Outline

- U.S., China and the onset of global imbalances
- Effects on China and implications for global re-balancing
The ‘savings glut’ debate

- Not just global imbalances but also globalisation
- Acceleration in 1990s; Freeman dates to 2000s
- Focus on U.S. & China, but part of larger picture of emerging markets, financial deregulation and independent central banks
Changed global macroeconomic structure & the 2008 financial crisis

- Globalisation: inflation and the ‘Great Moderation’
- Global imbalances: savings glut vs. consumption via borrowing; trade surplus vs. trade deficit
- Foreign exchange reserve accumulation and the appetite for U.S. debt
- Exchange rate policy and global re-balancing
China rising

Real GDP growth, 1980-present

Source: IMF
The China Effect

- International trade
- Global capital flows
- Global supply and demand for commodities & raw materials
- Incremental global growth
China’s exports, 1992-2006

Source: UNCTAD.
China’s imports, 1992-2006

Source: UNCTAD.
U.S. import partners

China’s export partners

Gravity estimates

- **USA imports 2000s**
  - Canada 6.226***
  - Mexico 5.247***
  - **China 5.408***
  - EU 1.630***
  - Middle East 1.511**
  - Asia ex. China -1.161**

- **China exports 2000s**
  - **USA 6.003***
  - Canada 3.376***
  - East Asia 4.521***
  - SE Asia 3.271***
  - Mexico 2.737**
  - EU 2.232***
  - Australia 3.386***
Gravity estimates

- USA imports 1990s
  - Mexico 14.31***
  - Canada 12.96***
  - China 4.237**
  - EU 1.630***

- China exports 1990s
  - USA 9.367***
  - East Asia 7.280***
  - Australia 6.749***
  - Canada 6.679***
  - SE Asia 6.430***
  - Mexico 5.057**
  - Middle East 4.077***
  - S. America 4.025**
  - Africa 3.119**
Gravity estimates

- USA imports 1980s
  - Mexico 13.62***
  - Canada 7.128**
  - Middle East 5.634***
  - Asia ex. China 2.255***
  - EU -1.771***

- China exports 1980s
  - Australia 14.72***
  - Canada 13.47***
  - Middle East 12.56***
  - S. America 11.04***
  - Mexico 10.63***
  - Africa 10.38***
  - USA 8.457***
  - EU 7.965***
The twin engines of growth

PPP adjusted share of global GDP

Source: IMF
But, low levels of consumption

GDP Per Capita (PPP), 2008

Source: IMF
Globalisation

- Of the global labour force of 3 billion, roughly ½ were added at the start of the 1990s through the global integration of China (opening in 1992), India (opening after the 1991 crisis), and Eastern Europe (fall of Communism).

- Freeman calls this the ‘great doubling,’ which has halved the capital/labour ratio, resulting in lower cost of production, goods/services, and encouraged offshoring to utilise the labour from emerging markets.
Foreign investment to developing countries
Low inflation during the ‘Great Moderation’

Source: IMF.
U.S. base interest rates

Source: U.S. Federal Reserve Board.
10 Year U.S. Treasuries

Source: U.S. Federal Reserve.
Gross domestic saving, % of GDP

Source: World Development Indicators, World Bank.
Current account balances, % of world GDP

Source: World Development Indicators, World Bank.
Change in reserves, % of GDP

Source: World Development Indicators, World Bank.
Exchange rates of surplus countries

Source: IMF. Exchange rates against SDRs.
Adding up to a crisis

- Rise in global labour supply; fall in prices of traded goods & services
- Fall in global capital to labour ratio; increasing returns to capital
- Global imbalances: excess liquidity, cheap credit & leverage
- Capital controls & trapped savings limited capital account outflows in EMs
Adding up to a crisis

- Inflation targeting regimes in developed economies: not focused on asset bubbles.
- Fixed exchange rate regimes prevented automatic re-balancing as purchasing of U.S. Treasuries continued regardless of the yields.
Macroeconomic context of 2000s

- Last US slowdown ‘avoided’ recession after 2001 in part because of loose monetary policy, i.e., cutting interest rates.
- China joined WTO in December 2001; multi-fibre agreement phased out in January 2005.
- Demand factors: rising commodity prices in 2000s, leading to acceleration of Middle East reserves.
The 2008 global financial crisis

- 1980s financial deregulation; 1990s globalization; 2000s global imbalances

- Dot.com bubble → sub-prime mortgages → credit crunch

- Housing has much wider coverage than tech stocks & securitization spread the debt instruments throughout global markets
Consequences of the financial crisis for China & implications for global re-balancing
Avenues of effect of global financial crisis

- Financial effects: contagion
- Real economy effects: de-coupling
- Credit crunch in the West vs. excess liquidity in China due to trapped savings and few diversified sources of investment, particularly inter-temporal allocation of assets
Some state-owned commercial banks have write-downs, but of limited magnitude.

No comparable trade in securitised assets, so limited exposure to the financial crisis.

Despite limited global integration, China’s stock markets have fallen dramatically since October 2007 but recently risen over 80% since January... followed by a 20% drop in August.

Reflects concerns/optimism about the real economy.
Real economy effects: de-coupling

- Exports have collapsed, resulting in 20 million unemployed migrant workers.
- Unemployment as a result is rising, though not captured by official figures which is expected to rise to 4.5%.
- Annual growth was 9% in 2008 and 7.1% in first half of 2009, with fears of continued fall in exports dragging down growth but will it be offset by increased government spending?
Falling consumption/rising savings

Composition of GDP in China: 1978-2006

Source: China NBS
Fiscal stimulus & public spending

- 4 trillion RMB/$586 billion to be spent as a stimulus measure, plus another $125 billion on health (to achieve universal coverage by 2020) and around $400 million on rural pensions.

- $1.26 trillion in lending in first 9 months of 2009 has led to GDP growth of 7.7%, but asset bubbles building in stock markets and real estate.

- Infrastructure is needed, but few measures to address corporate savings and little on other social welfare coverage, e.g., pensions, unemployment.
Savings, jobs & institutional reform

- Opportunity to focus on reducing motives for precautionary savings and address social insecurities to increase consumption.
- Reforming capital markets to reduce corporate savings so that productive investments can take place and increase domestic demand.
- Public works (infrastructure) create jobs to absorb job losses and provide future benefits.
- Must do more to shore up institutional foundations of the market.
Re-industrialization & services

Sectoral Composition of GDP: 1978–2007

Source: China NBS
Internal reasons for global re-balancing

- Export-orientation and synchronization with global business cycle point to need for internal re-balancing.
- Volatility in its own assets points to the need for reform, e.g., stock markets and housing.
- Participate in global regulatory reforms, including ‘early warning’ system against build up of macro imbalances.
“Going out” policy

- Launched in mid 1990s and culminated in first commercial outward FDI with TCL and Thomson deal in 2003, Lenovo and IBM, Rover, Hummer, etc.
- Before crisis fully hit, Chinese firms were raising funds for overseas M&A deals.
- Stalled but renewed as second half of 2008 witnessed the first capital account deficit in a decade.
- However, backlash exists & there is need to differentiate among SWFs, SOEs and private firms.
Outward FDI

- 2008: outward FDI totalled $55.6 billion, a 194% increase over a year earlier.
- Of which, $40.7 billion was from the financial sector and $11.9 billion from non-financial sector.
- Also, $130 billion deficit in portfolio investments.
- China receives around $60 billion p.a. in inward FDI, so it may be a capital exporter, especially as investments in energy, minerals, raw materials accelerated in 2009.
Implications for global imbalances

- Already some global re-balancing:
  - China’s exports (and imports) are down and the U.S. trade position has improved.
  - U.S. savings rate is up some four-fold and Chinese consumption is steady.
- Gradual re-balancing is preferable as Western economies issue record levels of debt, and China may well continue its surplus this year.
- Participate in global regulatory reforms, including ‘early warning’ system against build up of macro imbalances.
Conclusion

- The U.S.-led crisis has its roots in a changed global economy and institutional structures.
- There are, nevertheless, significant real economic consequences for China as its growth had slowed to less than the desired 8%.
- Where China goes from here is a challenge, but also an opportunity to focus more on domestic demand, institutional reform and also to play a greater role in the international system.
- For the U.S., the need for revisiting monetary policy, financial regulation and a recognition of the nature of the global economy of the 21st century is no less profound.