

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

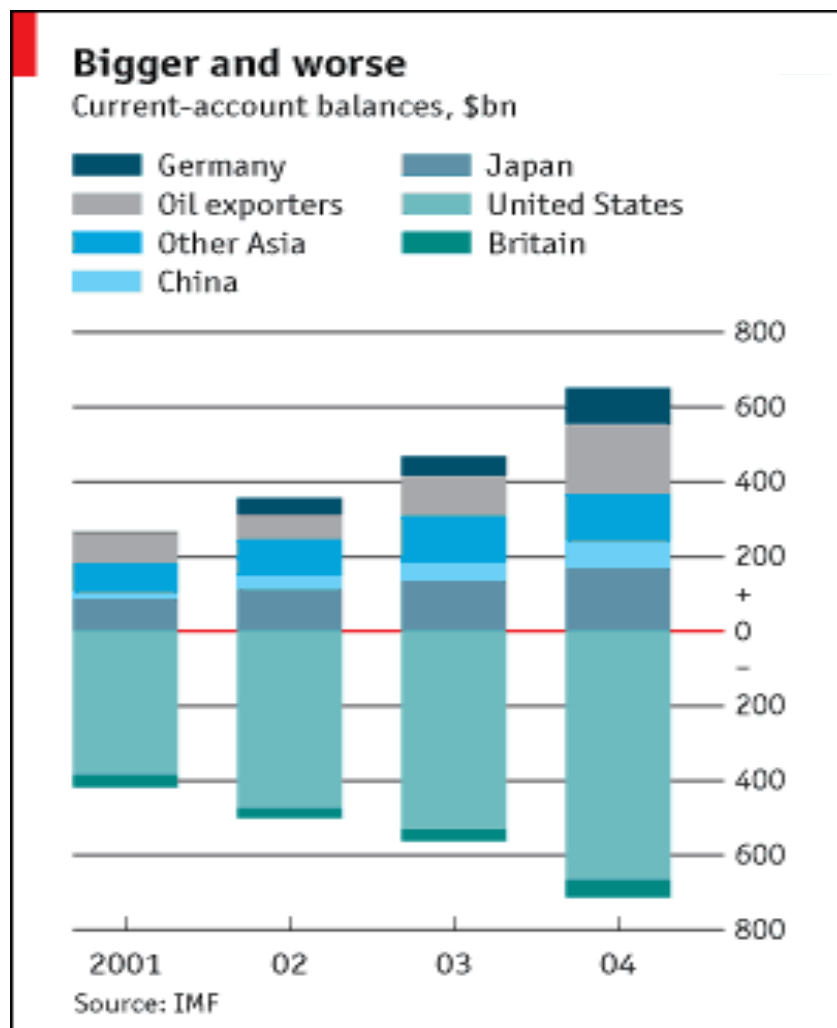


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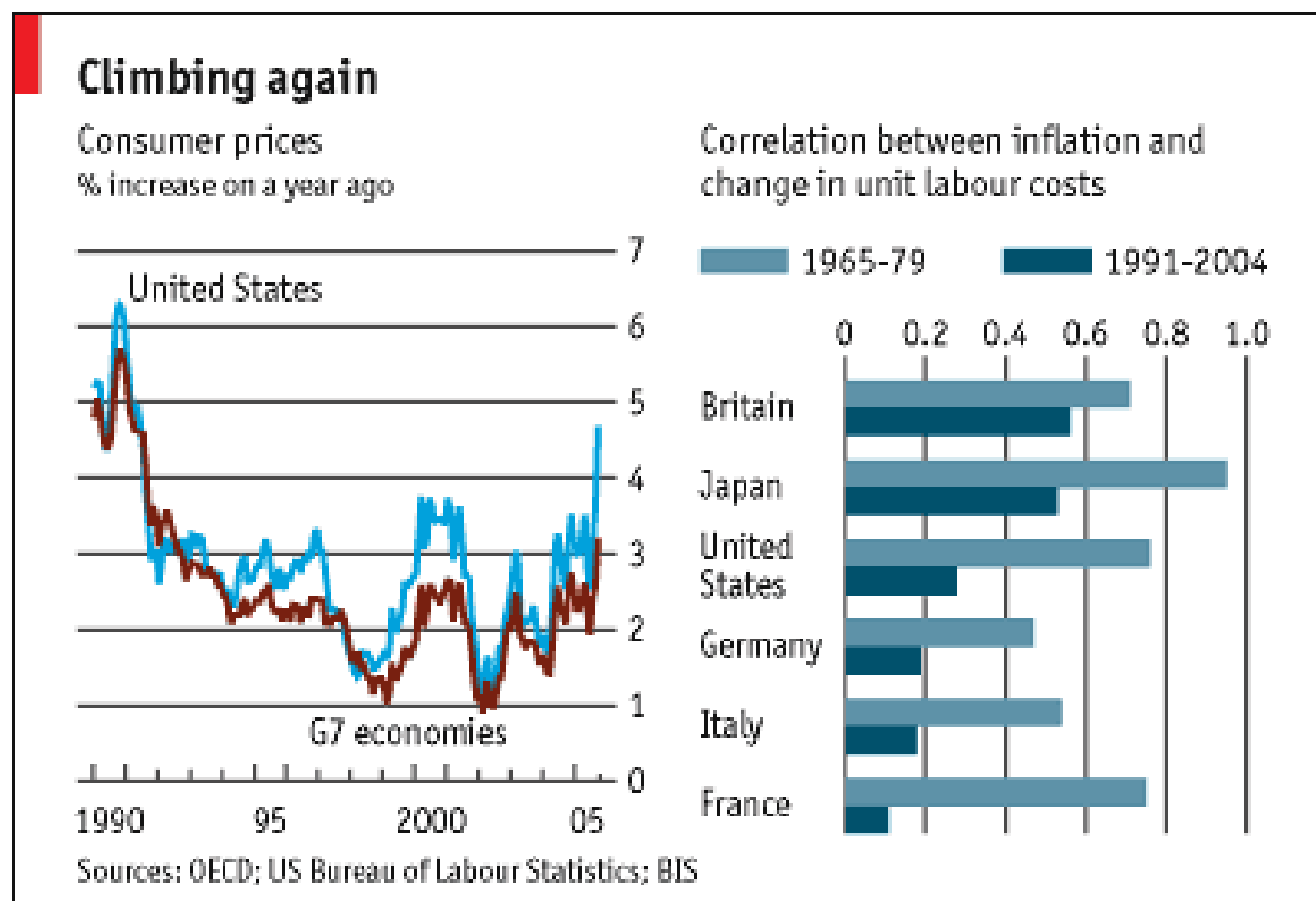
Key indicators for the US economy

- ◆ **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?

- ❖ **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**

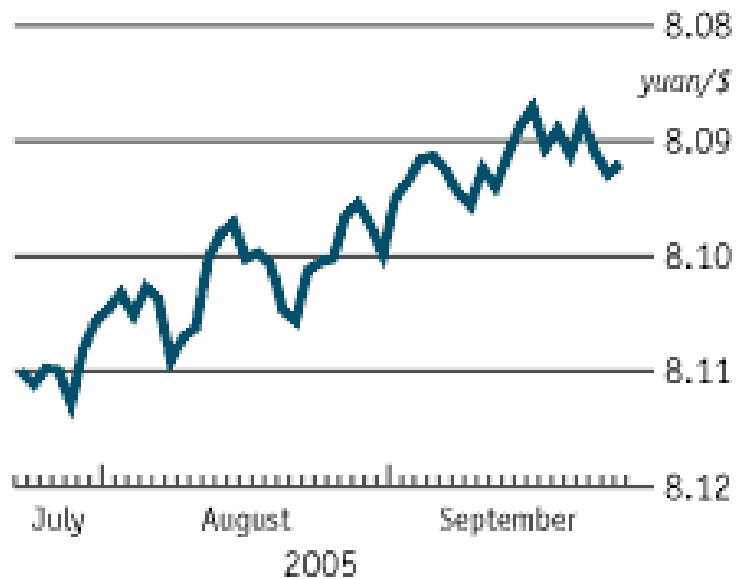


Freeing up the Yuan

Little appreciated

Chinese yuan against the dollar

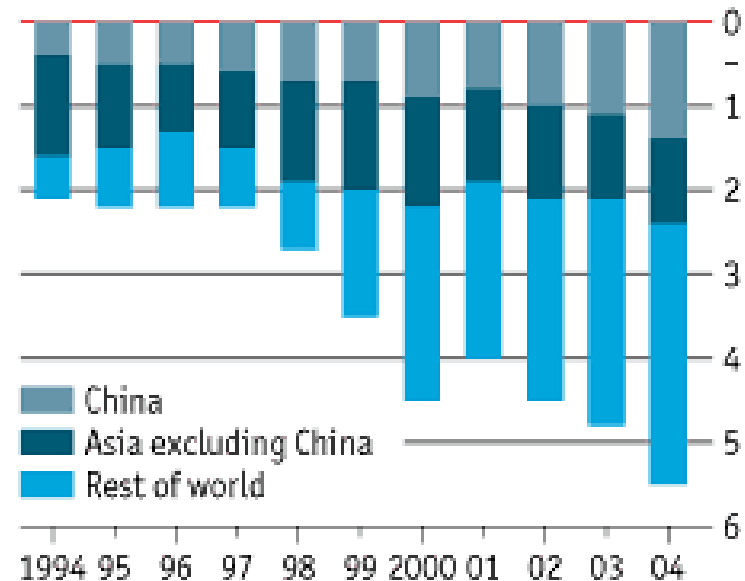
Inverted scale



Source: Thomson Datastream

Not guilty

US trade deficit as % of GDP by region



Source: UBS

A lack of US savings?



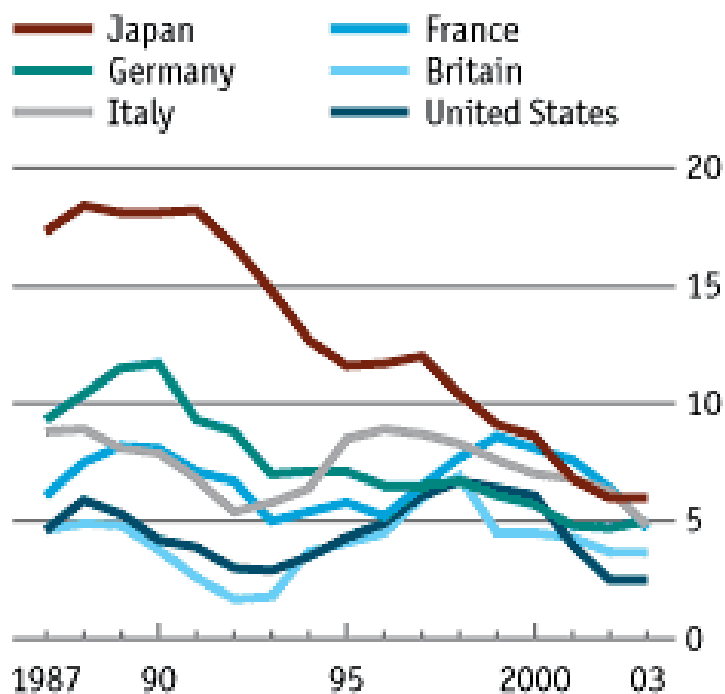
- ❖ **Net national saving at 2% of GDP – lowest since the Great Depression**
- ❖ **Personal savings rate is negative**
- ❖ **Consumers borrowing against increasing house prices – 13%/year**
- ❖ **Debt service at a record high**

US savings rates



A picture of decline

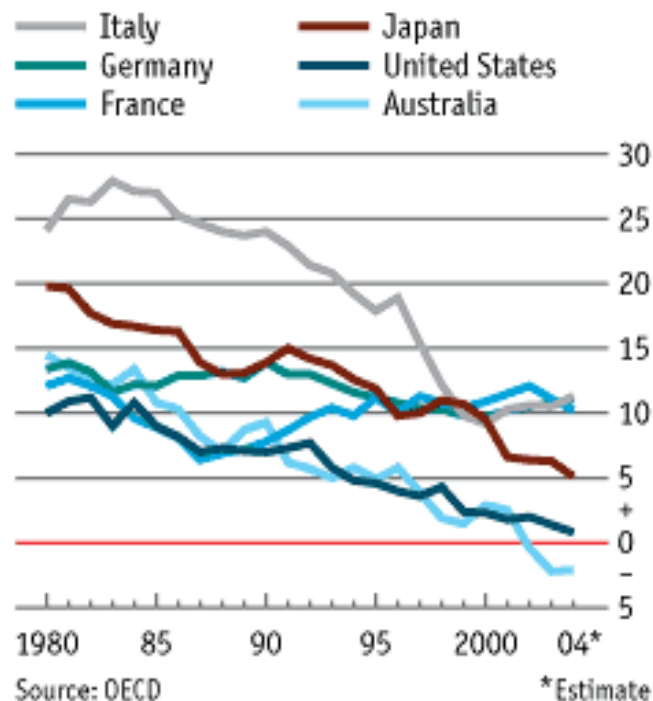
Net national saving rates as % of GDP



Sources: PricewaterhouseCoopers; OECD

Come tomorrow

Net household saving rates as % of disposable household income



Source: OECD

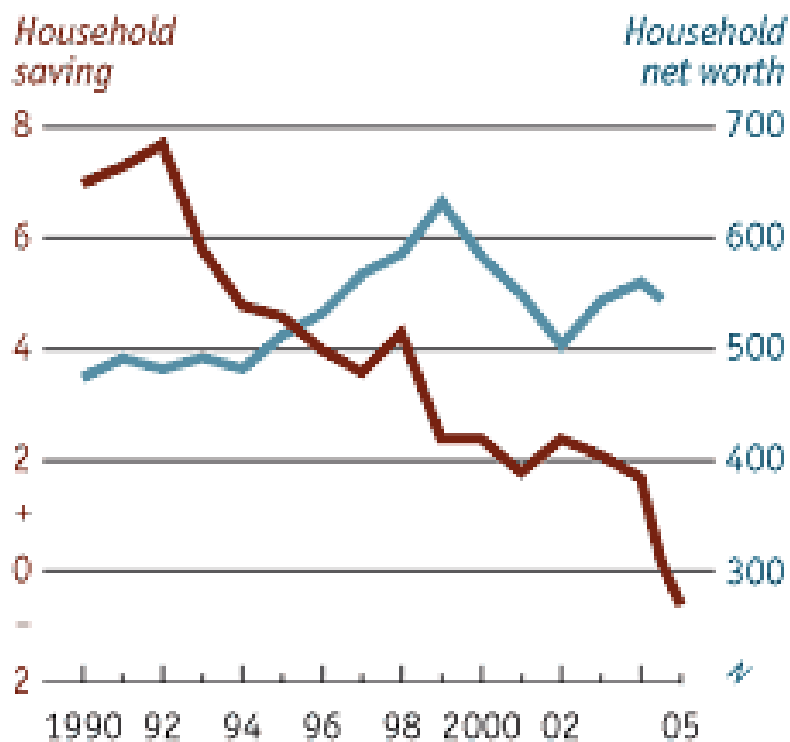
* Estimate

Getting rich quick.....



Getting richer without trying

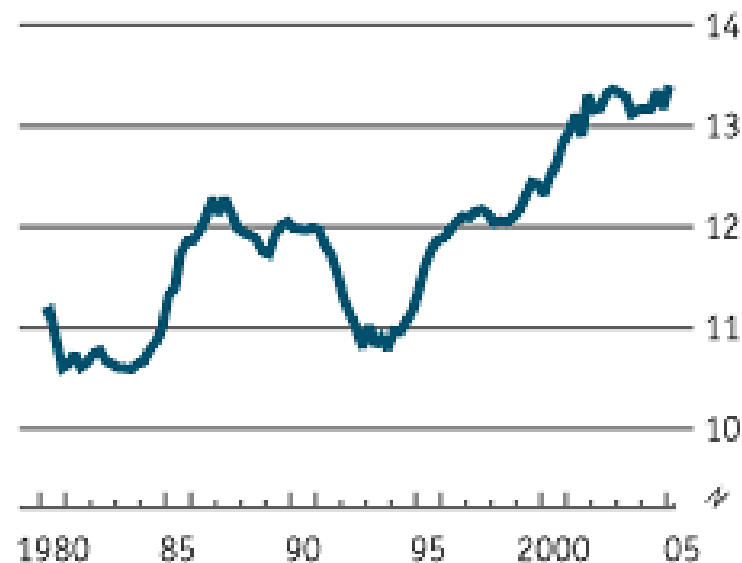
United States, as % of disposable income



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”

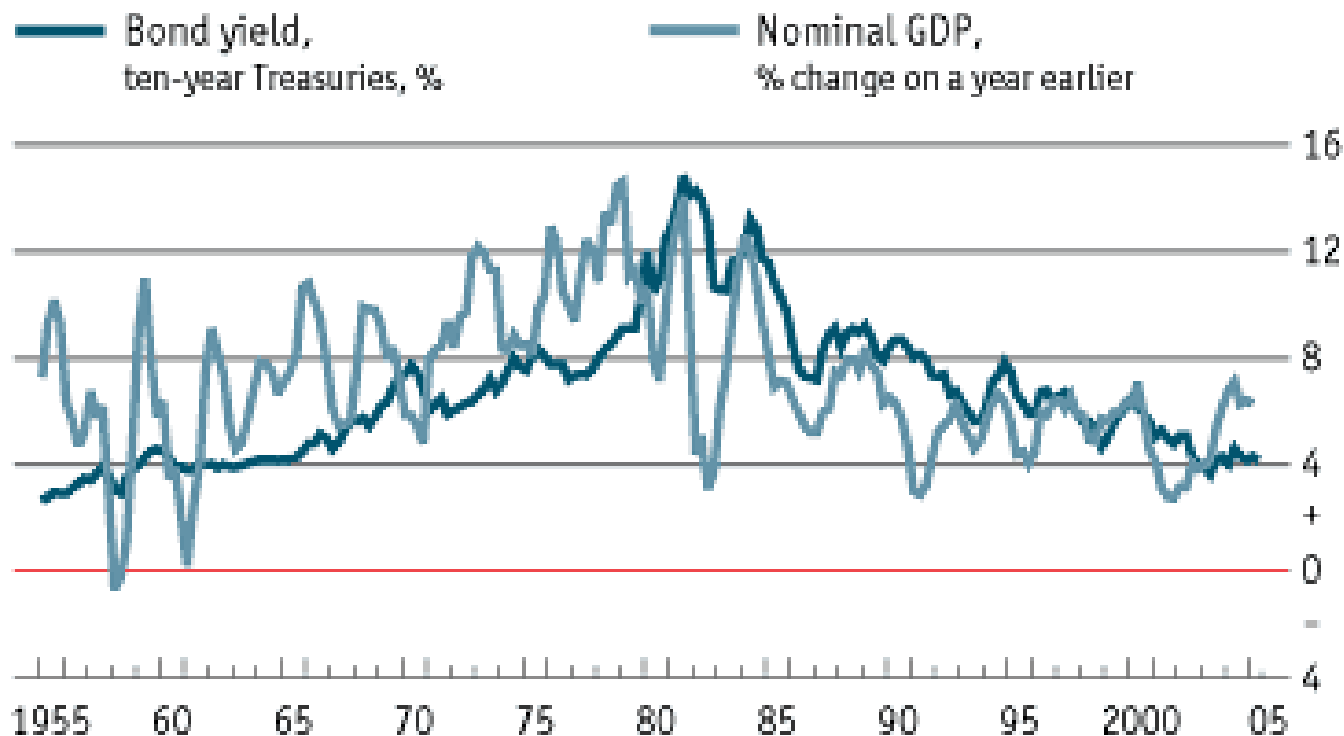
- ❖ Dismisses “twin-deficits” argument
- ❖ Lack of US savings more likely due to external factors
- ❖ A “global savings glut” – helps finance US trade deficit
- ❖ Link between growth and interest rates may not hold



US treasury bond yields

Rock 'n' roll yields

American bonds and growth

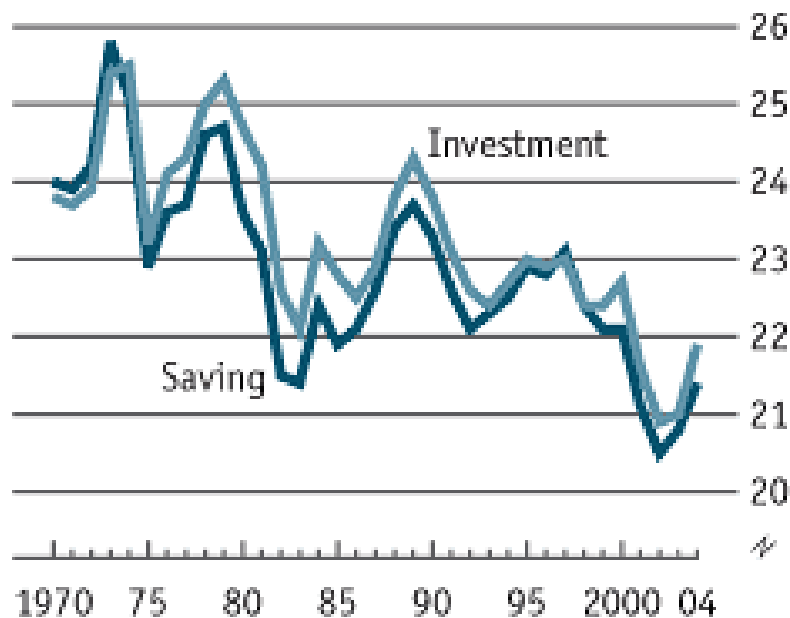


Sources: HSBC; Thomson Datastream

Where is the glut though?

What glut?

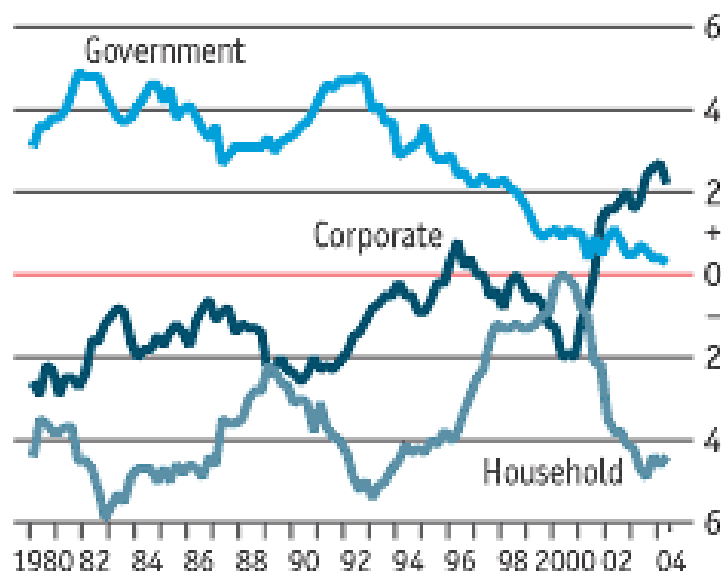
Global saving and investment as % of world GDP



Source: IMF

Shifting fortunes

G7 net saving balances, % of GDP



Source: UBS

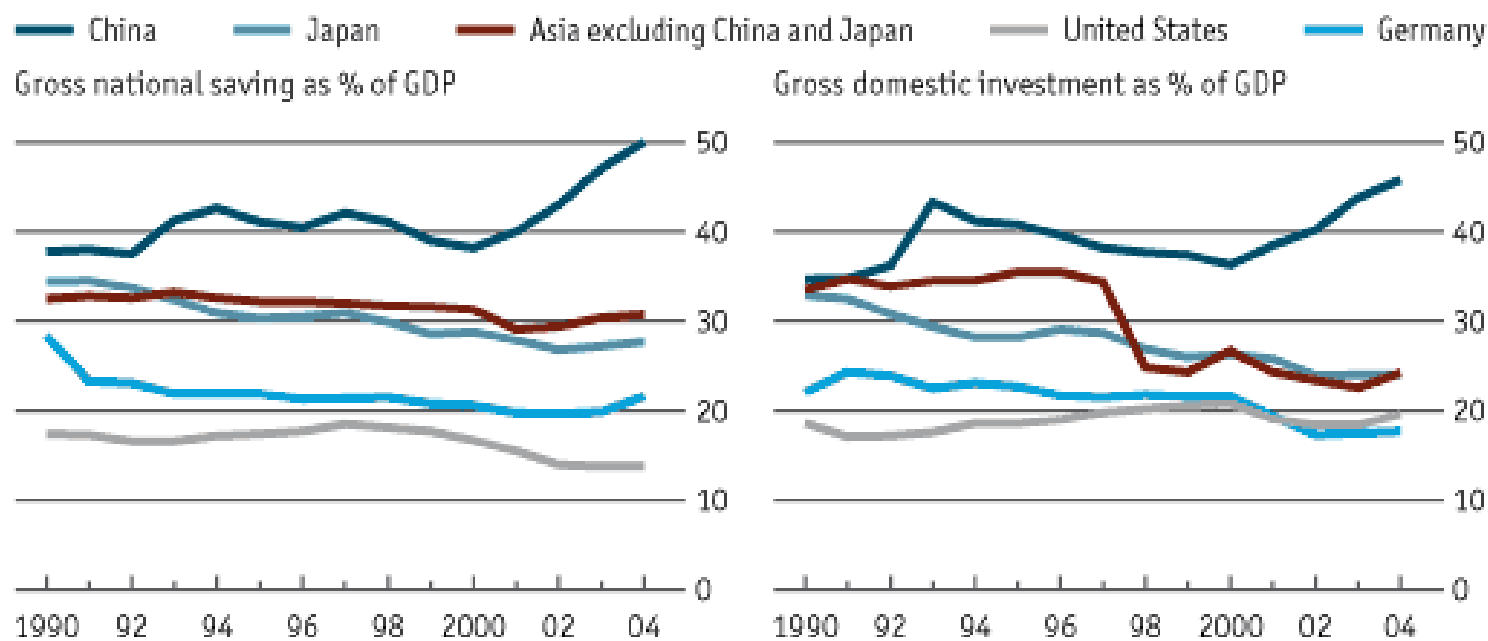
Investment vs. savings

- ❖ **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

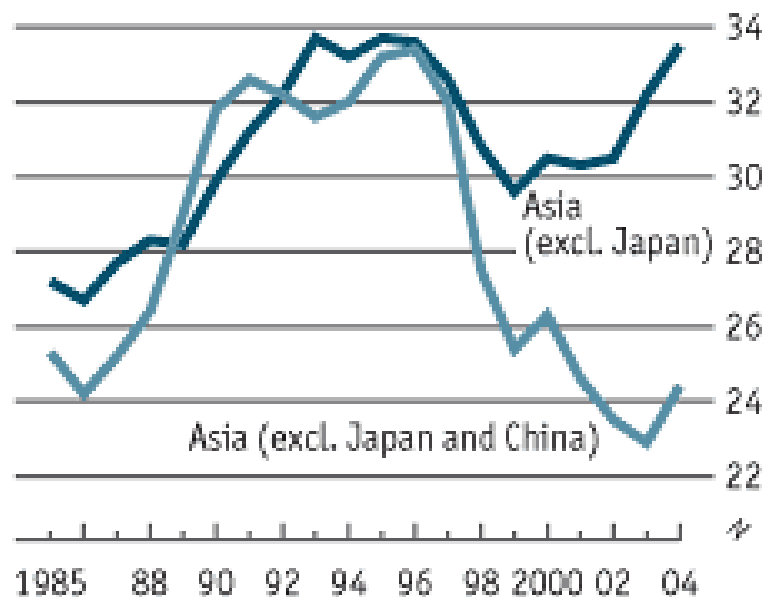


Source: IMF

Asian tigers and oil exporters

The China effect

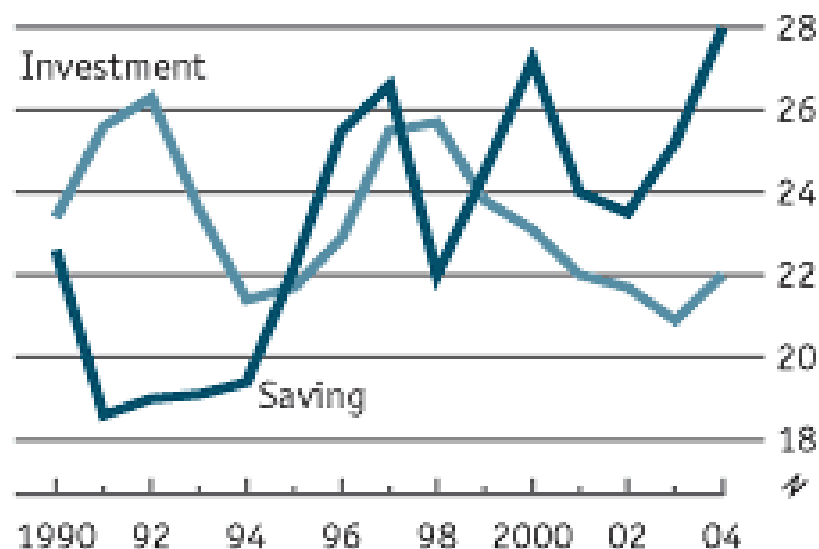
Investment as % of GDP



Source: Goldman Sachs

Let's be prudent

Oil producers' national saving and investment
% of GDP



Source: IMF

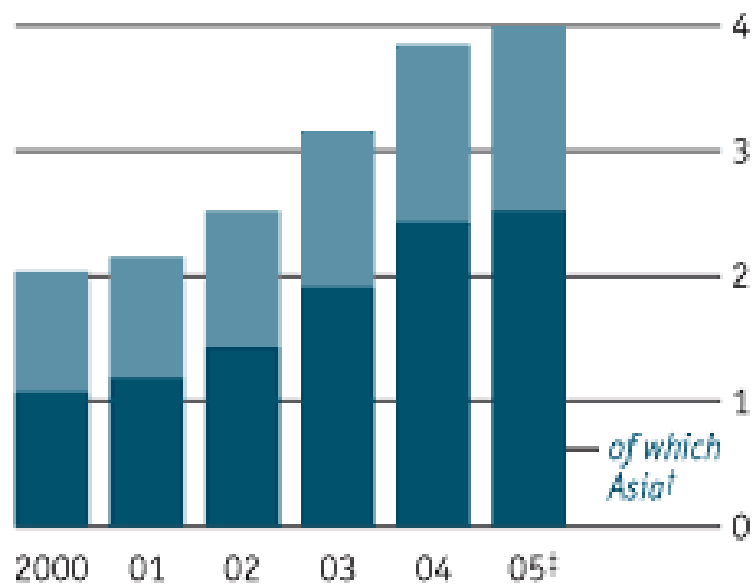
Where's the money gone?

- ◆ **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

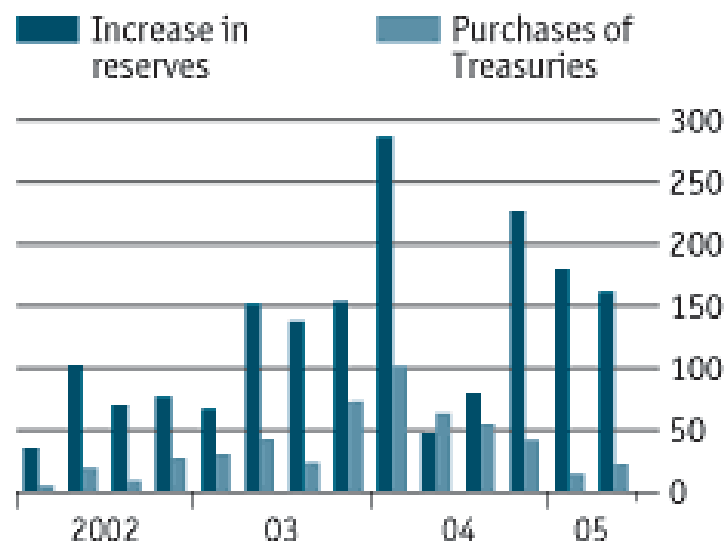
*Minus gold

†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?

- ◆ **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?

- ◆ **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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