Rebalancing the U.S. Economy

The trend is favorable.

BY JASON FURMAN

Although economic performance bounces around from quarter to quarter, it is widely appreciated that the trend in the U.S. economy in recent years has been one of steady improvement. American businesses are extending the longest streak of job creation on record, the unemployment rate has fallen below 6 percent years ahead of expectations, and aggregate output has accelerated. But perhaps less appreciated is the improvement in a broad range of structural imbalances that pre-dated the crisis. Rather than accelerating the recovery with new borrowing that would exacerbate many of the problems that precipitated the Great Recession, the United States has rebalanced toward a more sustainable position than before the crisis.

The United States has reduced its indebtedness on four levels: in the household sector, in the private business sector, on a national level with higher aggregate saving, and in international trade as a net recipient of foreign capital. On top of recent acceleration in U.S. output and employment growth, these structural improvements lay the foundation for more sustainable growth beyond the current business cycle. Our international rebalancing is particularly noteworthy as part of a broader global movement toward smaller current account imbalances. This movement has come despite global macroeconomic policies in some current account surplus countries that have militated toward increasing disparities—and

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in some notable and concerning cases have created troubling growing surpluses.

U.S. INTERNAL REBALANCING

While many households still face challenges, the aggregate ratio of debt to disposable income in the household sector has decreased to a level last seen in 2002, as households have both increased their savings and reduced their borrowing. The combination of lower debt levels and lower interest rates has reduced the aggregate value of household debt service payments to 9.9 percent of disposable income, the lowest level since at least 1980. Declining debt service, together with lower gasoline prices and improved consumer confidence, leaves more room for households to consume and grow the economy.

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Indeed, personal consumption expenditures have been one of the fastest-growing components of gross domestic product.

Declines in real median household net worth now appear to have moderated, owing to lower levels of household debt and recovering asset values. But there is no doubt that the typical family faces greater challenges than the aggregate figures alone suggest. Indeed, it is important to ensure creditworthy borrowers at a wide range of income levels have access to mortgage credit. Our challenge in the household sector today stems from mortgage credit standards that are too tight, rather than the overly lenient credit standards that contributed to the financial crisis.

America's corporations have also reduced their debt burdens. Corporate debt-to-equity ratios in the non-financial sector have retraced all of the increase that resulted from the crisis. At the same time, corporate borrowing costs have declined sharply, reflecting the market's perception that the risks of lending to private business have eased. Bank capital is up more than 30 percent since the crisis, while the net worth of nonfinancial corporate businesses has risen more than 40 percent from its trough.

On a national level, gross saving has increased sharply as a share of the economy since the crisis. One important driver of increased saving has been the reduction in Federal dissaving amid the fastest pace of deficit reduction since the post-World War II demobilization.

The pace of federal discretionary spending reductions and state and local fiscal consolidation was faster than optimal, creating challenges for growth. However, when taken together with factors such as revenue increases from high-income households and slower health cost growth, the U.S. fiscal outlook is in a more sustainable position today compared with a few years ago.

U.S. EXTERNAL REBALANCING

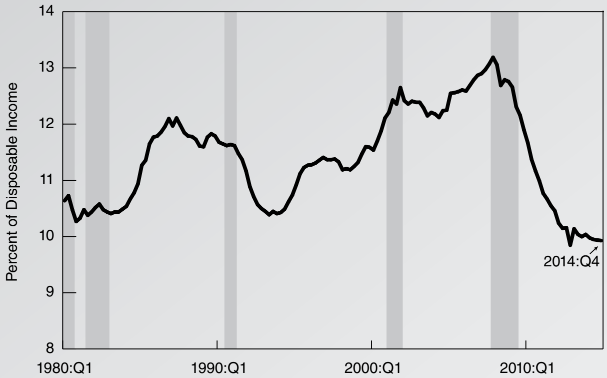
As a nation with a persistent current account deficit, the United States is a net recipient of global capital flows. But since the global financial crisis, the U.S. economy has made strides toward rebalancing on an international level as well. The U.S. current account deficit fell from 5.8 percent of GDP in 2006 to 2.4 percent of GDP in 2014, the lowest share of the economy since the late 1990s. This progress is especially notable given our advanced position in the business cycle versus that of our trading partners, which would tend to increase the deficit since domestic demand has outpaced foreign demand. In part, this progress is attributable to our own policies, including the increase in net national saving associated with the reduction in our federal budget deficit and the dramatic reduction in net petroleum imports—the latter being a function of both increased domestic production and reduced consumption.

But also in part, the reduction in the current account deficit reflects a broader move towards rebalancing in much of the rest of the world: global current account imbalances have narrowed since the financial crisis, largely as a result of weak aggregate demand. However, they remain large on a historical basis, and remaining current account surplus countries effectively force other countries to maintain current account deficits, dragging on aggregate economic growth.

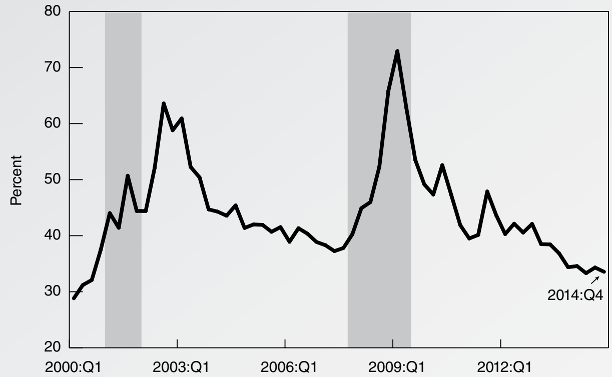
The United States has rebalanced toward a more sustainable position.

Deficit countries such as the United States must import capital from abroad to make up for the difference

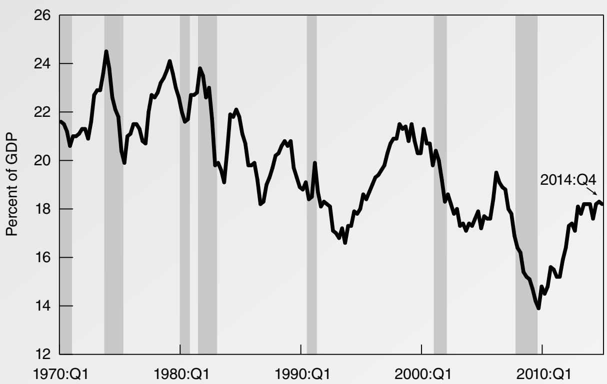
Household Debt Service Payments



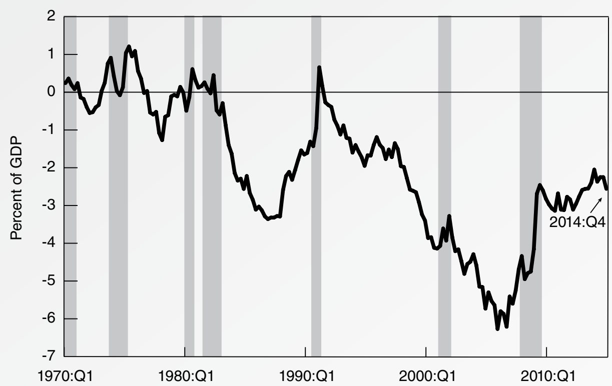
Non-Financial Corporate Debt-to-Equity Ratio



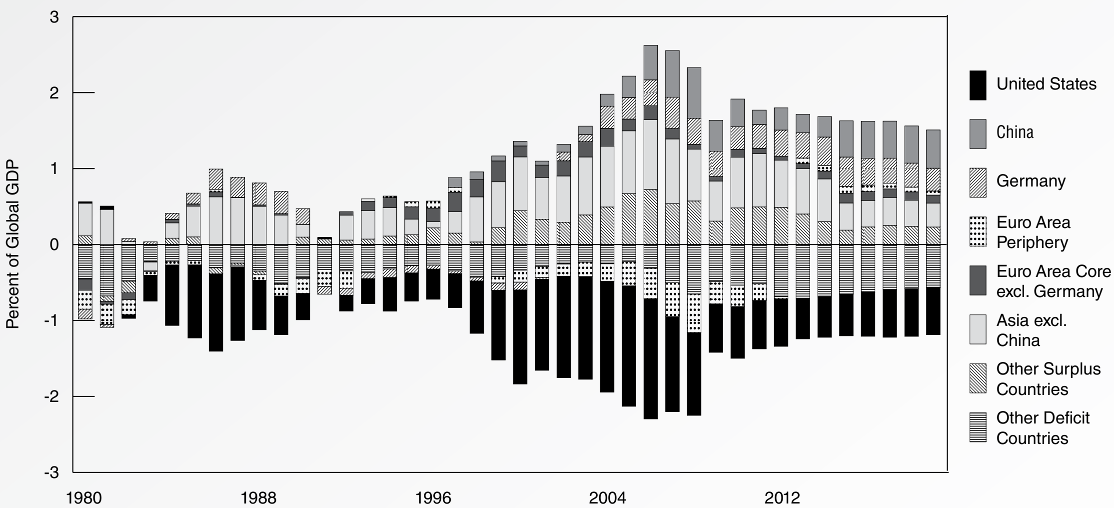
Gross National Saving



U.S. Current Account Balance



Current Account Balance



between saving and investment, creating current account deficits—the dominant component of which is the trade deficit. Notably, such trade deficits appear to have been linked with other imbalances, like the debt-fueled housing

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bubble that precipitated the financial crisis. Overall, according to this view, large, persistent current account deficits—driven in part by other countries' current account surpluses—threaten the sustainability of U.S. and global growth.

GLOBAL IMBALANCES

Global imbalances can be understood as being rooted in three factors: macroeconomic policies broadly construed, national exchange rate policies specifically, and other asymmetries across countries, including in trade policies.

The largest source of current global imbalances stems from macroeconomic policies broadly construed. Specifically, while many of the large surplus countries have reduced their current account surpluses, the adjustment process in core European countries—especially Germany—has been more concerning. Germany's outsized surplus is largely attributable to its high exports beyond the borders of the euro area. Germany is not the only substantial surplus country and macroeconomic policies have contributed to imbalances in other economies as well.

A second source of global imbalances can be currency policies that target an undervalued exchange rate in order to shift global demand. The United States has made progress toward promoting more transparent, market-based exchange rates as a key element of our international economic policy, including through the G-7, the G-20, and in our bilateral economic engagement with countries such as China. However, the United States and the broader global economic community will continue to push China to fulfill its Strategic and Economic Dialogue commitments to move toward a market-determined exchange rate.

The third source of global imbalances is other economic asymmetries across countries, including asymmetries in the level of government interventions that distort the free flow of trade. For a given set of exchange rates, the openness of the U.S. economy combined with the often larger barriers to our exports to the rest of the world can be a source of imbalance. In that respect, it is notable that, using available data, the United States is currently running a small goods and services trade surplus with the totality of our twenty Free Trade Agreement partners—as compared to a trade deficit with all other countries.

SUBSTANTIAL PROGRESS

The United States has made substantial progress toward rebalancing its economy on both an internal and external basis. But in both cases, there is more work to do. Internally, U.S. fiscal policy must continue to focus on the proper balance between supporting growth and ensuring that government debt is on a falling trajectory as a share of the economy over the medium and long run. On a household level, though, aggregate rebalancing is nearly complete with household debt service as a share of income at multi-decade lows—but we must continue to focus on factors affecting middle-class households. Indeed, our challenges with respect to household credit growth are likely to stem from mortgage credit standards that are too tight, rather than the reverse.

Externally, it is important that global macroeconomic policies continue to support rebalancing. In particular, surplus countries should commit toward channeling those

Our international rebalancing is particularly noteworthy.

surpluses toward pro-growth policies, generating internal and external benefits. Recent wage increases in Germany and the higher German minimum wage are important steps in the right direction. Policymakers must also maintain the focus on promoting market-determined exchange rates as well as liberalizing world trade. The major global trade agreements that the United States is now negotiating—the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership—will make important strides to that effect. ◆