

Research Fellowship Programme – Growth perspectives for the EU

Essay on Growth risks for the EU emanating from global imbalances

Background

The global economy continues to be plagued by large external imbalances among major countries and regions. While these imbalances are considered by some to be at the roots of the economic and financial crisis, there has not been a significant adjustment over past several years. The future prospects for global rebalancing are unclear. Much research has focused on the drivers of these imbalances and a number of possible hypotheses have been formulated, including the global saving glut, new mercantilism approaches, excess global demand for safe assets coupled with asymmetric provision of such assets. The implications of these different alternatives for the future prospects for rebalancing vary significantly: while some are driven by unsustainable trends and imply reversals in the current trends, other explanations are consistent with the perpetuation of global imbalances. To promote balanced growth, the initiatives at G20 level strive for a gradual and coordinated reduction of imbalances. However, a spontaneous and disorderly unwinding, involving large shifts in nominal and real exchange rates among the major currencies and 'sudden stops' in capital flows, cannot be excluded. The high levels of indebtedness of most advanced economies implying the need for further deleveraging and the unbalanced growth models in emerging market economies are just two factors which could affect the evolution of global imbalances.

Less attention has been paid in economic literature to the implications of adjustment in global imbalances for the EU. This is partially due to the fact that the EU has had a roughly balanced external position for years. At the current juncture, the economic situation in the EU remains fragile and adverse adjustment in global imbalances could weigh heavily on the growth prospects and complicate the macroeconomic management, particularly in the euro area. The impact of global rebalancing, in whatever way it occurs, will likely be rather differentiated across Member States and can further accentuate the existing differences and jeopardise the necessary rebalancing within the euro area.

Aims of the essay and key questions to be tackled

The objective of the essay is to provide analysis on the possible implications of adjustment of global imbalances for the EU, particularly in terms of its impact on economic growth and inflation.

Important issues to be addressed include:

- The envisaged research should re-examine the pre- and post-crisis trends in these global imbalances and re-assess the medium-term implications associated with the process of adjustment, particularly the risks associated with disorderly unwinding of imbalances. In this sense, the analysis should differentiate between potential drivers of

rebalancing and the major contributors to such a process (e.g. China and the US, but also oil exporting countries) and analyse the main transmission channels involve,(e.g. financial and trade channels), and their relative strength. Account should be taken of the effects of a likely continuous rise in oil prices.

- In particular, the analysis could focus on the risks to growth and inflation in the EU emanating from high public and private sector debt in most advanced economies, significantly unbalanced growth models in emerging market economies, and on eventual implications for exchange rate developments and macro-economic policy settings in the euro area as a whole.
- Alongside of the implications for the EU and euro area, the envisaged research should also focus on the implications of (dis)orderly adjustment for the evolution of divergences inside the EU. In particular, what would be the implications for the euro area countries and non-euro area countries with fixed exchange rates? What role would the differences in trade and financial exposures of individual Member States would play?
- Based on conclusions, the study should provide policy advice on the growth-enhancing reforms EU/EA should undertake to increase its absorption and adjustment capacity in view of global shocks.