Global Imbalances in a Post-Exorbitant Privilege World: Spillovers and Vulnerabilities

Stefan Avdjiev, Bank for International Settlements and CEPR
Kristin Forbes, MIT-Sloan School of Management, NBER and CEPR
Tsvetelina Nenova, Bank for International Settlements and CEPR
Marjorie Santos, Bank for International Settlements

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This paper analyzes the international evolution and drivers of global imbalances in order to understand the potential cross-country spillovers and vulnerabilities to specific shocks. Global imbalances have recently increased sharply, with a deterioration in the US net international investment position (NIIP) mirrored by improvements in most other major economies. We develop a framework to decompose these changes and find that the financial effects (through valuation changes and investment income) have become more important in explaining short-term fluctuations, while trade and investment income are still more important in explaining long-term shifts in the levels of imbalances. The US "exorbitant privilege" of the 2000's has reversed to be a 'generous giveaway" since 2010, providing an underappreciated wealth effect supporting global growth. Recent changes are partly driven by "valuation effects" linked to the stronger relative performance of US assets (led by US equity markets), and highlight the vulnerability of many countries to certain adjustments in financial markets. The paper closes by using this framework to simulate the direct effects and spillovers of several shocks: a repricing of US equity markets, sharp dollar depreciation, and increase in global interest rates. These scenarios highlight how certain shocks can mitigate or aggravate imbalances, and how different channels for reducing imbalances can be much more painful for individual economics and the world as a whole

EXTENDED ABSTRACT

Growing global imbalances

This paper begins by analyzing the current landscape of international investment positions and then evaluates how they have evolved between 1980 and 2024 in a sample of 28 countries (including 17 advanced economies and 11 emerging markets). Global imbalances, measured as the size and divergence in net international investment positions, have increased meaningfully since 2010 and reached historical highs by many measures, despite rising restrictions on international trade and some cross-border financial flows in many jurisdictions. The recent growth in imbalances does not reflect larger imbalances in emerging markets, although China's trade surplus and international creditor position are sizable and expected to increase sharply in 2025. Instead, the recent divergence primarily reflects the growth in imbalances in advanced economies, which in turn, primarily reflects a sharp deterioration in the US debtor position.

Decomposing the trade and financial components of imbalances

To understand these imbalances, we develop a framework that builds on the methodology in Forbes, Hjortsoe and Nenova (2017) to decompose the levels and changes in NIIPs into contributions from three main components – (i) trade flows, (ii) investment (and other) income flows, and (iii) valuation effects. This analysis demonstrates that the primary drivers of *changes* in NIIPs have evolved meaningfully over time, with an increased role of valuation effects since 2000. However, the effects of trade and income flows, both of which tend to be more persistent, are more important in explaining the *levels* of NIIP positions. Since 2010, the primary drivers of the sharp increase in global imbalances has been financial effects, including investment income flows (including international interest payments) and valuation effects (particularly for equities), albeit trade still plays a crucial role for some individual emerging markets (such as China).

Diving deeper: Decomposing the drivers of financial effects

To better understand these financial effects driving the recent increase in imbalances, and particularly the drivers of the volatile valuation effects and the more persistent investment income flows, we further develop the framework introduced above. We introduce a detailed decomposition quantifying the relative importance of "stock" effects (i.e., the initial level of each category of assets and liabilities), exchange rates (adjusted for the currency of exposures), relative returns (for each asset and liability category relative to that in other countries), and the composition of holdings (i.e., the categories of assets and liabilities). The analysis shows that relative returns are most important factor explaining valuation effects (on average across countries)—especially since 2000—although large exchange rate movements can also be important for specific countries during specific periods. Investment income flows are primarily determined by "stock effects", i.e. initial investment positions and the composition of these holdings. As the size of imbalances has grown, the impact of these "stock effects" has also grown, suggesting any future reductions in imbalances will be even more impactful (and likely more disruptive).

Individual country vulnerabilities

While the analysis documents several broad-based global shifts in the evolution and drivers of global imbalances since 1980, it also highlights important differences across economies, including different types of exposures and corresponding vulnerabilities. For instance, a detailed comparison of the evolution of the net international investment positions for the US and UK—two debtor countries that benefited from an "exorbitant privilege" in the 2000s—shows sharp changes in the evolution of these positions since 2010. The UK has continued to benefit from strong valuation gains, which have moderated the deterioration in its NIIP despite continued trade deficits. By contrast, what used to be the "exorbitant privilege" for the United States has turned into a "generous giveaway" through valuation effects, which have contributed to an even sharper deterioration in its NIIP than explained by its persistent trade deficits. The US valuation losses can be traced back to the recent outperformance of its equity market, while the UK valuation gains emerge as a result of the large depreciations of the pound following the global financial crisis of 2008/09 and in the wake of the Brexit referendum. Comparisons of major surplus economies and large emerging markets also yield important differences and vulnerabilities.

One of the most significant shifts since 2010 is that countries with exposure to US equities have had large gains and improvements in international net worth from the stronger relative performance of US markets. These valuation effects have been central to the recent divergence in global imbalances, but also provided an unappreciated wealth effect and boost to net worth around much of the world. This evolution of imbalances and centrality of financial effects in a world of larger international assets and liabilities highlights the importance of understanding these imbalances and how they could be affected by a range of potential adjustments in financial markets.

Risk Scenarios and spillovers

The paper closes by building on this analysis to assess the potential impact on countries around the world of several hypothetical events: a sharp correction in global equity markets back to 2019 levels (which reverses the substantial outperformance of US stocks), a sharp depreciation of the US dollar, and a spike in the long-run interest rates of economies with high government debt burdens. The results highlight how the increase in global imbalances has aggravated the vulnerabilities of many economies to certain types of spillovers, and that even if trade restrictions lead to a sharp reduction in trade flows, these vulnerabilities would persist. For example, any repricing of AI and tech related stocks in the United States would sharply reduce the large US debtor position and improve its sustainability, but be balanced by a meaningful deterioration in international investment positions and net worth around much of the rest of the world. The estimated effects are generally larger in advanced economies than emerging markets, but could lead to meaningful negative wealth effects in a number of economies and reduce growth.

This series of scenarios also highlights how a given reduction in global imbalances could occur through very different channels, generating significantly different spillovers to individual economies and more (or less) painful adjustments for the global economy.

Placement in Literature

Global imbalances is currently an important focus for the G-7, G-20 and IMF, with concern about imbalances driving changes in tariffs and trade policy more broadly. Although there has recently been increased attention to global imbalances in the academic literature (including excellent analysis in Atkeson et al. 2025; Bayoumi and Gagnon 2025; Chari et al. 2025; Chari and Milesi-Ferretti 2025; and Obstfeld 2024), most of this work has focused on the evolution of imbalances in the United States. This paper, as well as Milesi-Ferretti (2024a), focuses on the evolution of imbalances from a global perspective—highlighting how developments in large economies generate corresponding adjustments and spillovers in the rest of the world. For example, while research such as Atkeson et al (2025) has highlighted the impact of the relative performance of US equity markets on the US international investment position, there has been little detailed analysis of the corresponding impact on other economies and relationship to monetary policy—including through potential spillovers of an adjustment in US equity markets through international investment positions and net worth. The detailed scenario analysis of the impact of different types of shocks, ion countries around the world is only possible with the type of detailed decomposition provided in this paper of the individual drivers of changes in global imbalances that isolates the role of financial effects

Final note: A draft of this paper is nearly complete. We are happy to provide a copy for the organizers to review—but it has not been cleared yet and is not available for broader circulation.