Preliminary data show the U.S. current account deficit running at a $142 billion annual rate in 1996:IQ. The current account includes trade in goods and services, net investment income, and unilateral transfers. Most economists expect this year's current account deficit to exceed last year's $148 billion posting somewhat.

A country running a current account deficit is applying more of the world's output to its own consumption and investments than it is producing. To finance its imports, the U.S. must export financial assets—claims on our nation's future production—and a net inflow of foreign capital must occur. Any tendency for the foreign capital inflow not to match the current account deficit will initiate changes in interest rates, exchange rates, and other economic variables to restore balance. Interestingly, a net private capital outflow accompanied the 1996:IQ current account deficit. The requisite net capital inflow came when foreign governments added $206.5 billion (annual rate) to their official holdings. Often, foreign governments will make such a move to avoid adjustments in the exchange rate.

A country's ability to service future foreign claims on its output without a decline in its standard of living depends on whether it uses foreign capital to finance consumption or investment. Apparently, recent net foreign-capital inflows have supported U.S. investment.