United States and Euro Area External Adjustment: The Role of Commodity Prices and Emerging Market Shocks

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► **TRADE BALANCEs (TB)** of US and Euro Area (EA) improved after Global Financial Crisis

► Widely viewed as reflecting weak domestic aggregate demand & deleveraging

► This paper challenges conventional view

► Paper highlights key role of post-crisis commodity price collapse for EA and US trade balance reversals

► Aggregate demand shocks in Rest of World (RoW) too mattered for EA & US TB.

► Findings consistent with pre-crisis RoW saving glut (Bernanke) effect on US **and** EA TB

► Broader lesson: Emerging Markets and commodity shocks are major drivers of Advanced Countries' TBs & terms of trade

►Model captures other key changes in world economy since 2000:
● Growth acceleration in Emerging Economies
● Boom-bust cycle in Euro Area (EA) & US
● Enormous fluctuations in commodity price

►**Methodological contribution**: Bayesian estimation of three-region (EA, US, RoW) DSGE model with trade in manufactured goods and commodities. Commodity price reflects global demand and supply conditions. Sample: 1999-2017.
66 structural shocks; 60 observables for estimation
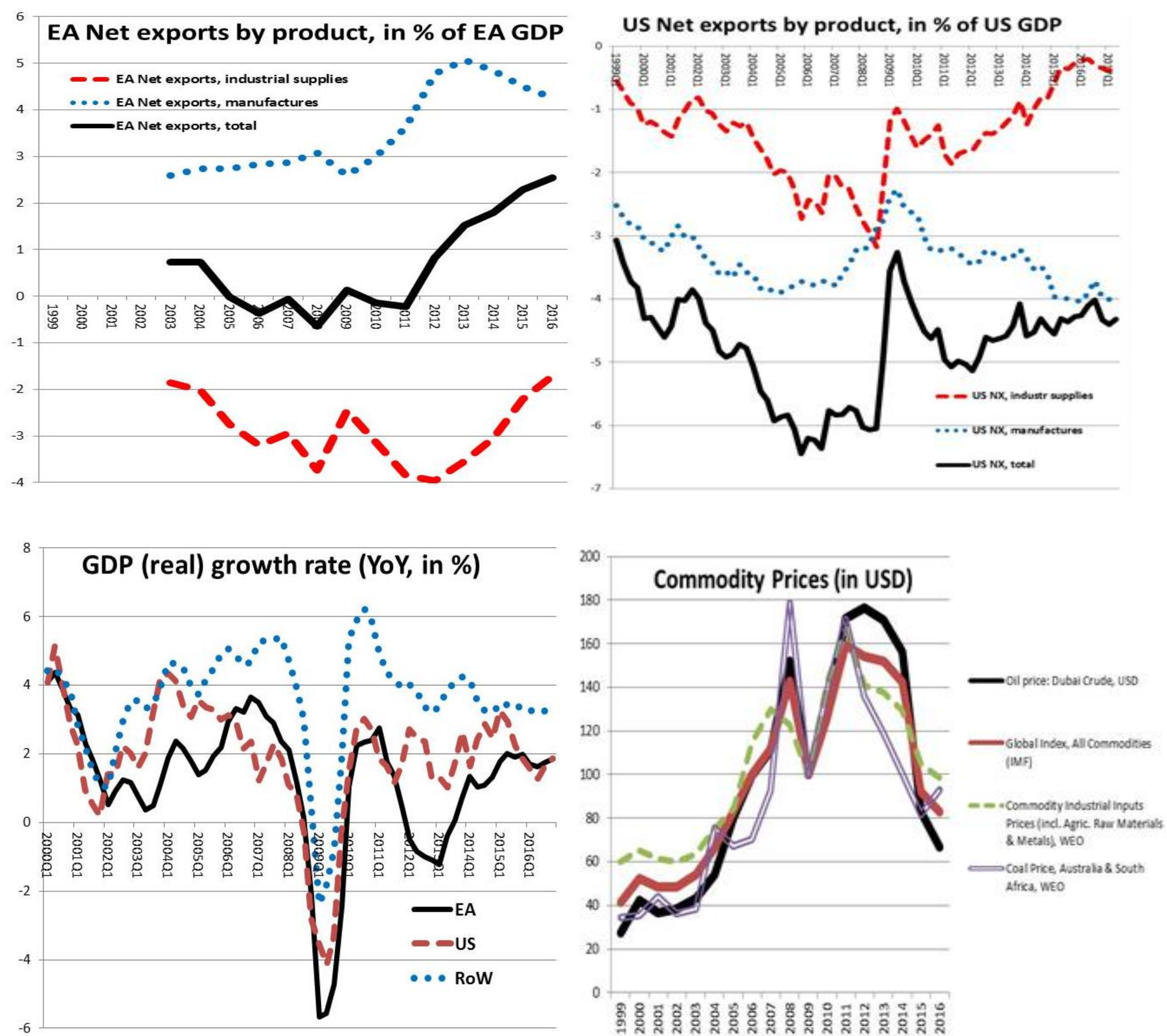
Historical shock decompositions (based on estimated model):

(a) Euro Area trade balance/GDP

(b) US trade balance/GDP
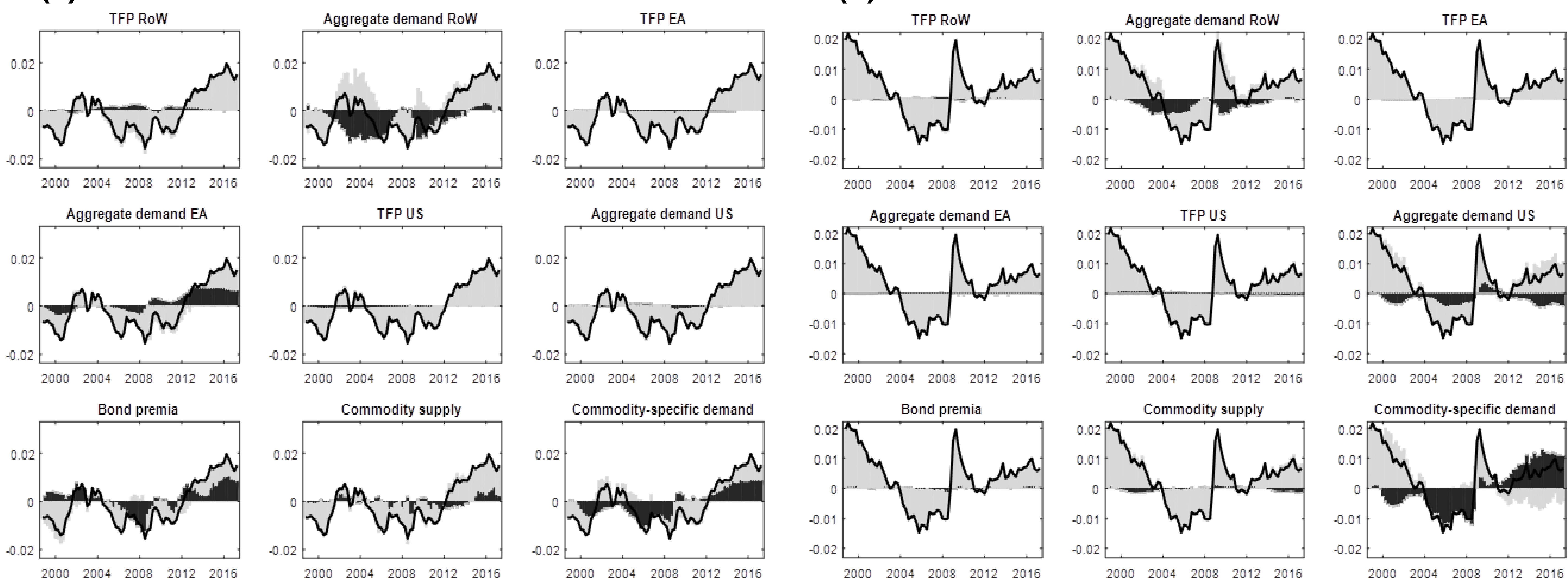
Continuous line: historical series (demeaned). Black areas show contributions of different shocks.
Areas above (below) dashed horizontal line show positive (negative) contributions