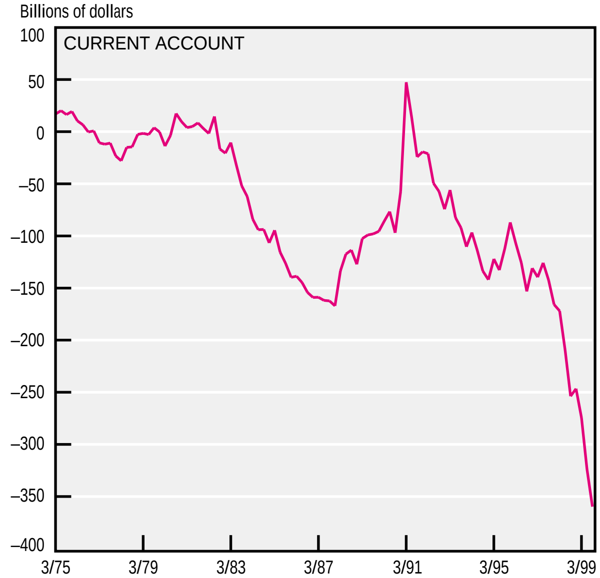
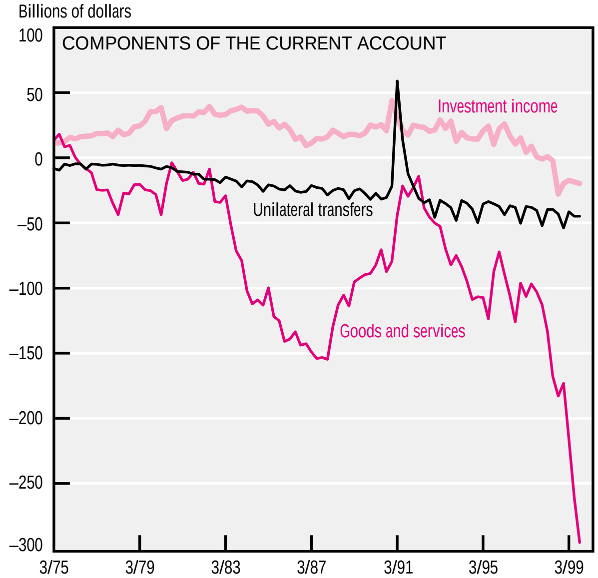
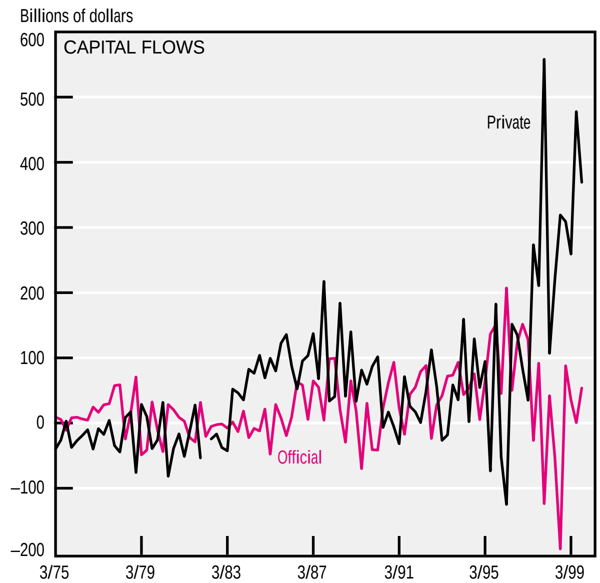
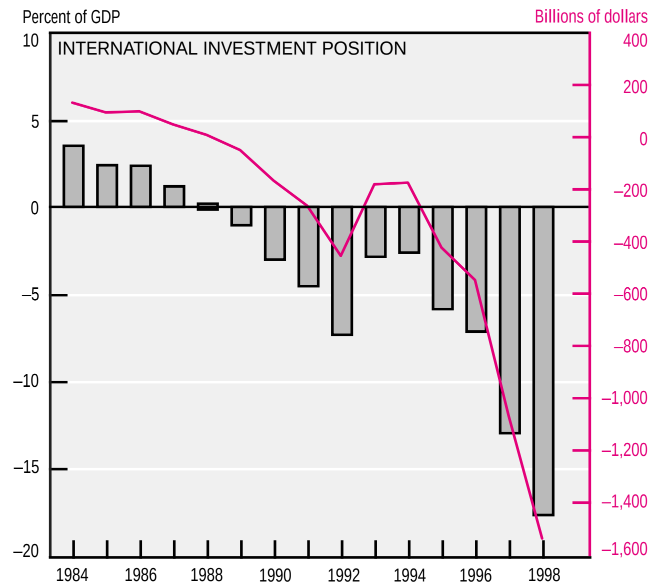
The Current-Account Deficit









SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

The U.S. current-account deficit has increased sharply since 1997 and is likely to top $360 billion (approximately 3.5% of GDP) when final data for 1999 become available. Most economists expect the deficit to rise further this year and next.

For the most part, the deficit in the U.S. current account moves in tandem with the deficit in our country's goods and services trade, but a growing shortfall in our net investment income could quickly become another important element. This shortfall results from the financing of trade deficits.

The U.S. has been importing more than it exports and has been paying for the surfeit by issuing securities, such as bonds and stocks, that give foreigners a claim on our future income. The process requires an inflow of foreign capital to the U.S. Since 1997, private—rather than official—capital inflows have risen dramatically. In 1988, foreign claims on the U.S. exceeded this country's claims on foreigners, making ours a debtor country. By the end of 1998, our international indebtedness totaled $1.5 trillion (17.5% of GDP).

As our indebtedness grew, so did our interest and dividend payments to foreigners. By 1997, they exceeded U.S. earnings from foreign investments, creating a shortfall in the investment-income component of

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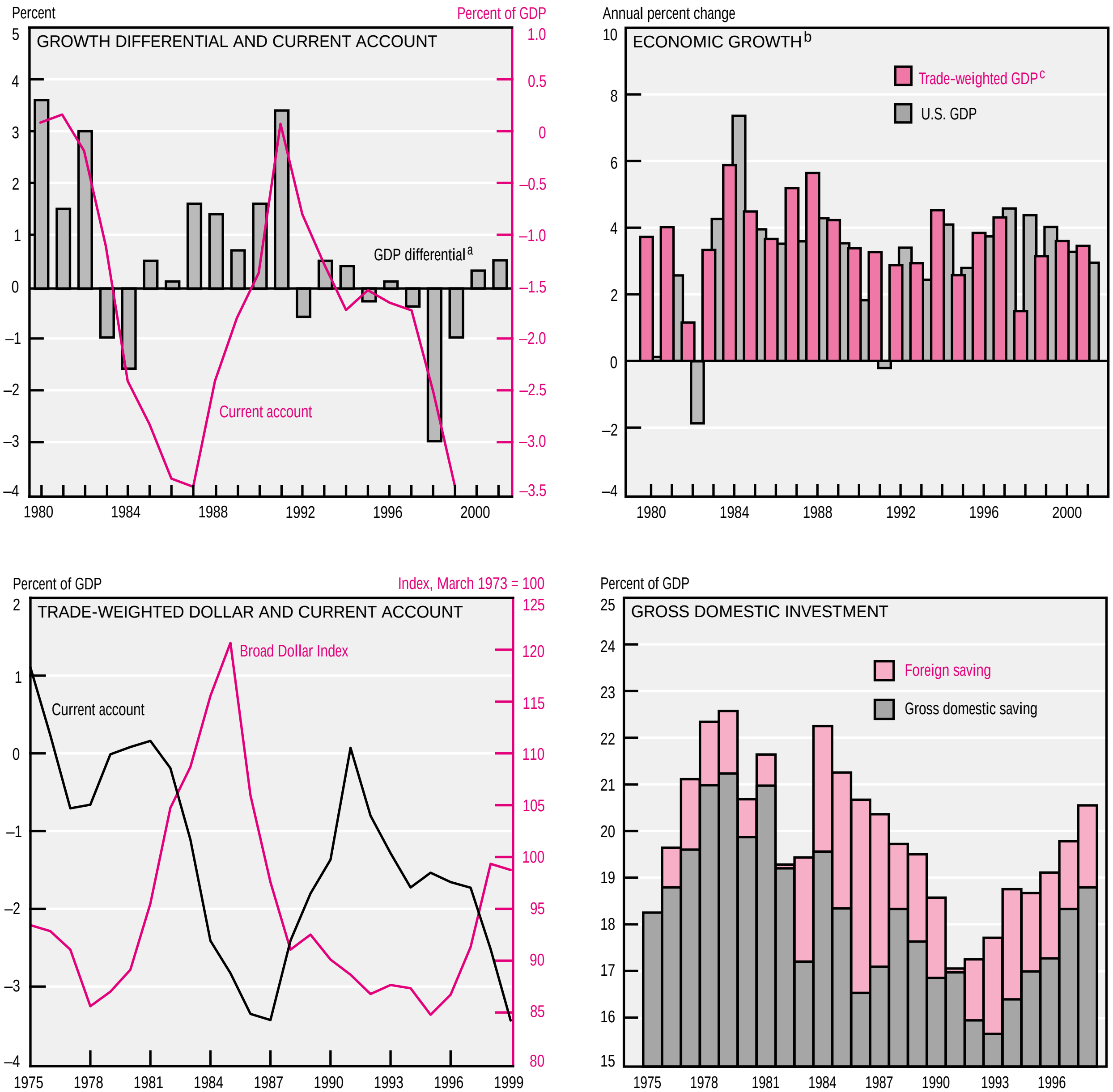
The Current-Account Deficit (cont.)



a. The GDP differential equals the difference between foreign and U.S. GDP growth.
b. Projections for 1999–2001 utilize various sources.
c. The top 15 U.S. trading partners in 1992–97 were Canada, Japan, Mexico, Germany, U.K., China, Taiwan, Korea, France, Singapore, Italy, Hong Kong, Malaysia, Netherlands, and Brazil.
d. Gross domestic investment is the sum of gross domestic saving and foreign saving.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; International Monetary Fund, *International Financial Statistics; Blue Chip Economic Indicators,* January 10, 2000; and *The Economist,* January 21–27, 2000.

the current account. If interest payments on our foreign indebtedness were to exceed GDP growth, our international indebtedness would grow even if the trade deficit vanished.

Prospects for narrowing the trade deficit depend, in large measure, on our major trading partners' prospects for economic growth. Economists expect foreign economic growth, at approximately 3.5%, to outpace U.S. growth next year. Although rapid foreign economic growth favors U.S. export expansion, the small differential will have little effect on the current-account deficit overall. Typically, foreign economic growth must exceed U.S. growth by 1½ to 2 percentage points before the trade deficit begins to narrow. There is no such growth differential in the immediate outlook.

Most people consider the current-account deficit detrimental to economic welfare, but they fail to appreciate the benefits of the associated foreign-capital inflow. Since the early 1990s, the inflow of foreign capital to the U.S. has helped finance an investment boom, with interest rates below what they otherwise might have been. The ratio of investment to GDP has risen from 17.5% to 20.3%. To the extent that this investment increase supports a higher standard of living, the U.S. will be able to service its international debts without reducing consumption.