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Economics Group

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U.S. Current Account Deficit Narrows Modestly in Q2

An increase in the primary income surplus caused the current account deficit to narrow in the second quarter. FDI inflows remained very strong in Q2.

Income Surplus Leads to Smaller Current Account Deficit in Q2

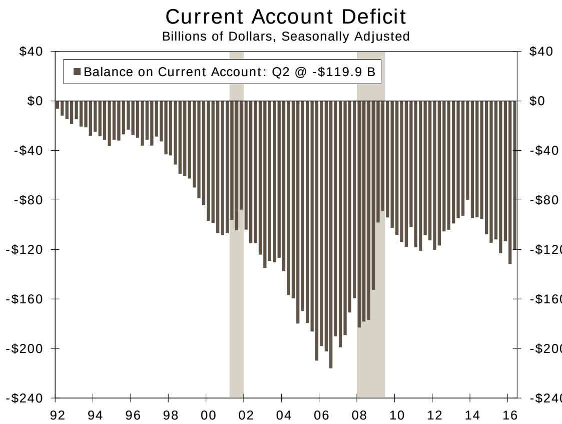
The red ink in the U.S. current account narrowed from a revised deficit of $131.8 billion in Q1-2016 to $119.9 billion in the second quarter (top chart). The deficit was more or less in line with the consensus forecast because the trade deficit, which measures trade in international goods and services and which comprises the lion's share of the current account, was already known from previously-released monthly trade data. In that regard, the trade deficit was unchanged in Q2 at $125.2 billion. Although there is not necessarily a one-to-one correspondence between the nominal current account deficit and real net exports, which are recorded in the real GDP accounts, the small decline in the former in the second quarter is consistent with slight narrowing in real net exports that also occurred in Q2.

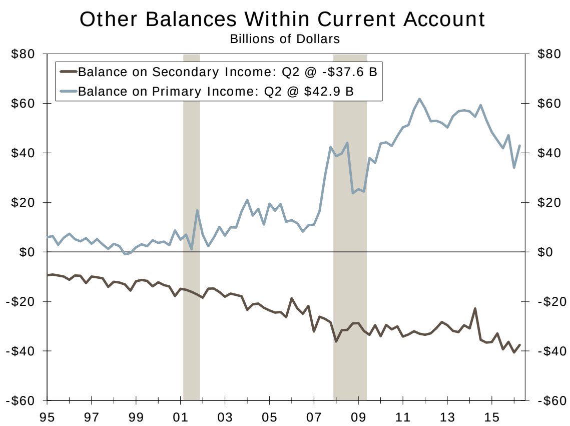
The overall current account deficit narrowed in the second quarter largely because the income that Americans receive from their direct investments abroad rose by $10.3 billion in the second quarter. Although the United States has incurred a large deficit in international trade in goods and services for many years, it continues to receive more income on the investments it has in foreign economies than it pays out to foreigners for the investments that they hold in America. In other words, the United States continues to record black ink in its "primary income" balance.

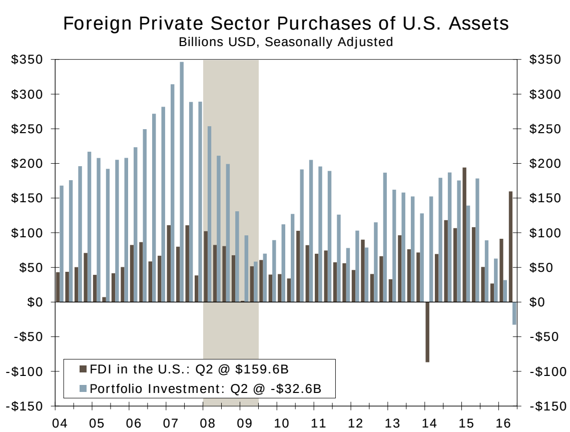
FDI Inflows Remained Strong in Q2

The counterpart to the current account is the financial account, which records the financial flows that finance the current account deficit. In that regard, the data show that the United States continues to have little trouble attracting directly-invested capital into the country. Indeed, there was nearly $160 billion worth of new foreign direct investment (FDI) in the United States in the second quarter (bottom chart). On the other hand, however, purchases of U.S. stocks and bonds by private foreign investors continued to weaken. Although foreigners remain enamored with U.S. debt securities, they continue to sell American equities. In the second quarter, net sales of American stocks and equity funds by foreigners totaled $56.4 billion, the fifth consecutive quarter in which foreigners have unloaded U.S. equities.

Should we be worried about the weakening in overall portfolios inflows? Probably not. Inflows of short-term capital, such as bank deposits by foreigners, remain strong and, as noted above, so too do FDI inflows. Moreover, the behavior of the dollar in Q2—the trade-weighted value of the U.S. dollar edged up in the second quarter—shows that the country has little difficulty at present in financing its modest current account deficit. As long as the underlying economic fundamentals of the U.S. economy remain solid, at least relative to other countries, then foreigners likely will continue to invest in the United States.







Source: U.S. Department of Commerce and Wells Fargo Securities

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