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Economics Group

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Current Account Deficit Widened to 10-Year High in Q4-2018

The current account deficit currently stands at a 10-year high, although it is manageable when measured as a percent of GDP. Indeed, the United States appears to have few issues financing the deficit at present.

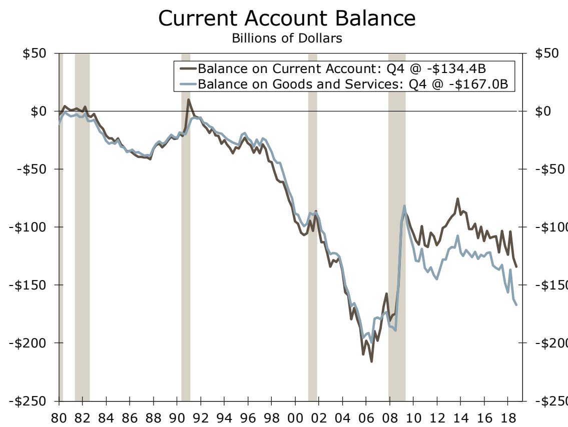
Current Account Deficit-to-GDP Ratio is Manageable

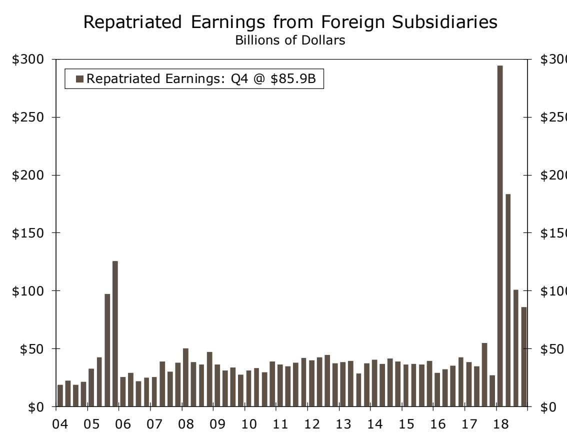
The red ink in the nation's current account rose from $126.6 billion in Q3-2018 to $134.4 billion in the fourth quarter, the largest deficit in ten years (top chart). The widening in the deficit did not come as much of a surprise because monthly data had already showed that the balance of trade in goods and services, the largest component of the overall current account, had deteriorated in the last three months of 2018. When measured as a percent of GDP, however, the current account deficit today (2-½%) is much smaller than it was ten years ago, when it exceeded 5%. Large current account deficits can make an economy vulnerable to the destabilizing effects of sudden outflows of foreign capital.

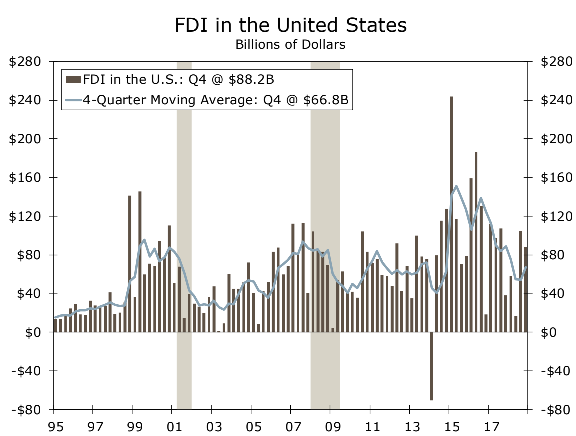
Although there were few surprises on the headline number, there were some notes of interest in the underlying data. For starters, U.S. companies continue to repatriate earnings from their foreign subsidiaries, which reflects changes to the corporate tax code that went into effect at the end of 2017. As shown in the middle chart, U.S. companies brought back $86 billion from their foreign subsidiaries in the fourth quarter, bringing the total for the year to a whopping $665 billion. Although these repatriated earnings do not appear to be financing a sustained acceleration in business fixed investment spending in the United States, at least not yet, U.S. companies still have ample cash holdings abroad that they could potentially repatriate in the future.

Another interesting observation is that foreign companies continue to find the United States an attractive investment location. Specifically, foreign direct investment in the United States (FDI) totaled $88 billion in Q4-2018, bringing the total for the year to $267 billion (bottom chart). Although this annual amount for 2018 was lower than the yearly totals for the previous three years, the run-rate of FDI flowing into the United States generally remains solid.

Although foreigners continue to show strong interest in buying real assets in the United States, they are currently showing less interest in buying paper assets. Although foreigners bought $88 billion of U.S. equity securities in the fourth quarter, net foreign sales of debt securities totaled $101 billion, the first time foreign investors have unloaded American debt securities in more than three years. Previously released monthly data show that foreigners, especially the "official" sector (*e.g.*, foreign central banks) have soured on U.S. Treasury securities in recent months. Yields on U.S. government bonds have receded markedly in recent months, which reduces their attractiveness to foreign investors, everything else equal. That said, the resilience of the U.S. dollar shows that the country is having few difficulties financing its current account deficit at present. In our view, the red ink in the nation's current account is not a major cause for concern for the U.S. economic outlook.







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

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