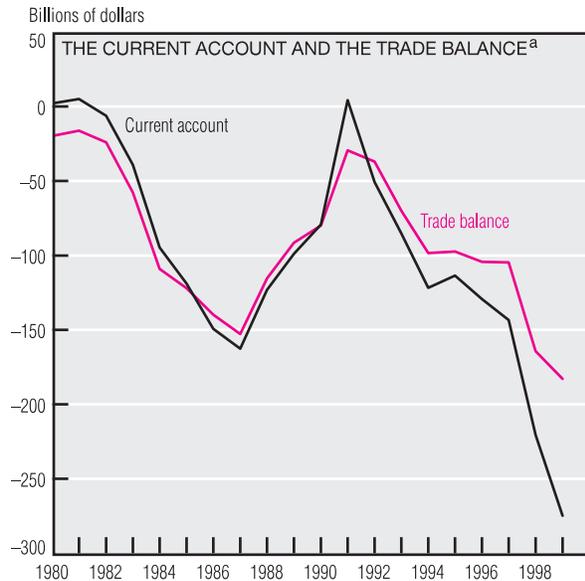
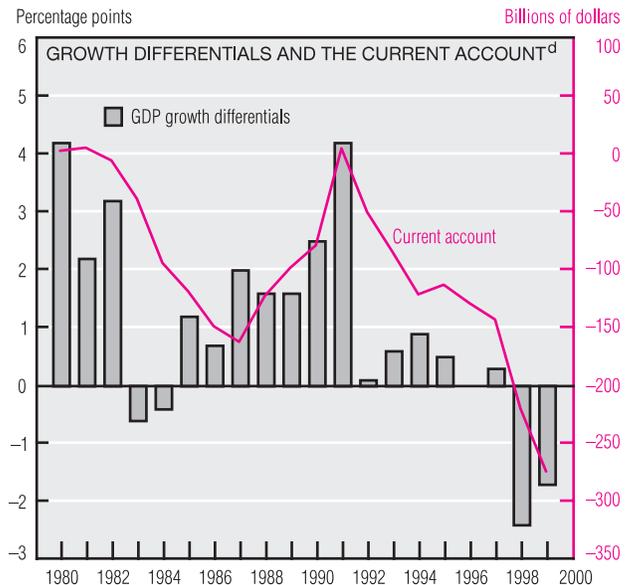
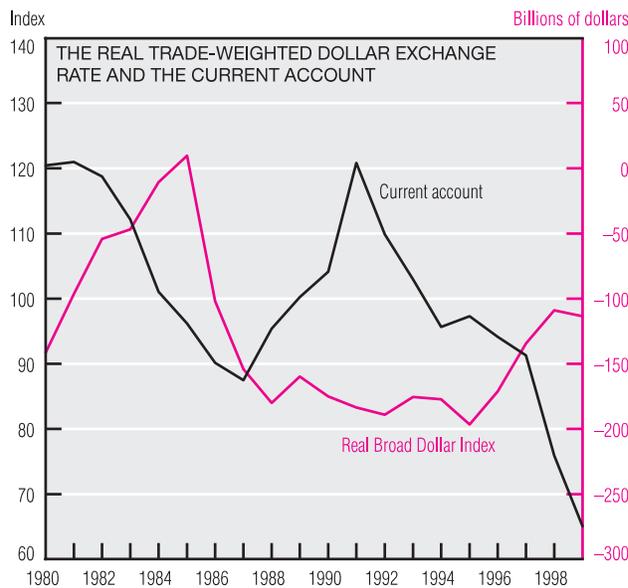


Current-Account Developments



U.S. International Transactions (Billions of dollars)^b

	Seasonally adjusted annual rate	
	1998	1999:1Q ^{b,c}
Current-account balance	-220.6	-274.4
Goods and services	-164.3	-215.2
Income	-12.2	-18.8
Unilateral transfers	-44.1	-40.4
Capital-account balance	210.5	336.4
Official	-28.9	51.2
Direct investment	60.6	} 285.2
Portfolio investment	178.8	
Statistical discrepancy	10.1	-62.0



a. Includes 1991:1Q at annual rate.

b. Seasonally adjusted annual rates.

c. Preliminary breakdown of data on direct and portfolio investment is unavailable.

d. The growth differential equals the trade-weighted average growth rate for the top 15 U.S. trading partners in 1992-97 minus the U.S. growth rate. Projections for 1999-2000 utilize various sources.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; International Monetary Fund, *International Financial Statistics*; Organisation for Economic Co-operation and Development, *World Economic Outlook*; *Blue Chip Economic Indicators*, August 1999; and DRI/McGraw-Hill.

The U.S. current-account deficit, which expanded sharply in 1999:1Q, is likely to reach \$310 billion by year's end. Since 1997, our trade shortfall has increased dramatically as foreign economic growth slowed in the wake of worldwide financial crises. Now, however, the worst has passed, and the enormous differential between U.S. and foreign rates of economic growth seems likely to disappear by 2000.

In addition, the dollar has begun to depreciate over the past year, reversing its previous 3½-year trend.

Movements in dollar exchange rates help ensure that an inflow of foreign capital always accompanies a current-account deficit, and offer important insights into the underlying causal events. The dollar, for example, appreciates as the current-account deficit expands, when an inflow of foreign capital initiates events. As foreign investors place their funds in dollar assets, they bid up the dollar's foreign currency price. This adversely affects the trade balance. Between 1995 and 1998, inflows of foreign capital—often flee-

ing turmoil in global financial markets—widened our current-account deficit. The dollar, however, depreciates as the current-account deficit grows, when expanding aggregate demand in the U.S. pulls in imports. As consumers buy foreign goods, they depress the dollar. This, however, entices foreign capital inflows by improving the return on dollar-denominated assets in the U.S. The dollar's recent shift in direction implies a change in the underlying nature of our current-account deficit.