

**PRESS POINTS FOR CHAPTER 4: *GETTING THE BALANCE RIGHT:
TRANSITIONING OUT OF CURRENT ACCOUNT SURPLUSES.***

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Key Points

- **An in-depth study of 28 policy-driven current account surplus reversals suggest that these were typically not associated with lower growth in output or employment. The study shows that the average effect on output growth and employment is small, and the quality of growth improves. In fact, there is a better balance between external and domestic demand, and between growth in the tradables and nontradables sectors.**
- **The analysis confirms that although exchange rate appreciation can play a key role in surplus reversals, the best results are achieved when appreciation is complemented with economic policies that support domestic demand and structural reforms.**
- **The study's findings caution that overly expansionary and protracted economic policies during reversal episodes can stoke inflation and asset price booms.**

The chapter analyzes the experience of countries that made a policy-induced transition away from large, sustained current account surpluses. In particular, it looks at 28 surplus reversal episodes in advanced and emerging market economies over the past 50 years. Using both statistical analysis and in-depth case studies, the chapter examines the implications of these reversals for economic growth and employment and identifies key factors that explain a large variation in growth outcomes.

The current account surplus narrowed significantly in response to policy changes.

Although exchange rate appreciation often played a role, other policies also facilitated the reversals, including macroeconomic policies that stimulated domestic demand and, in some cases, structural reforms. The narrowing of the current account surplus during policy-induced surplus reversals reflected both a significant fall in saving and a sharp rise in investment. And although exchange rate appreciation was a common feature in many surplus reversals, overshooting rarely occurred.

On average, surplus reversals were not associated with lower growth in output or employment. Output growth in the three years following the start of a reversal was, on

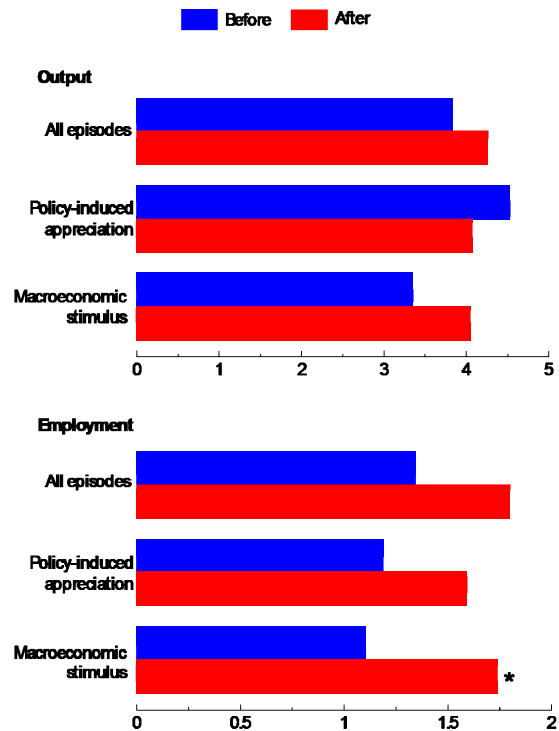
average, *higher* than in the preceding three years by 0.4 percentage point, although the change was not statistically distinguishable from zero. Demand frequently shifted from external to domestic sources, with rising consumption and investment offsetting a fall in net exports. Moreover, the level of employment increased slightly as the increase in employment in the nontradables sector more than offset the decline in employment in the tradables sector.

Behind this insignificant change in average growth, however, was a wide range of growth outcomes that can be explained by a host of factors. Other things being equal, a real exchange rate appreciation was associated with lower growth. But other factors frequently offset the effects of an appreciation, including improving global demand, strengthening terms of trade, macroeconomic stimulus, and structural reforms such as trade liberalization.

The analysis has important implications for economies considering an exit from large current account surpluses. First, a surplus reversal need not undermine growth: the average effect on output growth and employment is small, and the quality of growth improves—there is a better balance between external and domestic demand, and between growth in the tradables and nontradables sectors. Second, although exchange rate appreciation played a key role in many surplus reversals, the best results were achieved when appreciation was complemented with macroeconomic policies that supported domestic demand and, in some cases, structural reforms that addressed distortions that gave rise to the large current account surpluses. Finally, there is also a cautionary lesson from past reversal episodes: macroeconomic policies, if overly expansionary and kept in place too long to counter the effect of currency appreciation, can stoke inflation and asset price booms.

Output and Employment Growth during Surplus Reversals (Percent)

There is no evidence that a policy-induced surplus reversal is associated with significantly lower output or employment growth.



Source: IMF staff calculations.

Note: Figure reports average growth of real GDP per capita and employment in the three years before the reversal and the three years starting with a reversal. An asterisk (*) indicates that change in growth is statistically significant at the 10 percent level. "Policy-induced appreciation" denotes cases in which there was a policy-induced appreciation of at least 10 percent as described in the text. "Macroeconomic stimulus" denotes cases in which there was fiscal or monetary stimulus as described in the text.