



OENB Conference on European Economic Integration

## **Global Imbalances, Capital Flows and Monetary Policy**

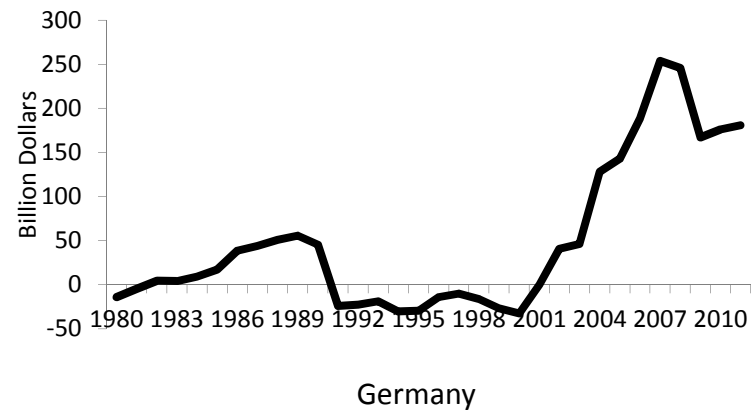
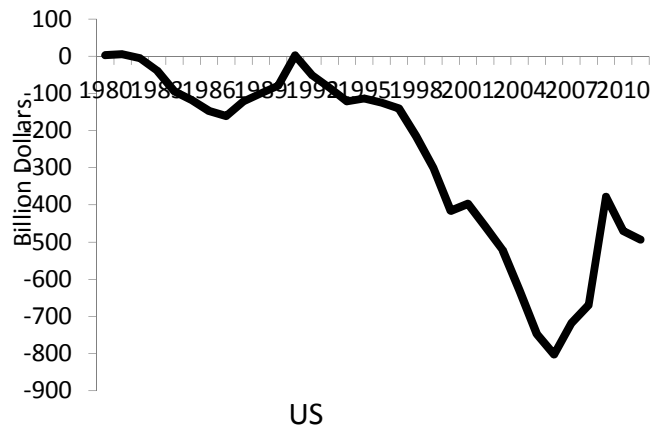
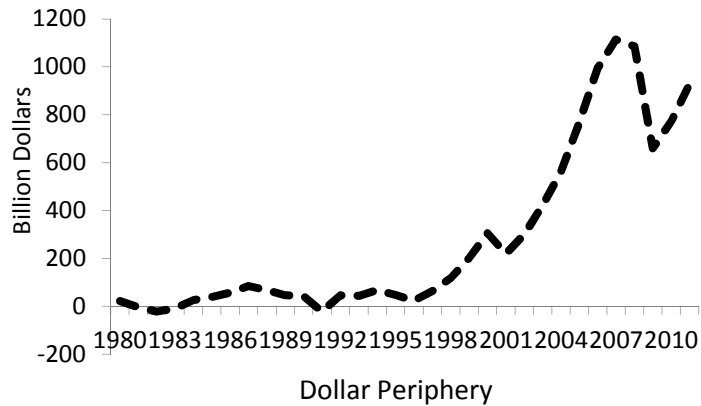
Comment on Chinn, Korhonen and Milesi-Feretti

Gunther Schnabl, University of Leipzig

Vienna, November 21, 2011



# An Asymmetry Matrix in Global Current Accounts





# Global Imbalances, Capital Flows and Monetary Policy

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## **Menzie Chinn**

- China / East Asia
- impact of appreciation on exports
- appreciation and structural change to cure imbalances (China)
- “to be cautious is to be incautious”

## **Iikka Korhonen**

- oil-exporting countries
- strong correlation between oil prices and current account surpluses
- no role attributed to the exchange rate regime

## **Gian Maria Milesi-Feretti**

- global approach, focus on recent contraction
- expansion and contraction linked to global liquidity conditions and risk aversion among lenders and borrowers
- adjustment in deficit countries mainly via compression of demand rather than exchange rate adjustment



# Elasticity and Absorption Approach

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## Elasticity Approach

- The elasticity approach assumes a systematic impact of exchange rate changes on exports (Chinn) and imports, and thereby the current account.
- Exchange rate changes have a systematic effect on exports, but not necessarily on current accounts (Korhonen for oil exporters, McKinnon and Schnabl 2009 for China/Japan).
- In face of appreciations exports and imports decline. The impact on current accounts is indeterminate (McKinnon/Schnabl 20xx).
- See Plaza Agreement and asymmetry matrix of global imbalances.

## Absorption Approach

- Current account balances hinge on saving-investment relationships. Internal adjustment is linked to external adjustment (Milesi-Feretti).
- Relative macroeconomic policy stances matter (Freitag/Schnabl 2011).



# Relative Macroeconomic Policy Stances and the Rise of Global Imbalances

	\$	€
<b>Centers (US, Germany)</b>	Expansionary monetary and fiscal policies	Restrictive wage and fiscal policies
<b>Peripheries (Europe (ex. G.), EA, Oil Exp.)</b>	Restrictive monetary (and fiscal) policies	Expansionary wage and fiscal policies



# Sterilization Policies in the Face of Capital Inflows

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## **Non-Sterilization and Current Account Balances (€)**

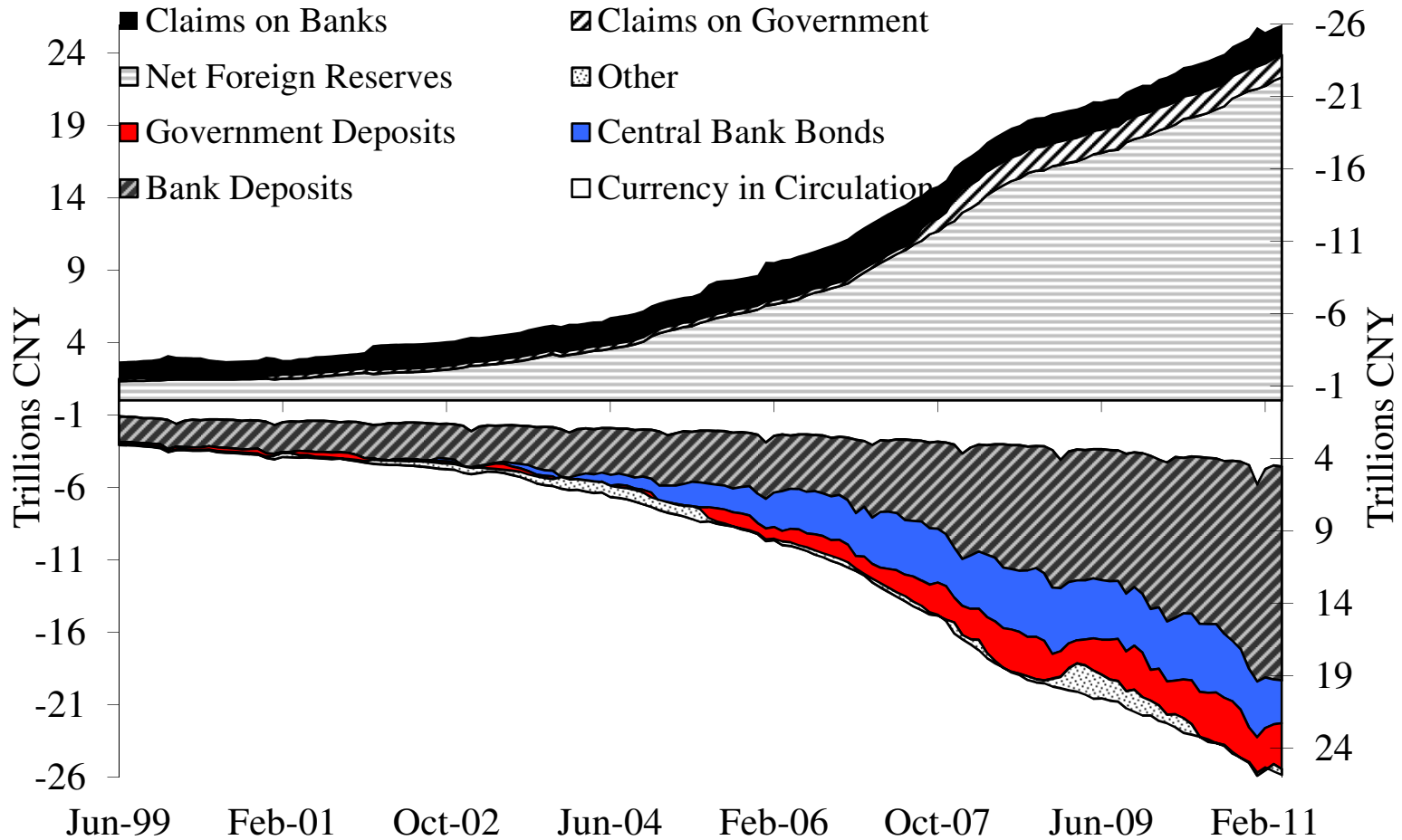
- Capital inflows led to buoyant credit growth, wage hikes and inflationary pressure.
- Real exchange rate appreciation turned current accounts negative.

## **Non-Market-Based Sterilization and Current Account Balances (\$)**

- Capital inflows and excess liquidity created by foreign reserve accumulation, cause inflationary pressure and overheating.
- Market-based sterilization would lead to “back firing effects” and high sterilization costs.
- Periphery countries counteract inflationary pressures by non-market based monetary (reserve requirements) and fiscal sterilization (government deposits at central bank, Sovereign Wealth Funds).
- Investment is slowed down by direct credit constraints, whereas saving increases. Current account surpluses emerge/increase.

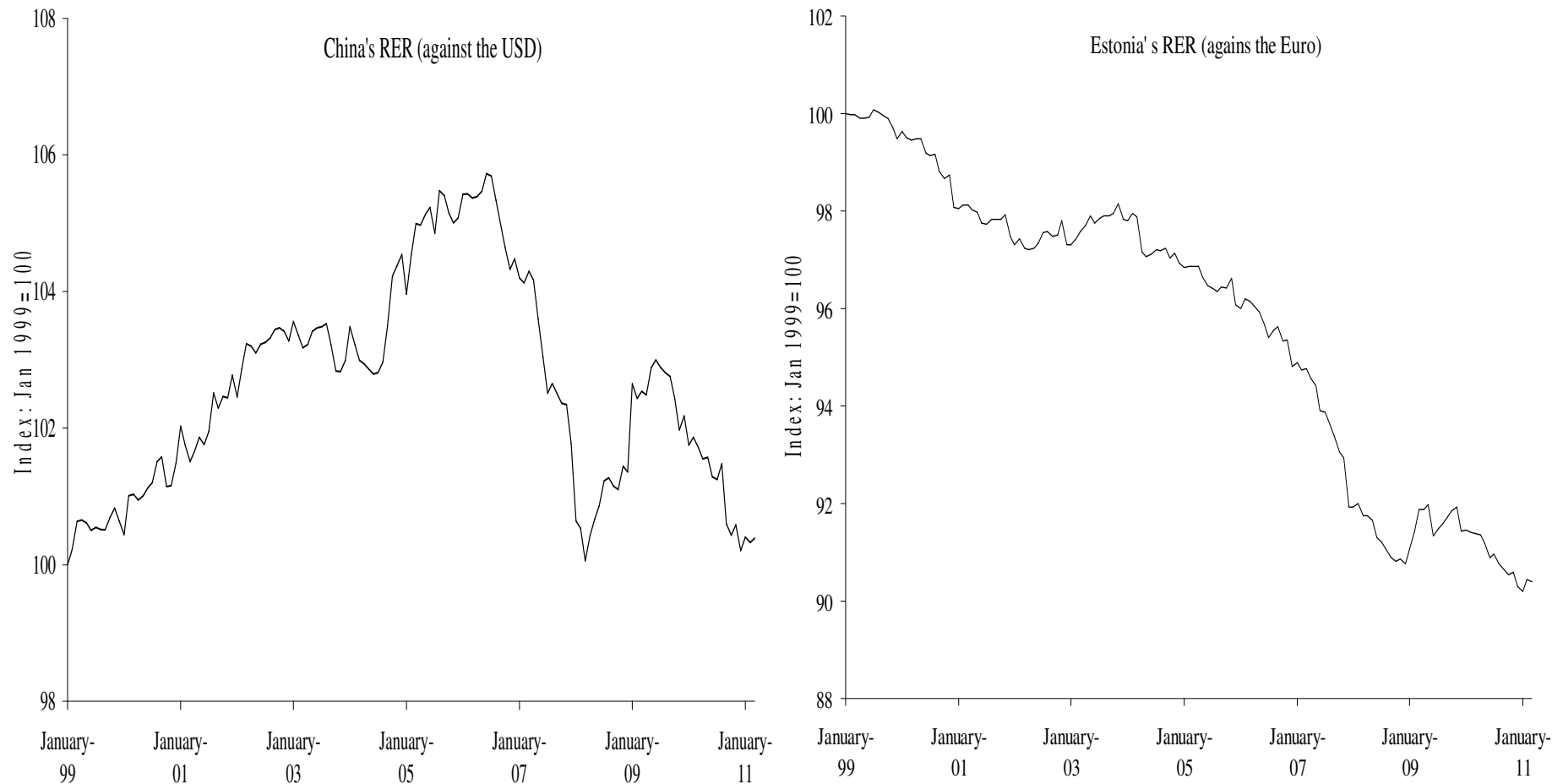


# Peoples Bank of China Balance Sheet





# Real Exchange Rate of Chinese Yuan and Estonian Kroon







## Conclusion and Policy Implications

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- The global imbalances hinge on country specific structural characteristics as well as on country specific characteristics in macroeconomic policy making (Chinn, Korhonen and Milesi-Feretti).
- Since the turn of the millennium the rising imbalances in the informal dollar bloc have been triggered by US low interest rate policies and exchange rate stabilization cum sterilization policies in the dollar periphery countries.
- In Europe, German wage and fiscal austerity was followed by wage and fiscal expansion in the later European crisis countries (Milesi-Feretti).
- As a prerequisite to cure global imbalances the US / world interest rate level has to increase.



## References

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**Thank you very much for your attention!**