle Vansteenkiste

I think I more or less alluded to that already before, that, you know, The reason why at least we look at imbalances and in particular the financial integrated world is from a global perspective, they could unwind disorderly and it's not just going to affect those jurisdictions that have the large imbalances, it's going to spill over across the entire world. And so this is the main concern. Just tying into some other points that were raised before, I mean, one thing I think is also relevant because we're asking like the composition of assets, liabilities, does it matter? Debt matters more, but in particular short-term debt. And I think the maturity of the issuance, at least on the US side, has been shortening. And that at least is something that I would be concerned about. And then finally, we're talking about also the differences in financial spaces. I think nobody had picked up that question by Tembayomi, but for me, it's more a reflection overall of your attitude towards risk. And Europe is very risk-averse, which you see in higher savings. You know, very careful in what you invest into. And maybe we invest indirectly via banks and VIFs.

[01:05:57.56]

We don't realize that we're doing risky investments. Whereas in the US, I think the attitude towards risk is far less. And so you see also much more market-based financing. I would see it like, you know, there's an underlying factor there.

[01:06:08.10] - Maurice Obstfeld

Okay, uh, we're now in deficit, and the last session also ended in deficit. And so that's a persistent deficit. And so I'm going to declare this session session over and please give the panelists a big hand.