PROSPECTS FOR REAL AND FINANCIAL IMBALANCES AND A GLOBAL REBALANCING

This article aims to shed light on global real and financial imbalances, which have been at the centre of the international economic policy debate for some time now and are likely to remain so in the years to come. To that end, it pays specific attention to the link between the build-up of these imbalances in the years preceding the outbreak of the crisis and the financial crisis itself, and to the challenges and risks faced by the global economy in dealing with imbalances in the future. The article also discusses the new international policy agenda for global rebalancing launched at the Pittsburgh G20 Summit in September 2009, notably through the G20 Framework for strong, sustainable and balanced growth, and looks at why this will be important for the global economy in the future.

The article outlines three main points. First, it shows that the build-up of large global real and financial imbalances was one of the early symptoms of the crisis and also reflected common causes, in particular policies inconsistent with sustainable external positions in both deficit and surplus economies. Second, it discusses how the subsequent reduction in global current account imbalances associated with the crisis appears to be largely cyclical and may reverse as the global economic recovery gathers strength, assuming unchanged policies. Third, going forward, if global real and financial imbalances re-emerge and there is an insufficient rebalancing of global growth patterns, risks to the global economy could remain substantial unless rigorous structural policy adjustments in economies with previously large external imbalances are pursued.

In this respect, the article concludes that it is important for the main surplus and deficit economies to implement the commitments made at the Pittsburgh G20 Summit to rebalance global demand patterns and ensure a durable and orderly reduction in global imbalances in the period ahead.

1 INTRODUCTION

Global real and financial imbalances have been at the centre of the international economic policy debate for some time now and are likely to remain so in the years to come. Unsurprisingly, the global economy is characterised by cross-country differences in the savings and investment behaviour of governments, households and corporate sectors. These, by definition, are reflected on the external level in global current account and capital flow patterns, which ultimately originate from several cyclical and structural factors.

Such differences are not necessarily a cause for concern, to the extent that they are sustainable and reflect market mechanisms. On the contrary these differences become a source of concern to policy-makers and call for corrective policy actions when they are the outcome of distortions, or are assessed as entailing substantial risks to the global economy, including that of a disorderly unwinding. In this respect, the build-up of large real and financial imbalances in the years preceding the outbreak of the crisis was identified by many observers, including the ECB,[1] as a key risk weighing on the global economy.

The crisis has been associated with a narrowing in these imbalances, but this phenomenon may reverse as the crisis draws towards its close. Therefore, the underlying picture is still one of global imbalances continuing to pose significant risks to the global economy.

1 For instance, as early as December 2002 it was indicated in the Editorial of the Monthly Bulletin that “the persistence of global imbalances is a factor that weighs adversely on confidence” and, in January 2004 it was emphasised in the Editorial that “the uncertainties continue to be related to persistent external imbalances in some regions of the world and their potential repercussions on the sustainability of global economic growth” and that these imbalances should be addressed by means of sustainable macroeconomic policies and structural reforms to “foster a sound balance between savings and investment in all major partner countries, enhance the production potential in the euro area and support a further expansion in the trade of goods and services at the global level.”

The purpose of this article is threefold. First, it aims to assess why the build-up in global imbalances in the past was unsustainable and why this created substantial risks to the global economy (see Section 1). Second, it attempts to show the partial and temporary nature of the narrowing in global imbalances that has occurred throughout the crisis and the prospects for their rewidening in the periods ahead (see Section 2). Third, the article reviews the international policy agenda for global rebalancing, notably under the G20 umbrella, which aims to ensure a durable and orderly correction of global imbalances, as well as a sustained global recovery (see Section 3).

2 GLOBAL IMBALANCES AND THE CRISIS

This section reviews key developments in global imbalances in the years preceding the crisis, as well as the debate surrounding the nature of the link between the build-up in global imbalances and the crisis itself.

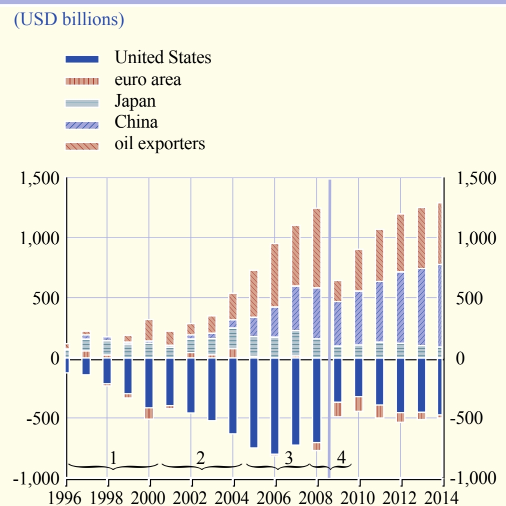
2.1 DEVELOPMENTS IN GLOBAL IMBALANCES SINCE THE MID-1990S

In a global economy, cross-country differences in the savings and investment patterns of the private and official sectors are mirrored in external imbalances. These imbalances grow or diminish over time along with the decisions of economic agents, and may not necessarily be a source of concern for the global economy. However, when these imbalances reflect distortions or entail risks for the global economy, they are to be considered as a source of concern.

When looking at the evolution in the global current account positions of the main surplus and deficit economies over the past fifteen years, several periods indeed stand out, suggesting that the nature of the imbalances has varied, with different factors and economic settings playing a role in different periods. According to Blanchard and Milesi-Ferretti (2009),[2] the evolution in global imbalances

Chart 1 Global current account imbalances since the mid-1990s: four key periods

(USD billions)



Source: IMF World Economic Outlook (October 2009).
Note: The vertical line marks the last official release of the data at the end of 2008. Thereafter, the chart is based on IMF staff projections.

since the mid-1990s is characterised by four main periods (see Chart 1).

During the first period from 1996 to 2000, global current account constellations among the main surplus and deficit economies were largely driven by differences in perceived profitability and capital reallocation. On the one hand, investment increased in some advanced economies, notably in the United States, owing to the high-tech boom and expectations of increasing productivity, leading to a widening in the current account deficit. On the other hand, investment decreased in Asia, as a result of the Asian crisis and Japan's protracted recession, which led to an increase in the current account surpluses of the economies in the region.

In the second period from 2001 to 2004, US savings declined, mainly owing to deteriorating US public savings. On the one hand, net US personal savings remained

2 O. Blanchard, G.M. Milesi-Feretti (2009), "Global Imbalances: In Midstream?" IMF Staff Position Note SPN/09/29, December 2009.

broadly stable, leading to further deterioration in the US current account deficit, despite the cyclical downturn. On the other, the picture in emerging Asia and Japan remained by and large unchanged, while oil exporters started to accumulate current account surpluses.

Developments in global current account constellations in the third period from 2005 to 2008, coincided with the period of rapidly rising financial asset valuations, higher oil prices and sustained reserve accumulation by emerging markets. With regard to the main deficit economies, the US current account deficit widened further, owing to lower private savings (with the personal savings rate decreasing to below 2%), higher financial asset and real estate prices and substantially increasing capital flows (in particular, debt flows). In 2006 the US current account deficit reached a 50-year high, at around 6% of GDP. Surpluses in emerging economies with positive current account balances increased even further, notably those of China (which exceeded 10% of GDP) and oil exporting countries. The increase in surpluses in these economies also led to sustained reserve accumulation in those countries as their exchange rate regimes did not allow for significant appreciation vis-à-vis the US dollar.

The fourth period from 2008 to today, coinciding with the financial turmoil, has been associated with a narrowing in global imbalances. This narrowing largely reflects: (i) lower commodity prices between mid-2008 and early 2009, which have led to a reduction in the current account surpluses of oil exporters and to a reduction in the oil bill paid by the main deficit economies, notably the United States; (ii) financial crisis-related factors, such as weaker US investment and private consumption, including adverse wealth effects created by asset price corrections and exceptionally high uncertainty; (iii) a major contraction in global trade flows; and (iv) China's fiscal stimulus, which contributed to reducing its current account surplus in 2009.

2.2 THE LINK BETWEEN GLOBAL IMBALANCES AND THE CRISIS

The build-up in global imbalances was identified relatively early on as posing substantial risks to the global economy. Considering developments in global current account positions relative to world GDP, the practically uninterrupted rise in the absolute size of imbalances among the main deficit and surplus economies, with the exception of the 2001-02 recession, and their peak just prior to the crisis, is particularly noteworthy (see Chart 2).[3]

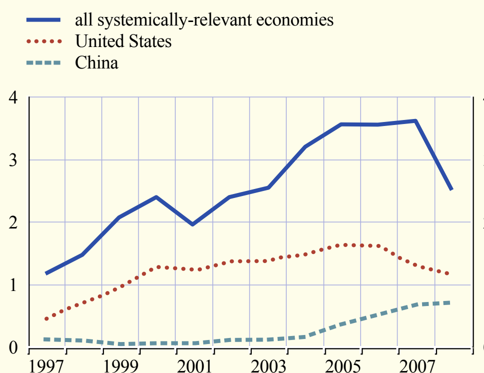
Concerns emerged that these developments could lead to an abrupt and disorderly unwinding in imbalances,[4] and a consensus was reached that a policy-led adjustment was needed to avert it. The euro area remained very close to external balance over the entire period. Together with

3 In absolute terms, the current account balances of systemically-relevant economies taken together reached a peak of almost 4% of world GDP in 2007. The United States and China accounted for half thereof.

4 As mentioned earlier in the IMF's September 2005 World Economic Outlook, as well as in academic papers, see M. Obstfeld, K. Rogoff (2005), "Global Current Account Imbalances and Exchange Rate Adjustments", Brookings Papers on Economic Activity (1), 67-123.

Chart 2 Absolute current account balances

(percentage of world GDP)



Sources: IMF World Economic Outlook (October 2009) and ECB staff calculations.

other main world economies, including the United States, China, Japan and Saudi Arabia (exemplifying the oil exporters), the euro area agreed to participate in 2006-07 in a round of "multilateral consultations" under the umbrella of the IMF with the aim of agreeing on policies that would cater for an orderly unwinding of the built up imbalances, while at the same time retaining the solid rate of global economic growth witnessed during the first half of the 2000s. A common assessment of the needed corrective policy measures was reached.[5] Unfortunately, implementation of corrective policy measures did not take place sufficiently at the level of the individual countries, and global imbalances started reducing only later, during the global economic downturn in the wake of the financial crisis.[6]

Almost three years after the start of the financial turmoil, the nature of the link between the build-up in large global imbalances and the financial crisis remains heavily debated among observers. Some consider that global imbalances are unrelated to the crisis and regard regulatory and supervisory failures, as well as micro-economic factors, to be its main determinants.

Others regard global imbalances as amplifying the mechanisms that ultimately led to the crisis.[7] Allegedly, US Treasuries were widely perceived as the main store of value available to emerging markets given their financial underdevelopment, which, in conjunction with an insufficient supply of safe assets globally, pressured the US financial system to create safe assets through securitisation from increasingly riskier sources. Other views suggest that global imbalances were the main determinants of the crisis as they set the macroeconomic conditions leading to the crisis, as reflected in the large saving-investment gaps in some advanced economies, the financial flows coming from less developed economies to finance these gaps (contrary to standard economic theories), and low risk premia, resulting in a low cost of financing and a global hunt for yield.[8]

A final perspective is to regard global imbalances and the crisis as reflecting common causes, namely policies inconsistent with sustainable external positions in both deficit and surplus economies.[9] These include the lack of medium-term orientation towards stability and sustainability in macroeconomic policies, insufficient mechanisms to ensure self-discipline and early adjustment in countries with unsustainable external positions, easily available financing of external deficits owing to an unprecedented wave of financial globalisation and innovation, and an inadequate risk assessment of the distortions that were contributing to the rise in global imbalances, including rigid exchange rate regimes in some of the surplus economies.

There was not only disagreement on the link between the crisis and the correction of global imbalances, but also about the nature of a possible correction. It was indeed widely expected that the adjustment of global imbalances, if any, would come mostly from the exchange rate. In particular, model-based simulations of an

5 See "IMF's International Monetary and Financial Committee Reviews Multilateral Consultation", Press Release No 07/72, IMF, 14 April 2007.

6 An overview of the main factors and developments in global real and financial imbalances was provided by T. Bracke, M. Bussiere, M. Fidora, R. Straub (2008), "A framework for assessing global imbalances", ECB Occasional Paper No 78, January 2008.

7 Caballero et al (2008) argue that there is a tight connection between persistent global imbalances, the financial crisis, and volatile oil and asset prices, claiming that they all stem from a global environment, in which sound and liquid financial assets are in scarce supply. According to this view, the root imbalances were not global imbalances, but "a safe asset imbalance". See R. J. Caballero, E. Farhi, P.-O. Gourinchas (2008), "Financial Crash, Commodity Prices and Global Imbalances", NBER Working Paper No 14521, issued in December 2008 and R. J. Caballero (2009), "The 'Other' Imbalance and the Financial Crisis", prepared for the Paolo Baffi Lecture delivered at the Bank of Italy on 10 December 2009.

8 See R. Portes (2009), "Global Imbalances", London Business School and CEPR, February 2009.

9 M. Obstfeld and K. Rogoff (2009), "Global Imbalances and the Financial Crisis: Products of Common Causes", CEPR Discussion Papers No 7606, December 2009. See also Lorenzo Bini Smaghi (2008), "The financial crisis and global imbalances: two sides of the same coin" speech at Asia Europe Economic Forum, Beijing, 9 December 2008 available on the ECB's website (http://www.ecb.europa.eu).

"abrupt and disorderly adjustment" of global imbalances designed in the years preceding the crisis,[10] were largely based on a sudden decline in demand for US assets, a corresponding US dollar adjustment and an ultimate correction in US output and the trade balance, in line with a number of influential academic contributions.[11]

However, this line of reasoning was challenged before the crisis on several grounds. First, some argued that an adjustment in the US current account did not need to be passed through the exchange rate channel, but could also result from supply-side adjustments. For instance, this kind of adjustment could also occur if deficit economies were to produce more exportable goods.[12] The view that the exchange rate is a potent channel of adjustment was also challenged by empirical evidence. Allegedly, sizeable exchange rate movements were not a key channel of adjustment in previous historical episodes of large current account imbalances, when adjustments relied more on relative financial and real estate price changes than exchange rate changes.

In this context, when the financial crisis intensified between September 2008 and March 2009, global exchange rate movements, which were at that time largely driven by a flight to quality and liquidity to US dollar-denominated assets and significant repatriation of capital to the United States, confounded previous scenarios of adjustment in global imbalances through the exchange rate channel.

Focusing on demand-side channels, from imported goods to domestically-produced goods, recent research has found that the closing up of the US current account deficit goes hand in hand with a large exchange rate adjustment. From a longer-term perspective, based on the role of the supply side in the adjustment process (leading towards a higher production of tradables), others argue that policy measures to foster a supply-side reaction would facilitate the external adjustment by alleviating an exclusive reliance on demand and exchange rate changes, with the latter being potentially destabilising for the global financial system.[13] Sizeable exchange rate movements are considered by some as not necessarily a key element in an adjustment of today's large current account imbalances and that relative global asset price changes, in particular, could be a more potent source of adjustment.[14]

3 PROSPECTS AND CHALLENGES

Since the outbreak of the crisis, global imbalances have narrowed, but this narrowing is likely to remain transitory to the extent that it has been driven by cyclical factors that are likely to reverse from 2010 onwards. On the one hand, the US current account deficit was expected to have narrowed to -2.6% of GDP in 2009 (half of its peak in 2006) and to stabilise at around -2.7% in 2014 (see Table 1). However, even though a slight widening of the US current account deficit in the course of the recovery is expected, the extent of the widening should not be comparable to previous recessions. On the other hand, China's current account surplus was expected to have declined at the end of 2009 to about 6% of GDP (from close to 10% before the crisis) and those of the oil exporting countries to have shrunk considerably (see Table 1).

A key reason for the expected rewidening in global imbalances is that the cyclical factors

10 Presented, for instance, in the September 2005 release of the IMF World Economic Outlook.

11 M. Obstfeld, K. Rogoff (2005), "Global Current Account Imbalances and Exchange Rate Adjustments", Brookings Papers on Economic Activity (1), 67-123.

12 See M. Fidora, M. Fratzscher and C. Thimann (2007), "Home bias in global bond and equity markets: the role of real exchange rate volatility", Journal of International Money and Finance 26, June 2007, 631-55.

13 For the demand-driven channel, see M. Obstfeld and K. Rogoff (2009), "Global Imbalances and the Financial Crisis: Products of Common Causes", CEPR Discussion Papers No 7606, December 2009. For supply-side effects, see P. Engler, M. Fidora, C. Thimann (2009), "External adjustment and the US current account: how supply-side changes affect an exchange rate adjustment", Review of International Economics, Vol. 17(5), November 2009.

14 M. Fratzscher, L. Juvenal and L. Sarno (2009), "Asset prices, exchange rates and the current account", European Economic Review, December 2009.

Table 1 Current account balances in selected economies

(percentage of GDP)

	2006	2007	2008	2009 (p)	2014 (p)
World	**0.4**	**0.5**	**0.3**	**0.2**	**1.1**
Advanced economies	**-1.3**	**-0.9**	**-1.3**	**-0.7**	**-0.3**
United States	-6.0	-5.2	-4.9	-2.6	-2.7
Euro area	-0.1	0.1	-0.5	-1.0	-0.2
Japan	3.9	4.8	3.2	1.9	1.5
United Kingdom	-3.3	-2.7	-1.7	-2.0	-2.0
Canada	1.4	1.0	0.5	-2.6	0.9
EMEs and developing countries	**5.2**	**4.3**	**3.9**	**2.0**	**3.6**
Developing Asia	**6.1**	**7.0**	**5.9**	**5.0**	**5.4**
China	9.5	11.0	9.8	7.8	8.4
India	-1.1	-1.0	-2.2	-2.2	-1.8
Oil exporters	**16.3**	**12.9**	**13.3**	**4.2**	**8.0**

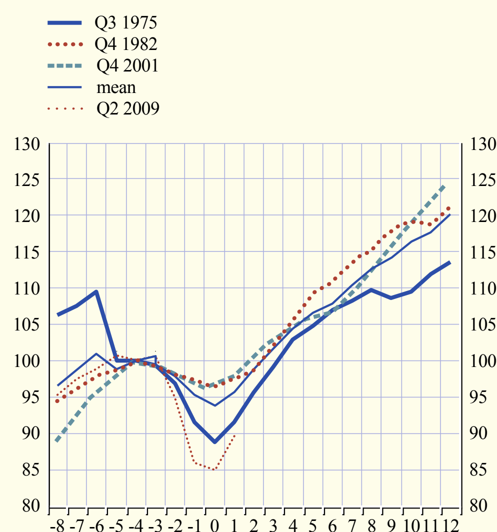
Source: IMF World Economic Outlook, October 2009.

that led to a temporary narrowing in imbalances are already reversing. These include the impact of: i) rebounding oil and commodity prices on the surplus of oil exporting countries and on the deficit of the net oil importers; ii) diminishing negative wealth effects associated with the US housing markets and global equity markets, which are likely to have a negative effect on US private savings; and iii) the resumption in global growth and trade. In particular, in the United States, which is the main deficit economy, the outlook for public and private savings remains uncertain, as does whether US private savings will continue to increase in line with the need for households and corporates to repair their balance sheets as a result of the collapse in financial and real estate asset prices. The outlook for the US economy is therefore conditional on households repairing their balance sheets and the labour market remaining weak. The increase in US private savings is expected to have negative implications for both global activity and world trade.

The resumption in global trade since summer 2009 can indeed be expected to lead to the mechanical rewidening of global imbalances, as well as current account imbalances. The contraction in global trade following the collapse of Lehman Brothers mostly reflected: (i) a significant decline in global demand and private agents' postponement of durable goods purchases in the face of unusually high uncertainty; (ii) the amplification of this shock through international supply chains; and (iii) strains in global trade financing, which further added to uncertainty. However, as historical experience suggests, the impact of these factors on trade could reverse fairly quickly as the global economic recovery gathers pace. All three major post-1945 episodes of global trade contraction were followed by swift recoveries in global trade flows (see Chart 3).

Chart 3 Evolution of global imports during major episodes of global trade contraction

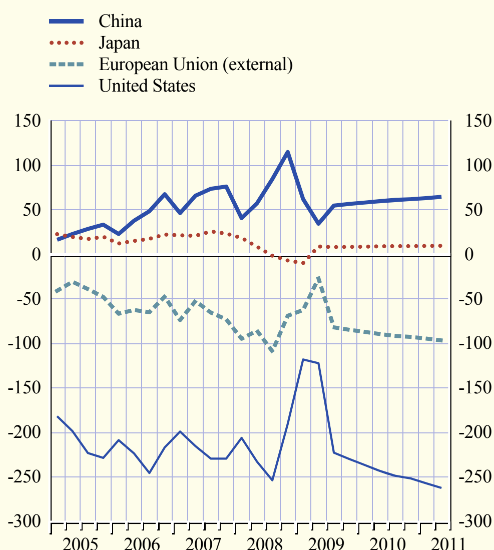
(four quarters before the trough = 100)



Sources: OECD (real monthly trade data).

Chart 4 Simulated evolution of the trade balance of the European Union and key surplus and deficit economies

(USD billions)



Sources: OECD (real monthly trade data).

Baldwin and Taglioni (2009), using the fit from these episodes to project the expected recovery in exports and imports in the two years following mid-2009, suggest that external imbalances could rewiden quickly in the main deficit and surplus economies in the absence of any major structural change or real exchange rate adjustments (see Chart 4). Declining imbalances can also be mechanically explained by the collapse in global trade, and are likely to re-emerge as world trade recovers.[15] However, trade growth is likely to be less buoyant than before 2008, and the level of world trade is not expected to reach pre-crisis levels until 2011.

Another key reason why global imbalances are likely to rewiden in the period ahead is that the main structural factors that led to the initial build-up in imbalances are likely to remain largely in place and hence will not be able to compensate for a cyclically-driven widening in imbalances. As such, structural policy adjustments are needed to ensure a durable and orderly narrowing in imbalances. These adjustments should be made as early as possible given the usual lags that are typically required to produce a tangible impact on respective current account positions.

On the side of surplus economies, limited social safety nets in emerging Asia continue to encourage domestic savings, and the financial underdevelopment of these economies remains an incentive to channel domestic savings abroad. Arguably, pervasive restrictions on private capital outflows in some economies might still reduce the scale of such domestic saving exports.

Another reason why emerging Asian economies are likely to continue to register sizeable current account surpluses in the period ahead is the preference of some of these countries for exports as a key engine of growth. Admittedly, authorities in some of these countries have become increasingly aware of the need to change the pattern of growth by reducing their dependence on the export sector and strengthening domestic demand, and are discussing reforms that would contribute in this direction. Yet, and as mentioned earlier, it takes time for this kind of a change in growth patterns to be implemented and to produce effective results.

A further aspect to consider is that, from the perspective of large emerging market reserve holders, the financial crisis could be interpreted as having vindicated the usefulness of building even larger stocks of reserves as self-insurance against the risk of future crises, although a distinction should be made between the use of these reserves to provide foreign exchange liquidity and other uses, such as providing funding for budget stimulus, which is the case in some countries. In line with this, it is worth noticing that reserve holdings by emerging economies were already higher in the third quarter of 2009 than prior to the intensification of the crisis in the third quarter

15 As pointed out by R. Baldwin and D. Taglioni (2009), "The illusion of improving global imbalances", 14 November 2009, (http://www.voxeu.org), as well as Paul Krugman's account of this paper in "World Out of Balance", The New York Times, 15 November 2009, (http://nytimes.com).

Table 2 Reserves of selected emerging markets

(USD billions)

	Q4 2008	Q1 2009	Q2 2009	Q3 2009
All emerging economies	**4,265**	**4,175**	**4,483**	**4,738**
Emerging Asia	**3,321**	**3,337**	**3,608**	**3,836**
China	1,946	1,954	2,132	2,273
India	247	241	254	264
Korea	200	206	231	249
EU neighbourhood	**536**	**458**	**491**	**500**
Russia	406	334	365	368
Latin America	**408**	**379**	**384**	**401**
Brazil	191	188	196	211

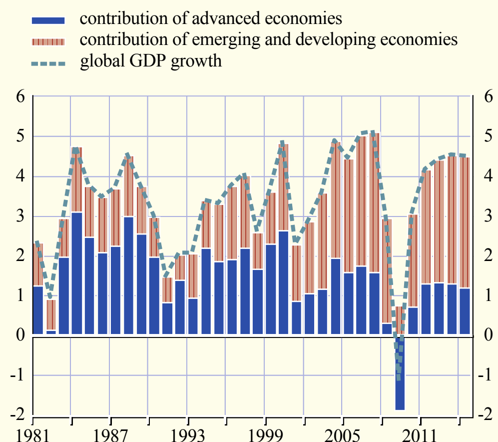
Sources: IMF International Financial Statistics and national data sources.
Notes: These figures do not capture financial assets held by non-central bank public entities, such as sovereign wealth funds, or foreign assets held by private entities. The "EU neighbourhood" encompasses Russia and the European countries of the CIS, the countries on the southern and eastern shores of the Mediterranean, the Middle East and Sub-Saharan Africa."

of 2008, although a number of these economies had to use a large share of their reserves in support of their currencies in late 2008 and early 2009 (see Table 2).

A final structural factor that would suggest that global imbalances might rewiden in the future relates to asymmetric patterns in global growth. In particular, as the crisis has abated, growth differentials between the main external surplus and deficit economies have increased, with emerging Asia leading the recovery. Chart 5 shows that emerging markets, with their export-driven growth, have gradually become an increasingly important source of global growth since the 1980s and are projected by the IMF to remain so in the years to come. This might have implications for global current account constellations given that, of all the regions, it is emerging Asia's surplus that has least corrected since the eruption of the crisis.

Chart 5 Global real output growth

(annual percentage changes; percentage points)



Sources: IMF World Economic Outlook (October 2009) and ECB staff calculations.

Going forward, re-emerging global real and financial imbalances and limited rebalancing in global growth patterns might create additional substantial risks to the global economy if corrective policy measures are not taken in time. With global recovery, on the one hand, a return to the previous high-growth scenario can be envisaged in which surpluses in emerging Asia will rise again in tandem with increasing exports. On the other hand, deficits in advanced economies may grow again, in particular if public sector deficits are not reduced decisively. Such developments would again lead to an increase in the previous imbalances, which would create further risks for the world economy. An alternative low-growth scenario, based on the assumption of lower potential growth in advanced economies coming out of the crisis would result in somewhat reduced imbalances, but also much lower global growth, as the export model of the emerging market economies would falter. Hence both the developed and emerging markets should

be interested in achieving an alternative with more growth and less imbalances. This aim is addressed in the following section.

4 INTERNATIONAL POLICY AGENDA FOR GLOBAL REBALANCING

4.1 THE G20 FRAMEWORK

To address these challenges and in order to ensure an orderly and durable reduction in global real and financial imbalances, as well as a sustained global recovery, G20 leaders decided at the Pittsburgh Summit in September 2009 to launch a "Framework for strong, sustainable and balanced growth", which includes a pledge to "promote more balanced current accounts". The G20 group, which has now designated itself as "the premier forum for international economic cooperation" aims to bring together the systemically-relevant economies of the world and to agree on policies that could help change global demand patterns and ensure strong, sustainable and balanced growth.

Specifically, G20 members with "sustained, significant external deficits" committed themselves to "undertake policies to support private savings and undertake fiscal consolidation, while maintaining open markets and strengthening export sectors", whereas those with "sustained, significant external surpluses" agreed to "strengthen domestic sources of growth". Depending on national circumstances, this could include increasing investment, reducing financial market distortions, boosting productivity in service sectors, improving social safety nets and lifting constraints on demand growth.[16] These commitments are expected to be reflected in medium-term economic policy plans prepared by the G20 members. These plans will then be assessed based on their mutual compatibility and subsequently in terms of their consistency with the overall objective of "strong, sustainable and balanced growth". The IMF and other IFIs, to the extent needed, will be involved in this assessment. The timetable for the G20 framework process comprises a number of specific steps. First, at the end of January 2010 G20 countries set out their policy frameworks and plans, which were then discussed in February with the IMF with a view to clarifying member submissions and assessing their mutual compatibility. Second, the aggregated impact of individual frameworks and policy plans at the global level will be discussed initially at the spring meeting of the G20 ministers and governors. The IMF will then produce policy scenarios for discussion by G20 leaders in June, which will lead to final refined mutual assessments and more specific policy recommendations for consideration and agreement by G20 leaders at the Seoul Summit in November 2010.

4.2 CHALLENGES RELATED TO THE IMPLEMENTATION OF THE G20 COMMITMENTS

In this context, it remains to be seen whether significant progress will be made in the main deficit and surplus economies in terms of living up to the commitments made at the Pittsburgh G20 Summit. The previous experience with the multilateral consultations on global imbalances in 2006-07, whereby the related policy commitments were not fully implemented by the economies involved, suggests that the commitment of the countries involved to deliver effectively on their pledges is key to the success of the process. The new G20 framework process is markedly different from the past multilateral consultations in the following ways: it involves all the major stakeholders, and not only selected countries or regions; it is driven at the highest level by the G20 leaders; and it is based on peer surveillance (rather than institutional surveillance), which creates leeway for peer pressure among members.

16 The framework agreed in Pittsburgh partly draws on the policies agreed upon during the round of multilateral consultations led by the IMF on the global imbalances of 2006-07 between China, the euro area, Japan, the United States and Saudi Arabia, as well as on subsequent IMF analysis (see, for example, O. Blanchard "Sustaining a Global Recovery", Finance & Development, Volume 46, Number 3, September 2009; "Beyond 2010: How will the global economy rebalance?", IMF World Economic Outlook, October 2009).

In this context, one of the main challenges that the new process will have to overcome is to ensure that international cooperation and the common drive towards making progress on policy commitments remain strong as the crisis draws to a close. In addition, it will not be easy to devise a globally consistent outlook on the basis of the individual G20 members' contributions. In this respect, the IMF will strive to identify inconsistencies in national assumptions in G20 submissions and to analyse the multilateral compatibility of country submissions.

Another key challenge is to assess how medium-term global prospects could be enhanced through additional policy actions, as well as what is required in terms of policy recommendations for groups of countries, and how the latter could be translated into country-specific measures and implemented in a sustained manner. As for the euro area's policy commitments, the best contribution they can make to an orderly reduction in global imbalances remains the same as that agreed during the multilateral consultations of 2006-07, namely to press ahead with structural reforms aimed at boosting productivity and raising potential growth. Such a contribution would be in line with the objectives of the EU's structural reform agenda, both past and future, including the Lisbon agenda and EU 2020 strategy.

5 CONCLUSION

At the current juncture, global imbalances continue to pose a key risk to global macroeconomic and financial stability. The narrowing of imbalances during the crisis has been only partial and is likely to be largely temporary, assuming no fundamental changes in policies. The stakes are high to prevent a disorderly adjustment in the future that would be costly to all economies. All economies should therefore play their part in resolving these imbalances in a manner that is compatible with a sustained global recovery. Rebalancing the global economy is challenging, not least owing to the difficulty of implementing the necessary reforms or the time it takes for needed structural measures to produce their effects. Nevertheless, a global and significant policy response is required. The commitment of G20 members to effectively deliver on their pledges will remain key to successfully ensuring an orderly unwinding of global imbalances and a truly sustainable global recovery. The international spillover of policies is growing in an increasingly globalised world. Strengthening surveillance on policies of the main surplus and deficit economies in order to foster more discipline in line with the G20 process is therefore of crucial importance.