Germany's current account and global adjustment

THE SPECTACULAR increase in Germany's external current account balance since the millennium—from €37 billion deficit in 2000 (-1¾ percent of GDP) to €263 billion surplus as of 2017Q1 (+8¼ percent)—has caught the eye of commentators and policymakers alike in recent years.

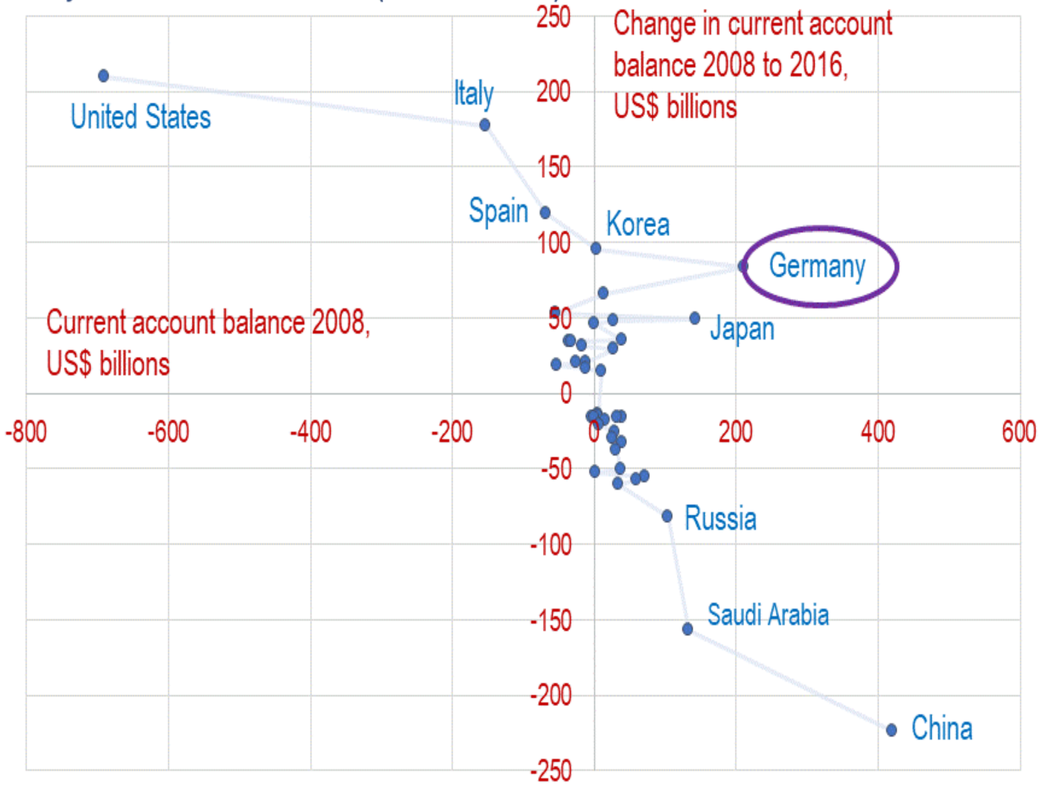
Indeed, interest in Germany's export growth "miracle" has given way to protectionist voices—notably from the United States' President—as Germany's surplus has grown. From a macroeconomic perspective, however, it is crucial to understand how this surplus impacts the global distribution of balances. Against whom is this surplus being carried? How is Germany contributing to global adjustment?

The promise of the Bretton Woods Conference in 1944 was the *public good* of an international monetary system based on symmetric adjustment. Doesn't failure to promote symmetric adjustment represent an abrogation of international commitments?

In any case, protectionism and unbalanced adjustment are closely related. If you mind the global macroeconomy, free trade and a liberal outlook will follow! But if those in deficit—countries, regions, groups within society—are forced to carry the full burden of adjustment, the failure of surplus agents to contribute will only fuel social unrest or protectionism.

As the G20 meet in Hamburg, it is worth pausing to place Germany's external accounts in context. Has Germany contributed to global adjustment in recent years? Against whom is Germany's surplus recorded? And how has it evolved?

Figure 1: Global rebalancing: The forty largest current account adjustments since 2008 (US$ billions)



Source: IMF World Economic Outlook database, April 2017

I. Global adjustment since 2008

Since the onset of the global financial crisis—here taken as 2008—Germany stands out for lack of adjustment. See Figure 1. Nearly every major deficit or surplus country over the last 8 years has adjusted *down* their external current account "imbalance" (that is deficits or surpluses contracting.) Most countries therefore fall into the top-left or bottom-right quadrant in Figure 1, which shows the scale of the adjustment against their initial 2008 "imbalance."

But Germany—and to a lesser degree Japan—has gone from a large to even larger surplus over this period.

The contrast with China is perhaps most revealing. Admittedly there are concerns with the quality of China's data, but from what we know China's current account surplus has fallen roughly one-half in dollar terms since 2008 to reach $196 billion in 2016. Germany's external surplus meanwhile has grown. From the second largest in US dollar terms in 2008 at $211 billion, Germany's surplus has continued to expand to reach $294 billion in 2016—despite the euro area crisis! Germany's surplus in 2008 was about 5½ percent of GDP; during the past two years, it has registered above 8 percent of GDP.

Indeed, taking the euro area as a unit—only individual countries are shown in Figure 1—unveils the largest absolute current account move of all time. From a deficit of $173 billion in 2008 to surplus of $400 billion in 2016, this eight-year-$573 billion change in the current account by far exceeds the $210 billion and $224 billion equivalent adjustments of the United States and China. It also exceeds any other historical eight-year current account change in US dollar terms—such was the deflationary force of the euro area crisis.

Figure 2: Germany's latest current account balance decomposed by region (2017Q1, 4Q Sum, billions €)

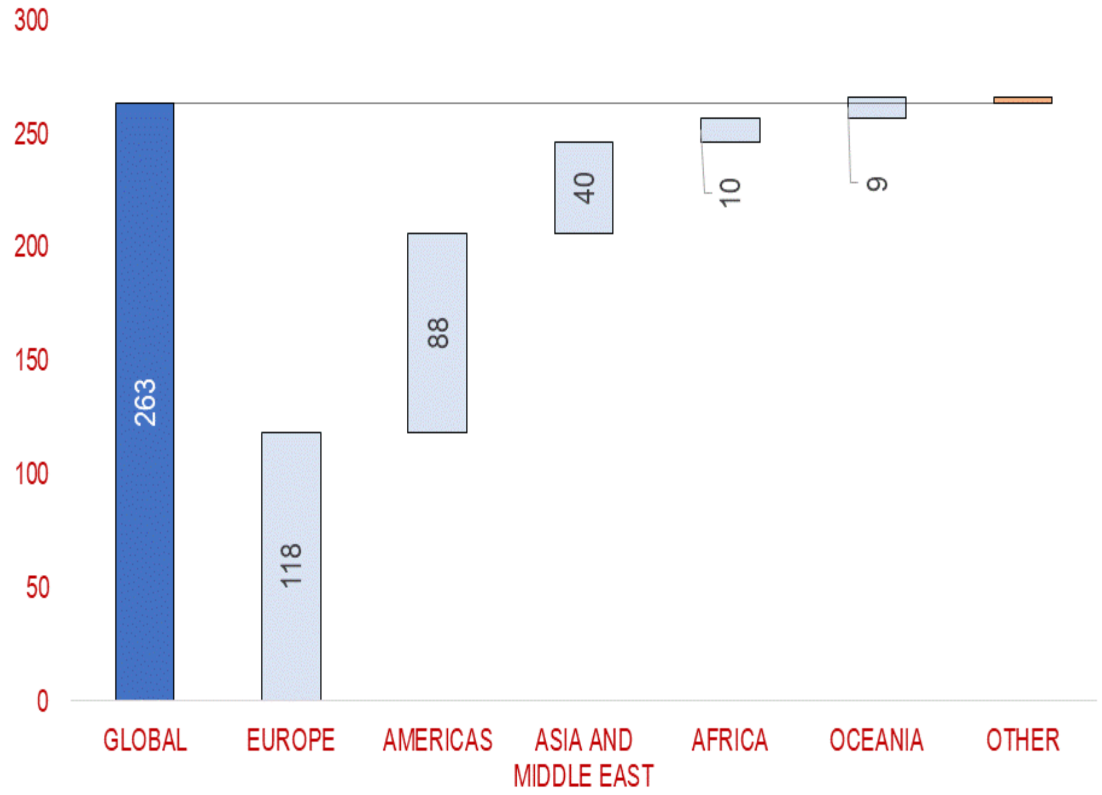
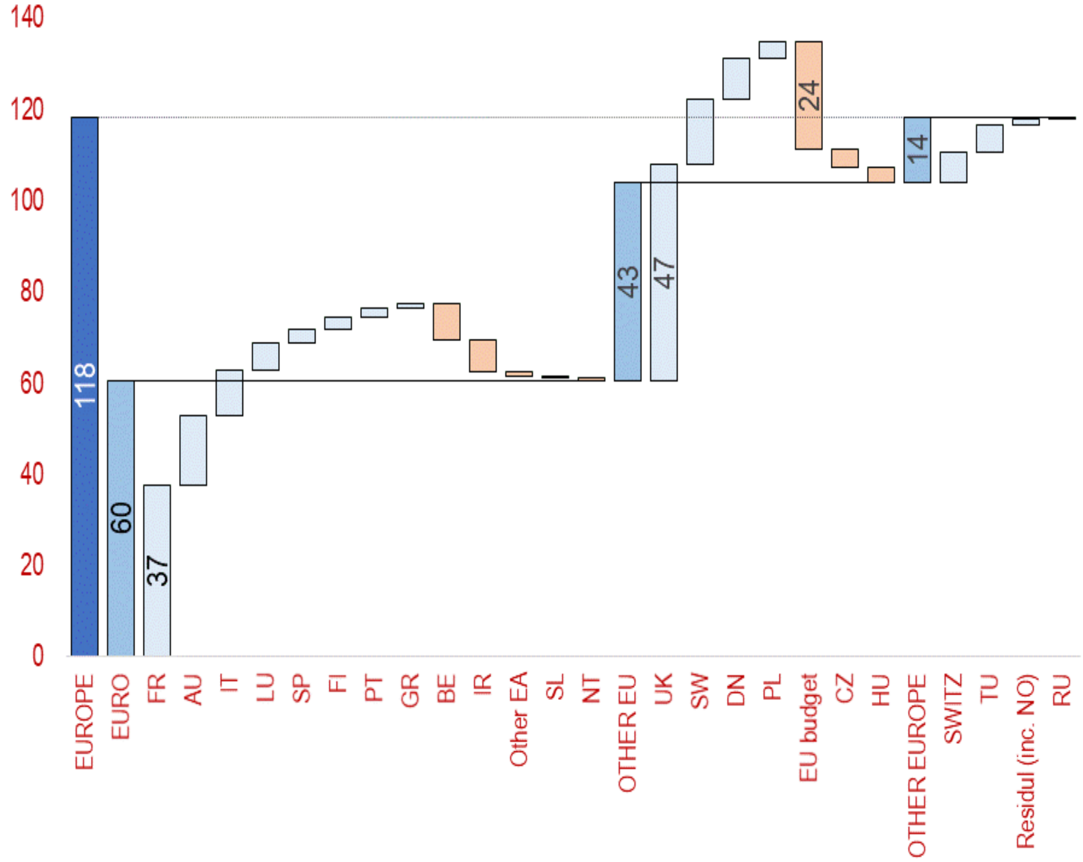


Figure 3: Germany's current account balance against Europe decomposed (2017Q1, 4Q Sum, billions €)



II. Dissecting Germany's surplus

Figure 2 dissects the Germany's current account surplus—decomposed by major region. This focuses on the current account balance—the sum of net trade, service, primary and secondary account balances by bilateral partner—using data provided by the Bundesbank.

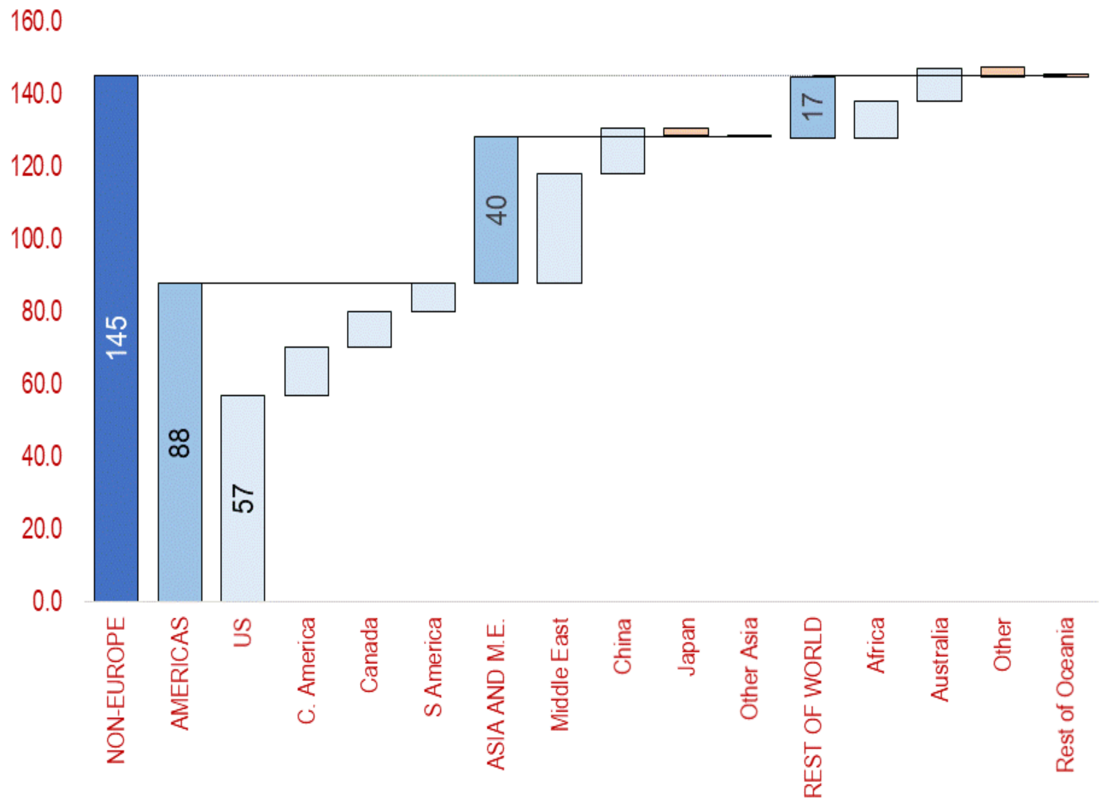
The most striking feature of Figure 2 is the fact that Germany's runs a bilateral surplus against *every major region*—the largest being Europe at €118 billion, the Americas (North and South) at €88 billion, and Asia and Middle East at €40 billion. The only negative contribution to the chart (on the right, which is tiny) relates to German transfers to non-EU, non-ECB institutions—such as the European Investment Bank.

Figure 3 further disaggregates Germany's bilateral balances against Europe while Figure 4 completes the picture against the remaining regions of the world.

Of note in Figure 3, a surplus (shown in blue) is again registered against nearly every country. Small bilateral deficits are recorded against Belgium and Ireland (in orange); additionally, countries in Eastern Europe that comprise the supply chain for German manufacturing (Slovenia, Czech Republic, Hungary) also show a small deficits from Germany's perspective.

The largest deficit item in Figure 3 is the European Union Budget (strictly the data aggregate this with Bulgaria, Croatia, Romania, but these are not reported separately and are in any case small).

Figure 4: Germany's current account balance against non-Europe decomposed (2017Q1, 4Q Sum, billions €)



Germany's net transfers to the EU budget were €24 billion in the 12 months through March 2017. These, once transferred on, provide a small offset to the surpluses recorded elsewhere in the EU—as well as some near-neighbours. But the offset to the overall surplus is slight; the EU budget is not a counter-cyclical tool—and at roughly 1 percent of EU-wide GDP it cannot be used as such.

One final observation about Figure 3 is noteworthy. Germany relies on fossil fuel imports—mainly from Russia and Norway. Thus, the fact that surpluses are still recorded against "Other Europe" here—meaning Switzerland, Turkey, Russia, and a residual that includes Norway—is remarkable. Despite reliance on fuel imports, Germany still records a surplus against her major fossil fuel providers! Partly, this is a feature of recent oil price weakness. Throughout much of the last two decades Germany has recorded a deficit against Russia and Norway combined. But the latest data records a surplus nonetheless.

Figure 4 further decomposes Germany's bilateral balance against remaining regions of the world. The largest bilateral balance is against the United States, at €57 billion—although the UK runs a larger balance in percent of GDP. Of other countries, Germany registers a deficit against Japan, though this is miniscule.

The general pattern of Germany registering a surplus against virtually every trading partner is confirmed.

III. Germany's evolving surplus

But how has Germany's surplus evolved against major trading partners? Figure 5 shows Germany's surplus in percent of GDP decomposed into select trading partners or regions.

The pattern revealed is one of Germany slowly chipping away at other balances to record ever greater surpluses throughout the period.

Germany began the millennium registering a deficit on current account. A small surplus against the Americas (mainly the United States) and the euro area periphery (the aggregate of Portugal, Ireland, Italy, Greece, and Spain—the so-called PIIGS) was more than offset by deficits against the United Kingdom and other countries in Europe as well as Asia.

As the decade progressed, however, Germany's surplus against Europe grew. By 2005, Germany recorded a surplus against all but Asia. Her surplus against Europe peaked at 6 percent of GDP in 2008Q1, of which the PIIGS contributed 2.3 percentage points, France 1.5 percentage points, and the United Kingdom 1 percentage point. Thereafter, with the onset of the global financial crisis and later the euro area crisis, the PIIGS surplus contracted, to reach only 0.2 percent of GDP end-2013.

What is remarkable, however, is how during the euro area crisis, Germany's surplus grew despite the large fall in demand amongst key trading partners. Indeed, as China and Asia became the driver of global growth from 2010, Germany turned a deficit of 1.4 percent of GDP against Asia in 2006Q3 to a surplus of 1.5 percent in 2014Q4. More recently, as the oil price has fallen, Germany's surplus against other European countries has grown—noted above.

The same information is recast in Figure 6, plotting Germany's bilateral balance against major trading partners or regions in 2000 in percent of GDP against the latest balance in 2017Q1. All but the euro area periphery registers above the 45

Figure 5: Evolution of Germany's current account balance against major regions (2017Q1, percent GDP)

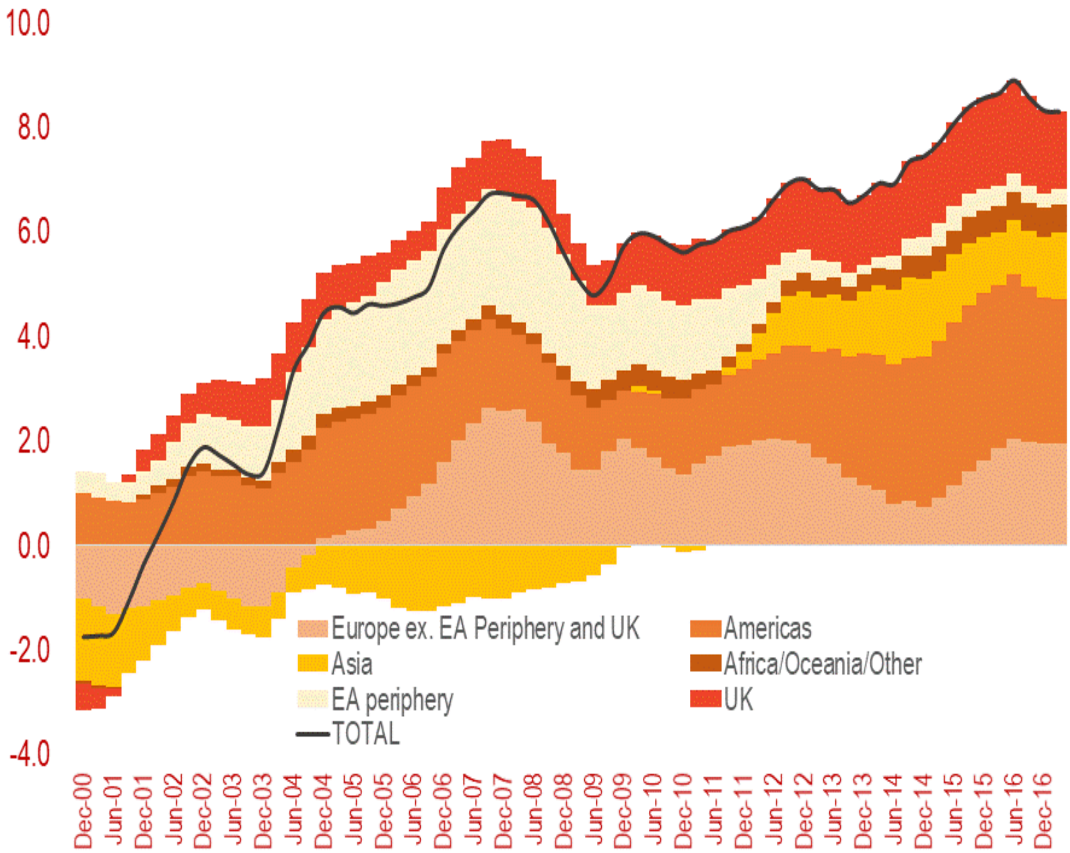
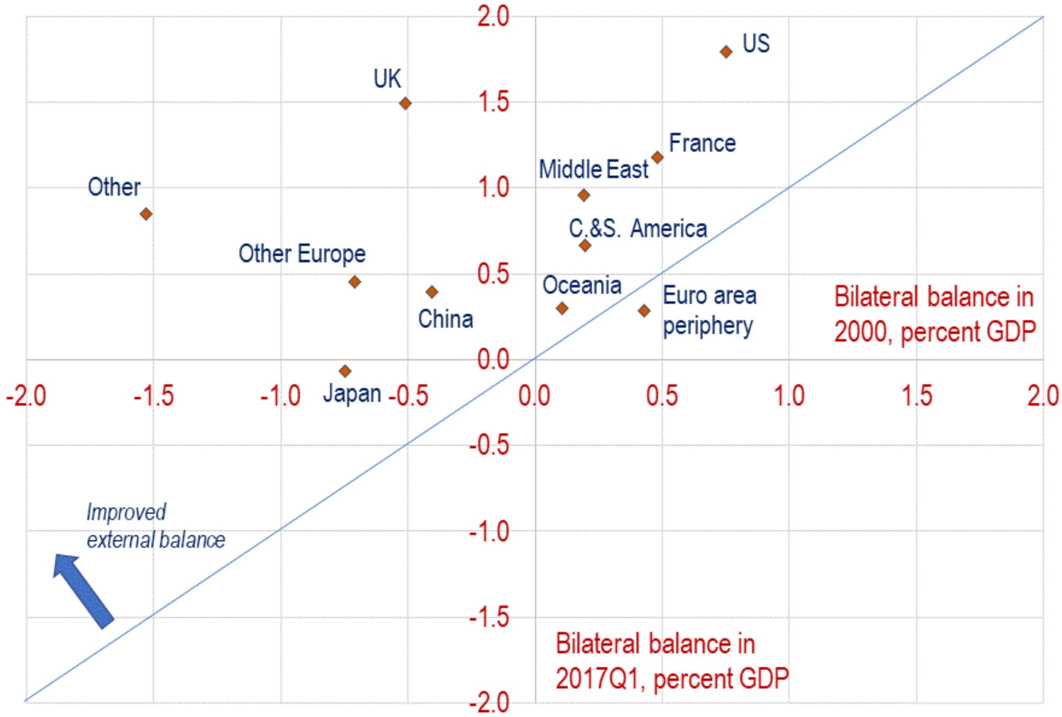


Figure 6: Germany's current account balance against major regions in 2000 and 2017Q1 (Percent of German GDP)



degree line, meaning Germany's external balance has improved against all countries or regions since the millennium—and the peripheral outcome is only a consequence of depressed conditions there.

IV. Time for heroes

A recent pick-up in domestic demand in Germany cannot excuse the egregious magnitude of her current account surplus.

It is sometimes argued that Germany's surplus is simply an aggregation of a multitude of rational private decisions; the surplus is not a matter of concern for policy. Were this the case, macroeconomics as a subject would be moribund, the only purpose being to provide a statistical record—let individual decisions aggregate as they might, let the poker chips fall as they may!

In truth, the evolution of Germany's external balance since the millennium hardly resembles the working-out of Ricardian comparative advantage. Past deficits have turned to surplus, and past surpluses have grown larger still. There has been no effort to recycle surpluses through domestic demand.

It's difficult not to lament the failure of institutions in Europe (and globally) to align Germany's domestic demand to fundamentals. Herbert Stein once noted—though the reference evades me right now—how the government's fiscal balance serves as a last resort when a country's saving-investment balance will not otherwise adjust. To this end, Germany's fiscal policy has in recent years been unhinged—under the cloak of fiscal prudence during the euro area crisis, failing to serve the needs of the global economy.

As the G20 meet in Hamburg, at a time when global leadership is needed more than ever, it's time for Germany to take the lead on the global economy. A good place to begin is by moving towards a macroeconomic policy mix that is good for Europe and the World.

Germany needs a substantial fiscal expansion—and the global economy needs it now!