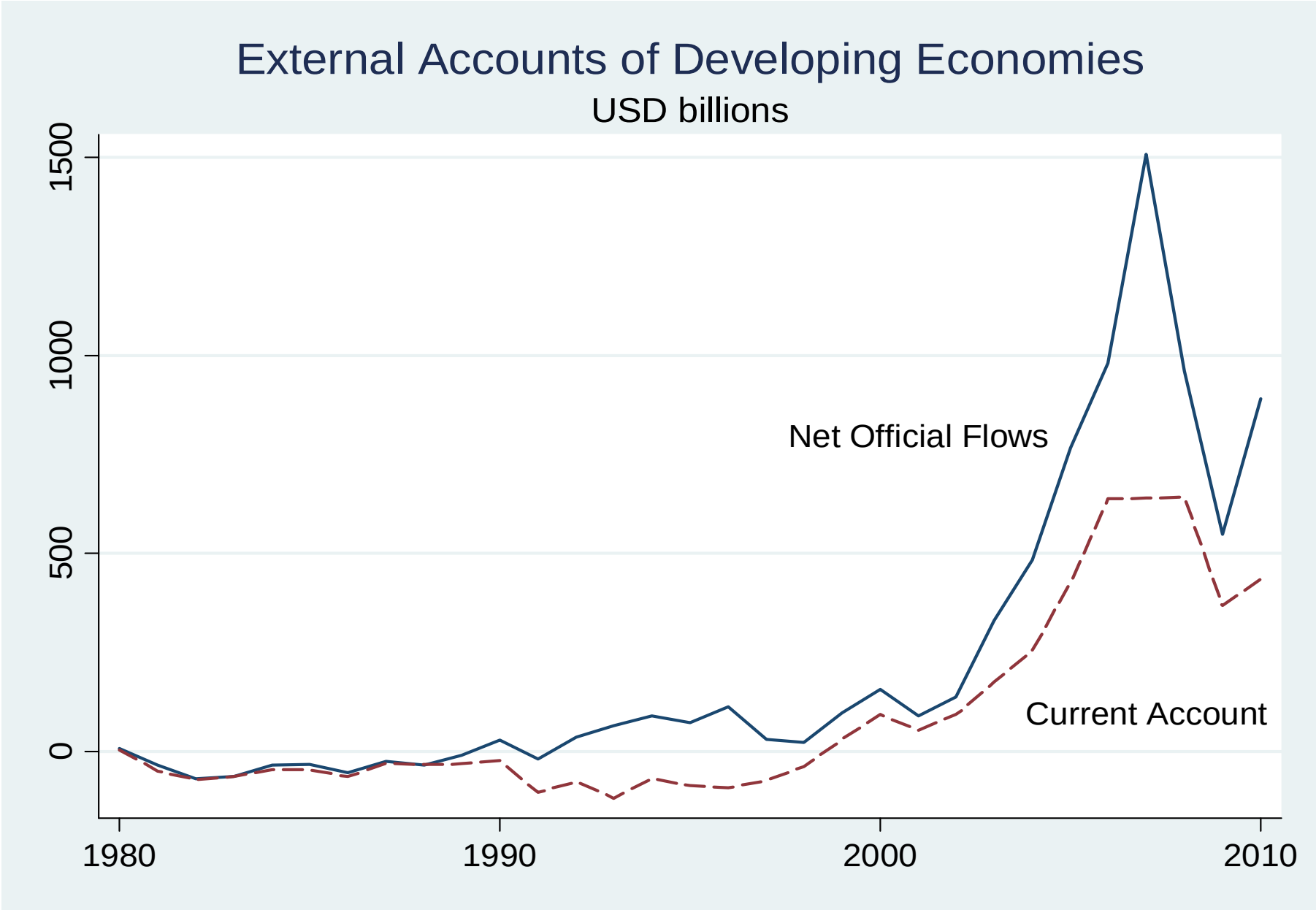
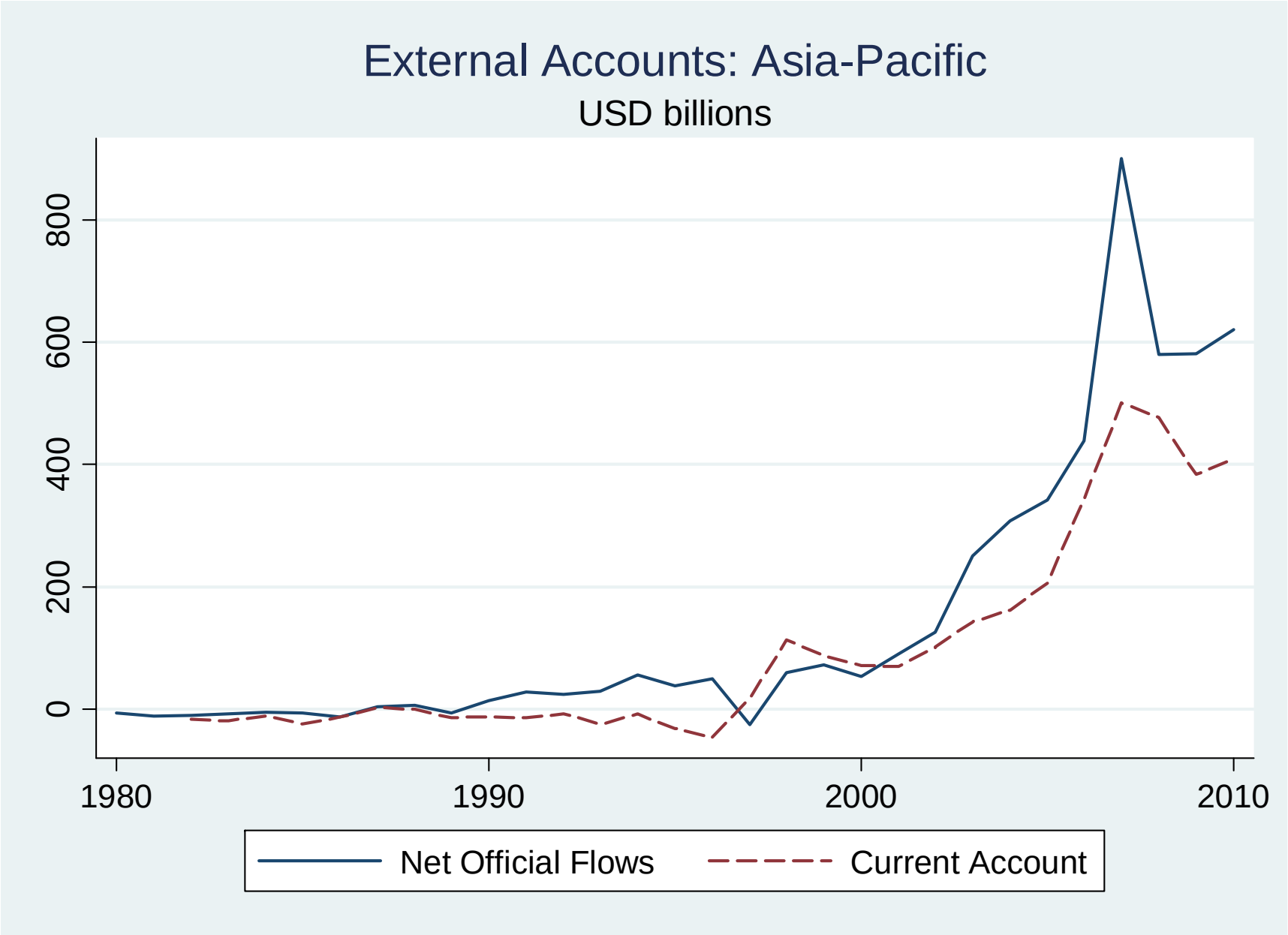
Peterson Institute for International Economics

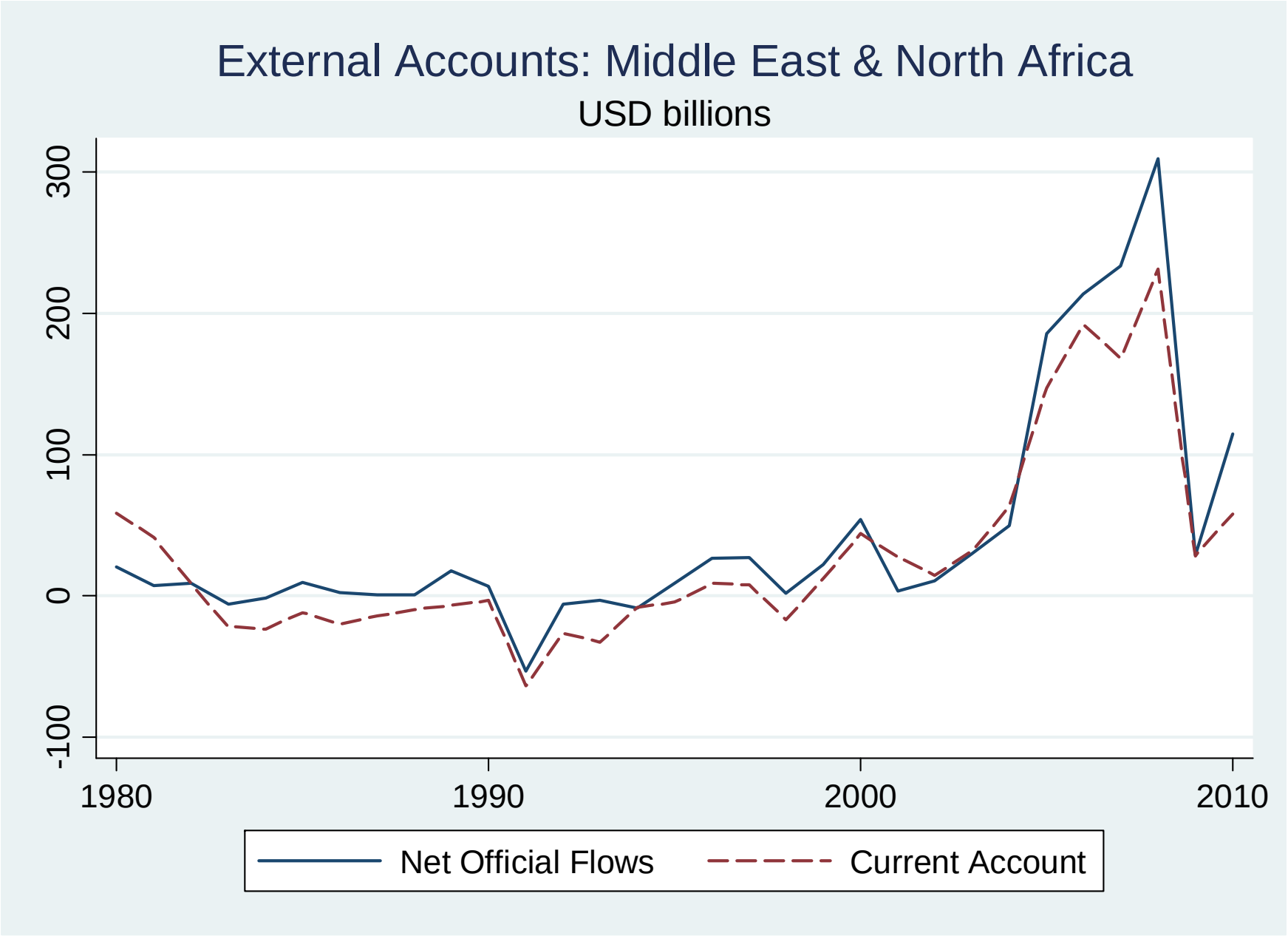
Global Imbalances and Foreign Asset Expansion by Developing-Economy Central Banks

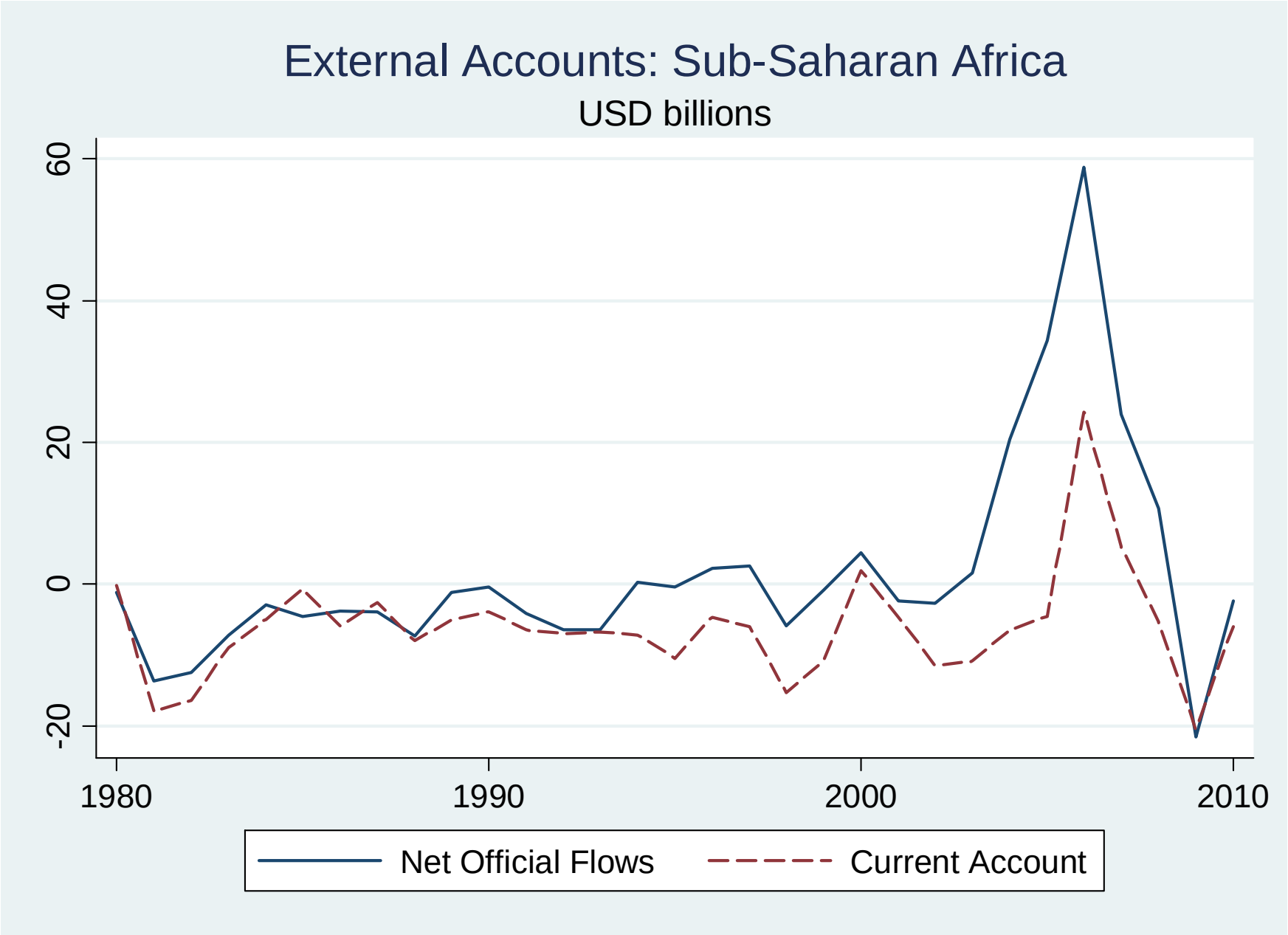
Joseph Gagnon

January 2012


External Accounts of Developing Economies
USD billions
1500
1000
500
0
1980
1990
2000
2010
Net Official Flows
Current Account


External Accounts: Asia-Pacific
USD billions
0
200
400
600
800
1980
1990
2000
2010
Net Official Flows
Current Account


External Accounts: Middle East & North Africa
USD billions
300
200
100
0
-100
1980
1990
2000
2010
Net Official Flows
Current Account


External Accounts: Sub-Saharan Africa
USD billions
60
40
20
0
-20
1980
1990
2000
2010
Net Official Flows
Current Account

Is the regression coefficient of Current Account on Net Official Flows biased?

Floating Exchange Rate: No

Fixed Exchange Rate: Maybe

Is the regression coefficient of Current Account on Net Official Flows biased?

Floating Exchange Rate: No

Fixed Exchange Rate: Maybe

No bias from shock to exchange rate target.
Upward bias from shock to trade/current account.
Downward bias from shocks to domestic demand and private capital flows.

Bias is small when either:
- Private capital mobility is low, or
- Real exchange rate expectations close to a random walk.

Is the regression coefficient of Current Account on Net Official Flows biased?

Floating Exchange Rate: No

Fixed Exchange Rate: Maybe

No bias from shock to exchange rate target.
Upward bias from shock to trade/current account.
Downward bias from shocks to domestic demand and private capital flows.

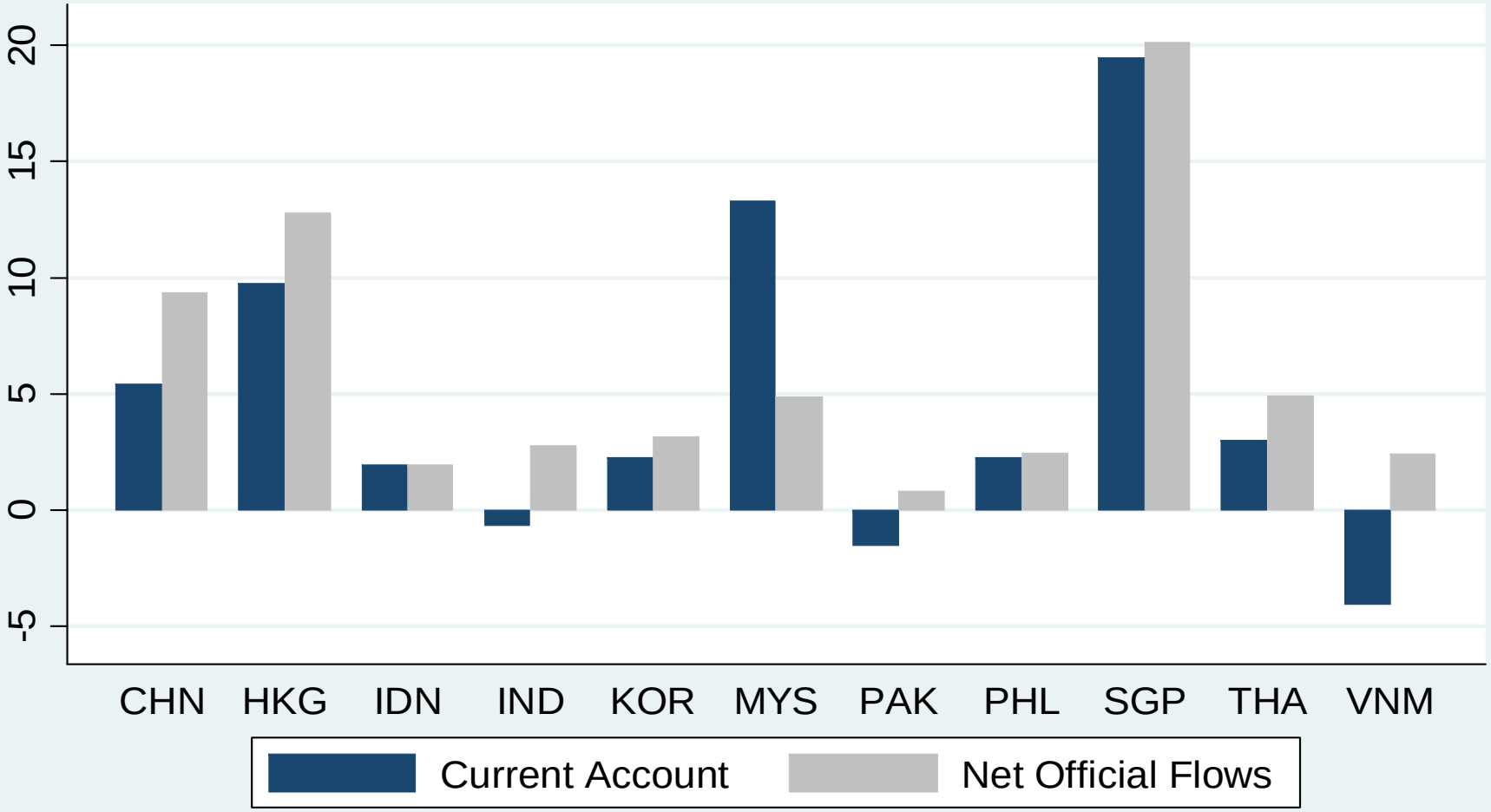
Bias is small when either:
Private capital mobility is low, or
Real exchange rate expectations close to a random walk.

Gagnon (2011) shows that this coefficient is little affected by splitting the sample according to different classifications of exchange rate regime.

This coefficient is by far more stable and robust than others commonly estimated.

Average External Balances of Asian Economies, 2001-2010

percent of GDP



Sources: IMF International Financial Statistics and Truman (2011, Table 1).
Note: Net official flows include an estimate of sovereign wealth fund flows.

Table 2. Major Factors behind Current Account Balances, 1981-2010
(Pooled cross-country regression on decade averages with decade dummies)
(weighted by country share of world nominal GDP)

	(1)	Unweighted (2)	1981-1990 (3)	1991-2000 (4)	2001-2010 (5)	Unadj. Official[1] (6)	Official Only (7)	Fiscal Only (8)
Official Flows	0.67**	0.40**	0.38	0.56*	0.71**	0.67**	0.76**	
	(.11)	(.11)	(.21)	(.26)	(.17)	(.13)	(.10)	
Fiscal Balance	0.24*	0.44**	0.26	-0.04	0.32	0.41**		0.56**
	(.11)	(.13)	(.13)	(.13)	(.26)	(.13)		(.14)
R^2	.42	.28	.21	.16	.56	.34	.39	.19
No. Obs.	397	397	108	131	158	399	430	441

	Ind. Econ. (9)	Devel. Econ. (10)	Devel. Econ. (11)	Devel. Asia (12)	Africa (13)	MENA (14)	Latin Amer. (15)	CEE & CIS (16)
Official Flows	0.69** (.21)	0.54** (.08)	0.62** (.11)	0.73** (.10)	0.51** (.17)	0.44 (.29)	0.38** (.10)	0.99* (.38)
Fiscal Balance	0.40** (.15)	0.27** (.09)	0.32** (.09)	0.23** (.07)	0.49* (.23)	0.55** (.20)	-0.13 (.11)	0.76* (.30)
Change in Elderly Ratio	0.36** (.13)	-0.22 (.20)	-0.07 (.18)					
Net Foreign Assets (x100)	6.93** (1.92)	3.85** 1.20)						
R^2	.62	.59	.61	.75	.27	.78	.25	.75
No. Obs.	65	235	321	67	103	40	90	31

How Important Is This Phenomenon?

IMF (September 2011) estimates that net official flows of emerging and developing economies will total $1.2 trillion each in 2011 and 2012.

- This estimate does not include official purchases of newly industrialized economies (Hong Kong, Israel, Korea, Singapore, Taiwan).
- This estimate does not include purchases by sovereign wealth funds.
- On the other hand, the slowdown of private capital inflows to emerging markets since August may not be fully factored into this estimate.

$1.2 trillion is roughly 4 percent of combined euro-area and US GDP, which are almost exclusively the destinations of this capital flow.

- A 4 percent of GDP net official capital flow into the world's two largest economies is an enormous amount in terms of net savings flows.
- This negative net external demand is a significant contributor to weak economic recovery at present in the euro area and the United States.
    - There is limited room for maneuver by monetary and fiscal policy in the euro area and the United States right now.

“I think right now a concern is that the Chinese currency policy is blocking what might be a more normal recovery process in the global economy. In particular, we have now a two-speed recovery where advanced industrial countries like the United States and Europe are growing very, very slowly; where emerging market economies are growing quite quickly.

In a more normal recovery, a more balanced recovery would have some more demand being shifted away from the emerging markets toward the industrial economies. The Chinese currency policy is blocking that process. And so it is to some extent hurting the recovery process.”

Federal Reserve Chairman Ben S. Bernanke
Response to Senator Casey
4 October 2011
www.c-spanvideo.org