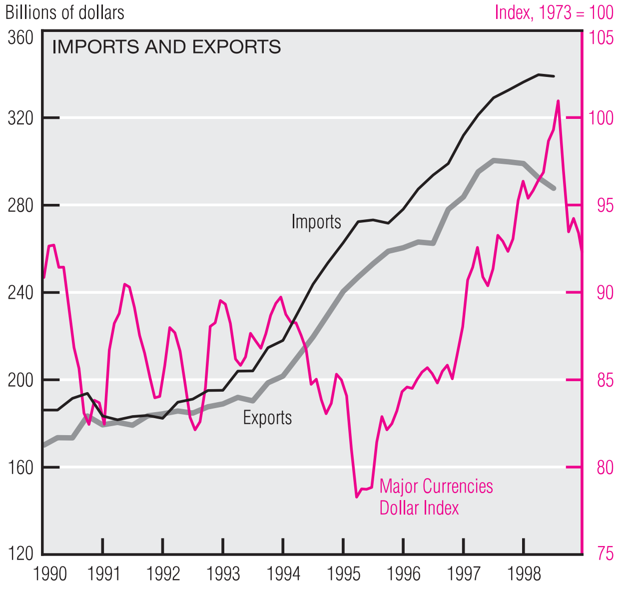
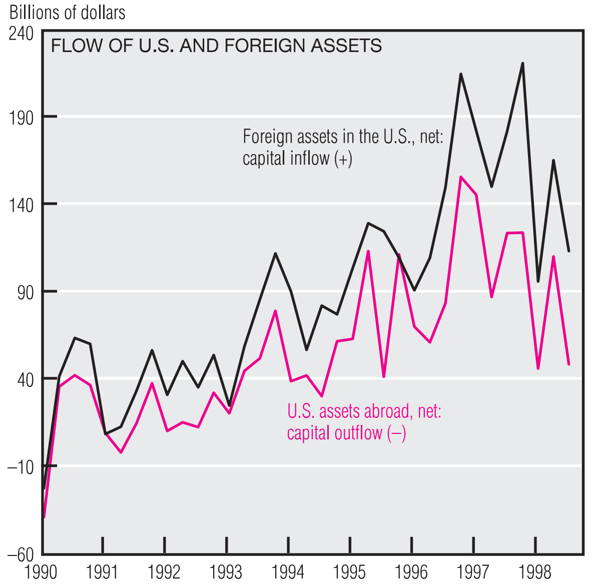
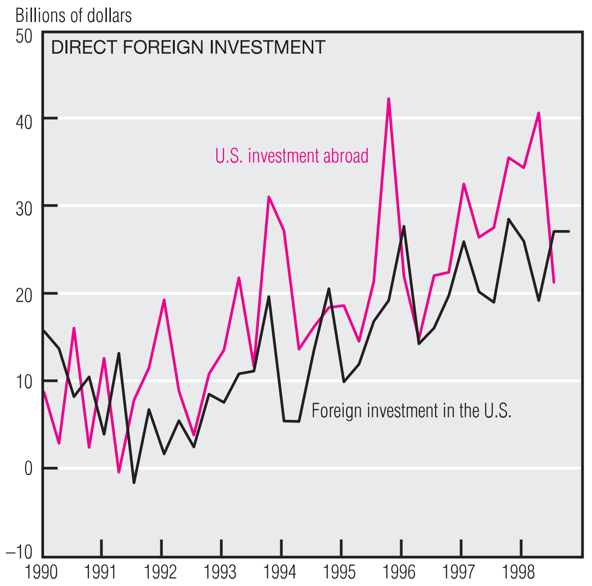
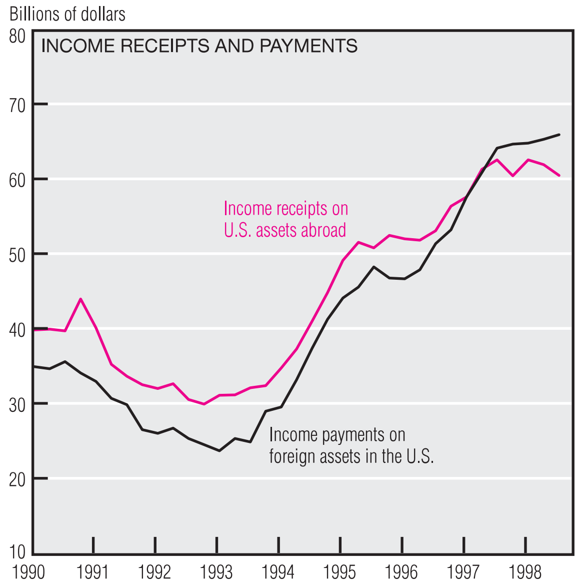
Trade Deficits









SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System

Increased concerns about the widening U.S. trade deficit can be understood by examining the 1998:IIIQ data on international transactions from different perspectives. The increased gap between imports and exports of goods, services, and income may reflect a relative increase in the disposable income of U.S. citizens, or an increased attractiveness of investing in the U.S. On the other hand, it could be seen as the U.S. economy's increased vulnerability to withdrawals of foreign funds.

Net capital inflow, the increase in foreign holdings in the U.S., continues to exceed net capital outflow. However, the accounting requirement that a current-account deficit must be balanced by capital flow does not mean that the current-account deficit *causes* the capital flow—the sequence could be reversed. The form taken by the inflow might be important in this regard. Direct foreign investment (DFI) in the U.S., which involves ownership control rather than portfolio design, now exceeds U.S. DFI abroad. Fluctuations in DFI have been much more moderate than those shown by other components of capital flow, suggesting that at least part of the increased net capital inflow will not quickly reverse direction.

A country relying on capital inflow may see it turn to outflow unless the capital is invested wisely. In addition, since the services provided by capital imply payments to the lenders, a long period of net capital inflow might lead to an increase in the burden of such payments. The most recent data show an increase in the excess of payments on foreign assets in the U.S. over income receipts on U.S. assets abroad. However, the debt burden facing the U.S. does not approach the levels typically found in countries that subsequently experience significant net capital outflow.