conomic analysis for business

Global capital flows and imbalances

VANESSA ROSSI

Director International Economics, Oxford Economic Forecasting and Associate Fellow, Chatham House

November 2005

www.oef.com and vrossi@oef.co.uk

Tel: (44) 1865 268900 and 268903

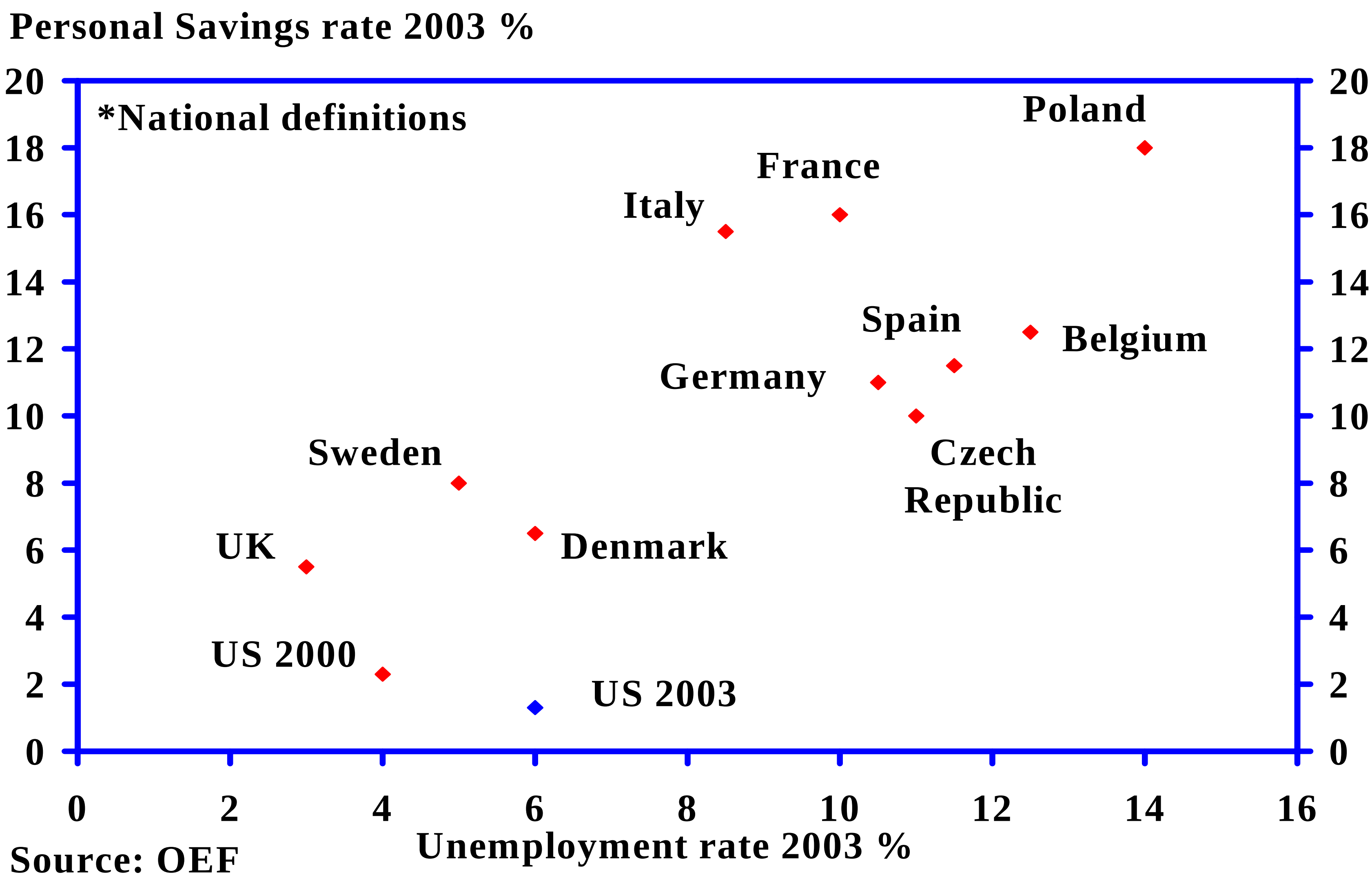
The "simultaneous" world

- **Reminder that the world economy is complex - no one magic bullet for imbalances – well *not one we would like***

- **Hope to "persuade" global imbalances to gradually unwind – every little helps – but *"must try harder"***

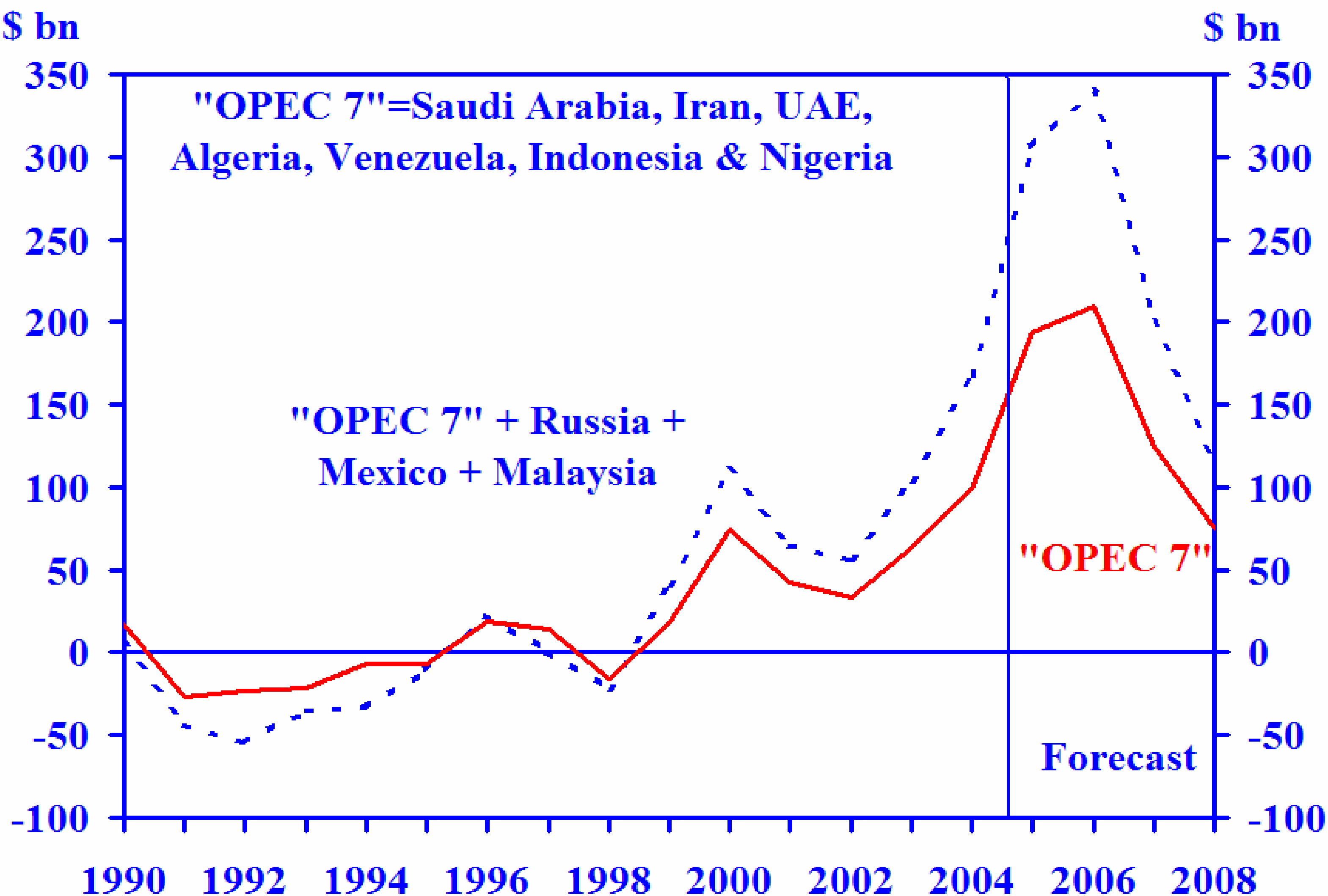
- **Counterparts to US problem – China trade surplus – Europe's capacity gap and high unemployment – oil market …**

Savings rates* & unemployment



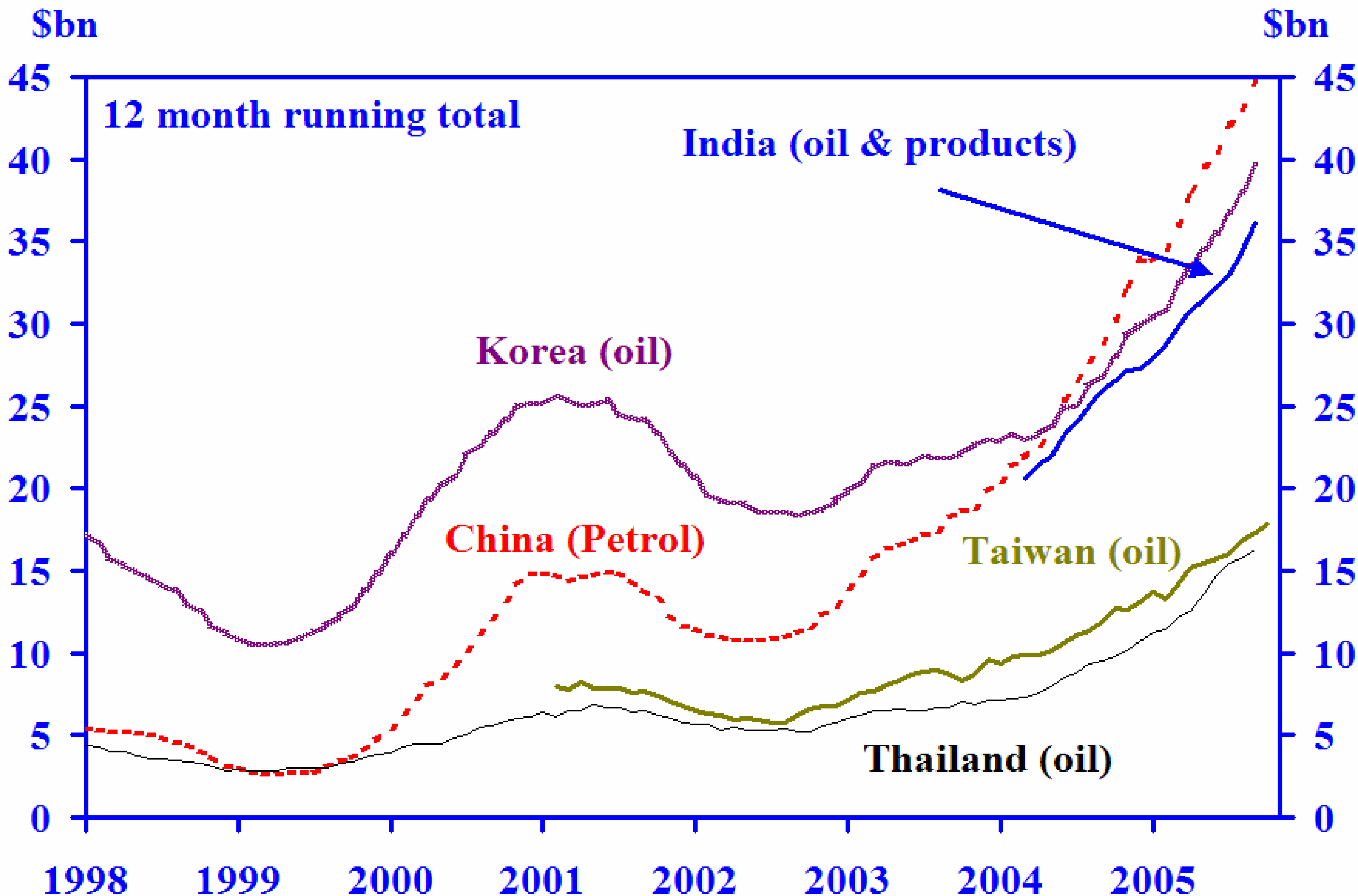
Source: OEF

Oil producers: Current account balances



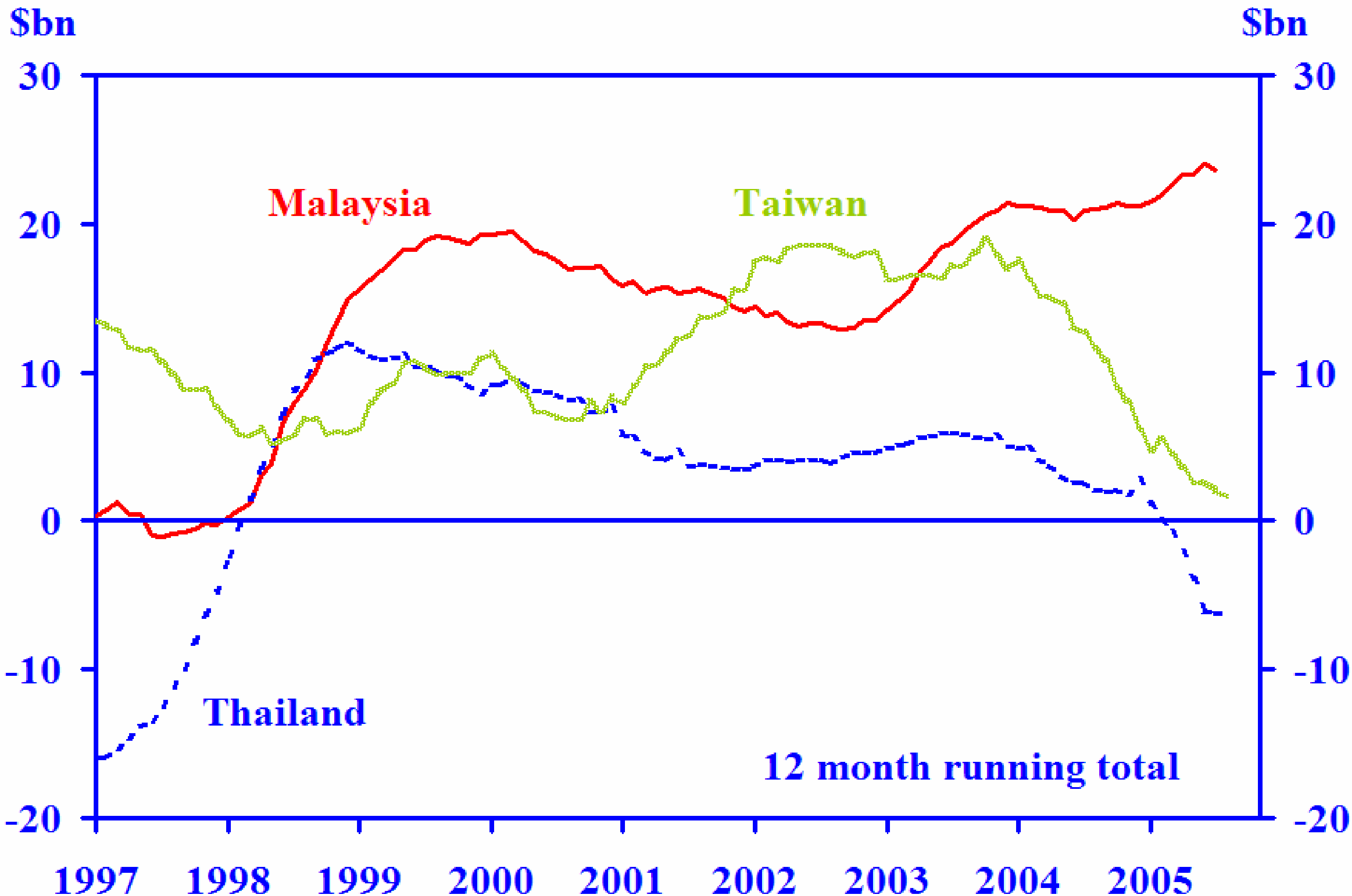
Source: OEF

Asia: Oil import bill



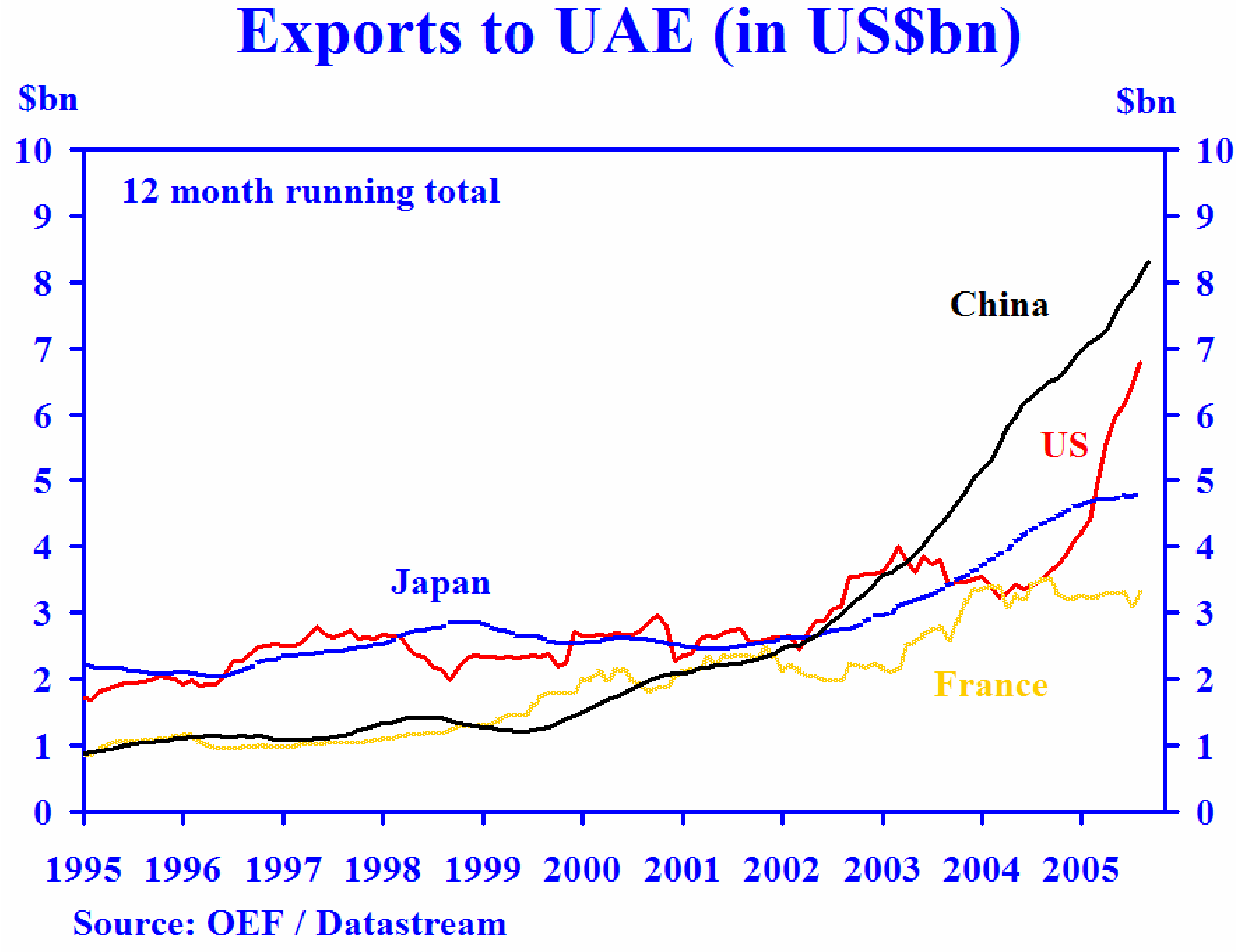
Source: Datastream / central banks

Asia: Trade balances

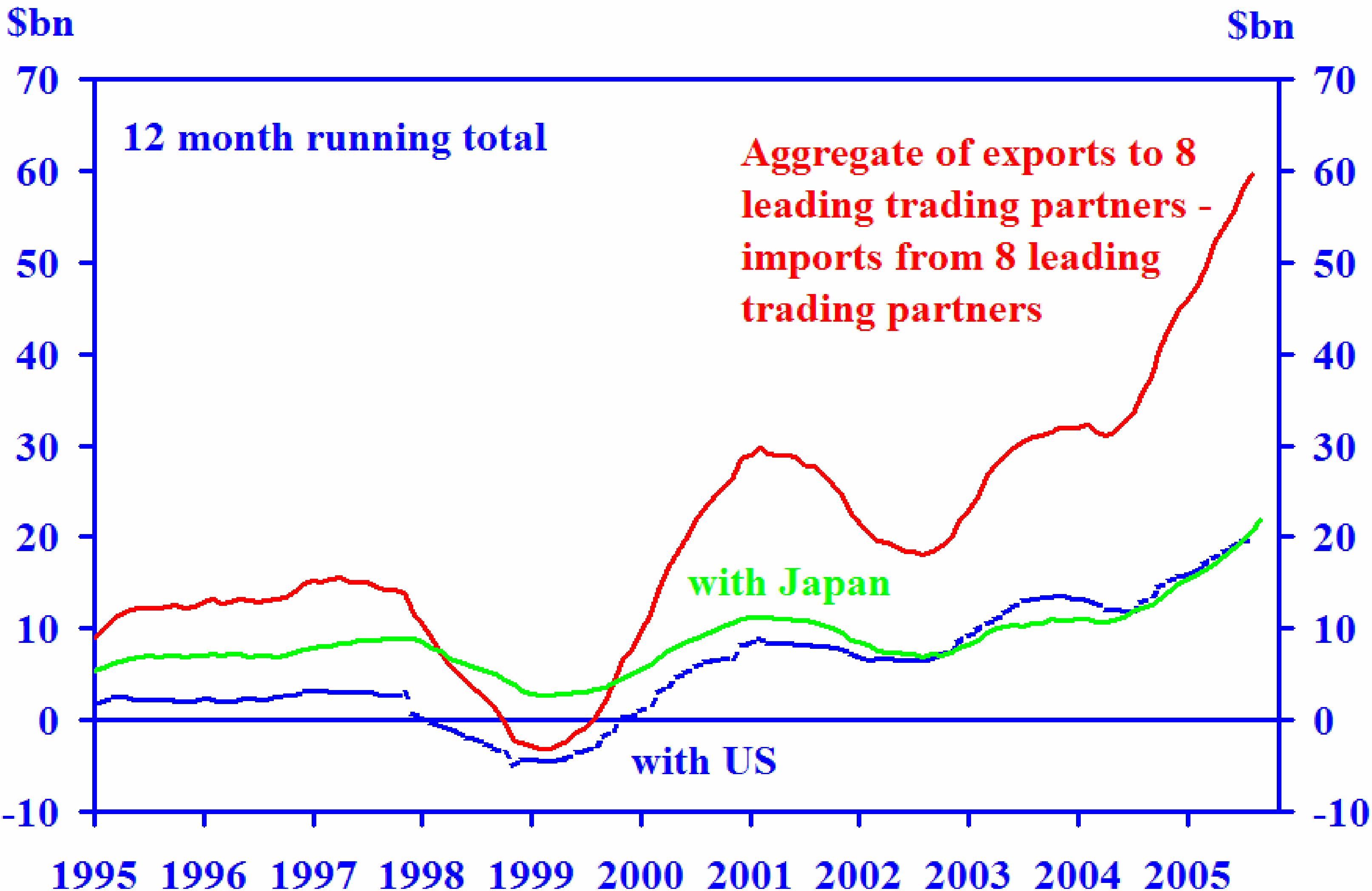


Source: OEF


China: Trade balance
$bn
$bn
105
90
75
60
45
30
15
0
105
90
75
60
45
30
15
0
12 month running total
2001
2002
2003
2004
2005
Source: OEF/Datastream

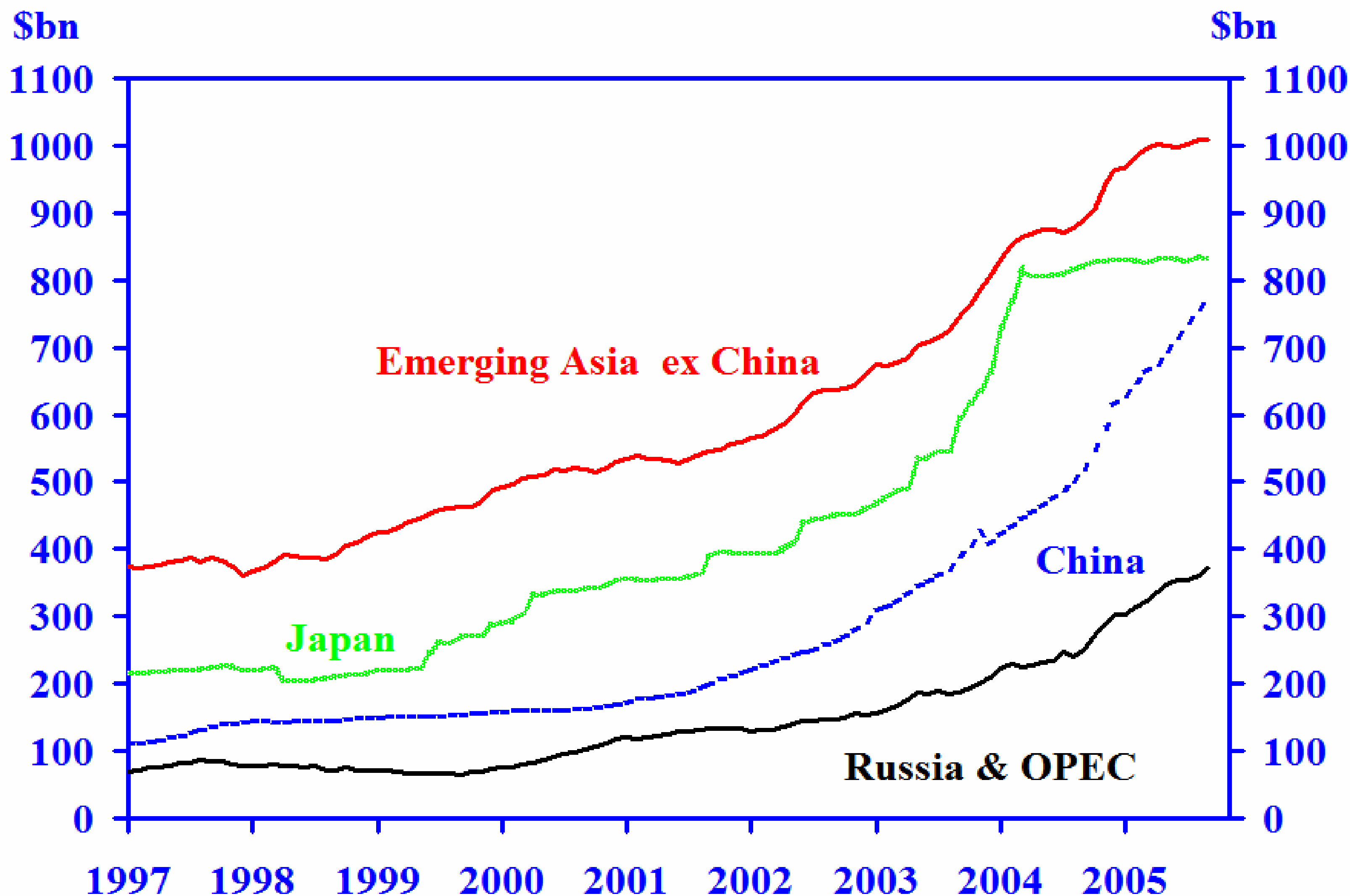

Exports to UAE (in US$bn)
$bn
$bn
12 month running total
China
US
Japan
France
0
1
2
3
4
5
6
7
8
9
10
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Source: OEF / Datastream

Saudi Arabia: Trade surplus indicator



Source: OEF / Datastream

Emerging Asia: Official fx reserves



Source: OEF

Are we heading for a crisis?

- **Yes - according to those who see the US trade deficit as "unsustainable"**
- **But it has been "sustained" so far – so at what point is it "unsustainable" ?**
- **Demand for dollars is high – trade finance largely in $, rising FX reserves but also strong private investor demand**
- **What proportion of US assets do investors want in their total wealth?**

US current account $bn

	2003	2004
Exports of goods	713	808
Exports of services	309	344
Income receipts	310	380
Total	1332	1531
Imports of goods	1517	1769
Imports of services	257	296
Income payments	264	349
Total	1781	2118
Net current transfers	-71	-81
Current account	-520	-668

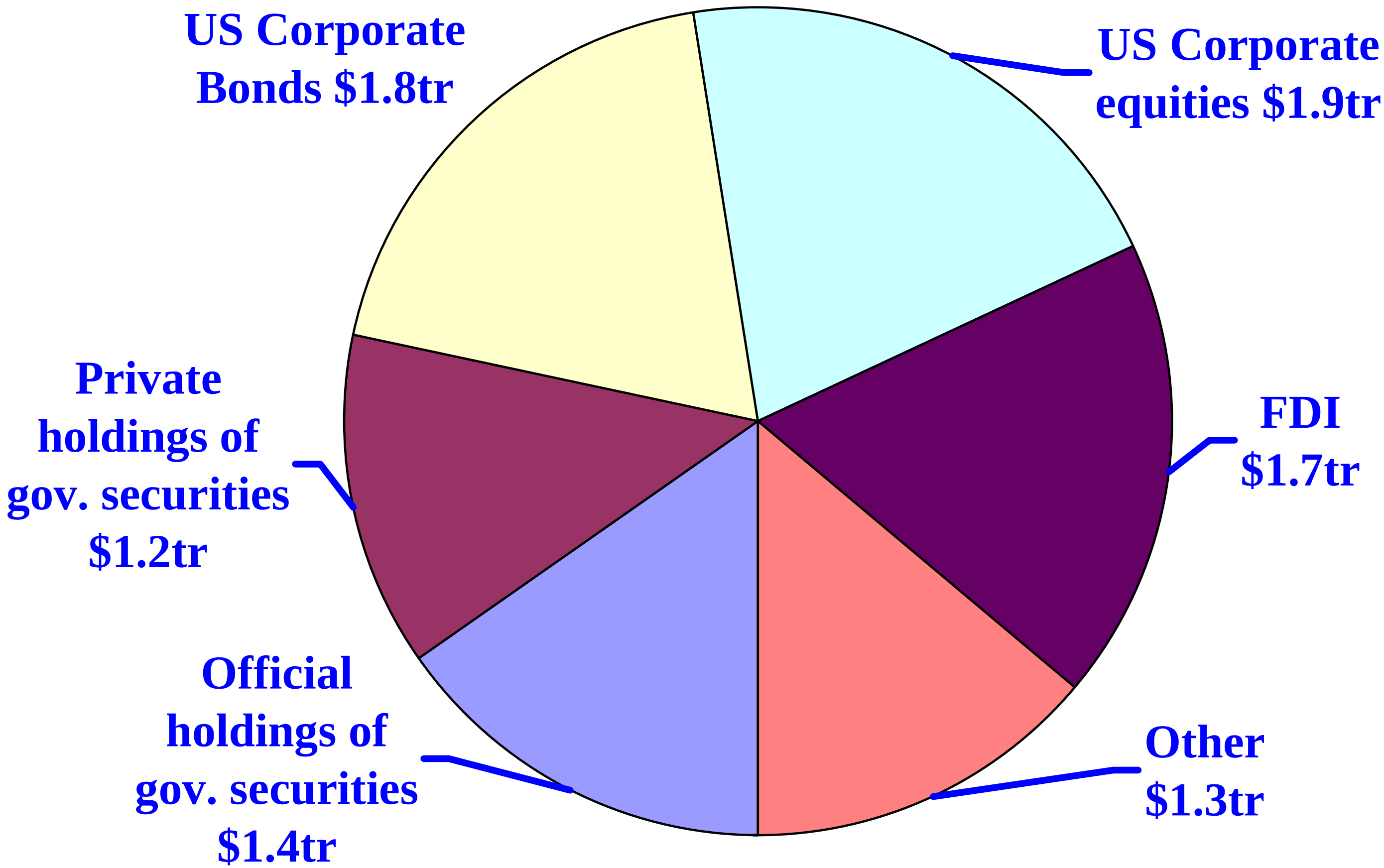
Source: US Bureau of Economic Analysis

US financial account in 2004 (US$bn)

	2003	2004
US assets abroad	-328	-856
US private assets	-330	-860
Direct investment	-141	-252
Foreign securities	-156	-102
US claims reported by non bank	-24	-149
US claims reported by US banks	-10	-356
Foreign assets in US	889	1440
Official assets	278	395
Direct investment	67	107
US treasury securities	104	107
US securities other than treasury	226	370
US liabilities reported by US banks	97	323

Source: US Bureau of Economic Analysis

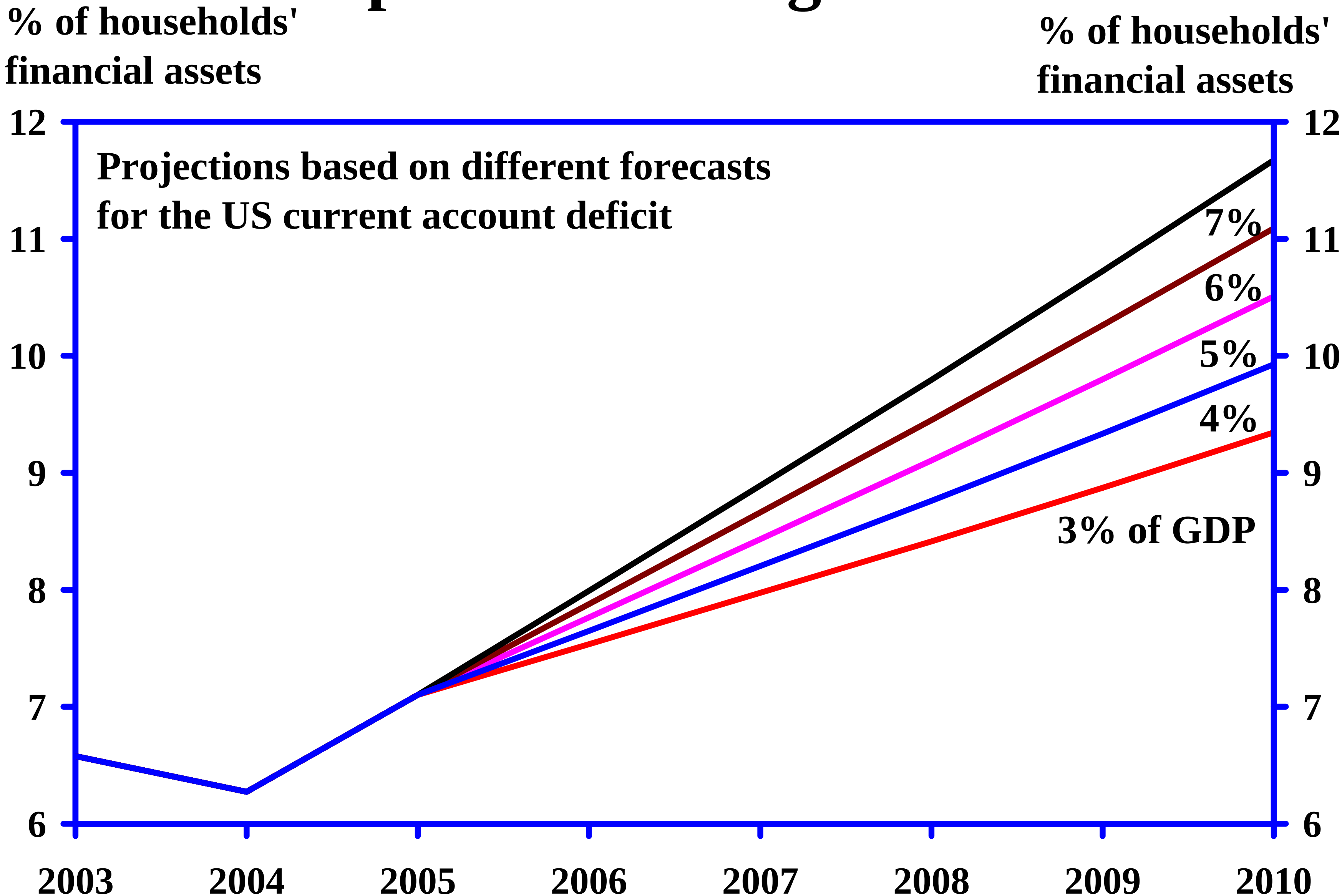
Foreign holdings of US Assets (2004)
US$ trillion



Total assets = US$9.3 tr
Total liabilities = US$4.3 tr

Source: Flow of Funds Accounts

Non-US private holdings of US Assets



Source: OEF calculations

threat of discontinuities

- We must understand the case for "sustaining the unsustainable"
- Then its important to recall that small continuous changes can lead to major dislocations – financial markets fickle
- Investors could back out of dollars
- But the system can be stabilised – cut deficits and/or act to stabilise global interest rates in event of turbulence