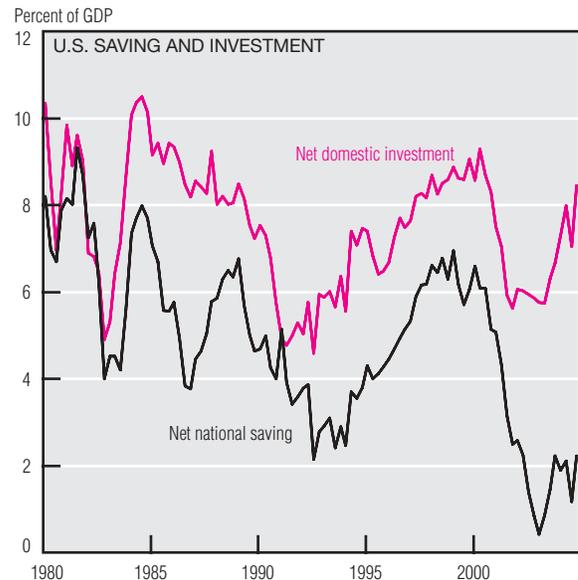
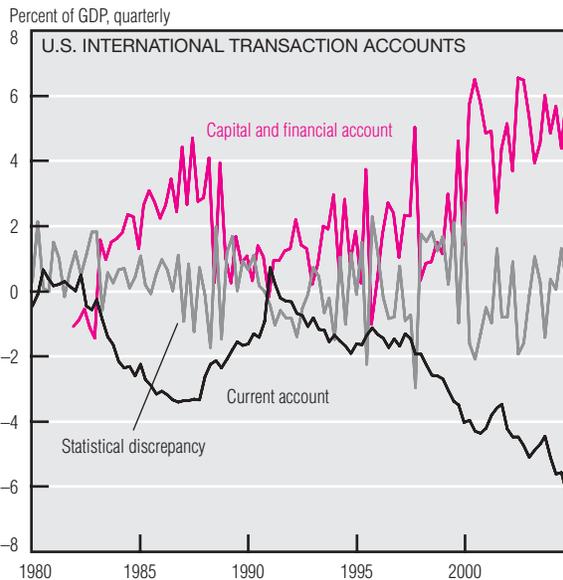
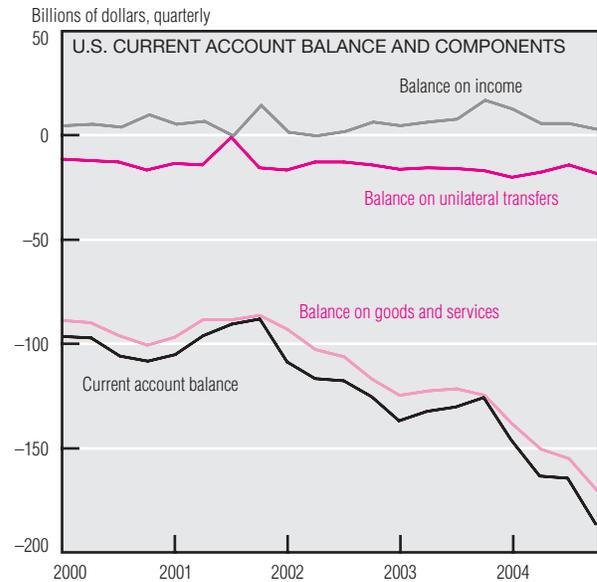
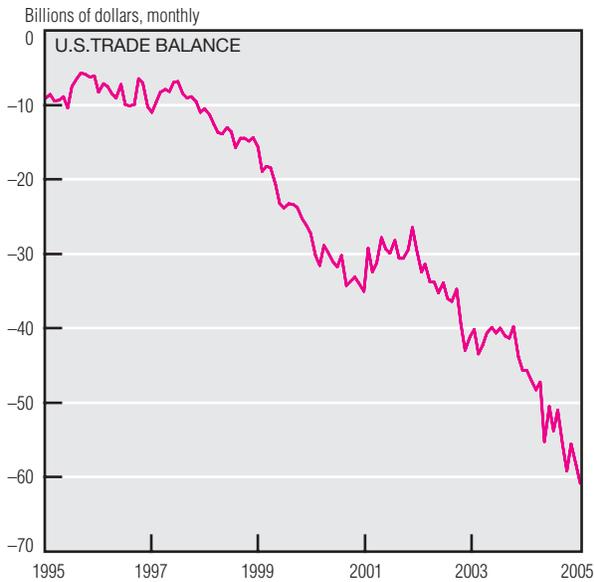


The U.S. Current Account Deficit



SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census.

The nominal U.S. deficit for trade on goods and services increased in February to \$61 billion, the largest on record. The trade deficit has been increasing for the last three years.

The current account deficit, a broader, quarterly measure, reached an all-time high of \$188 billion in 2004:IVQ, the latest in a series of steady increases that began in mid-2001. The current account balance includes a country's trade deficit, net income from abroad, and net unilateral transfers. In the fourth quarter, the balance on goods and services

was -\$171 billion, net income \$2 billion, and net unilateral transfers -\$19 billion.

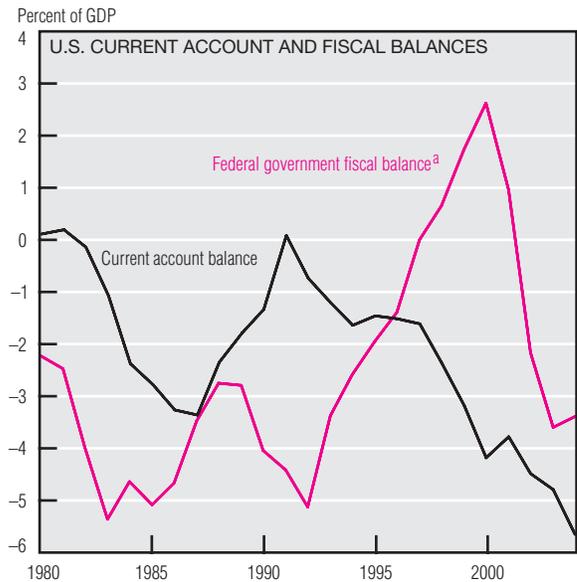
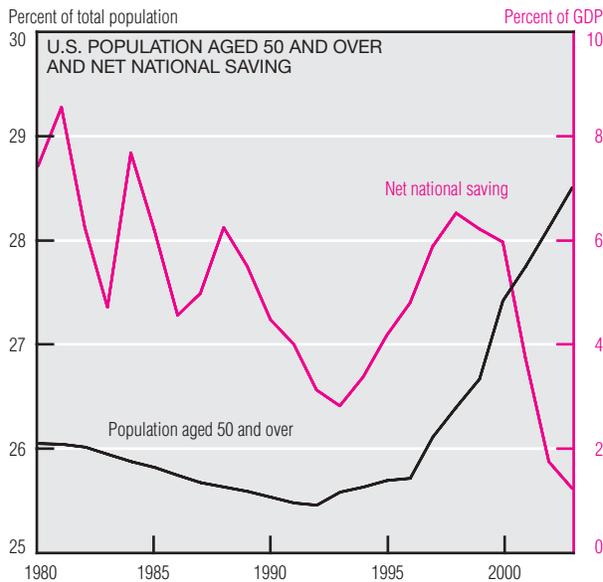
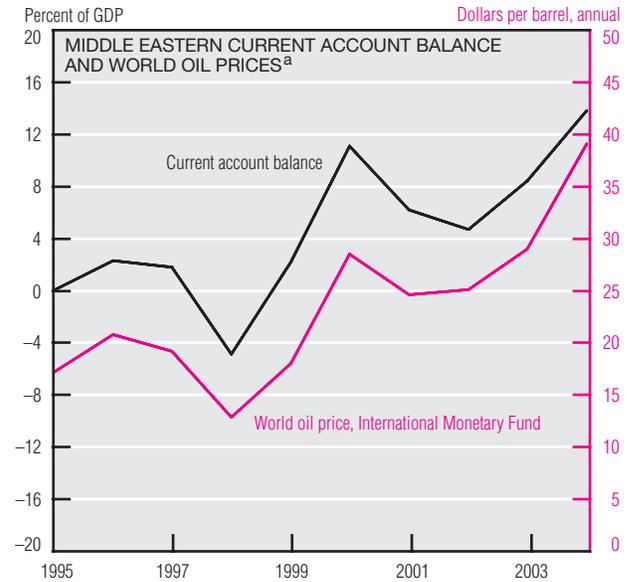
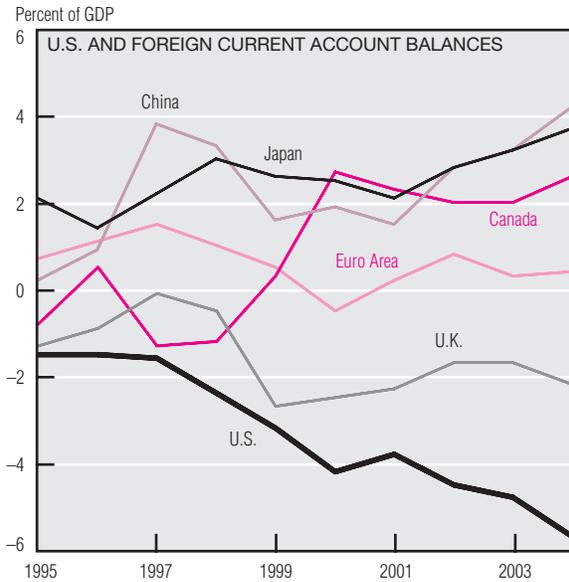
A country with a current account deficit is buying from and paying and transferring income to the rest of the world in excess of what it receives in sales, income payments, and transfers. This means that the rest of the world must lend to or take equity positions in that country to make up the difference. The capital and financial account balance measures this net inflow of funds; the capital account balance records

direct investments; and the financial account balance includes net borrowing, lending, and securities transactions involving foreigners. The current account balance should equal the negative of the capital and financial account balance. In practice, however, measurement difficulties create a statistical discrepancy between the two.

The difference between national (domestic) savings and national investment necessarily is financed by net foreign capital and financial flows, which equal the current account

(continued on next page)

The U.S. Current Account Deficit (cont.)



a. Cumulative balance for the calendar year.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; U.S. Department of the Treasury, *Monthly Treasury Statement*; and International Monetary Fund, "World Economic Outlook," April 2005.

deficit. For the past two decades, excluding the early 1980s and 1991, U.S. national investment has exceeded national savings and foreigners have been financing a significant portion of U.S. domestic investment.

If the U.S. runs a current account deficit, other countries must be running current account surpluses. In 1995, Japan and the Euro Area posted current account surpluses. Since then, China and Canada have emerged with such surpluses, whereas the U.S. and the U.K. continue to run deficits. For the last six years, Middle Eastern

countries have had current account surpluses; not surprisingly, the sign and size of their current account balances are positively correlated with the world price of oil.

Holding all other things constant, lowering the U.S. saving rate will worsen the current account balance. The national saving rate has declined steadily since the late 1990s. This puzzles some analysts because the share of the population aged 50 and over has increased significantly since mid-1990. One might think that the national saving rate would rise as a

larger proportion of the population saves for retirement. However, interest rates have been low by historical standards since 2001; low interest rates tend to depress savings.

Although it is difficult to identify what is causing the high U.S. current account deficit, some analysts believe that an increase in the federal budget deficit has this effect. Although it is quite possible for both of these deficits to move in tandem, as they did in the early 1980s and since 2000, they can also move in opposite directions, as they did during most of the 1990s.