

# **The US current account deficit: will there be a hard landing?**



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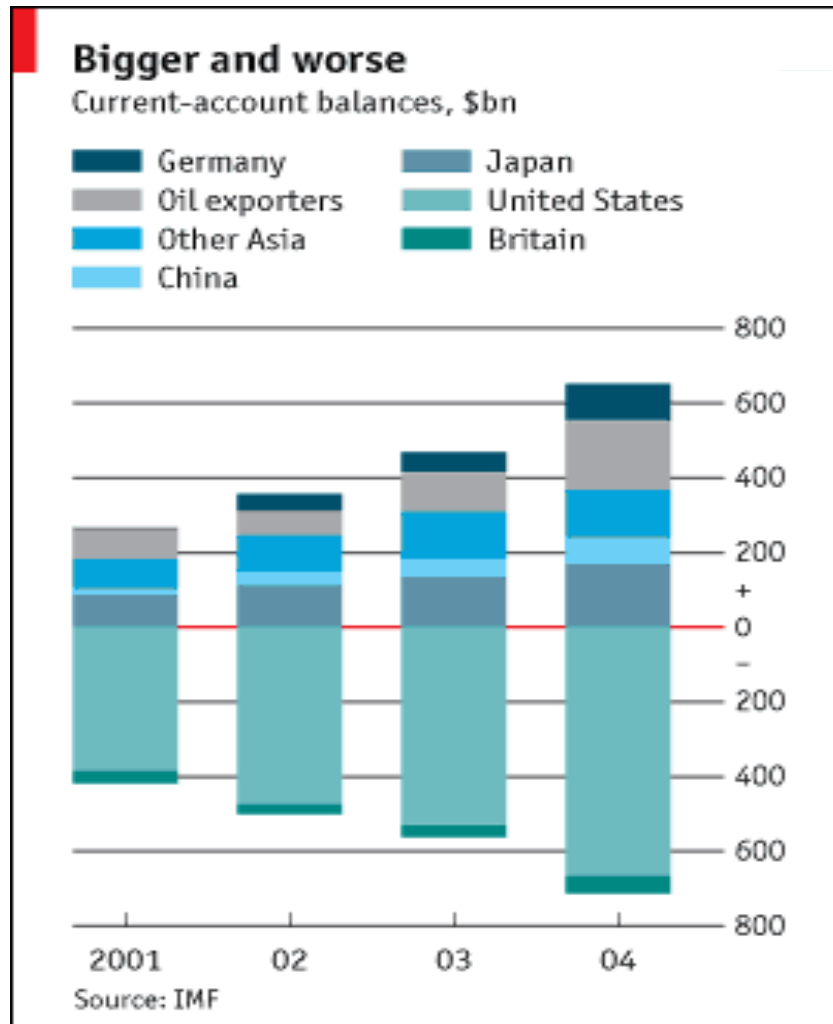


# Key indicators for the US economy

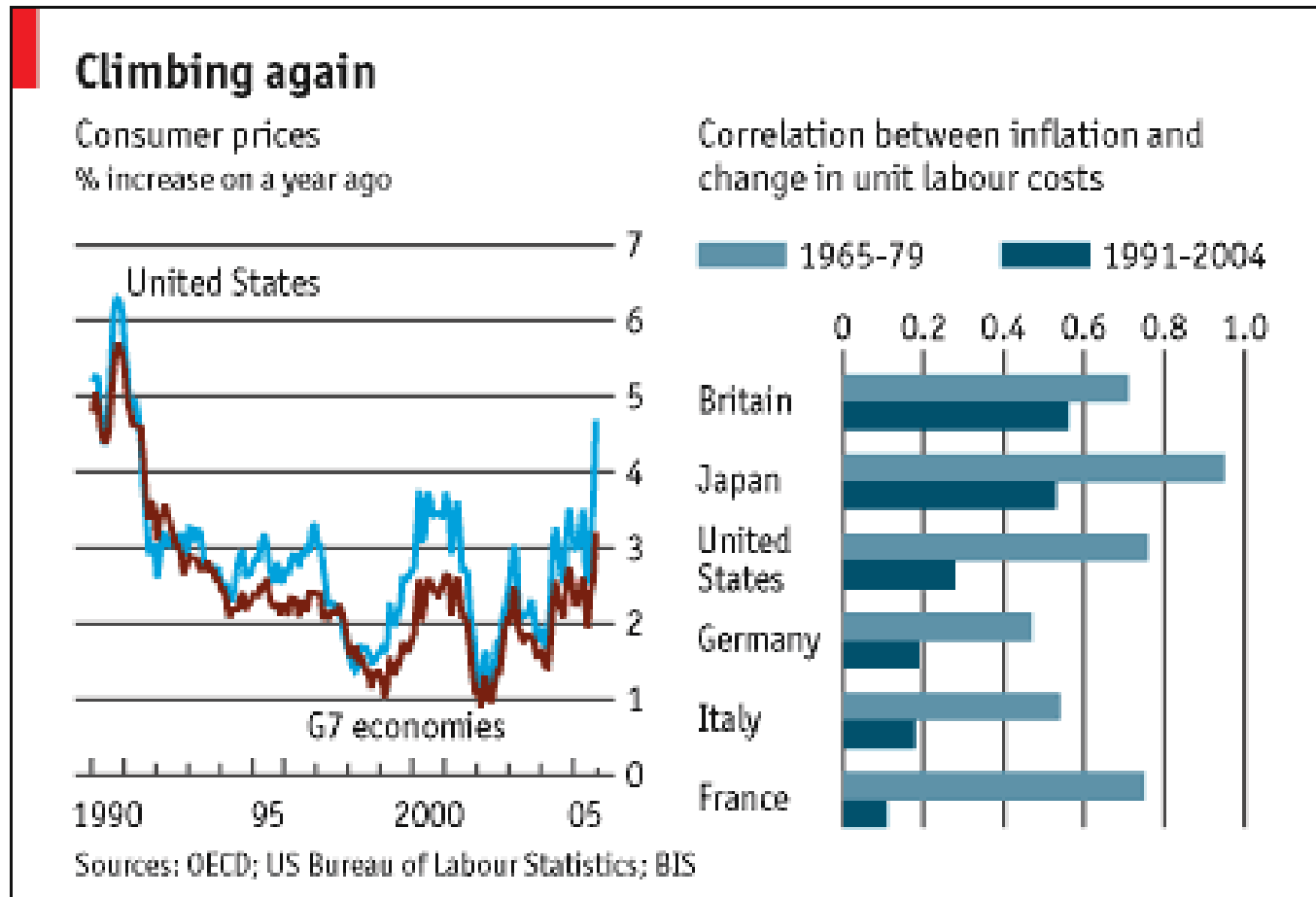
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- ◆ **GDP growing at annual rate of 3.5%**
- ◆ **Current account deficit at \$635 billion – 6% of GDP**
- ◆ **Fiscal deficit \$412 billion – 3.6 % of GDP**
- ◆ **US inflation rate rising**
- ◆ **Interest rate – 4%, 10 year bond yields – 4.6%, US\$ at two-year high**

# Current account deficit



# US inflation rate





# Is the deficit “made” in China?

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- ❖ **Politicians see China as the culprit**
- ❖ **Yuan pegged to US\$ for past decade, but peg was abandoned in July 2005**
- ❖ **Yuan would have to appreciate by 5-10% over next 12 months to even dent deficit**
- ❖ **China accounts for only a fraction of US trade deficit**



# Freeing up the Yuan

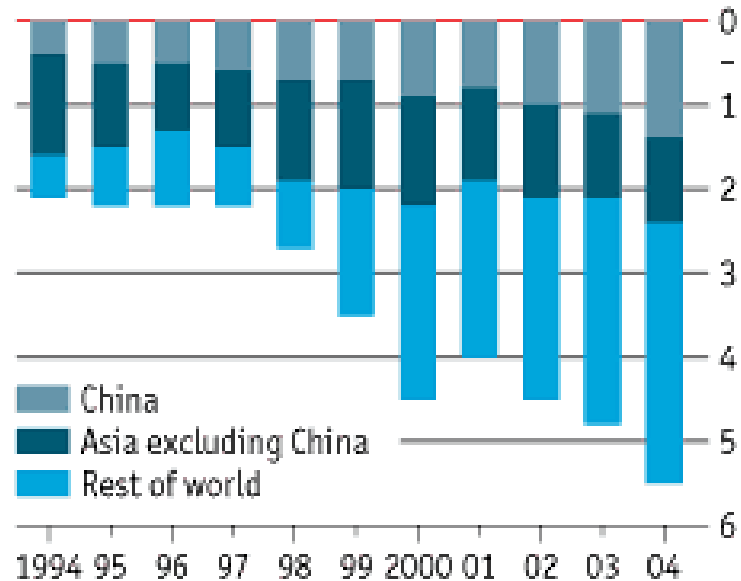
## Little appreciated



Source: Thomson Datastream

## Not guilty

US trade deficit as % of GDP by region



Source: UBS

# A lack of US savings?



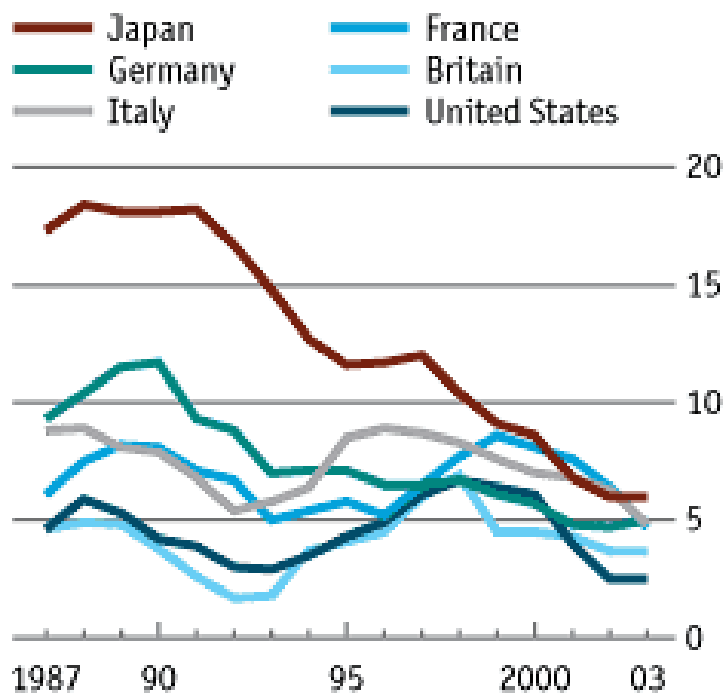
- ◆ **Net national saving at 2% of GDP – lowest since the Great Depression**
- ◆ **Personal savings rate is negative**
- ◆ **Consumers borrowing against increasing house prices – 13%/year**
- ◆ **Debt service at a record high**

# US savings rates



## A picture of decline

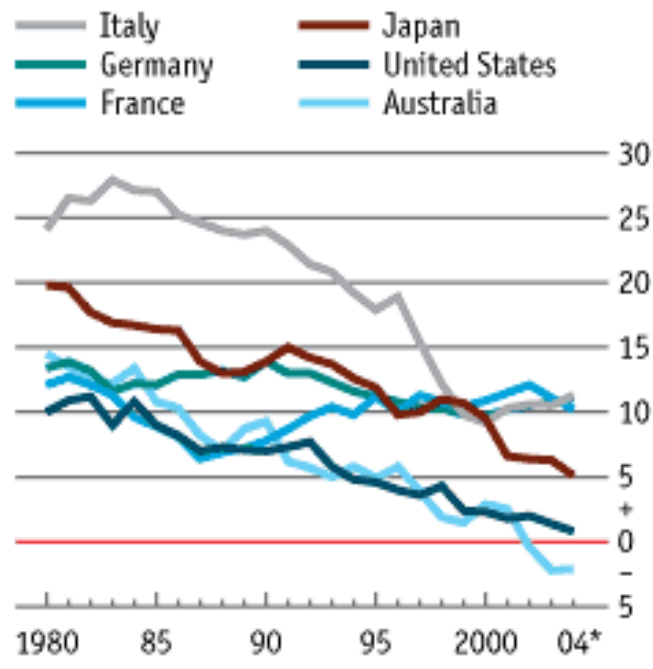
Net national saving rates as % of GDP



Sources: PricewaterhouseCoopers; DECD

## Come tomorrow

Net household saving rates as % of disposable household income



Source: OECD

\*Estimate

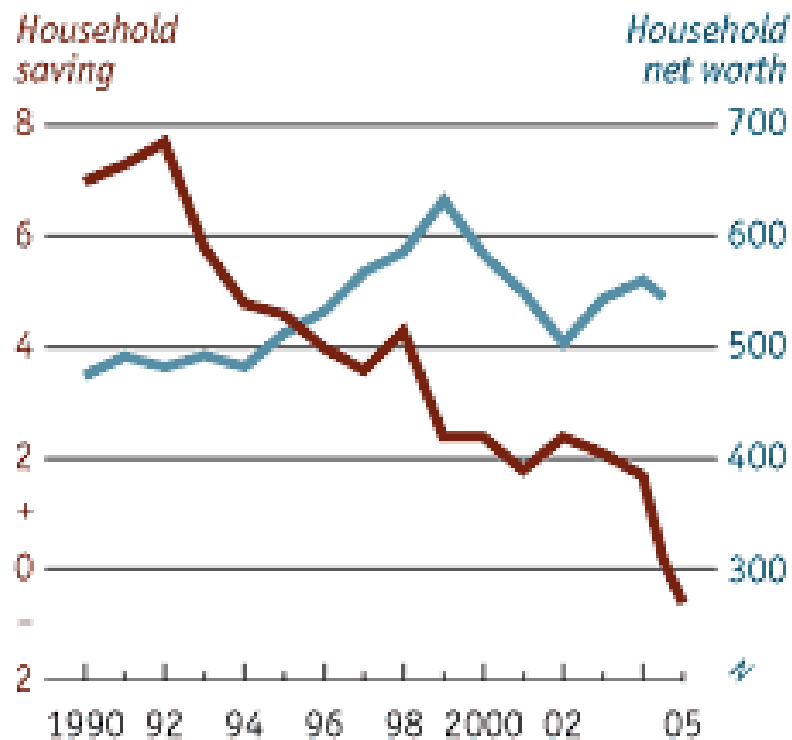


# Getting rich quick.....



## Getting richer without trying

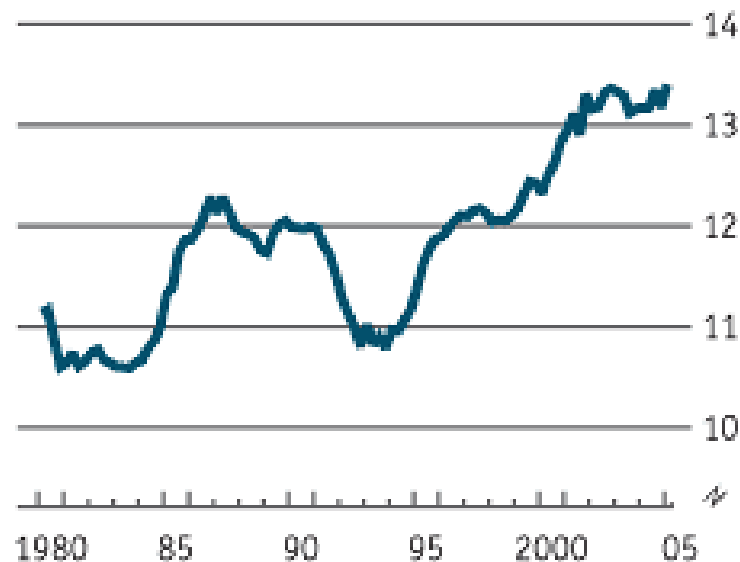
United States, as % of disposable income



Sources: Federal Reserve; US Department of Commerce

## The trouble with borrowing

US debt-service payments as % of disposable income



Source: Federal Reserve



# Or is it “Bernankeconomics”

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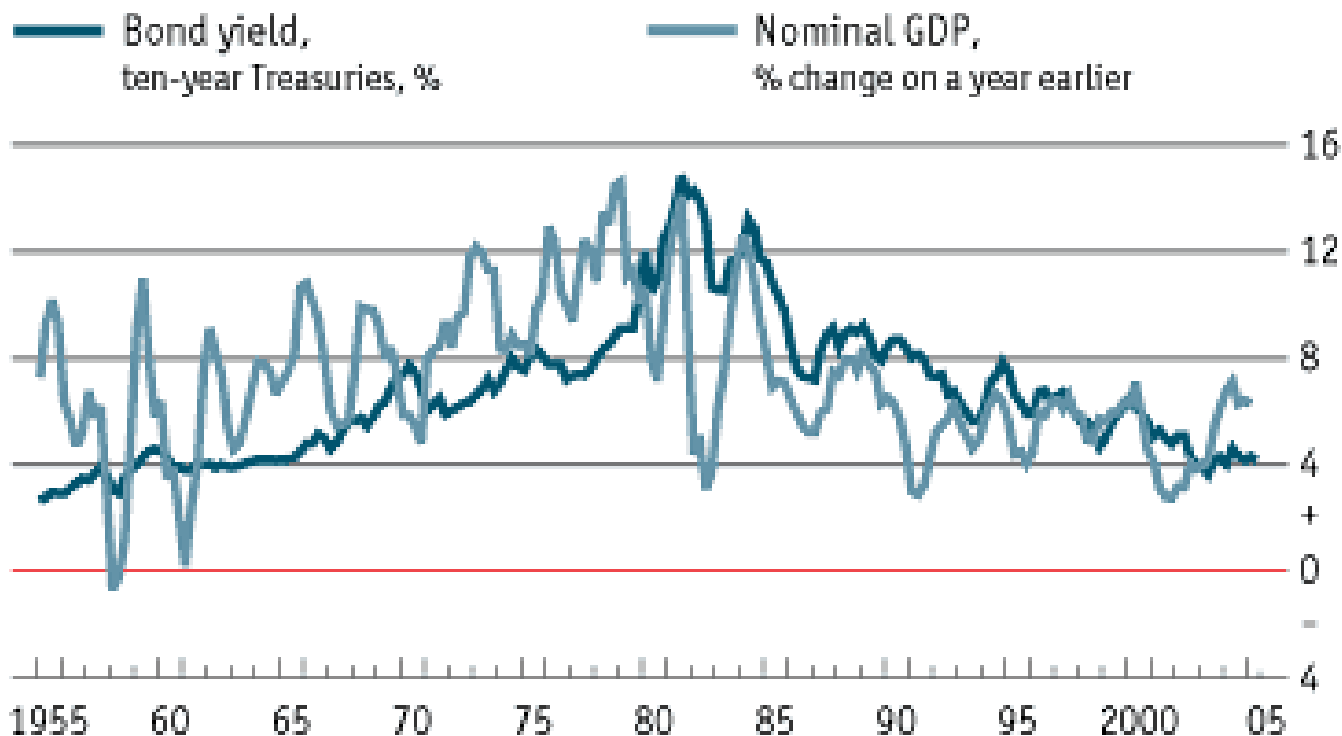
- ◆ Dismisses “twin-deficits” argument
- ◆ Lack of US savings more likely due to external factors
- ◆ A “global savings glut” – helps finance US trade deficit
- ◆ Link between growth and interest rates may not hold



# US treasury bond yields

## Rock 'n' roll yields

American bonds and growth

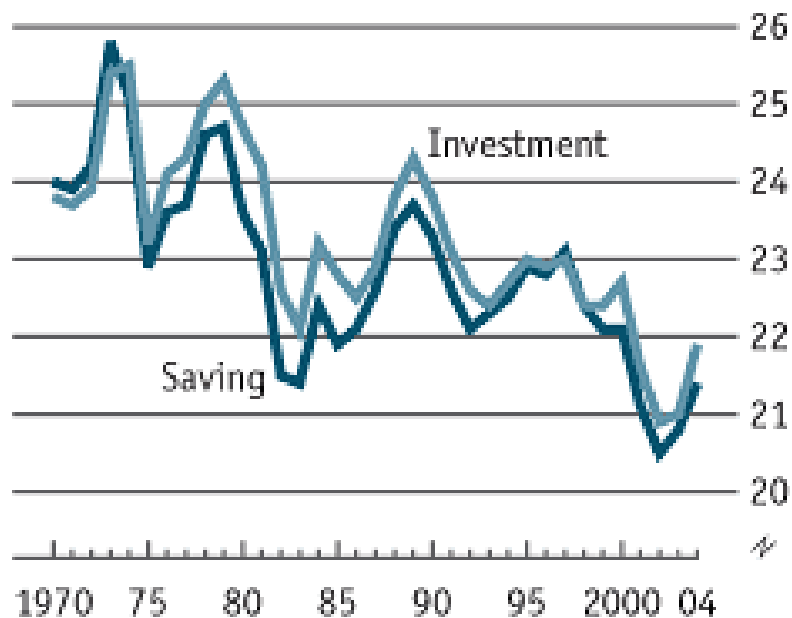


Sources: HSBC; Thomson Datastream

# Where is the glut though?

## What glut?

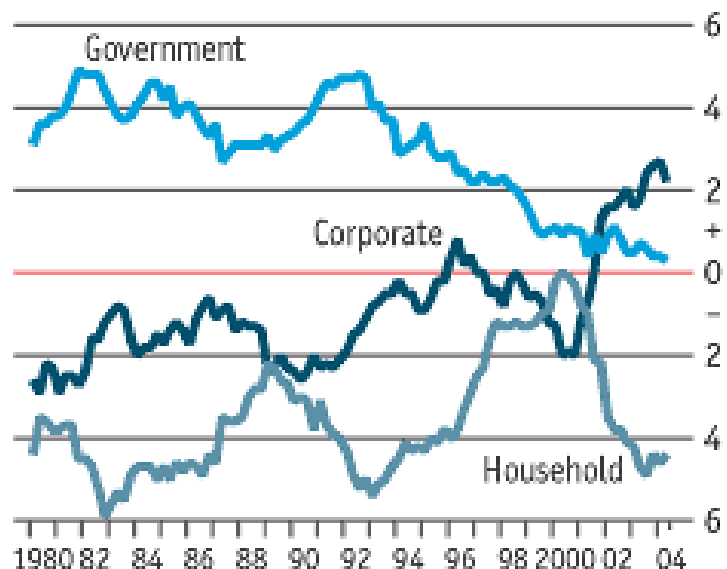
Global saving and investment as % of world GDP



Source: IMF

## Shifting fortunes

G7 net saving balances, % of GDP



Source: UBS

# Investment vs. savings

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- ❖ **Low investment rates may explain low interest rates - but not imbalance between US and world**
- ❖ **Explanation lies in differing economic structures and policies:**
  - **fiscal/monetary stimulus in US since 2001**
  - **Asia has built up foreign-exchange reserves**
  - **China's savings rate and rising price of oil**

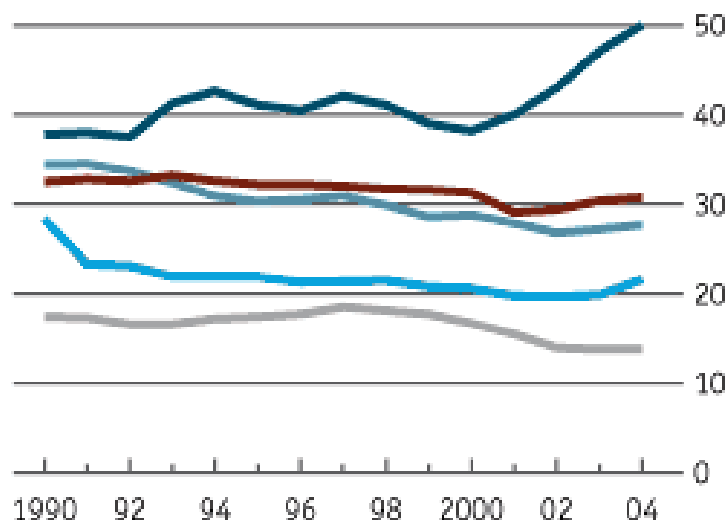
# Frugal China



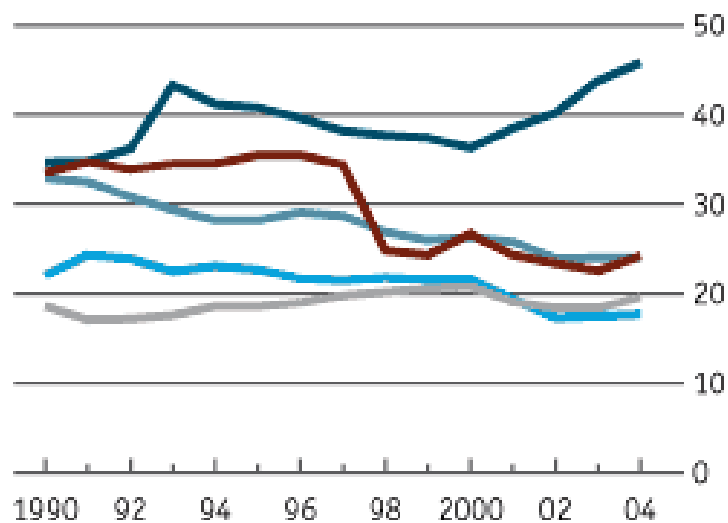
## In a league of its own

China Japan Asia excluding China and Japan United States Germany

Gross national saving as % of GDP



Gross domestic investment as % of GDP

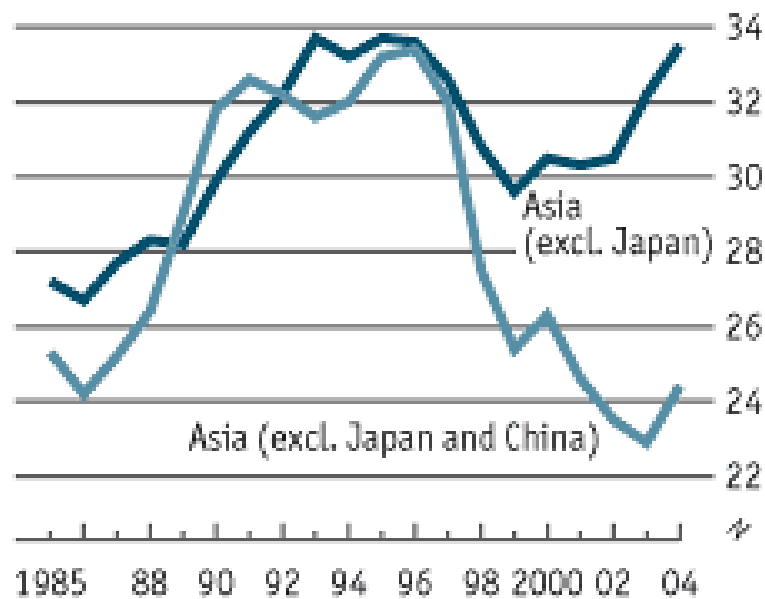


Source: IMF

# Asian tigers and oil exporters

## The China effect

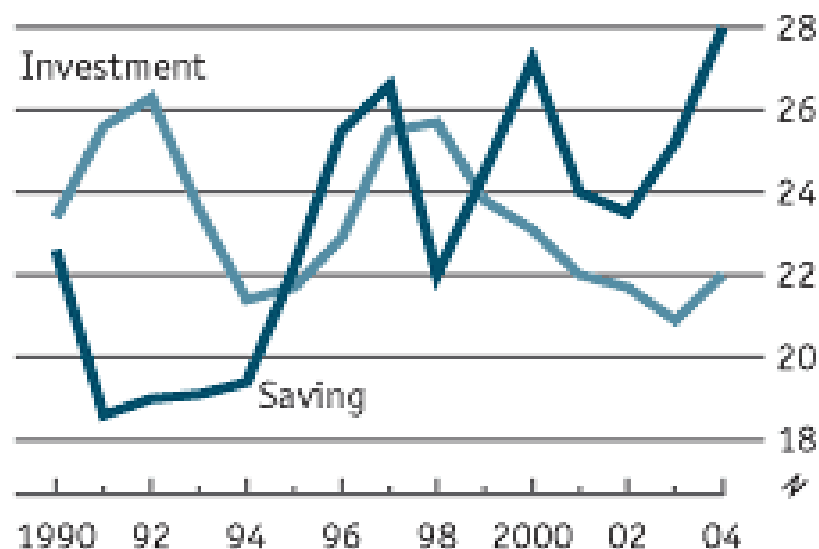
Investment as % of GDP



Source: Goldman Sachs

## Let's be prudent

Oil producers' national saving and investment  
% of GDP



Source: IMF

# Where's the money gone?

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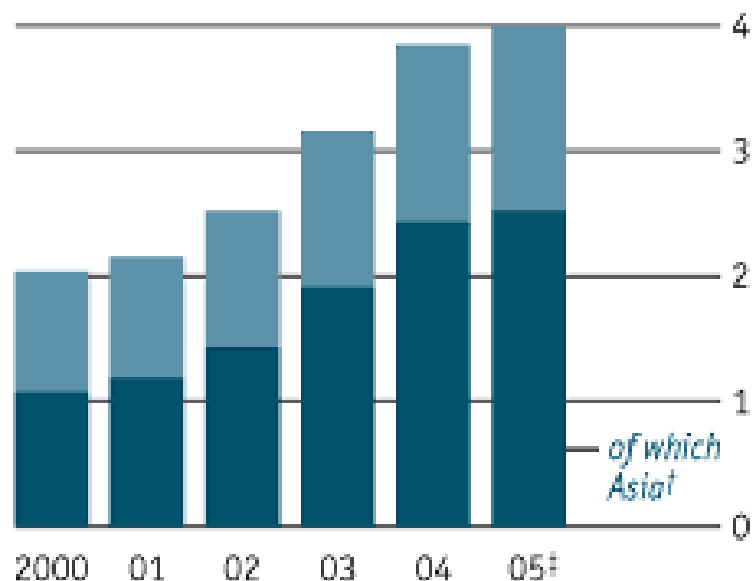
- ◆ **Increased foreign exchange reserves**
- ◆ **50% of US bonds purchased by foreign central banks in 2003/4**
- ◆ **In 2004 – central banks financed 60-70% of US trade deficit**
- ◆ **US treasury bond yields determined in Beijing – a “balance of financial terror”**



# Foreign exchange reserves and US bonds

## Too much of a good thing

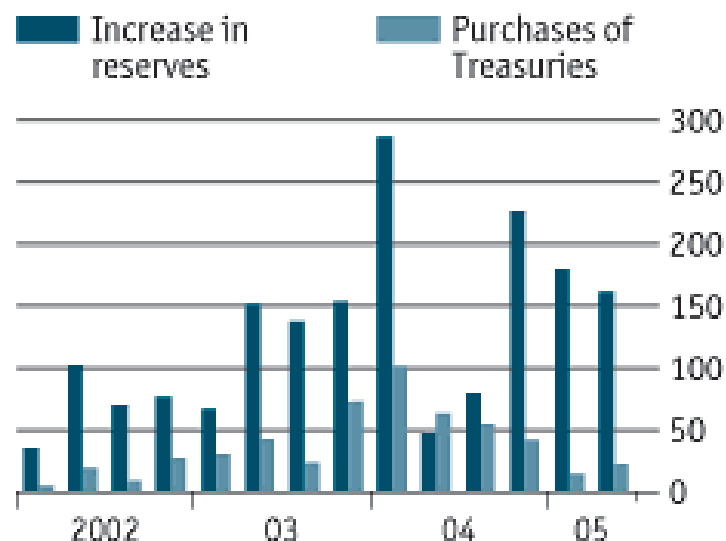
World foreign-exchange reserves\*, \$trn



Source: IMF \*Minus gold †Including Japan ‡Latest

## Waning appeal

Global increase in reserves and foreign central-bank purchases of US Treasuries, \$bn



Source: Brad Setser, Roubini Global Economics

# What is a hard landing?

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- ◆ **Trade deficit → crash in US\$**
- ◆ **Domestic inflation → nominal rates of return have to rise**
- ◆ **Inflation → interest rates rise**
- ◆ **Inflationary expectations → bond yields rise due to risk premium**
- ◆ **House price “bubble” bursts**

# Might there be a crash?

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- ◆ **Decline in purchase of US bonds causes US\$ to depreciate**
- ◆ **Short-term rates and bond yields rise**
- ◆ **End result – global recession**
- ◆ **Policy implications:**
  - **reduce savings surplus in China**
  - **encourage savings in US**
  - **reduce US budget deficit**
  - **EU should ease interest rates**

# Is this too pessimistic?



- ◆ **Purchases of US bonds have fallen in 2005, yet US\$ has appreciated**
- ◆ **Recent currency depreciations followed by falling bond yields**
- ◆ **Investors believe inflation has been tamed by monetary authorities**
- ◆ **Greenspan may be right – US imbalances will adjust gradually**

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