GLOBAL IMBALANCES, CAPITAL FLOWS, AND THE CRISIS

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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

- change in REER, 2010 vs 2005-8 average
- change in CA balance, 2010 vs 2005-08
...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

Capital inflows
(annualized rates, billions USD)

- 2007
- 2008Q4-2009Q1
- 2009Q2-Q4
- 2010Q1-Q4
- 2011Q1-Q2

Advanced economies
Emerging markets