Summary for non-specialists
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Growth risks for the EU emanating from global imbalances

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Global imbalances have been at the forefront of macroeconomic research and international policy debate for some time. There is consensus that global imbalances and financial crises are strongly interrelated (Blanchard, Milesi-Feretti, 2009, Obsfeld, Rogoff, 2009, Claessens et al., 2010, Bracke et al., 2008). By many observers and policy makers, global disequilibria are also considered to be one of the major factors contributing to the recent crisis (Bernanke, 2009, Dunaway, 2009, Eichengreen, 2009, Krugman, 2009, Portes, 2009, Barrell et al., 2010, King, 2010). The crisis has also led to a reduction in global imbalances, however, they are now widening again. The rebalancing remains at the core of world macroeconomic policy, both at the global and European levels (G20, 2009, G20, 2010, IMF, 2011, EC, 2012).

The objective of this paper is to investigate the macroeconomic implications of the unwinding of global imbalances for the biggest world players: the US, China, oil exporting countries and the European Union and its individual members, and to examine the implications of current accounts adjustments within the Euro Area.

First, the paper analyses the pre- and post-crisis trends in global imbalances, focusing on potential drivers of rebalancing and the major contributors to this process. Next, we quantitatively assess the macroeconomic impacts of unwinding global imbalances for the US, China, the oil exporting countries, the EU and its individual members, and study the impacts of correcting internal imbalances within the Euro Area. Finally, we discuss policy implications of these adjustments.

To assess the effects of the adjustment to global imbalances empirically we conduct a series of macroeconomic simulations. The analysis is undertaken using the National Institute's global macroeconomic model NIGEM. NIGEM is a large-scale quarterly macroeconomic model of the world economy with most OECD countries modelled separately, and the rest of the world modelled through regional blocks. By incorporating the models for individual countries into the global context, we ensure that the unwinding of global imbalances has, via links between countries, an impact on all economies.

We analyse two groups of scenarios and differentiate between various types of policies that may be applied to reduce global and intra-European imbalances:

- Our global scenarios encompass: a Chinese scenario, an US scenario, an oil exporting countries scenario, and a scenario of a coordinated policy action across the Pacific

- Our European scenarios include: an internal devaluation scenario, a structural reforms and an increase in technology competitiveness scenario, and scenarios of deleveraging in the private and the public sectors.

Our key findings suggest that:

- Global imbalances may be adjusted either through adjustment policies in China or in the US. The adjustment on the Chinese side results in a lower current account in China and higher current accounts in the US and the Euro Area. The adjustment on the US side results in a higher current account in the US and lower current accounts in China and the Euro Area.

- From the European perspective, adjustments in China result in an improvement of current accounts in all Euro Area countries, while adjustments in the US result in a deterioration of current accounts across the Euro Area. In the case of the US adjustment, the deterioration of the current account in the Euro Area is larger than in China which results from the fact that China is less responsive to external shocks due to, *inter alia*, a relatively rigid exchange rate.

- Intra-European imbalances may be adjusted through various policies: internal devaluation in the Southern European countries, structural reforms and improvements in technological competitiveness in Greece, Portugal, Spain and Italy, and deleveraging of the private and public sectors in Southern Europe.

- There is no silver bullet solution, and an appropriately calibrated mix of policies is probably required. The adjustment on the side of the Southern European countries results in an improved current account for the Euro Area as a whole.