

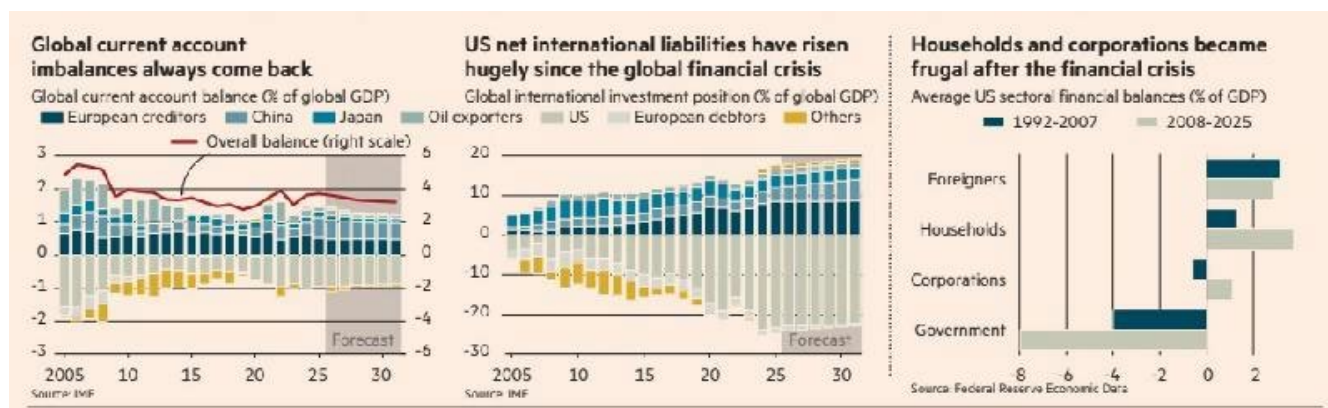
Imbalances are back on the global agenda

di Martin Wolf

Policy makers must overcome the fallacy that the way to get rich is by running surpluses forever. Again? Didn't we just have this debate?" This is how the opening chapter of a collection of essays published by the Centre for Economic Policy Research, on "The New Global Imbalances", starts. Yes, we did. We did so in the 1980s, in the 2000s and now, once again, in the 2020s.

Once roughly every 20 years, it appears, the issue comes to the fore. This is so for two good reasons. One is that current account imbalances drive protectionist sentiment. The other is that they are harbingers of financial crisis. In the 1980s, protectionist sentiment rose against Japan, which is also where the financial crisis struck. In the 2000s, the era of "the China shock", protectionism began to rise against China and a financial crisis hit the western world. In the 2020s, the protectionism is already here, in the US above all. But the financial crisis is not — yet.

The view of many economists today is that if a crisis is going to strike, it is likely to be triggered in the US. Thus the authors of the chapter quoted above, Beatrice Weder di Mauro and Jeromin Zettelmeyer, state that "the stock of external liabilities of the central country in the global financial system is already high and projected to rise further. At the same time, asset managers hold increasingly concentrated exposures, equity valuations are stretched, and signs of investor nervousness are emerging, with greater efforts to hedge risk." In other words, be afraid, be very afraid.



So, how similar are today's conditions to those of two decades ago? What might go wrong? What should be done? How might today's situation end?

The answer to the first question is that there are similarities and differences.

One similarity is that the main surplus and deficit economies are the same: China, European creditor countries (especially Germany), Japan and oil producers are yet again the main surplus countries, while the US is the main borrower. Meanwhile, China's reported surplus is much the same size now

relative to the world economy as it was in 2008, though it is a far smaller share of its own GDP because the relative size of its economy has more than doubled. One difference is that former deficit European countries are now running a small surplus. More important differences are that net US liabilities reached 24 per cent of global output in 2024 against a mere 6 per cent in 2008, and that the US private sector has moved into balance. So, the domestic counterpart of its external deficits today is borrowing by the US government. What might end up going wrong?

One answer is protectionism. A part of what we see today is the lagged result of the first China shock on today's US politics, now demonstrated in Donald Trump's blunderbuss approach to tariffs. Another is the impact of Chinese success in advanced manufacturing, particularly against Europe.

As Michael Pettis has long argued, trade, protectionism and finance are linked. If a country has an extremely low share of household consumption in GDP (40 per cent in China's case), it will also have an enormously high share of savings in GDP. Surplus savings then have to be absorbed abroad, especially after the alternative of a domestic property boom (as in Japan in the 1980s and China in the 2010s) collapses. If a country is to export surplus savings, it needs to produce a surplus of tradeables. In China's case, that means manufactures. In sum, China's trade surplus of \$1.2tn last year is not just a product of competitiveness, but also of its macroeconomic imbalances. Moreover, if China has huge savings surpluses, others must have offsetting deficits. The US is the world's most creditworthy country and so naturally its safest borrower.

"If something cannot go on forever, it will stop." This is known as Stein's law (after the late Herbert Stein). But if it is to be stopped wisely, policymakers need to rid their minds of some nonsense.

One such piece of nonsense is that US trade deficits can be eliminated by trade or exchange rate policy alone. It also requires macroeconomic adjustment, notably a reduction in a US general government fiscal deficit forecast by the IMF at 7.5 per cent of GDP in 2026.

Another and opposite piece of nonsense is the idea that the borrower is always at fault: all that is needed is for it to reduce its spending, especially its fiscal deficits. That is the creed of the irresponsible creditor. In the case of small borrowers, this makes some sense. In the case of the US, it does not.

If the only adjustment is US fiscal tightening we will get a global slowdown. Aggregate demand matters. Big economies like China and the EU need to generate enough domestic demand to balance their own economies without forcing foreigners to borrow incontinently. The latter will end up in crises.

The final piece of nonsense is the mercantilist fallacy that the way to get rich is by running surpluses forever. This runs into two dangers. The first is that sooner or later debtors will default. The

second is that, fairly or not, they will also end up hating the surplus countries for ruining their domestic industries. That will be seen as creating poverty and insecurity, on multiple dimensions. That China is now doing this to Germany is mildly amusing. But the amusement must stop and action start now.

So, what should be done? The sensible action would be to follow the advice for macroeconomic adjustments and changes to trade and industrial policies offered by the IMF and by an excellent recent paper for the G7 summit in Paris. The chances of such pre-emptive action are close to zero. Whatever ability we had to do this has vanished in an age of populism, nationalism and multiple follies. The second best option is to prepare for a crisis. Now is the time to start.