ECONOMIC VIEWPOINT

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Where Do We Stand With Major Macroeconomic Imbalances?

About a decade ago, many economists were worried about something called major macroeconomic imbalances. These included large trade deficits and surpluses posted by some countries, as well as high household and government debt. After the 2008–2009 financial crisis, the hope was that the imbalances would gradually disappear in favour of economic growth that was more sustainable in the long term and of a lower risk of another major financial crisis. This growth would also have to be marked by higher non-residential investment and increased productivity. This *Economic Viewpoint* takes stock of these imbalances and the characteristics of economic growth. Despite some progress, the situation still seems to be worrisome.

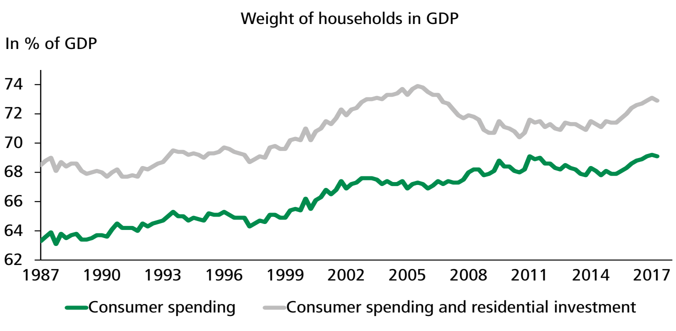
Progress Among Households

In the long run, the economy may underperform if too much strain is put on households. Excessive consumption, often coupled with significant debt, may subsequently require a period of lower consumption to get back on track.

Hit hard by the 2008–2009 crisis, the United States had previously posted a significant economic contribution from consumption. With investment in real estate, the economic contribution of U.S. households had risen to close to 74% of GDP before dropping to between 70% and 71% after the crisis (graph 1). The decrease was observed mainly in residential investment, while consumer spending stabilized for a few years before resuming an upward trend recently.

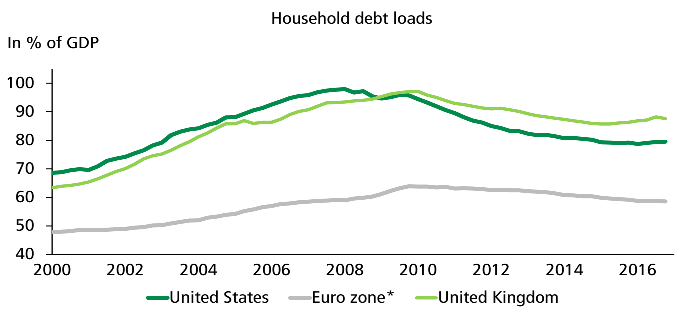
The decline in residential investment in the United States helped reverse the trend in household debt. The same phenomenon was observed in the United Kingdom and in some euro zone countries, including Spain, Portugal and Ireland (graph 2). This adjustment in debt put disposable income back in consumers' pockets and improved long-term economic growth outlooks. However, household debt continued to grow in many other advanced nations (graph 3 on page 2), which carries a certain level of risk.

GRAPH 1
Households are a little less under strain in the United States



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

GRAPH 2
Household debt has decreased in the United States and in other countries



* Main declines in Spain, Portugal, Ireland, Germany and the Netherlands.
Sources: Bank for International Settlements and Desjardins, Economic Studies

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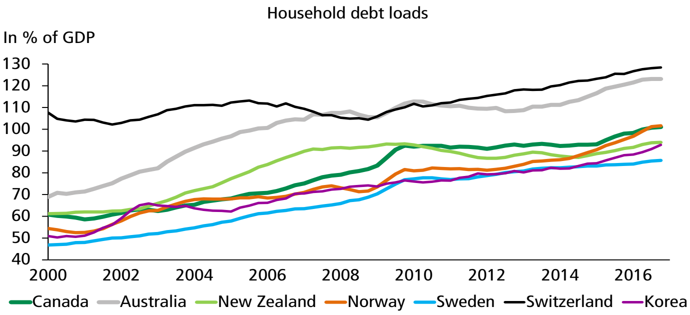
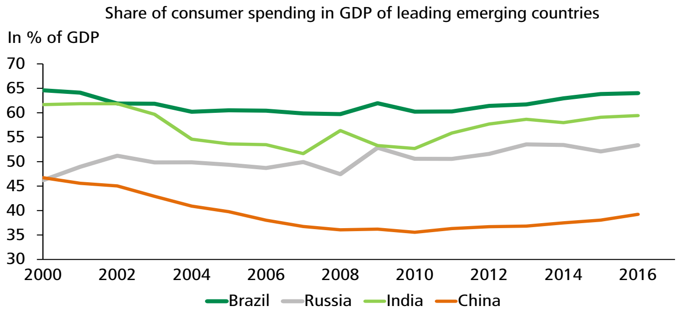
GRAPH 3
Household debt continues to rise in many other advanced nations



Sources: Bank for International Settlements and Desjardins, Economic Studies

GRAPH 4
China consumption remains weak



Sources : World Bank, National Bureau of Statistics of China and Desjardins, Economic Studies

Household debt also increased in emerging countries, but is generally considerably lower than the debt observed in advanced nations. Furthermore, consumer spending continues to be sluggish in some emerging countries, particularly in China (graph 4). There is therefore still a potential for improvement in that respect. While the Chinese economy may be the largest in terms of production, it remains far behind the United States in terms of consumption and is roughly equivalent to the euro zone (graph 5).

Public Debt Is on the Rise

High government debt load was already a source of concern before the 2008–2009 crisis, when a number of countries posted public debt above 60% GDP. Most G7 countries now carry debt loads of more than 100% of GDP, with the Organisation for Economic Co-operation and Development (OECD) country average exceeding 110% (graph 6).

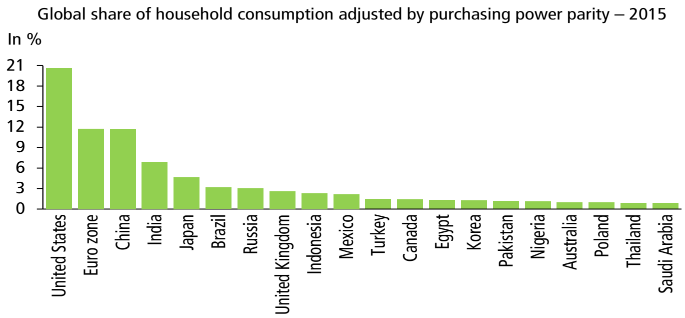
Debt has risen as governments were called upon to support the economy and the financial system in response to the 2008–2009 crisis. The financial burden of debt was, however, mitigated by low interest rates and massive purchases of government bonds by central banks.

Governments could soon have more difficulty maintaining high debt loads, as interest rates have begun an up cycle. Central banks could also complicate the situation by gradually reducing their bonds holdings. The Federal Reserve has already taken such steps. Pressures to reduce debt will therefore become greater, and the required adjustments to tax and public spending levels could penalize the economy for some years.

Less Imbalance in International Trade

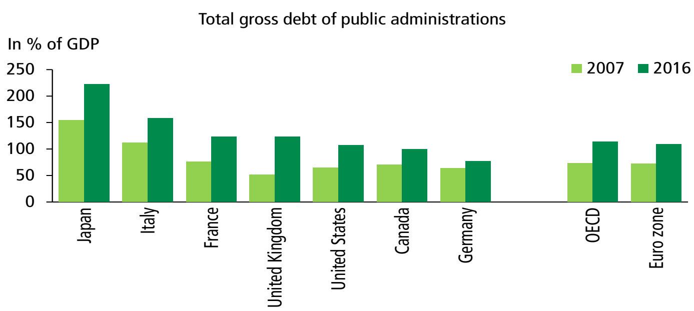
The United States had a large current account deficit at the end of the previous economic cycle. The current account measures the trade balance, plus net foreign investment income and current transfers, such as donations. In 10 years, the U.S. current

GRAPH 5
Chinese consumption accounts for less than 60% of U.S. consumption



Sources: World Bank and Desjardins, Economic Studies

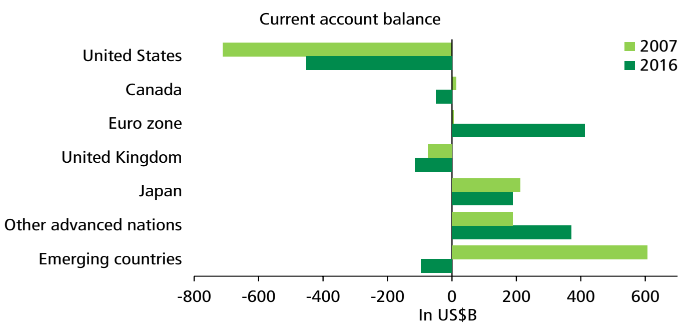
GRAPH 6
Public debt has surged in advanced nations



OECD: Organisation for Economic Co-operation and Development
Sources: OECD and Desjardins, Economic Studies

account deficit decreased by close to US$300B (graph 7). Japan, the United Kingdom and Canada have seen their position deteriorate as other advanced economies improved, on average. The euro zone went from a balanced current account to a surplus of about US$400B.

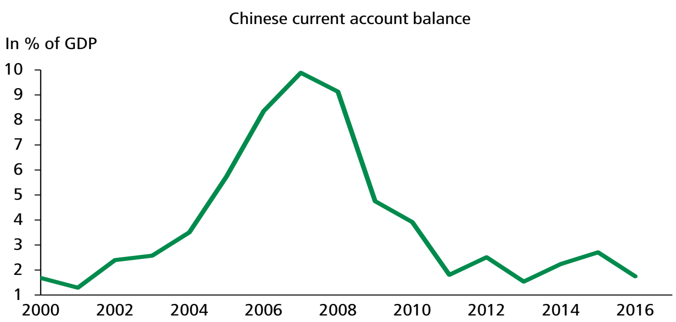
GRAPH 7
Fewer imbalances in international trade



Sources: International Monetary Fund and Desjardins, Economic Studies

The big losers were emerging economies, which saw their current account balance plummet from a large surplus of US$600B to a deficit of about US$100B. Some were especially hurt by the decline in oil revenues. Although China is still posting a surplus, that surplus has shrunk considerably relative to the size of its economy and may be considered less excessive (graph 8). At less than 2% of GDP, the Chinese surplus is lower than that of the euro zone, which sits above 3% of GDP.

GRAPH 8
China contributes far less to global imbalances



Sources: International Monetary Fund and Desjardins, Economic Studies

Current account deficits can be interpreted as being the equivalent of a capital inflow and indebtedness to the rest of the world. In the euro zone, lower consumption and investment generated a substantial savings surplus that can be loaned abroad. In oil-producing countries, the decline in revenues that followed the 2014-2015 drop in oil prices led to a shortfall that had to be offset by foreign capital. In the United States, falling residential investment after the 2008–2009 crisis drove down the need for foreign capital.

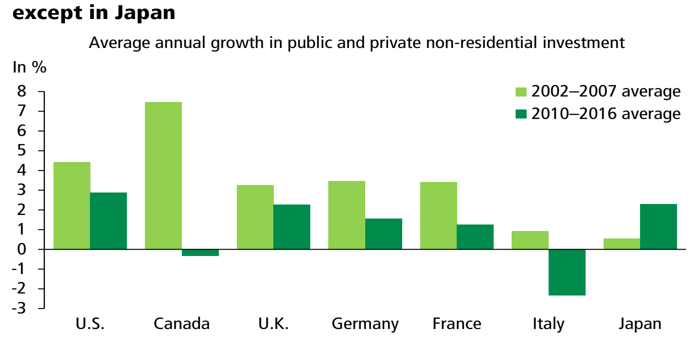
A country cannot keep accumulating large current account deficits unless its economic growth is sufficiently strong. An increase in the size of the economy helps amortize accumulated deficits. Moreover, if the current account deficit comes from higher investment, economic growth could be stimulated over the long term. Conversely, if the current account deficit is associated with higher consumption or a rise in government current expenditure, long-term economic growth potential will probably be weaker and the risk of financial instability greater.

Improvement in Investment and Productivity Still Desirable

Investment increases capital stock, which can be used for goods and services production. This is why long-term economic growth will tend to increase if investment is high. The effect on the economy can, however, vary depending on the type of investment and the utilization rate of the capital already in place. On another front, a rise in capital stock generally improves labour productivity, which fosters a rise in real wages and increases consumers' buying power. Higher wages can also help households shed debt.

Investment growth has generally been weaker in the current cycle compared to the one before. While residential investment has certainly corrected itself in a number of countries after the crisis, non-residential investments made by governments and the private sector have also decreased, particularly in the leading advanced nations (graph 9). This type of investment is also more likely to influence economic growth potential in the long term.

GRAPH 9
Investment has declined from the previous cycle in G7 countries, except in Japan



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

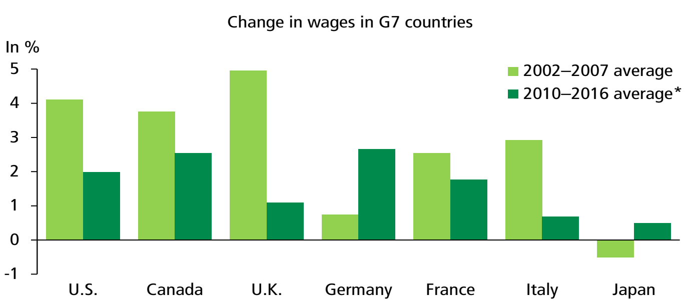
Along with slow investment growth, labour productivity has made little headway in recent years (graph 10 on page 4). A temporary rebound was observed in 2010, but that is mostly

GRAPH 10
Productivity is slow to recover

Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

reflective of the sweeping layoffs in the wake of the 2008–2009 crisis and the reduction in hours worked. Since 2011, productivity growth in G7 countries has remained below 1%. Wages, meanwhile, have generally been slower to go up compared to the previous cycle (graph 11). However, an acceleration has been noted in Japan and Germany, where wage progression had already been very slow beforehand. The link with productivity is not always robust, and many other factors, such as the structure of the labour market and regulation, can affect wages.

GRAPH 11
Wages are rising at a slower pace in most major economies



* 2010–2015 average for Japan.
Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

In light of these data, it would be good to see an acceleration in non-residential investment over the next few years in order to support productivity and maximize the chances of wages going up faster. The most recent investment data show an improvement in several countries for the current year, which is encouraging. The momentum could be maintained in 2018 if we rely on various indicators, such as business confidence indices, which are hovering at historically high levels.

Toward a Gradual Continuation of Adjustments for More Balanced Economic Growth

To sum up, some of the imbalances that built up in the previous economic cycle have disappeared. The financial situation of households in the United States and in other countries is healthier, which can now support slightly stronger consumption. Improvements are also noted in international trade, with fewer deficits and surpluses deemed extreme or problematic for future economic growth.

Overall, debt load remains high, however. This is mainly due to household debt, which has nonetheless continued to rise in a number of countries, and to government debt, which skyrocketed after the 2008–2009 financial crisis, especially in advanced nations. There is also some cause for concern when it comes to non-residential investment, compared to the previous cycle, and low productivity growth.

The most recent investment figures seem more encouraging, and the hope is that the trend will continue in the coming years. A larger contribution from China in terms of consumption might also be worthwhile. However, bringing down government debt is expected to be the main issue over the next few years. Rising interest rates and declining asset holdings by central banks will increase their debt burdens. While a reduction in their debt load may seem desirable, it would be at the expense of economic growth, stunted by lower public spending or higher taxes.

An acceleration in productivity-backed economic growth could help governments shed debt. Central banks could also contain the shock by taking a very gradual approach to normalizing their monetary policy. This seems to be the direction they want to take. Hopefully, inflation will not be a spoilsport, as central banks could see their leeway narrowed.

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