U.S., China and Global Imbalances

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Outline

- U.S., China and the onset of global imbalances
- Effects on China and implications for global re-balancing

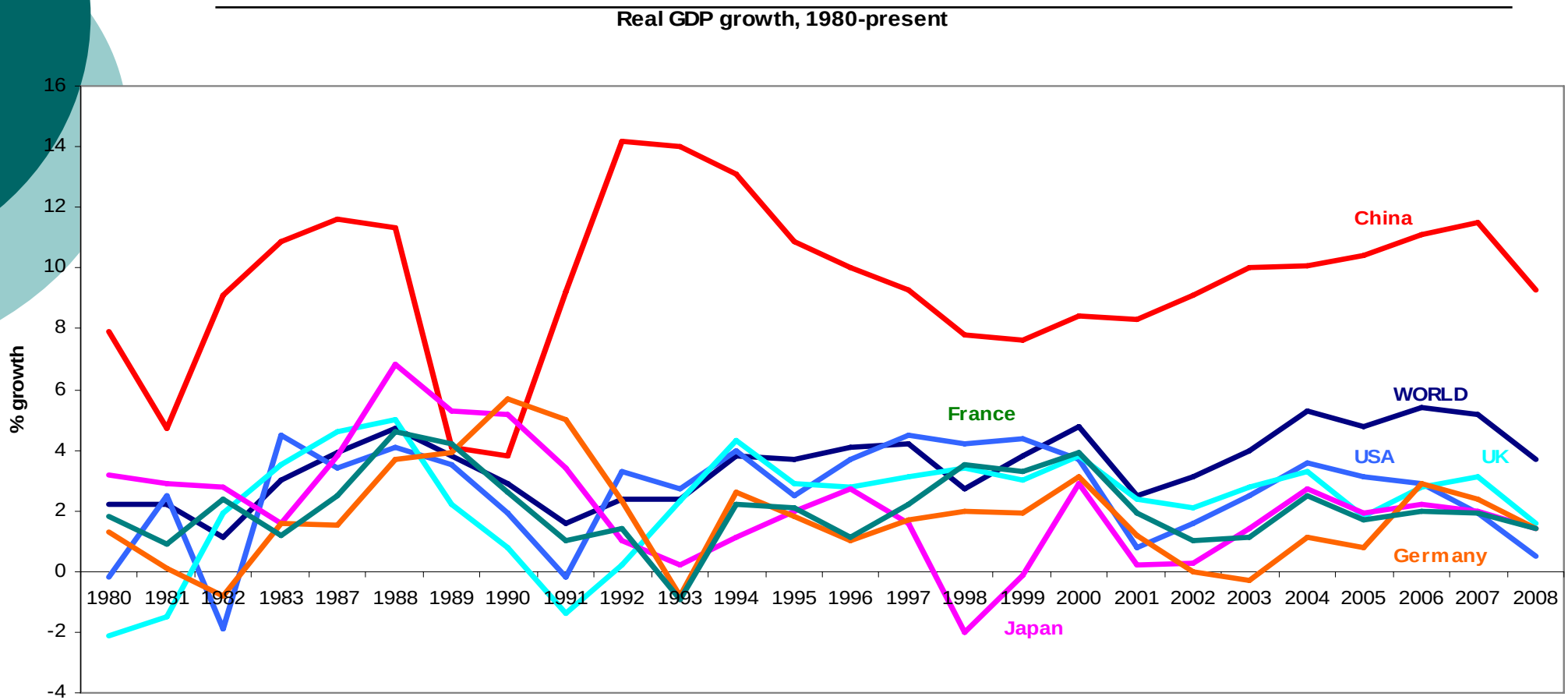
The ‘savings glut’ debate

- 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

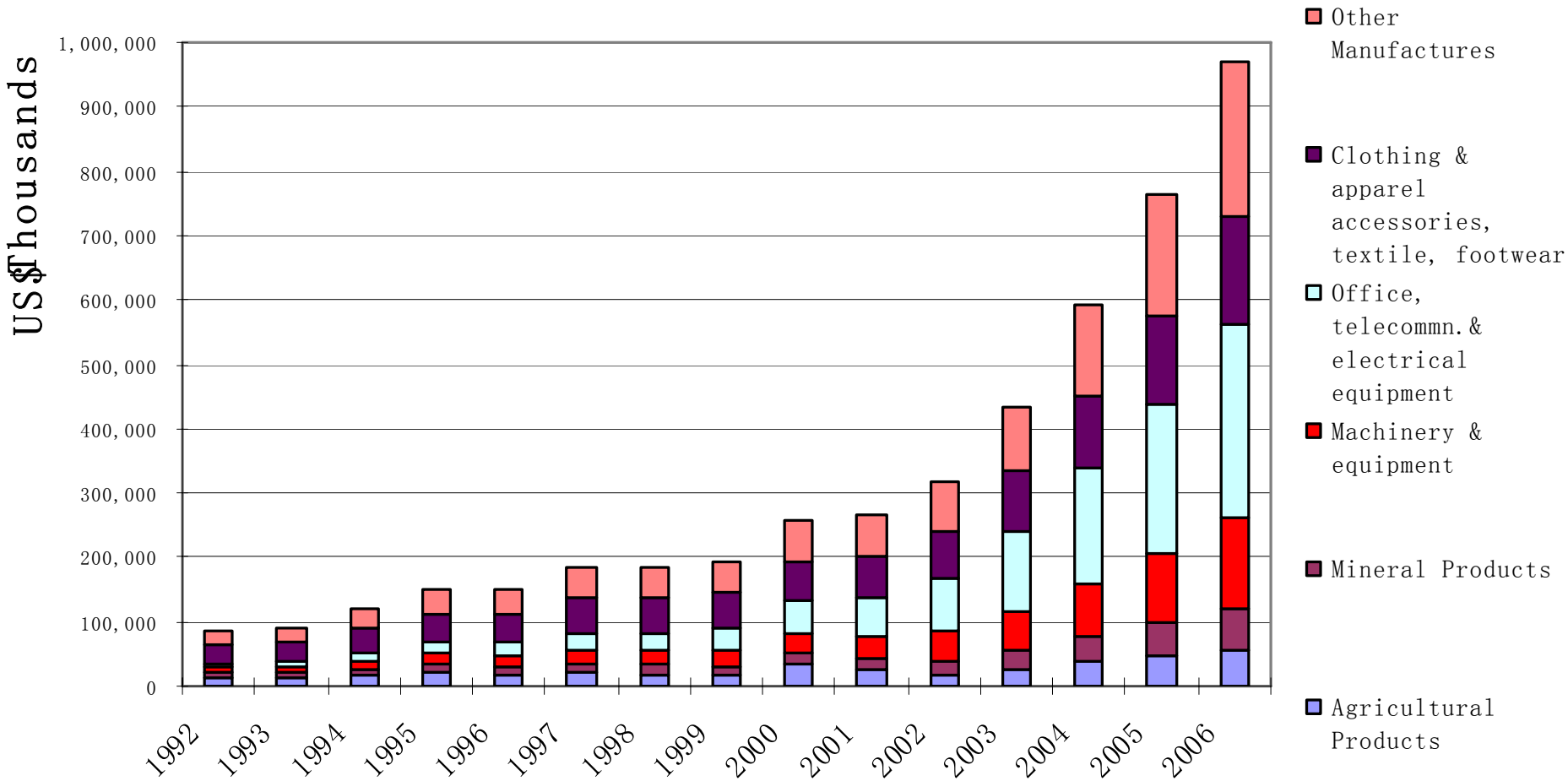


Source: IMF

The China Effect

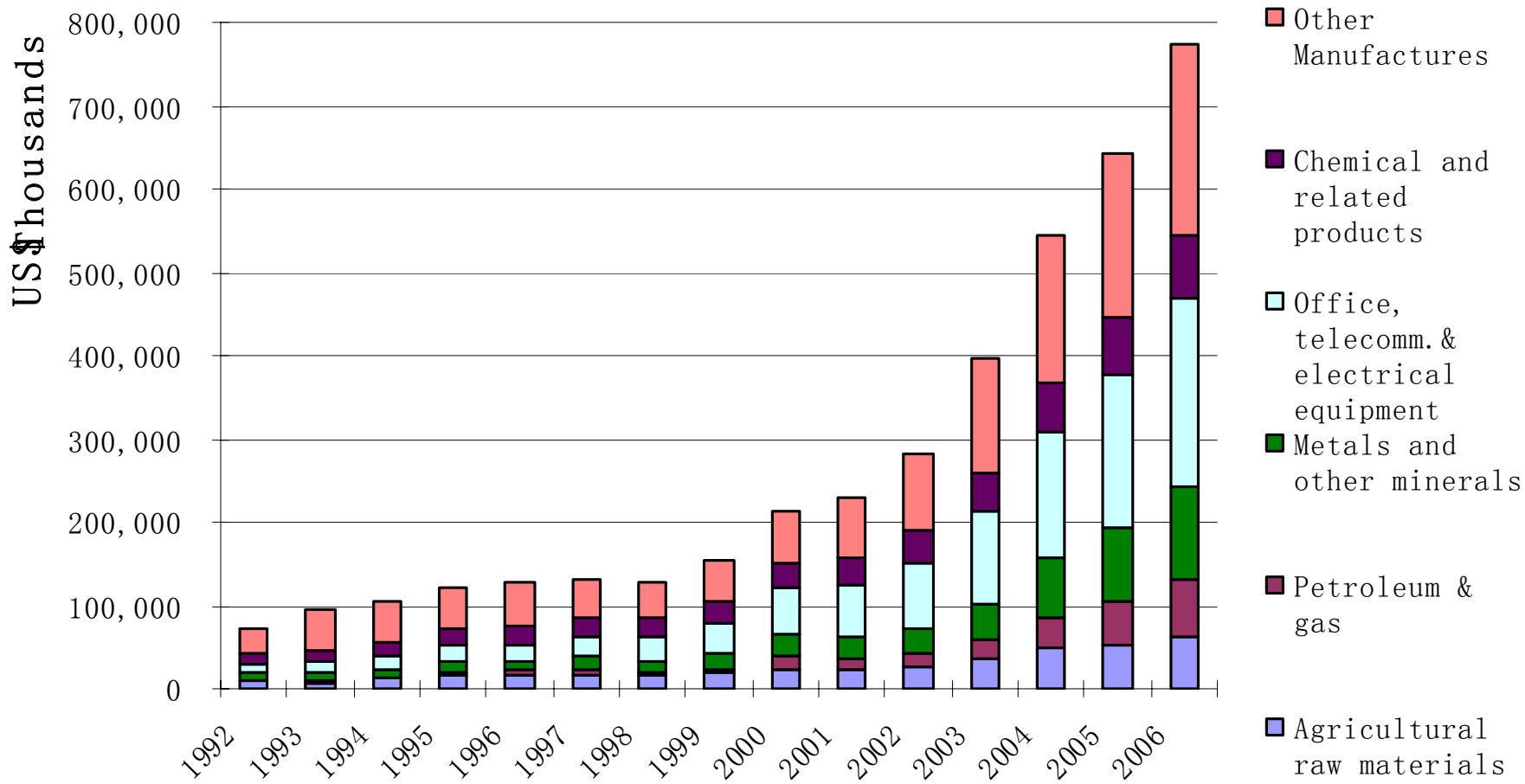
- International trade
- Global capital flows
- Global supply and demand for commodities & raw materials
- Incremental global growth

China's exports, 1992-2006



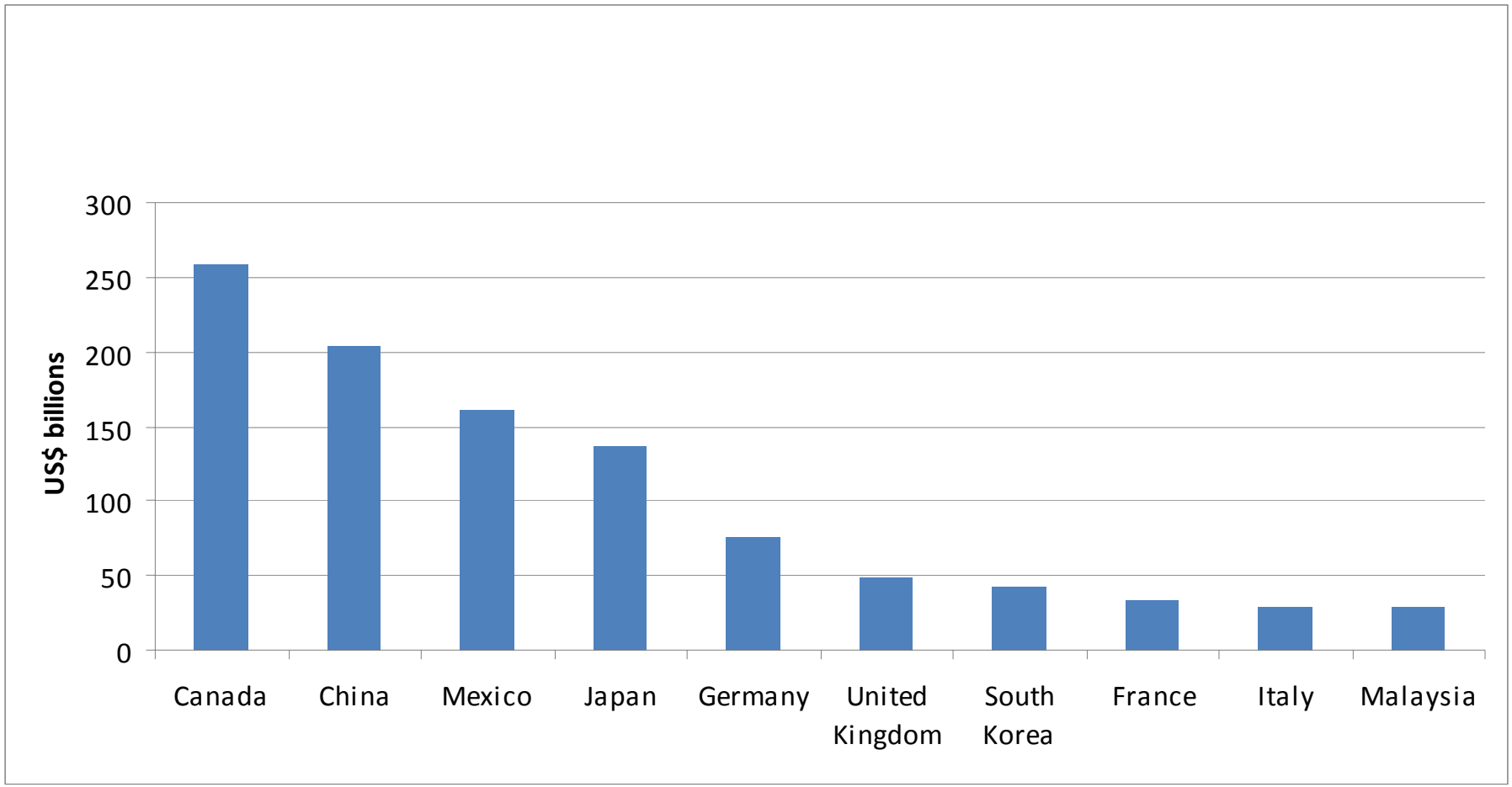
Source: UNCTAD.

China's imports, 1992-2006



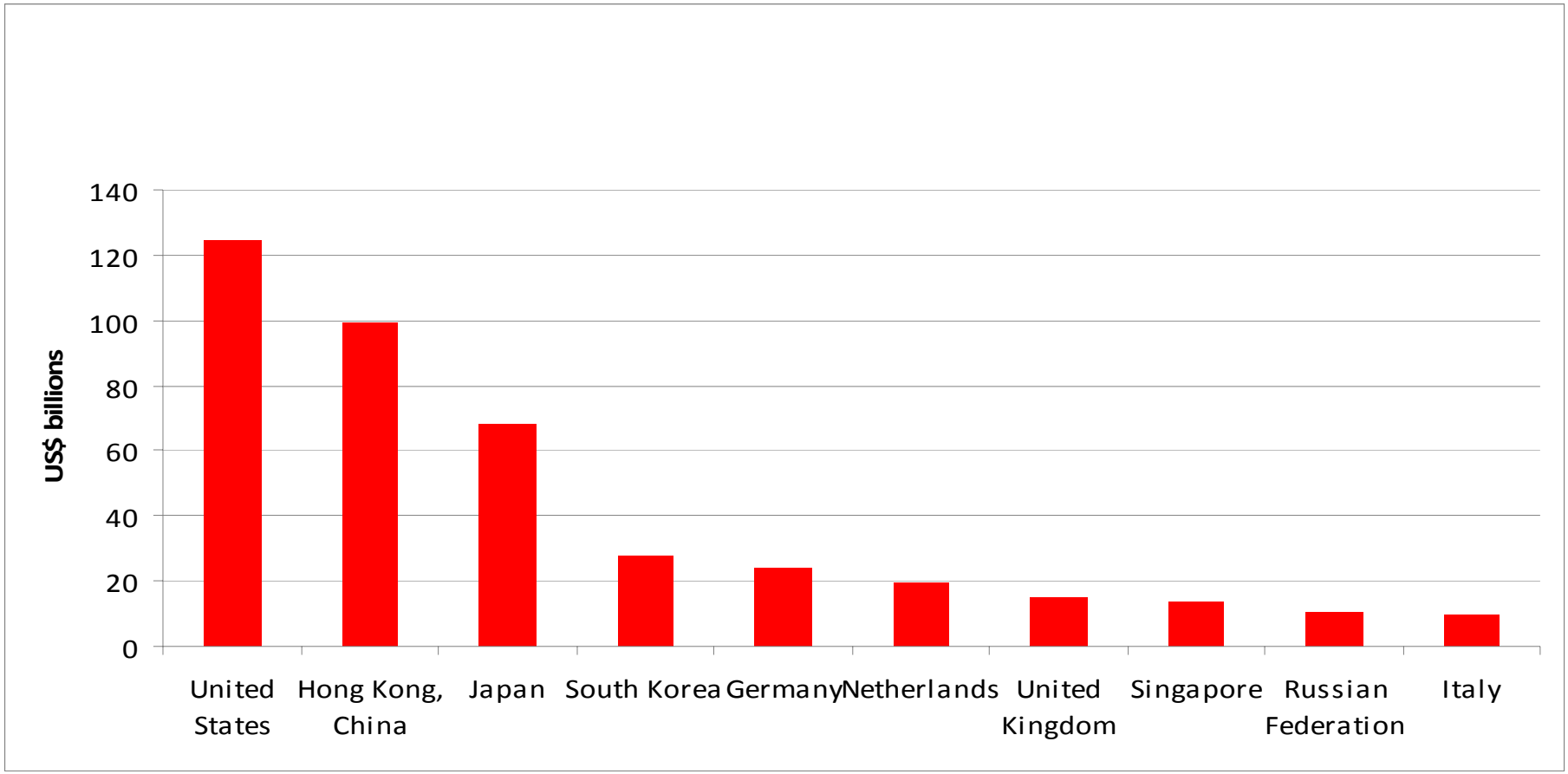
Source: UNCTAD.

U.S. import partners



Source: IMF Direction of Trade statistics showing average annual trade, 2000-2007.

China's export partners



Source: IMF Direction of Trade statistics showing average annual trade, 2000-2007.

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***

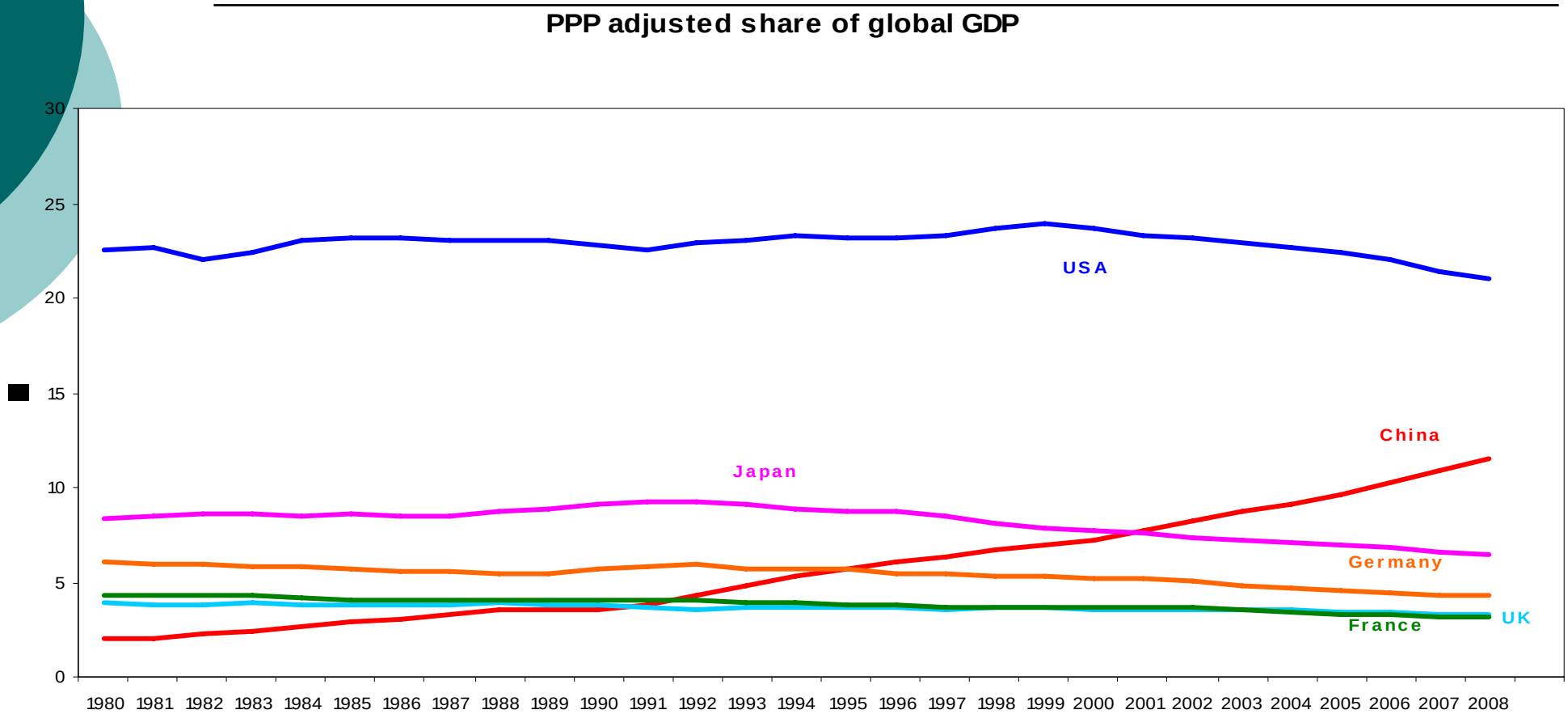
Gravity estimates

- 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

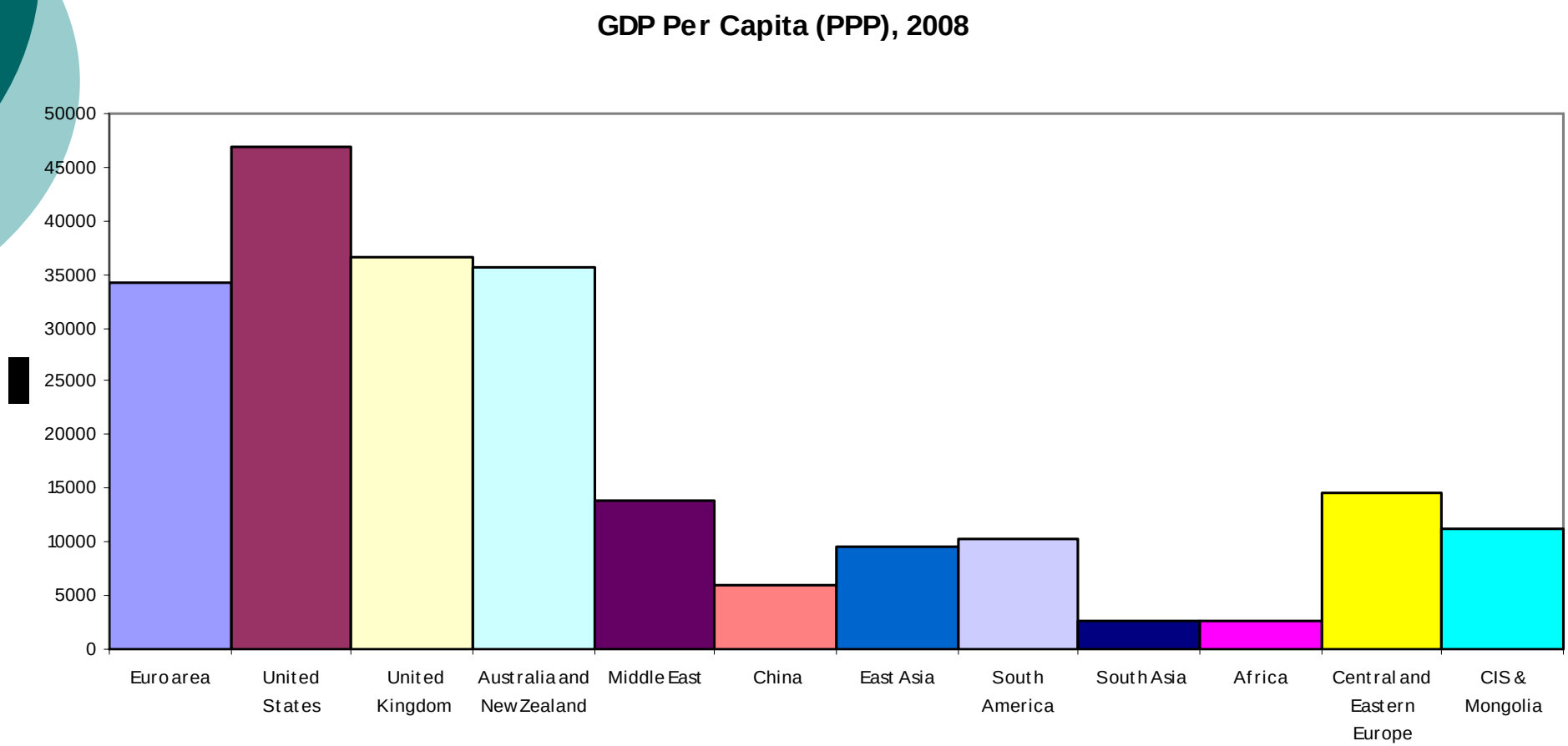
- USA imports 1980s
  - Mexico 13.62***
  - Canada 7.128**
  - Middle East 5.634***
  - Asia ex. China 2.255***
  - EU -1.771***
- China exports 1980s
  - Australia 14.72***
  - Canada 13.47***
  - Middle East 12.56***
  - S. America 11.04***
  - Mexico 10.63***
  - Africa 10.38***
  - USA 8.457***
  - EU 7.965***

The twin engines of growth



Source: IMF

But, low levels of consumption

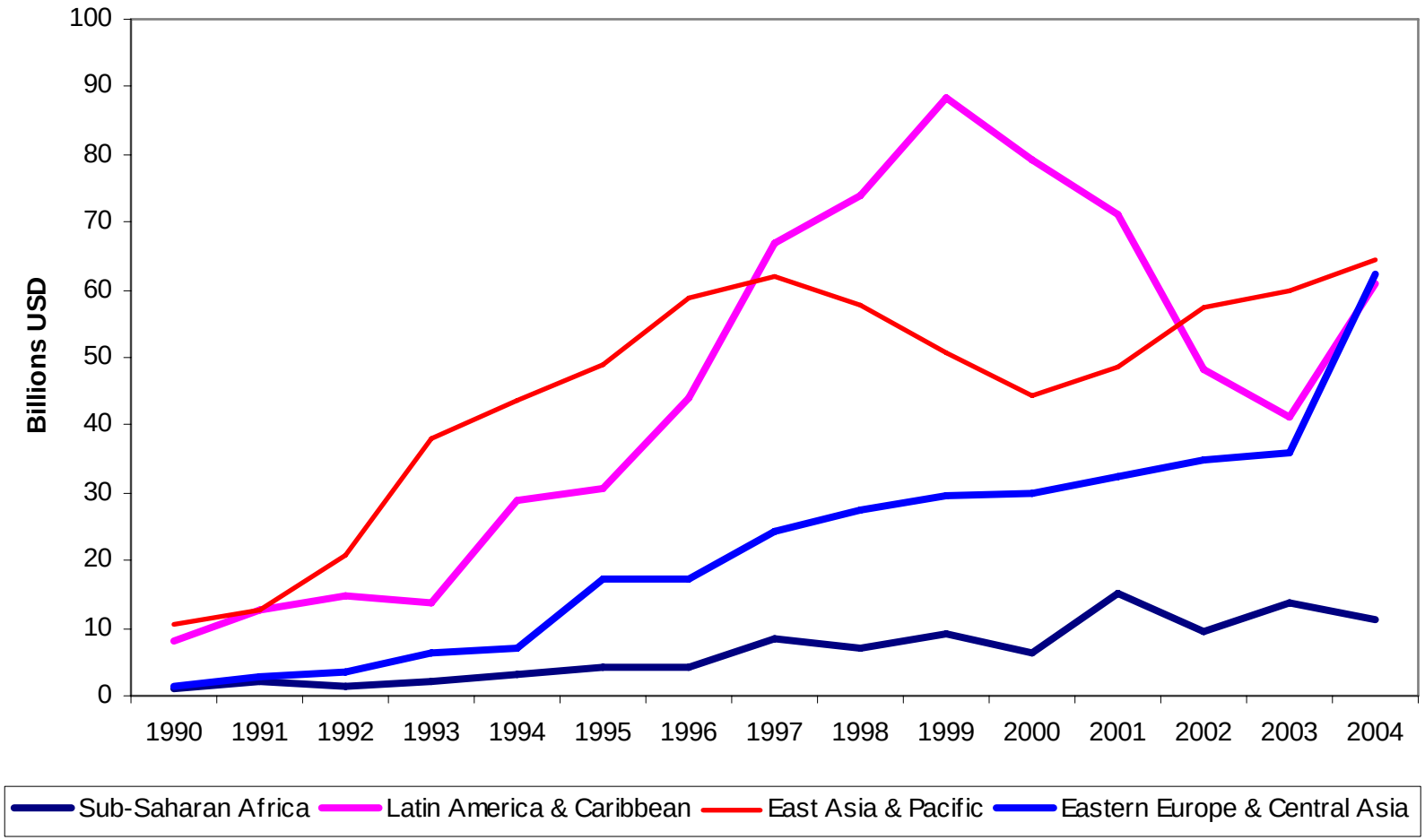


Source: IMF

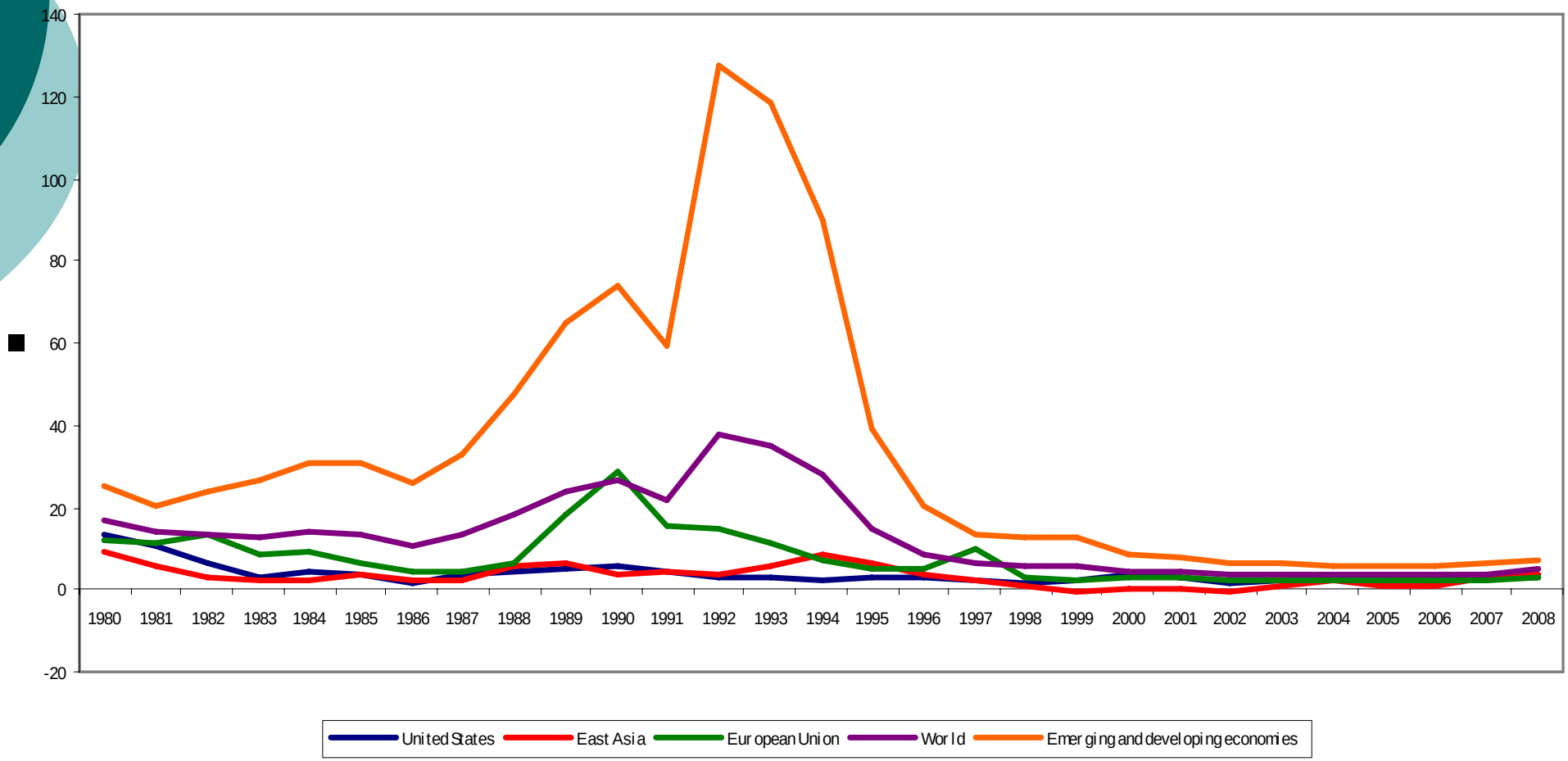
Globalisation

- 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

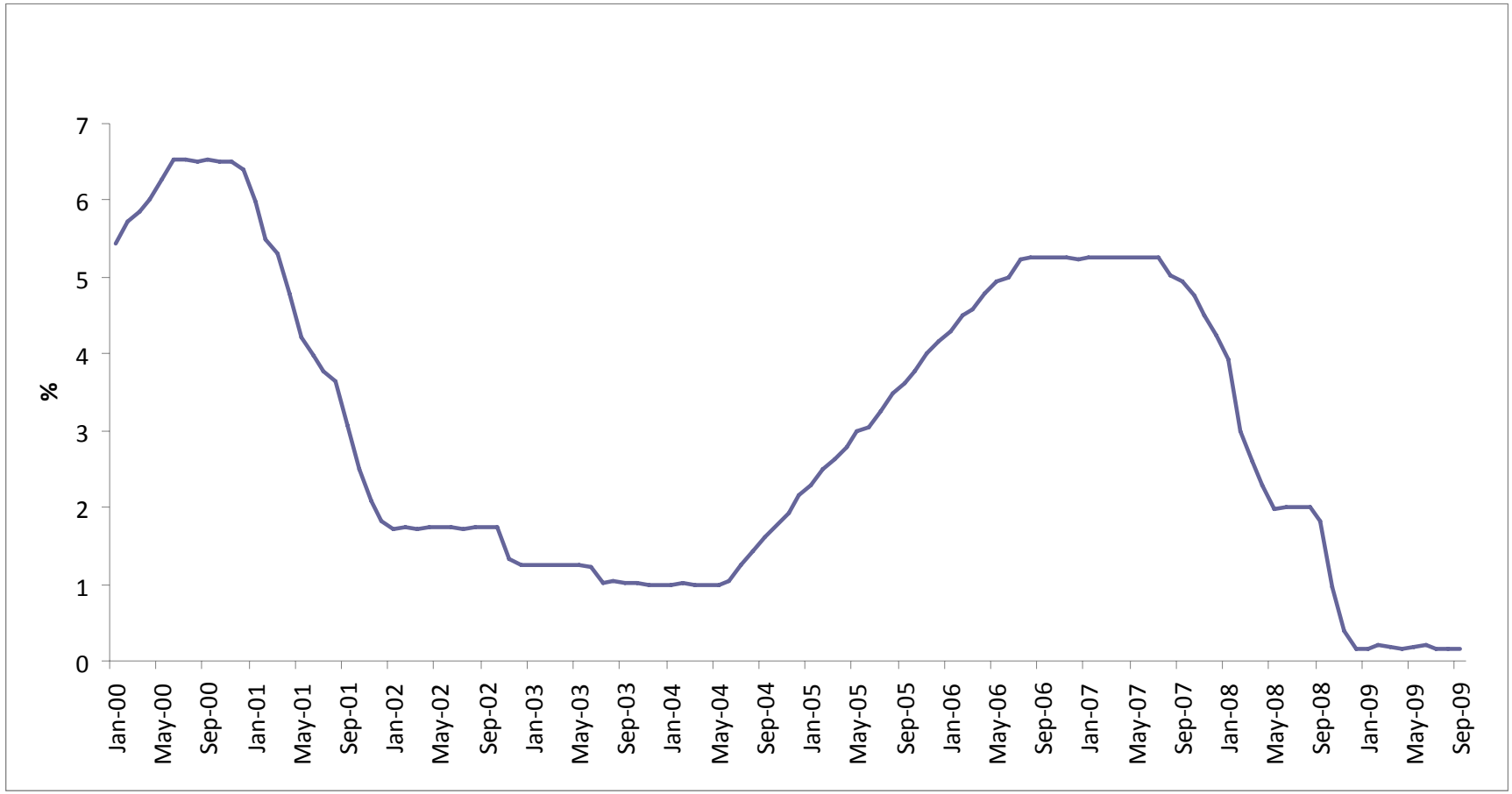


Low inflation during the ‘Great Moderation’



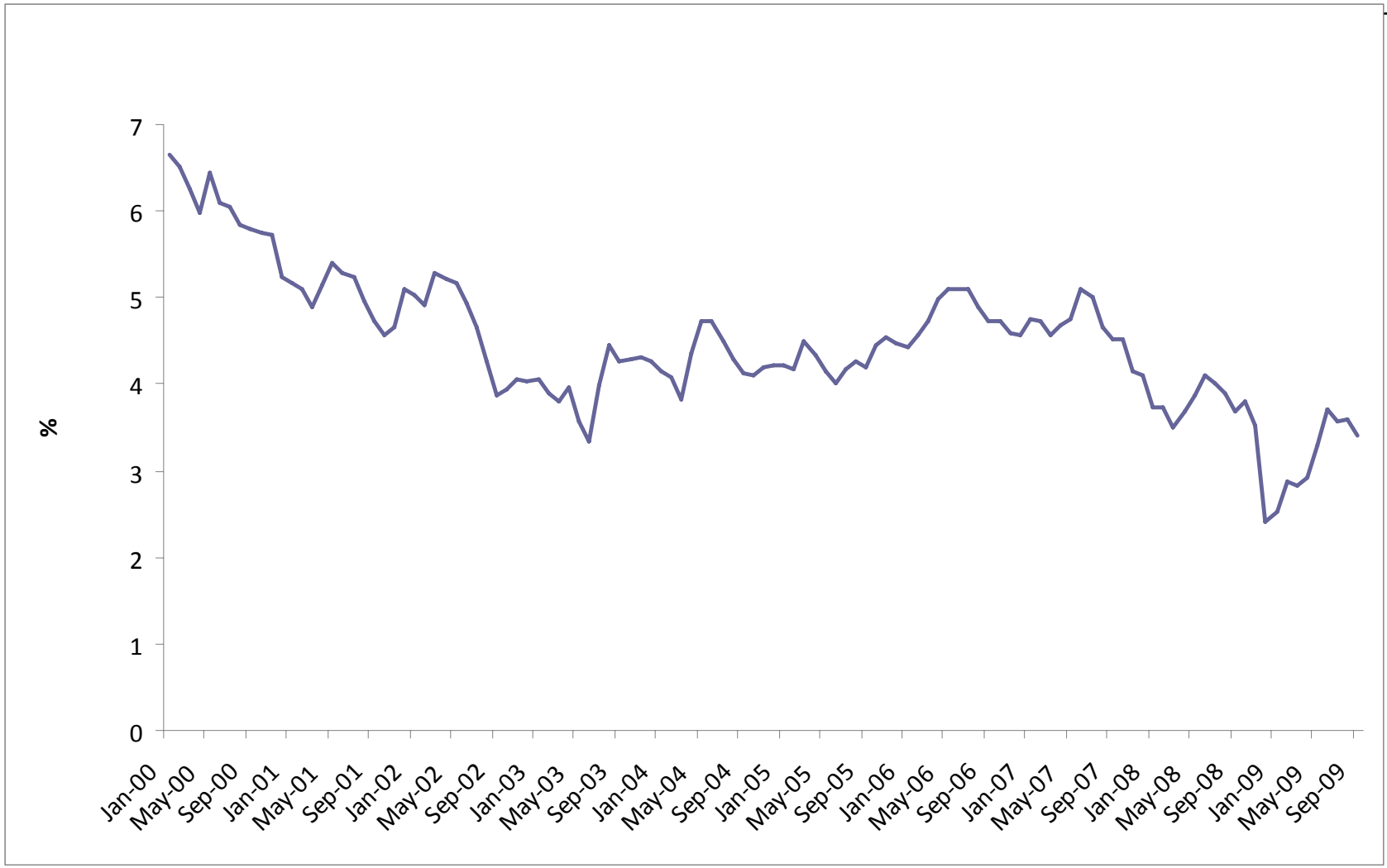
Source: IMF.

U.S. base interest rates



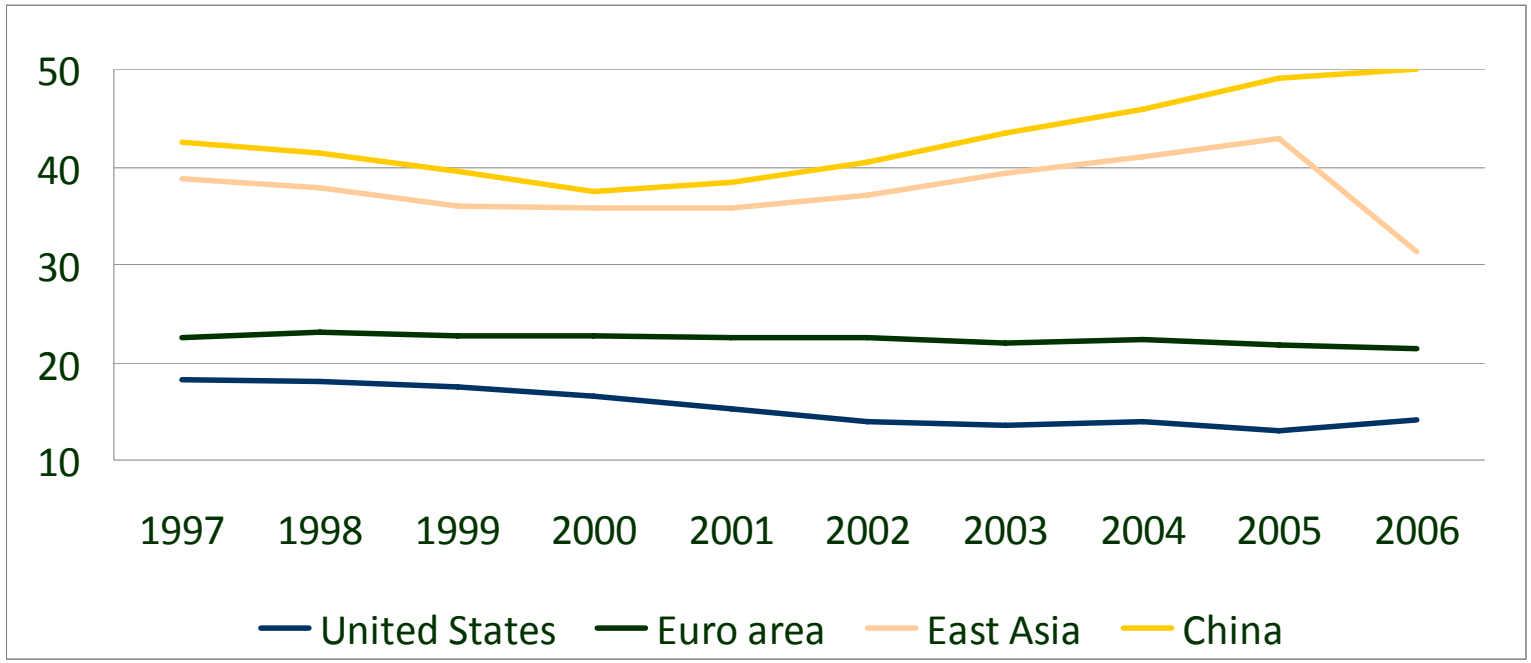
Source: U.S. Federal Reserve Board.

10 Year U.S. Treasuries



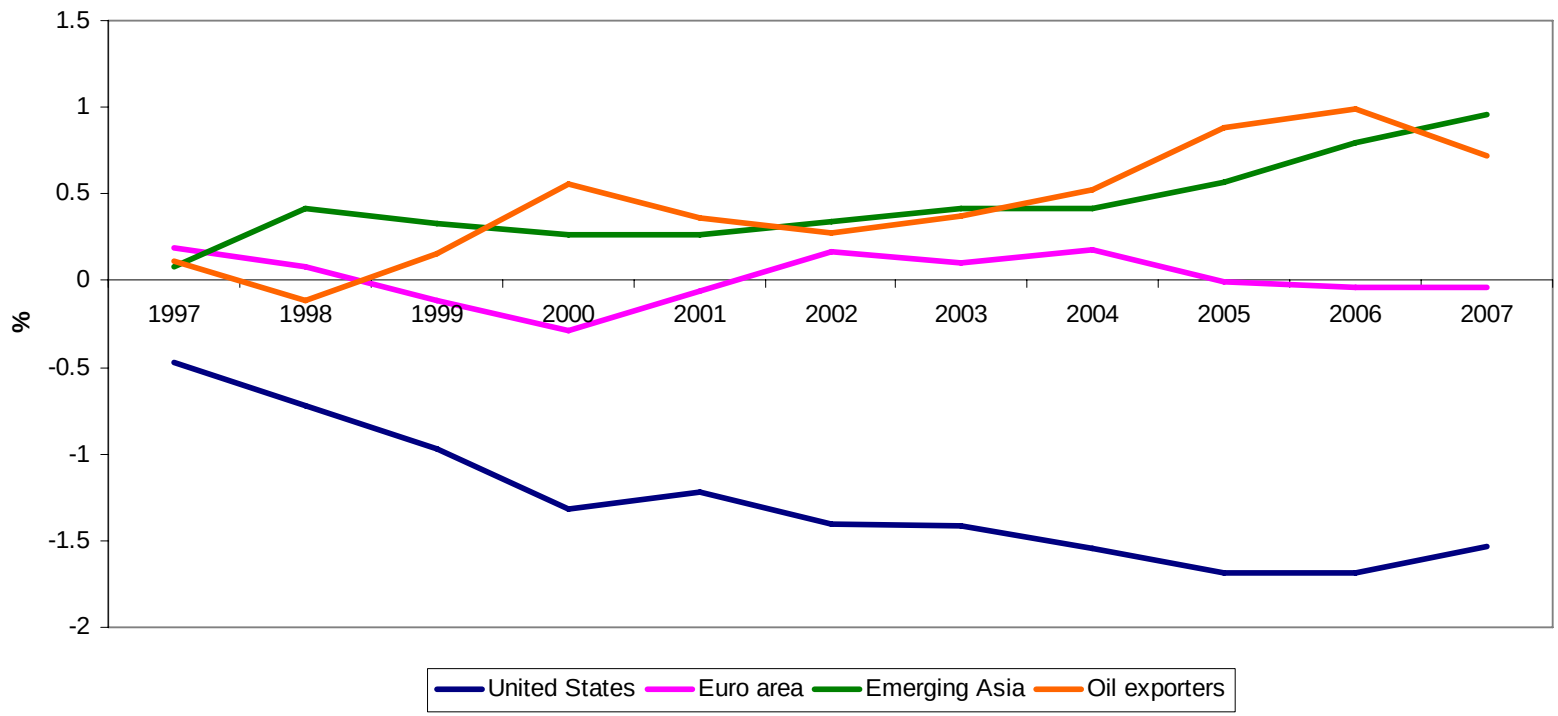
Source: U.S. Federal Reserve.

Gross domestic saving, % of GDP



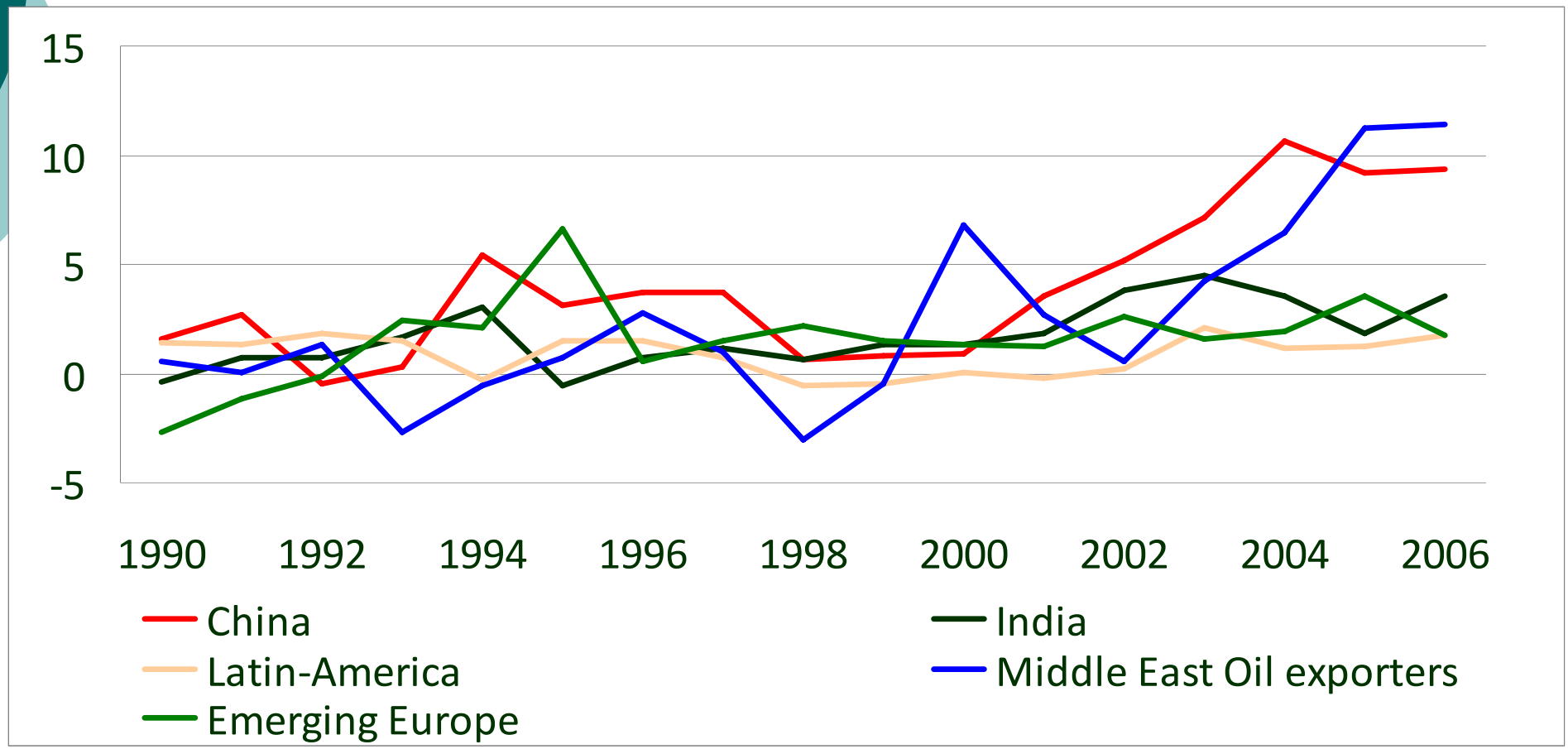
Source: World Development Indicators, World Bank.

Current account balances, % of world GDP



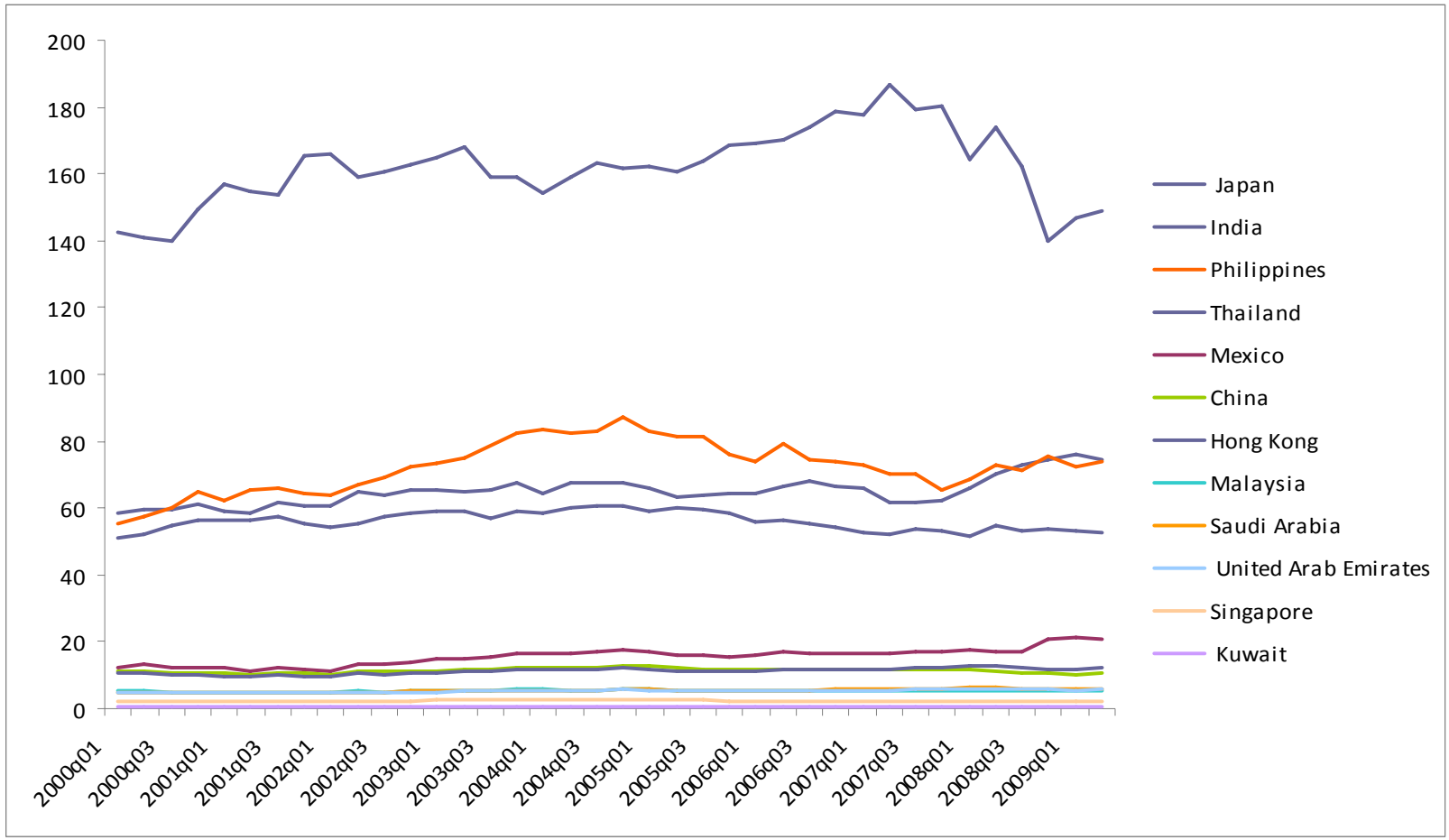
Source: World Development Indicators, World Bank.

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.
- Asian recovery after Asian financial crisis of 1997/98 with net capital flows turning positive in 2002.
- 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

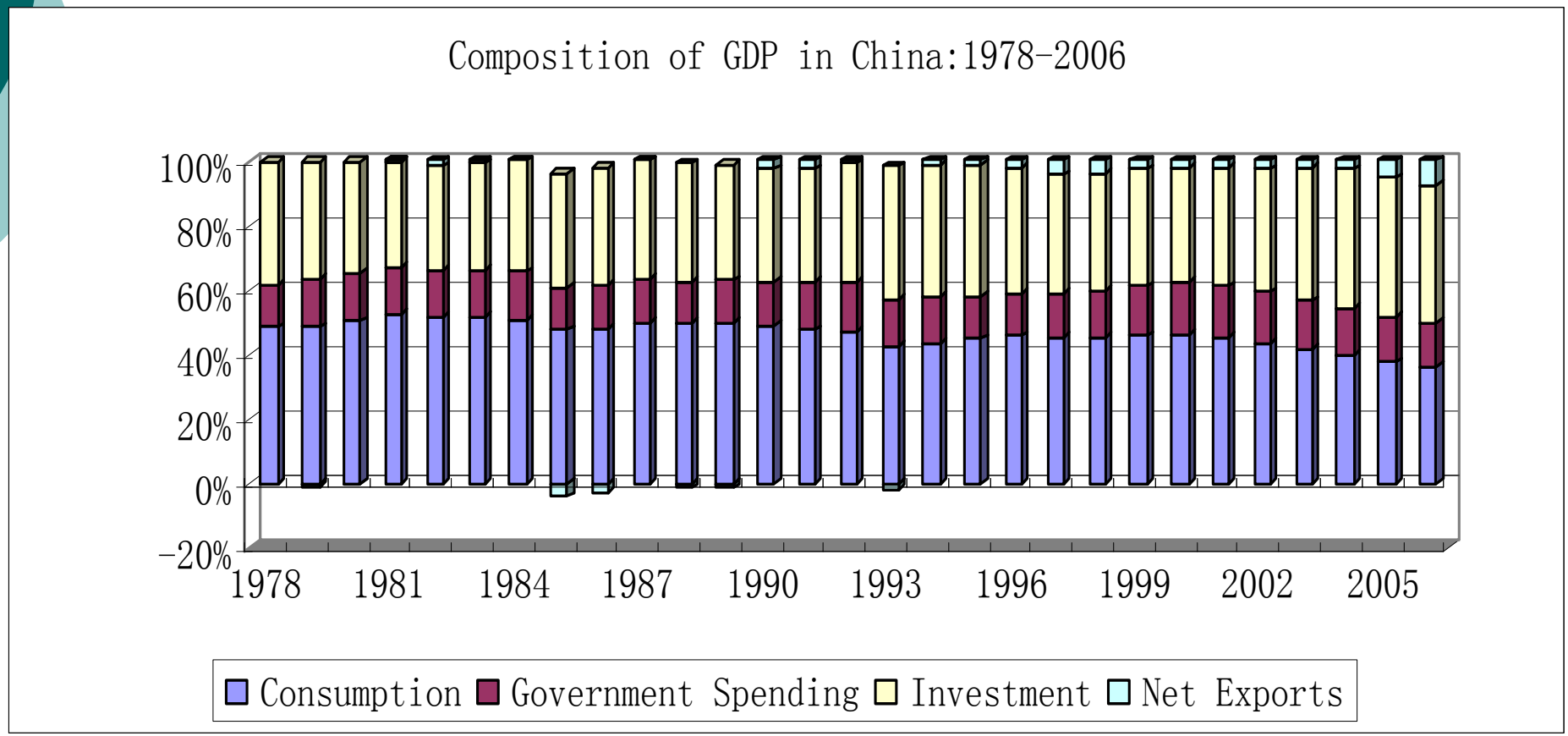
Financial sector effects: contagion

- 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



Source: China NBS

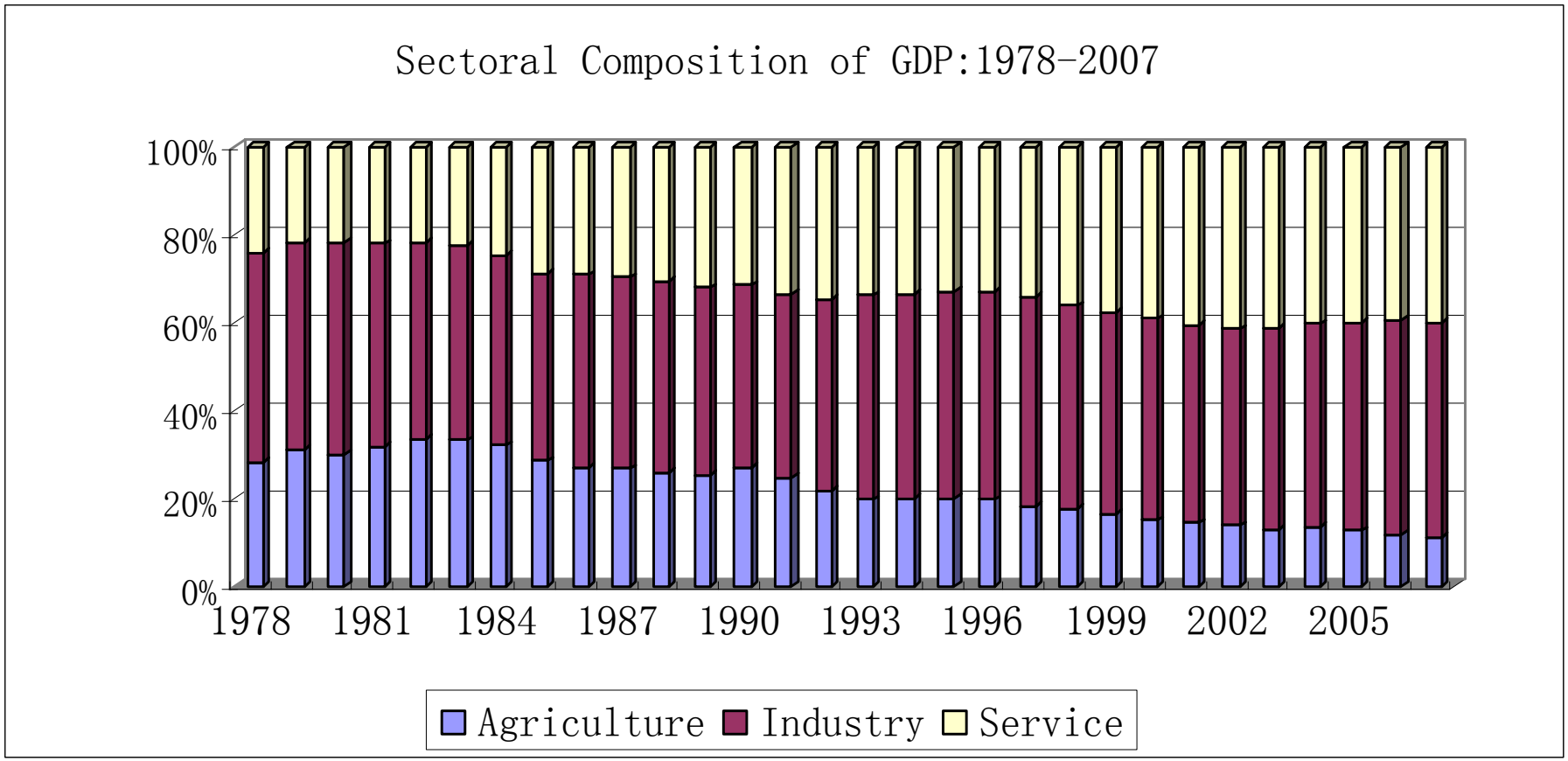
Fiscal stimulus & public spending

- 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



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.