

Comments on the IMF's 2013 External Sector Report

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New Approach to Policy Surveillance

- First unveiled in 2012
- A coherent framework for analyzing major countries together
 - Considers interactions through trade and finance
 - Estimates effects of policies and other factors
 - Establishes policy norms
 - Identifies areas for policy improvement
- Central to IMF purpose

CA Norms Are Biased toward Outcomes

- Large unexplained imbalances
- Too much judgment makes norm-setting a black box
- Effects of official flows (reserve accumulation) are underestimated
 - Reserve norms too high
- Fiscal recommendations are broadly OK
 - Asymmetry between CA deficit and surplus countries

Conclusions I Support

- China needs flexible exchange rate
- Germany needs more inflation
- Nonrenewable resource exporters should have moderate surpluses
- Euro area and Japan should have small surpluses
- Most EMs and developing economies should have small deficits

Policies in Surplus Countries

- Large and robust effect of public health expenditures on imbalances
 - Holds even after controlling for fiscal deficit
 - A mechanism for China rebalancing
 - May extend to education (but data missing)
- Any non-fiscal ways to expand domestic demand in surplus countries?

Conclusions I Reject

- Many Asian EMs should have small to moderate surpluses
- Brazil should have a small surplus
- Switzerland and Singapore should have very large surpluses
- Canada, the United Kingdom, and the United States should have small deficits

Reserves Norms Are Too High

- Analysis assumes aggregate reserves are optimal and focuses only on country differences
- Analysis ignores rise of local currency debt
- Net official flows have exceeded \$1 trillion/year for a decade
 - Same order of magnitude as current account imbalances

Official Flows and Current Accounts

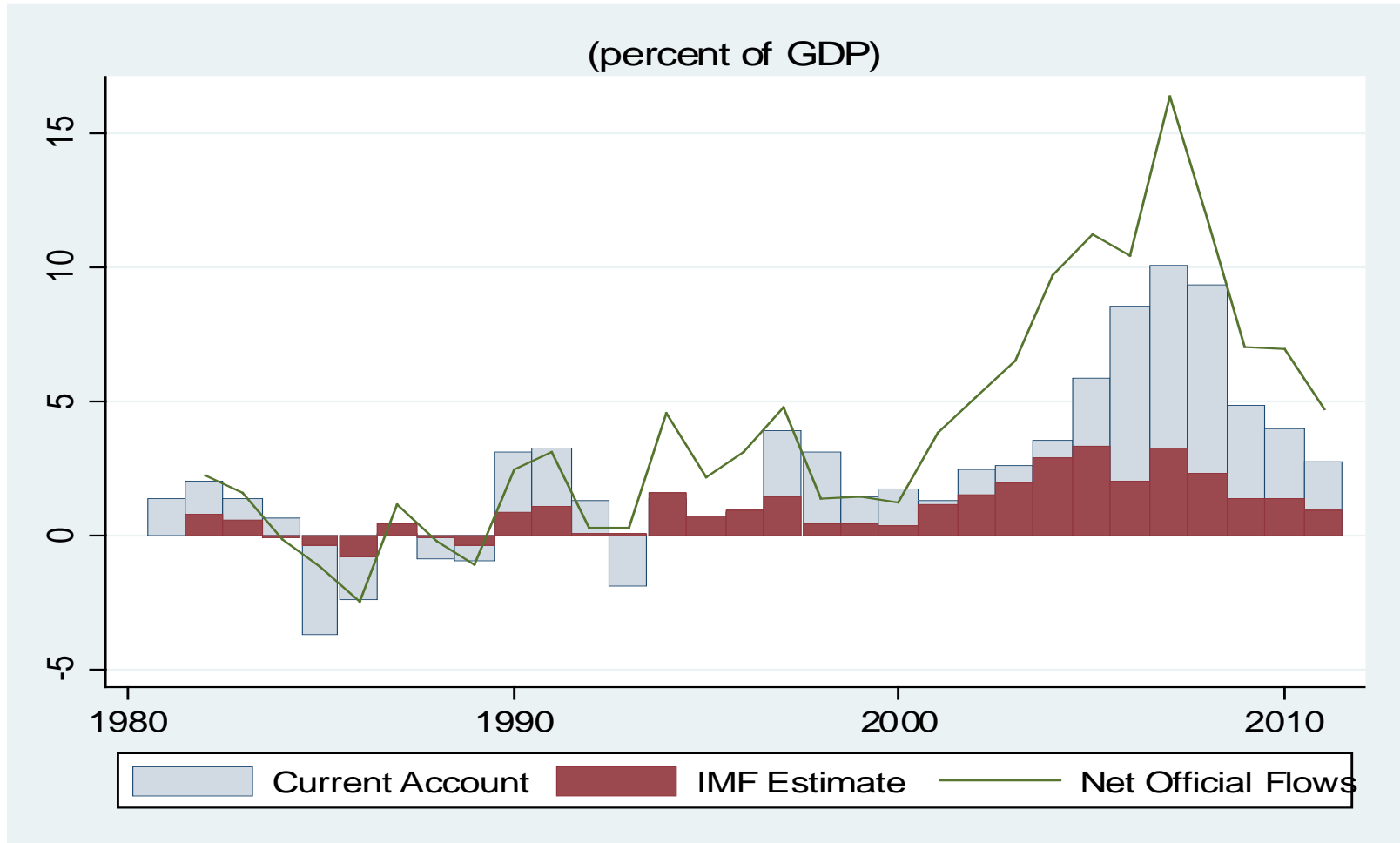
- Current account is financed by official flows and private flows
- $CA = NOF + NPF$
- All three interact, including through exchange rates and interest rates
- An increase in NOF must cause an equal increase in CA and/or decrease in NPF
- Efficiency of financial markets is key

Estimated Effect of NOF on CA

IMF EBA (2013) $\frac{\Delta CA}{\Delta NOF} = 0.0 - 0.4$
 (increases with capital controls)

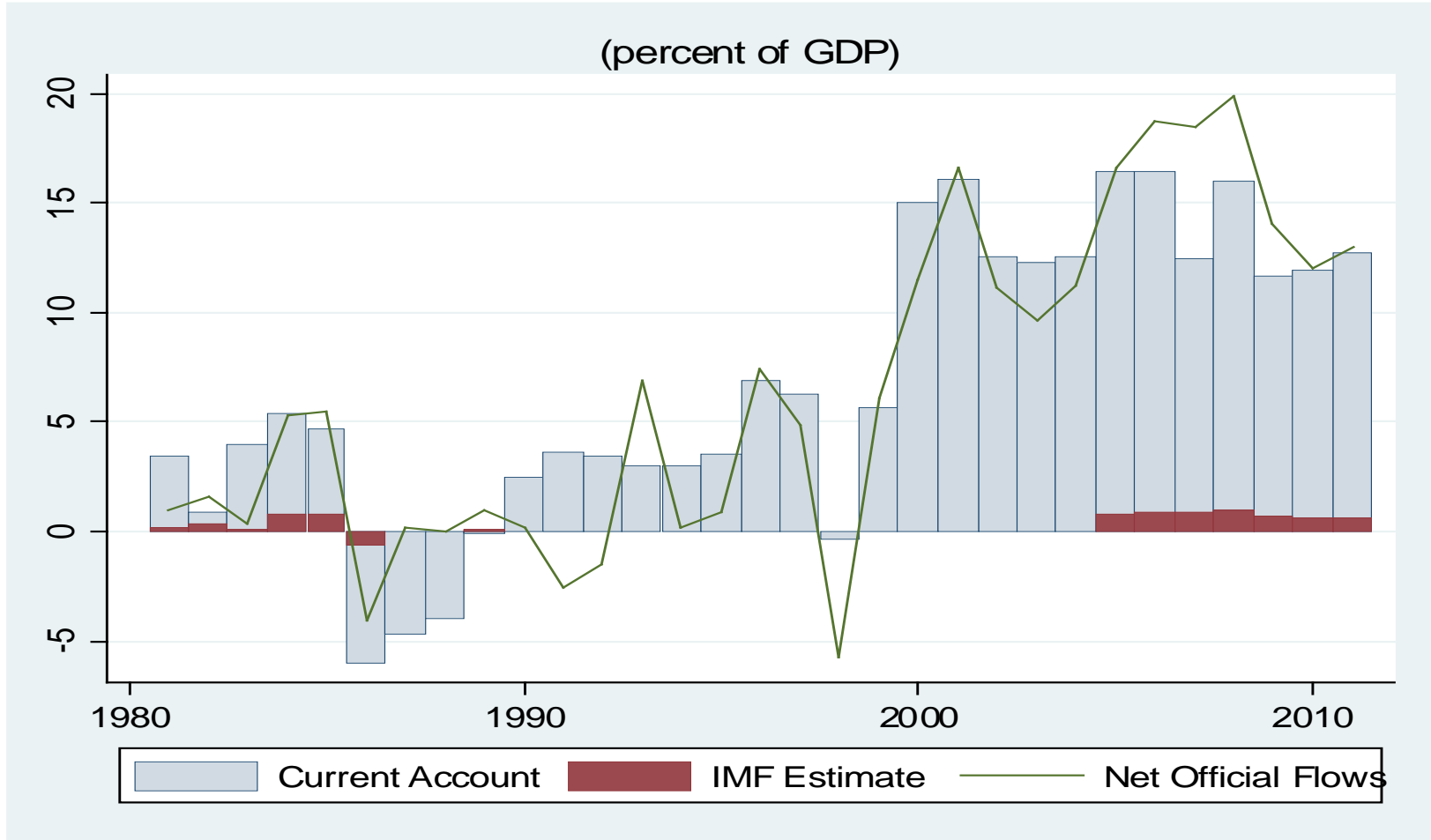
Gagnon (2013) $\frac{\Delta CA}{\Delta NOF} = 0.6 - 1.0$

The Effect of Official Flows on China's Current Account



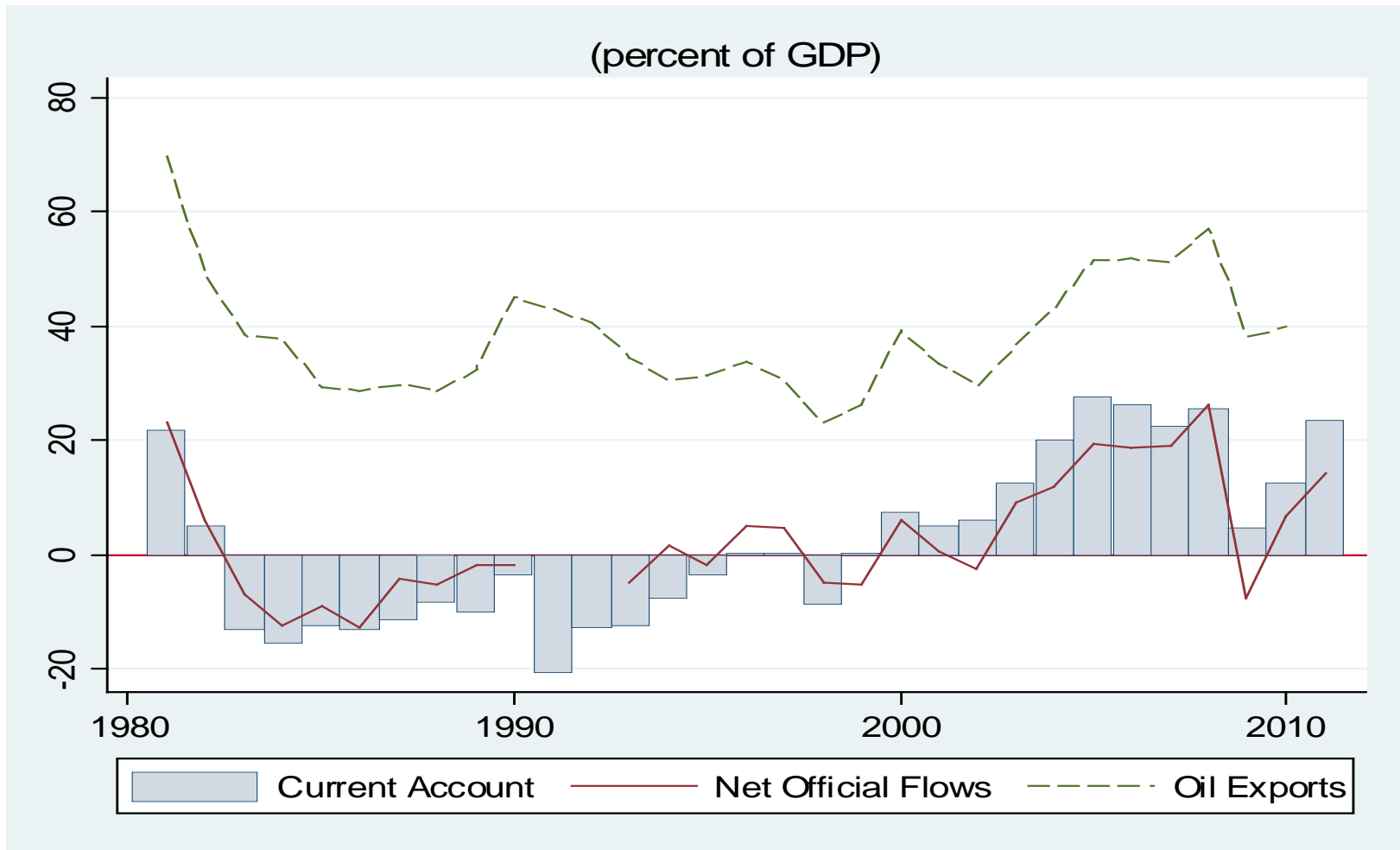
Sources: IMF Balance of Payments database, IMF EBA Technical Background, and author's calculations

The Effect of Official Flows on Norway's Current Account



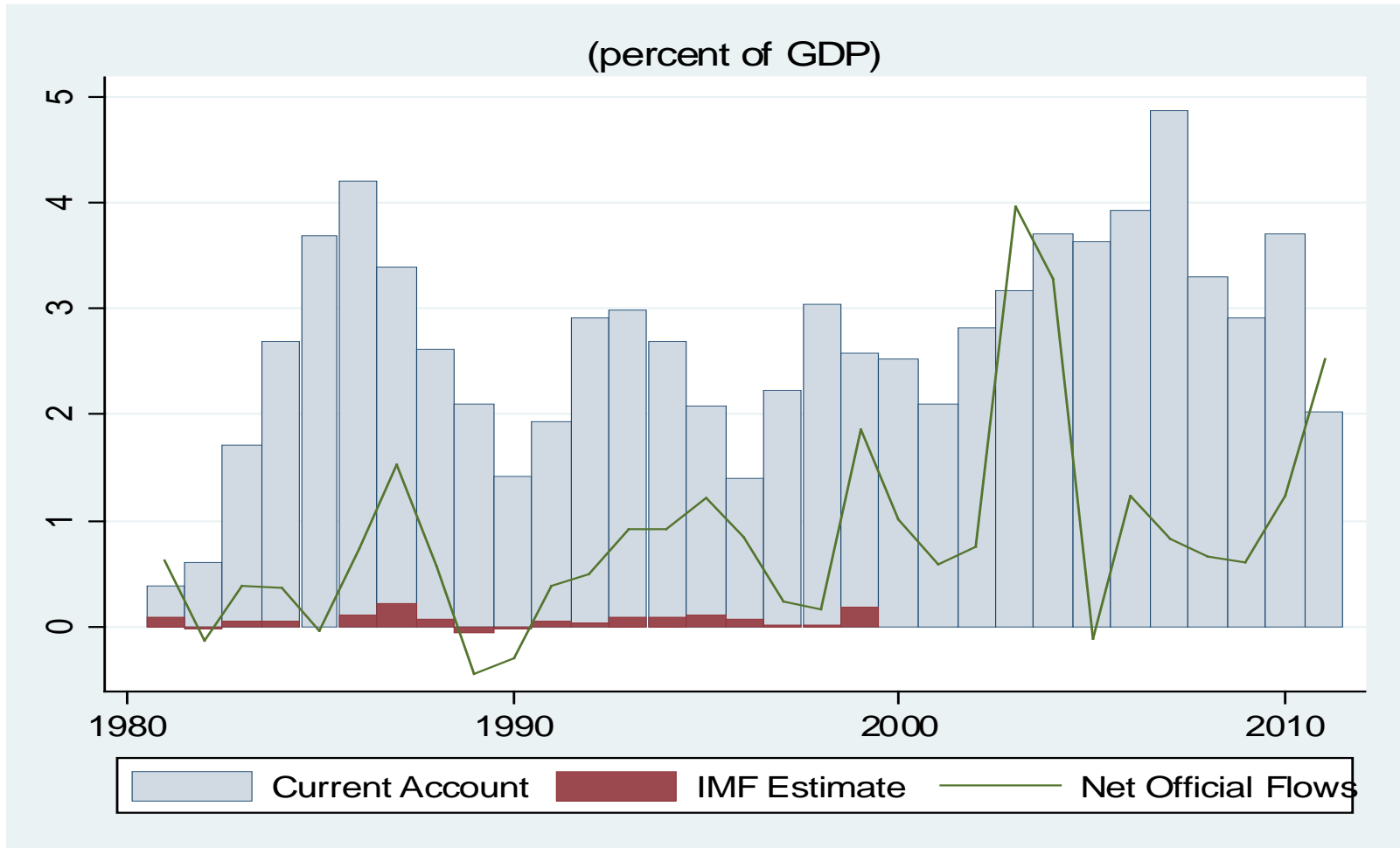
Sources: IMF Balance of Payments database, IMF EBA Technical Background, and author's calculations

Oil Exports, Official Flows, and Surpluses: Saudi Arabia



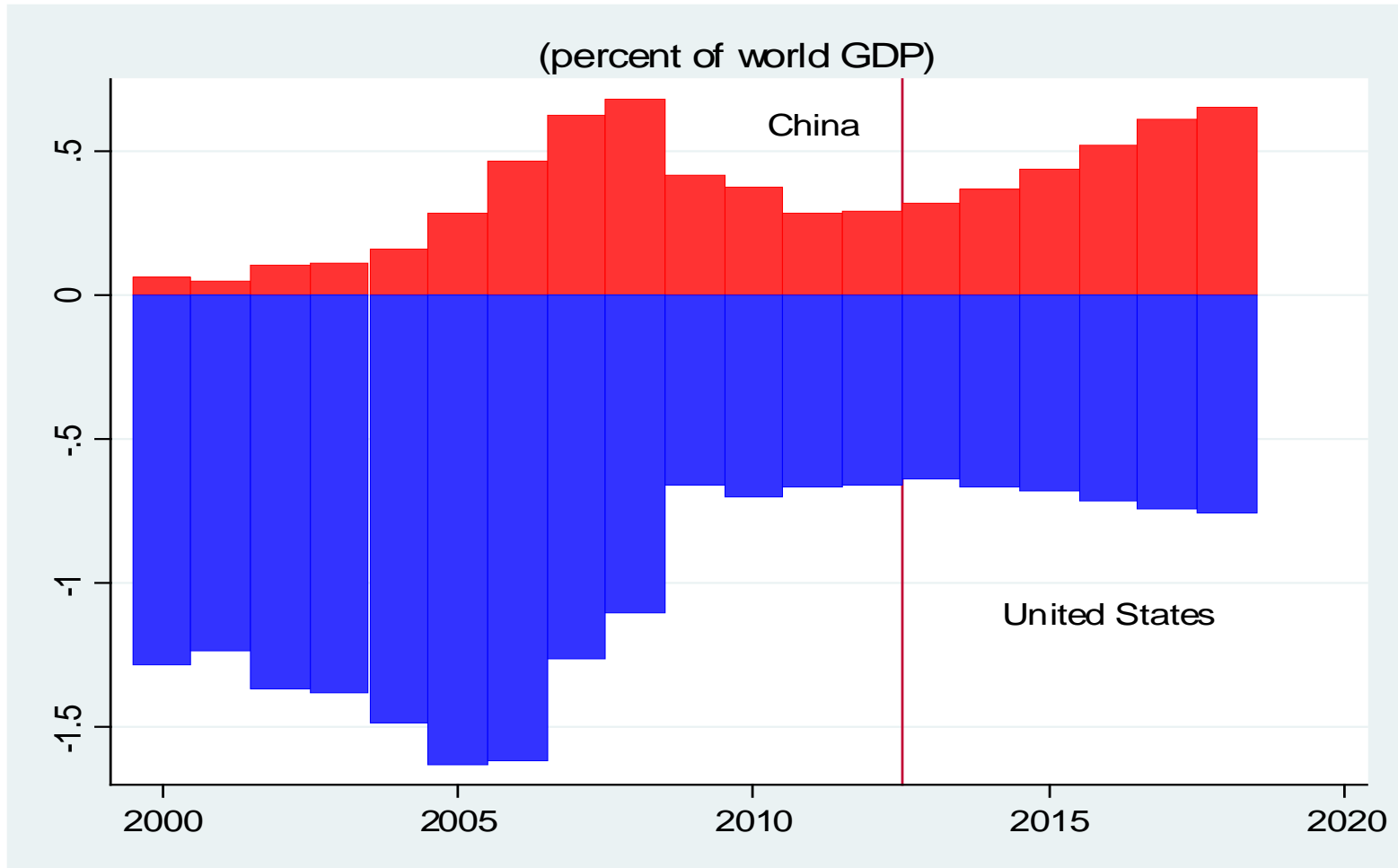
Sources: IMF Balance of Payments database, World Bank WDI database, and author's calculations

Why the Effect Is Hard to Measure: The Case of Japan



Sources: IMF Balance of Payments database, IMF EBA Technical Background, and author's calculations

Current Account Imbalances Set to Widen



Source: IMF World Economic Outlook database