GLOBAL IMBALANCES, CAPITAL FLOWS, AND THE CRISIS

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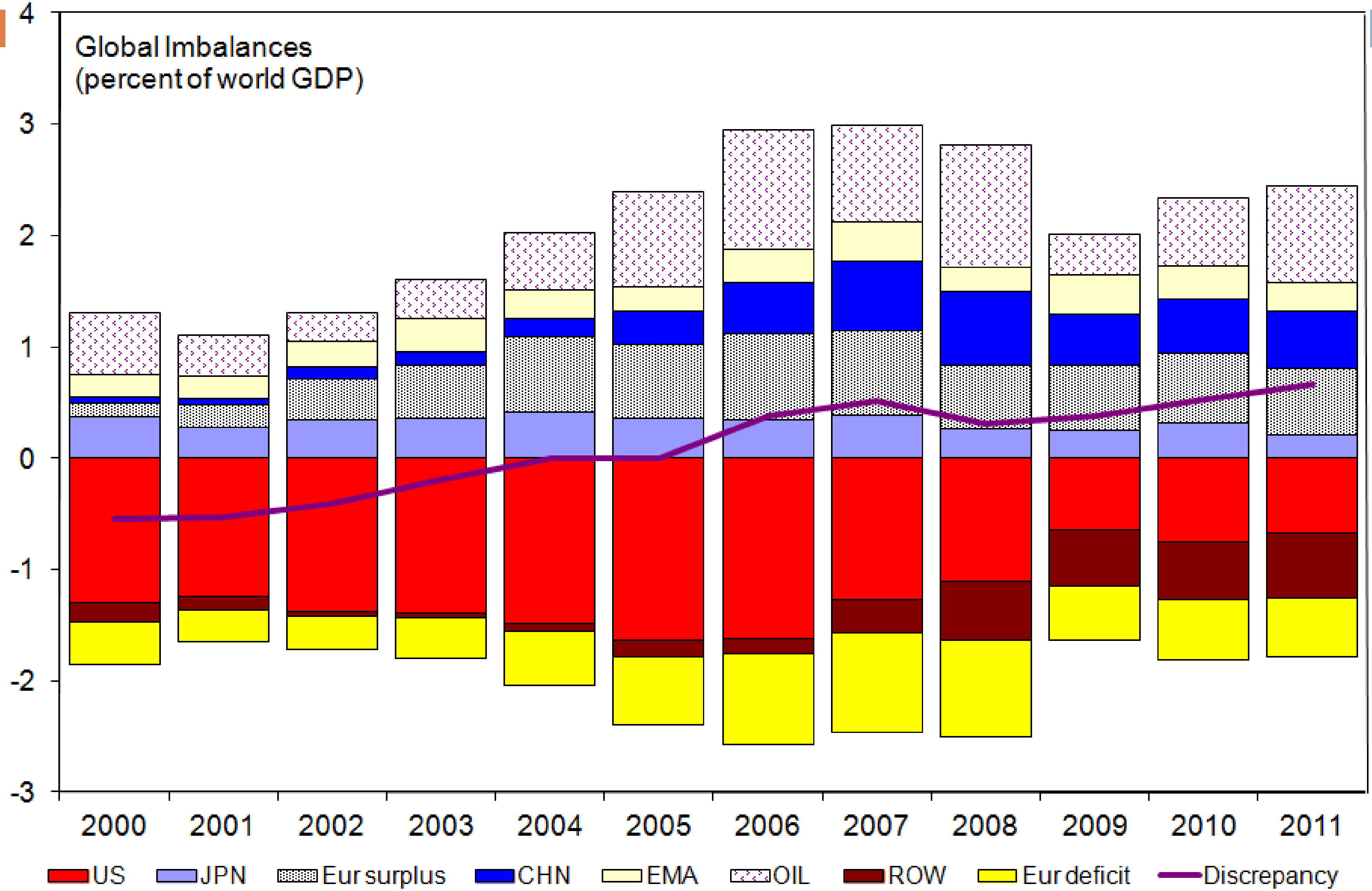
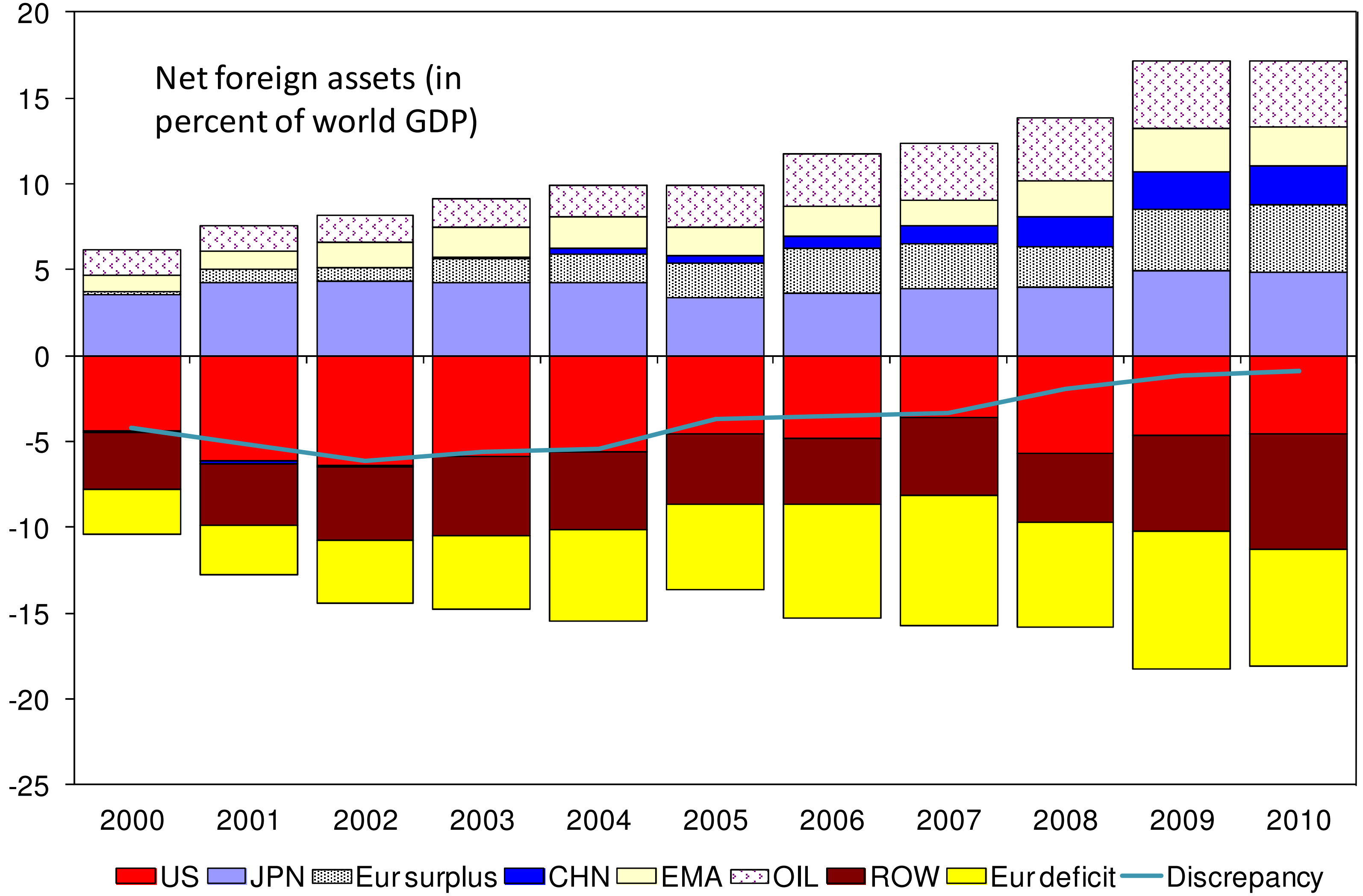
International Monetary Fund

Global imbalances have declined..



Even though stock positions are still expanding



Imbalances in the euro area

Joint work with Ruo Chen and Thierry Tressel

A lot of emphasis on intra-euro area factors in explaining internal imbalances

- Loss in competitiveness

Paper stresses "external" factors and shocks and pattern of external financing

Imbalances in the euro area: REER and Asymmetric Trade Shocks

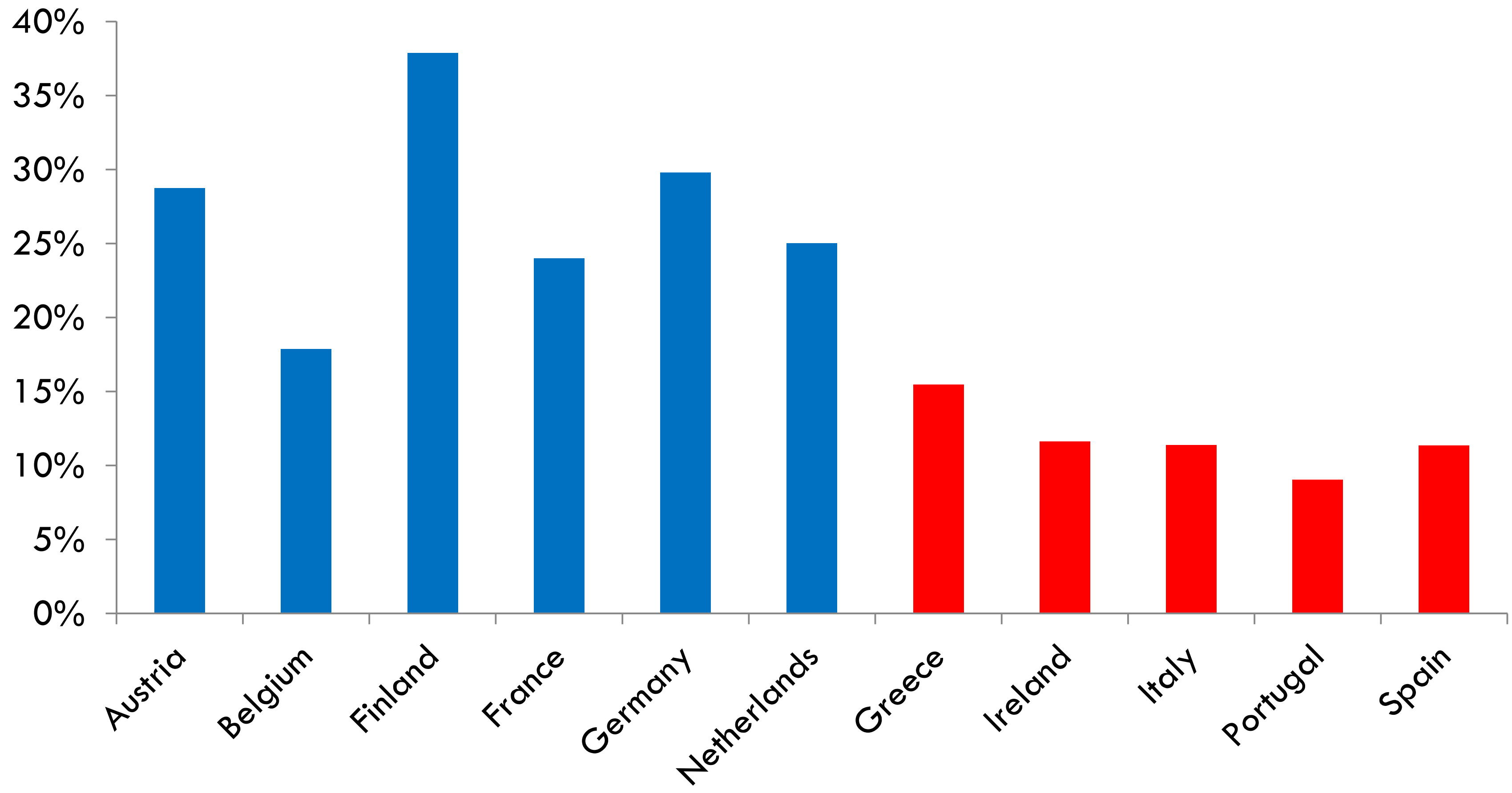
- Euro appreciation, 2000-onwards
- Trade with non-euro countries explains a large share of worsened CA in "Southern Europe"
  - Imports from China
  - Increase in commodity prices
- In contrast, Germany's TB gained from rising exports to China, CEE and oil exporters
  - Exports of investment goods to China
  - Commodity exporters have high demand for German K-goods

Imbalances in the euro area: Financing of deficits

- “Southern” deficits financed mainly by euro area investors.
  - Outside investors purchased German and French securities

- External exposure and public debt
  - Private sector sold government bonds to non-residents and banks raised funds overseas. Proceeds used to finance C & I → worsened private balance sheets, increased foreign exposure to public debt and domestic banks

Share of outstanding debt securities held outside the euro area (2008)



Is Rebalancing Underway?

Work with Philip Lane on factors explaining contraction in CA balances

Hypothesis: unwinding of pre-crisis "excesses"

- Easy credit
- Asset price bubbles
- Rosy growth expectations

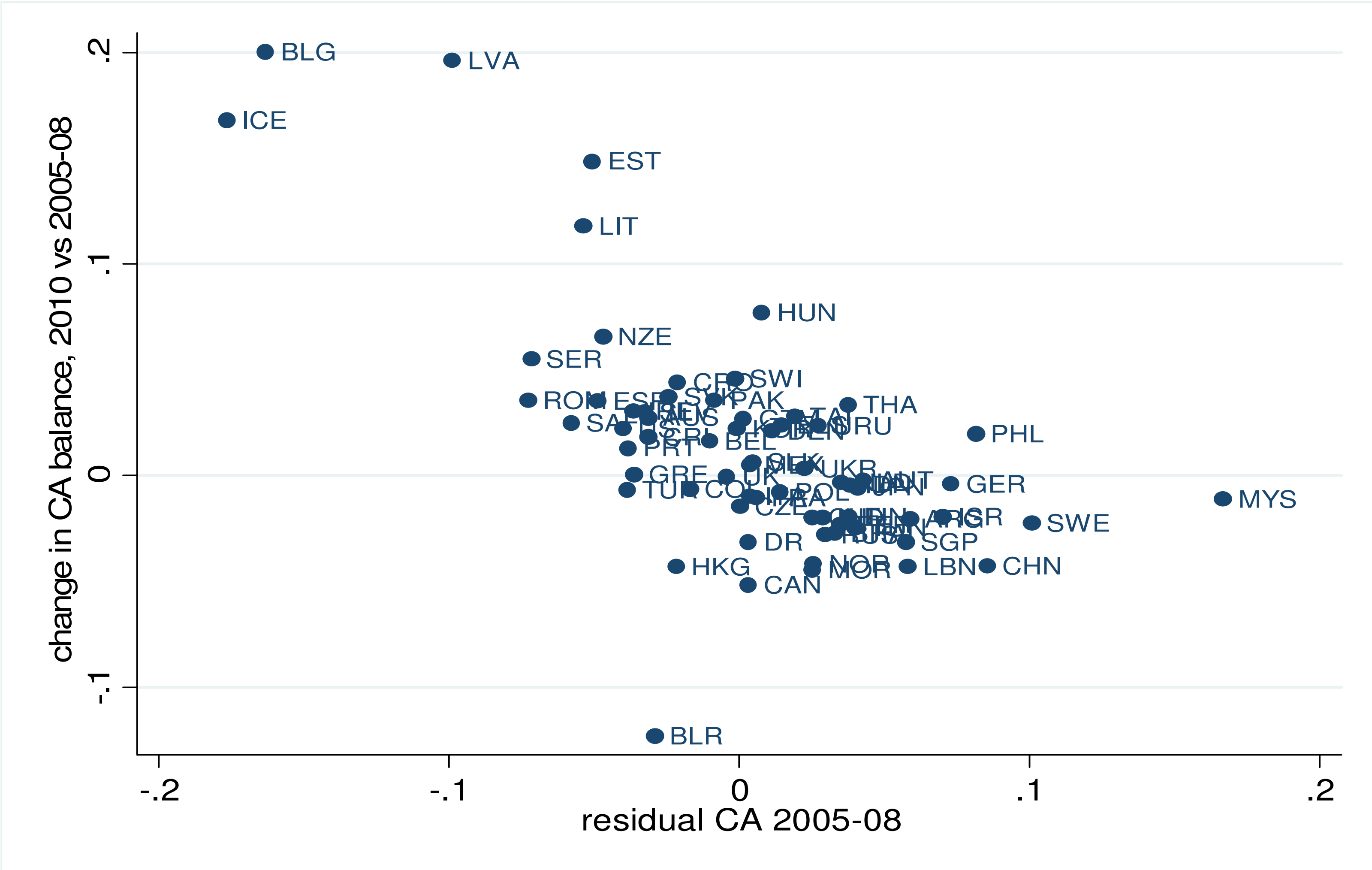
Estimation of "excess" CA

Panel regressions, advanced economies and emerging markets, 1969-2008, 4-year averages

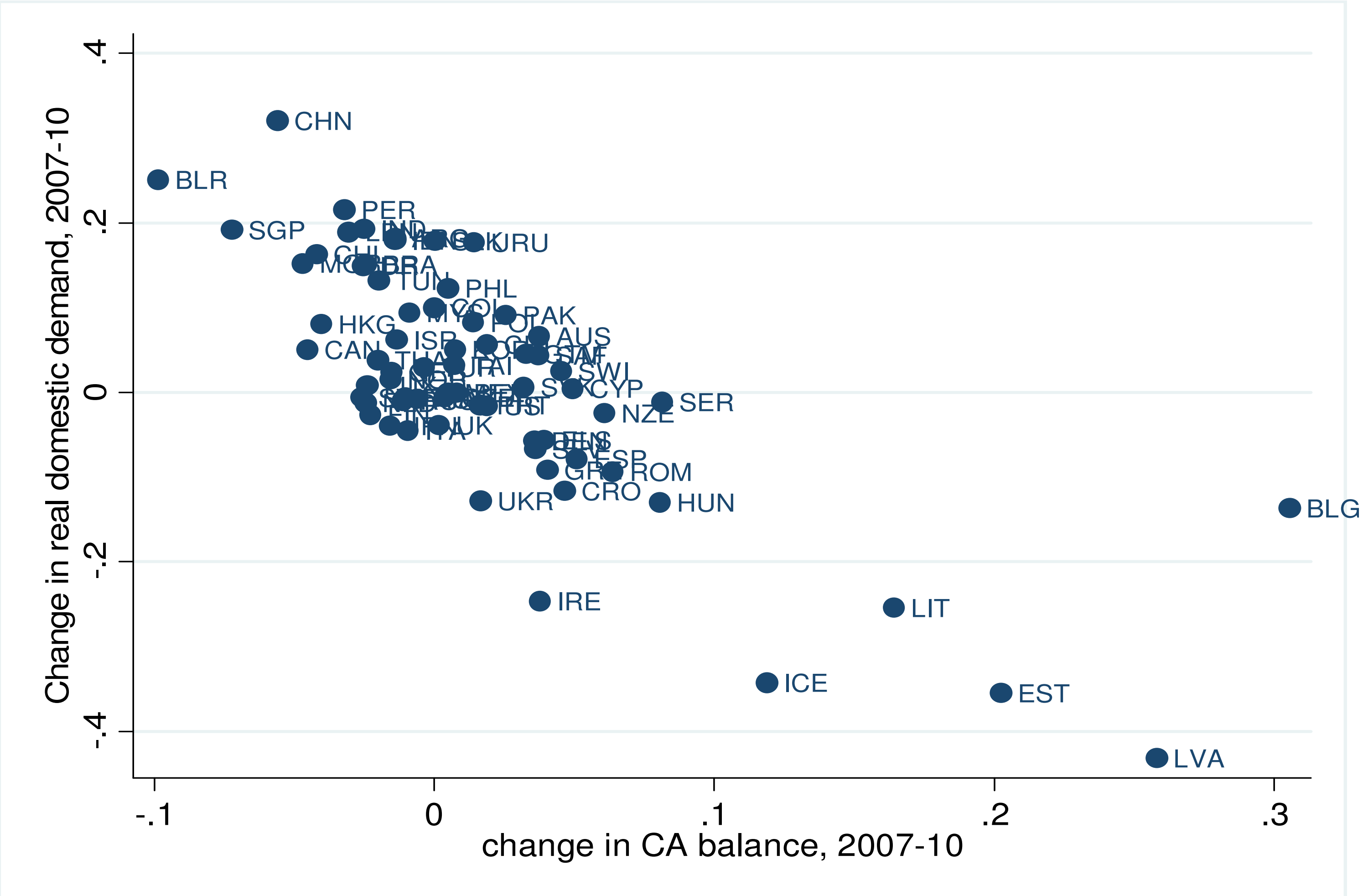
Determinants include:

- Demographics
- Level of development
- Fiscal balance
- Oil prices
- etc.

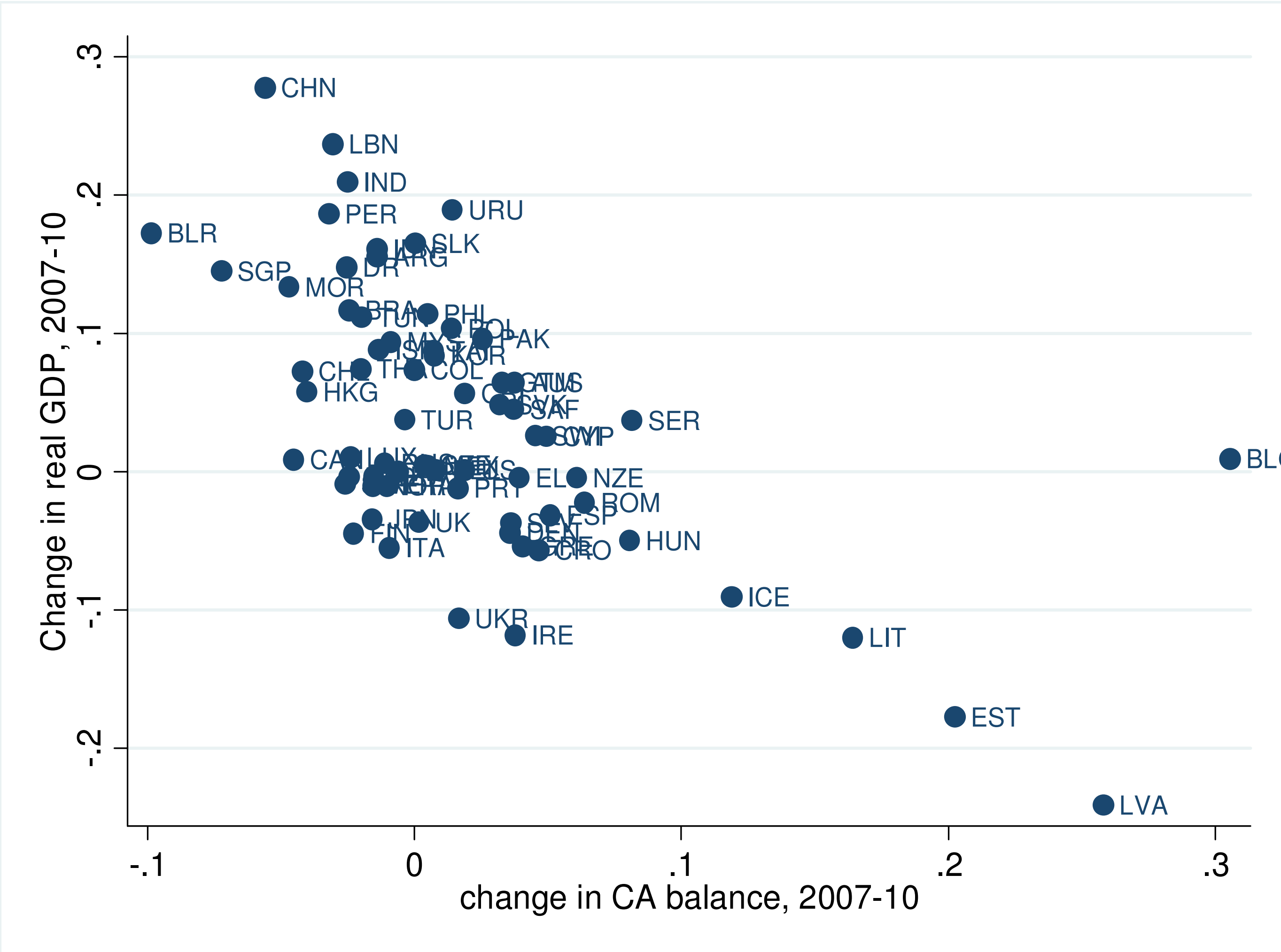
Very strong correlation between "pre-crisis "gap" and subsequent CA adjustment



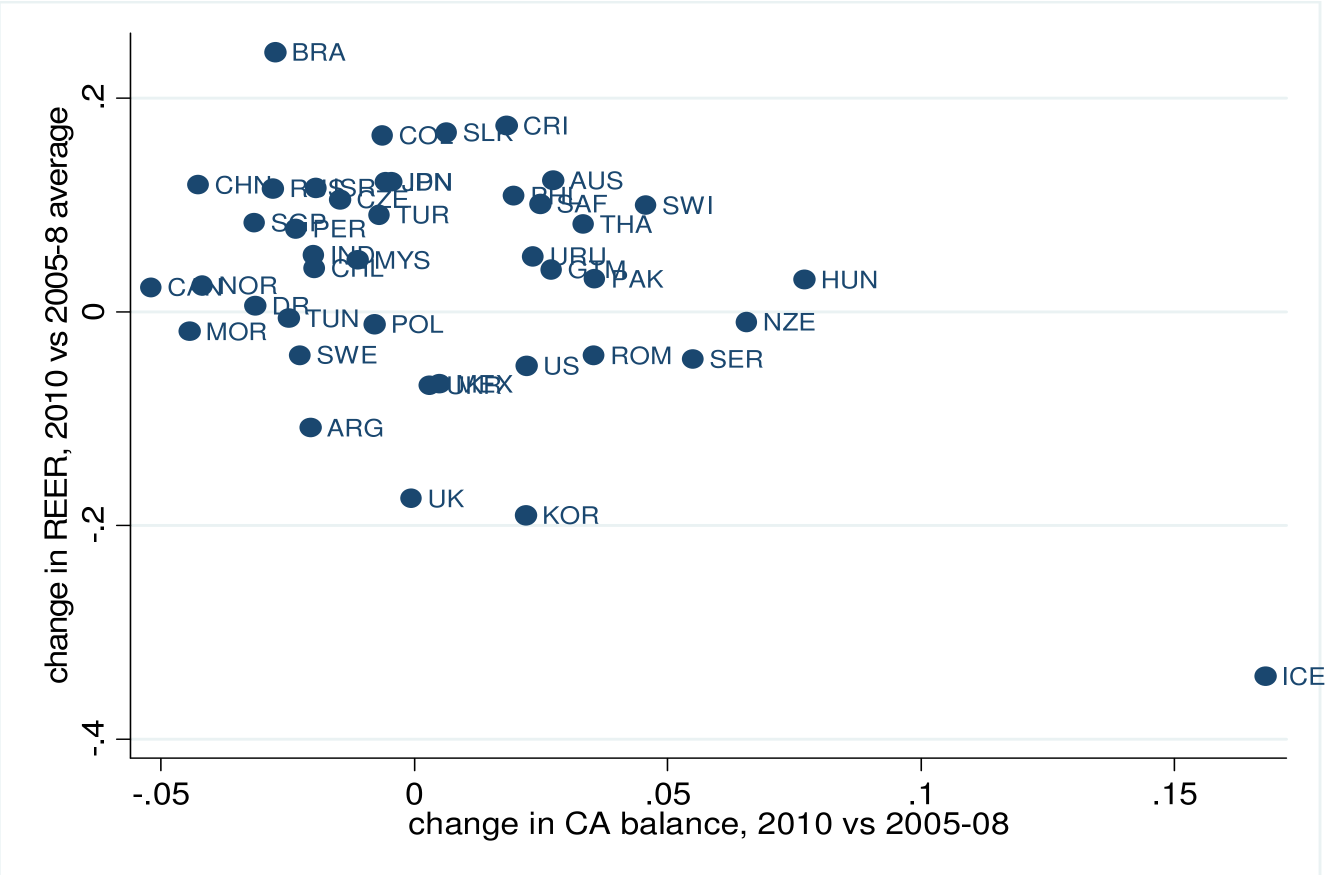
How did adjustment take place? Changes in domestic demand…



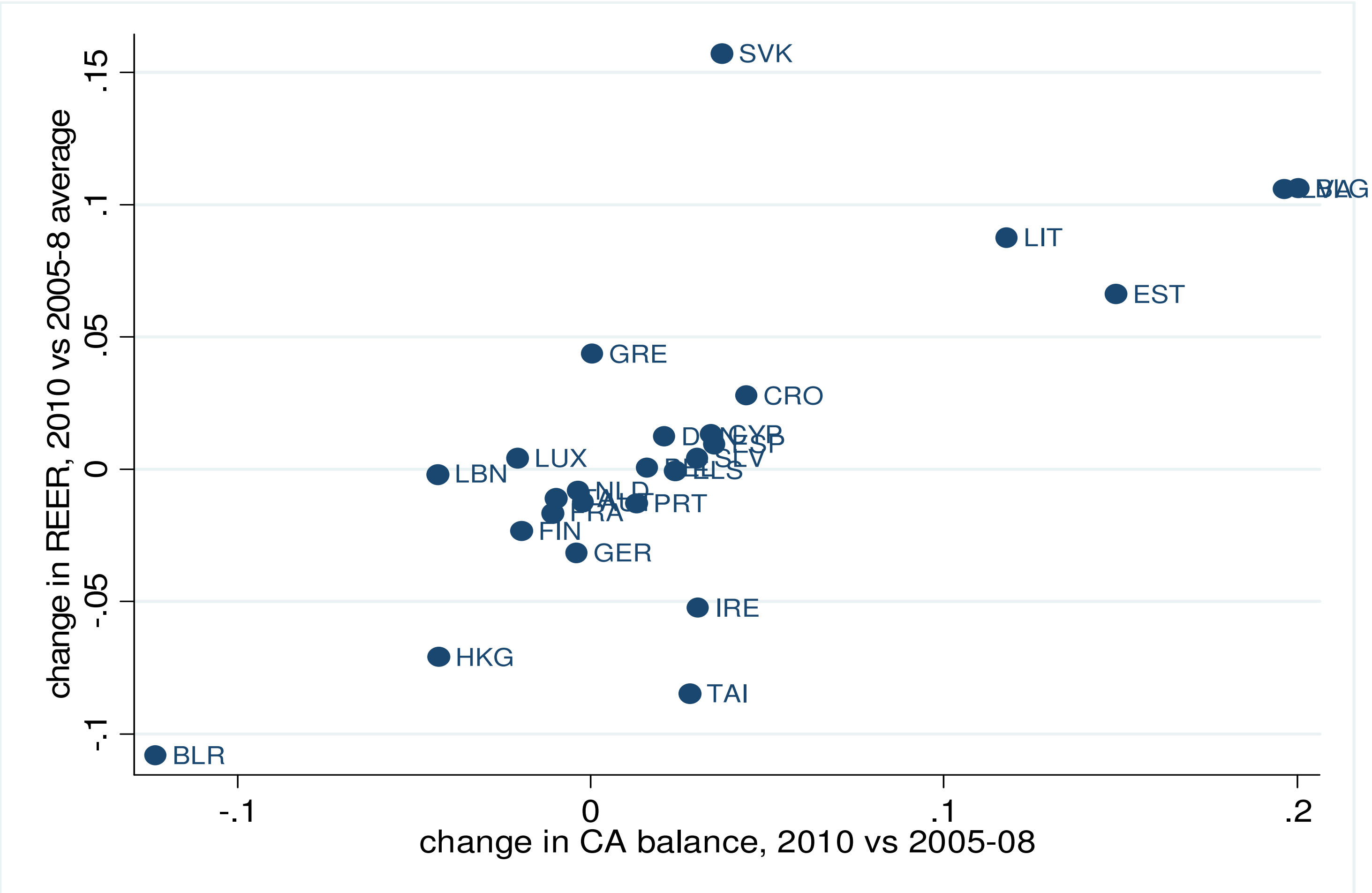
…and changes in output



Some exchange rate adjustment in non-pegs



...but not in pegs



Summary

- Very strong CA adjustment after 2007-08
- Reduction of pre-crisis “excesses”
- CA reduction reflecting primarily compression of demand and output in countries with excess deficits, and swings in “other investment flows”
- Modest role of REER adjustment
- Role of external finance
- Looking forward: durable rebalancing or cyclical compression? What are the “output gaps” in deficit countries?

Capital flows have recovered only for emerging markets