

EXECUTIVE SUMMARY

After declining steadily since 2015, global current account balances—the sum of absolute deficits and surpluses—increased in 2020 and are set to widen further in 2021, amid diverging economic prospects across countries. The widening—from 2.8 percent of world GDP in 2019 to 3.2 percent of GDP in 2020—mainly reflects the unequal impact of the COVID-19 crisis, including on the travel, oil, medical goods, and household consumption goods sectors. It also reflects, in 2021, the larger fiscal expansions in advanced economies with current account deficits, notably the United States. Without these pandemic-related shifts and policy responses, global balances would have continued on their declining path. The stocks of external assets and liabilities remain near historic highs, with large valuation-induced changes and attendant risks for both creditor and debtor economies.

At the country level, the COVID-19 pandemic has triggered wide fluctuations in external positions, with uneven effects. Despite the global recovery in merchandise trade, spending on services remains subdued, with global tourism arrivals far below their 2019 levels and sharp falls in trade balances for tourism-exporting economies. Oil exporters also initially saw sharply falling trade balances, but these gradually recovered after mid-2020 with rising oil prices. The lockdown-induced shift in household spending from services to consumer goods and the health-emergency-induced trade in medical products have triggered further movements in exports and imports.

Unprecedented government borrowing to finance health care and economic support has had uneven effects on trade balances. As the analysis in Chapter 2 highlights, what happens to the current account depends on a country's relative fiscal policy stance compared with that of its trading partners. Countries with the largest budgetary expansions have caused their trade balances to fall, all else equal, while those with smaller fiscal expansions have had their trade balances rise. The movements in overall saving-investment (current account) balances as a share of GDP reflect these fiscal expansions, with falling public saving,

and partially offset relatively stable investment rates and increases in private saving—especially by higher-income households. With richer economies borrowing relatively more than poorer economies to fund government spending, their current account balances have, on average, declined by more. This development suggests that the pandemic may have slowed the “downhill” flow of funds from richer to poorer countries, highlighting the unequal impact of the pandemic and potentially exacerbating the divergent speeds of recovery across income groups.

Currencies fluctuated widely early in the pandemic, with more moderate movements since mid-2020. Reserve currencies at first appreciated during the flight to safety at the onset of the crisis, but most have since depreciated amid exceptional policy support, including significant expansions in liquidity by central banks and expansionary fiscal packages, as well as positive vaccine news and global risk sentiment. Emerging market currencies that depreciated early in the crisis have, in many cases, rebounded, but some economies with external vulnerabilities have experienced continuing pressure on their currencies, along with declining foreign exchange reserves.

The IMF's multilateral approach suggests that excessive current account deficits and surpluses—deviations from desirable medium-term levels—were broadly unchanged in 2020 at about 1.2 percent of world GDP. Excessive current account imbalances can fuel trade tensions, become targets for protectionist measures, and increase the likelihood of disruptive asset price adjustments. The assessments for 2020 take into consideration the temporary impacts of the pandemic in a multilaterally consistent way, through the use of additional cyclical adjusters. About 72 percent of the excess balances in 2020 pertained to advanced economies, up from 69 percent in 2019. The largest contributors to lower-than-warranted current account balances—as a share of world GDP—were, in order, the United States, France, the United Kingdom, and Canada. The largest contributors to larger-than-warranted current account balances were Germany, The Netherlands, Mexico, Poland, and Russia.

The relatively large fiscal expansions of some economies affected their trading partners' external positions and assessments.

The outlook for global current account balances is a gradual narrowing during 2022–26, mainly reflecting a narrowing of the US deficit and China's surplus to below pre-pandemic levels. Numerous uncertainties surround this forecast. The path depends crucially on fiscal policy developments (Chapter 2). A resurgence of the pandemic could make the aforementioned sectoral effects of the crisis more persistent than currently expected. A tightening of global financial conditions could further slow the downhill flow of capital. A retreat from trade integration could weaken growth prospects, especially for economies integrated into supply chains. On the upside, expedited vaccinations, including in lagging regions, would improve confidence and contribute to unwinding crisis-induced current account movements.

In the near term, policy efforts should focus on averting downside risks by ending the pandemic globally. Strong international cooperation is needed to secure up-front financing for vaccinations and public health measures. If further external shocks materialize, economies with flexible exchange rates should allow them to adjust, where feasible, although for economies with adequate reserves, exchange rate intervention can alleviate disorderly market conditions, particularly if

there are shallow foreign currency markets and large balance sheet mismatches.

Multilateral efforts should intensify to resolve trade and technology tensions and to modernize international taxation. Priorities include phasing out tariff and nontariff barriers, including on medical products, and addressing gaps in the rules-based multilateral trading system. Tariffs negatively affect business sentiment and consumers and do not effectively address policy gaps and structural distortions to lower external imbalances.

Over the medium term, collective action is needed to reduce global imbalances in a growth-friendly manner. Where excess current account deficits reflect larger-than-desirable fiscal deficits, fiscal consolidation would promote debt sustainability, reduce the current account gap, and facilitate raising international reserves. Countries with export competitiveness challenges would benefit from productivity-raising reforms, including to enhance education outcomes and innovation. In economies with excess current account surpluses and remaining fiscal space, policies should support the recovery and medium-term growth, including through greater public investment in digitalization, upgrading infrastructure, and climate change mitigation. Intensifying reforms to encourage private investment and discourage excessive precautionary saving may also be warranted, including by reducing informality and expanding social safety nets.