



G7 Economists Memo on Global Imbalances Chong-En Bai, Gita Gopinath, H el ene Rey, Axel Weber¹

Executive summary

Balanced growth and reciprocal trade are fundamental to a well-functioning global economy. Growth is “balanced” when it is durable, resilient, and consistent with national security. Trade is “reciprocal” when it is mutually beneficial for countries.

The rise of excessive current account deficits and surpluses reflects increasingly unbalanced growth dynamics in China, the European Union (EU), and the United States (US). China has chronically low domestic consumption, the EU suffers from persistently weak levels of productive investment, and the US has enduring fiscal deficits that are too large relative to economic conditions. These structural divergences underpin persistent external imbalances and contribute to global tensions. These risks call for urgent policy action and not waiting for overly precise measures of excess imbalances.

Growing sectoral imbalances—in goods and services trade as well as in the financial sector—though not the primary drivers of global imbalances, can undermine balanced growth and reciprocal trade. They **fuel protectionist policies** and heighten **national security concerns**. **Financial sector imbalances**, especially those involving large gross flows, maturity and currency mismatches, and excessive leverage, can generate systemic risks.

Addressing global imbalances requires rebalancing growth, which is in the individual and collective interest of China, the EU, and the US. China’s growth can be rebalanced by increasing ‘investment in people’ as prioritized in its 15th Five-Year Plan. This calls for public support for healthcare, safety nets, repairing balance-sheets damaged by the property market crisis, changing incentives of regional administrators, and scaling down unwarranted industrial policies to free up fiscal resources for investing in people. The European Union should raise its growth potential by implementing key recommendations of the Draghi report, including deeper integration of goods and services markets to increase scale, and further capital markets integration to expand long-term risk capital. The United States can strengthen growth

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resiliency by reducing its public deficit and reinforcing financial stability. Policy measures to put public debt on a sustainable path are essential.

Policy coordination — even in the limited form of simultaneous policy actions — **will reduce adjustment costs** significantly. Asymmetric adjustment (for example, surplus countries adjusting without deficit countries doing so) could raise global real interest rates and increase financial risks.

Sectoral trade tensions, including those linked to trade surges or hard-to-measure non-market practices, should be **managed pragmatically within the WTO framework**. The **safeguard mechanism** (GATT Article XIX and the WTO Agreement on Safeguards) provides a necessary “safety valve” for sustaining reciprocal trade. Reforms are necessary to increase the effectiveness of this tool including potentially broadening its application to wider sectors as opposed to a single narrow product.

Financial sector imbalances should be addressed through prudential policies and enhanced IMF and Financial Stability Board (FSB) surveillance, improved data collection on cross-border exposures of non-bank financial intermediaries (NBFIs) and on crypto assets, system-wide stress testing that incorporates international linkages between banks and NBFIs, and international cooperation on emergency liquidity provision.

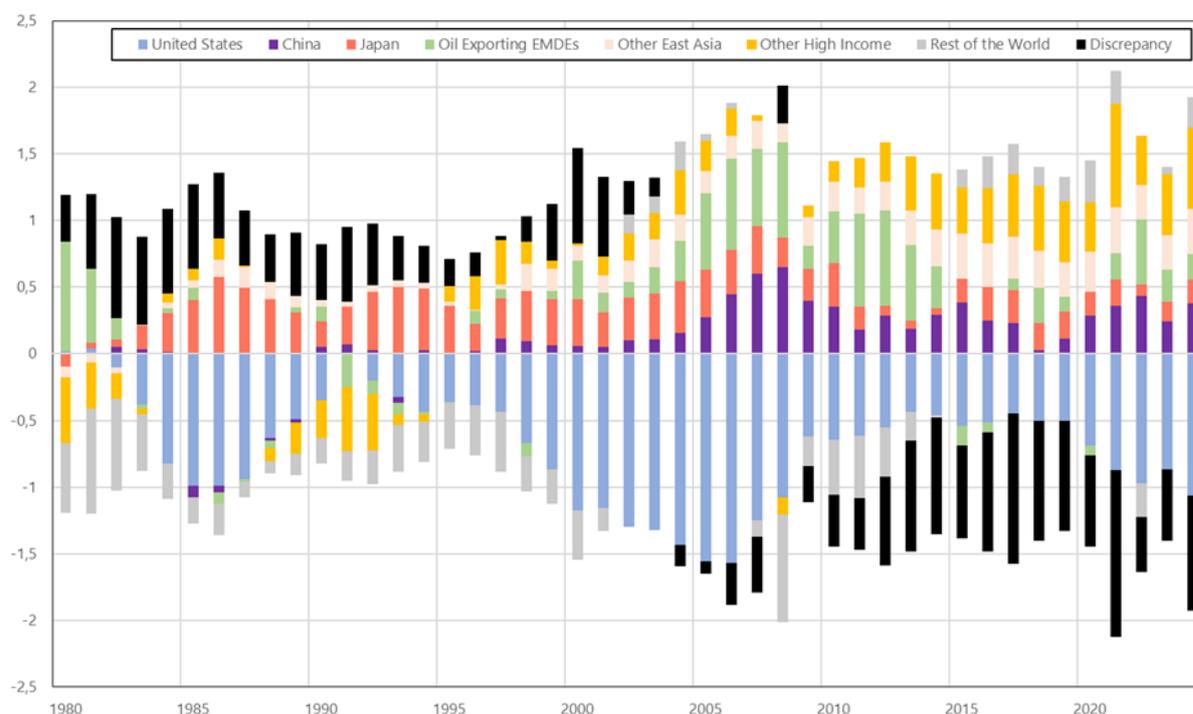
The IMF plays a central role in assessing excessive imbalances and conducting bilateral and multilateral surveillance. **Continued close cooperation** and information sharing among the **IMF, WTO, and FSB** will strengthen the global capacity to manage both macroeconomic and sectoral imbalances. Complementary data efforts and analysis on non-market practices by the **OECD** and on cross border exposures by the **BIS** are highly beneficial.

In sum, reducing excessive global imbalances requires simultaneous macroeconomic policy actions in the major economies, while managing sectoral imbalances requires pragmatic trade governance, strengthened financial oversight, and enhanced information sharing and cooperation between existing international organisations with relevant and complementary mandates.

A. Introduction and current developments.

- 1. After a decline in the last two decades, the issue of global imbalances has once again come to the fore.** The US current account deficit reached 4.6% of US GDP in 2025H1, the highest level since the previous peak in 2006 just before the Great Financial Crisis (GFC). Further back, the US deficit had reached elevated levels in the 1980s that led to the Plaza agreement (**Chart 1**).² The Euro area current account surplus stood at 2% of GDP in the first half of 2025 compared with over 3% during the same period in 2024. China's 2024 current account was about 2.3% of Chinese GDP and continued to grow to 3.5% of GDP in 2025Q1-Q3. China, Europe and the US (G3) drove the widening in current account balances in 2024, with the US and China continuing the divergence in 2025H1 (Balakrishan (2026))³. Current account deficits and surpluses, which reflect the international borrowing and lending behavior of countries, have become increasingly persistent (Chart A1) raising the risks of disorderly adjustment. The persistence of current account imbalances, explains, together with valuation changes, the large increase in US net international liabilities which has reached a high of 90% of GDP (Chart A2).

Chart 1: Current accounts.
Percentage of world GDP.



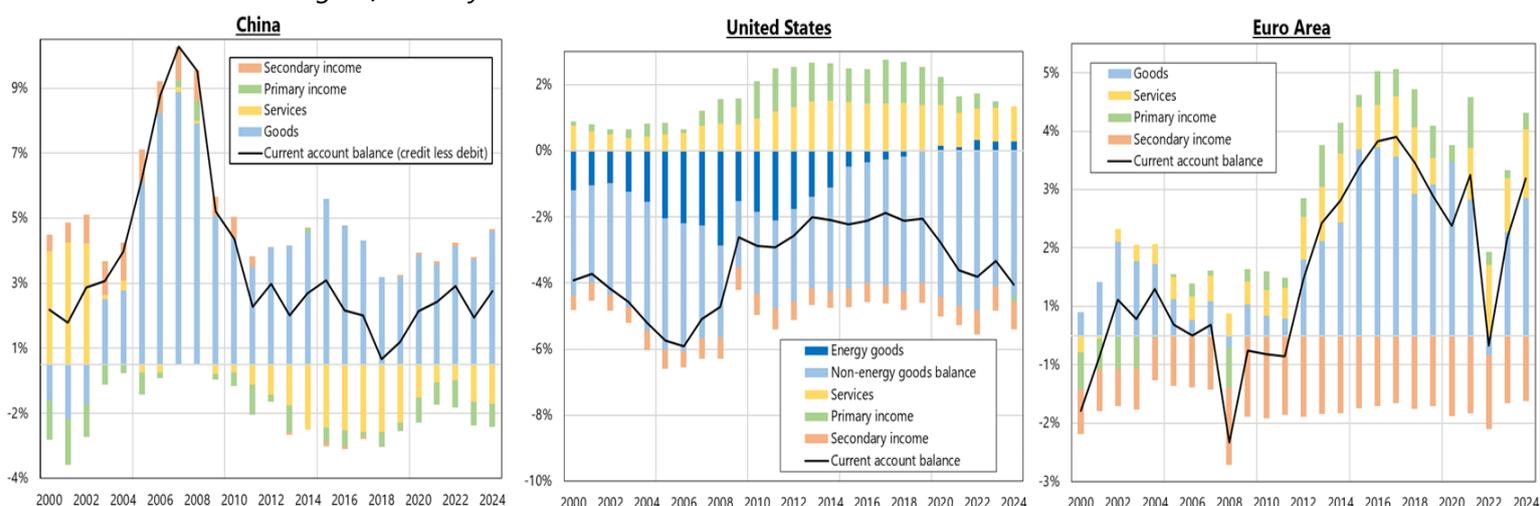
Source: *The External Wealth of Nations*, Lane, Philip R. and Gian Maria Milesi-Ferretti, 2018.

² See Box 3.

³ This memo focuses on the developments in the G3 but the analysis and policy recommendations are broader.

2. Sectoral imbalances are also large and warrant attention (Chart 2). China's 2025 trade surplus in goods increased to almost US\$1.2 trillion based on customs data– up from US\$ 421 billion in 2019, before the pandemic. There are growing concerns around imbalances in more narrowly defined sectors like, rare earths, electric vehicles, and more. The US remains the leader in the financial sector with growing exposure of global investors to US equity markets. About 20% of US stocks are held by non-resident investors. Financial risks are pertinent due to global investors' concentrated exposure to AI-related assets and to lightly regulated non-bank financial intermediaries (NBFIs).

Chart 2: Current account composition
Percentage of country's GDP.



Source: Paris Report. Balakrishnan (2026).

B. Principles and common ground.

3. Balanced growth and reciprocal trade are fundamental to a well-functioning international economy. Balanced growth is durable, resilient, and supportive of national security. Trade is "reciprocal" when it is mutually beneficial for countries. Current account deficits and surpluses naturally arise from international trade and are, in many cases, desirable because they facilitate a more efficient global allocation of capital. Aging economies, for example, may run current account surpluses as they save for the future and accumulate foreign assets. More innovative or rapidly growing economies may run current account deficits, attracting net capital inflows that finance higher investment and raise potential growth. Temporary imbalances can also represent an efficient response to shocks, such as the Covid-19 pandemic. For these reasons, global imbalances are not inherently problematic; they often reflect the normal workings of open and interconnected economies.

4. **Sectoral imbalances, similarly, can occur naturally** as they reflect differing comparative advantage of countries. They also do not necessarily drive current account imbalances. The US shale-gas revolution turned the US energy sector deficit of close to 3% of GDP in 2006 into a surplus in 2020, but US current account deficits remain sizeable. Similarly, even in the absence of global imbalances, countries can still face risks of rapid and destabilizing sectoral imbalances.
5. **Global and sectoral imbalances are problematic when they jeopardize the shared principles of balanced growth and reciprocal trade.**
6. **Global imbalances** are currently estimated to be **excessive, large, and persistent**, by the International Monetary Fund. Excessive global imbalances can **rupture international cooperation and generate financial instability**, which damage growth and trade. Recent historical episodes of global imbalances are prime examples of those risks. Protectionist tensions were rife in the 1980s and were defused to some extent by the Plaza agreement; the large capital flows imbalances of the 2000s, driven by growing safe asset demand, export-led growth, financial deregulation and real estate price bubbles, unwound painfully with the Global Financial Crisis in 2007.
7. **Large sectoral imbalances** such as imbalances in bilateral trade flows are also a source of rising international tensions especially if they **build up quickly**, are associated with an absence of a level playing field via the use of **Non-Market Practices (NMP)** or create **risks to national security**. Sectoral **financial** imbalances, which are linked to large **gross inflows and outflows** of capital are also a threat to financial instability even if they are not necessarily associated with large *net* flows -net flows are the mirror of the current account (see **Box 1**).
8. Historical experience suggests that **today's excessive global imbalances**, as well as **certain sectoral imbalances, warrant policy action to mitigate risks to global growth and international cooperation**. While the IMF (WEO 2025) projects some narrowing of current account imbalances, the policy mix in the United States and China, together with cyclical dynamics, may instead cause them to widen (Balakrishnan, 2026). A further increase in global imbalances would heighten risks of protectionism and financial instability, ultimately weighing on global growth.

C. Causes of global imbalances

9. **Global imbalances are macroeconomic in nature; they are a consequence of unbalanced growth models**. The drivers of current account imbalances are best understood through the lens of the savings and investment balances, which are shaped primarily by structural factors, macroeconomic policies, and macro-relevant shocks.

Structural factors like demographics, and factor endowments (oil exporters); macroeconomic policies such as fiscal and monetary policies, financial regulation; and shocks like the Covid-19 pandemic and the Great Financial Crisis, can all lead to sizeable changes in current account imbalances. The smoothing of transitory shocks for example can lead to current account adjustments that are welfare improving.

10. Industrial policies and NMP affect sectoral imbalances in goods and/or services trade. Their impact on global imbalances is less clear.

Industrial policies and NMP are multidimensional. Some are 'micro' and targeted to a very specific sector or value chain (targeted subsidies) while others are more 'macro' and affect large parts of the economy, such as cheap credit or underpriced land, to boost entire sectors⁴. While 'macro' NMP alone may not impact global imbalances they can do so when combined with weak domestic demand (Obstfeld (2026), Box 2). The impact of industrial policies on global imbalances requires further study including better measurement of industrial policies and NMP (OECD (2024)).

11. Exchange rates alone do not generate large and persistent imbalances.

For exchange rates to have lasting effects, they must be supported by the underlying macroeconomic policy mix. Savings and investment dynamics—shaped by fiscal, monetary, and financial policies—can induce real exchange rate movements that reinforce current account deficits or surpluses. As a corollary, real exchange rate appreciations are not a prerequisite for a country to run a current account deficit. Historical episodes of excessive global imbalances illustrate this point. In the early 1980s, the U.S. dollar experienced a sharp real appreciation even as the U.S. current account deficit widened, driven by expansionary fiscal policy combined with tight monetary policy. In contrast, during the 2000s, the dollar weakened while the U.S. deficit reached unprecedented levels (–6% of GDP in 2006), reflecting a period of financial deregulation and large gross cross-border capital flows associated with rising global demand for safe assets.

12. Equally, floating exchange rates, while desirable, do not ensure that global imbalances are self-limiting.

All they do is clear the balance of payments, bringing equilibrium current account deficits into line with desired net capital inflows and surpluses with desired net capital outflows (Obstfeld (2026)). When nominal exchange rates are managed, real exchange rates over time adjust to clear markets via adjustment in goods prices, as currently in China where the fallout of the real estate market crisis depresses the non-traded sector; which combined with macro industrial policies cause industrial goods prices to fall, depreciating the Chinese real exchange rate. More flexibility in the RMB exchange rate would still be desirable as discussed in China IMF AIV (2026).

⁴ Certain Pigouvian taxes or subsidies can be beneficial as they correct market failures.

13. Since 2022, the widening of global imbalances has been accompanied by an appreciated U.S. dollar and euro, and a depreciated renminbi (Chart A3), developments that have reinforced imbalances and fueled protectionist sentiment. China accounts for nearly all of the euro's real effective appreciation since 2021, at a time when euro area and Chinese export structures have become increasingly similar, heightening competitive pressures (ECB, 2025). The situation in the United States, the euro area, and China echoes the early 1980s, when a very strong dollar, a weak yen, and rising protectionism marked a period of escalating trade tensions. That episode offers important lessons: nominal exchange rate movements alone—even large ones—do not resolve global imbalances. Post-Plaza, Japanese monetary and fiscal adjustments were central to the subsequent rebalancing (see Box 3).

14. Issuing an international currency does not require running current account deficits. The United Kingdom was running current account surpluses during the Gold Standard and so did the United States under much of the Bretton Woods period and part of the Floating rate period. Being a reserve currency does entail issuing a large amount of safe assets which are then held abroad. This means that the gross stock of safe external liabilities is large but these liabilities can be offset by gross external assets resulting in a neutral or positive net external position. Switzerland have run persistent current account surpluses despite their reserve currency issuer status, while New Zealand has run persistent current account deficits despite not being a reserve currency issuer.

15. Tariffs, unless extreme, do not close imbalances⁵ but they can redirect bilateral trade flows creating spillover effects. Tariffs often act as a negative supply shock in the countries imposing them. They reduce both investment, which is less profitable, and savings to smooth the income shock, with potentially limited impact on current account balances. The 2025 IMF ESR illustrates the general equilibrium effects using model-based analysis. It finds import tariffs do not have a robust impact on the savings and investment balance with varying short-term and longer-term current account responses in major economies. While tariffs have very limited effect on aggregate imbalances for the country imposing them, they do have some effect on bilateral trade flows in the form of rerouting of trade, change in firms' investment strategies and some reshaping of global value chains (Clayton et al. (2025)).

16. Excessive global imbalances are the consequence of unbalanced growth strategies in China, the European Union, and the United States. In China, an investment-oriented growth strategy with growth targets at the regional level has favoured the traded manufacturing sector to the detriment of consumption and the non-traded services sector (Huang (2026)). The real estate sector crisis in 2021-2022 has led to a

⁵ In the short run, current account imbalances may even increase due to frontloading effects.

sharp drop in investment and to a rise in savings as household consumption declined following the drop in housing wealth. This decline in investment and rise in savings has increased China's current account surplus. In the EU, the absence of policies to support higher productivity growth has dampened investment relative to savings resulting in current account surpluses and capital outflows, in particular towards the US. In the US, large fiscal deficits, especially after 2019, have reduced national savings and raised national debt (Harr and Krogstrup (2026)). Global investors preferences for USD assets and the dynamism of the US economy have underpinned large capital flows into US Treasury markets as well as into US equities (Milesi-Ferretti (2026)), particularly in AI related sectors, where valuations have risen sizably and are a source of vulnerability.

17. The risks created by unbalanced growth strategies in the G3 are rising over time.

China faces challenges from "involution,"⁶ as intense competitive pressures coincide with a weak non-traded (services) sector, limiting domestic demand growth. At the same time, China risks "hitting a protectionist wall" in several key export markets as exports are redirected away from the United States following recent tariff increases. Europe's limited integration is hindering its growth potential. Europe's limited integration is hindering its growth potential. As highlighted in the Draghi Report, substantial investments in defense, energy, research, and innovation are now essential to reverse stagnation and restore competitiveness. US debt and fiscal risks are growing with the concentration of risk in the AI sector, high equity valuations and potential stresses in debt markets (high rollover needs in Treasuries)⁷. The recent widening in global current account balances poses risks to **both deficit and surplus countries** in the form of **lower productivity growth, trade wars, market volatility and financial crisis. If these excessive and persistent imbalances are not resolved, the economic outlook could deteriorate significantly.**

D. Measures of excessive global imbalances

18. Measuring "excessive" global imbalances is a complex task, undertaken in particular by the IMF since 2012 in its annual External Balance Assessment (IMF 2025). The IMF estimates current account "norms" for a range of countries. These norms encompass macroeconomic factors and reflect IMF staff's judgement on appropriate (rather than actual) policies. Current account balances that exceed these norms are labelled "excessive". In 2024, about two-thirds of the widening in global current account balances was considered excessive with China, the United States, and to a lesser extent the euro area driving the increase. (Chart A4).

⁶ Involution refers to intense and self-defeating competition that yields ever smaller gains in the economy and in society. It materializes in price wars, falling margins and deflationary pressure. Chinese 30% share in global manufacturing means that international spillover effects are large and raises concerns about survival of industries in other geographical areas.

⁷ The duration of outstanding US public debt is declining which makes borrowing costs increasingly sensitive to central bank interest rate policy. Turbulence in the US treasury market will have sizeable international spillovers.

19. Inherent complexity and data limitations limit the degree of precision of excessive imbalance assessments. There is a large statistical global discrepancy as all the counterpart deficits to surpluses cannot be identified in the data (Chart 1). Moreover, surpluses can be mismeasured when, as for the case of China, the size of the imbalance varies between customs and balance of payment data (Setser and Sobel (2025), Ma and Wei (2026)). There is also considerable uncertainty regarding structural variables (i.e. demographic projections (Depalo and Giordano (2025)) and what are some forms of desirable policies Pigouvian subsidies for green policies for example are not necessarily distortionary as they can correct market failures but the precise level of these subsidies are difficult to pin down. The presence of the lagged international investment position in the IMF's estimation equation may also "normalize" past excesses. Further, a significant portion of estimated excesses remains unexplained and cannot be related to identified policy distortions. The IMF is currently working on improving the methodology for assessing imbalances.

20. While it is desirable to have a more robust assessment methodology, including better data and improved measures of NMP, **we do not need estimates to be overly precise to recognize the risks** embedded in the current widening of global imbalances. Once it is understood that large and persistent excess current account imbalances come with large risks an excessive focus on providing exact measures of excess imbalances may be counterproductive.

E. Policy recommendations to address excessive global imbalances: A common direction of travel.

21. It is in the individual and collective interest of each of the G3 to rebalance their growth strategies, thereby reducing global imbalances. Macroeconomic adjustments that improve the resilience of medium-term growth for each economy are aligned with a decrease in global imbalances. **Coordination in the simple form of simultaneous policy actions will reduce the adjustment costs** for all involved as exports of one country are imports of others and similarly for capital inflows and outflows. If, for example, surplus countries were to adjust but not deficit countries the real interest rate would rise and so would global financial risk. Policies should (i) directly affect the savings-investment balances, (ii) minimize negative spillovers, (iii) avoid relying on exchange rates alone, (iv) manage financial risks and (v) reduce uncertainties in the governance of international trade and finance. Conversely, using the wrong tools -such as tariffs- to rebalance can be damaging to all.

22. China's growth can be rebalanced by increasing 'investment in people' as highlighted in China's 15th Five-Year Plan. This will require public support for healthcare, education, and improved social safety nets for households. Such measures

can help reduce the high levels of precautionary savings by households⁸. Simultaneously, scaling down unwarranted industrial policies can improve the allocation of resources, reduce fiscal costs, and limit international spillovers (IMF China Article IV (2026)). Further measures to clean up balance sheets following the real estate crisis will help raise subdued domestic demand.⁹ Regional administrators should be incentivized to stimulate consumption of services instead of industrial production¹⁰. Scaling up anti-involution policies is needed to prevent a significant decline in medium-term growth, entrenchment of deflationary pressures and the risk that trade partners close their markets to China's exports. Such policies will help reduce the high levels of household and corporate savings. Reforming local government financing vehicles to become more like market entities can reduce inefficient investment that has led to supply and demand imbalances. Such reforms would create jobs, increase consumer welfare, support a real appreciation of the renminbi and reduce imbalances. Increasing the flexibility of the exchange rate is also desirable¹¹.

23. The EU can raise its growth potential by prioritizing and implementing the Draghi Report's recommendations to deepen the integration of goods, services, and capital markets. A key source of Europe's imbalances arises from **limited channelling of savings into risky high-return investments within the EU**. The EU market is also too fragmented to support demand at scale for innovating firms. A strengthened **Savings and Investment Union** should therefore prioritize patient risk capital and improve scale-up conditions, enabling faster productivity growth. This framework should be articulated as a **financing plan for innovation and growth**, supporting the sectors identified in the Draghi Report: defence, energy, deep tech, and health¹². Targeted investment in common assets, financed by common debt could play an important role and deepen the pool of European safe assets underpinning capital market integration. The EU could also consider improving its **FDI governance**, clearly distinguishing national-security concerns from normal investment screening. Allowing more FDI inflows—when accompanied by technological transfers—could accelerate innovation and productivity. If implemented effectively, this strategy would mirror earlier successful episodes, such as U.S. FDI into Europe during the post-war reconstruction period (Eichengreen, 2026), which generated significant positive spillovers, or more recent European FDI into China, which supported China's industrial upgrading.

⁸ Specific measures include extension of health insurance to family members and free kindergarten.

⁹ The real estate crisis started in 2021-2022. The volume of sales of newly constructed properties was 17.02 trillion yuan in 2021, accounting for 14.5% of GDP, and it dropped to 8.39 trillion yuan in 2025, only accounting for 6.0% of GDP, with negative growth each year in between.

¹⁰ On the fiscal side, the current system which incentivizes regional administrators to increase industrial production could be modified.

¹¹ Allowing for greater flexibility of the exchange rate and relaxation of capital controls may not necessarily lead to an appreciation of the renminbi in the short run as savings could flow out.

¹² Constructive policy initiatives include the creation of a 28th corporate regime to speed up integration (Letta Report (2024)) and the design of individual EU wide savings and investment accounts to increase the supply of patient capital.

24. The United States can strengthen growth resiliency by reducing its public deficit and reinforcing financial stability.

U.S. general government debt has risen to around 120 percent of GDP and is projected to climb further to around 140 percent of GDP by 2031, as fiscal deficits remain elevated (IMF art. IV (2026)). Consistent with the government's intentions, policy measures to reduce deficits and place the debt trajectory on a sustainable path are essential. Rising interest payments, already above 3 percent of GDP, are eroding fiscal space and limiting the government's ability to respond effectively to future shocks. U.S. technological dynamism has attracted substantial capital inflows into equity markets and non-bank financial institutions (NBFIs). While this has generated strong returns for investors, it has also increased vulnerabilities: a large sell-off could sharply reduce investment and household consumption and push up corporate borrowing costs, particularly as an expanding share of credit now flows through less transparent NBFIs. Ensuring well-functioning U.S. Treasury markets and strengthening oversight of NBFIs to mitigate liquidity risks would help reduce the likelihood of financial disruptions with global repercussions. In this context, policy initiatives to establish a regulatory framework for stablecoins represent a constructive step forward.

25. The April 2025 World Economic Outlook models a scenario where China, EU, and the US simultaneously implement policies to rebalance growth.

In this scenario global GDP increases by 0.8% and medium term global current account balances decline by about 0.5 percentage point of world GDP. In the scenario, the US consolidates fiscal spending, the euro-area raises public investment, and China enacts reforms to boost consumption and reduce precautionary savings. Because such joint action also reduces financial risks associated with large global imbalances, the overall benefits are likely significantly larger than the direct growth effects alone. By contrast asymmetric adjustment (for example, surplus countries adjusting without deficit countries doing so) could raise global real interest rates and increase financial risks.

F. Risks from Sectoral Imbalances

26. Sectoral imbalances, including imbalances in trade in goods and services and in gross financial flows, do not necessarily translate into global imbalances (Box 1). However, when they grow large, they **can fuel protectionist pressures and heighten security and financial stability risks**.

27. Political support for trade in goods and services has weakened as grievances with globalization have intensified and political preferences have shifted. The United States has imposed tariffs on virtually all its trading partners, while pursuing bespoke, bilateral

trade arrangements rather than broader multilateral frameworks. China's record goods trade surplus in 2025, and redirection of exports from the United States to third markets in response to U.S. tariffs, has further heightened tensions. At the same time, the heavy concentration of critical inputs, such as semiconductor chips and rare earth minerals, in a small number of countries is amplifying national security concerns and increasing the strategic risks associated with supply-chain disruptions.

28. Financial risks are increasing due to global investors' concentrated exposure to AI-related assets and to lightly regulated non-bank financial intermediaries (NBFIs).

Over the past fifteen years, international capital has increasingly flowed into U.S. equity markets. The strong outperformance of U.S. stocks and the sustained strength of the dollar have pushed U.S. net international liabilities to an unprecedented 90 percent of GDP. The concentration is particularly pronounced in technology: the "Magnificent Seven" firms now represent roughly 35 percent of the S&P 500 and about 20 percent of global equity indices. While AI is likely to be a profoundly transformative technology, the high levels of uncertainty regarding the profitability of this sector has the potential to generate a boom-bust dynamic reminiscent of the dot-com cycle, with potentially large global wealth effects. Equity valuations are historically elevated, estimates of U.S. equity premia are even lower than on the eve of the Global Financial Crisis (Fed, 2025), and corporate credit spreads remain compressed. Risk premia in the euro area are similarly subdued (ECB, 2025). These benign financial conditions, despite heightened geopolitical risks, are striking. At the same time, NBFIs are assuming an increasingly systemic global role (Milesi-Ferretti, 2026; Harr and Krogstrup, 2026). Their growing footprint in core markets, especially of highly leveraged hedge funds, raises the likelihood of sharp price swings.

29. These pressures impact all countries, on both the trade and financial fronts, underscoring the need for international governance frameworks that are fit for purpose.

F. Policy recommendations on sectoral imbalances: Managing tensions in trade and finance.

A. Trade and WTO

30. Sectoral trade tensions should be managed pragmatically through governance consistent with WTO principles.

While today's trade tensions are complex, the challenge is not new. The WTO emerged in 1995, after nearly five decades of GATT negotiations, to support global trade while remaining clear-eyed about the political-economy implications of trade integration.

- 31. Effective implementation of the WTO’s “safety valves” is essential for sustaining mutually beneficial trade.** The core objective of the GATT/WTO system is to provide a platform for countries to negotiate reciprocal and mutually advantageous market access. The Most-Favored-Nation (MFN) principle underpins this process by ensuring that concessions granted to one trading partner are automatically extended to all others, eliminating the need for each country to negotiate bilateral agreements with every counterpart. This prevents negotiated market access commitments from being undermined by preferential arrangements granted elsewhere. The MFN framework functions effectively when countries follow transparent, market-based policies in shaping their trade regimes. Challenges arise when there are unanticipated outcomes such as trade surges that damage the recipient country’s industry or there are national security risks in trading certain products with countries. Challenges also arise when some countries employ non-market practices that distort competition and make it difficult to reach balanced, reciprocal agreements. **The WTO has the tools to address such concerns. What is needed are reforms to improve the effectiveness of these tools which can then help preserve the MFN principle.**
- 32. Strengthening the WTO’s implementation of the Safeguard clause is essential to sustaining an open and politically durable trading system.** The safeguard clause—GATT Article XIX and the WTO Agreement on Safeguards—was designed as a pragmatic pressure-release mechanism for trade liberalization. It allows governments, on a **temporary basis**, to raise tariffs above bound levels when a domestic industry suffers serious injury due to heightened import competition. Quantitative restrictions (quotas) can also be put in place under certain conditions. By providing this escape mechanism, negotiators can make deeper concessions ex ante, confident that they retain a legal means of responding if liberalization generates unexpected harm. As emphasized by Sykes (2003) and Hoekman and Mavroidis (2023), safeguards offer a temporary response—a “breathing space”—that helps prevent the political costs of openness from overwhelming its longer-term benefits. Such a mechanism is vital for maintaining political support for an open trade regime.
- 33.** Despite its importance, effective use of the Safeguard clause has been hindered. The legal standards for determining when safeguards are justified remain insufficiently clear (Sykes (2003), Hoekman and Mavroidis (2023)), and the product-level investigations required under current rules are lengthy and burdensome. These procedural and legal obstacles have made the safeguard instrument less usable in practice than originally intended. In addition, there may be a case for modifying the clause to allow actions to be taken **at the level of a broad sector**, rather than requiring investigations for narrowly defined individual products.

- 34. Departures from MFN are also allowed by GATT Article XXIV**, which allows countries to enter free trade agreements with a subset of the membership, agreements that reduce tariffs to zero for a sizeable share of trade. This approach preserves the benefits of MFN while enabling departures that advance greater trade liberalization.
- 35. National security concerns** are legitimate concerns **covered under GATT Article XXI**. However, there is a risk that Article XXI may be invoked arbitrarily to penalize trading partners even in the absence of a genuine national security threat. An approach that preserves the core principles of the WTO could proceed along the following lines: **for a narrowly defined set of products** deemed essential for national security, a country could raise tariffs uniformly on all its trading partners and subsequently reduce those tariffs to zero for a subset of trusted allies. This would operate in the spirit of Article XXIV.
- 36.** Deviations from MFN are supported by **GATT Article VI (Anti-dumping) and Article XVI (Countervailing duties)**. Article XVI covers a narrow definition of subsidies and excludes policies like cheap credit and cheap land, which are common NMP. For this policy to be effective it would **require expanding the definition of industrial policy support**. This will require extensive data work along the lines already started by the OECD. (OECD (2024)).
- 37.** Lastly, it is important to **restore the functioning of the appellate body**. Proposals by Sykes (2024) on the optimal structure for appellate review, and by Grossman and Sykes (2025) on industrial policy and subsidies can be helpful.

B. Finance and IMF + FSB

- 38.** Financial sector risks should be addressed through **prudential policy and international cooperation on liquidity provision**.
- 39. Prudential policies are hindered by the lack of data on cross border exposures of NBFIs and on the links between NBFIs and the banking sector.** It is important to increase transparency on these exposures to better assess the adequacy of the loss absorption capacity and of the liquidity in the financial system. The Financial Stability Board (FSB) is making progress towards filling some data gaps related to NBFIs (FSB (20205b)) though the absence of timely entity-level data hinders the monitoring of cross-border exposures and systemic vulnerabilities. The FSB could also take an important role in helping **devise stress tests** encompassing NBFIs and banks. The Bank of England's System Wide Exploratory Scenario (SWES) exercise offers a useful step forward. The rising role of crypto currency flows and exchanges and their interconnections with the conventional financial system also deserve the attention of

the FSB and the BIS. Given the importance of offshore locations for NBFIs and crypto actors, enhancing transparency on activities in offshore jurisdictions and dealing with regulatory arbitrage should become a priority.

40. More generally, designing plans for international liquidity provision in crises in a more multipolar and fragmented world should be a priority.

G. Institutions and monitoring

41. Given the limited effectiveness of earlier initiatives—such as the G20 Mutual Assessment Process (MAP), which lacked institutionalization—a more **pragmatic path is deeper cooperation among existing international organizations** with complementary mandates, namely the IMF, WTO, BIS, FSB, and OECD.

42. **The IMF has a central role in assessing excess global imbalances** and in conducting both bilateral and multilateral surveillance. The ongoing review of the External Balance Assessment (EBA) methodology is therefore timely and necessary to reinforce the credibility of these assessments. To strengthen surveillance, the External Sector Report could focus more explicitly on the largest economies driving global imbalances, offering deeper analysis of their policy commitments and tracking progress over time. Policy paths should be consistent with Article IV recommendations. As part of its multilateral mandate, the IMF could also develop **joint adjustment scenarios** that quantify both the gains from policy cooperation and the risks of a disorderly unwinding of global imbalances. These scenarios could explicitly incorporate fragmentation dynamics and assess their implications for global growth and stability. Finally, liquidity provision in an increasingly fragmented global environment requires heightened attention, including the adequacy of existing backstops and the appropriate design of new instruments.

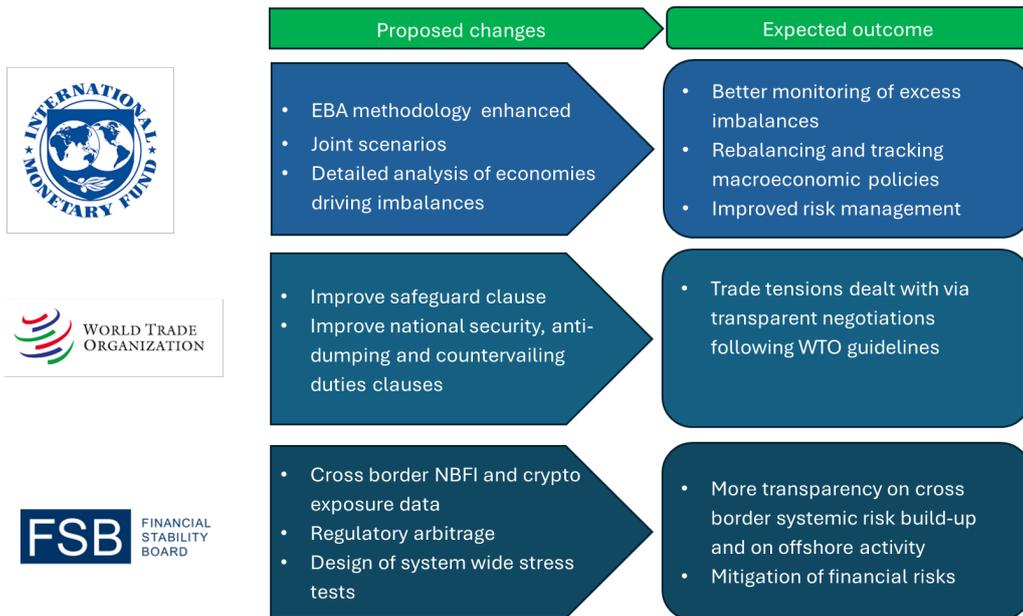
43. **The WTO remains key to supporting mutually beneficial global trade.** However, fulfilling this role will require reforms. Although several tools exist to address member grievances, their current effectiveness is limited, reducing the system's ability to manage disputes and prevent escalation. The ongoing consultation process on WTO instruments and governance arrangements provides an important opportunity to jump-start reform efforts and rebuild confidence in the multilateral trading system.

44. **The IMF, the WTO and the FSB could collaborate on the issue of global and sectoral imbalances, with input from the OECD and the BIS. As macroeconomic and sectoral policies have become increasingly intertwined enhanced cooperation across the multilateral institutions is necessary.** The WTO rules are built around commitments on non-discrimination and market access. It shapes the permitted repertoire of responses when macro adjustment and coordination fail but it has no macroeconomic

mandate, while the IMF has no enforcement power regarding trade distortions. This institutional separation may prevent constructive policy dialogues that could mitigate tensions in the international economy. For example, there may be WTO tools that can help to cushion abrupt trade changes during a period of macroeconomic adjustment. IMF external sector assessments could systematically inform WTO trade policy reviews as they provide the macroeconomic context for trade outcomes. Conversely, persistent trade distortions identified by the WTO framework could feed back into IMF surveillance as a potential source of imbalance. Macro financial spillovers identified by IMF could be integrated into FSB systemic risk analyses (Papakonstantinou (2026)). The FSB and the BIS on the financial flow side can complement IMF's macroeconomic views by identifying systemic vulnerabilities linked to imbalances. Continued joint IMF/FSB assessment of the impact of changes in financial regulation and of new asset classes, including crypto currencies, on financial sector risk taking, leverage and cross-border exposures would be valuable to mitigate risks of crises and contagion.

- 45.** Greater information sharing could help defuse tensions and improve understanding of cross-border spillovers. In the spirit of strengthening cooperation across countries and across institutions, it would be useful to systematically list, classify, and quantify the effects of the policy tools countries use to manage global and sectoral imbalances. Potential macroeconomic effects and spillovers could be assessed in collaboration with the WTO via a dedicated joint committee.

International Economic Governance Institutions



Enhanced Cooperation Across Institutions



Box 1. Current Account and Balance of Payments: A Refresher

1. "Global" and "Sectoral" Imbalances

Global imbalances

- Refer to a country's **current account (CA)** balance.
- Also relate to the stock counterpart: the **Net International Investment Position (NIIP)**, which measures the difference between a country's external assets and liabilities at market prices.

Sectoral imbalances

On the trade side: imbalances in **specific goods or services sectors** (e.g. manufacturing exports, financial services exports).

Net exports: $NX = X - M$
where X = exports and M = imports.

On the financial side: imbalances in **gross capital inflows and outflows**, possibly in specific asset classes (e.g. bond markets) or risk exposures (e.g. AI-related sectors).

Sectoral imbalances do not necessarily give rise to global imbalances.

2. National income identity:

$GNP = C + I + G + NX + NI$ where:

- **GNP** = Gross National Product
- **C** = Private consumption
- **I** = Investment
- **G** = Government spending
- **NX** = Net exports
- **NI** = Net income from abroad

National savings: $S = GNP - C - G$

This can also be decomposed into private and public saving.

The key identity: $CA = S - I = CF$ where:

- **CA** = Current account balance
- **S - I** = Savings–investment balance
- **CF** = Net capital flows

These identities show that a country's external balance is simultaneously:

1. A **current account imbalance**
2. A **savings–investment imbalance**
3. A **net capital flow**

3. Capital Flows: Definitions

Net capital flows = outflows – inflows

- **Inflows:** Net purchases of domestic assets by foreign investors
 - Example: A foreign bank lends to a domestic firm.
 - Inflows can be negative if a foreign investor sells domestic assets to residents.
- **Outflows:** Net purchases of foreign assets by domestic investors
 - Example: A domestic household buys a foreign government bond.

4. Flows vs. Stocks

- **Flows:** Value of cross-border transactions during a given year.
- **Stocks:** Value of external assets and liabilities at a given point in time.
 - Stocks reflect the accumulation of past flows plus valuation effects (exchange rate changes, asset price movements).

Net International Investment Position (NIIP):

$$NIIP = \text{External assets} - \text{External liabilities}$$

The NIIP is the stock counterpart to the current account at market prices (include valuation effects) and provides a measure of a country's external wealth or indebtedness.

Bottom line:

A current account deficit is not just a trade imbalance — it reflects a gap between domestic saving and investment and is financed by net capital inflows, which accumulate into the country's net international investment position over time.

Box 2. Non-Market Practices (NMPs)

Non-market practices (NMPs) are inherently difficult to measure. They are multidimensional—encompassing credit allocation policies, land pricing, targeted subsidies, tax incentives, procurement rules, and regulatory preferences—and they may pursue different objectives, from correcting market failures to gaining strategic market share. Significant data gaps remain in documenting their scope and intensity, and improving measurement would be highly valuable (OECD, 2024).

Like sectoral imbalances, industrial policies do not automatically translate into current account imbalances. Those reflect macroeconomic conditions and aggregate savings–investment balances, not sector-specific interventions. As emphasized by Gourinchas et al. (2024), in China subsidies have been directed toward specific sectors—such as electric vehicles, software, semiconductors, and green technologies—yet the resulting manufacturing trade surplus is not narrowly concentrated in those sectors. Instead, it is broad-based and contributes to the overall current account surplus.

This raises an important question: how can industrial policies that target investment in specific traded sectors translate into an aggregate current account surplus?

As argued by Obstfeld (2026), the key channel may operate through accompanying macroeconomic conditions. When industrial policy boosts the manufacturing sector, a simultaneous weakness in domestic demand can allow net exports to rise without generating inflationary pressures. Weak household consumption and a subdued real estate sector restrain inflation, limit expansion in the non-traded sector, and facilitate the emergence of a current account surplus. In China’s case, the decline in household consumption and property-related investment following the 2021–2022 real estate crisis has not only contained inflation but contributed to deflationary pressures. An undervalued RMB in real terms supports this macroeconomic configuration.

Importantly, even when industrial policies do not alter a country’s aggregate current account balance, large trade surges in certain sectors may still generate disruption abroad. Under WTO rules, countries facing such surges may legitimately consider policy responses, whether for political economy reasons or for concerns related to dynamic efficiency. The disappearance of entire industries in specific regions can have long-term consequences for innovation capacity and productive ecosystems.

Box 3 Lessons from the Plaza Accord

In the early 1980s, tight U.S. monetary policy and expansionary fiscal policy led to very high real interest rates and a sharp appreciation of the U.S. dollar (over 35 percent between 1980 and 1985). The strong dollar widened the U.S. current account deficit and hurt manufacturing, fueling political pressure for protectionism.

In response, the United States and the other G-5 countries (France, Germany, Japan, and the UK) signed the Plaza Accord on September 22, 1985, agreeing that an orderly depreciation of the dollar was desirable and undertaking coordinated foreign exchange intervention. The main shared goal was to reduce global imbalances and head off rising protectionist pressures in the United States. The Accord was successful in bringing down the dollar relatively quickly. However, it was less successful in achieving sustained macroeconomic adjustment. The U.S. current account deficit initially continued to widen, peaking in 1987, and fiscal and structural policy coordination among the major economies was limited. Over time, adjustment came through a combination of dollar depreciation, policy changes, and cyclical developments (including recession), rather than through a fully coordinated reform package. In short, the Plaza Accord helped correct an overvalued dollar and reduced immediate political tensions, but it did not by itself resolve the deeper structural causes of global imbalances (Obstfeld (2026)).

The fundamental lesson of the Japanese experience is that global imbalances cannot be resolved through exchange rates or coercive trade tactics alone (Hoshi (2026)). They require:

- Time-consuming structural adjustment in both surplus and deficit countries,
- Domestic policy reforms aligned with long-run growth,
- International cooperation to prevent protectionist escalation while reforms take effect

Following the sharp appreciation of the yen, the prolonged Japanese monetary policy loosening led to asset price bubbles and eventually the Japanese financial crisis. Monetary stimulus was appropriate initially to prevent a recession, but without timely tightening and structural reform, it contributed to financial instability.

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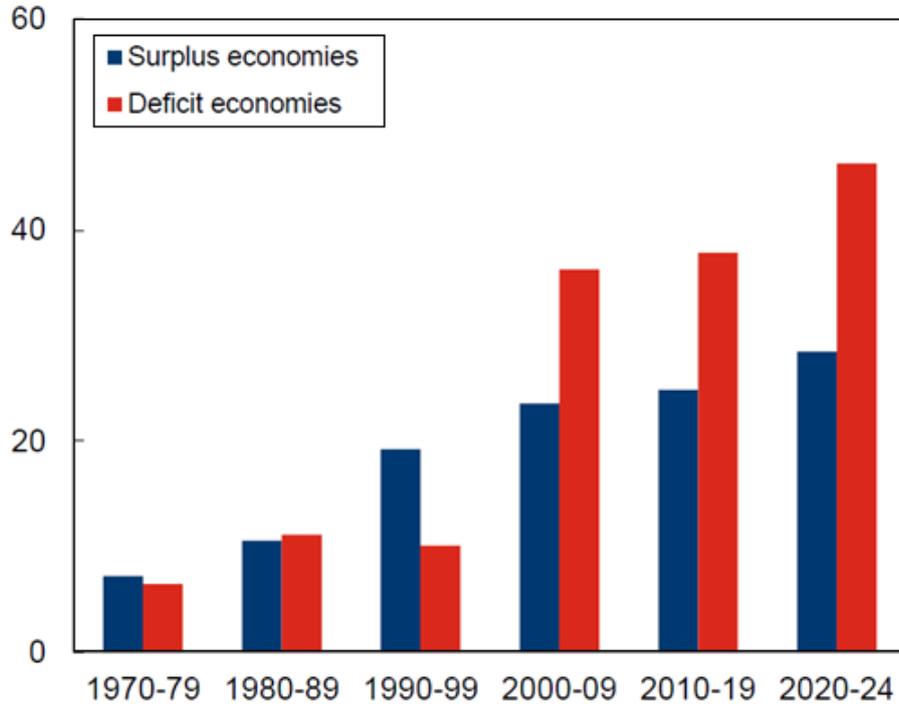
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Annex

Chart A1: Persistence of current account imbalances.

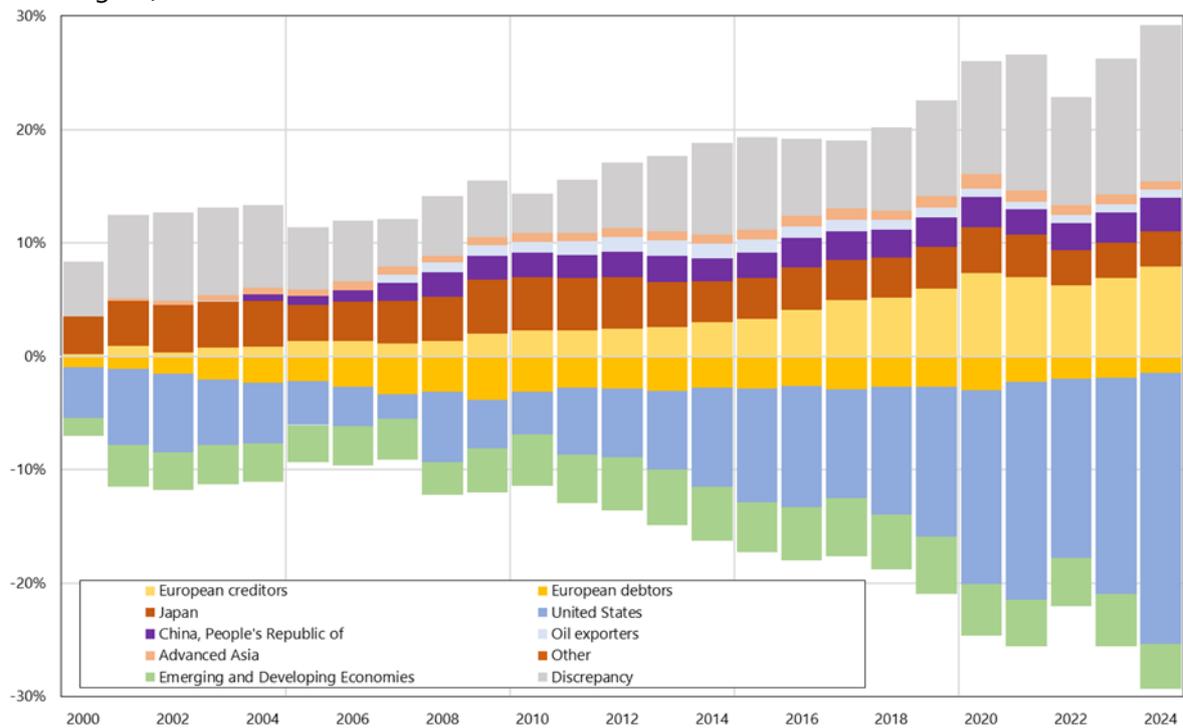
(GDP weighted share of countries where deficits or surpluses change by less than a third within three years, percent)



Source: IMF staff calculations.

Chart A2: Net international Investment Positions.

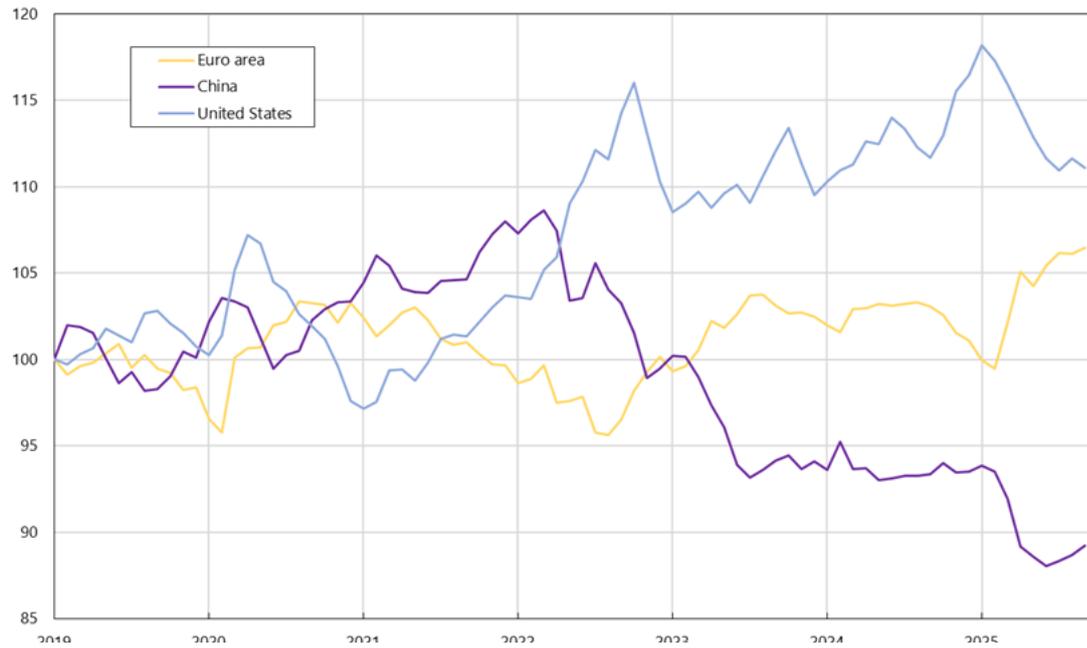
Percentage of world GDP.



Source: Balakrishnan, in: CEPR Paris Report (2026).

Chart A3 : Real Effective Exchange Rates.

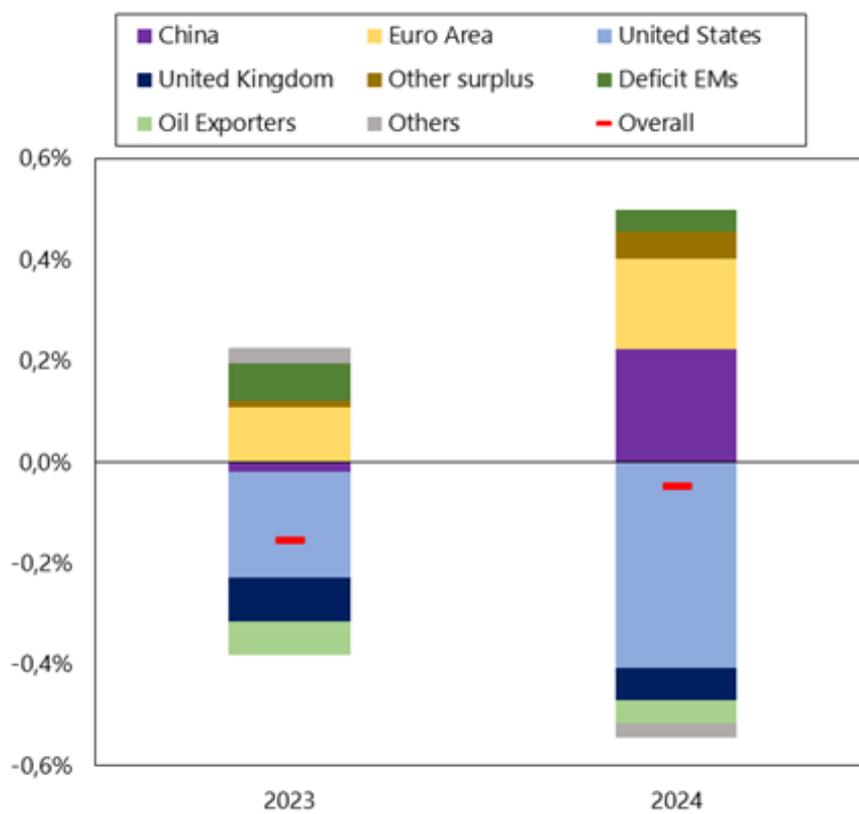
2019=100.



Source : Balakrishnan, in: CEPR Paris Report (2026).

Chart A4 : Excess Current Account Balances

Percent of ESR GDP.



Source : IMF: External Sector Report (2025).