Over the first three quarters of 1996, the U.S. current account deficit grew at a $123 billion annual rate, somewhat slower than in the previous two years. Official and private capital inflows of $96 billion and $27 billion, respectively, have financed this deficit. Since 1991, net official capital inflows have accounted for a growing share of our tap on the world’s savings, as foreign governments and official agencies have acquired dollar-denominated assets.

Separate data on countries’ holdings of international reserves show that Japan and China have greatly increased their portfolios. Although these data include assets denominated in other currencies, much of the increase probably represents dollars, since both countries maintain trade surpluses with the U.S.

Countries’ current and capital account balances must exactly offset each other. Changes in economic variables, primarily exchange rates, interest rates, and prices, automatically correct any divergence between the two accounts. International reserves, however, can provide countries with a bit of a buffer against sharp adjustments. When a surplus country (like Japan) acquires dollars, its money stock grows, other things being equal. An unexpected monetary expansion can check a currency appreciation, but because it also promotes inflation, monetary ease cannot indefinitely secure a current account surplus.