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Can global imbalances be corrected?

Global current account imbalances are concentrated mainly in the United States, the European Union and China. The United States runs a particularly large current account deficit, while the European Union and China post substantial surpluses. These imbalances can be explained neither by demographic dynamics – theory would suggest that ageing economies, in Europe and China, should run external deficits – nor by the level of per capita income – the economy with the lowest per capita income, China, would in principle be expected to attract foreign capital and, accordingly, to run an external deficit.

These imbalances are caused by:

- in the United States, a low national saving rate combined with a high investment rate;
- in the European Union, a sluggish investment rate;
- in China, a high saving rate combined with persistently weak consumption.

Correcting these imbalances would strengthen global financial stability and improve the world economy's long-term growth prospects. Their correction nevertheless faces major structural obstacles :

- in the United States, technological progress and the shift in income distribution in favour of corporations sustain high profitability, which attracts foreign capital; the United States could not forgo this advantage;
- in Europe, the low return on capital and difficulties in financing innovation limit the continent's attractiveness to investors; moreover, there is no indication that Europe is prepared to scale back the generosity of its social model in order to free up additional resources for investment;
- in China, population ageing weighs on domestic demand and makes growth reliant on export momentum, an orientation that shapes economic policy; China could not forgo its market share gains in world trade.

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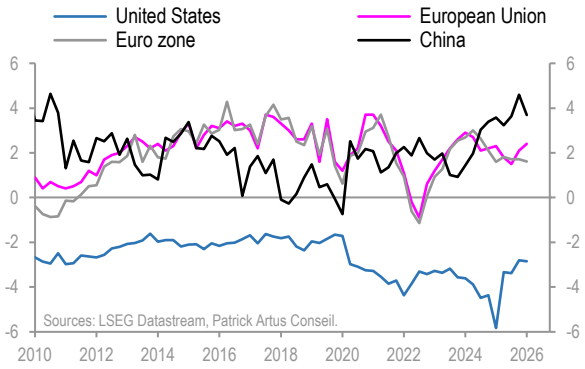
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Current account imbalances across the United States, the European Union and China

The United States runs **a very large current account deficit** while the European Union and China **post significant surpluses** (**Chart 1**).

Chart 1
Current account balance (as % of GDP)



Current account imbalances cannot be explained:

- **by demographics**: the economies facing the most pronounced ageing (Europe and China, **Chart 2**) should, in theory, run current account deficits, as ageing leads to the repatriation of previously accumulated external assets to support consumption;
- **by the level of per capita income**: China, whose per capita GDP remains low (**Chart 3**), should enjoy a high marginal productivity of capital, attract foreign capital and, accordingly, run a current account deficit.

Chart 2
Fertility rate (births per woman)

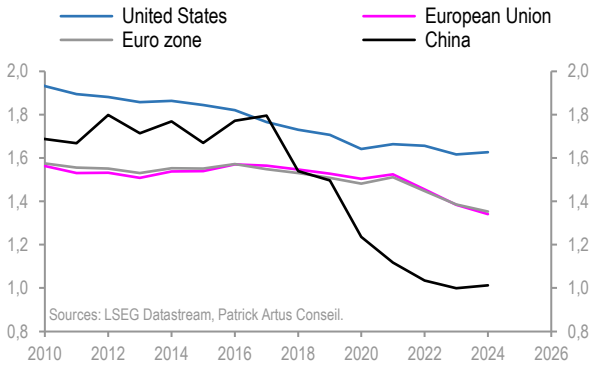
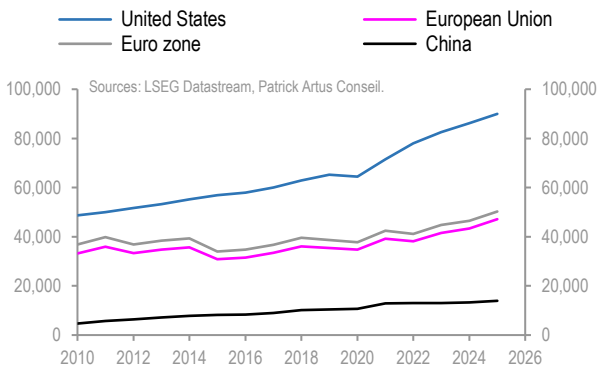


Chart 3
GDP per capita (USD)



Where do global imbalances originate?

1. The US current account deficit

In the United States, the current account deficit is explained by **the low national saving rate** – due to weak household saving and the large general government deficit (**Chart 4**) – as well as the high investment rate (**Chart 5**).

Chart 4
Gross national savings (as % of GDP)

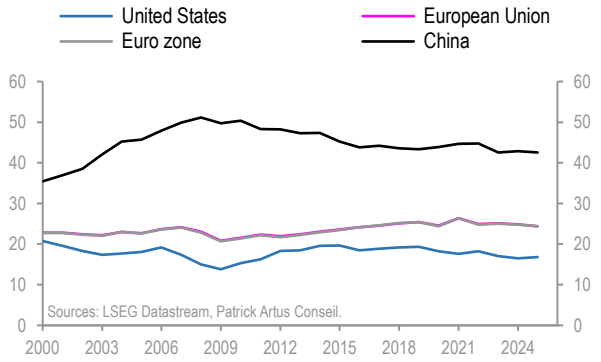
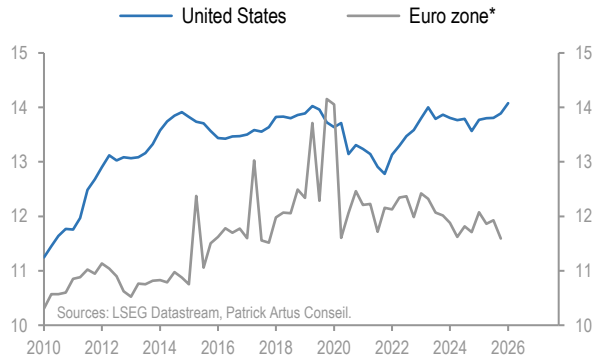


Chart 5
Private non-residential fixed investment (as % of GDP)

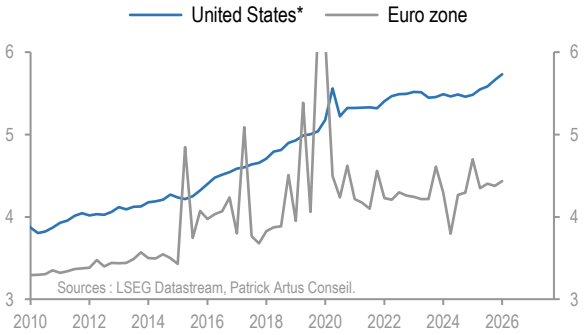


*Euro zone : non financial corporations' investment

2. The European Union's current account surplus

In the European Union, the current account surplus is explained by **the low investment rate** (**Chart 5** above), in particular **weak investment in intellectual property products** (patents, research and development; **Chart 6**).

Chart 6
Investment in intellectual property products
(as % of GDP, at current prices)

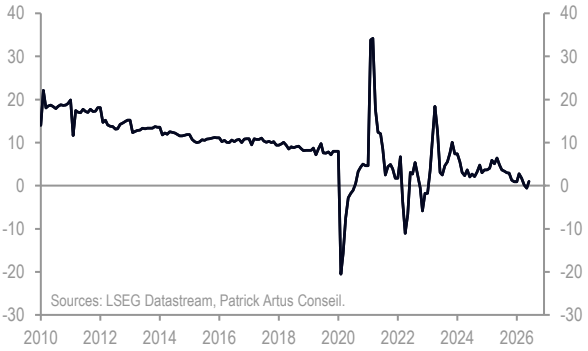


*United States: private investment in intellectual property products

3. China's current account surplus

In China, the current account surplus stems from the high national saving rate (**Chart 4** above) and from **weak household consumption** (**Chart 7**).

Chart 7
China: Retail sales of consumer goods (Y/Y, %)

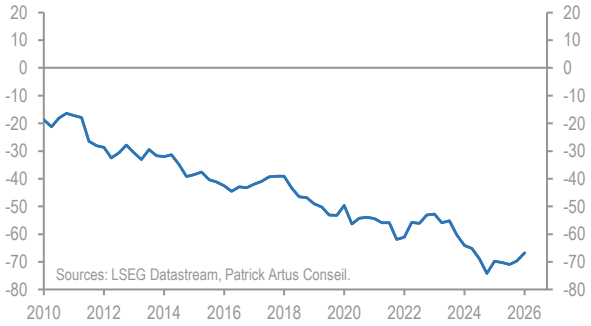


Weak consumption in China is consistent with the limited coverage of pension and health insurance schemes, the speed of population ageing and the decline in property prices.

These global imbalances carry risks:

- the accumulation of external debt by the United States (**Chart 8**) exposes the US economy to the risk of a balance of payments crisis should its attractiveness to foreign capital weaken;

Chart 8
United States: Net international investment position (as % of GDP)



- the European Union would stimulate its long-term growth if European savings were invested within the continent rather than lent to the rest of the world;
- China, given its weak domestic demand, remains dependent on exports for growth which is a source of vulnerability in the event of a global economic slowdown or an intensification of protectionist measures targeting Chinese products.

Summary: global imbalances that will prove very difficult to correct

The United States has no interest in forgoing **its attractiveness to foreign capital**, which stems:

- **from technological progress** (**Chart 9**);
- from the shift in income distribution in favour of corporations and at the expense of employees, which **sustains high profitability** (**Chart 10**).

Chart 9
Productivity per head (2010.Q1 = 100)

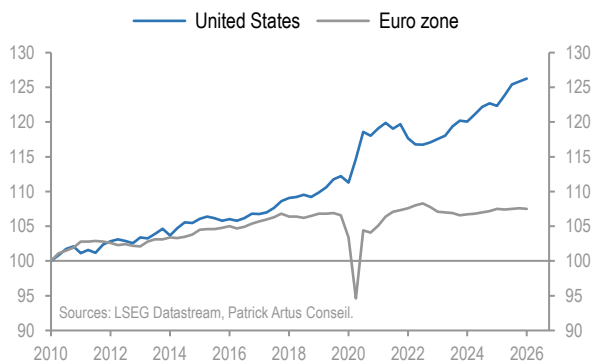
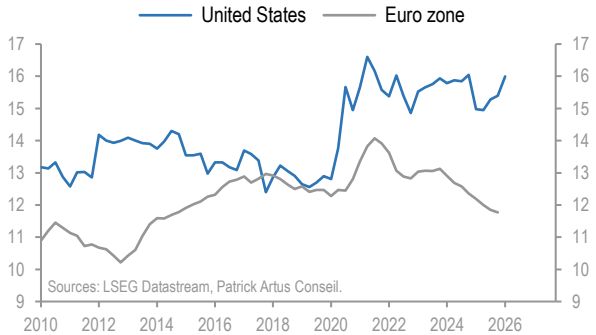


Chart 10
Profits after tax and interest of non-financial corporations (as % of GDP)



This attractiveness enables the United States to maintain a low saving rate and a high investment rate simultaneously.

China, facing a domestic demand weakened by population ageing, **cannot forgo export growth higher than world trade growth** (**Chart 11**).

Chart 11
Exports of goods (in volume terms, Y/Y as %)



Europe is likely to remain **unattractive to foreign capital**, owing:

- **to the low return on capital** of its companies (**Chart 12**);
- **to its low investment rate** (**Chart 5** above), which primarily reflects the priority given to financing social protection (**Chart 13**).

Chart 12
RoE

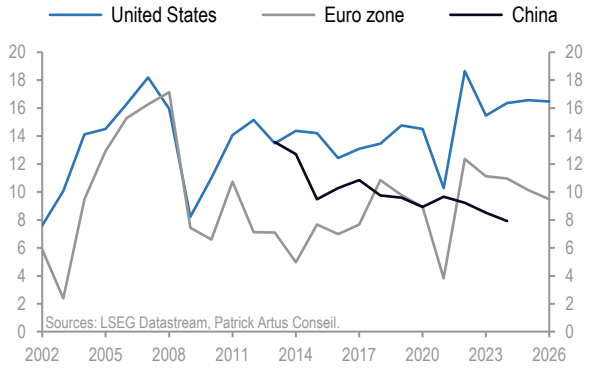
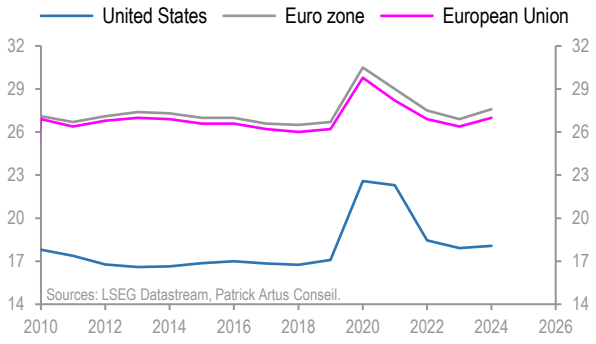


Chart 13
Public expenditure on health and social protection (as % of GDP)



The **persistence of global imbalances** would thus give rise, over time, to risks of crisis associated with the United States' excessive external debt, weak European growth and China's dependence on exports.

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