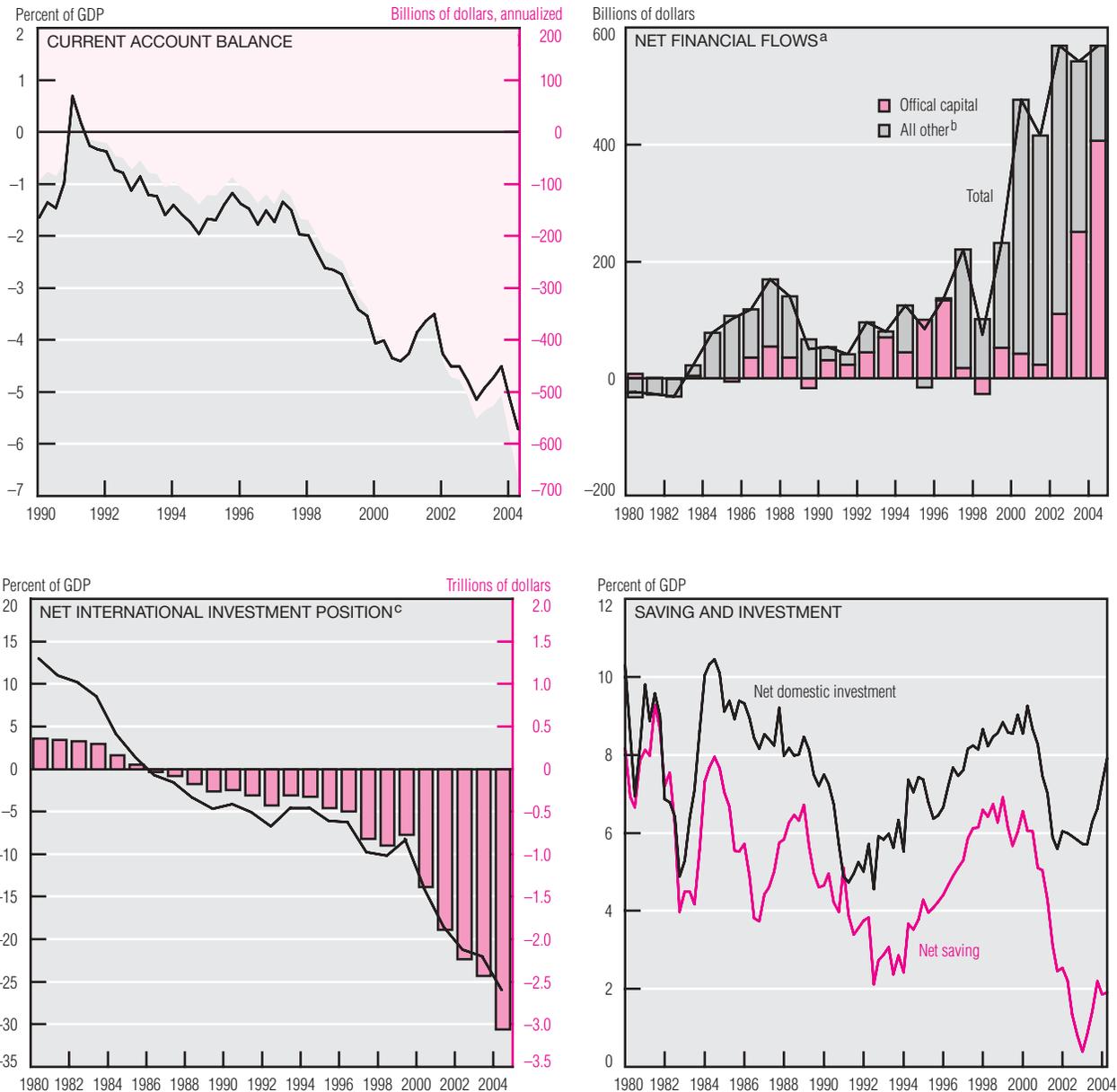


# The U.S. Current Account Deficit



a. Includes capital account transactions.

b. Includes direct investment, portfolio investment, other miscellaneous financial flows, and capital account transactions.

c. The net international investment position for 2004 is estimated by adding the annualized current account deficit for the first half of 2004 to the investment position for 2003. GDP for 2004 is estimated by averaging GDP for the first two quarters with Blue Chip forecasts for the last two quarters.

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

The U.S. current account deficit reached a record high in 2004:IIQ, renewing concerns that its continued growth could cause a flight from the dollar, adversely affecting economic growth, and complicating monetary policy.

The U.S. has financed a long string of current account deficits by issuing net financial claims to foreigners, including official claims to foreign governments. As a consequence, foreigners now hold substantially more claims on the U.S. than we hold on

the rest of the world. This is shown by our negative net international investment position, which could equal \$3 trillion or roughly 25% of our GDP by year's end.

The net international investment position cannot fall indefinitely as a share of GDP. Eventually, foreign investors will become hesitant to add any more dollar-denominated assets to their portfolios, triggering a dollar depreciation and a rise in U.S. real interest rates. These adjustments will probably shrink the current account

deficit, but they also can affect investment and prices in the U.S. We do not know if, when, or how fast this adjustment will take place.

Foreign investors' attitudes may depend on U.S. saving and investment. During much of the 1990s, rapid growth in domestic saving and investment—implying a rising potential for future growth—accompanied an expanding U.S. current account deficit. Since 2000, saving and investment have fallen relative to GDP, but the trend may be reversing.