

Balancing China's Current Account Surplus: Policy Choices and Impacts

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(Includes preliminary projections; Not for quotation or circulation; Comments welcome)



Structure of presentation

- Current account imbalances in period of growth
- Persistently high saving rate in China, causes and impediments to growth
- Longer-run policy scenarios for saving and investment
- Longer-run modelling environment
- Key results
- Policy implications



Current account imbalances in periods of growth not unusual

- Value adding output can increase ahead of consumption in periods of rapid growth creating a CA surplus
- For example – Japan in the 1960s and 1970s; the United Kingdom in the 19th Century; the United States post World War II; Germany, consistently in surplus, but peaking at 9% of GDP in 2016
- Several policy strategies – foreign investment, aid, consumption
- Typically, domestic consumption-saving/investment choices adjust and CABs converge towards country-specific rates within global norms
- China's saving rate currently remains above historical average and levels observed for other major economies, CAB in surplus



Persistently high saving rate in China, causes and impediments to growth

- China's growth has been shaped by high domestic saving, extraordinary capital growth and export demand
- There are concerns over declining returns, overcapacity, external volatility
- Leading to a 'dual circulation' strategy aimed at reducing dependence on external demand through expansion of domestic demand – focused on raising household consumption, lowering saving
- Confounding factors impeding growth: low household consumption; income inequality; demographic change; large share of national income accruing to the corporate sector; curtailed government revenue growth; erosion of efficient investment



There is considerable doubt as to how the saving rate may evolve

- Possibilities
 - China converges to international norms for saving and investment
 - China maintains a high saving rate for foreseeable future matched by higher investment
 - Each while maintaining CAB to GDP within international norms
- There are warnings that just to raise investment to absorb saving could exasperate resource misallocation and public debt risk
- However, there is also evidence to suggest scope for domestic product and financial market reform to:
 - Improve the desirability of China as an investment destination (for local and foreign investors) and to avoid capital flight
 - Improve the ease of doing business in China and financial market efficiency



Longer-run policy-scenario approach adopted to consider the economic implications of possibilities

- Central tenet – CAB to conform to international norms
 - CAB to converge to around 2 percent of GDP – historical average (rounded) over period 1980 to 2019
- Longer-run Gross saving as a percent of GDP uncertain but could tend towards one of three scenarios
 - Lower case 27% - around average of pre-reform era 1965 to 1977
 - Medium case 33% - average over the early 1980s
 - Higher case 38% - close to average over the period 1980 to 2019
- Longer-run Gross investment to GDP conforms to saving rate scenario *less* conjectured CAB to GDP to give: 25%, 31% and 36%



Scenarios in the context of baseline assumptions

Longer-run Gross saving and Gross investment to GDP scenarios, China

Gross saving to GDP				Gross investment to GDP			
Policy scenario				Policy scenario			
Baseline	1 Lower	2 Medium	3 Higher	Baseline ^a	1 Lower	2 Medium	3 Higher
%	%	%	%	%	%	%	%
27.0	27.0	33.0	38.0	24.9	25.0	31.0	36.0

a. Baseline model longer-run target value for Gross investment to GDP based Baseline Gross saving to GDP and target CAB to GDP (unrounded).

Source: Gretton (2021b); Author conjectures.



Economic modelling environment

- Dynamic approach adopted – Compares growth path for economy with and without policy
- Time horizon for policy simulations – 2028 to 2070
- GDyn-FS model used – a multi-region, multi-sector *dynamic* global general equilibrium model in GTAP family
- China a separate region – trades and invests with 5 other regions (Australia, Japan, USA, EU28 and ROW)
- Some novel features of the model – (i) projects a stable long-run base line; (ii) includes a rate of return rule for the allocation of saving between regions; and (iii) relaxes the assumption of fixed shares for consumption-saving choice
- Model applied in a variety of relevant applications

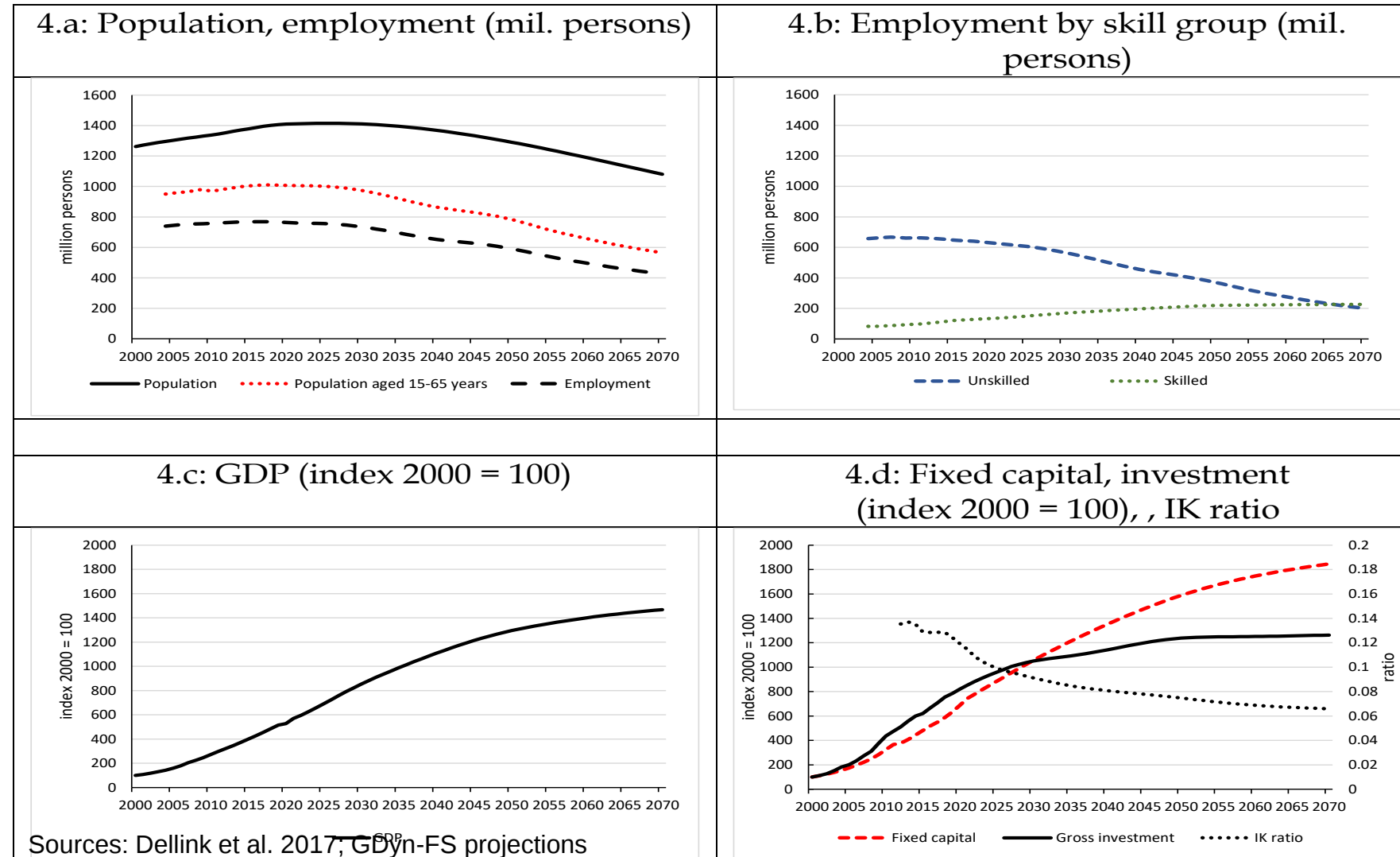


Modelling approach to longer-run scenario analysis

- Adopt a dynamic partial adjustment mechanism to bring structural ratios towards 'target' values given by: $RG_{R_r} = \left(\frac{RTARG_r}{R_r} \right)^{\lambda_r}$
- Parameterised to close half the gap between target and actual values over about 7 years
- Target CAB as a share of GDP where $CAB/GDP = S/GDP - I/GDP$
 - By changing the consumption/saving mix in income to achieve a policy target for S/GDP
 - By varying the desirability of investing in a region to achieve a policy target for I/GDP



Simulation baseline referenced to OECD SSP2 (moderate global growth) scenario

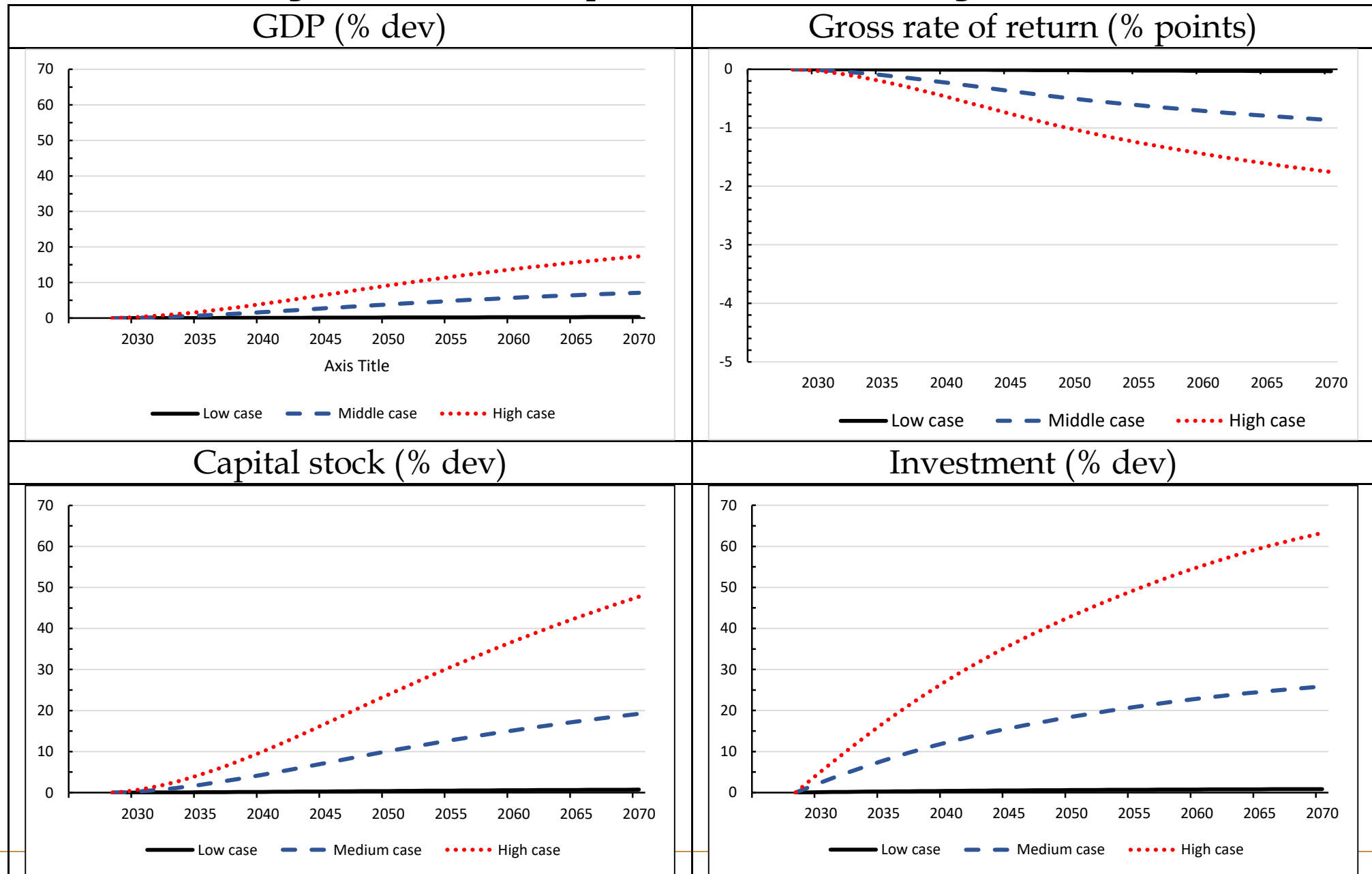


Policy deviations from the baseline, key activity indicators, after 40 years (2070)

		After 40 years (at 2070)		
		Low	Medium	Higher
GDP	%	0.300	10.199	18.854
Capital	%	0.684	26.818	52.191
BoT to GDP	% points	-0.001	0.001	0.003
CAB to GDP	% points	-0.001	0.004	0.008
Real income – unskilled labour	%	0.267	10.617	19.797
Real income – skilled labour	%	0.272	5.716	9.675
Real consumption				
Private	%	0.313	2.094	1.822
Government	%	0.209	-0.120	-1.780
Trade				
Export volumes	%	-0.158	12.801	24.791
Imports volumes	%	0.458	10.051	18.746
Terms of trade	%	0.022	-2.274	-4.170



Dynamic adjustment paths for key indicators

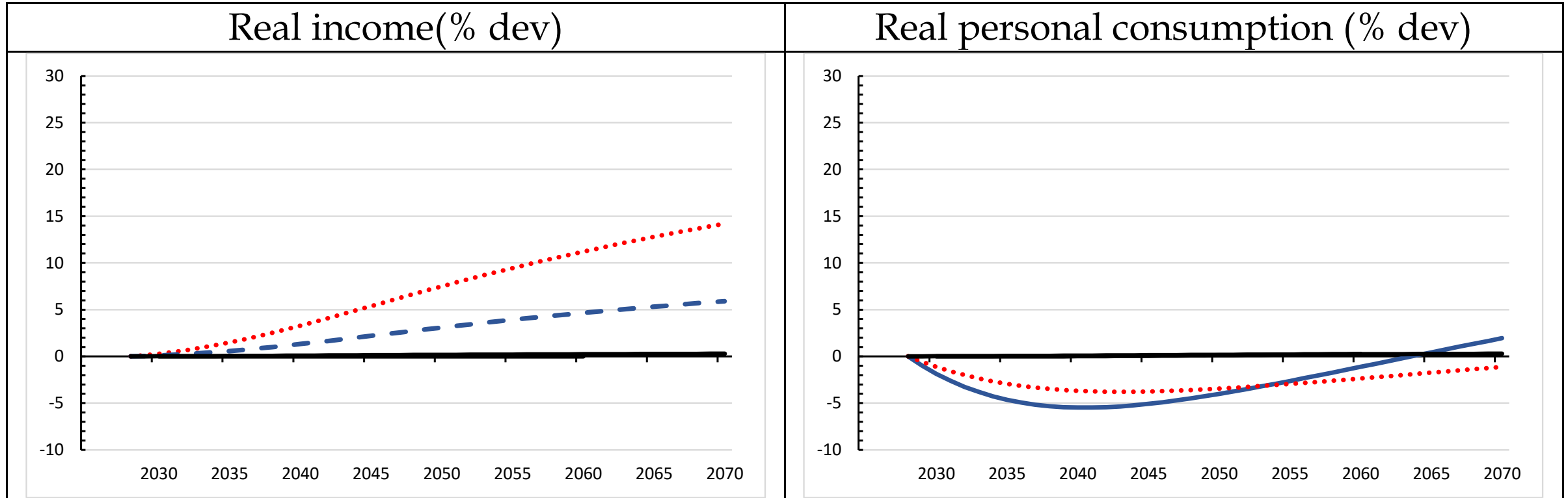


Source: GDyn-FS projections

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What the paths mean for real income and personal consumption



Source: GDyn-FS projections



Some policy implications

- Two broad pathways are available for maintaining current account balance as a proportion of GDP within accepted norms
 - Increase domestic consumption by lowering the national saving rate
 - Increase domestic investment to absorb available saving
- Both require difficult policies choices
 - On the consumption-saving mix, lower bound saving rates prevailed when China had a strong social service and welfare system – a modern version of that system may lead the economy to a lower saving-higher consumption regime; short-run consumption incentives do not seem to be very effective
 - On a higher saving-higher investment regime, there is evidence that further financial market development and improvements in the desirability of investing in China are possible



THANK YOU

