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An Uneven COVID Recovery Widens Global Current Account Imbalances: Is U.S. Outperformance A Problem?

April 29, 2021

CONTACTS

Paul F. Gruenwald
Global Chief Economist
55 Water Street, New York, NY
+1 212 438 1710
Paul.gruenwald@spglobal.com

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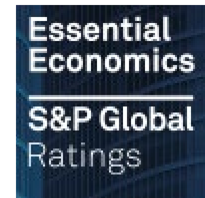

A salient characteristic of the economic impact of COVID-19 – both the initial shock and the evolving recovery - has been the extraordinary extent of the unevenness. We have documented this from both a macro and credit angle in our most recent Credit Conditions round. [1]

One dimension has been sectoral. Due to social distancing and mobility constraints, the economic fallout from the pandemic has been an outsized negative effect on firms and workers in a small number of sectors: food and beverage, entertainment, and travel and tourism. Economies that struggled to contain the pandemic and that relied more heavily on those sectors for growth were hit harder.

Another dimension has been uneven governmental response reflecting available fiscal space. Many advanced economics and some emerging markets had more scope to borrow that previously thought, which help to cushion the immediate blow from the pandemic and to lay a bridge to the recovery.

The latest dimension has been the speed of vaccine rollouts. While economies in the Asia Pacific region generally have done a better job containing the spread of the virus relative to the West, the script has flipped as we move into the vaccination phase of the crisis. Now, the US (and the UK) are the major economies leading the way, with fast vaccination leading to rising confidence and the unlocking of spending as social distancing restrictions are relaxed relatively quickly. First quarter US data showing 6.4% annualized growth and another negative contribution from net exports underscores this view. [2]

In this blog we focus on a less covered dimension of unevenness: widening current account imbalances. While the recovery from COVID-19 was always more consumption heavy in the US and manufacturing and export led in Asia (with Europe somewhere in between), the rollout of vaccinations will amplify this pattern. This can be seen from the national account identities.

Saving (S) – Investment (I) = Exports (X) – Imports(M) = Current Account Balance (CA)

While the global current account is always zero by definition (we earthlings don't trade with anyone else so X-M =0), the pattern of current accounts can move across economies. That is exactly what is happening now. At present, a faster recovery and unwinding of pent-up savings in the US will result in faster growth and risings imports, pushing the current account balance lower. The effects in much of the rest of the world will push current accounts higher, as must be true from the identity.

Chart 1

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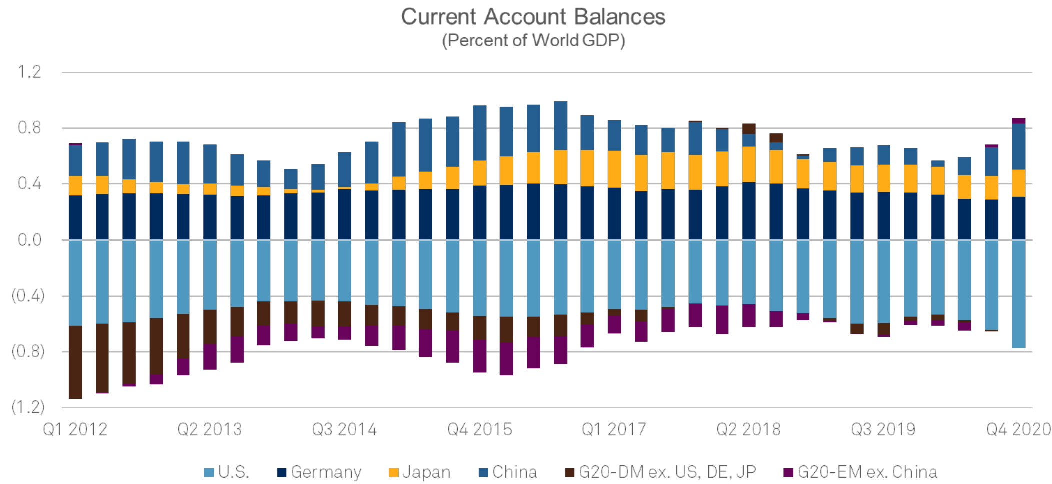

Note: Country group data as PPP GDP-weighted averages.
Source: National Statistics Bureau, Bloomberg. Data through Q4 2020

Is this relative US outperformance a problem? Global current account imbalances do not necessary portent a crisis, but they need to be monitored. Here are our takeaways:

- *Global current account imbalances will widen also long as the present macro configuration persists.* That is, a demand/consumption driven US recovery fueled by accelerating vaccinations and a manufacturing/ supply led recovery in Asia and parts of Europe with lagged vaccinations is the current configuration. On current trends, this will get worse before it gets better.
- *Higher bilateral tariffs do not resolve trade and current account deficits.* Remember these? The US-China trade war tariffs – which from the US side were designed to reduce the widening trade (and current account) deficit -are still in place. What happened? [3] Unless the tariffs alter the overall savings and investment behavior of an economy, they are not driving the current account dynamics. Instead, they just redirect trade flows within the envelope of existing savings and investment.
- *Current account deficits need to be financed.* This is the most critical issue in our view. While there is not a one-to-one financing mapping from surplus to deficit countries (we have more sympathy with the BIS view than the Bernanke view), [4] those countries depending on external financing will now need to compete with the US. This is particularly relevant for those emerging markets that do not issue debt in their own currency, although these needs may be mitigated by the global recovery.

We continue to have orderly global reflation on the back of a balanced recovery as our baseline macro-credit scenario. But, as noted in our latest Credit Conditions rounds, disorder can stem from an imbalanced recovery, including having the US get too far ahead of the rest of the world. We have already seen some market volatility. And several emerging market central banks raising rates in order to protect their balance of payments including their ability to access global capital markets. Continually imbalanced growth – and current accounts – will raise the risk of macro-credit disorder.

This product does not constitute a rating action.

[1] Our latest credit conditions documents can be found here: https://www.spglobal.com/ratings/en/research-insights/topics/global-credit-conditions.

[2] For details from the Bureau of Economic Analysis, see: https://www.bea.gov/sites/default/files/2021-04/gdp1q21_adv.pdf.

[3] For a nice breakdown by the Council on Foreign Relations, see: https://www.cfr.org/blog/tariffs-and-trade-balance-how-trump-validated-his-critics?utm_source=twtw&utm_medium=email&utm_campaign=TWTW%202021April23&utm_content=Final&utm_term=TWTW%20and%20All%20Staff%20as%20of%207-9-20.

[4] The idea here is that gross financing flows are the relevant metric rather than current account balances, which represent net flows. See https://www.bis.org/publ/work525.pdf.

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