INCREASING MACROECONOMIC IMBALANCES IN THE WORLD AND IN THE EURO AREA

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Abstract

Current globalized world is characterized by many macroeconomic imbalances, such as foreign exchange reserves accumulation, current account imbalances (external imbalance) or general government debt (internal imbalance), that are gradually and consecutively increasing in time. External and internal imbalances are observed not only in the world, but also within the Euro area, where the divergence of some indicators is evident. The paper offers the view on some chosen imbalances in the world (reserves accumulation, current account imbalance, debt increase) and in the Euro area countries (current account deficits / surpluses, public debt growth, government bonds interest rates divergence and real effective exchange rate divergence). Furthermore, the paper points out differences between the north and the south of the Euro area, as the north is characterized by current account surpluses while countries in the south have current account deficits and more irresponsible fiscal discipline leading to public debts increase. The paper was elaborated within the project VEGA 1/0973/11.

Keywords: macroeconomic imbalances, external and internal imbalance, current account of balance of payments, public debt, government bonds interest rates

1 INTRODUCTION

“Achieving a ‘strong, balanced and sustained world recovery’...was never going to be easy. It requires much more than just going back to business as usual. It requires two fundamental and complex economic rebalancing acts...” Olivier Blanchard

Nowadays, when the world is globalized, economies are so much interconnected that they cannot exist independently. On the one hand, we can observe international synchronization of macroeconomic cycles, in other words a high correlation of cycles that results from the international commerce increase. On the other hand, we cannot
point out systematically mutual convergence between countries. Actually, we observe divergence between some economies in case of some indicators and we are talking about so called “global imbalances”.

In recent years, different macroeconomic imbalances (for instance balance of payments and its current account deficit / surplus, external and public debt, saving, investments or foreign exchange reserves accumulation) are in the centre of economic research of many researchers but also institutions, such as International Monetary Fund (IMF Conference on imbalances in February 2012), World Bank and European Central Bank. Macroeconomic imbalances became really discussed issue in last few years.

There are different types of imbalances. First of all, we can observe extremely fast increase of foreign reserves in some countries, mainly in China, Japan, India, Brazil and Russia. Secondly, there are current account or trade imbalances (persistent deficits or surpluses), which hold over several years. Moreover, it should be pointed out that they are increasing in time. Thirdly, we are talking more and more about fiscal imbalances (increasing budget deficits) and consequent large and rising public debts especially in some Euro area countries (Greece, Ireland, Portugal, etc.).

In this paper, we will outline tree main imbalances (foreign reserves, current accounts and public debt) evolution in the world. Furthermore, we will focus on European countries and their current account imbalances (external imbalances), the increasing debt problem (internal imbalance), government bonds interest rates divergence and real effective exchange rate divergence.

2 IMBALANCES IN THE WORLD AND IN THE EURO AREA

2.1 Imbalances recent research

Macroeconomic imbalances have been analyzed by many authors from different points of view. The biggest current account imbalance in the world can be observed between United States (deficit country) and China (surplus country). This imbalance is probably the most discussed and described one (e. g. by Brunet and Guichard (2011)).

In recent years, it is clear that China accumulates large amounts of foreign exchange reserves and this process leads to undervaluation of its exchange rate and policy of export-oriented growth (Popov (2010)). These effects of foreign exchange reserves accumulation have been confirmed by several authors such as Easterly (1999), Polterovich and Popov (2004) and Rodrik (2008).

Do global imbalances represent a problem in the world economy? The opinions are different. Many economists (e. g. Blanchard (2009)) consider it as quite a big threat for the future. Others, such as Cooper (2007), who analyzed imbalance between United Stated and China, do not see a problem with the deficit and surplus countries existence. He claims that the disequilibrium does not exist because it has been in the world for quite a long time and even if it exists, it will remain forever. So according to Cooper,
current account imbalances are not a problem and Asia can finance United States for decades.

Conference on “Analyzing (External) Imbalances” organized by International Monetary Fund’s Research Department in February 2012 is the proof that external imbalances interest many economists (Blanchard, Obstfeld and others) who pointed out the importance of this problem and the necessity of balancing imbalances.

2.2 Three imbalances in the world

Last years are characterized by big increase of foreign reserves in the world. According to World Bank statistics (WDI), total world reserves increased from the value 1.4 billion USD (in 1995) to 10.5 billion USD (in 2011). Foreign reserves annual growth rate was the biggest in 2007 (up to 27 %). The situation is illustrated by chosen countries that started to accumulate large amounts of reserves, for instance China, Russian Federation, Japan, India, Europe and Central Asia, Brazil and Arab World (see Figure 1). The highest foreign reserves increase is noted in China. Its reserves were 75 milliards USD in 1995 and reached the value of 3203 milliard USD in 2011. The higher increased is observed from 2002 to 2006, when annual growth were from 30 % to 50 %. High growth rates of reserves are also observed in Russia, India, Brazil and Japan. It is important to notice that the accumulation process did not end and trend of foreign reserves growth persists until today.

![Figure 1 Foreign reserves accumulation in the world](source: own editing, World Bank (WDI))

Why China continues in accumulating its reserves despite numerous criticisms? It seems that appreciation of Yuan could stop fast Chinese economic growth. On the other hand it seems that currency devaluation through foreign exchange reserves accumulation is a politic that encourages export oriented economic growth (Popov (2010)). This idea is confirmed in numerous economic literature, for example Polterovich and Popov (2008), Rodrik (2008) and Easterly (1999).
Another question is whether such big accumulation of foreign exchange reserves is desirable and good for future development of the world. According to Popov (2010), one argument against politics of foreign exchange reserves accumulation and consequent exchange rate undervaluation in developing economies is following: If some countries accumulate large amounts of foreign exchange reserves, developed countries will accumulate unsustainable debts.

Second large imbalance in the world is imbalance in balance of payments current account evolution (external imbalance). Countries can be divided into two groups – those with current account deficits and current account surpluses. It should be pointed out that this type of imbalances seems to be increasing in large measure in recent years.

An increase in current account disequilibrium in chosen groups of countries is noticeable on Figure 2 which captures the evolution from 1980. During the period from 1980 to 1994, there were almost no current account imbalances. But then, current account deficits / surpluses became to increase. On the one hand, developing Asia and Middle East and North Africa are characterized by very big surpluses of their current accounts. Moreover their surpluses are increasing in time. On the other hand, in Unites States, major advanced economies (G7) and Central and Eastern Europe, current account deficits have been observed.

Note: years 2012 – 2015 are IMF estimations

Figure 2 Current account imbalances in the world
Source: own editing, International Monetary Fund
As we mentioned, current account imbalances are consecutively growing during several years. Will they continue to deepen in the future? Are they sustainable? Popov (2010) analyzed current account imbalances and concluded that they can help to diminish the difference in revenue of developed and developing countries. This difference has been actually reduced during last 50 years. The logic is following: if the west is in debt, it helps developing countries to have surpluses which will consequently help them to develop faster.

In addition to foreign exchange reserves accumulation and current account disequilibrium increase, many countries have to face so called internal imbalances. These countries are characterized by budget deficits that result in debt growth each year. Figure 3 outlines the evolution of general government gross debt / GDP ratio in chosen analytical groups of countries. Very fast public debt growth is noticed mainly in major advanced countries (G7), Euro area and United States.

It should be pointed out that the group of countries having current account deficit (see Figure 2) features also public debt increase (see Figure 3). This fact confirms so called “twin deficit” hypothesis – the existence of simultaneous current account deficit and budget deficit (that contributes to public debt increase each year).

![Figure 3: Public debt increase in the world](image)

*Note: the government debt of analytical group = average of government debts of all countries included in given group*

*Source: own editing, International Monetary Fund*
2.3 Imbalances and divergence within the Euro area

Macroeconomic imbalances exist also within the Europe, even within the Euro area. First of all, current account disequilibrium divides euro area countries in surplus and deficit countries (see Figure 4). Interesting fact is that each country of Northern Europe (Finland, Belgium, Netherlands, Luxembourg, Austria and Ireland) has current account surplus almost all analyzed period 1995 – 2011 (exception is only Estonia). On the other hand, countries in the south of Europe are characterized by large current account deficits (Greece, Portugal, Spain, Cyprus, Malta and Slovenia). Ireland and Italy were surplus countries at the beginning, but they started to increase their current account deficits in the second half of analyzed period.

Figure 4 Current account imbalances in the Euro area

Source: own editing, Eurostat

Furthermore, it is important to notice that deficit countries, such as Greece, Portugal or Ireland significantly increased their government debts during recent years. Eurostat statistics show that Portugal raised its debt from 67.7 % of GDP (in 2005) to 107.8 % of GDP (in 2011). The highest government debt increase was observed in...
Ireland, from 27.2 % (in 2005) to 108.2 % (in 2011) and also very large rise was noted in Greece, from 100 % (in 2005) to 165.3 % (in 2011). The evolution of general government debt of selected southern and northern Euro area countries from 2005 to 2011 is given in Table 1.

Table 1 General government debt (% of GDP)

<table>
<thead>
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<th>EUROS AREA - SOUTH</th>
<th>EUROS AREA - NORTH</th>
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<tbody>
<tr>
<td>Greece</td>
<td>100.0</td>
<td>66.4</td>
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<tr>
<td>Portugal</td>
<td>67.7</td>
<td>64.2</td>
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<tr>
<td>Spain</td>
<td>43.2</td>
<td>68.1</td>
</tr>
<tr>
<td>Italy</td>
<td>105.4</td>
<td>44.2</td>
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<tr>
<td>Ireland</td>
<td>27.2</td>
<td>62.3</td>
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<td>France</td>
<td>66.4</td>
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<td>Germany</td>
<td>68.6</td>
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<tr>
<td>Austria</td>
<td>64.2</td>
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<tr>
<td>Netherlands</td>
<td>51.8</td>
<td>58.5</td>
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<tr>
<td>Finland</td>
<td>41.7</td>
<td>33.9</td>
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Source: own editing, Eurostat

Another macroeconomic indicator of increasing divergence within Euro area is 10-year government bonds interest rate evolution, as interest rates reflect country’s macroeconomic development (such budget balance, public debt, external debt, economic growth, etc.).

Many authors (e. g. Hallerberg and Wolff (2008), Gerlach et al. (2010) and Bernoth and Erdogan (2010)), confirmed that higher budget deficit, higher public debt, higher external debt and lower economic growth lead to higher government bonds interest rates, because of risk premium increase. (Note: according to many studies, risk premium of euro area countries is approximately given as a difference between country’s interest rate and interest rate of non-risk country, e. g. Germany).

The evolution of 10-year government bond interest rates in chosen euro area countries from January 1993 to July 2012 is given on Figure 5. We can observe the interest rate convergence and also divergence during the analyzed period.

Interest rates were quite different in January 1993. The highest interest rates were in Greece (24.5 %), Italy (13.4 %) and Spain (12.6 %), whereas Germany, Belgium and Austria had only about 7 % government bonds interest rate. Interest rates were converging from 1993. In January 1998, they were almost of the same value (exception was Greece). The European Monetary Union (EMU) creation led to perfect interest rate convergence. It was the sign of convergence within euro area countries also in other macroeconomic indicators. Interest rates were the same up to 2008, when the divergence started to be increasing. We observe rapid interest rates growth in countries characterized by large debts (Greece, Portugal and Ireland). This fact explains that some Euro area countries were different in fiscal area, so that they could not face the...
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global financial crisis in the same way. The result is government bonds interest rate divergence as a consequence of public debt increase in several Euro area countries.

It is important to notice that the interest rates range in January 1993 (24.50 % - 7.13 % = 17.37 %) was smaller than in July 2012 (25.80 % – 1.24 % = 24.56 %) when interest rates should normally converge as all analyzed countries are in European Monetary Union (see Figure 5).

Figure 5 10–year government bonds interest rates evolution (January 1993 – July 2012)
Source: own editing, European Central Bank

Allesandrini and Fratianni (2012) pointed out that fiscal fragility and external imbalances are principal factors, which explain a significant share of the widening spreads between interest rates of government bonds since the beginning of the global financial crisis. Thus, one of the reasons of interest rate divergence is the fact that countries created only monetary union and no fiscal union, therefore some countries were increasing public debts (such as Greece, Portugal, etc.) as they were applying their own fiscal policy. According to Bordo et al. (2011), the Euro area is not typical economic union because monetary policy is decided at the central level (European
Central Bank) while fiscal policy is mostly carried out at the sub-central (member state) level.

In addition to described imbalances, when we look at real effective exchange rates (the indicator of country's competitiveness), taking into consideration 41 trading partners; we observe divergence within the Euro area, too (see Figure 6).

![Real Effective Exchange Rate Chart](image)

**Figure 6 Real effective exchange rate evolution in the Euro area countries**

*Source: own editing, Eurostat*

### 3 CONCLUSION

The analysis confirms the existence of macroeconomic (external and internal) imbalances in the world and in the Euro area. If we take into consideration the entire world, we observe three main imbalances: I. Very rapid increase in foreign reserves accumulation (mainly in China, Japan, Brazil and Russia), II. Growing current account surpluses (developing Asia, Middle East and North Africa) and deepening current account deficits (United States, G7 countries, Central and Eastern Europe), III. Public debt growth (United Stated, Euro area and G7 countries)

In the Euro area, we have found out that Europe can be divided into two parts: countries of the Southern Europe and countries of the Northern Europe that are quite different regarding external and internal imbalances. The South of the Europe (such as Greece, Portugal, Spain, Cyprus and Malta) is characterized by persistent current account deficits and some countries are characterized by high public debts whereas the
northern part of the Europe (such as Finland, Germany, Austria, Netherlands, Belgium and Luxembourg) has current account surpluses and no problems with public debts.

Furthermore, government bonds interest rates evolution (reflecting increasing budget deficits, public debts, economic growth and other macroeconomic indicators) outline the problem of divergence within the Euro area. According to many authors, the solution of this situation would be the Euro area fiscal integration.

REFERENCES


