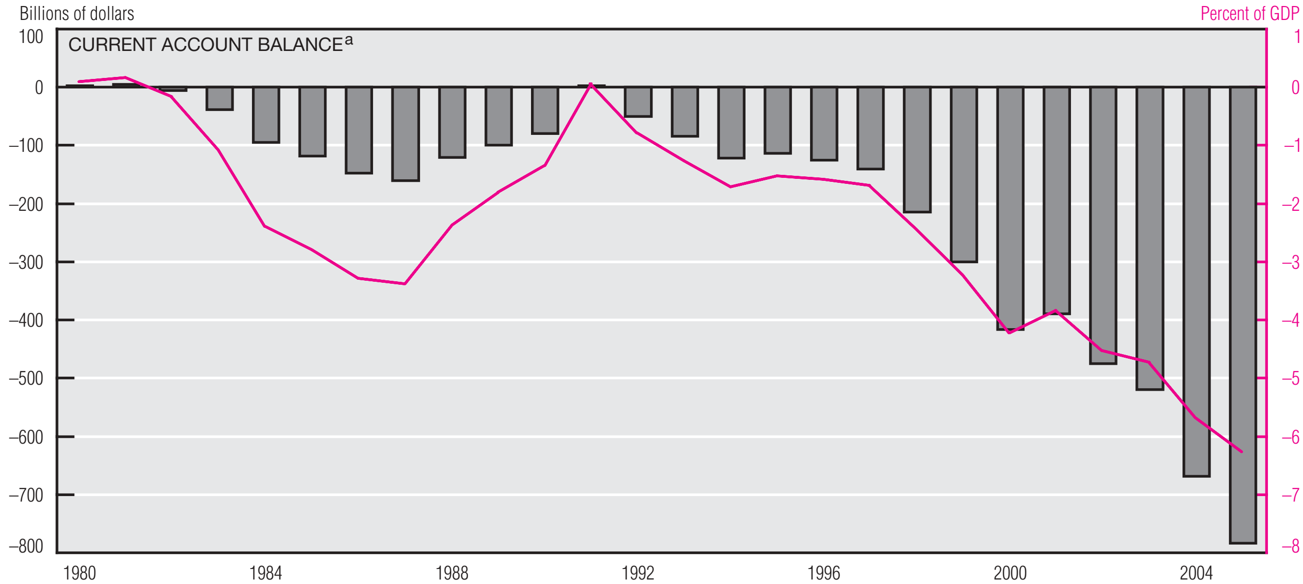
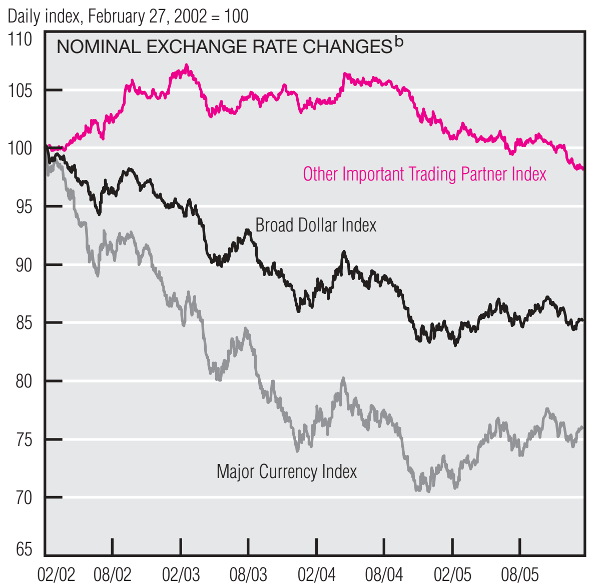
# The Current Account and Dollar Depreciation




**Selected Global Current Account Balances**

| | Billions of dollars 1996 | 2004 | Change |
|---|---|---|---|
| U.S. | –124.9 | –668.1 | –543.2 |
| Other advanced economies | 150.9 | 354.1 | 203.2 |
| Developing countries | –84.9 | 227.7 | 312.6 |
| Asia | –37.8 | 93.0 | 130.8 |
| Africa | –5.0 | 0.6 | 5.6 |
| Central and Eastern Europe | –17.8 | –50.1 | –32.3 |
| Middle East | 12.7 | 102.8 | 90.1 |
| Commonwealth of Independent States | 2.5 | 63.1 | 60.6 |
| Western Hemisphere | –39.6 | 18.3 | 57.9 |

a. The 2005 observation is estimated using data from the first three quarters.

b. The Broad Dollar Index measures dollar movements against the currencies of our 26 most important trading partners. The Other Important Trading Partner Index measures dollar movements against 19 emerging-market currencies. The Major Currency Index measures dollar movements against developed countries' currencies. All indexes are constructed on a trade-weighted basis.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; and International Monetary Fund, *World Economic Outlook Database*, September 2005.

In 2005, the U.S. current account deficit will reach an estimated $783 billion or about 6.3% of GDP. Globally, current account balances must sum to zero. Less obviously, at the national level, the current account must equal the financial flows account because a country that runs a current account deficit must finance it by a financial inflow. There are two possible causes for the large U.S. deficit: Either the U.S. has a high demand for current consumption, which it must finance by borrowing from the rest of the world, or the rest of the world desires to invest in U.S. assets, which implies that we must run a current account deficit.

Which scenario is more likely? If the U.S. is demanding higher levels of consumption, then the dollar's value might decrease when our residents must purchase foreign currency with dollars in order to buy foreign goods. On the other hand, foreigners' desire to invest in U.S. assets could have the contrary effect—causing the dollar to appreciate—because the demand for dollars would be stronger. A quick look at the data cannot distinguish one story from the other. During the three-year period beginning in February 2002, the dollar depreciated substantially, which suggests that the dominant force behind the growing current account deficit was high U.S. consumption. Since February 2005, however, the dollar has stabilized and appreciated somewhat, which implies that strong foreign demand for U.S. investments is the dominant force behind the increase in the U.S. current account.