

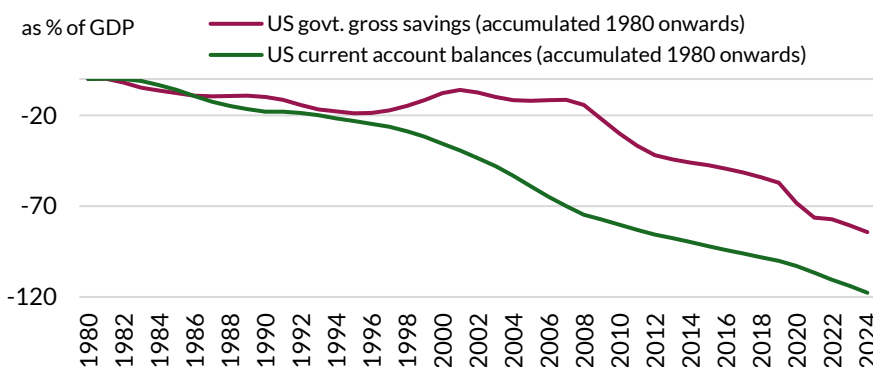
Economic Research | World in Focus

Root-cause and solution to global imbalances may be fiscal

Much commentary on unsustainable imbalances focuses on USD's role as a reserve currency, while the role of fiscal policy is under-appreciated. Widening of the US savings-investment gap (the CAD), has been caused mainly by a drop in savings, not a rise in investments. Further, private savings as % of GDP are unchanged; the deterioration has been primarily in fiscal balances. Instead of a purely Plaza-accord-like central bank-driven FX adjustment, which may be hard to execute (FX markets today are larger) and is also one-sided (JP/Germany were forced in 1985; China may be hard to convince), fiscal expansion in China/EU/Japan, which fund the US's deficits, may be more palatable and executable.

April 25, 2025
Dollar Dominance

Exhibit 1 - Twin deficits: not just correlated, direction of causality is clear



Source: IMF, Axis Bank Research

Trump's tariff wars have brought into focus several unsustainable trends ([external liabilities](#), [fiscal](#)). We investigate drivers of US's persistent and large current account deficits (CAD).

Persistent US current account deficits are not just due to the capital account

Two advisors to President Trump, Miran and Navarro, argue respectively that a persistent CAD was due to (1) the strong dollar resulting from its reserve currency status ([link](#)) – as foreign holders buy more USD assets, they make the USD unduly strong, raising costs for US suppliers; and (2) non-tariff barriers in other nations hurt US firms ([link](#)). These arguments have some merit, but we believe the main driver is the savings-investment imbalance, more so after 1985, when its CAD has expanded sharply (Ex. 3). Investments in the US have been largely stable (Ex. 9), and productive (less housing), but savings have declined (Ex. 2).

Both local (US) and global (EU, CN, JP) macro imbalances play an important role

The fall in savings has been primarily due to the government's fiscal stance (Ex. 5), as private savings have been largely unchanged (Ex. 4), especially in the last 10 years. Higher corporate savings have offset the fall in personal savings as % of disposable income (Ex. 6). The latter could be due to the wealth effect (wealth to GDP has risen steadily post-1990, helped by falling rates), social security (less need to save), or higher inequality (narrow gains in wealth). In any case, the level of consumption is higher than optimal, supported by fiscal transfers (Ex. 7). This growing CAD, as well documented, is financed by CA surplus economies like China/EU/JP (Ex. 7-10); over time these have built global macro imbalances ([link](#), [link](#)).

FX adjustments can be achieved through the fiscal route as well

As the USD on REER is as overvalued as in 1971 and 1985, and its net international assets position is unsustainable ([link](#)), should the correction be via central bank coordination like in the Plaza accord (as desired by Miran: [link](#))? Given the larger size of financial markets, monetary intervention may not be as effective as in 1985. The one-sided nature of loss-bearing in this route would also make it less acceptable to all (esp. China). Fiscal adjustments, on the other hand, are under government control, and may be more equitable/palatable.

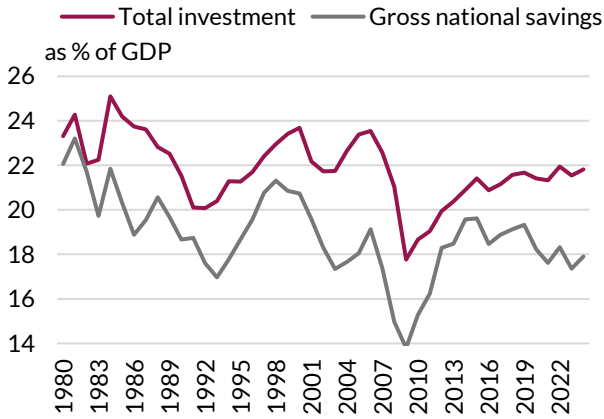
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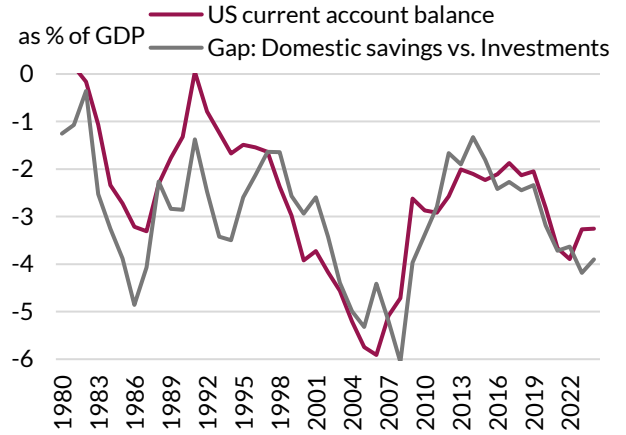
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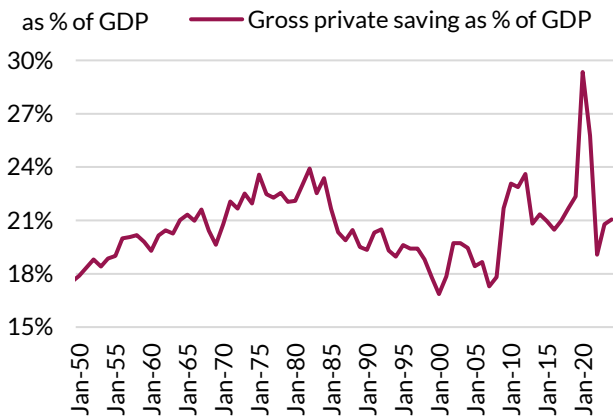
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Exhibit 2 - Savings (S) and investment (I) move together: all investments are financed by savings (domestic + foreign)


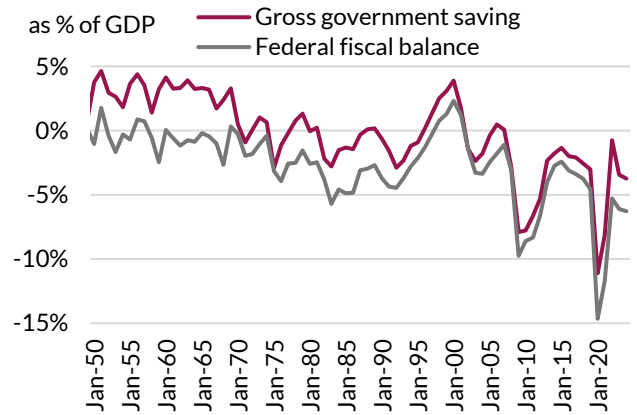
Source: CEIC, Axis Bank Research

Exhibit 3 - Relationship between CA and S-I: they are the same (the gap below is a statistical discrepancy)


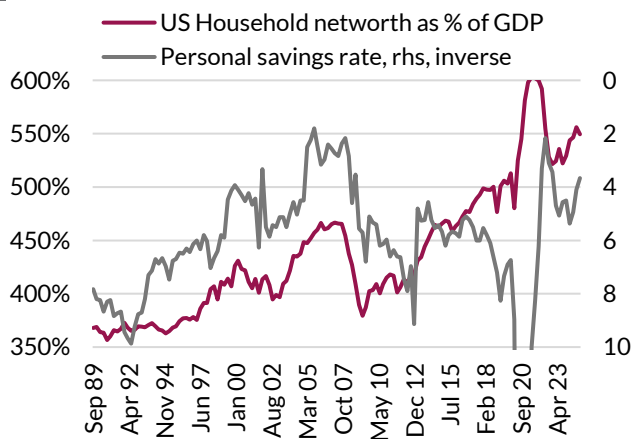
Source: CEIC, Axis Bank Research

Exhibit 4 - US private savings (HH + corporate) largely stable


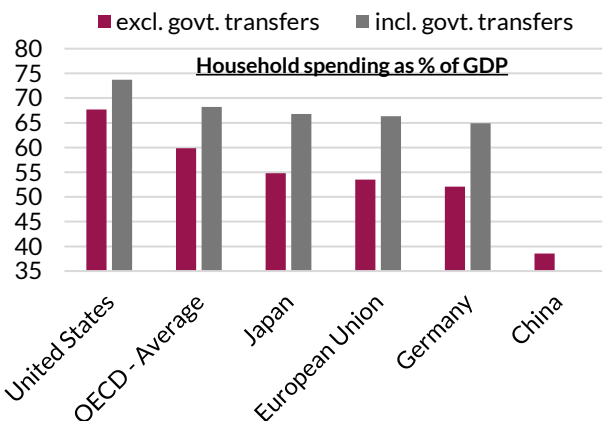
Source: CEIC, Axis Bank Research

Exhibit 5 - US govt. savings worsen over last 20Y


Source: CEIC, Axis Bank Research

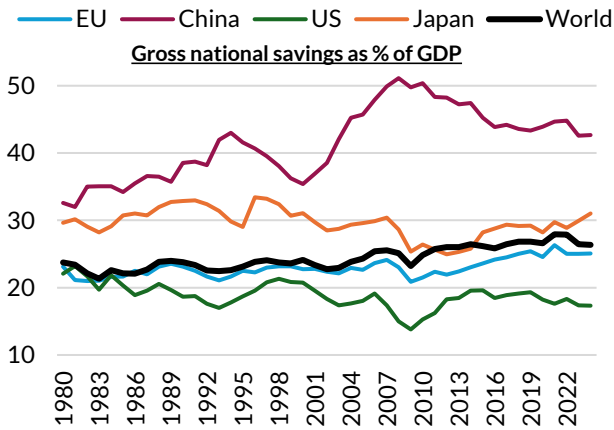
Exhibit 6 - HHs lowered their savings rate in response to their rising wealth (higher equity + home prices)


Source: OECD, Axis Bank Research

Exhibit 7 - Wealth effect dominates: US Households (HHs) consume too much and the Chinese too little


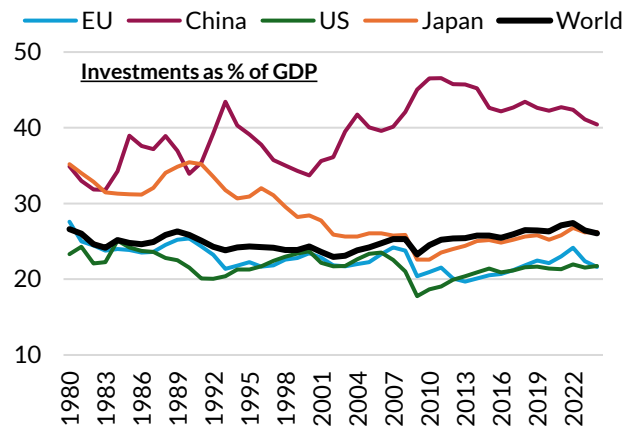
Source: OECD, Axis Bank Research

Exhibit 8 - US consumes too much and saves little; China has the reverse problem



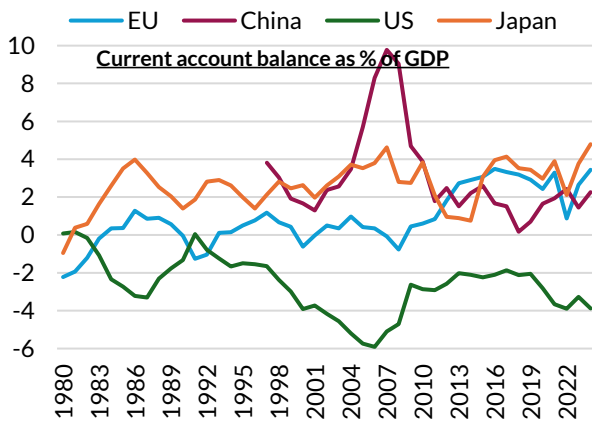
Source: CEIC, Axis Bank Research

Exhibit 9 - Chinese investment-led growth model has hit limits ([link](#), [link](#))



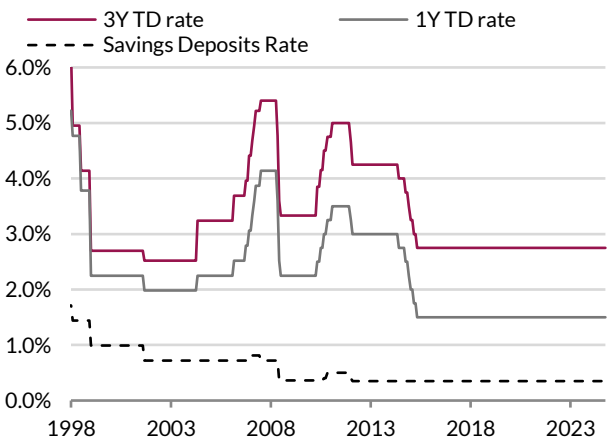
Source: CEIC, Axis Bank Research

Exhibit 10 - Global macro imbalances: CN/EU/CN have excess savings



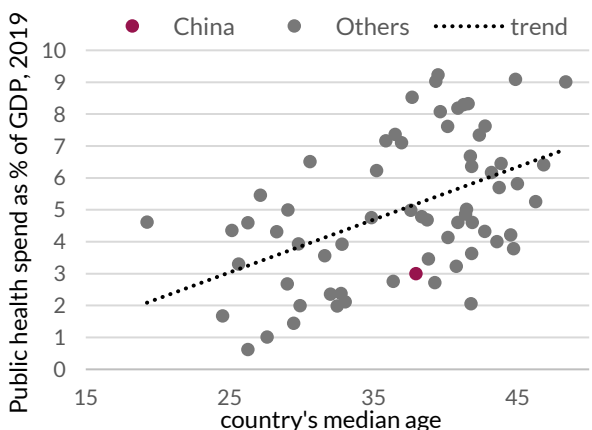
Source: CEIC, Axis Bank Research

Exhibit 11 - CN HHs forced to accept very low returns on their savings, constrains household consumption



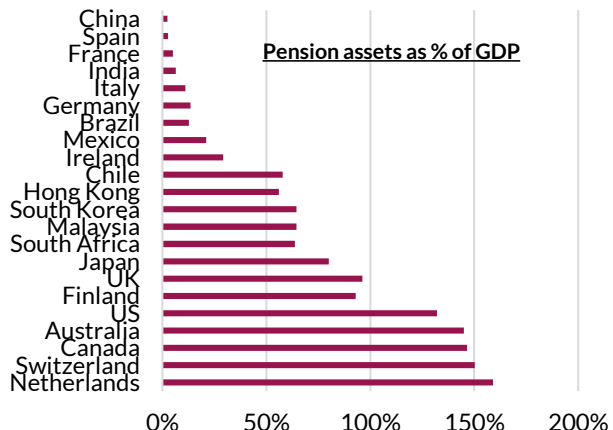
Source: CEIC, Axis Bank Research

Exhibit 12 - Weak CN public safety nets: low govt. public health expenditure necessitates higher savings



Source: CEIC, Axis Bank Research

Exhibit 13 - China pensions spend weak vs advanced economies; pension assets worse



Source: CEIC, Axis Bank Research

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