Growing Global Current Account Imbalances

By Takashio Yoshiyuki

This article will look into the "growing global current account imbalances" that have been recognized in recent years as a risk factor in the world economy.

1. Trends in 2006

Global current account imbalances continued to grow in 2006 as well.

In 2006, the US current account deficit, which accounts for the major part of the world's current account deficits, increased by $56.6 billion over the previous year to yet another record of $811.5 billion (6.1% of nominal GDP) *(Chart 1)*. The US deficit in goods and services trade, which accounts for about 90% of its total current account deficit, hit a record $758.5 billion (5.7% of nominal GDP) in 2006. Furthermore, the US income balance surplus declined for the second straight year in 2006.

On the other hand, China and oil-exporting countries saw their current account surpluses continue to grow in 2006 through brisk exports and boosts in crude oil prices, respectively. China reported a $184.2 billion current account surplus, a $23.3 billion increase over the previous year, while oil-exporting countries reported a $355.0 billion surplus, a $115.8 billion increase. Meanwhile, no significant changes were seen in the levels of current account surpluses reported by Japan, newly industrializing economies (NIEs) and the ASEAN-4 countries (except Indonesia).

2. Worsening US Current Account Balance

(1) US Trade Deficit Hits Record

In 2006, the US economy experienced an annual growth of 3.3% in its real GDP. This was because private-sector investments, mainly in the fields of information equipment as well as buildings and other structures, remained active while personal consumption remained solid. These factors more than offset a sharp decline in housing investments. Imports increased sharply to a record annual high of $2,204.2 billion in 2006, while exports continued rising to reach $1,445.7 billion. But imports grew faster than exports, resulting in the record deficit in goods and services trade in 2006.

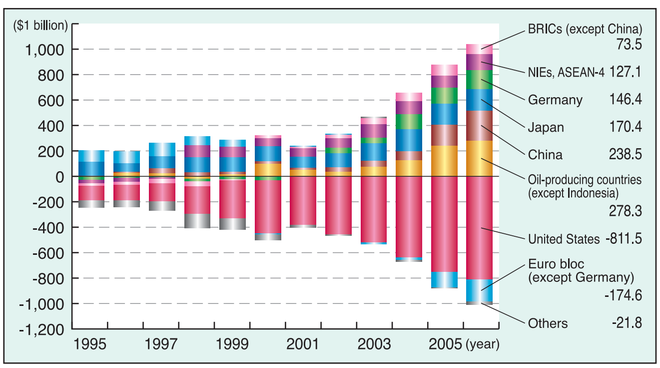
(2) Shrinking US Income Balance Surplus

The US income balance surplus declined for two years in a row since 2005. This was chiefly because a deficit in the balance of income on governmental investment expanded to top a surplus in the balance of income on direct investment.

The US external liabilities have consisted of such relatively low-cost instruments as corporate bonds, while its external assets have comprised such relatively high-return instruments as equity securities. This has helped the United States maintain surplus in the income balance despite the fact that the United States is a net debtor nation whose external liabilities exceed its external assets.

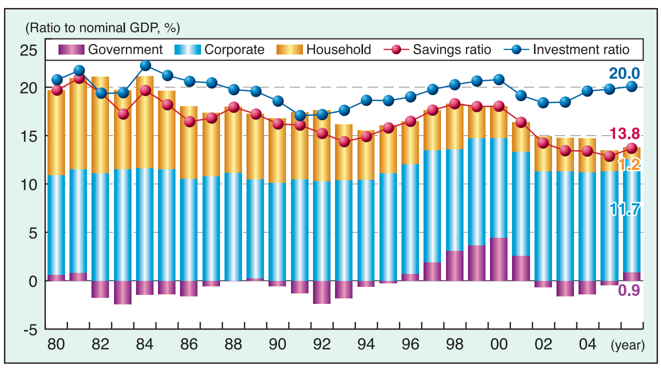
However, the governmental investment income balance has continued to expand its deficit since 2004, while the amount of surplus in the direct investment income balance has remained almost unchanged since then. As a result, the US income balance surplus shrank again in 2006 as it did in 2005. The increased deficit in the governmental investment income balance apparently stems from increased foreign investments in US treasury bonds and governmental agency securities, and growing interest payments due to short-term interest rates rising since 2004 and long-term rates climbing since 2005.

Chart 1 Trends in world current account balances



Note : *2006 figures are projections.*
Source : *IMF World Economic Outlook Database, April 2007*

Chart 2 Trends in US savings by sector



Source : *National Income & Product Accounts, Bureau of Economic Analysis, US Commerce Dept.*

3. US Savings / investment Balance Deteriorates

The US trade imbalance and the worsening current account deficit reflect the savings / investment disequilibrium in both the government and household sectors.

The US current account balance has remained in the red since the 1980s. Seen on a trend basis, this is not because the share of investments in US GDP has increased, but because the US economy has fallen into the state of savings shortage resulting from a decline in the savings rate. Moreover, the savings rate decline can be attributed to a savings drop in the household sector, not in the corporate sector *(Chart 2)*.

Looking into trends in the savings / investment balance by category, the government sector was the main player in investments in excess of savings from the 1980s to mid-1990s, while the corporate sector took over the position from the latter half of the 1990s to the 2000 burst of the IT bubble. Since 2001, the corporate sector has fallen into the state of excess savings and the government sector has again emerged as the main player in excess investments due to its budget deficits. In addition, the margin of the government sector's excess investments has leveled off since 2005 while that of excess investments by the household sector has tended to expand. As a result, the US current account deficit has widened rapidly because of excess investments over savings in both the government and household sectors *(Chart 3)*. Fund shortage from the imbalance has been covered mainly by investments from overseas.

4. Increasing US Net External Liabilities

The US net external liabilities have continued to increase as a result of the deterioration in the current account balance. Outstanding net external liabilities reached an all-time high of $2,546.2 billion at the end of 2005. The US net external liabilities as a share of nominal GDP was on the decrease from the end of 2003 to the end of 2005 *(Chart 4)*. Among the factors contributing to the decrease in the share are: (1) while most US external liabilities are denominated in US dollars and a major portion of the US external assets in foreign currencies, the dollar-denominated US external assets have decreased amid a prolonged depreciation of the US dollar since 2002; (2) the market value of US external assets including stockholdings has been on the rise; and (3) the US income balance has been in surplus. On the other hand, it should be noted that (1) the US dollar's nominal effective exchange rate has turned stable since 2005; (2) the US trade balance has continued to deteriorate; (3) the value of US external assets including stock prices are unlikely to continue rising over the long term; and (4) the US income balance surplus has been on the decline since 2005. Taking these unfavorable developments into consideration, the US external liabilities as a share of nominal GDP are likely to increase. Therefore, it is necessary for the United States to reduce its trade deficit to a certain level to curb a rise in the share.

5. Policy Coordination Required

As described above, if the global current account imbalances are left unresolved, the US external net debts will continue to expand and may develop into a major risk for the entire world economy.

China, which posts an annual net increase of more than $200 billion in its foreign exchange reserves under a rigid exchange rate mechanism, is required to accelerate reform for a more flexible exchange rate system and also for healthy management of its domestic economy. But an adjustment in foreign exchange rates can play only a limited role in reducing savings / investment imbalances. A sharp reduction in current account imbalances cannot be achieved only with an exchange rate adjustment. Moreover, a reduction in the current account imbalance with a specific country would only lead to an expansion in current account imbalances with other countries unless the savings / investment balance is adjusted. To reduce the global current account imbalances, policy coordination among countries is essential to narrow the savings / investment imbalance and thus achieve more balanced and healthy macroeconomic development of each country. JS

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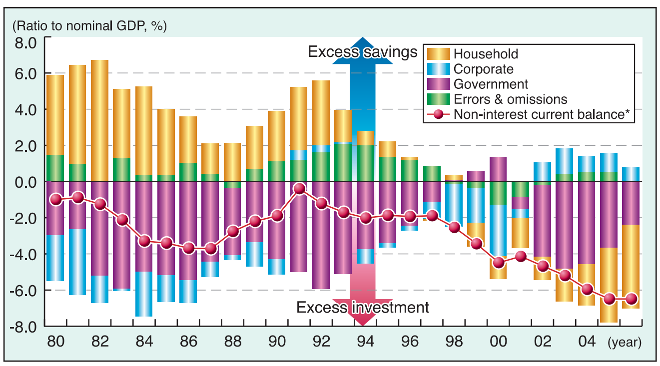
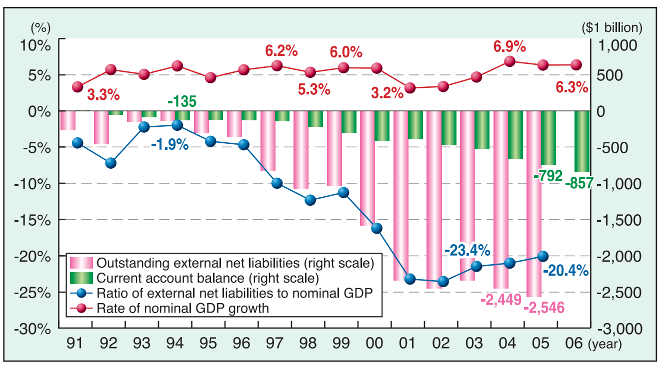
Chart 3 US savings / investment balance by sector



Note : *Non-interest current balance = trade balance + current transfer balance + employers' pay

Source : *National Income & Product Accounts, Bureau of Economic Analysis, US Commerce Dept.*

Chart 4 Trends in US external net liabilities



Source : *Bureau of Economic Analysis (website), US Commerce Dept.*