INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

UNDERSTANDING GLOBAL IMBALANCES

April 2026

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its 1 April 2026 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on 3 March 2026 for the Executive Board's consideration on 1 April 2026.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 26/107

IMF Executive Board Discusses Global Imbalances

FOR IMMEDIATE RELEASE

Washington, DC – April 6, 2026: The Executive Board of the International Monetary Fund (IMF) discussed the IMF staff policy paper on Understanding Global Imbalances on Wednesday, April 1, 2026.

Against the backdrop of persistent and recently widening global imbalances, the paper presents a structured framework for understanding how domestic policies can influence current account positions by altering domestic saving and investment decisions. Staff analysis finds that traditional macroeconomic policies remain the dominant drivers of imbalances, but certain types of industrial policies could also play a role. Micro industrial policies—those targeting specific sectors or firms—generally have ambiguous and limited effects on the current account depending on their impact on aggregate productivity. Macro industrial policies—those deployed economy-wide and often paired with restrictions such as capital flow management measures—can materially affect the current account but come at a cost to consumption. Trade restrictions, often deployed to counter imbalances, would only meaningfully alter current account balances when used temporarily or to support higher public savings.

Using scenario analysis, the paper shows how domestic rebalancing, undertaken simultaneously, across deficit and surplus economies yields both a reduction in global imbalances and higher global output. The report concludes that the future path of global imbalances will be largely shaped by domestic macroeconomic trajectories. Durable rebalancing is a collective endeavor: it requires sound domestic policy action across major economies and works best when countries move together. To help design such policies, the Fund is pursuing a multipronged approach by strengthening data, analysis, surveillance and dialogue across the member countries.

Executive Board Assessment[1]

Executive Directors welcomed the paper on Understanding Global Imbalances, noting its timeliness particularly as imbalances have widened again and remain concentrated and persistent. They agreed that the paper provides a clear and coherent analytical framework to analyze the drivers, risks, and policy implications of global imbalances, and usefully contributes to the Fund's multilateral and bilateral surveillance by clarifying how macroeconomic, trade, and industrial policies interact to shape external positions. Directors broadly agreed with the paper's conclusions, while also encouraging further efforts to enhance the Fund's evaluation of global imbalances, including tackling statistical and methodological gaps, financial stocks and flows, and refining the External Balance Assessment.

[1] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Directors emphasized that persistent and large surpluses or deficits, beyond those justified by fundamentals, warrant close assessment, given potential risks to macroeconomic and financial stability. They agreed that the saving–investment framework remains the appropriate conceptual anchor for monitoring and diagnosing global imbalances. They welcomed the paper's emphasis on forward-looking saving and investment decisions as the core determinants of current account balances, and its clear articulation of the links between flow imbalances, stock positions, valuation effects, and financial stability risks. Directors underscored that the analysis of imbalances should also encompass capital flows and external balance sheet positions, stock-flow dynamics, and the role of expectations and strategic behavior.

Directors agreed that the paper usefully highlights the conditions under which trade and industrial policies may affect current account balances. They generally concurred with the finding that tariffs and sectoral (micro) industrial policy have limited and ambiguous effects on current account dynamics. It was also noted, however, that this finding may reflect model dependency and data limitations. Directors noted that certain economywide policy combinations—such as sustained foreign reserve accumulation combined with capital flow restrictions or other policies that suppress domestic consumption—can have more material and persistent effects on external balances, with important cross border spillovers. Many Directors cautioned, however, that such policies may, when appropriate, be deployed for macroeconomic stabilization objectives, and stressed the importance of careful clarification and country specific assessments to avoid conflicting with existing Fund guidance, including under the Integrated Policy Framework. A few Directors called for further analysis of the role of the international monetary system in shaping saving–investment dynamics.

Directors agreed that domestic rebalancing, through a better mix of macroeconomic and structural policies, is central to an orderly resolution of global imbalances. They underscored that effective adjustment requires actions by both surplus and deficit economies, and that industrial and trade policies cannot substitute for reforms that support productivity growth, resilient domestic demand, and macroeconomic stability. Directors welcomed the scenario analysis which points to the benefits of simultaneous and symmetrical domestic policy reforms in terms of both reducing imbalances, preserving financial stability and increasing global growth.

Directors emphasized the need to continue refining the External Balance Assessment (EBA) models, to better capture policy interactions, and further analyze the role of capital flows and stock imbalances. They emphasized the importance of further engagement with the Board and country authorities on the EBA methodology refinement. Directors also stressed the importance of addressing remaining statistical and data gaps in external sector statistics and improving transparency around trade and industrial policies. They encouraged staff to develop more comprehensive datasets and dashboards in these areas, while continuing close collaboration with other international institutions. Directors welcomed ongoing efforts under the Comprehensive Surveillance Review and encouraged staff to further strengthen the integration of external sector analysis into surveillance, including outward spillovers.

Going forward, Directors encouraged staff to build on this work through continued analytical refinement, regular monitoring of global imbalances, enhancement of databases, and clear communication of policy tradeoffs. They underscored the importance of maintaining evenhanded, evidence-based surveillance that supports international cooperation and contributes to global economic and financial stability.

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SU/26/46

April 3, 2026

The Chair's Summing Up
Understanding Global Imbalances
Executive Board Meeting 26/32
April 1, 2026

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INTERNATIONAL MONETARY FUND

UNDERSTANDING GLOBAL IMBALANCES

March 3, 2026

EXECUTIVE SUMMARY

After more than a decade of steady decline, global imbalances have widened in recent years. While current account surpluses and deficits can be appropriate when they reflect economic fundamentals and desirable policies, the buildup and persistence of large imbalances raise concerns when they are driven by policy distortions and unwind in a disorderly manner. The expansion of industrial policies and the rise in trade restrictions—often motivated by imbalances themselves—has intensified the debate on the causes and consequences of global imbalances, despite limited analytical and empirical clarity on how both policies affect the current account.

In recent decades, global imbalances have become highly concentrated among a small group of systemic economies and display greater persistence. Trade balances remain a significant component of overall current account balances. Over time, current account surpluses and deficits have accumulated into historically large stock imbalances, heightening vulnerability to financial shocks. At the same time valuation effects—from movements in exchange rates and asset prices—now play a larger role in changes in external wealth, particularly for economies with large gross cross-border positions.

This paper provides a framework for unpacking global imbalances, building on the foundational intertemporal approach to examining the current account. In this framework, external balances are the outcome of national saving and domestic investment. Hence, changes in current account balances require understanding why and how forward-looking saving and investment decisions change in response to policy or shocks. This approach encompasses cyclical factors, macroeconomic and structural fundamentals, and key economic policies as drivers of the current account and demonstrates how spillovers propagate. This framework also underpins the Fund's External Balance Assessment (EBA) used to assess the external positions and exchange rates of member countries. The framework is expanded here to examine the implications of industrial and trade policy for saving and investment and thus the current account.

The analysis shows that trade and industrial policies could affect external balances and do so in fundamentally different ways shaped by their duration and scope. The analysis finds that tariffs can increase the current account if they are temporary, whereas permanent tariffs are broadly neutral, with any modest effects operating mainly through fiscal channels. On industrial policies, the paper complements the standard concept of "micro industrial policies" (targeted at the level of firms or sectors) with the notion of "macro industrial policies" (deployed economy-wide). The former tend to have ambiguous and limited effects—they increase the current account insofar as the policy "fails" or generates aggregate productivity losses through sectoral misallocation. In contrast, the latter—such as foreign reserve accumulation or financial

repression combined with policy induced restrictions (e.g., capital flow management measures) to help achieve industrial policy objectives—can have a more material effect on external balances, often at the cost of suppressing domestic consumption and increasing external deficits elsewhere. However, there are many circumstances where these policy measures (such as foreign reserve accumulation, capital flow management) may be deployed to achieve appropriate macroeconomic stabilization objectives. This paper does not provide a normative assessment of these policies. Potential implications for the Fund's external sector assessment are left to future work.

Illustrative model simulations and existing empirical evidence corroborate the analytical conclusions of the framework and highlight policy trade-offs. Policies that raise the current account often do so by suppressing consumption, output or investment, while policies that support productivity and domestic demand tend to lower surpluses or widen deficits. Empirical evidence suggests that tariffs and industrial policies have, on average, small effects on current account balances. This reflects both the nature of their application, which aligns with cases of the framework where they are expected to have limited effects, and interaction with key macroeconomic channels already captured in standard empirical models.

Traditional macroeconomic policies remain significant drivers of imbalances, but certain industrial policies could play a role. Scenarios highlight how different combinations of fiscal, structural, and industrial policies could narrow or widen global imbalances. Trade restrictions play a limited role in correcting imbalances, especially under flexible exchange rates, but can worsen output. Furthermore, prolonged imbalances or those that build alongside financial vulnerabilities risk disorderly adjustment with severe economic consequences. By contrast, policy actions aimed at removing domestic distortions through fiscal and structural reforms can simultaneously narrow imbalances while enhancing global output.

Fund surveillance is central to engaging members on policies that address external imbalances and promote economic and financial stability. The focus on external imbalances is anchored in the Fund's founding mandate and legal framework. Resolving global imbalances will require policy adjustment by both surplus and deficit countries. While the Fund supports member countries in designing such policies with data, analysis, surveillance, and dialogue, adjustment ultimately depends on domestic policy actions, preferably synchronized. These reforms are challenging and can be disruptive in the short term. However, the alternative — continued widening of imbalances — is also economically disruptive and ultimately more costly. To strengthen engagement with its members, the Fund is pursuing a multi-pronged approach: refining its External Balance Assessment model; advancing the Comprehensive Surveillance Review; enhancing external sector statistics; undertaking further analytical work on stock imbalances and financial stability; and supporting international policy dialogue in multilateral fora.

Approved By
Pierre-Olivier Gourinchas and Christian Mumssen

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Glossary

AI	Artificial Intelligence
CA	Current Account
CSR	Comprehensive Surveillance Review
EBA	External Balance Assessment
ES	External Sustainability
ESA	External Sector Assessment
ESR	External Sector Report
FA	Financial Account
FXI	Foreign Exchange Intervention
GFC	Global Financial Crisis
GIMF	Global Integrated Monetary and Fiscal Model
GNDI	Gross National Disposable Income
GTA	Global Trade Alert
ICRG	International Country Risk Guide
IMS	International Monetary System
IP	Industrial Policy
IPF	Integrated Policy Framework
ISD	Integrated Surveillance Decision
KA	Capital Account
NFA	Net Foreign Assets
NIIP	Net International Investment Position
NIPO	New Industrial Policy Observatory
NX	Net Exports
R&D	Research and Development
REER	Real Effective Exchange Rate
SSBIG	Strong, Sustainable, Balanced, and Inclusive Growth
TFP	Total Factor Productivity
WEO	World Economic Outlook
WTO	World Trade Organization

INTRODUCTION

1. In recent years, global imbalances have returned as a cause for international concern.[1] The recent widening in global imbalances—a reversal of the steady narrowing since the global financial crisis—has sparked renewed uncertainty about the modalities of trade and financial integration. At the outset, it should be recognized that current account surpluses or deficits can be warranted to the extent that they reflect economic fundamentals and desirable policies or the actions of 'consenting adults' (Pitchford 1989). In such circumstances, an approach of benign neglect is appropriate, going back to the view of self-limiting imbalances (Hume 1752).[2] However, the accumulation and persistence of large deficits and surpluses may be worrisome for the global economy because of how they arise or the potential consequences of how they unwind.

2. With the growing prominence of industrial and trade policies, additional analysis is in order. The expansion of industrial policies and rise in trade restrictions—notably, the recent U.S. tariff increases as an explicit trade protection tool—have coincided with the period of widening current accounts, intensifying the debate on the drivers of global imbalances. This includes a "beggar-thy-neighbor" view that the extensive use of industrial policies excessively stimulates exports with negative spillovers to production and employment in other economies. These fresh waves of industrial and trade policies mark a significant departure from the trade liberalization trajectory of the 1990s and early 2000s. However, there is limited analytical and empirical clarity on how these policies impact the current account.

3. This paper presents a structured discussion of the drivers of global imbalances, building on a well-established macroeconomic framework. This framework is rooted in the intertemporal approach to the current account, which provides a link between domestic saving and investment dynamics and external imbalances. To the extent that these external imbalances, in turn, correspond to international borrowing and lending patterns for a given world interest rate, the framework also provides insights into financial imbalances. This framework underpins the IMF's External Balance Assessment (EBA). However, unlike the EBA, this paper uses the framework to provide only a positive analysis of the impact of different types of domestic policy on the current account and does not take a normative stance on a policy's desirability.

4. Using the framework, the impact of industrial and trade policies on the current account is found to depend on their scope and duration. The paper examines the impact of trade and two different types of industrial policies—those targeted at certain sectors of the economy ("micro industrial policies") and those deployed economy-wide ("macro industrial policies")—on the current account. Micro industrial policies and broad-based tariffs have ambiguous

[1] For the purposes of this paper, and as its analysis is positive rather than normative, the term "global imbalances" is defined as the sum of the absolute value of each economy's current account deficit and surplus. This is not a strict definition and at times the terms imbalances and balances are used interchangeably.

[2] A fortiori, countries' bilateral imbalances with each other should also not be viewed as problematic and are only weakly linked to systematic movements in aggregate imbalances (Cuñat and Zymek 2024).

effects on current account balances depending on whether they are temporary or permanent, their impact on aggregate productivity, and their fiscal implications. Macro industrial policies instead have a clearer impact on the current account, often leading to outcomes such as exchange rate depreciation. However, these policies have tradeoffs, at times suppressing consumption to increase the current account.

5. The paper also presents scenarios that highlight the costs and benefits of alternative policies for adjustment. Global imbalances could widen further if existing trends continue or are amplified in major economies. Without corrective policy actions, adjustments of imbalances are unlikely to be orderly. The use of tariffs to address imbalances has a limited impact on current account balances but generates disruptions leading to output losses. In contrast, a simultaneous set of domestic growth-enhancing policies can materially narrow imbalances while boosting global output.

6. The paper is organized as follows. The next section provides an overview of global imbalances, providing a historical perspective and documenting stylized facts. The following sections introduce the conceptual framework and assess its findings through a quantitative general equilibrium model featuring a number of real and financial frictions. The subsequent sections present empirical evidence on the drivers of the current account, with a focus on recent empirical work on the impact of trade and industrial policies, and scenarios of policy packages that could help resolve imbalances in an orderly way. The penultimate section discusses the role of the Fund with regard to global imbalances. The final section raises issues for discussion.

OVERVIEW OF GLOBAL IMBALANCES

7. The current account balance (CA) measures the net flow of goods, services, and income between a country and the rest of the world. It is defined as the sum of the trade balance (net exports, NX), net primary income (factor receipts from abroad minus payments to nonresidents, PI), and net secondary income (current transfers, receipts minus payments, SI). By definition, gross national disposable income ($GNDI$) equals the sum of private and public consumption (C^P and C^G), private and public investment (I^P and I^G), and the current account. Rearranging this identity shows that the current account identity equals the difference between national saving (S) and investment (I) and establishes a fundamental link between domestic policies and external positions:

$$GNDI = C^P + C^G + I^P + I^G + NX + PI + SI$$

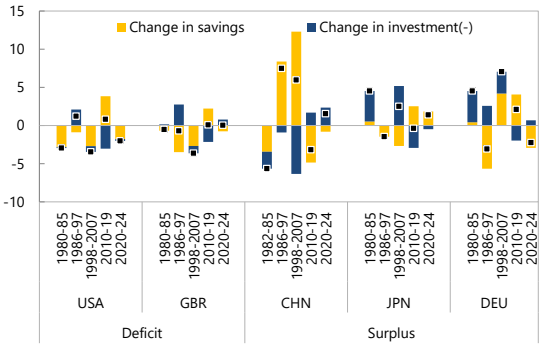
$$NX + PI + SI = (GNDI - C^P - C^G) - (I^P + I^G)$$

$$CA = S - I$$

8. By the balance of payments identity, the capital and financial accounts mirror the current account and are thus jointly determined. The current account equals the financial account (FA) net of the balance on the capital account (KA): $CA = (FA - KA)$.[3] Thus, net resource flows to or from the rest of the world are matched by changes in net foreign claims. For example, a country running a current account deficit (an excess of domestic investment over saving) must finance this gap through net capital inflows. Conversely, capital flows dynamics – from changes to saving or investment in other countries or interest rate shocks – must be reflected in the current account. These capital account flows accumulate over time into net international investment positions (NIIPs), which measure the stock of external assets less liabilities.

9. The current account balance is an outcome that reflects cross-country differences in national saving and investment, and not a policy target. These differences are shaped by structural characteristics such as demographics and productivity growth, as well as policies, institutional features, and different economic structures and systems (Corden 1991). As such, policymakers cannot directly target a specific external balance; any attempt to change a country's external position must operate through policies that alter saving and investment decisions. For example, Japan's surplus since the 1990s largely reflects high corporate saving and subdued domestic investment, while deficits in the US have been mostly driven by dissaving by households and the government (Figure 1).

Figure 1. Current Account Balances Decomposed into Saving and Investment
(Percentage point change in ratio to GDP, change calculated for entire period)

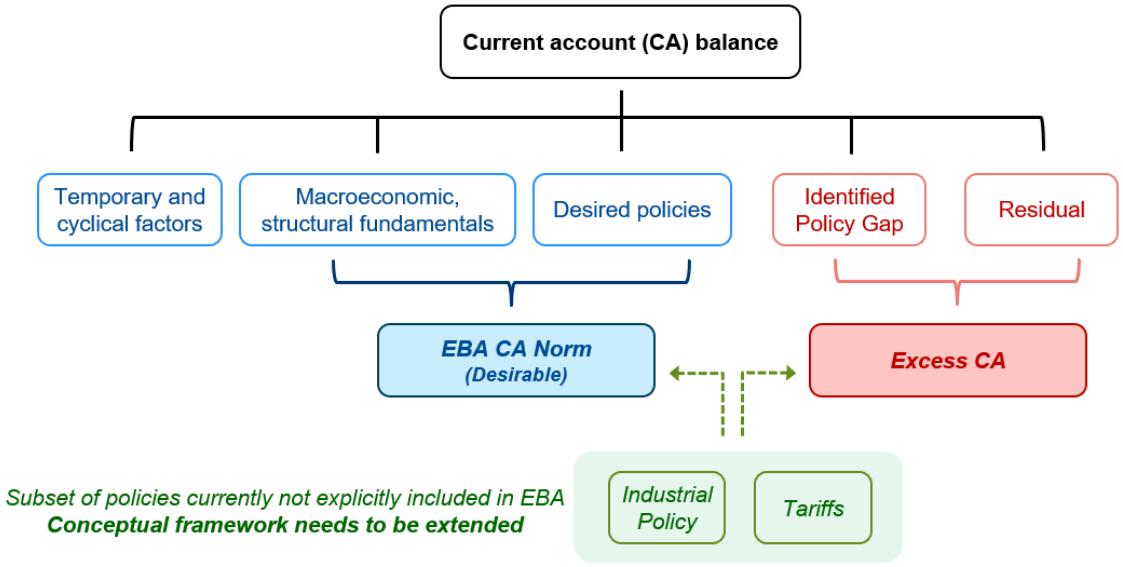


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

10. Current account surpluses or deficits need not be a cause for concern. Some external balances are consistent with economic fundamentals and desirable policies—for instance, it is desirable for young or rapidly growing economies to finance part of their economic development with foreign capital. However, excessive balances arise when these underlying forces are amplified by policy-induced distortions that systematically raise saving or depress investment—or vice versa—beyond levels implied by fundamentals and desirable policies. The challenge lies in distinguishing between warranted balances—or "norms"—and excessive balances caused by policy distortions (e.g., excess fiscal deficit) and other factors. This notion of excessive balances is operationalized at the Fund through its EBA methodology (Box 1). Trade and industrial policies could contribute to either the norm, to the extent that they are desirable, or the excess. The framework developed in subsequent sections attempts to conceptualize how these factors affect the current account, without taking a position on the desirability of the policies themselves (Figure 2).

[3] This identity follows the BPM6 convention but ignores errors and omissions.

Figure 2. Diagnosing Excess Current Account Balances



Box 1. The Nuts and Bolts of IMF External Sector Assessments

The IMF has a mandate to promote a stable system of exchange rates, exercise firm surveillance over exchange rate policies, and help correct maladjustments in members' balance of payments. Thus, Article IV consultation report should assess the member's external position and its impact on the stability of the member and global stability. To operationalize the concept of excessive balances, the IMF employs the External Balance Assessment (EBA) framework, which benchmarks observed positions, stripped of cyclical factors, against norms consistent with fundamentals and desirable policies. It is the main analytical tool for the Fund's External Sector Report (ESR) and country-level external sector assessments (ESA) in bilateral surveillance. The EBA methodology has provided a systematic framework for conducting multilaterally consistent ESAs since its introduction in 2012 and is built on the IMF's earlier Consultative Group on Exchange Rates (CGER) models (see Lee and others 2008).

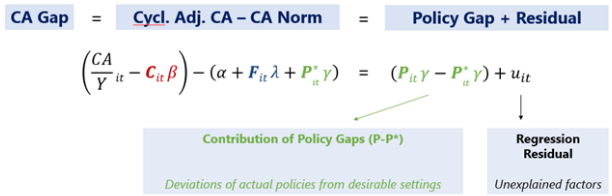
The main challenge when conducting external sector surveillance (ESA) is assessing what is appropriate, and what can be considered excessive and driven by a country's policy settings or other distortions. Because the drivers of current account balances and exchange rates are complex, no single approach can provide complete and multilaterally consistent answers for all countries. Therefore, the ESA process combines EBA model inputs with Fund staff judgment to arrive at a final staff ESA.

The EBA methodology includes three main components: (i) a cross-country regression model to benchmark the current account, (ii) regression models to benchmark the real effective exchange rate (REER), and (iii) the external sustainability (ES) approach for cases where risks arising from large net international debtor positions may be relevant. Generally, greater weight is given to the current account model because real exchange rates tend to be more volatile and harder to explain econometrically.

The EBA model produces the following outputs: (i) Current account *norm*: An estimate of the current account balance consistent with medium-term fundamentals (F_{it}, such as demographics, output per worker, expected growth) and desirable policies (P_{it}^{*}); **(ii) Current account *gap*:** The difference between the realized current account after adjusting for cyclical and other short-term factors (C_{it}) and the norm. These *gaps are a measure of excess external balances*, indicating potential distortions or misalignments. A positive gap indicates a balance that is larger (more surplus or less deficit) than warranted by fundamentals and desirable policies;

Box 1. The Nuts and Bolts of IMF External Sector Assessments (concluded)

(**iii) Policy gap and residual:** The current account gap equals the sum of model-identified *policy gap and the regression residual*. The policy gap quantifies how much of the excess balance is due to deviations of key policy variables—fiscal stance, foreign reserve accumulation, capital controls, and public health spending (a proxy for social protection)—from desirable levels. The residual captures country features or policy distortions not explicitly incorporated in the model.



While the EBA models provide numerical inputs for identifying external imbalances, in some cases, they may not fully capture all relevant economic characteristics and potential policy distortions. In such cases, staff judgement is essential and involves selecting relevant indicators to reach an overall assessment. This includes deciding how much weight to give to the outcomes of different models, and whether indicators outside the regression models are relevant. Examples of resulting adjustors include accounting for the effects of the pandemic on the external sector and adjustments for countries with significantly lower life expectancies. These adjustors should be analytically grounded, applied evenhandedly, and multilaterally consistent (see IMF 2022).

A. Evolution of Global Imbalances

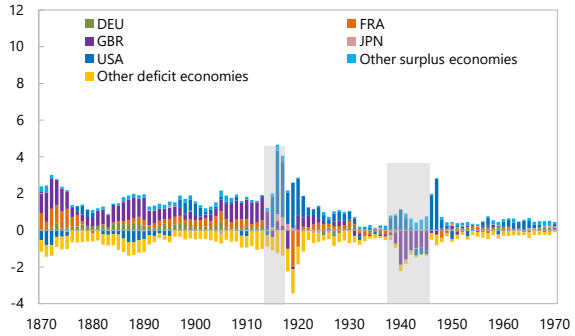
11. Global imbalances have become concentrated and persistent over time. Global imbalances have been a recurrent feature of the global economy since the 1870s and countries have switched positions over time (Figure 3). The United Kingdom, for example, ran sustained surpluses prior to World War II—reflecting colonial trade and large investment income—before shifting into a structural deficit position after 1945. More recently, the US transitioned from surplus to deficit in the 1970s, while Germany and Japan moved into surplus.

- *Concentration*. Four economies—the US, China, Germany, and Japan—account for roughly two-thirds of global imbalances. The US deficit—equivalent to 4 percent of GDP as of 2024—has been financed by capital inflows and portfolio investors seeking dollar assets. Germany and Japan's surpluses have been driven by high saving rates, joined by substantial surpluses in China beginning in the 2000s. Oil-exporting countries' surpluses fluctuate with commodity prices, creating episodic contributions to global imbalances.

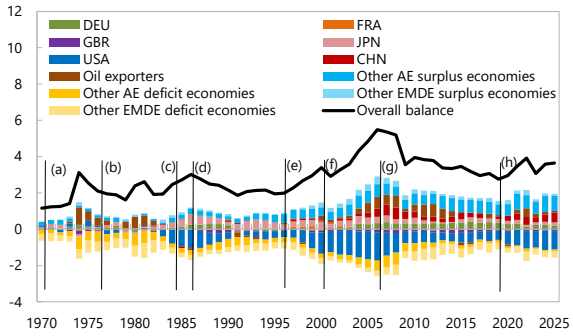
- *Persistence*. In earlier decades, surpluses and deficits were more cyclical: countries moved in and out of surplus depending on business cycles, commodity shocks, and exchange rate movements (Figure 4). While there is no standard definition of persistence, the average duration of a deficit or surplus spell roughly doubled since the 1980s. Countries where the share of those where deficits or surpluses remain for over three years has also increased since the late 1980s and remained at the elevated level since.

Figure 3. Evolution of Global Imbalances

Selected Advanced Economies: A Century of Current Account Balances, 1870–1970
(Percent of sample GDP)



Global Current Account Balances, 1970–2025
(Percent of world GDP)

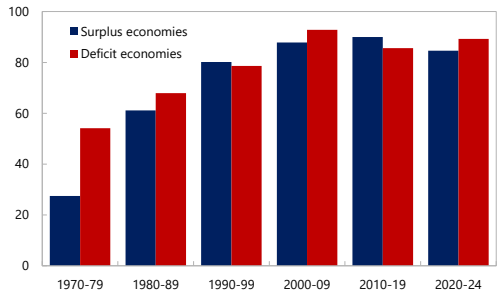


Sources: IMF, *World Economic Outlook*; IMF, *Balance of Payments*; Jordà, Schularick, and Taylor (2017); and IMF staff calculations.
Notes: Left panel: Based on a sample of 18 advanced economies, which account for around 80 percent of global GDP. Right panel: The *overall balance* is defined as the sum of absolute values of current account surpluses and deficits. *Adjusted overall balance* removes the impact of COVID-19 pandemic factors and commodity price fluctuations from the overall balance. (a) Collapse of Bretton Woods System (1971); (b) Dollar Crisis (1977); (c) Plaza Accord (1985); (d) Louvre Accord (1987); (e) Asian Crisis (1997); (f) China WTO accession (2001); (g) GFC (2007); (h) COVID-19 Pandemic (2020).

12. Trade in goods and services remains the largest component of current account balances. Other components, such as primary income and secondary income, instead typically attenuate the magnitude rather than reverse the sign (Figure 5). In particular, primary income flows have grown in importance over recent decades—notably for financial centers and advanced economies with large cross-border asset positions—such that they can partially offset goods

Figure 4. Persistence of Current Account Balances

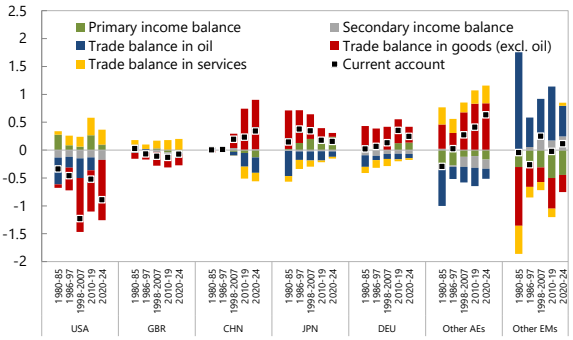
(GDP weighted share of countries where deficits or surpluses remain over three years, percent)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Notes: The chart shows the GDP-weighted share of countries in the global economy for which the sign of the current account balances does not change within the following 3 years. The share is computed for each year and then averaged over the relevant time periods.

Figure 5. Decomposition of Current Account Balances

(Percent of GDP)

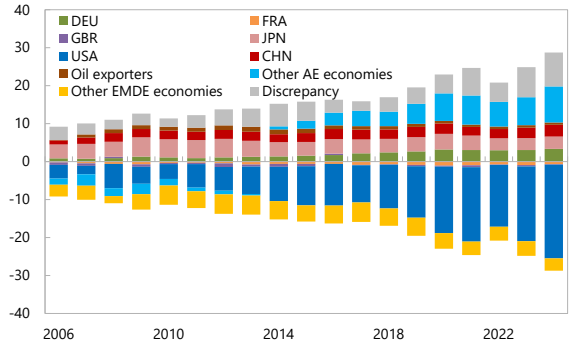


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

balances. At the same time, flows in digital services, royalties from intellectual property, and professional services have grown rapidly, complicating the measurement and cross-country comparison of current account balances.

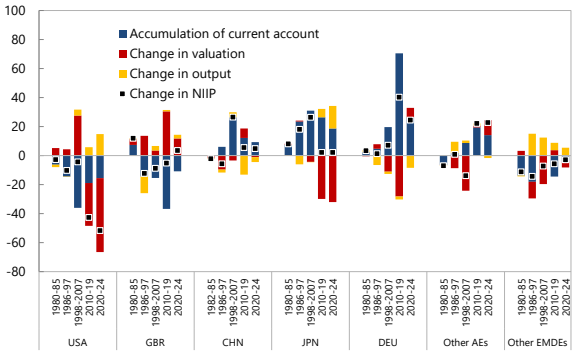
13. Persistent current account imbalances accumulate into large stock imbalances, but the importance of valuation effects has grown over time. Persistent surpluses over the past two decades have accumulated into very large net foreign asset positions for economies such as China, Germany, and Japan, with each holding net foreign assets equivalent to 3–3.5 percent of global GDP in 2024. Similarly, persistent deficits have built up into large net liability positions, most notably in the US where the NIIP stands at about -25 percent of global GDP in 2024, underscoring the central role of the US position in global balances (Figure 6). Stock balances can also move independently of current account flows, a phenomenon increasingly important for advanced economies with large financial exposures (Figure 7). Valuation effects—arising from exchange rate movements, asset price changes, and differences in portfolio composition—can amplify or offset flow dynamics. Some countries have seen sizeable valuation gains that have slowed the buildup of net liabilities; others have seen valuation losses that deepened their net debtor position despite only moderate deficits. In the 1980s and 1990s, changes in NIIP were driven primarily by trade balances, with valuation effects playing a limited role. Since the 2000s, this relationship has partly reversed: valuation changes have become more important than trade flows in explaining movements in the NIIP of some economies driven by financial globalization and increased cross-border flows and gross positions.

Figure 6. Net International Investment Positions (Percent of world GDP)



Sources: IMF, *World Economic Outlook*; IMF staff calculations.

Figure 7. Decomposition of Change in Net International Investment Positions (Percent of GDP)



Sources: IMF, *Balance of Payments*; IMF, *World Economic Outlook*; The External Wealth of Nations Database; and IMF staff calculations.

B. Risks from Global Imbalances

14. Large current account surpluses and deficits pose risks to global economic stability especially if they unwind through a disorderly adjustment.[4] Over time, large deficits or surpluses can amplify vulnerabilities to shocks. Orderly adjustment typically involves a gradual narrowing of imbalances through shifts in saving and investment behavior, with implicit relative price adjustments, and more limited macroeconomic disruption. By contrast, disorderly adjustment is often associated with abrupt capital flow reversals, sharp asset price corrections, and deep economic downturns. Two historical episodes illustrate different outcomes (see Box 2). At the time of the Plaza Accord, which involved coordinated policy actions, adjustment occurred primarily through domestic rebalancing and avoided global output losses, though it arguably came at a high domestic cost for some countries. During the global financial crisis, policy coordination played a more limited role, with rebalancing occurring mainly through financial stress and balance sheet repair.

Box 2. Historical Episodes of Large Global Balances and Adjustment: Plaza Accord and GFC

Two prominent episodes—the Plaza Accord of 1985 and the global financial crisis (GFC)—illustrate different pathways through which global balances have adjusted (Figure 2.1).

The Plaza Accord. By the mid-1980s, the global economy was characterized by large and widening current account balances, with the US running a sizable deficit mirrored by surpluses in Japan and Germany. In the US, these balances reflected a combination of expansionary fiscal policy in the US, tight monetary conditions following the Volcker disinflation. Highlighting the major role of policy adjustment, a scenario in the April 1985 World Economic Outlook illustrated how a triple package of US fiscal consolidation, trade liberalization in Japan, and structural reforms in Europe could improve current accounts and lead to better outcomes. A turning point came with the May 1985 Bonn Summit on a coordinated macroeconomic response coupled with the September 1985 Plaza Accord, which reiterated these policy commitments and adopted a coordinated currency intervention strategy (Funabashi 1988; Frankel 2015). Subsequently, a gradual narrowing of external balances ensued, driven in part from adjustments to fiscal and monetary policy, without a significant slowdown in global growth. Meanwhile, the Plaza agreement also underscored the cooperative approach, thus serving to defuse protectionist pressures in Congress. Nevertheless, the benefits of this approach for individual countries has been questioned, particularly in Japan with some attributing its "lost decades" to such a rebalancing, though several other factors contributed to this outcome (IMF 2011).

The Global Financial Crisis. In the years preceding the crisis, large current account deficits in the US and parts of Europe were matched by persistent surpluses in emerging Asia and oil-exporting economies, alongside rapid growth in cross-border financial positions. Unlike the Plaza episode, perspectives differ on the underlying determinants of these balances (Obstfeld and Rogoff 2009; Caballero and Krishnamurthy 2009). They were closely intertwined with financial excesses, including credit booms, rising leverage, risk-taking within the global banking system and growing cross-border financial exposures. When the crisis hit, adjustment occurred largely through sharp contractions in domestic demand, collapses in trade volumes, and sudden reversals of capital flows. The unravelling of the financial excesses - some of which could have contributed to the imbalances in the first place - led to a sharp decline in global current account balances

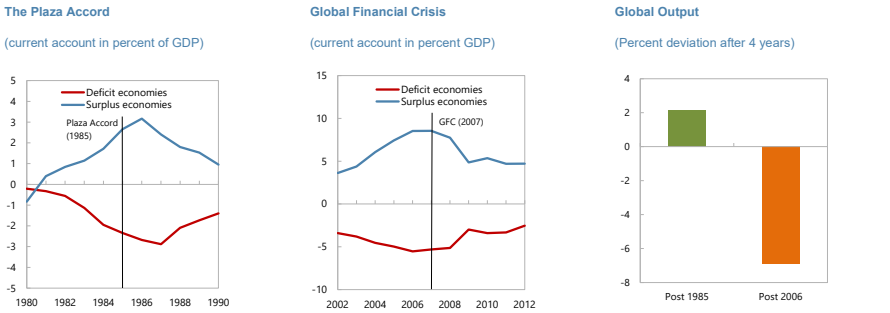
[4] Although the discussion in this section relates to large current account deficits or surplus (relative to the global economy), and hence large global imbalances, negative spillovers arise primarily from deficits and surpluses which exceed the levels consistent with medium-term fundamentals and desirable policies (IMF 2025a).

Box 2. Historical Episodes of Large Global Balances and Adjustment: Plaza Accord and GFC (concluded)

(Blanchard and Milesi-Ferretti 2009). Unlike the Plaza episode, policy coordination played a more limited role initially, happening only in the aftermath of the crisis.

These episodes underscore that coordinated, forward-looking policy actions—particularly when imbalances are recognized early—can facilitate gradual global rebalancing with more limited economic disruptions, highlighting the importance of multilateral surveillance. By contrast, balances that build alongside financial vulnerabilities risk unwinding through disorderly channels with severe economic consequences.

Figure 2.1. Current Account and Output Outcomes during the Plaza and GFC Episodes



Sources: IMF, *Balance of Payments*; IMF, *Effective Exchange Rate*; IMF, *World Economic Outlook*; and IMF staff calculations. Notes: Left panel: Weighted averages for the 10 largest deficit and surplus economies. Economies are classified as deficit or surplus economies according to current account balances recorded in 2007. Middle panel: Weighted average of Germany and Japan (surplus economies) and France, United Kingdom, and United States (deficit economies).

15. Large current account deficits expose economies to external financing risks with negative spillovers globally. Insufficient saving—often driven by fiscal deficits—can fuel consumption booms financed by external borrowing. Persistent reliance on external borrowing can heighten rollover risk, exchange rate volatility, and vulnerability to sudden stops in capital flows, particularly when global financial conditions tighten or investor sentiment shifts. When large relative to an economy's size, the current account deficit is subject to market discipline, either gradually through a slow rise in spreads or rapidly through a balance of payments crisis. For systemically important economies, a "sudden stop" in financing can generate sizeable spillovers through trade, financial, and confidence channels. Large deficits in countries with extensive cross-border financial links increase systemic risk and may trigger rapid cross-border financial contagion (Box 3).

Box 3. Financial Risks from Large External Stocks of Assets and Liabilities

Large gross stocks of international assets and liabilities can generate significant financial risks when mismatches arise across currency denomination, maturity, or rate of return, even when net international investment positions appear moderate or current account balances are moderate. Such mismatches can amplify shocks through valuation effects, income flows, and balance-sheet channels, increasing the risk of abrupt external adjustment.

Currency mismatches have historically been a key source of vulnerability, particularly in emerging market economies that borrow externally in foreign currency while holding domestic-currency assets. During the Asian financial crisis, countries such as Thailand, Indonesia, and Korea faced sharp deteriorations in their external balance sheets as currency depreciations raised the domestic-currency value of foreign-currency liabilities, despite limited changes in net positions prior to the crisis. More recently, economies with high

Box 3. Financial Risks from Large External Stocks of Assets and Liabilities (concluded)

shares of dollar-denominated external debt—such as Argentina and Türkiye—have remained exposed to exchange rate shocks, with depreciations translating quickly into higher debt burdens and capital outflows.

Maturity and rollover mismatches also pose risks when short-term external liabilities finance longer-term or illiquid assets. In the run-up to the global financial crisis, European banks accumulated large short-term dollar liabilities while holding longer-maturity US mortgage-related assets. When dollar funding markets froze in 2008, countries such as Iceland, Ireland, and the United Kingdom experienced acute liquidity and currency stress, requiring central bank swap lines and, in some cases, sovereign intervention. These episodes highlighted how large gross cross-border positions can transmit financial stress even in economies with relatively small net positions or current account balances.

Rate-of-return differentials can further generate substantial valuation effects. The US, despite a persistently negative NIIP, has historically earned higher returns on its foreign assets than it paid on its liabilities—a phenomenon often referred to as "exorbitant privilege." However, this advantage is not guaranteed: shifts in global risk appetite, interest rates, or asset prices could compress return differentials, leading to rapid NIIP deterioration given the scale of US gross positions. Indeed, in recent years, the US NIIP has markedly deteriorated because of the strong outperformance of US equities (Figure 7). Furthermore, even relatively small adjustments in the US NIIP—at a historically high -25 percent of global GDP—could have outsized spillovers, requiring much larger adjustments in other countries.

16. Large current account surpluses can also be problematic from a multilateral perspective and may be more persistent than deficits. Excess domestic saving in surplus economies, when channeled abroad, can put downward pressure on global interest rates, generating spillovers through eased financing conditions and lower prices in other economies. However, the opportunity to invest with lower rates could also trigger excessive risk-taking or leverage, generating financial vulnerabilities. These vulnerabilities can spread globally through cross-border linkages, including back to the surplus economy, which may have developed significant risk exposures too large to effectively hedge. The burden of adjustment tends to fall disproportionately on deficit countries—with the possible exception of reserve currency issuers—which face stronger market-driven pressures than countries with persistently large surpluses, implying that net capital outflows can be more 'sticky' with consequences for the global economy. Second, large surpluses may complicate policy trade-offs in deficit economies and trading partners (IMF 2025a). Faced with lower global interest rates, deficit economies are more likely to hit the effective lower bound on interest rates, complicating the use of monetary policy to accommodate demand shocks. When surpluses arise from higher export competitiveness, the disinflationary effects may benefit some trading partners facing inflationary pressures, but harm those facing weak demand or economies specialized in competing industries. Importantly, while market discipline can correct large deficits, there is no analogous force for large surpluses, a well-known issue (Keynes 1943).

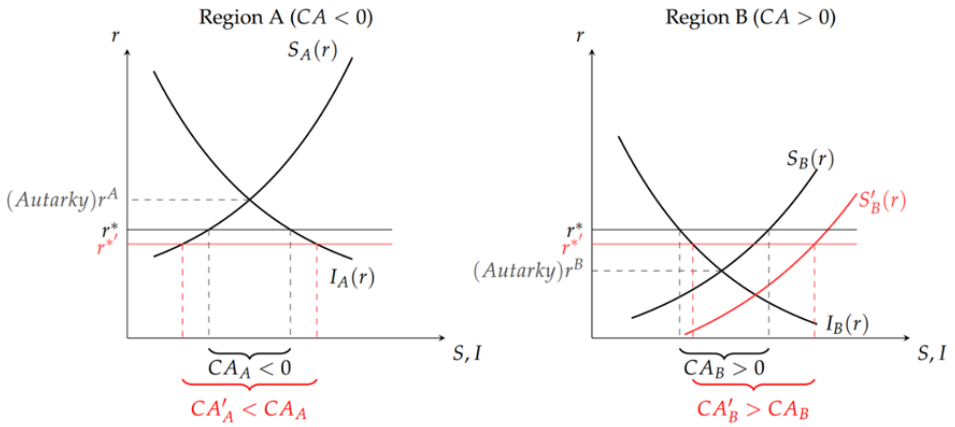
17. Large global imbalances can also carry political economy risks with significant distributional implications for trading partners. This is particularly the case if trade increases faster than trading partners are able to reconfigure their economies. Even if aggregate real incomes rise in trading partners' economy from increased trade, perceptions of unfair outcomes—for example, from concentrated regional or sectoral employment losses—can also fuel protectionist sentiment and undermine support for open markets, ultimately leading to worse outcomes for all.

CONCEPTUAL FRAMEWORK FOR ASSESSING DRIVERS OF CURRENT ACCOUNT BALANCES

18. The Fund's workhorse for analyzing global imbalances since the 1980s is the intertemporal approach to the current account. The intertemporal approach models the current account as the outcome of optimal saving and investment decisions by forward-looking economic agents (firms, households, and governments). Within this framework, the current account is primarily driven by intertemporal trade-offs, whereby households optimize consumption over time, "tilting" it either toward the present or future (e.g., for life-cycle saving motives or for precautionary saving reasons) and "smoothing" it in the face of shocks to income through external borrowing or lending. Meanwhile, firms invest to the point that the expected marginal return to capital, inclusive of any productivity shocks and taxes, equals the equilibrium interest rate. In this approach, the real exchange rate, capital flows, and the current account and real interest rates are all consistent in equilibrium. This saving-investment framework also forms the analytical basis of the Fund's EBA methodology and provides a useful framework for analyzing how different shocks and policies affect current account balances (see Box 1 and Phillips and others 2013).

19. The framework can be broadly illustrated through a Saving-Investment diagram where aggregate saving and investment schedules are shown as functions of the real interest rate (Metzler 1960). Aggregate saving increases with the real interest rate, while investment declines (Figure 8). We can illustrate the framework in a two large-region setting, where region A is assumed to have low desired saving and high desired investment, resulting in a high autarky interest rate and an initial current account deficit in equilibrium, while region B is assumed to have high desired savings and low desired investment resulting in a low autarky interest rate and a corresponding current account surplus in equilibrium. The figure illustrates how certain policies or shocks could change the current account in one region with spillovers to the other. For instance, an important explanation put forward as a driver of the rise in global imbalances in the 2000s was high desired savings in some emerging market economies for precautionary purposes following the financial crises of the 1990s. This shifted the saving schedule outward for those economies and gave rise to a "global saving glut" and lower world interest rates (Bernanke 2005). This case is illustrated in the diagram as an exogenous positive shock to saving preferences in region B, which increases domestic saving at every level of the interest rate, shifting the saving curve out and reducing the world interest rate as global saving increases. As a result, the current account surplus in region B rises, while increased capital flows from region B to A and lower global interest rates widen the current account deficit in region A.

Figure 8. Example of Saving Glut in a Saving-Investment Framework



Note: Savings-investments diagrams for two large regions, A and B. In A, the autarky interest rate is assumed higher than the world interest rate r∗, whereas in B the autarky rate is lower than r∗. Under free trade, region A runs a current account deficit ($CA_A < 0$)and region B runs a current account surplus ($CA_B > 0$). In the counterfactual equilibrium, higher desired savings (e.g., for precautionary motives) in B lead to a shift outward of the savings schedule. The higher supply of savings depresses the world interest rate, offsetting only partly the increase in the current account surplus in B -- which is matched by a larger deficit in A.

20. The saving-investment intertemporal framework remains the appropriate analytical foundation for understanding global imbalances. This framework is richer and more insightful than an intratemporal approach that focuses narrowly on competitiveness and relative prices (Obstfeld and Rogoff 1994). As the current account is inherently dynamic in nature, the intertemporal approach provides a consistent and coherent foundation for open-economy policy analysis. The next sub-section briefly summarizes the role of standard macroeconomic policies and structural determinants in shaping the current account, which have been widely analyzed in the context of the intertemporal approach. It also discusses how capital flows and the supply and demand of safe assets can be rationalized within this setup and articulates the link between capital flows/stocks and risks from financial imbalances. The section then discusses how the framework can integrate trade and industrial policies, with the aim of better understanding their impact on current account positions, without taking a normative view on the desirability of such policies or assessing their potential contribution to excess imbalances.

A. Standard Macroeconomic Determinants of the Current Account

21. This section briefly summarizes the role of standard macroeconomic policies and structural factors in shaping the current account.

- *Temporary and cyclical factors.* Exogenous shocks influence the current account by changing the time profile of income. An increase in economic uncertainty, or a decline in expected future growth can increase contemporary saving and shift the saving curve outwards. Uncertainty can also increase the option value of waiting and delay investment. Positive terms-of-trade shocks can also shift the saving schedule outward when temporary, increasing the current account.

- *Macroeconomic and structural fundamentals.* Trends such as population aging increase the incentive to save, thus increasing the current account balance. Large natural resource discoveries make countries richer in the future, decreasing saving, but require upfront investment, and typically worsen the current account (Arezki and others 2017). Other structural factors, such as GDP per capita, can be associated with whether capital is relatively scarce. Developing economies may wish to import capital and run a current account deficit to finance domestic investments with higher relative returns than are available abroad.

- *Policy-related factors.* Government tax and spending policies can influence aggregate saving, investment, and thus the current account. A fiscal expansion in one region would reduce national saving, lowering the current account balance of that region, and raising the world interest rate. Everything else equal, this could result in "twin deficits" (e.g. in the U.S. in the 1980s), where growing fiscal deficits are matched by larger current account deficits. This has spillovers to the other region, as higher world interest rates increase saving and reduce investment, increasing their current account. Structural policies can also influence the current account. For example, expanding the social safety net (e.g., by higher spending on public health) reduces households' desire to save thus lowering the current account. More broadly, policies that stabilize future income by reducing volatility, lower precautionary saving and thus the current account balance.

22. In the intertemporal setup, the current account, capital flows and net international positions are jointly determined.

- The intertemporal budget constraint links a country's net foreign asset position to its current account: for a given external liability stock, solvency requires either future trade surpluses or excess returns on the external portfolio (Gourinchas and Rey 2007; Gourinchas and Rey 2014).

- The imbalance in the supply of and demand for safe assets can also shape current account balances. For instance, a limited and asymmetric supply of safe assets can generate net capital flows from fast growing regions with few safe assets towards slower growing safe-asset issuing countries (Caballero, Farhi and Gourinchas 2008). This phenomenon is closely linked to the savings glut view where capital from large surplus countries (driven by demographics, precautionary motives) flows into reserve-currency-issuing countries, lowering real interest rates and desired saving, resulting in a lower current account balance.

- Capital flows also respond to a variety of "push" and "pull" factors that can influence current accounts through the real interest rate channel. This can be illustrated through a risk-premium shock as a result of a sudden inflow or outflow of volatile short-term assets or through a loss of market confidence in countries with persistent deficits (Ghosh 1995; Calvo and Reinhart 2000). Such a shock drives a wedge in the interest rates of both regions with respect to the world interest rate, altering their current accounts.[5] This shock could also manifest due to geopolitical

[5] The effect is similar to the dynamics shown later in Figure 10a, but with the domestic rates of region A higher than the world rate and vice versa for region B.

tensions that trigger financial fragmentation across regions whereby the risk premium in the deficit region A increases from lower financial flows between region A and B. The net effect is a narrowing of imbalances as investment falls in region A and increases in region B. However, such narrowing can be associated with more volatility in current account and exchange rate dynamics both temporally and across regions (see IMF 2024a), including through an abrupt reversal of capital flows or its composition that could have financial stability implications (see Box 3).

B. Trade Policies and the Current Account[6]

23. This section considers the impact of uniform tariffs on the current account.[7] While average applied tariff rates have declined substantially since the 1990s, there has been a resurgence in trade protection through tariffs, at times with the explicit goal of addressing persistent trade deficits. The partial equilibrium effect of unilateral tariffs is to raise the price of imported goods, leaving export demand unchanged, suggesting it can improve the trade and current account balances. However, this partial equilibrium intuition is often misleading and the final impact will depend on how saving and investment respond.

24. The duration of tariffs is a key determinant of their impact on the current account. In a simple version of the intertemporal framework where investment does not respond to tariffs, import tariffs would affect the current account only if temporary (Razin and Svensson 1983). Temporary tariffs raise import prices in the short term, encouraging higher national saving through postponed consumption. Permanent tariffs do not generate such intertemporal trade-off: with tariffs remaining indefinitely higher for imported goods, there is no incentive to increase aggregate saving in anticipation of lower future prices. For this reason, permanent tariffs are generally considered current-account neutral.

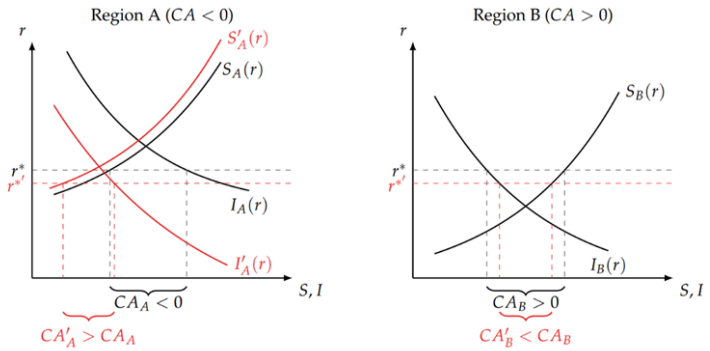
25. Permanent tariffs may have a limited effect even when investment responses are considered. Higher costs of imported goods and lower demand for exports can depress investment, potentially overturning the "neutrality" result from simpler intertemporal models (Sen and Turnovsky 1989).[8] Without a corresponding fall in desired saving, the current account will initially improve as investment declines. Yet uniform tariffs could also reduce desired saving: if tariffs improve the terms of trade and tariff revenues are redistributed to households, real purchasing power rises for a given level of domestic output, lowering the saving rate relative to GDP. The net effect from permanent tariffs, therefore, depends on the relative magnitude of shifts in saving and investment (Figure 9). In addition, if other countries were to retaliate by imposing their own tariffs, this would negate the impact on terms of trade.

[6] The analysis in this and the next section draws on Gourinchas and others (2026). We refer to the working paper for additional technical details.

[7] Narrowly targeted tariffs function as micro industrial policies, analyzed later.

[8] A special case where investment could instead increase occurs when tariffs induce a reallocation towards domestic investment and import competing industries spread the increase in capital stock over time, leading to a persistent increase in the current account deficit (Roldos 1991).

Figure 9. Impact of Uniform Tariff on the Current Account



Note: Savings-investments diagrams for regions A and B. In the counterfactual equilibrium, region A implements across-the-board import tariff increases perceived as permanent. The figure depicts a case where the tariff depresses desired investments as the cost of capital and imported inputs increases,and the savings schedule shifts inward - e.g., because tariff revenues are redistributed to households. Since the shift in investment is assumed stronger than the one in savings, the deficit in A decreases, while the lower world interest rate also pushes down the surplus in region B.

26. The transmission of trade policies to the current account can be influenced by the degree of exchange rate adjustment. The lack of impact of permanent tariffs on the current account requires an exchange rate appreciation to equilibrate the demand for exports and imports in response to the tariff. If the exchange rate is unable to appreciate—for example, due to a fixed exchange rate regime or some other policy intervention—there may be a larger and positive effect on the current account (Erceg and others 2023). Without the exchange rate channel, current account adjustment must instead occur more slowly through relative price adjustment. Non-tradable prices will rise over time to equilibrate demand with more expensive tariffed tradable goods, resulting in a gradual real appreciation and eroding the current account improvement.

27. The impact of tariffs on the current account can be further complicated by whether the current account deficit is temporary or structural. When a trade deficit is driven by temporary factors and expected to be followed by future trade surpluses, permanent tariffs effectively raise the cost of current consumption relative to the future (as consumption of imports is higher initially), which encourages households to save more and successfully could shrink the deficit (Dornbusch 1983; Obstfeld 1996). However, for countries running permanent deficits funded by an initial positive net international investment position or the present value of excess returns on net foreign assets (such as the US exorbitant privilege), the impact of tariff becomes less predictable. It depends on how tariffs reshape the market value of a nation's net financial position rather than just its trade flows, potentially leading to smaller or even counterintuitive changes in the trade deficit (Itskhoki and Mukhin 2025).

C. Industrial Policies and the Current Account

28. This section illustrates how the impact of industrial policy on the current account can be incorporated in the framework, through their effect on saving and investment. The prevalent use of industrial policies across advanced and emerging market economies necessitates an understanding of how they may impact the current account. Industrial policies are understood as measures to support specific sectors or firms for economic or non-economic objectives. They have typically been deployed for the purposes of boosting competitiveness or establishing technological dominance for some sectors with more recent objectives including climate change mitigation or supply chain resilience (Evenett and others 2024, 2025). Such interventions could be justified from an economic point of view to the extent that they address well-identified market failures, such as externalities, coordination failures, or under-provision of public goods (this includes security considerations).[9] Regardless of the objective and justification, industrial policies may have an effect on the country's current account and, therefore, on global imbalances.

29. Traditionally, industrial policies have been defined as measures targeted at the level of specific firms and sectors. Such policies may, for example, include production or export subsidies, directed or subsidized credits, "infant-industry" trade protection, quantitative restrictions, and access to lower-priced inputs from state-owned enterprises (IMF 2024b). These can be financed by budgetary subventions or by cross-subsidies from other industries and households. Many micro industrial policies could be broad-based, applied across several sectors in the economy, for example, R&D tax credits or the establishment of national development or public investment banks.

30. In this paper, we complement the sectoral definition of industrial policy by expanding the analysis to include a limited set of macroeconomic and financial sector policies that achieve similar industrial policy objectives. For the purposes of this paper, we refer to sectoral measures described above as "micro" industrial policies. However, given our focus on policies that can influence aggregate saving and investment decisions, this paper complements the concept of sectoral industrial policies with certain macroeconomic and financial sector policies that are implemented with an industrial policy objective. Such policies, referred to here as "macro industrial policies, can have non-neutral effects across sectors particularly by altering relative prices (Warwick 2013). An example of such a policy is an export-led growth strategy operationalized through a combination of real exchange rate depreciation and enforced low domestic demand (Corden 1980; Blanchard and Milesi-Ferretti 2012; Ottonello and others 2024).[10] The micro and macro typology is used solely for analytical purposes to cover a number of relevant policy scenarios that do not feature the traditional class of (micro) industrial policies, which helps illustrate distinct economic

[9] The implementation and design of industrial policy should be guided by cost-benefit analysis indicating that the benefits exceed the cost, ensuring fiscal sustainability, consistency with legal obligations, a robust governance framework to minimize rent-seeking, among other considerations (IMF 2024b).

[10] Given the structural objectives of industrial policy, it is also important to emphasize that conventional macroeconomic stabilization policies are not considered in the analysis of industrial policy.

tradeoffs. It also helps cover cases where they work synergistically to produce specific external outcomes.

'Micro' Industrial Policy and the Current Account

31. To understand the effect of micro industrial policies on current accounts, we need to evaluate their impact on aggregate productivity. Well-designed industrial policies can boost productivity and growth by shifting resources toward sectors with increasing returns and learning-by-doing externalities (Lashkaripour and Lugovskyy 2023; Bartelme and others 2025). However, poorly targeted policies can reduce productivity by diverting resources away from sectors with positive externalities or by creating rent-seeking. As IMF (2024b) notes, while industrial policy can address market failures, successfully doing so is challenging. Misallocated support—whether to sectors lacking sufficient positive spillovers or where market failures are improperly diagnosed—could generate sufficient inefficiencies that aggregate productivity is reduced (IMF 2025b). By contrast, targeting sectors with strong production externalities can raise aggregate productivity.

32. The initial impact on the current account is ambiguous and depends on whether the policy-induced productivity changes are seen as temporary or permanent. A temporary productivity decline prompts households to smooth the lower current income over time (shifting the saving schedule outward), while investment is less affected given the transitory nature of the shock. This decreases the current account balance in the implementing country. When the negative productivity effects are anticipated in the future, both higher saving (driven by the expectation of lower future income) and reduced investment increase the current account balance. Table 1 summarizes the possible effects of micro industrial policies on the current account balance through their impact on aggregate productivity. The IP-induced productivity shock is expected to increase the current account when policies prove ineffective at durably lifting aggregate efficiency—that is, when the productivity gains are positive but transitory, or when they are negative and permanent (reflecting structural misallocation).

Table 1. Impact of Micro Industrial Policy-Induced Productivity Shock on the Current Account

		Direction of Productivity Shock	
		Positive	Negative
Time Horizon	Temporary	CA ↑	CA ↓
	Permanent	CA ↓	CA ↑

33. Industrial policy without a direct or immediate impact on productivity can also have important implications for the current account. Take the example of policies to boost quantities in an export-focused sector without using a financial incentive to do so (such as subsidies). These

policies could include state directives to achieve output targets, or other similar directions to increase output that may override commercial interests. Such interventions push resources towards these sectors and increase their production to the detriment of profit margins. At the same time, a relative shortage of inputs in the non-tradable sector creates additional demand for more workers and investment, raising non-tradable prices and leading to a real appreciation. The net effect is to increase investment and lower the current account balance.

34. Micro industrial policies are more likely to affect aggregate macroeconomic variables when applied across a broad set of sectors or targeted at a few large and critical industries. Under these circumstances, micro industrial policies are more likely to affect aggregate productivity. Across-the-board micro industrial policies such as broad-based investment subsidies are also more likely to influence the current account through their fiscal impact. In these cases, when private saving does not fully offset public dissaving— as is likely given well established failures of Ricardian Equivalence—deficit-financed fiscal outlays can reduce aggregate saving. Other forms of financing can also influence the impact of subsidies on the current account balance. For example, the timing and type of taxation matters: an immediate increase in consumption taxes may lower consumption by credit-constrained households, increasing aggregate saving initially in contrast to the deficit-financing case. The ultimate impact on the current account will depend on whether saving rises sufficiently to offset an increase in investment driven by the subsidy.

'Macro' Industrial Policy and the Current Account

35. The concept of "macro industrial policies" introduced here differs from the standard concept of (micro) industrial policies in that they are implemented economy-wide rather than targeted at specific firms or sectors. Some of these policies could reflect different economic systems and structure. As illustrated by the examples discussed below, a common feature of macro industrial policies is their broad deployment across the economy—which combined with policy induced restrictions (e.g., capital flow management measures)—help achieve industrial policy objectives.[11] These accompanying restrictions often limit (private-sector) offsetting behavior and can create a "wedge" between domestic and world interest rates. Two clarifications are important. First, there are cases where the same policy combinations may be deployed for objectives other than industrial policy; for this reason, the policy objective is useful as a guiding principle for consideration of any policy as a macro industrial policy[12]. Second, even when such policies meet their industrial policy objectives, they need not have a material impact on the current account. The examples that

[11] An example not considered is fiscal devaluation—such as a revenue-neutral reduction in employers' social contributions with an increase in the value-added tax rate—which when implemented in the presence of nominal wage rigidities and fixed exchange rates, can improve competitiveness and meet industrial policy objectives (Farhi and others, 2014).

[12] Industrial policy objectives (e.g., national security or green transition) can be challenging to ascertain in practice, also because they tend to be multidimensional. However, when these policies generate significant spillovers beyond the desired objectives, it is useful to consider if the original objective can be achieved by alternative policy instruments (for instance, standard targeted instruments). Under the Fund's integrated surveillance decision when certain polices lead to significant international spillovers, alternative options achieving the same objective should be discussed during the Article IV consultation.

follow illustrate both cases. As before, we do not take a normative stance on the desirability of these policies.

36. Two examples of macro industrial policies illustrate how they meet industrial policy objectives and conditions under which current accounts can be affected.

- *Foreign reserve accumulation with capital flow management measures*: Governments can force saving by selling domestic debt to the private sector and using the proceeds to buy foreign assets. With a restricted capital account, the domestic private sector cannot offset this operation by selling assets to—or borrowing from—the rest of the world. The resulting financial account surplus translates into a current account surplus, which requires a real exchange rate depreciation (Jeanne 2013). Foreign reserve accumulation in surplus region B coupled with capital inflow restrictions depresses the interest rate in Region A below the world interest rate and raises it in Region B to finance foreign reserve accumulation. This creates a negative interest rate wedge, $\Delta r = r^{\mathrm{A}\prime} - r^{\mathrm{B}\prime} < 0$, depressing investment and expanding the current account surplus in Region B, while expanding deficit in Region A (see Figure 10a). In the example considered here it is important to note that such type of foreign reserve accumulation – a sustained, one-way sterilized foreign exchange intervention (FXI) that increases foreign reserves - is distinct from short-term operations aimed at preventing excessive exchange rate volatility (including during periods of disorderly market conditions), which would not be considered as a macro industrial policy as no industrial policy objective is served in the latter case. [13]

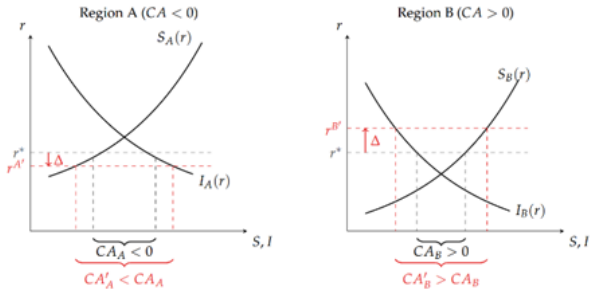
- *Financial repression and forced saving with capital flow management measures:* Governments could undertake financial repression measures that lower lending and borrowing interest rates by imposing legal restrictions on interest rates, credit allocation, capital movements, and other financial operations. On their own, financial repression policies simply shift households further down their saving curve, limiting saving. However, in practice financial repression is often combined with forced saving policies that shift the desired saving curve to the right. Examples of these measures are low provision of a social safety net and directed lending policies that quantitatively ration consumer borrowing in favor of preferential sectors, restrictive corporate dividend policies and directives around the use of revenues of sovereign wealth funds or exporters. To lower the domestic cost of capital relative to the global one, these measures are typically accompanied by restrictions on capital outflows that bottle up private savings in the domestic economy. Financial repression and forced saving policies in surplus region B, would shift the saving schedule outward (see Figure 10b). With capital flow restrictions, a positive wedge in interest rates, $\Delta r = r^{A\prime} - r^{B\prime} > 0$, between region B and A emerges as domestic households are prevented from purchasing higher-yielding foreign assets. The net result is a simultaneous increase in domestic saving and domestic investment, leaving the current account

[13] In general, the IMF's integrated policy framework (IPF) recommends against FXI aimed at preventing exchange rate appreciation to support export industries (IMF 2020). Under the IPF, FXI should only be considered for macroeconomic stabilization under certain circumstances in the presence of frictions (such as shallow FX markets, FX mismatches, and weakly anchored inflation or inflation expectations). FXI should not substitute for a warranted adjustment of macroeconomic policies.

largely unchanged in both regions. However, financial repression in region B can improve the current account to the extent that the forced saving is able to 'leak' to the rest of the world instead of financing domestic investment. This example also illustrates how, even though production can be pivoted towards certain sectors meeting the objective of the industrial policy, the current account is little affected if capital controls are fully enforced.

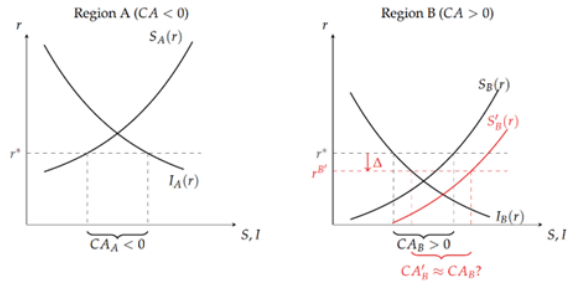
Figure 10. Illustration of Wedges: Impact of Macro Industrial Policy on the Current Account

Case a. Foreign Reserve Accumulation +Capital Controls



In the counterfactual equilibrium, region B implements a combination of foreign reserve accumulation and restrictions to capital inflows. These policies create a wedge Δr between the interest rates of the two countries -- in region B, the interest rate $r^{B\prime}$ is higher than the world interest rate r*, while in region A the interest rate decreases. The current account surplus increases in B, while the deficit widens in A.

Case b. Financial Repression + Capital Controls



In the counterfactual equilibrium, region B implements a combination of forced savings (shifting the savings schedule of B outward) and restrictions to capital outflows (lowering the local interest rate $r^{B\prime}$ below the world interest rate r*). The capital controls create a wedge Δr between the interest rates in region A and region B. The Figure depicts a case where the current account balances remain unchanged as the interest rate wedge in Country B increases investment and lowers savings enough to offset the schedule shift.

37. Interactions of various types of industrial policies may generate a more material impact on the current account. For instance, the policy of foreign reserve accumulation with capital controls has the arguably undesirable effect of keeping interest rates high with adverse effects on domestic investment. If such a policy were paired with financial repression this can further increase the current account balance while keeping domestic interest rates low. Similarly micro industrial policies that successfully increase output in export-oriented tradable sectors through quantity targets do not necessarily result in an increased current account balance as prices increase in the non-tradable sector, causing inflation and undoing competitiveness improvements. However, in combination with a forced saving policy that suppresses demand for non-traded goods, these side effects can be reversed, resulting in an increase in the current account balance, at the cost of suppressing domestic consumption.

MODEL BASED SIMULATIONS

38. Model-based analysis broadly confirms the intuition of the conceptual framework , although real world frictions can result in richer current account dynamics. The IMF's Global Integrated Monetary and Fiscal Model (GIMF) is used to examine how different policy interventions affect the current account in practice.[14] The model can account for real-world frictions that the conceptual framework alone cannot capture and equilibrium outcomes not made explicit in the Metzler framework, providing a more comprehensive understanding of the trade-offs associated with these policies.[15]

39. Policies that lead to an increase in the current account balance can do so at the cost of suppressed consumption. Consistent with the conceptual framework, an increase in the current account is generally driven by expectations of weaker future output, for example, through tariff imposition with fiscal consolidation or industrial policies that create resource misallocation and lower aggregate productivity. In some cases, the current account can increase even when GDP increases or is little changed. However, these cases rely on consumption suppression through taxes to finance industrial policy or financial repression, or due to market frictions and rigidities that cause consumption to lag behind improvements in income.

40. The model also captures "standard" drivers of the current account, such as shifts in saving preferences (a "saving glut") and fiscal policy. Non-policy related drivers of the current account, such as an exogenous shift toward higher saving preferences, delivers model responses consistent with the conceptual framework.

- For example, a shift in saving preferences in a set of hypothetical "Saving Glut" economies that increases private saving by 2 percent of GDP over five years increases their current account balance by about one percent over the same horizon (Figure 11). This pushes down domestic interest rates and also spills over abroad, lowering interest rates in a hypothetical "Major recipient" economy[16].

- In a second example, an increase in the fiscal deficit of 2 percent of GDP for 5 years in the "Major Recipient" economy leads to a fall in their current account balance of up to 0.5 percent of GDP, while it increases the current account balance in the hypothetical "Saving Glut" economies. Section 5 further elaborates on standard macroeconomic drivers and analyzes how domestic policy reforms across countries can help redress global imbalances

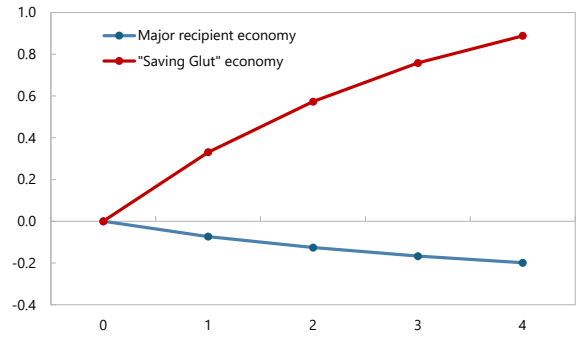
[14] GIMF is a global dynamic model featuring capital accumulation, numerous rigidities, three sectors, and global value chains. The version of GIMF employed here has eight regions.

[15] The results of the stylized simulations in GIMF presented in this paper are also consistent with a simpler two-country model outline in Gourinchas and others, 2026.

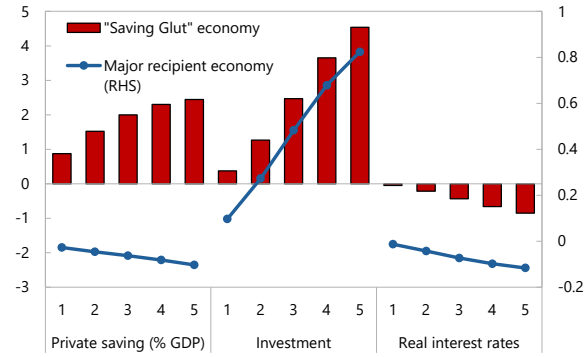
[16] There can be cases where the same current account dynamics are triggered by an investment boom in the recipient economy, but in this case global real rates would increase (see Gourinchas and others 2024).

Figure 11. Illustration of "Saving Glut" Impact

Current Account Impacts
(Deviation from baseline, percent of GDP)



Saving, Investment, and Real Interest Rate Effects
(Percent deviation from baseline)

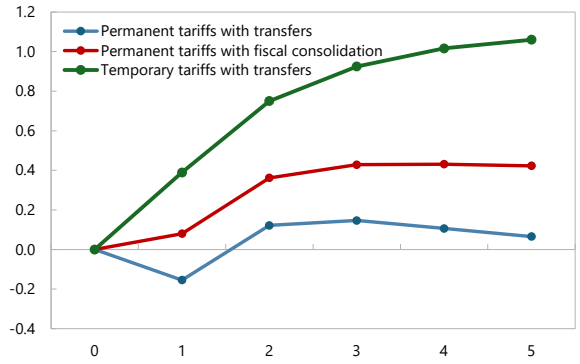


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Simulations are at annual frequency.

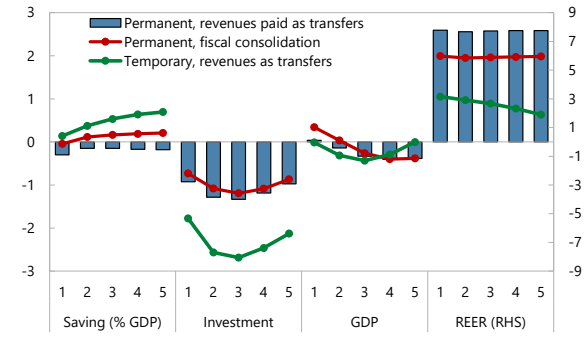
41. Permanent tariffs have a neutral effect on the current account that becomes modestly positive when coupled with fiscal consolidation using tariff revenues. As examined in the conceptual framework, temporary tariffs produce the expected increase in the current account in the model. In the case of a 10 percent unilateral increase in tariffs that is expected to be permanent, the exchange rate must immediately appreciate to equilibrate demand for imports and exports (Figure 12, right panel). When redistributing tariff revenues to households, two offsetting features of permanent tariffs generate broadly neutral effects on the current account: i) investment declines as firms face higher costs of intermediate goods and capital and as exports fall due to currency appreciation; ii) the saving rate as a share of GDP also declines by a similar amount. The latter effect materializes as households consume more from higher government transfers and improved terms of trade from real exchange rate appreciation, even as output declines. If instead tariff revenues are used to pay down government debt rather than being transferred to households, the saving rate increases while the decline in investment remains broadly similar. This generates a modest increase in the current account but it largely reflects the fiscal channel of tariffs rather than their relative price

Figure 12. Impact of Uniform Tariffs

Current Account Impacts
(Deviation from baseline, percent of GDP)



Saving, Investment, Output, and Exchange Rate Effects
(Percent deviation from baseline)



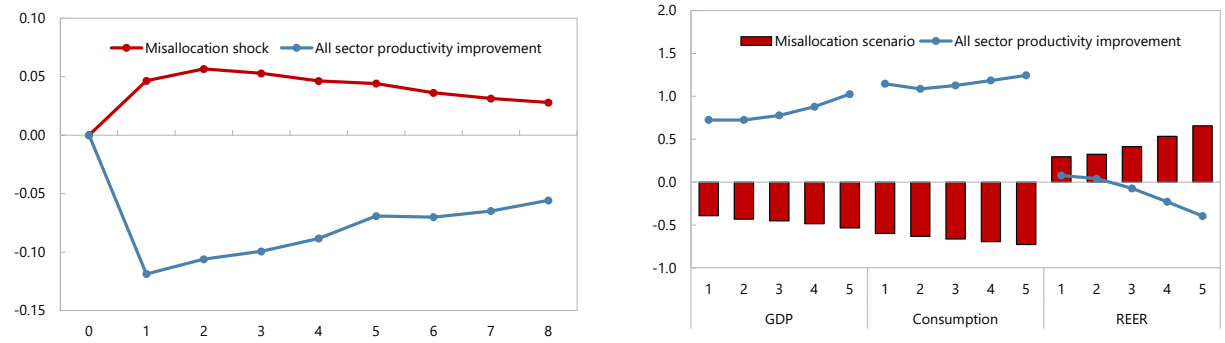
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Simulations are at annual frequency.

effects. Under both temporary and permanent tariff scenarios, output decreases as the tariffs raise the cost of intermediate and final goods and lowers demand for exports as the real exchange rate appreciates.

42. Micro industrial policy can generate macro-relevant effects even when targeted at specific sectors, with implications for the current account. In the case of a temporary positive productivity shock, model simulations show that the current account will initially rise, buoyed by high saving. In the case where productivity changes are permanent, two cases are considered: a *productivity-enhancing subsidy* and a *productivity-reducing subsidy*.

- **A productivity-enhancing industrial policy** will boost spending and lower the current account balance. Productivity improvements in the tradables sector driven by industrial policy can also boost productivity in other sectors—through effects such as technology diffusion and worker upskilling. In this case, following a permanent 1 percent boost to productivity, a modest real effective exchange rate depreciation and a medium-term boost to exports are achieved (Figure 13, right panel). However, because of anticipated gains in income, household saving declines, consumption and imports rise and the current account balance falls.

Figure 13. Impact of Productivity-Enhancing vs Productivity-Reducing Micro Industrial Policies



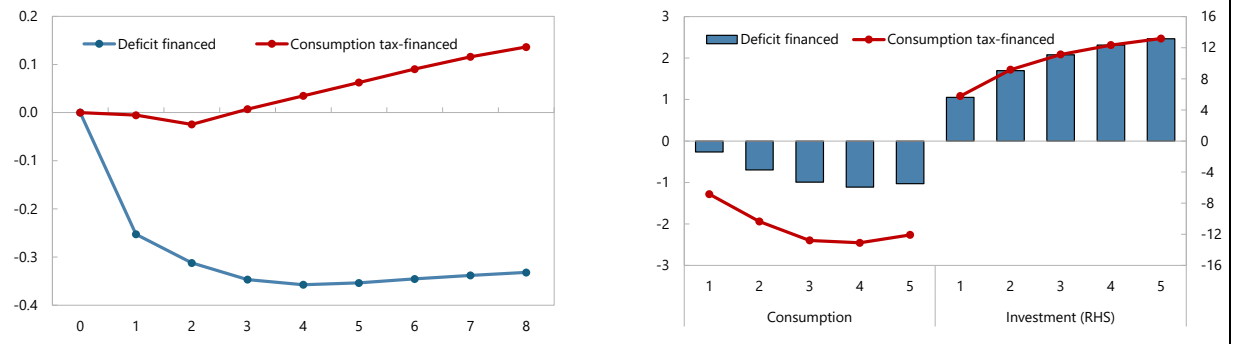
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Simulations are at annual frequency.

- **A productivity-reducing industrial policy** resulting from the misallocation of resources within the economy will increase the current account balance at the cost of lower output. By channeling resources to a particular sector, industrial policy can affect aggregate TFP—positively when well-targeted, but often negatively when they generate misallocation. In a scenario where productivity in the tradables sector increases but declines in the non-tradables sector, lowering overall TFP by about ½ percentage points, the current account remains largely unchanged (Figure 13, left panel). This reflects two contrasting forces. On one hand, expectations of lower future activity due to misallocation-related productivity decline increases desired saving and lowers investment. On the other hand, the economy faces a real exchange rate appreciation as productivity in the non-tradables sector falls. The net effect is a modest improvement in the current account, largely driven by falling consumption and import compression. The increase in

export competitiveness due to higher tradables productivity is partly offset by misallocation driving up costs elsewhere in the economy.

43. The source of fiscal financing for industrial subsidies influence the effects on the current account. Here we consider a permanent subsidy that reduces the price of investment in the tradable sector amounting to 1 percent of GDP each year. When investment subsidies are *deficit-financed*, the current account balance falls sharply as investment increases and public saving declines.[17] Private saving increases, but not enough to offset the decline in the current account balance. In contrast, when investment subsidies are *financed by higher consumption taxes*, consumption responds more negatively, particularly given the prevalence of households that cannot "smooth" through the higher tax burden in anticipation of higher income. In this case, the current account balance becomes modestly positive due to higher household saving (Figure 14, left panel). Other financing mechanisms that place a heavy burden on households, such as lower targeted transfers, would operate similarly. While output and the current account balance may be higher, domestic consumption is *lower* than in a base case without subsidies (Figure 14, right panel).

Figure 14. Impact of Micro Industrial Policies based on Source of Fiscal Financing



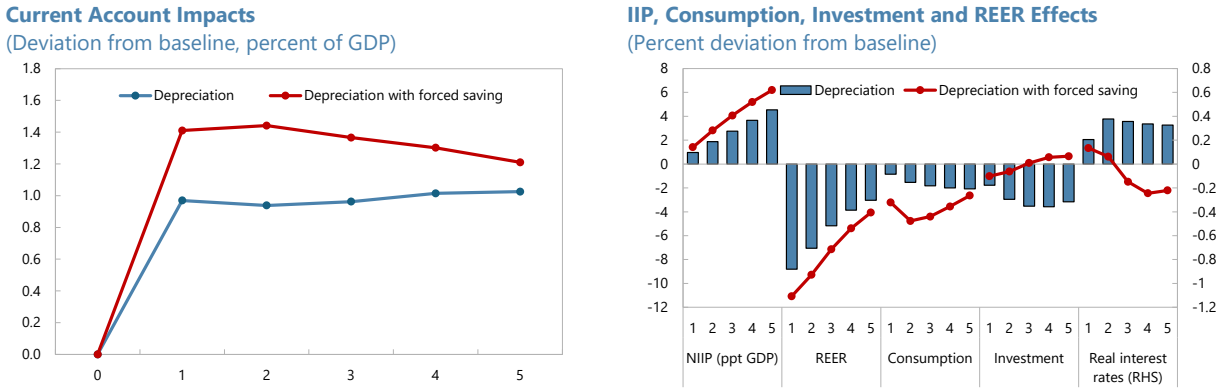
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Simulations are at annual frequency.

44. Macro industrial policy in the form of foreign reserve accumulation and capital controls, can increase the current account at the cost of lower domestic consumption. The combination of these policies can generate a persistently lower real exchange rate, that can serve to improve the competitiveness of the export sector, although this may come at the cost of other domestically focused sectors. To sustain a persistently weaker currency, authorities must incentivize households to finance the accumulation of foreign assets (build foreign exchange reserves) and prevent them from selling privately held foreign assets. Debt-financed reserve accumulation requires higher domestic interest rates to incentivize higher saving and capital controls to prevent private

[17] In the debt financing case, it is assumed that the deficit is larger due to the subsidy for the first 40 years of the simulation, before the deficit target reverts to its steady state value.

selling of foreign assets as the exchange rate depreciates.[18] These policies reduce consumption and domestic investment even as the current account and exports increase, leaving overall GDP little changed (Figure 15). In order to offset the increase in domestic interest rates that results from higher domestic debt issuance, foreign reserve accumulation can be combined with forced saving policies that further suppress consumption. This reduces real interest rates, which in turn limits the reduction in investment that results from foreign reserve accumulation and capital controls.

Figure 15. Impact of Macro Industrial Policy - Foreign Asset Accumulation with Capital Controls



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Simulations are at annual frequency.

EMPIRICAL EVIDENCE

45. This section presents empirical evidence from the literature on the impact of different drivers on the current account. It begins by examining the macroeconomic and structural determinants of the current account, including factors such as fiscal policy, demographics, and financial development. It then turns to the available evidence on the role of trade and industrial policy in shaping current account outcomes, considering macro and micro industrial policies, tariffs, and broader trade barriers. The evidence from this literature largely points to limited effects on the current account owing largely to the nature of their application or because the channels through which they operate are already accounted for by other variables.

A. Empirical Evidence on Standard Drivers of the Current Account

46. The main determinants of the current account identified in the empirical literature—and operationalized in the IMF's EBA—can be grouped into cyclical, structural, and policy factors. Variables under these buckets have been found to have a statistically and economically

[18] In GIMF, this is simulated as a shock to the UIP condition that incentivizes the net accumulation of foreign assets for a given interest rate differential. In Gourinchas and others (2026), this is formally modeled in a two-country setting, resulting in qualitatively similar effects.

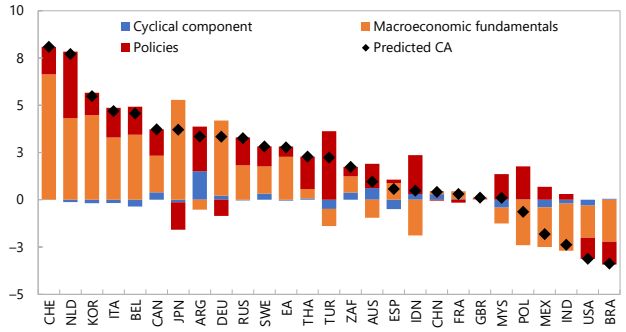
meaningful impact on the current account, consistent with the conceptual framework of the intertemporal model. The IMF's EBA estimates current account norms based on these determinants using a broad set of variables (Figure 16, for details see Allen and others 2023). Compared to other approaches in the literature (e.g., Chinn and Prasad 2003; Ca' Zorzi and others 2012; Coutinho and others 2018), the EBA includes a normative assessment of current accounts, and highlights the role of policy distortions.[19]

- *Temporary and cyclical factors* such as output gaps and changes to terms-of-trade relative to trend, reflecting short-term factors other than the effects of medium-term fundamentals and policies, can influence the current account in the short run. For instance, an increase in the output gap—signaling that output is running above potential—reduces the current account balance, likely through higher investment and lower saving. Similarly, short-term fluctuations in the terms-of-trade increase the current account balance as a temporary increase (decrease) in income typically leads to higher (lower) contemporaneous saving.

- *Macroeconomic and structural fundamentals* like demographics, financial structure, and expected growth, influence how much countries save and invest over time. For instance, both the population's age composition and longevity can affect saving behavior, with prime-aged savers typically accumulating more wealth to prepare for longer retirement periods. Expected output growth is another important determinant of the current account, closely tied to the productivity effects discussed in the conceptual framework. If output is expected to grow, the anticipation of higher returns to capital can lead to higher investment. At the same time, consumption-smoothing households will reduce saving. Hence, higher growth expectations are likely to lead to lower current account balances through both channels. Empirical evidence from technology and supply shocks confirms that productivity gains often stimulate consumption and investment enough to reduce current account balances.[20]

Figure 16. Decomposition of Predicted Current Account, 2024

(Percent of GDP)



Source: IMF, External Balance Assessment estimates.
Note: The predicted current account is multilaterally consistent. Macroeconomic fundamentals include output per worker, expected GDP growth, and International Country Risk Guide, demographics, Oil, NFA, and constant and multilaterally consistent adjustment. Residuals are calculated as the observed CA minus its predicted value. Policies include credit gap, fiscal balance, FXI, health spending.

[19] The existing empirical approaches exhibit broadly similar explanatory power (R^2 typically between ~0.51 and ~0.64), with variation mainly driven by model specification and estimation methods.

[20] Corsetti and others (2014) find that US manufacturing productivity shocks lead to current account deficits. Kim and Lee (2015) identify technology and supply-side shocks as the primary driver of current account variation—explaining

(continued)

- *Policy-related factors* also play a vital role in shaping the current account. Fiscal policy implies intergenerational transfers and is thus an important determinant of the current account balance. For instance, higher budget deficits increase the gap between public saving and investment and often widen the current account deficit when households do not fully offset government borrowing through higher private saving or reduced investment. Social insurance policies such as government healthcare provision can influence national saving by affecting households' need for precautionary saving. Moreover, financial policies may cause demand booms, in line with a positive credit gap that is found to weaken current accounts.

47. Evidence also indicates that financial factors have important implications for current account dynamics. As discussed in the conceptual section, current and capital account dynamics are determined jointly, shaped by savings and investment decisions which are also affected by financial factors. For instance, there is evidence that during periods of heightened uncertainty, global investors' flight to safety drives capital toward safe asset suppliers—primarily the United States— while forcing adjustments elsewhere (Caballero, Farhi and Gourinchas 2017; Gourinchas and Rey 2022). These risk-off episodes, coinciding with USD appreciation, have negative spillovers on emerging markets (IMF 2023). Furthermore, a large body of literature documents how push and pull factors related to capital flows influence the current account, primarily through the interest rate channel. For example, during upswings of the global financial cycle—characterized by low volatility and low interest rates—capital flows into emerging market economies financing their current accounts (Rey 2015). While this pattern is well-documented, the main drivers remain debated: some attribute a central role to U.S. monetary policy (Miranda-Agrippino and Rey 2020), others emphasize global risk appetite proxied by the VIX (Forbes and Warnock 2012), though this last pattern seems more muted since the global financial crises (Forbes and Warnock 2021).[21] The effects of such global factors may also vary depending on country-specific characteristics. [22]

B. Empirical Evidence on the Impact of Trade and Industrial Policies on the Current Account

48. The relationship between trade and industrial policies and the current account remain empirically underexplored. This gap stems primarily from the lack of consistent and comparable data on industrial policies, owing in part to uneven transparency, and shifts in their objectives, targeted sectors, and policy instruments used. The same problem exists, to a lesser extent, regarding data on trade barriers, and in particular, non-tariff measures. Even where such data exists, many

50–60 percent of fluctuations in the US, Japan, and the euro area—and observe a negative correlation between output and the current account. Finally, Kano (2008) documents that while permanent shocks to output in the UK and Canada exert negligible impacts on the current account, transitory shocks drive significant adjustments, as intertemporal theory predicts.

[21] To capture market sentiment or risk-on and risk-off episode, the EBA model includes the lagged real effective exchange rate as a temporary factor.

[22] Countries that are net debtors in safe assets experience current account reversals during global financial cycle downturns as portfolio rebalancing shifts wealth across borders (Davis and van Wincoop 2025), while more financially open countries with fixed exchange rates display greater sensitivity to global risk shocks (Habib and Venditti 2019).

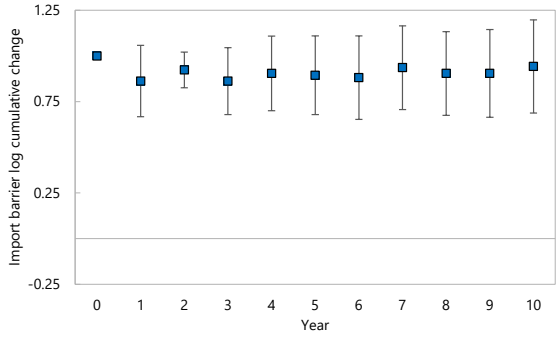
measures are also difficult to quantify. Furthermore, there has historically been insufficient variation across time and countries in the use of such policies to reliably identify their impact on the current account. This section synthesizes findings from emerging work on this topic and attempts to reconcile it with predictions from the framework and model.

Evidence on Tariffs and Trade Barriers

49. The empirical evidence on the impact of tariffs on the current account is mixed. Recent studies examining tariff changes have found small to negligible effects on the trade balance (Boer and others 2024; Furceri and others 2021). As shown by the model simulations distinguishing between temporary and permanent shocks is of crucial importance for understanding tariffs effects on the current account; indeed, recent findings have corroborate the models' results: temporary increases in certain tariffs have been found to improve the trade balance slightly (Barattieri and others 2021), while permanent changes have no statically significant effects in the case of the US (Schmitt-Grohé and Uribe 2025). Another strand of the literature explores the effects of trade barriers more broadly. Boz and others (2019) use the EBA methodology to explore how aggregate import and export barriers—estimated using gravity models—affect current accounts, and find no effect of the former and an economically negligible impact of the latter.[23] Finally, Jakubik and Wei (2026) show that trade policy uncertainty can delay investment and durable goods expenditures while prompting precautionary saving, resulting in a small temporary increase in the current account as both investment and saving shift.

Figure 17. Import Barrier Persistance

(Coefficient)



Source: IMF 2026
Note: The figure shows the estimated response of trade barriers after a 1 percentage increase in itself, based on a local projection: $trade\ barrier_{it+h} - trade\ barrier_{it-1} = \gamma_{ht} + \beta_h\, \Delta trade\ barrier_{it} + \varepsilon_{it+h}$, where $\mu_{hi}\ and\ \gamma_{ht}$ denote country and time effects.

Figure 18. Import Barrier Retaliation

(Probability it is followed by restrictions by other countries for the same product)

Implementing Jurisdiction	Responding Jurisdiction		
	China	EU-27	USA
	Within 12 months	Within 12 months	Within 12 months
China	–	0.68	0.73
EU-27	0.17	–	0.46
USA	0.25	0.61	–

Source: New Industrial Policy Observatory (Evenett and others 2024) and IMF staff calculations.
Note: This figure represents the frequency of an import restriction in the same product between 2021-2023.

[23] Importantly, trade barriers are estimated in a model-consistent way. Most of the cited papers use customs duties revenue as a percentage of total imports. Hence, these findings and measures are broadly consistent with the measures used in the model.

50. The high persistence of tariffs may explain the limited behavioral adjustment and small impact on the current account. Trade reforms—such as mutual or unilateral tariff reductions—are typically perceived as permanent, as most are typically embedded in trade agreements. The distribution of tariff changes over different horizons for countries between 1970 to 2024 indicates a high degree of persistence over time (Figure 17). Trade policy changes also tend to be frequently met with retaliation, with new temporary, mostly product-specific import restrictions met by similar measures from trading partners (Figure 18). Such retaliation serves to offset the effects of the initial tariffs. Given the permanent nature of trade policies and retaliation, trade barriers exert limited influence on the current account, a result consistent with the intertemporal approach as discussed in the model simulations. As a result, tariff changes behave empirically more like global shocks than country-specific shocks, dampening their effects on the current account.

Evidence on Industrial Policies

51. The direction and magnitude of the effect of micro industrial policies on the current account are also empirically uncertain. Preliminary evidence using broad indices of industrial policy from the New Industrial Policy Observatory (NIPO) shows ambiguous effects on the current account. Specifically, introducing an index of the number of industrial policy measures relative to the sample average yields insignificant coefficients. Using instead a categorical variable for the quintiles of its distribution (to reduce measurement error) yields an economically small but statistically significant negative coefficient. Interacting this term with trade openness and capital account openness yields small positive and insignificant coefficients, respectively (see Cesa-Bianchi and others 2026, for a similar exercise). The evidence is clearer on the impacts of specific industrial policy instruments on sectoral imbalances, but these cannot be extrapolated to effects on the aggregate current account.[24]

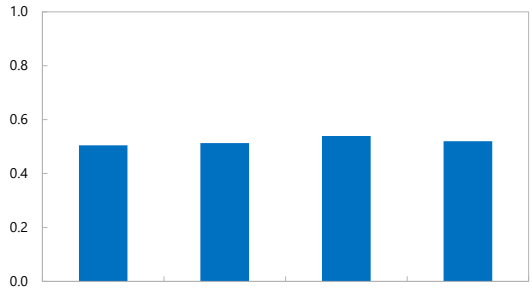
52. Certain features of micro industrial policies may explain the limited, in some cases positive, effects on the current account. First, micro industrial policies are targeted and normally affect only a limited number of sectors. That said, some of these sectors can be systemic, and the cumulative stock of interventions can be substantial, albeit difficult to measure. Recent research confirms that a boost to competitiveness in targeted sectors affects the composition of trade but does not generate identifiable aggregate trade impacts (Rotunno and Ruta 2024). Second, to the extent that these policies affect aggregate productivity, the evidence shows that the impact tends to be negative due to resource misallocation, which would increase the current account surplus. Taken together, these studies align with the framework and model findings that micro industrial policy has either limited or positive impacts on the current account.

[24] Emerging cross-country evidence on subsidies indicates an export-boosting effect of around 8 percent in G20 emerging market economies at the sectoral level (Rotunno and Ruta 2024), albeit competitiveness gains are temporary (Huang and others 2025). These findings are complemented by more granular country- and industry-specific evidence (Lane 2025; Girma and others 2009; Kalouptsidi 2018).

53. Macro industrial policy is found to meaningfully increase the current account. A widespread interpretation is that these policies can sometimes reflect a mercantilist motive, whereby governments deliberately seek a devaluation to promote export-led growth, with large-scale foreign reserve accumulation serving as the operative instrument (Rodrik 2008; Aizenman and Lee 2007; Korinek and Servén 2016). A growing empirical literature finds that such intervention can systematically generate real exchange rate depreciation and raise current account balances. Choi and Taylor (2022) provide the most direct evidence, showing that persistent foreign exchange intervention coupled with a relatively closed capital account, akin to the foreign asset accumulation case discussed in the conceptual framework, lowers the real exchange rate durably and increases the current account. This aligns with earlier work linking stronger real exchange rates to weaker external balances (Chinn and Prasad 2003), as well as with studies documenting that countries exhibiting "fear of appreciation"—i.e., one-sided intervention to prevent currency strengthening—experience slower current account adjustment and more persistent surpluses (Levy-Yeyati and others 2013; Bergin and others 2025). Similarly, Gagnon (2012) shows that official reserve purchases by emerging market central banks have driven a substantial portion of global current account imbalances. The IMF EBA models also estimate a positive effect of foreign exchange interventions (interacted with the degree of capital account openness) on the current account. Evidence on financial repression is more limited, but existing cross-country studies indicate that countries employing significant repressive financial policies are more likely to run current account surpluses (Johansson and Wang 2012; Wang 2020).

54. The explanatory power of international trade barriers may be swamped by other determinants of the current account. As discussed in the conceptual section, some important channels through which industrial and trade policies affect the current account, such as productivity shocks (sometimes proxied by expected GDP growth) and fiscal policy, may already be accounted for in a standard current account specification. Indeed, trade barriers yield only marginal gains in the fitted variance when incorporated into the full EBA specification (i.e. together with relevant other macroeconomic variables), indicating that existing variables capture much of their explanatory power (Figure 19). More broadly, important challenges remain in empirically establishing the relationship between trade barriers and the current account, including endogeneity concerns, the persistence of trade barrier shifts, and the heterogeneous impacts of granular policies.

Figure 19. Fitted Variance of EBA Specifications



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: All results are based on EBA regression using updated data from 1986 to 2019. Trade barriers are based on the baseline results from IMF 2026 forthcoming. All columns include all EBA variables.

55. Trade and industrial policies may also alter the response of the current account balance to the real effective exchange rate. Measures that raise trade costs – such as tariffs, non-tariff barriers, payment restrictions, and industrial policies – could dampen the medium-term sensitivity of the current account to the REER by narrowing the scope for adjustment through trade volumes, since more open economies typically adjust more readily to REER changes (Edwards 2004). This attenuation of the current account-REER semi-elasticity implies that policy-induced trade frictions can make external balances less responsive to relative price shifts. Moreover, tariffs can trigger a REER appreciation that endogenously offsets their impact on the current account, as higher domestic prices reduce competitiveness and limit the improvement in the trade balance (Jeanne and Son 2024). Together, these mechanisms suggest that policy-induced frictions might introduce additional complexity into assessments of countries' external positions and equilibrium exchange rates.

SCENARIOS FOR THE EVOLUTION OF CURRENT ACCOUNT BALANCES

56. Increasing domestic imbalances have played a significant role in the recent widening of global imbalances, though the role of certain industrial policies cannot be ruled out. Global imbalances had been on a downward trend in the aftermath of the GFC. This reflected a combination of terms of trade effects and macroeconomic policies; some key factors included private sector demand compression and deleveraging in advanced economies, tighter financial conditions in emerging market deficit economies and fiscal and credit policy easing in China resulting in higher investment (IMF, 2019). In recent years, however, global imbalances have widened, potentially signaling a shift in the underlying trend (IMF 2025a). An expansion of the fiscal deficit and household dissaving of funds accumulated during the pandemic in the US, together with domestic demand weaknesses in China driven by the real estate slowdown, drove some of the recent increase in global imbalances. Such an assessment holds when comparing model-simulated outcomes using actual shocks to investment, fiscal balances and household spending to actual outcomes. The model results from such shocks explain about half of the widening in US and China's current account balances relative to the pre-pandemic period (Gourinchas and others 2024). However, industrial policies, such as those deployed economy-wide, could account for part of the unexplained portion of the post-pandemic widening.

57. An illustrative exercise involving policy interactions can shed light on how global imbalances may evolve from this juncture. The discussion in this section aims at understanding what type of policies can facilitate global rebalancing compared to those that will further widen it. The IMF's Global Integrated Monetary and Fiscal Model (GIMF) is used to evaluate potential outcomes for current account balances in major economies. In each scenario, the model simulates output effects to present tradeoffs around policy choices. The results from this section should be seen as providing a sense of direction around intended effects rather than a quantitative assessment of policies. In other words, the policies underpinning the model-based risk scenarios presented are not chosen to reduce surpluses or deficits to any deemed desirable level and should not be interpreted as comprehensive policy advice for individual countries or regions.

A. How Could Imbalances Continue to Widen? Unbalanced Growth

58. Current account balances could continue to widen if existing trends with a narrowing base of growth drivers continue or are amplified in major economies. In the US, if fiscal deficits remain at historically high levels and household saving continues to be subdued, the current account deficit will likely remain large. A rapid acceleration in the adoption of AI technologies triggering a surge in U.S. business investment could further widen the current account deficit. In China, growth continues to be driven by net exports which increase further relative to the baseline through additional policy support for the exporting sector, funded by reduced transfers to households. This, together with the prolongation of the real estate downturn, leads to pessimism over future potential output, higher household saving, and a real exchange rate depreciation. China's current account balance increases further as a result. Finally, in Europe, lagging productivity growth persists due to lower innovation and lack of access to equity funding, resulting in persistently low private investment (see Chapter 1 of April 2026 World Economic Outlook; Figure 20, left panel).

59. The widening of domestic imbalances in major economies reinforces global imbalances through cross-border spillovers. In surplus economies, elevated saving and weak domestic demand continue to translate into persistent current account surpluses, while deficit economies experience sustained external shortfalls as domestic absorption remains high relative to income. These internal dynamics interact through trade, financial, and exchange-rate channels, amplifying one another across regions. For example, a substantial proportion of the widening in current account balances in each region is driven by shocks that are generated abroad.

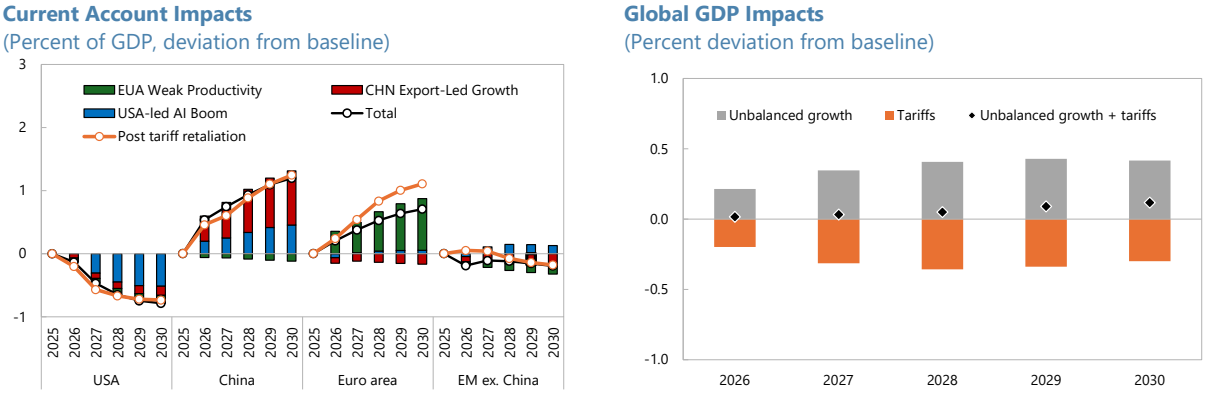
60. In such a scenario an escalation of tariff barriers would do little to mitigate global imbalances but lower output. The continued widening of global imbalances discussed above trigger a rise in tariffs in the US, China, and euro area. Bilateral tariffs are increased by 20 percentage points above current levels. Because the tariffs are reciprocated, the effect on the current account balance is small in all regions (Figure 20, left panel).[25] However, the tariffs result in a reduction in global output, such that the net effect of the unbalanced growth and tariff scenario is that global output is little changed relative to baseline (Figure 20, right panel).

61. A prolonged widening of imbalances increases the possibility of disorderly adjustment. In deficit economies, persistently high fiscal shortfalls and subdued private saving can sustain large external borrowing needs, leaving them more exposed to abrupt shifts in risk appetite, higher term premia, or a reassessment of sovereign and private credit risk—any of which could trigger a sharper-than-expected compression in domestic absorption through higher interest rates, weaker asset prices, and a sudden tightening of financial conditions. In surplus economies, continued weakness in domestic demand, whether from elevated precautionary saving, prolonged real-estate deleveraging, or industrial policies that tilt growth toward external demand, could intensify trade tensions and

[25] As shown in the model-based simulations section, even if tariffs were unilaterally imposed rather than reciprocated, the current account impact would be positive and of a modest scale only when tariff revenues were used to pay down government debt.

lead to larger and more damaging trade policy responses for output. Increased uncertainty generated by a tariff response to the widening of imbalances could also lead to reduced risk appetite and a higher likelihood of disorderly rebalancing.

Figure 20. Widening Imbalances Scenario: Unbalanced Growth and Tariffs



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

B. How Can Imbalances Narrow? Reforms Aimed at Domestic Rebalancing

62. Large and persistent global balances do not resolve automatically and the mode of adjustment matters. As discussed in previous sections, simultaneous forward-looking policy actions—particularly when imbalances are recognized early—can facilitate gradual rebalancing with lower macroeconomic costs. By contrast, balances that build alongside financial vulnerabilities risk a disorderly unwinding with severe economic consequences, for example, if triggered by a reappraisal of expectations of productivity gains from artificial intelligence (see Chapter 1 of April 2026 World Economic Outlook).

63. Simultaneous domestic policy reforms would support a more orderly adjustment, with global imbalances narrowing and output increasing.

- *Lower US government debt with tariff rollback and reduced uncertainty*. The United States embarks on a series of fiscal reforms to better target expenditure, shift from labor to consumption taxes, and contain health care costs. These reforms lower the fiscal deficit by 1 percent of GDP after five years, and US public debt declines by 25 percentage points of GDP in the long term. Tariffs imposed since January 2025 are permanently removed, reducing effective tariff rates on US imports by about 10 percentage points relative to the current baseline. Trading partners also remove tariffs on US exports, and US exports to China see a decrease in effective tariff rates of about 20 percentage points. There is a two-standard-deviation decrease in the global economic policy uncertainty measure in Davis (2016).

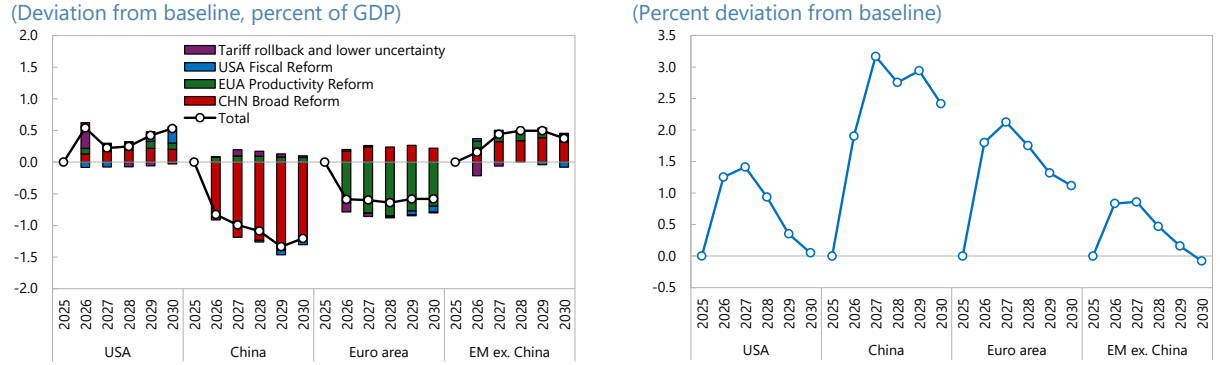
- *Tilting towards consumption-led growth in China.* A short-term fiscal expansion of 0.5 percent of GDP boosts social spending and supports residential investment, contributing to a fall in household saving. Lower industrial policy support reduces economic distortions and

misallocation and contributes to rising business dynamism and higher economy-wide productivity. In contrast to previous scenarios, the yuan is allowed to adjust in response to these policies.

- *Structural reforms with investment boost in Europe.* Public and private investment increases in the euro area, reaching 1 percent of GDP by 2026 and stays at that level until 2030. Total factor productivity improves and, combined with public and private sector capital deepening, increases potential output permanently.

64. In this rebalancing scenario, the net result is that global imbalances decline alongside higher GDP. The US current account balance increases by half a percent of GDP by the end of the scenario (Figure 21, left panel). The decline in the current account balance in China is also substantial, reaching up to 1.3 percent of GDP. In contrast to the "widening imbalances" scenario, output is equal to or higher than its baseline level in all three regions. GDP rises above baseline the most in China and the euro area given the sizable gains to productivity driven by reforms (Figure 21, right panel).

Figure 21. Narrowing Imbalances Scenario: Reforms Aimed at Domestic Rebalancing



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

65. Simultaneous policy actions reduce current account imbalances at home and abroad. While the impact of these reforms predominantly reduces imbalances in the home country, there are also important synergies abroad. For example, the broad-reform scenario in China and productivity improvements in the euro area contributes about half of the overall increase in the current account balance over the scenario horizon in the United States. Likewise, US fiscal reforms reduce current account surpluses in other regions. All regions have an increase in activity above the baseline throughout the scenario.

66. Asymmetric adjustment could raise risks in economies that do not tackle imbalances. One-sided efforts to reduce imbalances have the potential to adversely affect countries that continue to have large domestic and external imbalances. In countries with excessive surpluses, reforms that boost growth through demand stimulus and productivity improvements could increase global real interest rates, as outlined in the conceptual framework. Countries that continue to run

large external or domestic deficits, and those with high existing stock vulnerabilities could in turn face higher financing costs that put at risk the sustainability of public finances. On the other hand, a situation where adjustment is undertaken only by countries running large external deficits could dampen global growth and amplify deflationary forces in surplus countries.

ROLE OF THE FUND IN FACILITATING INTERNATIONAL ADJUSTMENT

67. The Fund's focus on external imbalances is rooted in its origins and its legal framework. The purposes of the Fund are set forth in Article I of the Articles of Agreement and include promoting international monetary cooperation and exchange stability, facilitating the expansion and balanced growth of international trade, and assisting members in establishing a multilateral payments system. The Fund's powers include oversight (surveillance, oversight of members' exchange systems), financial assistance, and advisory powers (financial and technical services), with the unifying theme that defines their scope and content being the promotion of stability of the international monetary system.

68. Fund surveillance plays a key role in engaging members on policies to address external imbalances and promote economic and financial stability. Article IV outlines members' obligations on exchange rate and economic policies. The Fund oversees members' compliance through bilateral surveillance and the International Monetary System (IMS) through multilateral surveillance (see Box 4).

- **Bilateral surveillance** focuses on individual member countries and their policies identifying vulnerabilities and imbalances at the country level while multilateral surveillance focuses on global linkages and systemic risks. In bilateral surveillance, each member is required to consult with the Fund on its exchange rate and domestic economic and financial policies and provide data to enable effective surveillance. Article IV consultations, which the Fund conducts regularly with all members, assess whether an individual member's domestic and external policies promote the member's balance of payments stability and domestic stability, focusing on exchange rate, monetary, fiscal, and financial sector policies, as well as other policies that may significantly influence the member's present or prospective balance of payments or domestic stability.

- **Multilateral surveillance**, focuses on assessing global economic and financial developments and the outlook for the global economy including risks to global economic and financial stability that bear on the IMS. This includes spillovers from individual members' policies that may significantly influence the effective operation of the IMS, for example by undermining global economic and financial stability.[26] The guiding principles of multilateral surveillance include the

[26] There is an early recognition of the impact that global imbalances can have on IMS. The 1965 Fund Annual Report, Annual Report of the Executive Directors for the Fiscal Year 1965, observed that "exceptionally large imbalance in

(continued)

recognition of the interconnectedness of national economies, the importance of policy coherence among members, and the need for early identification of systemic risks and cross-border spillovers. The 2012 Integrated Surveillance Decision (ISD), which elaborates on members' obligations and surveillance modalities and ensures integration of bilateral and multilateral surveillance, reinforces that systemic stability (i.e., the stability of the system of exchange rates) is best achieved when each member adopts policies that promote its balance of payments stability and domestic stability, thereby reducing risks of disruptive spillovers. The ISD expanded the scope of the Article IV Consultations to be a vehicle for bilateral surveillance and multilateral surveillance by allowing discussions of regional and global spillovers from individual members' policies, alongside the Fund's conduct of multilateral surveillance through "flagships" such as the World Economic Outlook, the Global Financial Stability Report, and the External Sector Report.

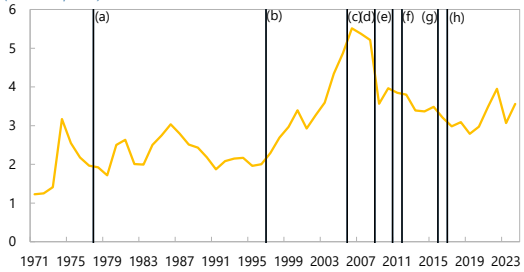
Box 4. The Fund's Evolving Role in Global Imbalances

Under the Bretton Woods system, Fund activities focused primarily on maintaining external stability through the par value system, the fixed-but-adjustable exchange rate system. Following the system's collapse in the early 1970s—a period of disorderly external adjustment—the focus shifted to the conduct of domestic policies to secure external stability. This shift in perspective was reflected in the Second Amendment of the Articles of Agreement in 1978 which modified Article IV to require members to collaborate to promote a stable system of exchange rates and introduced obligations with respect to members' domestic policies. In expanded Fund bilateral surveillance, the Fund focuses on a member's policies that can significantly influence present or balance of payments and domestic stability, focusing on areas such as exchange rate, monetary, fiscal, and financial sector policies (primarily conducted within Article IV consultations).

The Second Amendment also established the basis for the Fund's mandate for multilateral surveillance——the Fund "shall oversee the functioning of the international monetary system in order to ensure its effective operation". Although an important part of the Fund's activities since the Second Amendment, the scope and modalities of multilateral surveillance—including the Fund's precise role in assessing spillovers—took time to develop. Coverage of global imbalances and international spillovers from domestic policy (mis)settings increased gradually from the mid-2000s, but it was not until after the GFC—another disorderly adjustment—that the Fund adopted a more systemic perspective. The 2012 Integrated Surveillance Decision formalized coverage of spillovers from members' economic and financial policies in Article IV consultations and sought to better integrate bilateral and multilateral surveillance.

Figure 4.1: Global Imbalances and Related Adaptations of Fund Multilateral Surveillance

(Percent of GDP)



Source: IMF, *World Economic Outlook;* and IMF staff calculations

Notes: (a) Second Amendment; (b) CGER Launched ; (c) Multilateral Consultations; (d) G20 MAP Process Launched; (e) 2011 Triennial Surveillance Review, Spillover Reports Launched; (f) Pilot ESR Launched, Integrated Surveillance Division; (g) WEO Spillover Chapters Launched; (h) G20 SSBIG Report Launched.

world payments" in the global economy at that time put "strain on the international monetary system". The 1965 report also identifies key elements comprising the international monetary system, which is reflected in the ISD.

Box 4. The Fund's Evolving Role in Global Imbalances (concluded)

The Fund's monitoring of global imbalances has evolved over the past 20 years. Key initiatives include: *Multilateral Consultations (MC):* In 2006, amid rising global imbalances, and following criticism from its largest shareholder that the Fund was "asleep at the wheel on its most fundamental responsibility—exchange rate surveillance…", the Fund launched a supplementary MC on Global Imbalances involving China, the euro area, Japan, Saudi Arabia, and the US. The consultation process unfolded over 2006–07, culminating in a staff report and Board and IMFC discussions in 2007. The MC provided a forum for joint analysis and policy dialogue, while laying the groundwork for subsequent G20 and Fund initiatives.

Spillover Reports and WEO Spillover Chapters: Beginning in 2011, the Fund introduced the Spillover Reports—a series of reports initially focused on the external effects of domestic policies in systemically-important economies—to help fill the gap between the bilateral Article IV consultations and the broader scope of multilateral surveillance. From 2014, the Spillover Report shifted to a more thematic approach, and spillover analysis was later integrated into the WEO beginning in 2016, with dedicated spillover chapters that systematically assess cross-border effects of national policies and has included coverage of trade.

External Sector Report (ESR): Published annually since 2012, the ESR provides multilaterally consistent assessments of countries' external positions using the External Balance Assessment (EBA) framework, distinguishing between balances explained by fundamentals and desirable policies and those reflecting excesses.

G20 Report on Strong, Sustainable, Balanced, and Inclusive Growth (SSBIG). At the 2009 Pittsburgh Summit, G20 leaders committed to a framework for achieving strong, sustainable and balanced growth supported by the G20 Mutual Assessment Process (MAP). The IMF was tasked with providing technical assessments as part of the MAP, evaluating the consistency of G20 policies and frameworks with members' shared objectives. Since 2017, the IMF's annual Report on SSBIG to the G20 has become the main vehicle for the Fund's input to the G20's framework. This report includes backward looking accountability assessments and forward-looking scenarios in which members are assumed to pursue recommended policies.

69. The Fund's current work on external imbalances, a key pillar of Fund operations, comprises three layers:

- *Diagnosis:* The Fund collects data on external sector statistics based on the standard framework of the Balance of Payments and International Investment Position Manual, 6th edition, and related standards for data dissemination (the IMF Data Standards Initiatives). Recent efforts have also focused on monitoring policy announcements such as on tariffs and industrial policies in collaboration with WTO and Global Trade Alert, as reflected in the WTO-IMF Tariff Tracker and then New Industrial Policy Observatory (NIPO). Using this data, the analysis of external imbalances is anchored by the EBA and EBA-lite models, which seek to distinguish "excess" from appropriate balances in a multilaterally consistent and evenhanded manner. Complementary analytical tools that inform the CA norm also include the External Sustainability Model, Real Effective Exchange Rate models, Commodity Modules and the External Debt Sustainability Analysis.

- *Policy advice:* In bilateral surveillance, staff reports include external sector assessments (ESA) based on the results from the models noted above. The ESA focuses on five key areas: (i) the current account balance, (ii) the real effective exchange rate, (iii) capital flows, (iv) foreign reserves levels, and (v) the net international investment position. In multilateral surveillance, the

ESR assesses the external sector for the largest members, accounting for 85 percent of global GDP, in a multilaterally consistent manner. The report analyzes the factors driving global imbalances and provides policy recommendations to address them.

- *Supporting international policy dialogue:* The ESR and other analyses of global imbalances serve as input to the multilateral policy dialogue promoted by the Fund.

70. The present paper is part of several initiatives currently underway to strengthen the Fund's ESA and enhance engagement on external sector issues with Fund members. This includes actions in all three layers of the analysis of global imbalances.

- **Addressing Data Gaps**: Current account measurement challenges and data gaps complicate the interpretation of global statistics and hinder multilateral and bilateral surveillance. For example, the global current account asymmetry, measured as the sum of the current account balance across countries, has been rising over time driven by positive discrepancies in the goods and services balances and negative discrepancies in primary and secondary income balances. To lead the effort in reducing global asymmetries in external sector statistics, the IMF's Committee on Balance of Payments Statistics (BOPCOM) has established the Task Team on Global Asymmetries (TT-GA). While reasons for asymmetries vary across components, several common factors such as data under coverage and deviations from international standards influence them. The TT-GA has developed some preliminary views about how to address these asymmetries and has proposed preliminary recommendations, focused on international collaboration, standardization of methodologies, enhanced global data collection, and improved data collection and survey design and will continue developing recommendations in the near-term.

- **Refining Analytical Tools**: The fourth EBA Review is ongoing and will strengthen Fund's analysis and assessment of excessive imbalances. Staff are prioritizing improvements to the Current Account (CA) model of the EBA framework with particular attention to the key determinants of CA norms: NFA benchmarking and demographics. Another priority topic is trade barriers. The EBA-lite model update is also examining the role of policy interventions for the wider membership comprising emerging market and low-income economies. For the medium-term the goal is to explore the feasibility of dynamic models as a complementary tool to the single-equation analysis, with a focus on the largest economies. This model would adopt a multilateral (global) approach, incorporate key features of the international trade and financial system, assess the origins of historical current accounts, and simulate alternative policy-dependent scenarios. A revamp of the Real Effective Exchange Rate (REER) models is also being explored to keep them up to date with the advances in literature. Finally, future analytical work will study capital and financial flows and their links to stock imbalances, as well as the implications of the latter for financial stability risks.

- **Strengthening Policy Advice**: The 2026 Comprehensive Surveillance Review (CSR) will identify gaps in the coverage of the external sector in surveillance and provide recommendations to better integrate the ESA into Article IV surveillance. A diagnostic exercise is underway, including through reviews of past Article IV reports and surveys, which will inform the Surveillance

Priorities going forward. A better external sector analysis should aim to: (i) provide a broader discussion of drivers and risks of external imbalances—complementing the EBA results with a discussion of capital and financial flows/stocks, and industrial and trade policies where relevant—and policy adjustments needed to address them; and (ii) outline synergies and tensions between policies that address domestic concerns and those that tackle external imbalances. Staff will seek to develop solutions to close gaps in the external sector coverage and integrate them with other forward-looking strategic priorities. Final recommendations will inform medium-term enhancements needed in the Fund's external sector analysis. On the multilateral advice front, the 2026 External Sector Report (ESR) will shift towards a more forward-looking analysis, assessing risks to the global economy from imbalances and planned medium-term policies under a range of scenarios. Such an approach would allow for more focused policy advice in a multilaterally consistent way. Lastly, the CSR will also aim to identify weaknesses and provide specific suggestions on ways to improve quality and consistency of coverage of outward spillovers in Article IV consultations.

- **Enhancing Policy Coordination:** The Fund provides a platform for members to exchange views and coordinate policies to mitigate risks and address external imbalances. Building on a history of facilitating multilateral dialogue—most notably, the 2006 Multilateral Consultation—the Fund continues to assist multilateral fora by regularly monitoring and reporting on policy actions and external developments, and will provide enhanced support to the upcoming G7 and G20 Presidencies and the Study Group to develop a shared understanding on the drivers of global imbalances and spillovers of policies and adjustment mechanisms.

SUMMARY AND IMPLICATIONS FOR FUND SURVEILLANCE

71. This paper provides a structured framework to explain how macroeconomic, trade, and industrial policies can influence current account outcomes by altering domestic saving and investment decisions, and clarifies the conditions under which these effects are likely to be material. Several key conclusions emerge.

- The saving–investment framework remains the appropriate conceptual anchor for analyzing global imbalances. Current account positions reflect forward-looking saving and investment decisions shaped by macroeconomic fundamentals, structural characteristics, domestic policies, and different economic structures and systems. Traditional macroeconomic drivers continue to be significant drivers of global imbalances. Trade and industrial policies affect external balances primarily through these macroeconomic channels and should be analyzed within this broader framework rather than in isolation.

- Uniform tariffs tend to have small and often temporary effects on external balances, particularly when perceived as permanent and when exchange rates are flexible. If the exchange rate is unable to appreciate—for example, due to a fixed exchange rate regime—there may be a larger

and positive effect on the current account. Some modest effects on the current account may also materialize when tariffs are temporary or when revenues generated by tariffs are used for fiscal consolidation.

- Standard (micro) industrial policies, typically targeted at specific sectors, have ambiguous aggregate effects and are found empirically to have limited or modest impacts on current accounts, mainly through productivity and fiscal channels. In contrast, macro industrial policies—those macroeconomic and financial policies implemented economy-wide such as capital flow restrictions with sustained foreign exchange intervention to help achieve industrial policy objectives—can have more material and persistent effects on current accounts, typically by suppressing domestic absorption. However, there are many circumstances where these policies may be deployed to achieve appropriate macroeconomic stabilization objectives.

- Effective and sustainable adjustment requires domestic rebalancing through macroeconomic and structural policies that support productivity growth and resilient domestic demand. Industrial and trade policies cannot substitute for such rebalancing and external surpluses generated through demand compression or financial repression can exacerbate domestic distortions and shift the burden of adjustment to trading partners.

72. The findings have several implications for Fund surveillance. External sector assessments should remain firmly anchored in the saving–investment framework. Policies that affect external balances—particularly those that suppress domestic demand or rely on restrictions—should be evaluated in terms of their macroeconomic costs, distributional effects, and cross-border spillovers. Because adjustment in large surplus and deficit economies generates significant spillovers, bilateral advice should be complemented by analysis of outward spillovers. Finally, the paper points to priorities for future work, including improving data and transparency on industrial and trade policies, strengthening the integration of capital flow and stock dynamics into external assessments, further refining analytical tools to capture policy interactions and better integrating external sector analysis into Article IV surveillance through the CSR. These efforts would enhance the Fund's ability to assess global imbalances.

73. The analysis is intended to support coherent and evenhanded surveillance. It seeks to help staff assess policy interactions, identify when external balances may reflect underlying distortions, and distinguish between warranted adjustment and outcomes that risk generating domestic costs or cross-border spillovers. It is not intended to establish new Fund policy and does not automatically entail an operational shift in external sector assessments. It should also not create a presumption in favor of, or against, the use of any particular policy instrument, nor does it provide a normative assessment of specific policies.

ISSUES FOR DISCUSSION

74. Directors may wish to discuss the following issues:

- Do Directors agree that the Fund saving-investment framework serves as a conceptual anchor to monitor and diagnose global imbalances?
- Do Directors agree that the paper highlights the main conditions under which industrial and trade policies may impact current account balances?
- Do Directors agree that domestic rebalancing, through a better mix of policies, can contribute to a more orderly resolution to global imbalances?
- Do Directors agree that there is a need for further analysis to enhance the Fund's role in assessing global imbalances, including tackling statistical and methodological gaps, further work on refining the EBA, and analyzing the role of capital and financial flows/stocks?

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