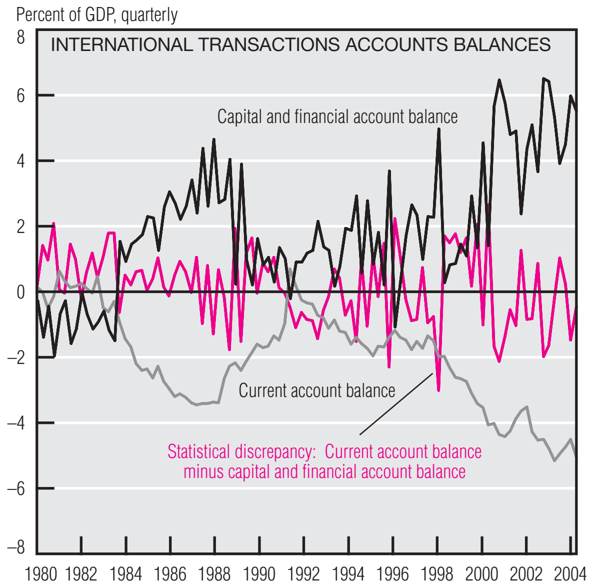
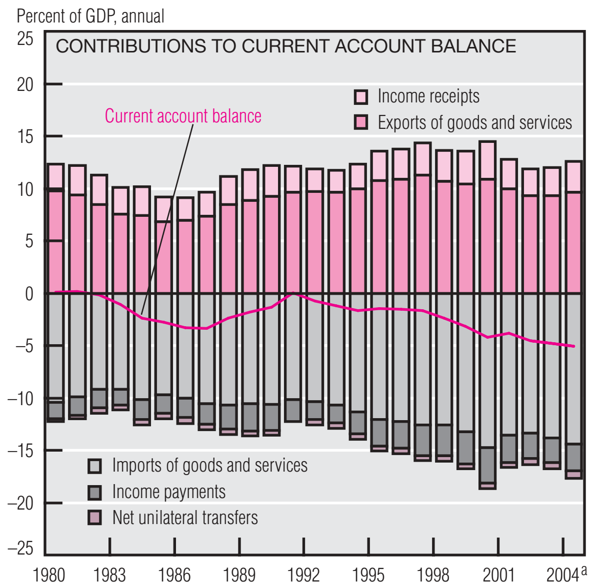
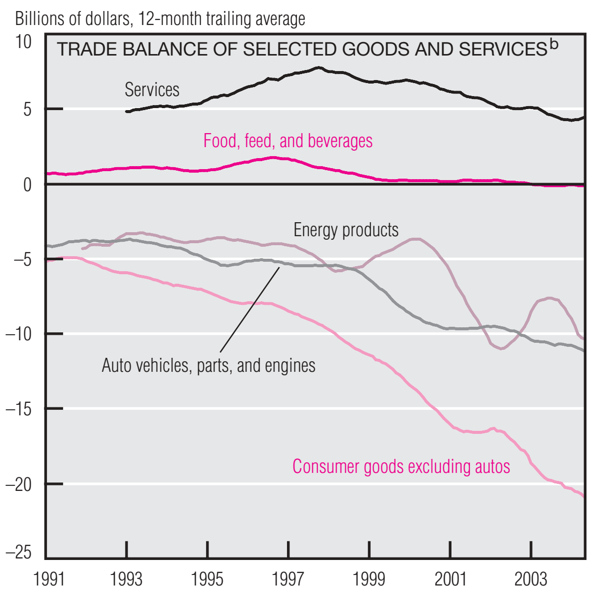
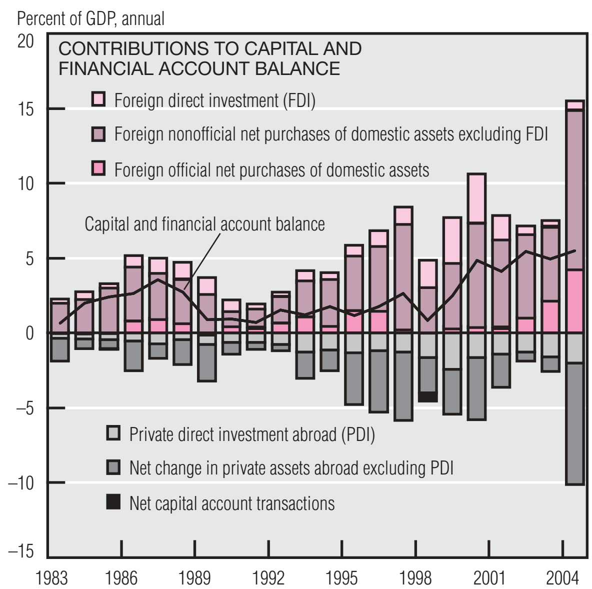
International Trade and Transactions









a. Data for 2004:IQ only. Annualized.
b. Measured on a balance-of-payments basis.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census.

The current account deficit has been increasing for the past 12 years. In 2004:IQ, the current account deficit fell to 5.1% of GDP. (The current account balance is defined as exports less imports, income receipts on domestically owned assets abroad less income payments on foreign owned assets in the U.S., and net unilateral transfers, comprising gifts received less gifts bestowed.) As usual, the trade deficit in goods and services has been the chief cause of the declining current account balance.

Trade balances differ significantly across different sectors of the economy. The trade balance in services has consistently been in surplus since 1992. On the other hand, trade in consumer goods, automotive goods, and energy products has been running larger and larger deficits.

The combined surplus in the capital and financial accounts must equal the current account deficit, but because of measurement error, the two are not always equal. Since capital account transactions are relatively small, the financial account balance is nearly equal to the current account deficit.

Flows within different categories of the financial account can be markedly uneven over time. For example, foreign direct investment (investment in a domestic firm that has a significant ownership stake by a foreign holder) declined significantly between 2000 and 2003, while foreign official net purchases of domestic assets (particularly government securities) increased significantly.

The current account deficit represents foreign claims on future output. That is, foreign investment must make up the difference between domestic

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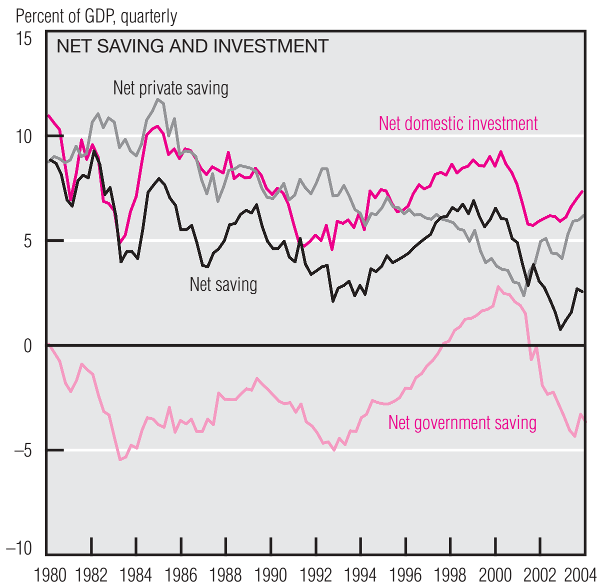

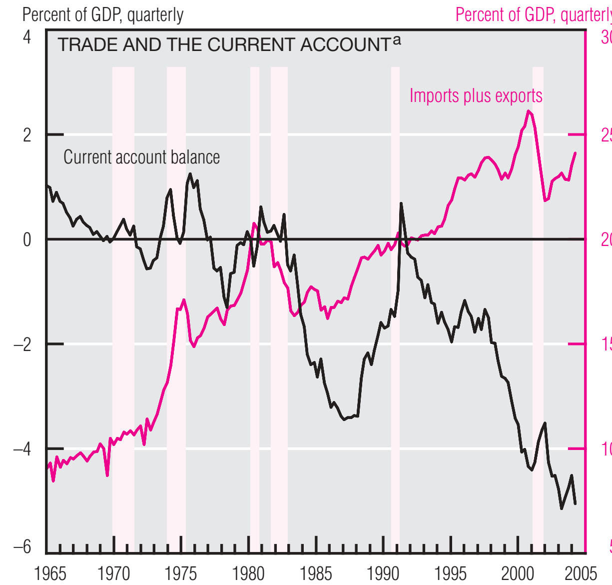

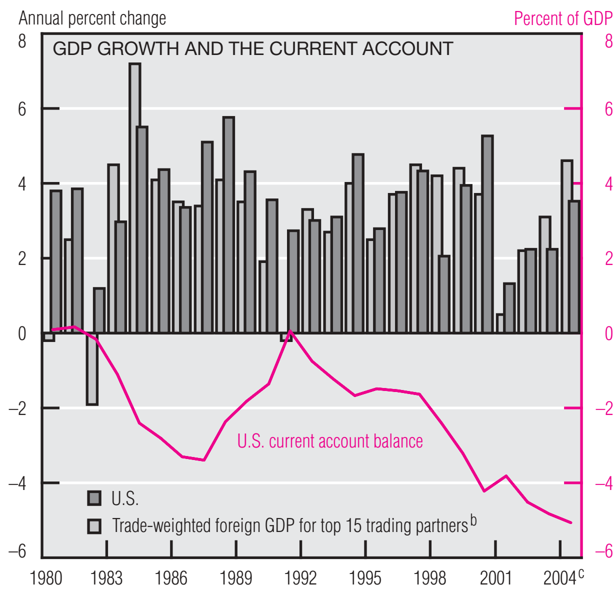

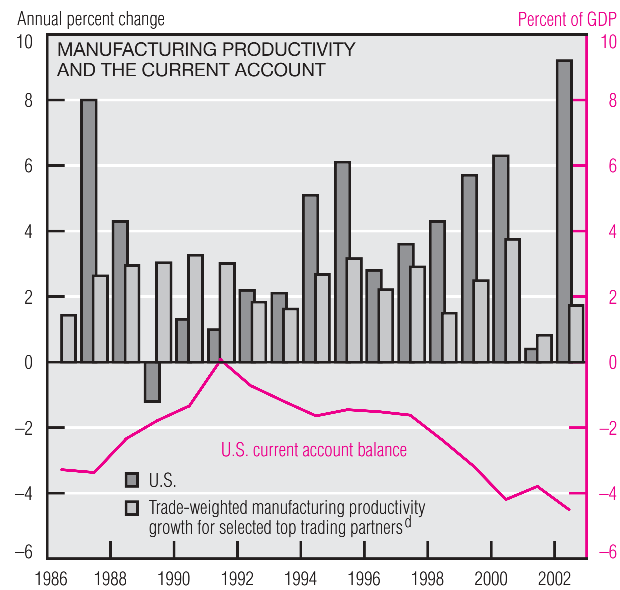

a. Shaded areas indicate recessions as dated by the National Bureau of Economic Research.
b. Includes Brazil, Canada, China, France, Germany, Hong Kong, Italy, Japan, Korea, Malaysia, Mexico, the Netherlands, Singapore, Taiwan, and the U.K.
c. Current account data for first quarter only. GDP data based on International Monetary Fund forecast.
d. Includes Canada, France, Germany, Italy, Japan, Korea, the Netherlands, Taiwan, and the U.K.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; International Monetary Fund, *World Economic Outlook 2004*, and National Bureau of Economic Research.

investment and domestic saving. The investment boom of the 1990s was financed primarily by foreign investment as private savings declined. In recent years, foreign investment seems to have increased in order to fund a growing budget deficit.

Because of freer flows of goods, services, and assets across countries, imports and exports have been a growing part of the economy over time. This may also have contributed to the larger U.S. current account deficits. During recent recessions, the move toward larger imports and exports has either moderated or reversed itself temporarily. The current account deficit also temporarily decreased in the years following these slowdowns. Differences in foreign and domestic demand contribute to this phenomenon. For a two-year period after both the 1982 and the 2001 slowdown in world economic growth, U.S. growth outpaced foreign growth. The current account balance fell in each of these two-year post-recession periods as domestic demand recovered more quickly than foreign demand. When U.S. growth outstrips foreign growth, the proportion of world goods and services consumed by the U.S. increases.

The exceptional growth of the nation's productivity during the latter half of the 1990s may have played a large role in the rising current account deficit during that period. Higher productivity growth in the U.S. economy than abroad favors both foreign and domestic investment in the U.S. economy, causing the financial account deficit to increase. This, in turn, produces an increase in the current account deficit.