Current account deficits

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The current account deficit is the broadest measure of U. S. trade balance plus the net balance of services, net income on overseas investments and net transfers. It basically measures the value of imports minus the value of exports. When the current account deficit is negative, which it has been over the last decade, the U. S. needs to borrow from or sell to foreigners to fund their consumption and investment. Foreign governments generallyfinanceour current account deficit by investing in U. S. Treasury Bills. For 2008 the current account deficit fell sharply for the second consecutive year. As a percentage of the economy or GDP, the fourth quarter deficit was 3. 7 percent, the lowest it’s been since 2001.

(1) It is projected that the current account deficit will fall further in 2009 due to the recession reducing significantly the amount of imports. However, the global economy recession will also reduce the amount of exports, but as long as the dollar does not appreciate considerably over foreign currencies the current account deficit should continue to decline. Many economists and politicians have blamed recent current account deficits on the valuation of the Chinese yuan compared to the U. S. dollar.

China has historically pegged the yuan to the U. S. dollar and many claim that the yuan is extremely undervalued compared to the dollar. This results in imports from China being less expensive than domestic goods and causes a huge trade imbalance with China. There has been much pressure put on China to raise the value of the yuan to put it on a more even keel with the dollar. In response to this pressure China has been appreciating the yuan but not fast enough to suit many in congress. For 2008 our net exports to China

were $71. 5 billion and our net imports were $337. 7 billion for a trade imbalance of -$266. 3 billion.

(2) This trade imbalance with China has contributed greatly to our current account imbalance. The current account deficit is problematic for the U. S. economy. Persistent U. S. trade deficits put a substantial drag on productivity growth. More dollars spent on imports than exports reduces domestic demand and employment and drives workers to less productive jobs. To lessen the current account balance the U. S. needs to expand domestic demand, see expansions of domestic demand in major foreign economies, reduce the U. S. budget deficit and continue to put pressure on China to appreciate its currency.

There are economists, however, that argue that current account deficits are not inherently bad for the economy. They believe that a current account deficit is a feature of a successful international monetary system. Analyses that have been done by these economists show that net capital flows from poor to rich countries. These net outflows of capital are associated with relatively high growth rates in emerging markets. Chronic current account deficits, though, are politically unsavory and will always be seen as a threat to our economic well being if they exceed 5% of GDP in any particular year.