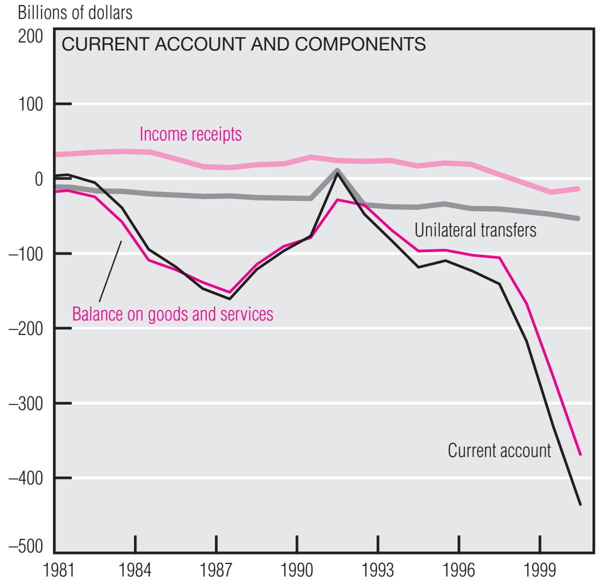
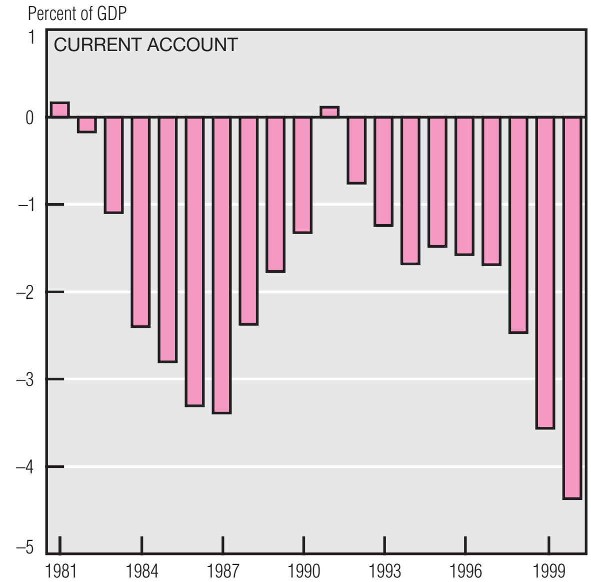
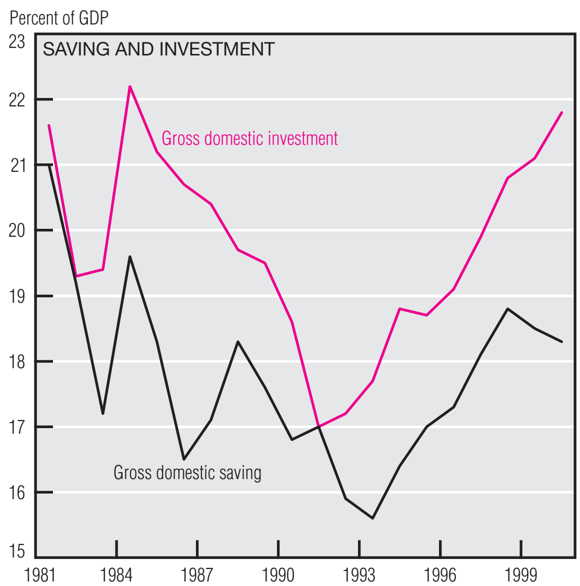
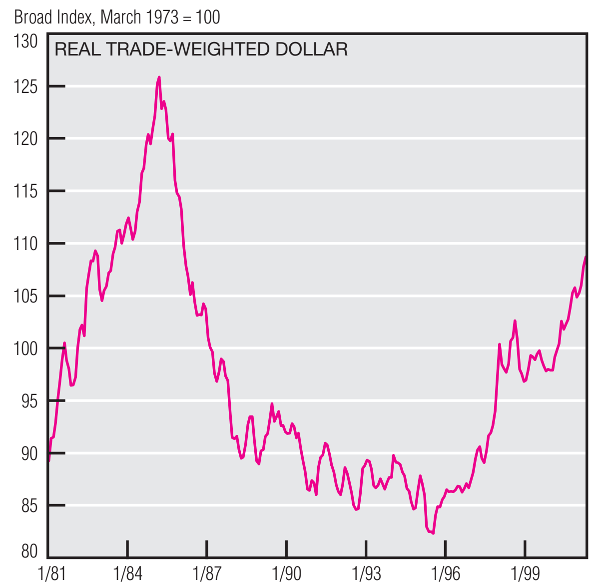
Saving, Investment, and International Financial Flows









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

The necessary counterpart to our enormous current account deficit is an inflow of foreign savings. Over the past decade, our current account deficit has generally reflected strong U.S. investment opportunities rather than American consumers' profligacy.

Each year since 1991, more financial funds have flowed into the U.S. than out of it. This net inflow of foreign funds has helped to finance U.S. investments at far higher levels than domestic savings alone could have supported. Since 1991, gross domestic investment in the U.S. has risen from 17% of GDP to 21.8%. Over the same period, gross domestic saving has increased to 18.3% of GDP.

To invest in this country, foreigners must first acquire dollars—a process that bids up the dollar's foreign-exchange price. Since 1996, the dollar has appreciated 25.6% on a real trade-weighted basis. The dollar's appreciation, however, raises the foreign currency price of U.S. exports and lowers the dollar price of foreign goods and services. The current account deficit expands until it exactly matches the dollar value of our country's net inflow of foreign funds. An expanding current account deficit, together with an appreciating dollar, indicates that our international accounts are driven by investment inflows, not consumption spending.