

Current Account Fact and Fiction

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Banco de Portugal, December 2005

This version: December 14, 2005

The US economy, December 2005

- Real GDP per capita and employment at all-time highs
- Growth rate about average, but higher than most other developed countries
- But ... does current account deficit signal trouble ahead?

Larry Summers

The most serious problem we have faced in the last fifty years is that of low national saving, resulting dependence on foreign capital, and fiscal sustainability. ... The current account deficit has widened sharply over the last four years ... to an unprecedented rate of 5% of net national product.

Stephen Roach

Lacking in domestic saving, America must import foreign saving ... to keep growing at ... acceptable growth rates. And so America must then run **massive and ever-widening current account deficits** to attract that foreign capital. ... America now requires an average of \$2.9 billion of capital inflows each and every business day to keep the magic going.

Maury Obstfeld and Ken Rogoff

Any sober policymaker or financial market analyst ought to regard the US current account deficit as a **sword of Damocles** hanging over the global economy.

Nouriel Roubini and Brad Setser

[We examine] ... US external deficits and the ... international monetary system that is integral to their financing – a system whose stability hinges on the willingness of Asian central banks to both hold enormous amounts of US Treasuries. ... The system is fragile. Our analysis suggests that **the US is on an unsustainable and dangerous path.**

Joe Stiglitz

America's huge fiscal and trade deficits ... jeopardise future American generations' well-being. As ... Herb Stein put it: 'If something can't go on forever, it won't.' But no one knows how, or when, it will all end. ... An even weaker dollar is a strong possibility.

Olivier Blanchard

The dollar must depreciate.

Warren Buffett

As time passes, and as claims against us grow, we own less and less of what we produce. ... Should we continue to run current account deficits comparable to those now prevailing, ... **our US ‘family’ will be delivering [a substantial fraction of] its annual output to the rest of the world** simply as tribute for the overindulgences of the past.

Martin Wolf (*Financial Times*)

Let's be blunt about it. The US is now on the comfortable path to ruin.

Overview

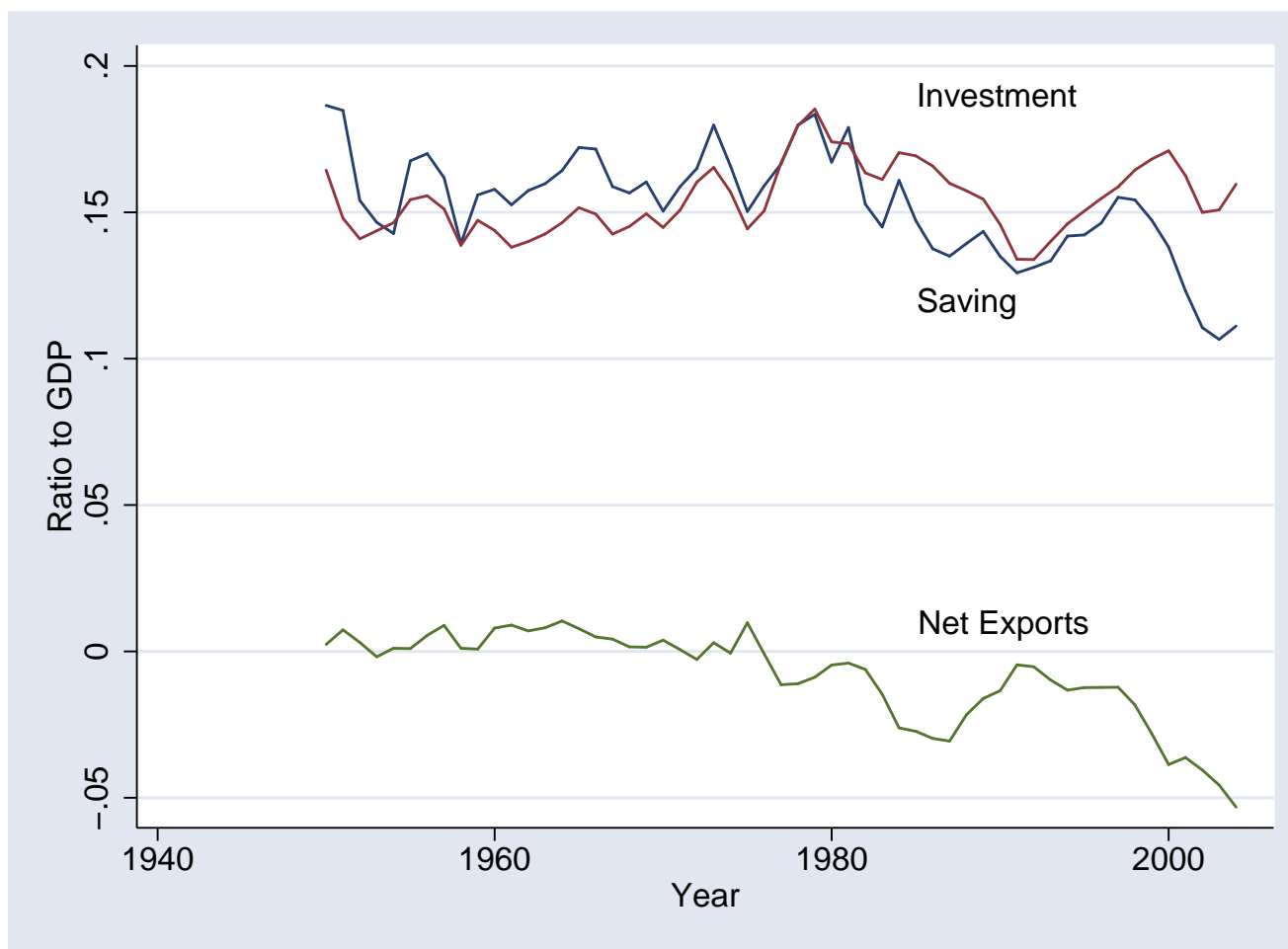
Objectives

- Show you some pictures
- Give you a new perspective on “imbalances”

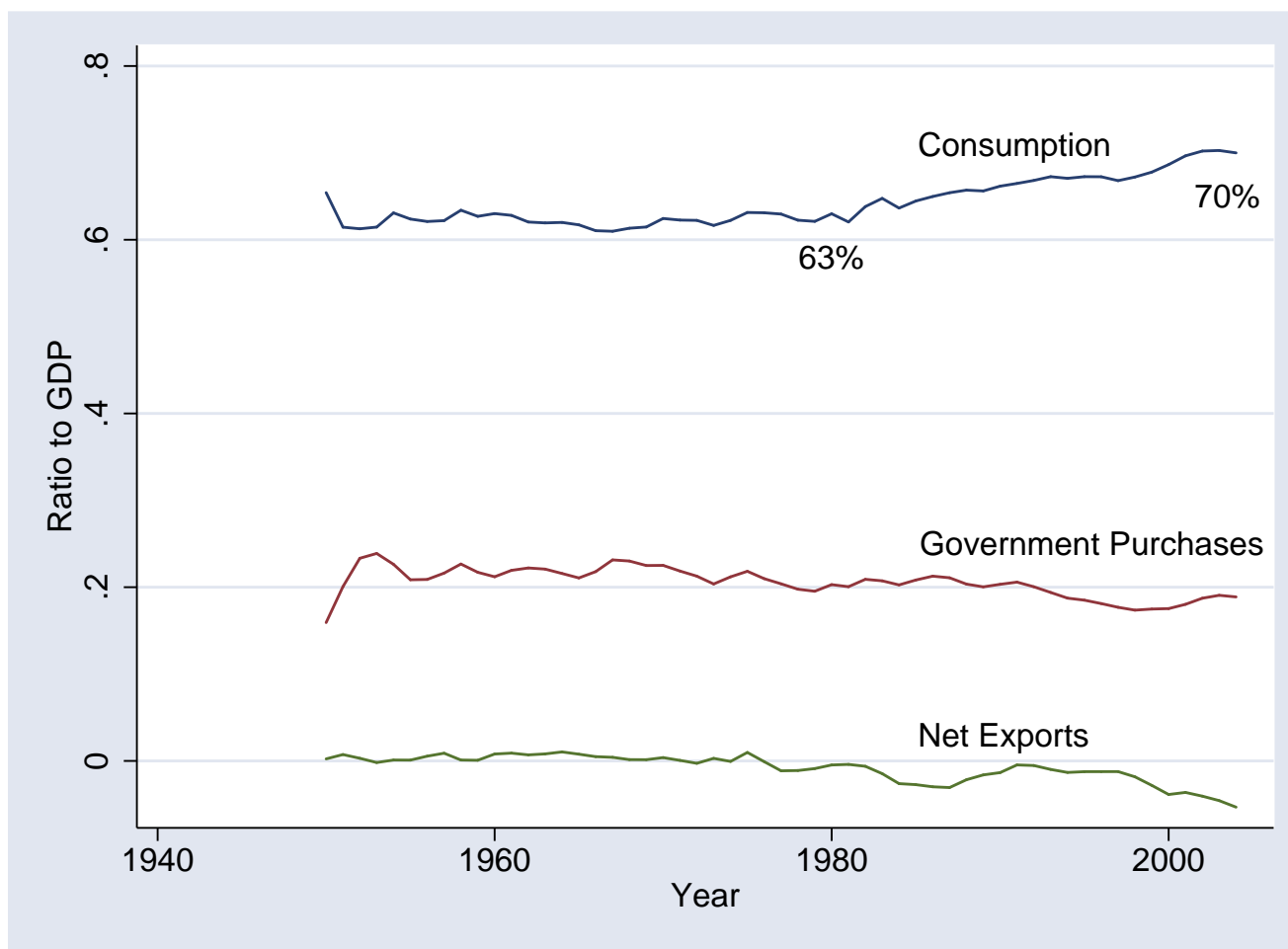
Plan of attack

- Review US and global situation
- Assess prophets of doom
- Speculate about sources of “global imbalances”

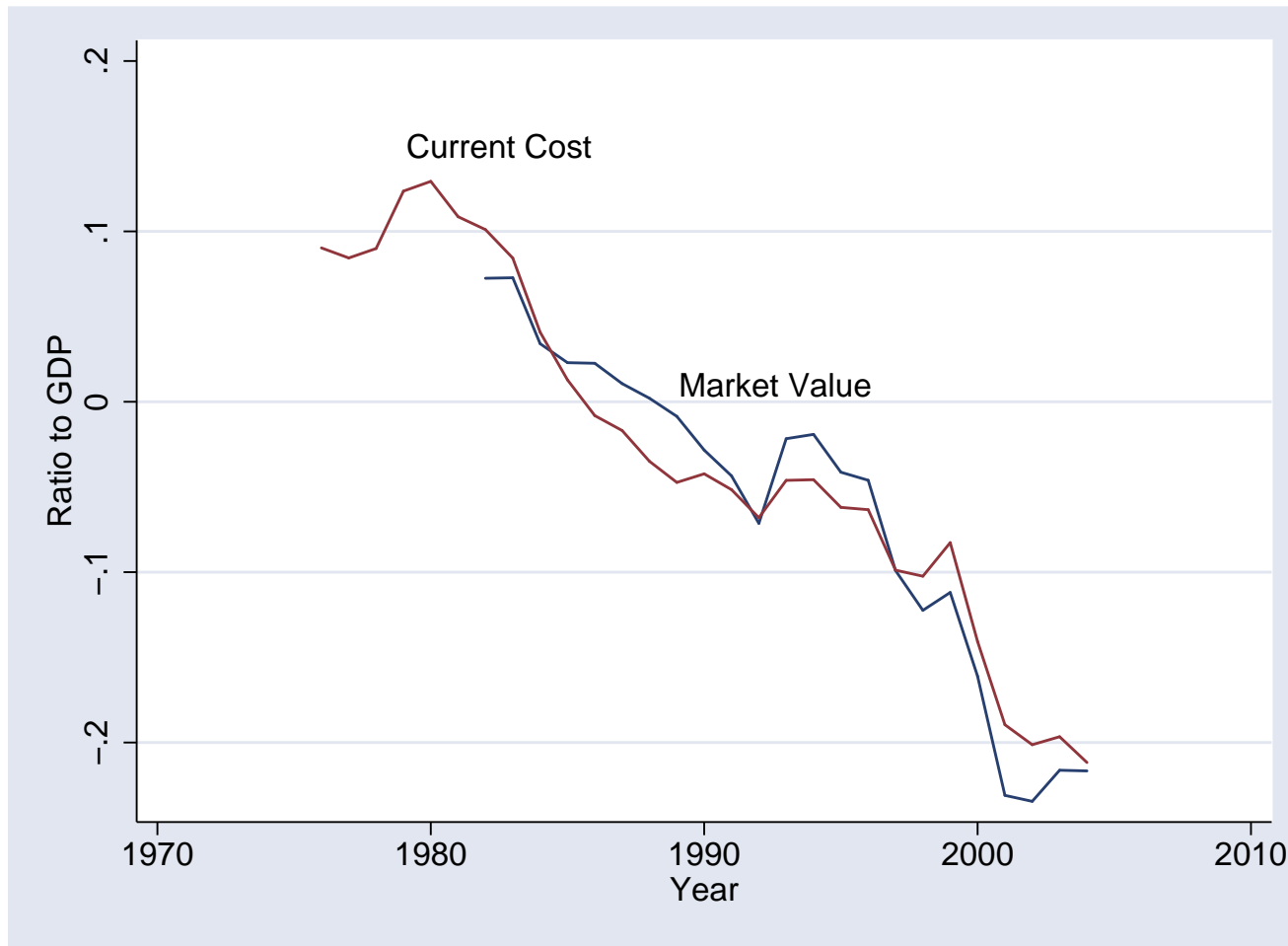
US flows ($S \equiv Y - C - G = I + NX$)



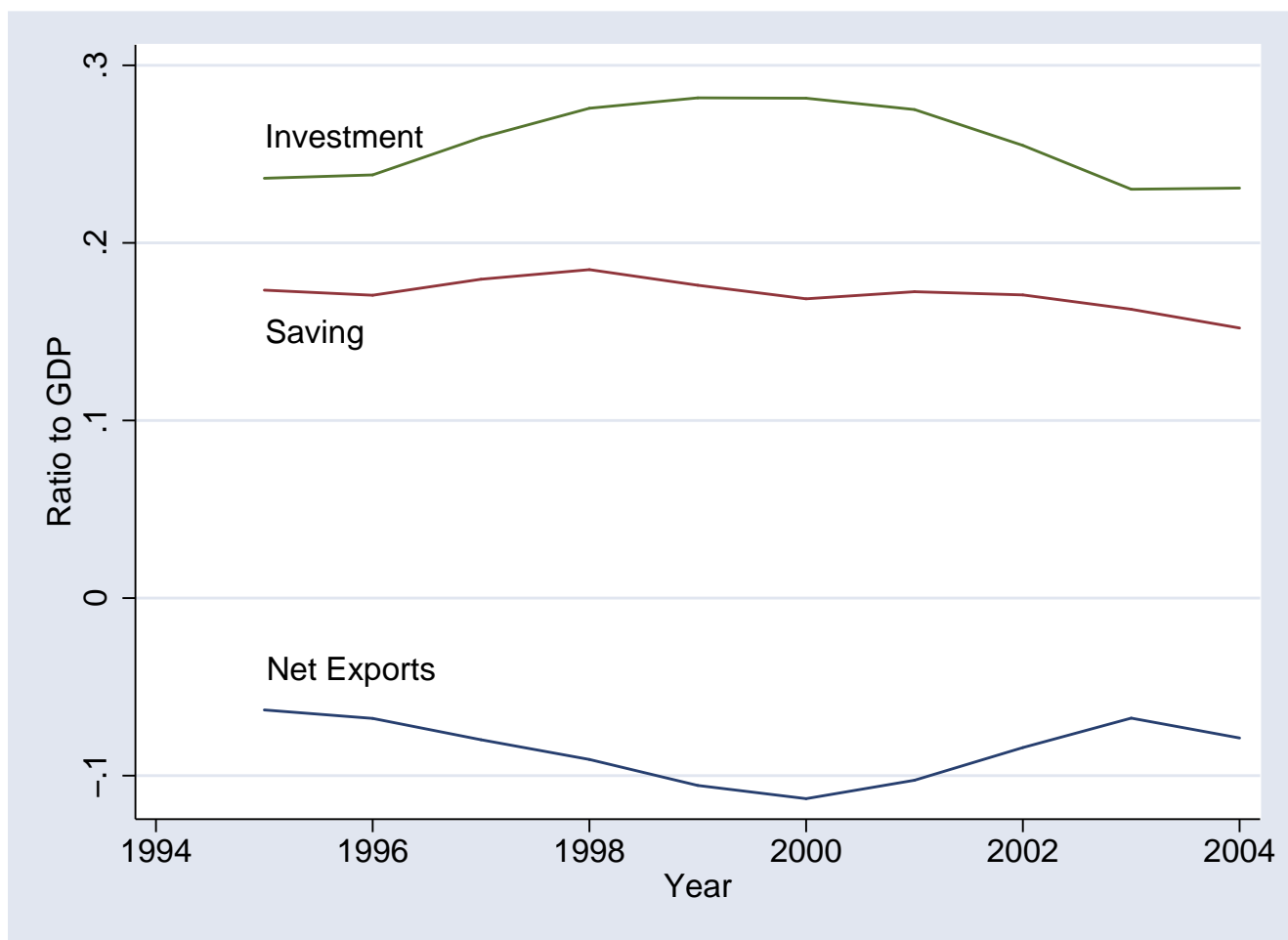
US flows



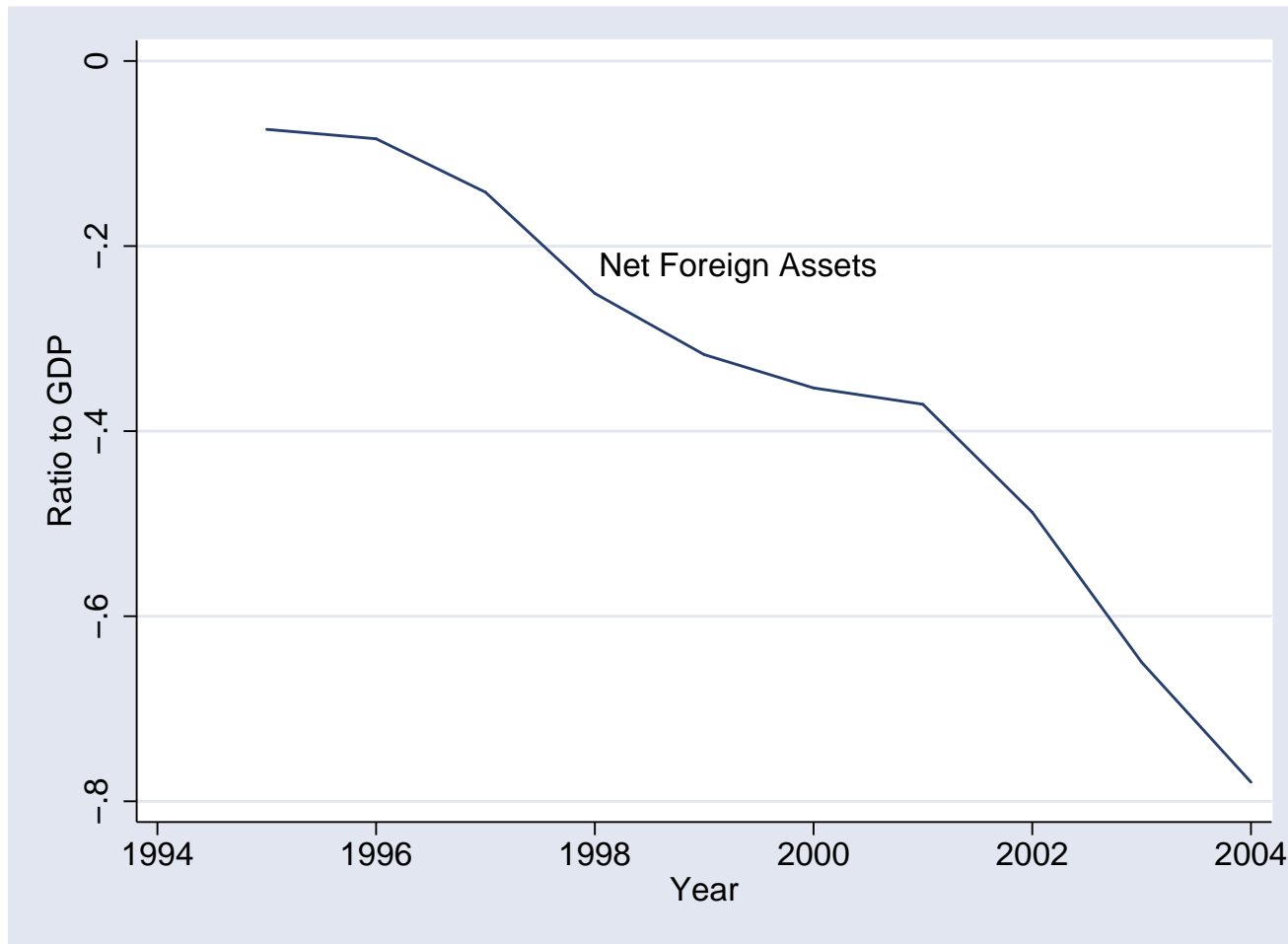
US net international investment position



Portuguese flows



Portuguese net international investment position



Largest deficits

Country or Aggregate	Current Account Balance, 2004	
	US Dollars (billions)	% of GDP
United States	-668.1	-5.7
Spain	-55.3	-5.3
United Kingdom	-42.1	-2.0
Australia	-39.8	-6.4
Turkey	-15.5	-5.1
Italy	-15.0	-0.9
Portugal	-12.7	-7.5
Hungary	-8.8	-8.8
France	-8.4	-0.4
Greece	-8.0	-3.9

Largest surpluses

Country or Aggregate	Current Account Balance, 2004	
	US Dollars (billions)	% of GDP
Japan	172.1	3.7
Germany	103.8	3.8
China	68.7	4.2
Russia	59.9	10.3
Saudi Arabia	51.6	20.5
Switzerland	43.0	12.0
Norway	33.8	13.5
Sweden	28.5	8.2
Singapore	27.9	26.1
Korea	27.6	4.1

Country aggregates

Country or Aggregate	Current Account Balance, 2004	
	US Dollars (billions)	% of GDP
United States	-668.1	-5.7
Other advanced economies	354.1	—
Emerging economies	227.1	—
Middle East	102.8	12.4
Developing Asia	93.0	2.9
World (discrepancy)	-86.3	—

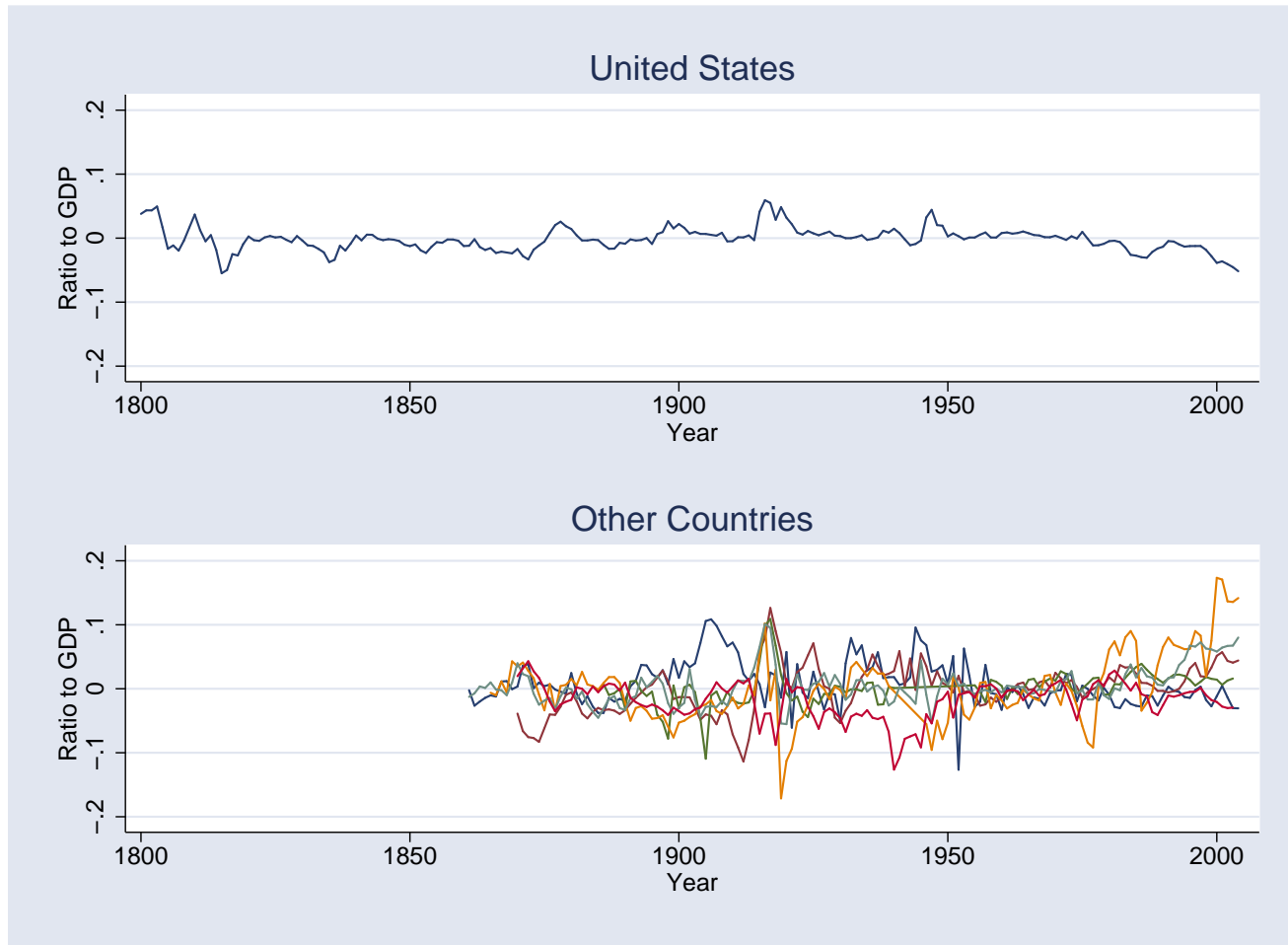
Fact or fiction?

“Consensus” view:

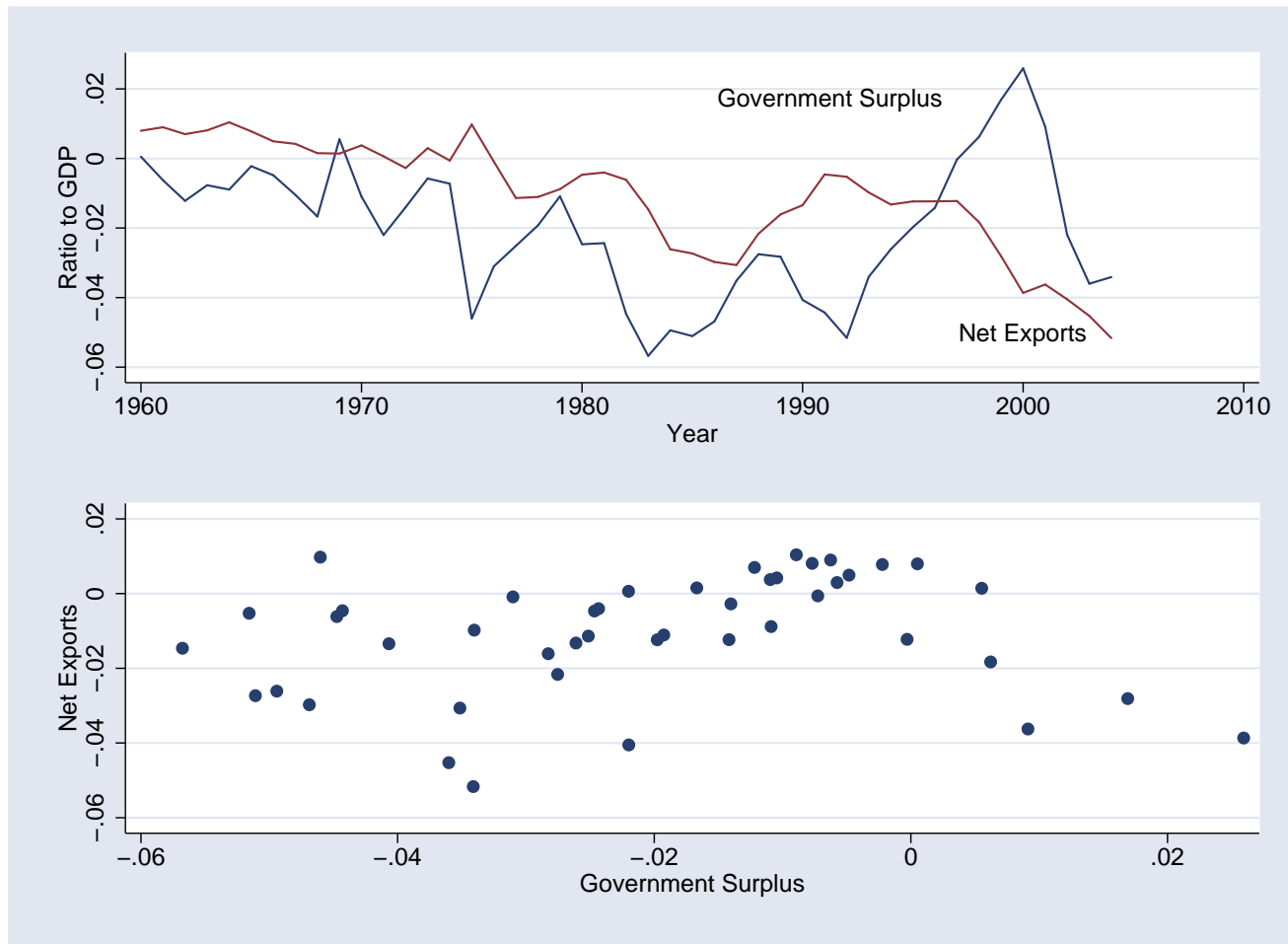
- Large external deficits are unprecedented
- Large external deficits are the result of fiscal deficits
- Interest on external debt becoming a significant burden
- Inevitable “adjustment” requires real depreciation
- Americans are living beyond their means

Fact or fiction?

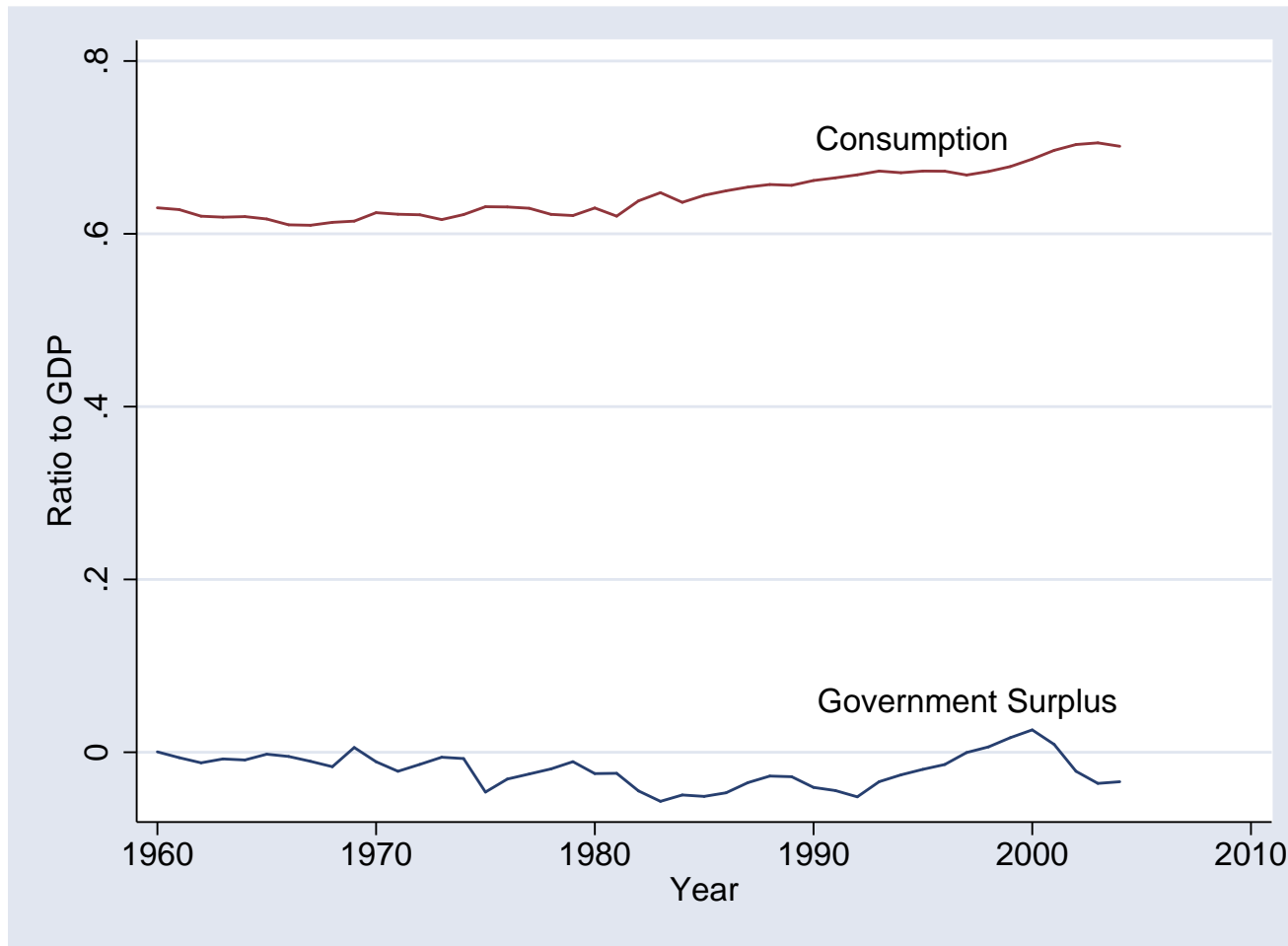
Unprecedented?



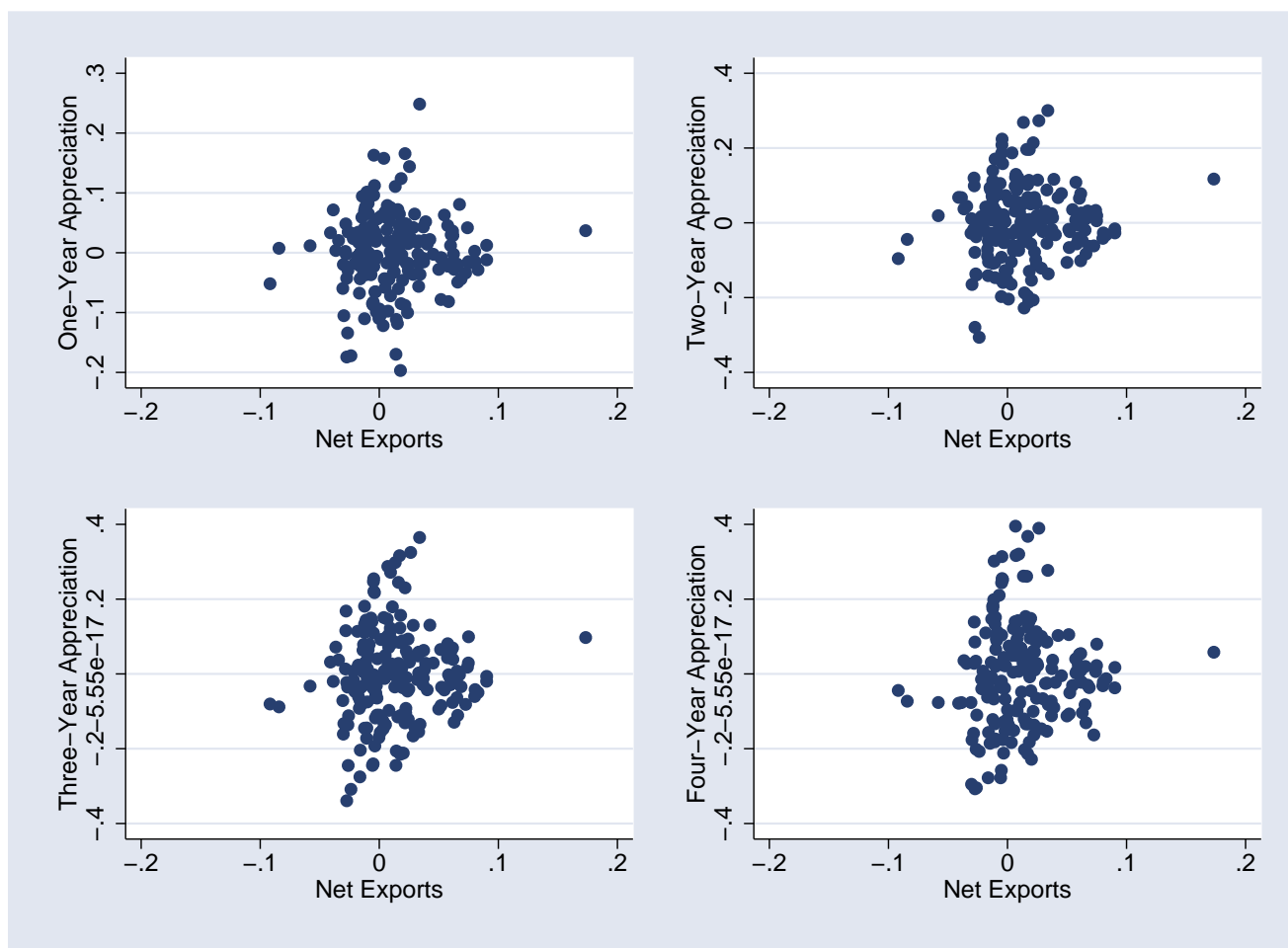
Twin deficits?



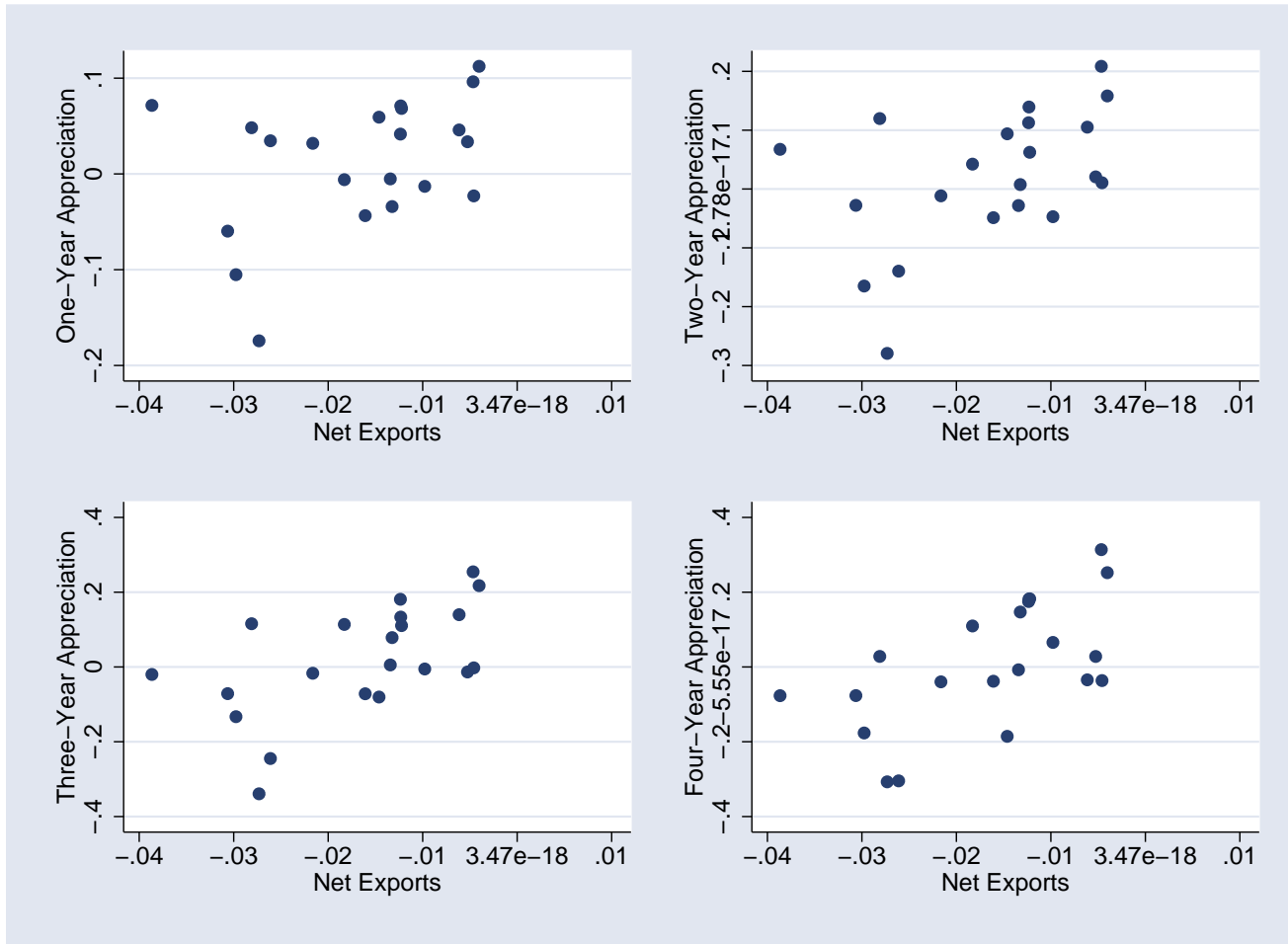
Twin deficits?



Real depreciation? (many countries)



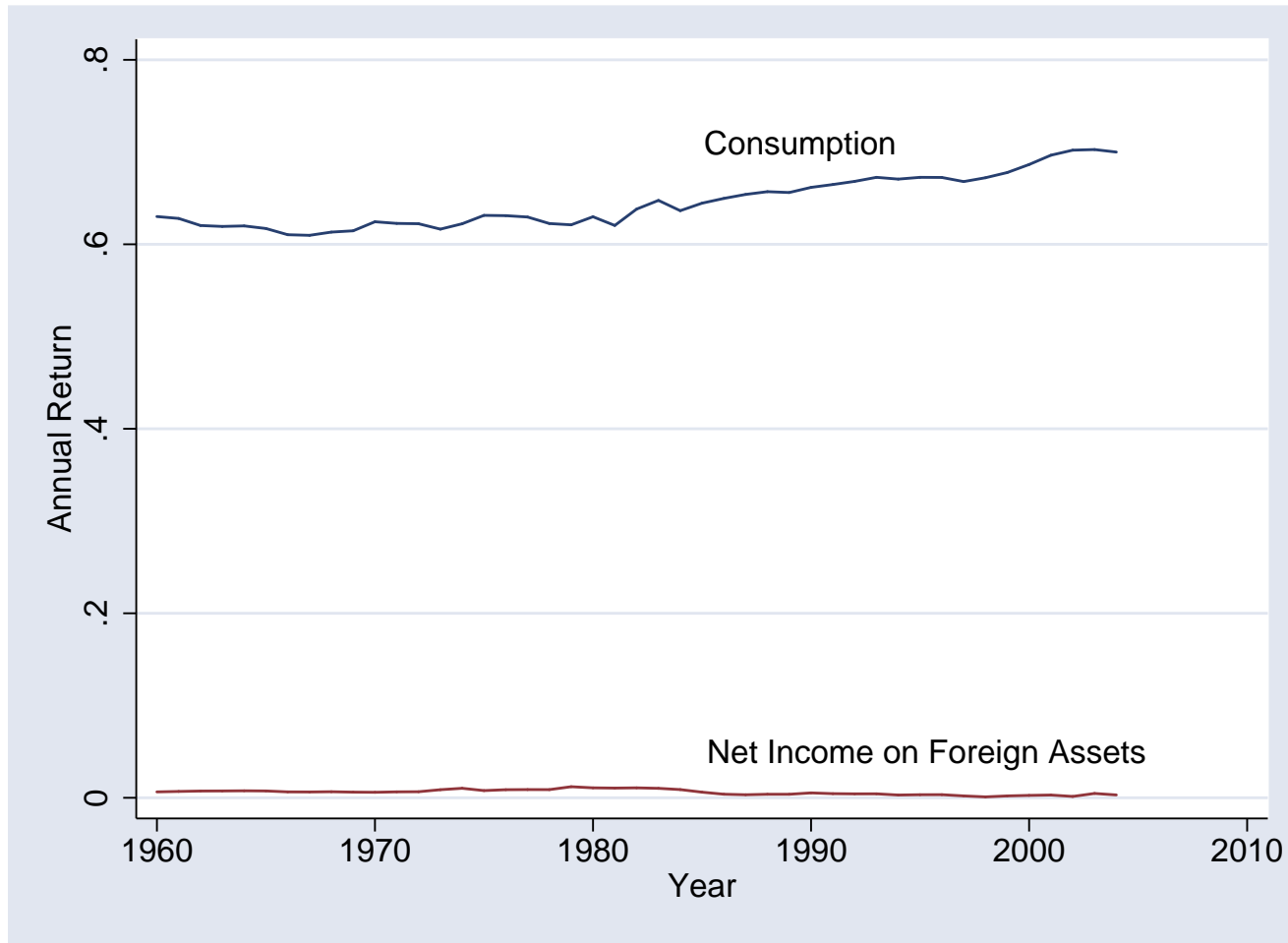
Real depreciation? (US)



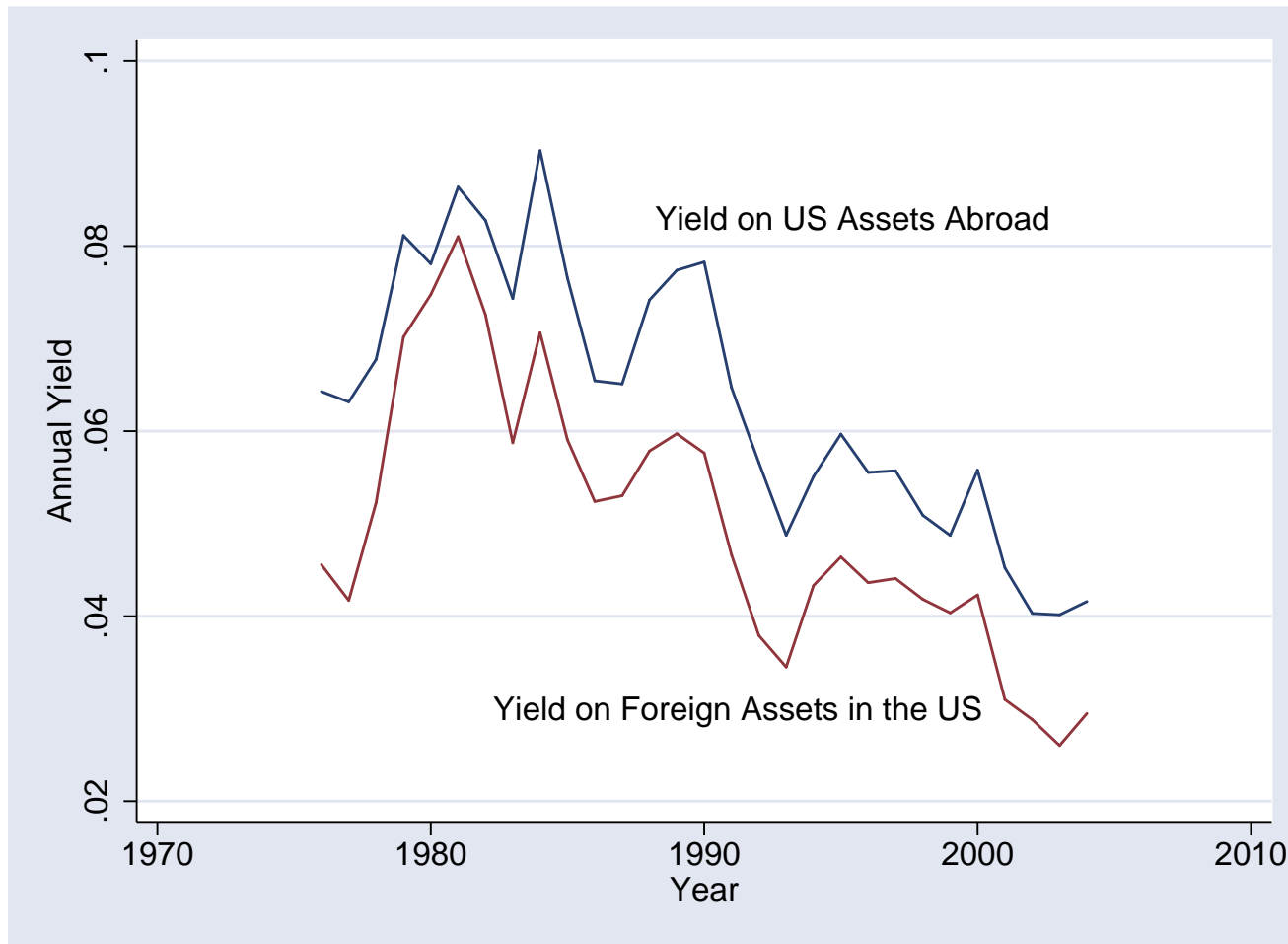
Charles Engel

I don't think anyone who looked at the data seriously could tell you with a straight face that there was any particular relationship between the real exchange rate, the trade balance, and net foreign assets.

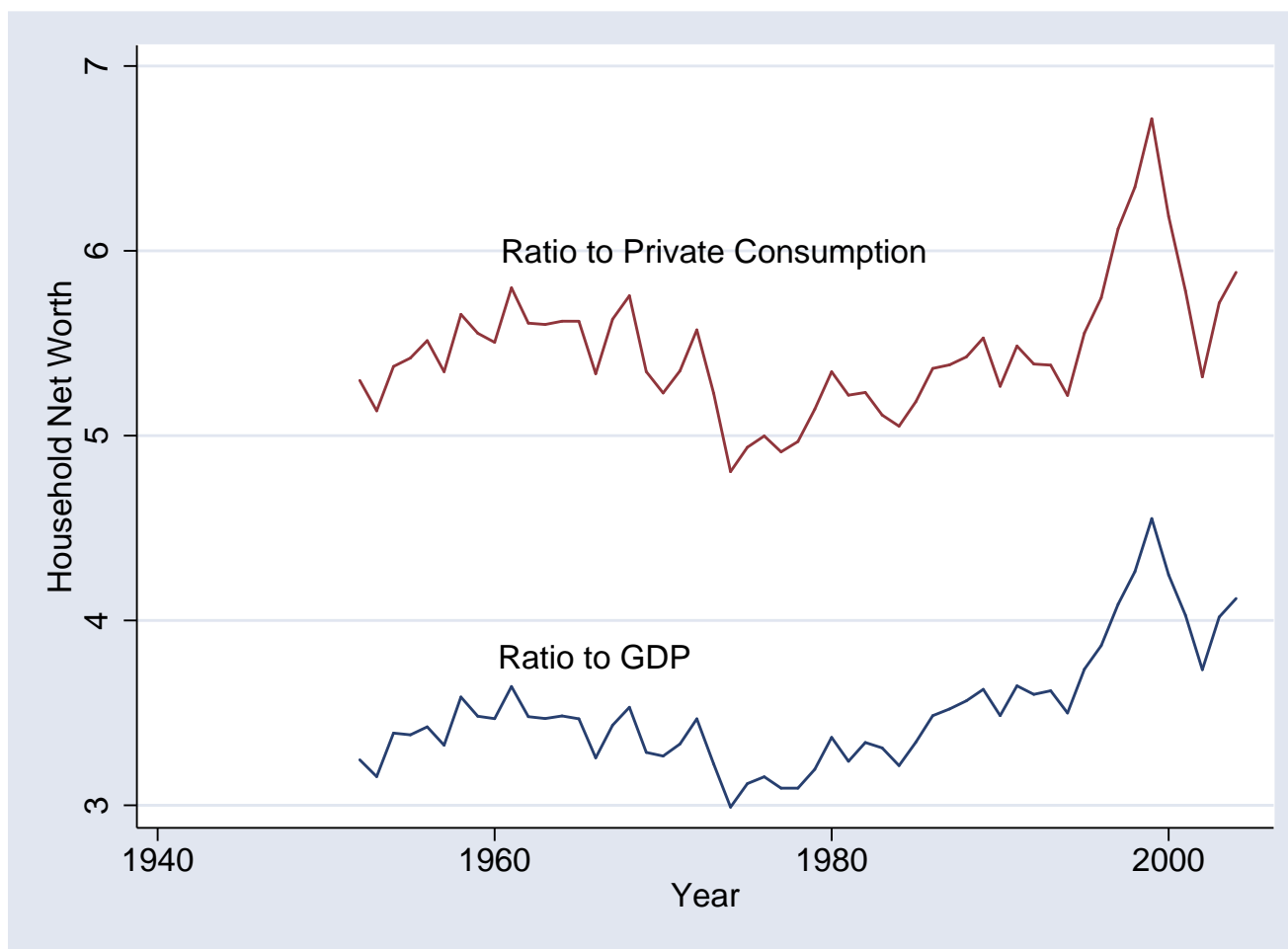
Interest burden?



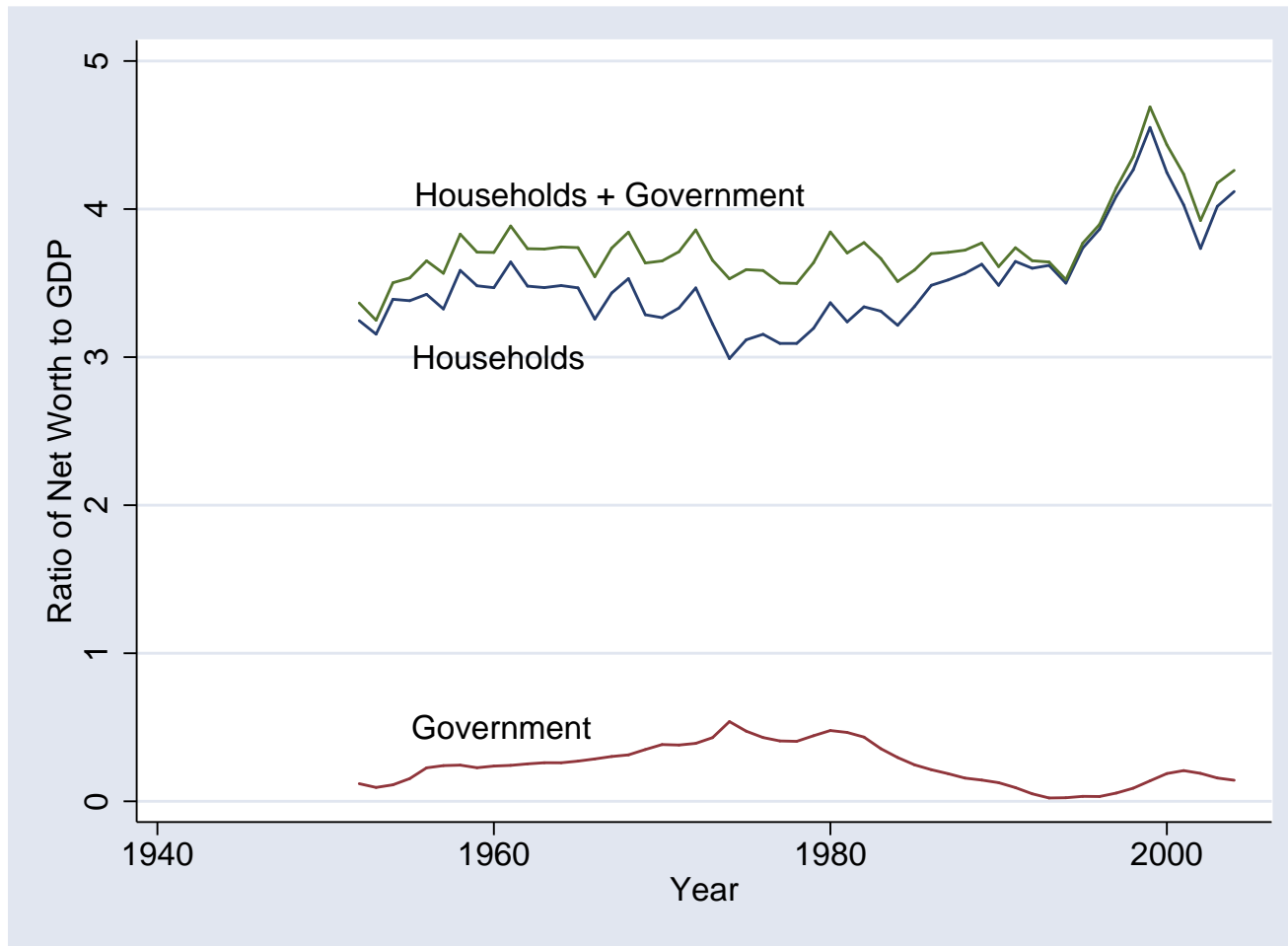
Interest burden?



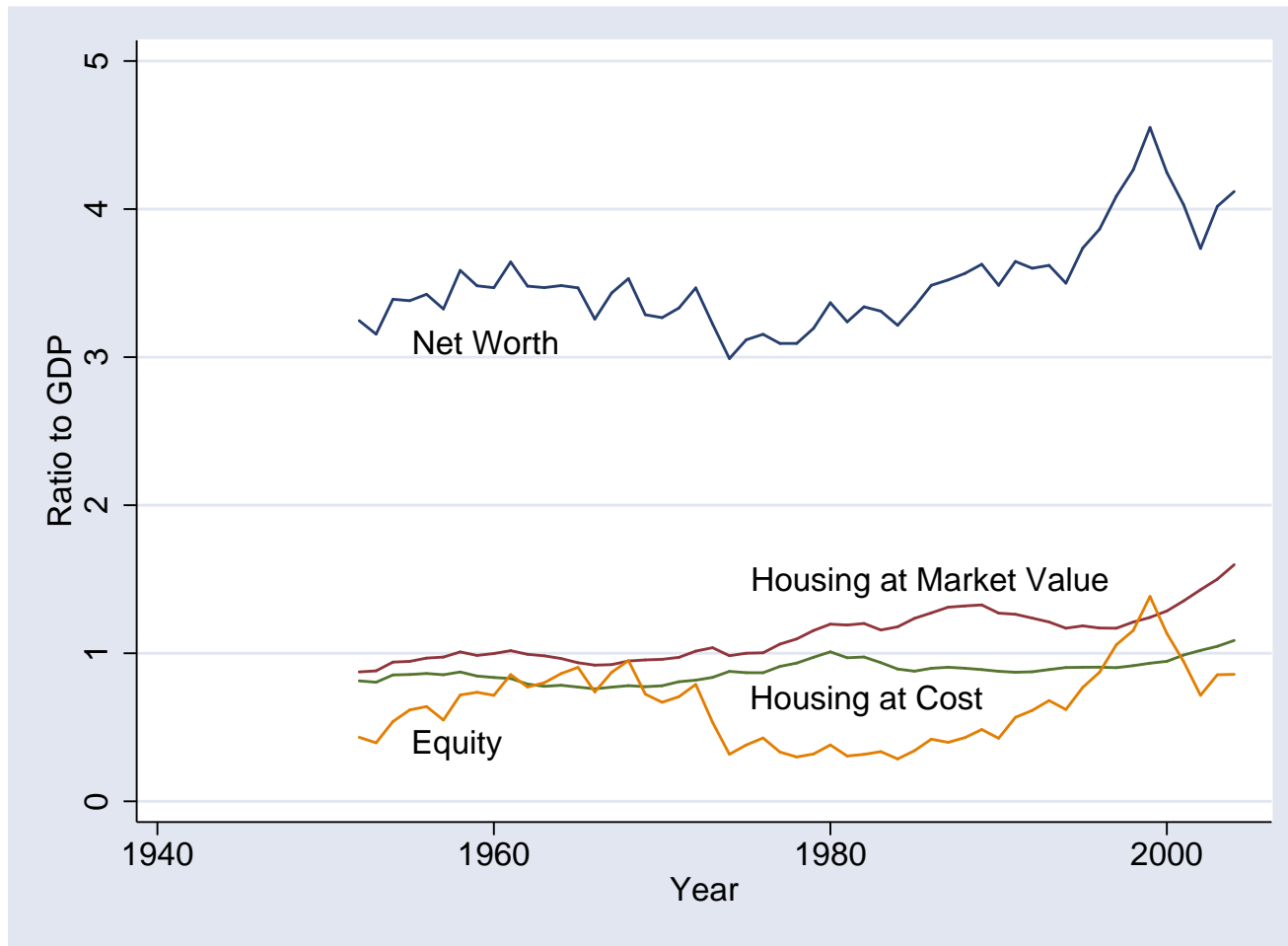
Beyond our means?



Beyond our means?



Beyond our means?



Fact or fiction?

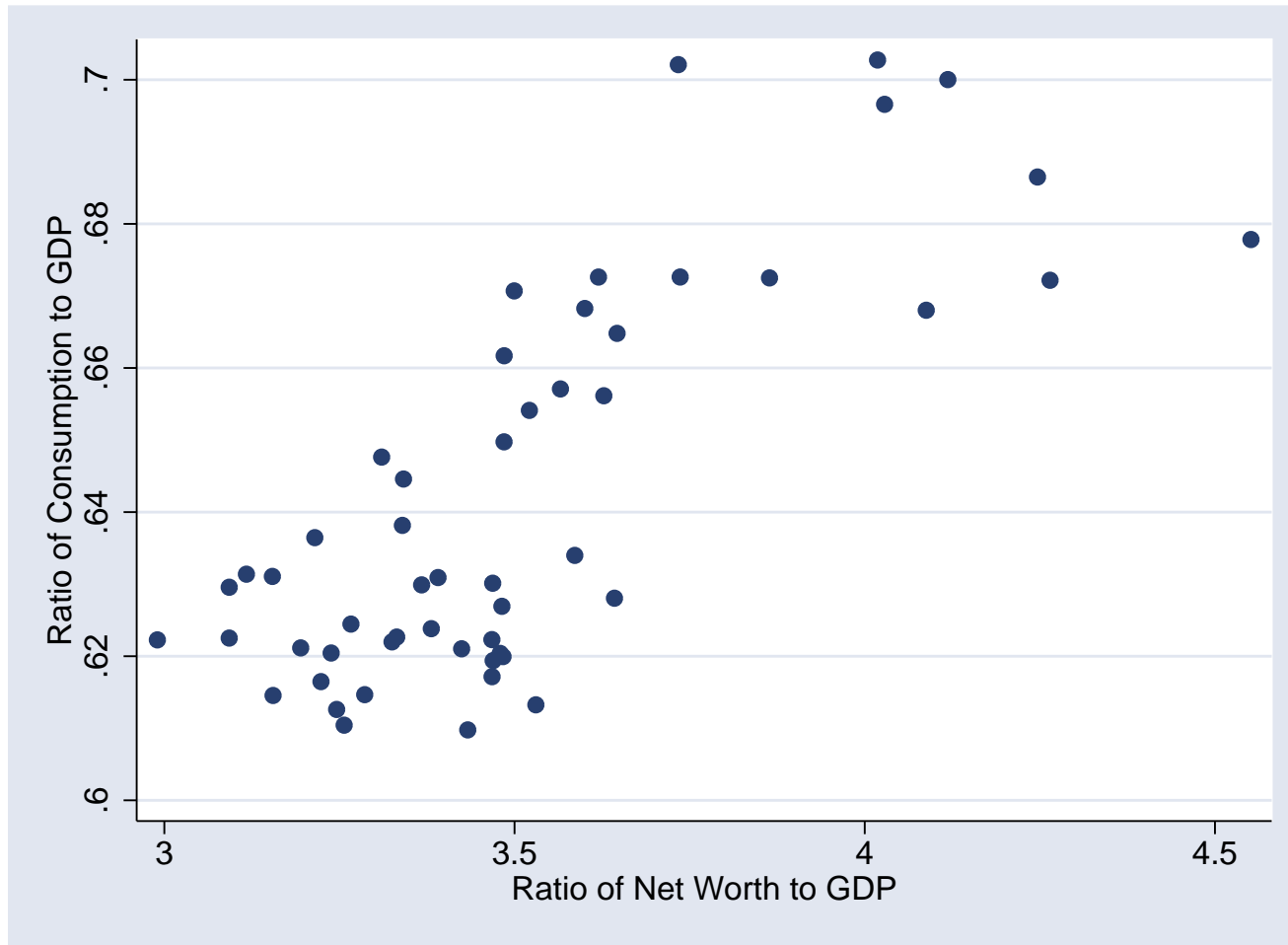
Consensus reconsidered

- Unprecedented: fiction?
- Due to fiscal deficits: fiction
- Interest burden: fiction
- Depreciation: maybe
- Beyond our means: fiction
- Benfica > Man United: fact

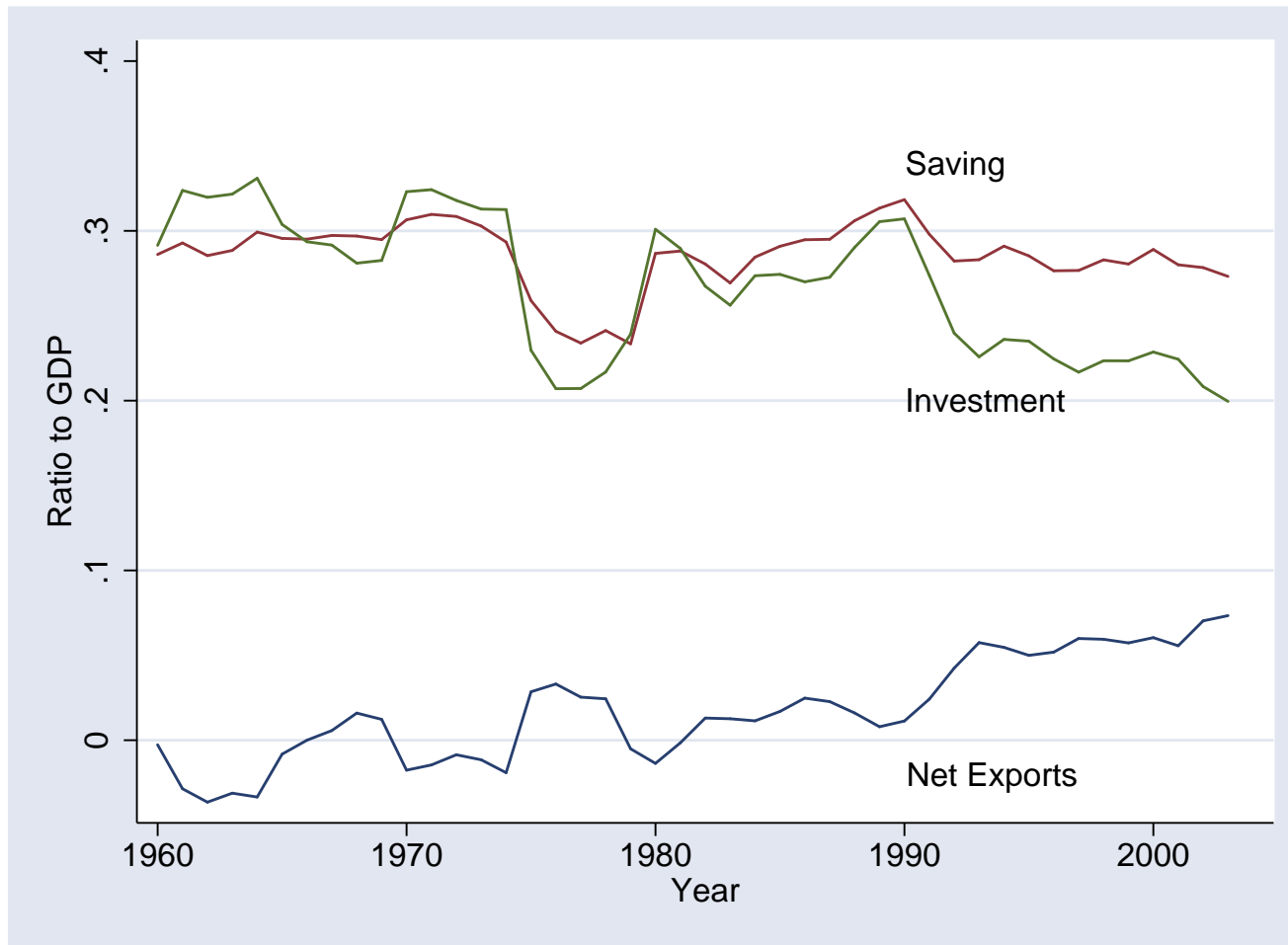
What's really going on?

- With the US?
 - Why has consumption risen?
- With the rest-of-the-world?
 - Why capital outflows?

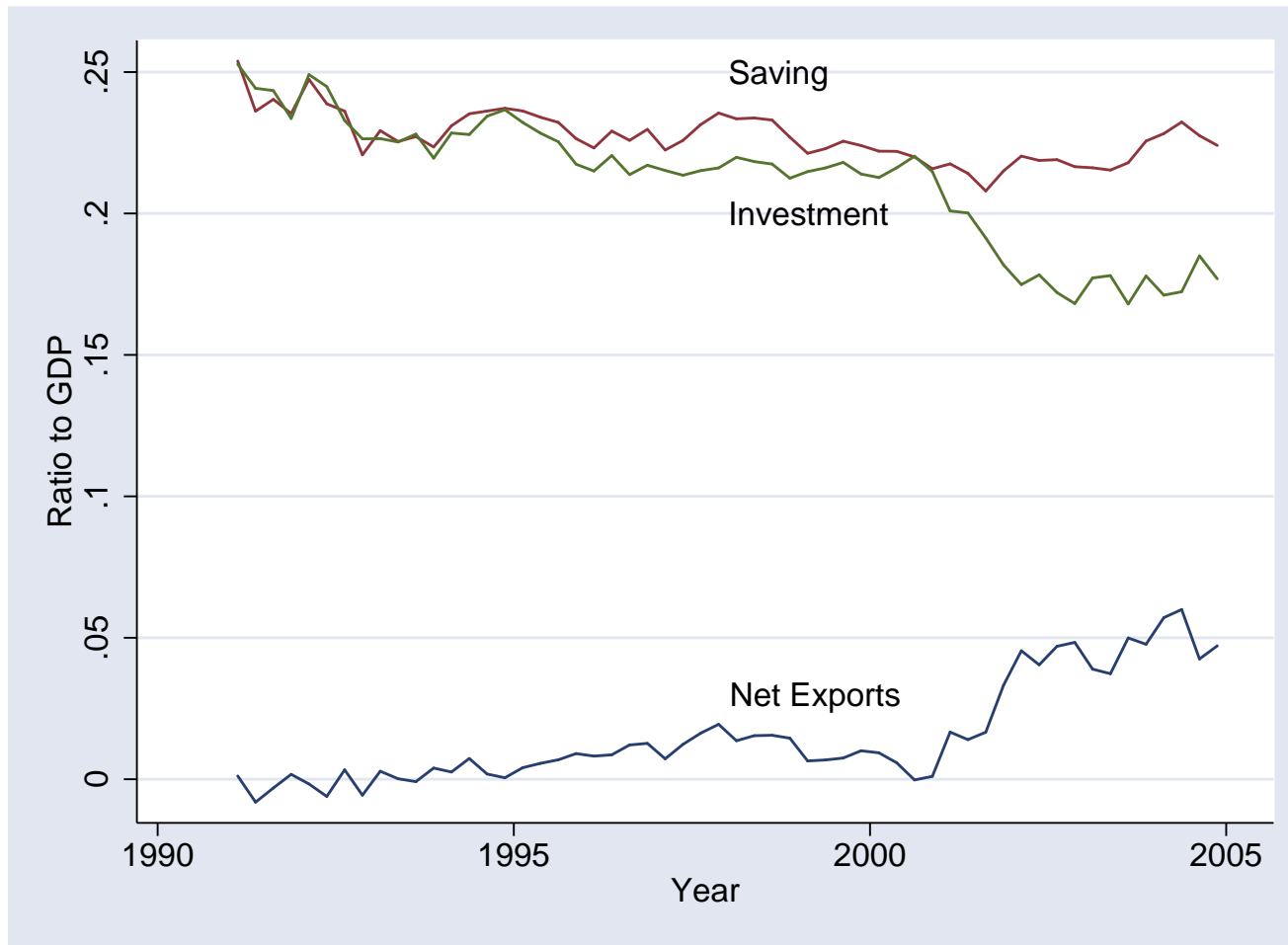
What's going on with US consumption?



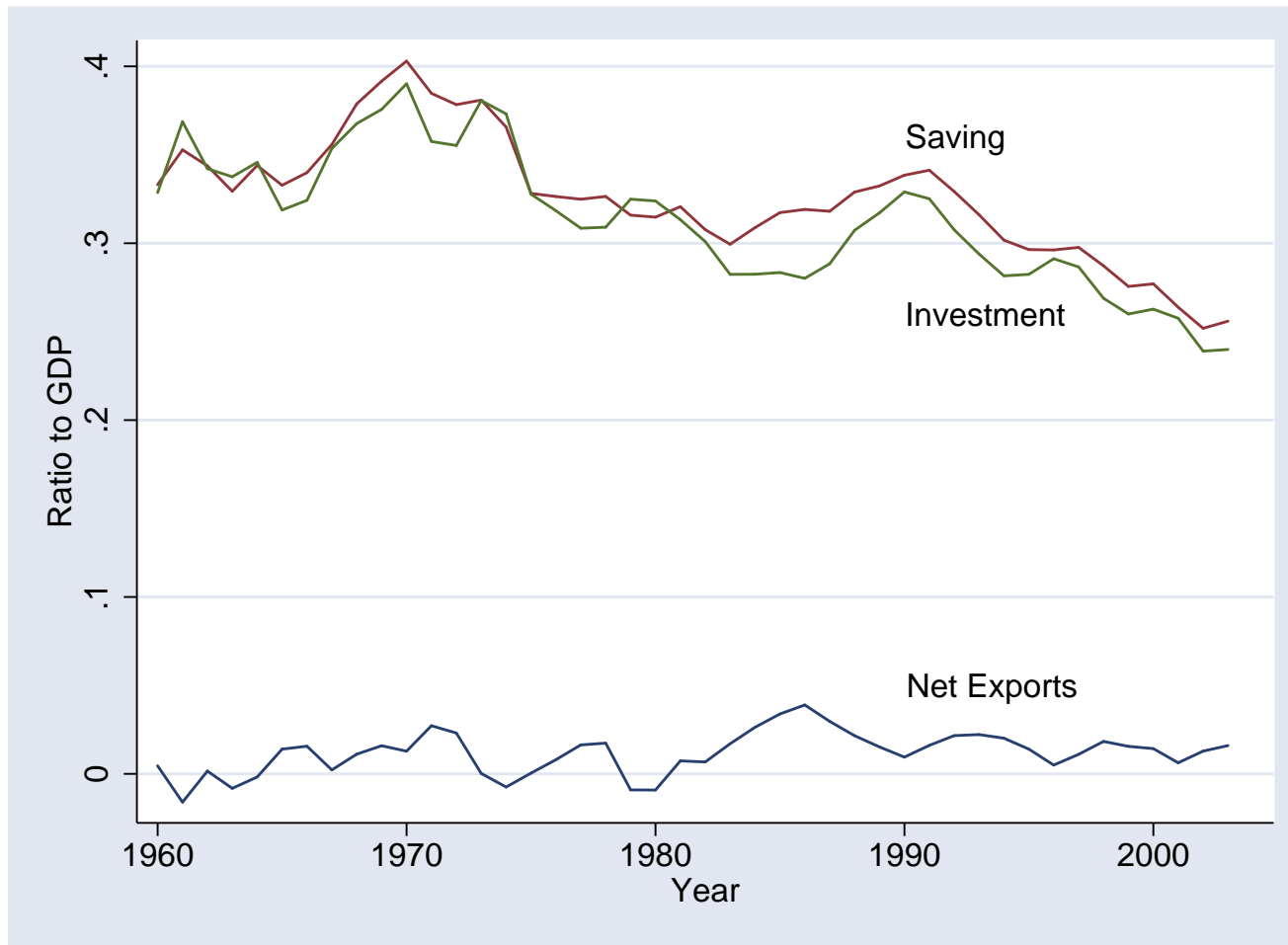
What's going on in Switzerland?



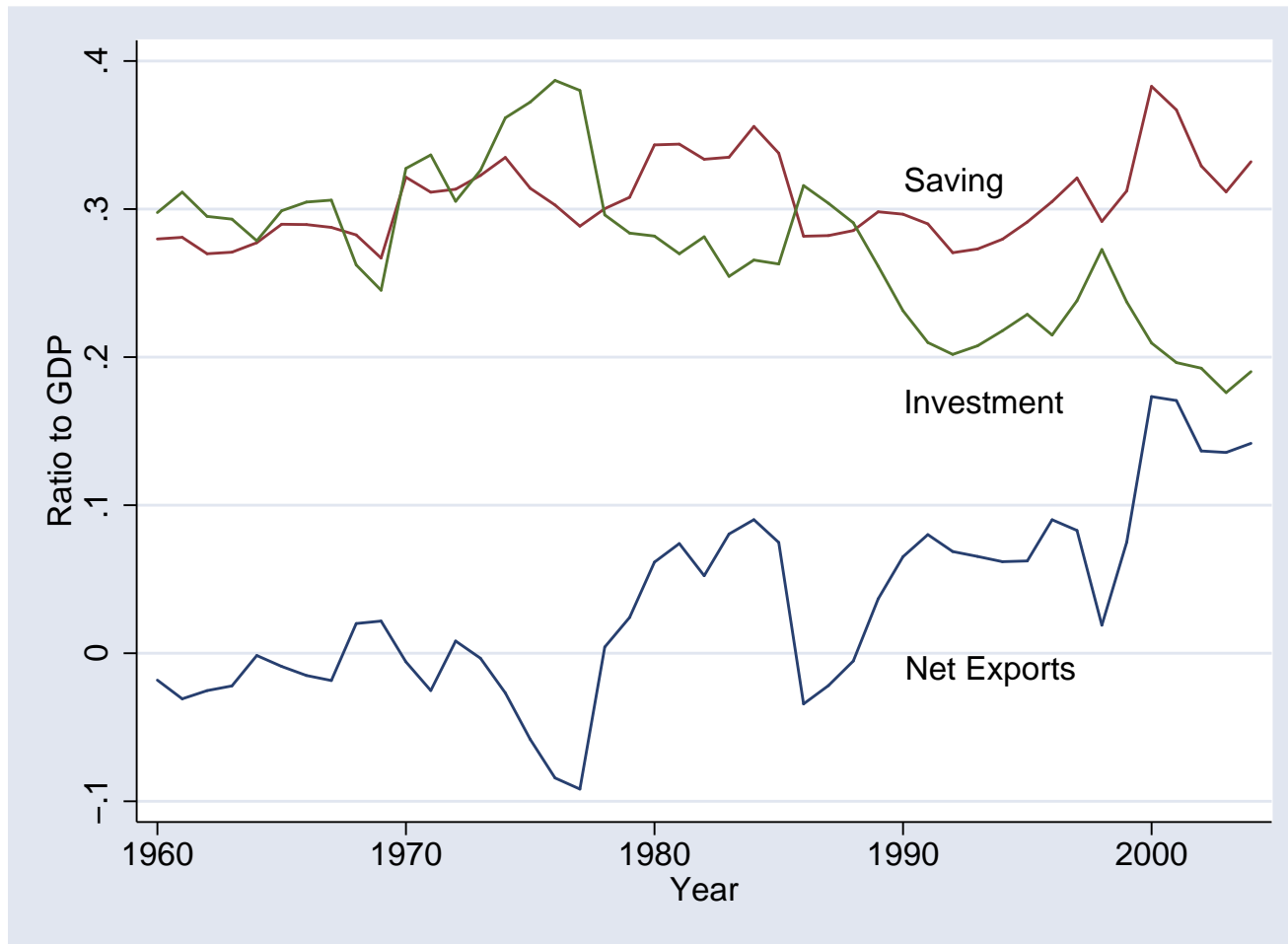
What's going on in Germany?



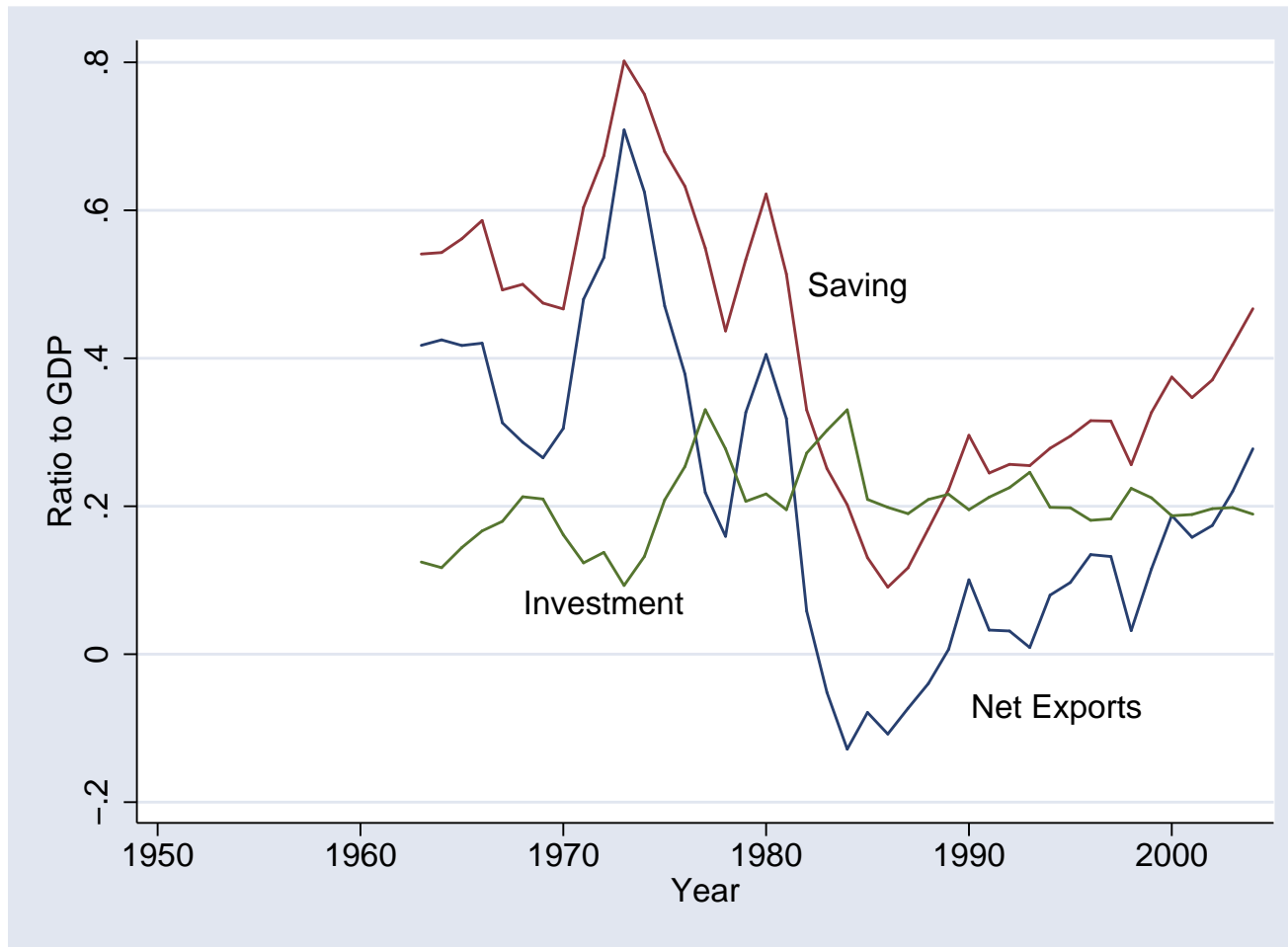
What's going on in Japan?



What's going on in Norway?



What's going on in Saudi Arabia?



What's going on in ROW?

In Germany, Switzerland, and Japan

- low investment, low growth
- trade surplus and capital outflows

In Australia, Spain, and the UK

- high investment, high growth
- trade deficit and capital inflows

In Norway and Saudi Arabia

- flat investment, high growth
- trade surplus and capital outflows

Summary

Conclusions

- US consumption is high because wealth is high
- Capital is leaving other countries because prospects are poor
- Plus: oil exporters

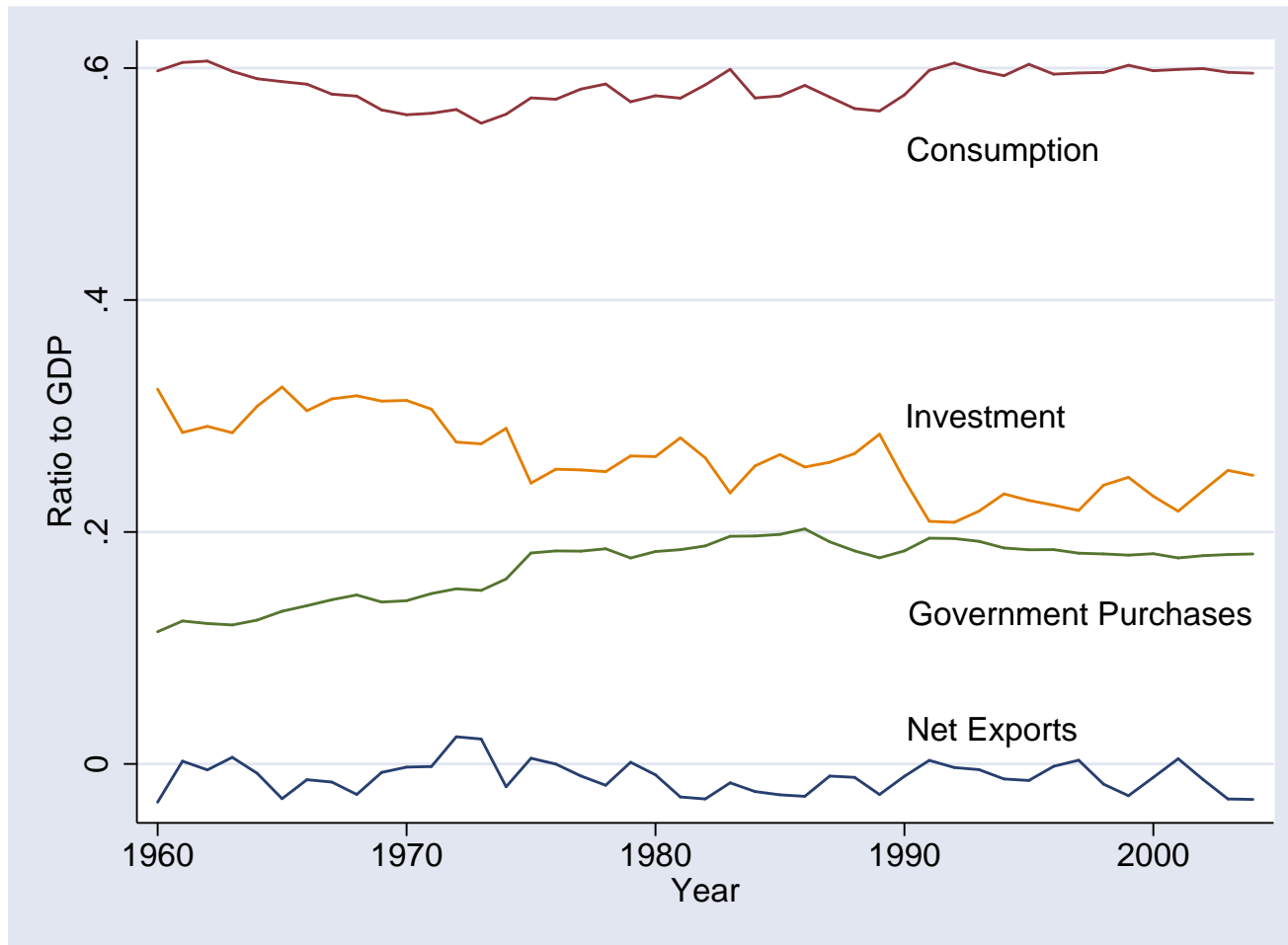
Open questions

- Are large current account “imbalances” becoming more common?
- Why are US valuations so high?
- Will ROW turn around?

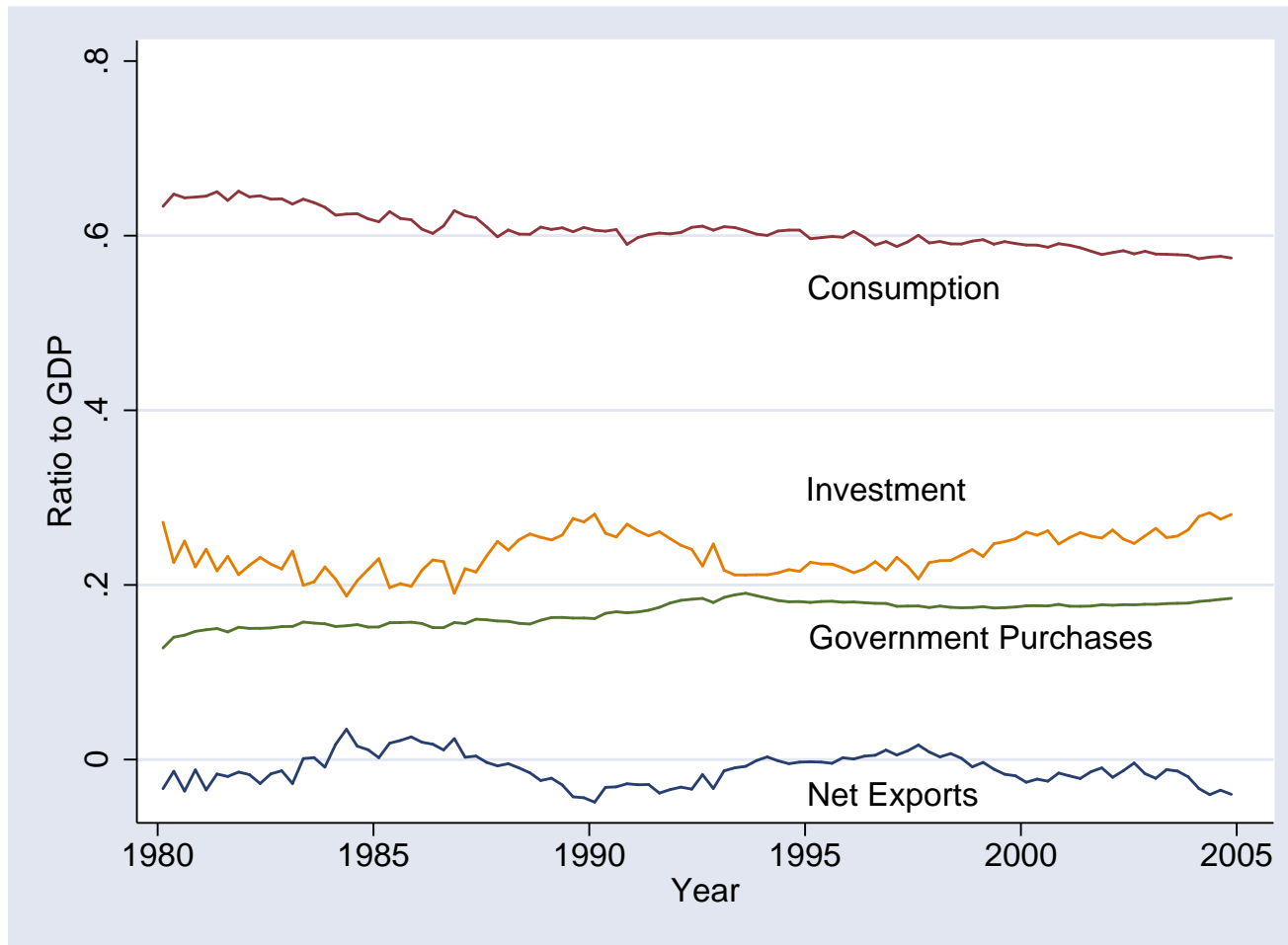
Larry Summers

There is a standard set of things that finance ministers of countries with significant current account deficits say, suggesting that such deficits are somehow a sign of economic strength. Perhaps the sharpest formulation I have heard is: ‘We live in a country that capital is trying to get into. **Would you rather live in a country that capital is trying to get out of?**’

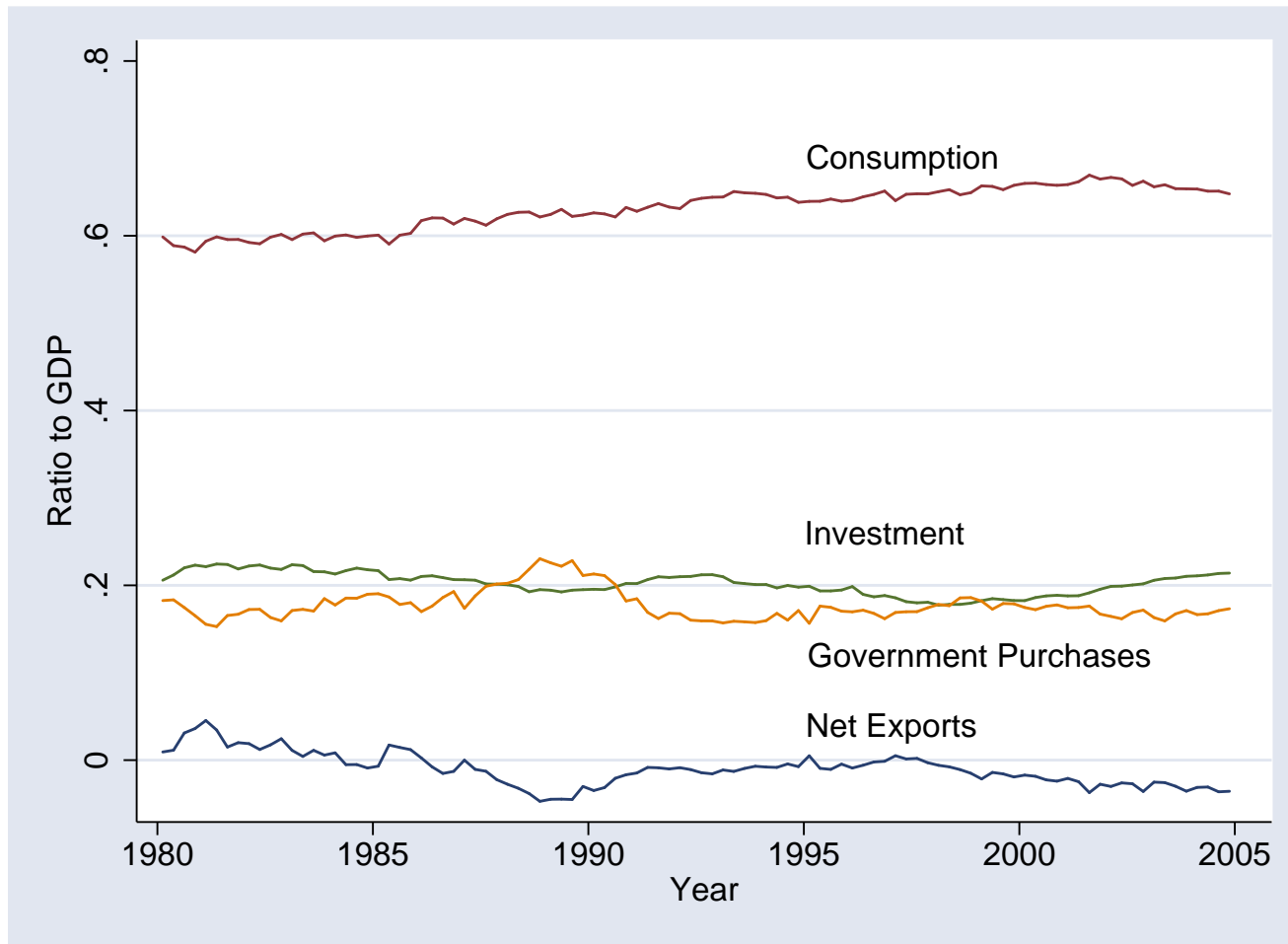
What's going on in Australia?



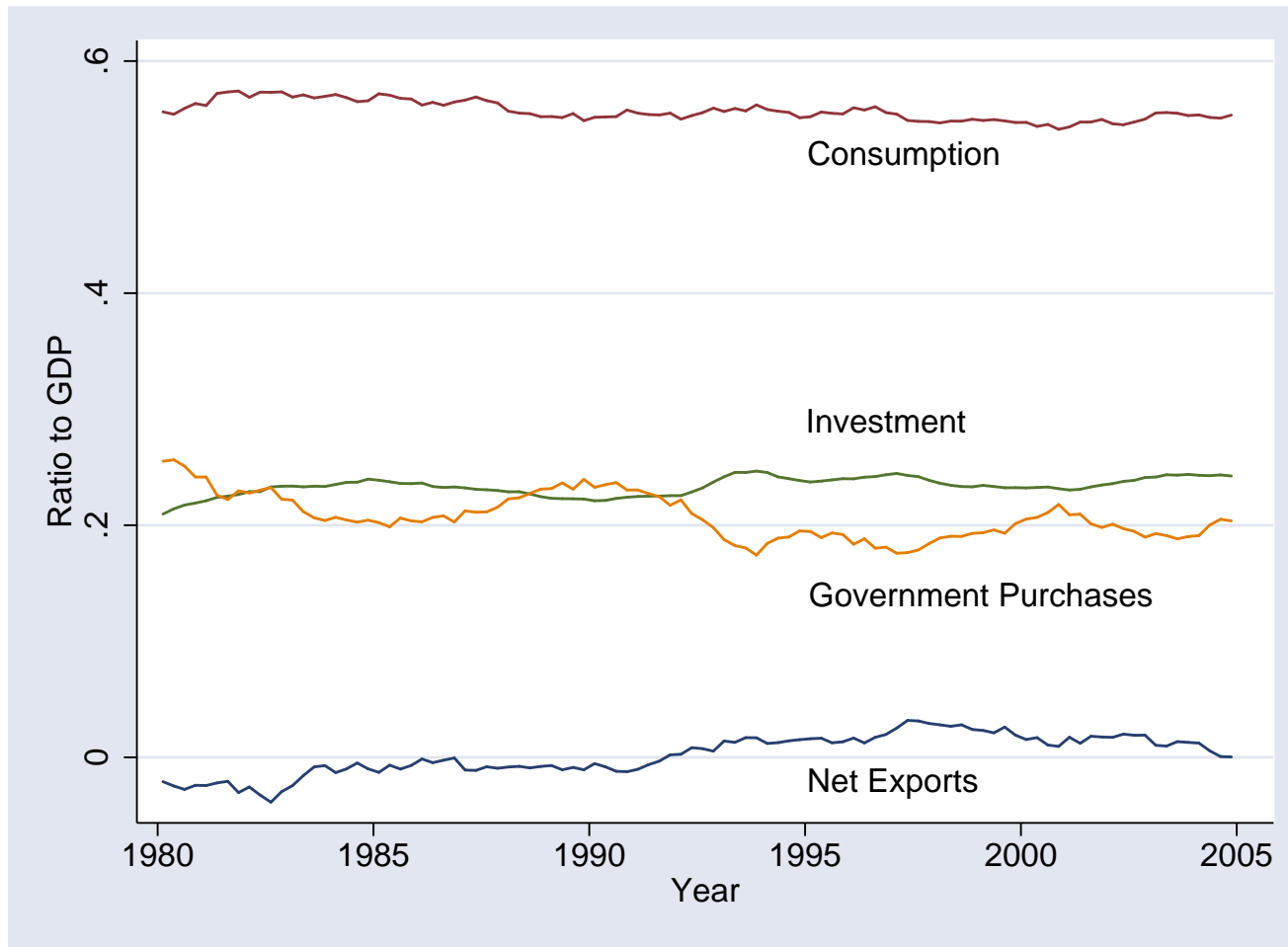
What's going on in Spain?



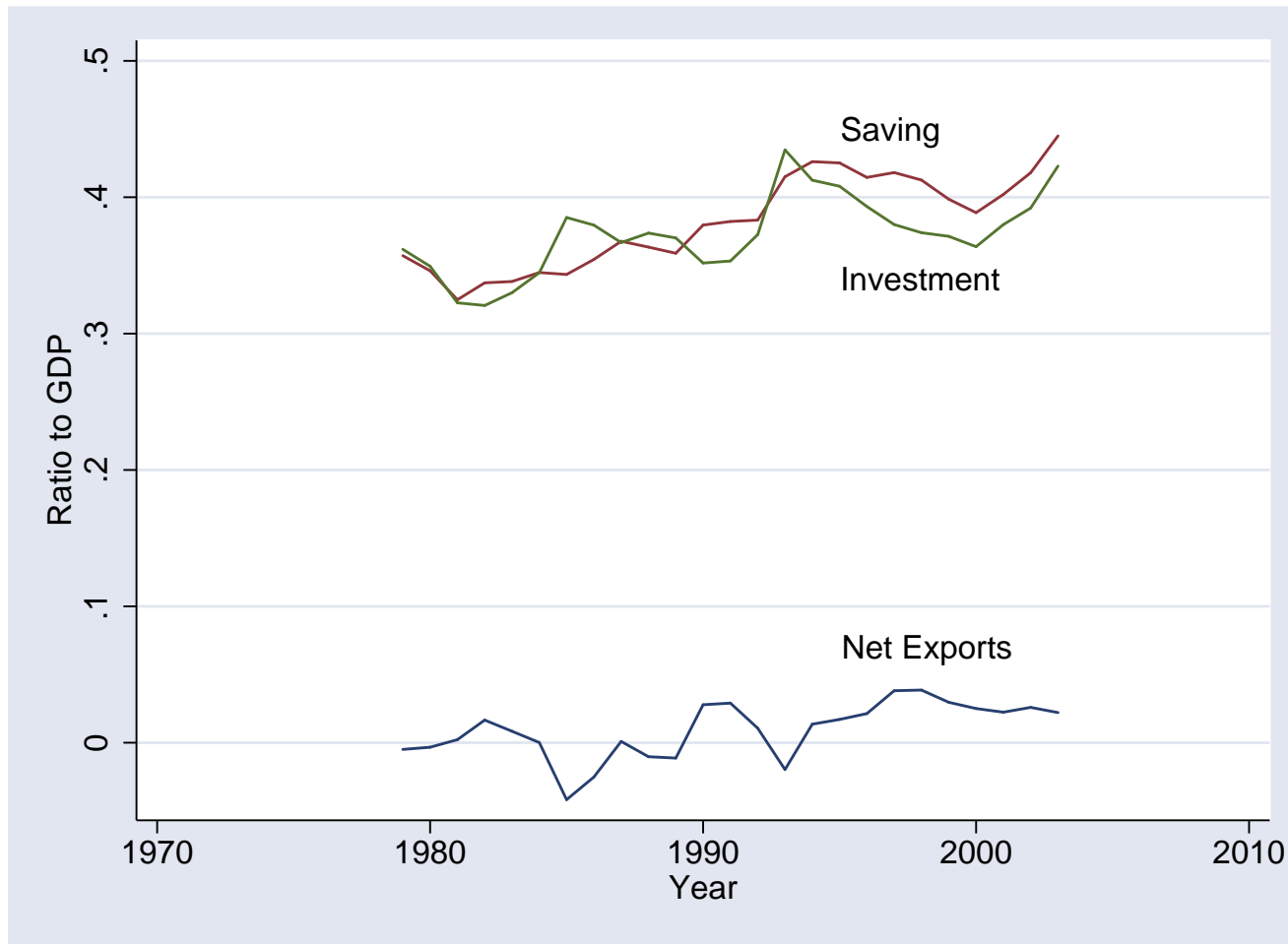
What's going on in the UK?



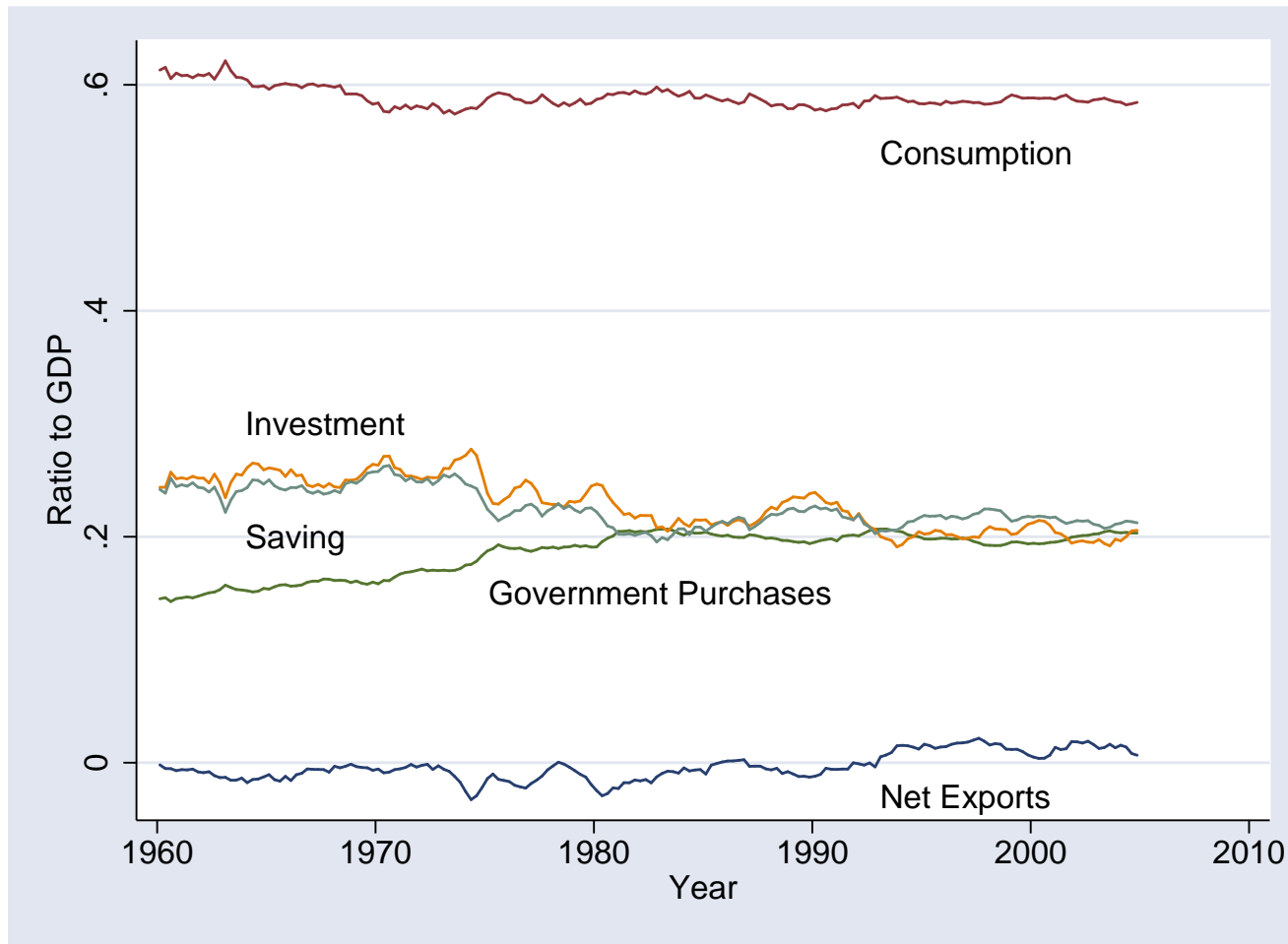
What's going on in France?



What's going on in China?



What's going on in Europe?



Notes

More authors than results?

Buying or selling, contrast with prewar Britain

Fact or Fiction: Benfica > Man United?