“Scary Deficit”

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Fall 2007 (updated 1/2019)

How big is the US CA deficit?

- $805 billion in 2005
- For comparison, Spain: $86
- UK: $58
- In percent terms, this is about 6% of US GDP
- 2.5% of UK GDP
- 9% of Spain`s GDP
- Thailand, Mexico, et al had 7+% prior to crises

2016 Update!

- In 2008 CA/GDP was still around 5%.
- But in 2009-2015, has fallen and remained steady at 2-3%. *(Source: US BEA www.bea.gov)*
- *2016: -$452 billion.*
- Why the fall? Mostly because of:
  - More domestic energy ("fracking" gas)
  - And cheaper imported oil (esp. this year with oil less than $30/bbl)

January 2019 Update!

- In 2017, US CA was (-) $456 billion dollars
- In 2017, GDP was $19,831 billion (almost 20 trillion)
- So, (CA Deficit) /GDP is 2.3%

- Source: FRED
- https://fred.stlouisfed.org/

March 24th, 2020 Update!!

- In 2019, US CA was (-) $498 billion dollars
- In 2019, GDP was $21,726 billion (nearly 22 trillion)
- So, (CA Deficit) /GDP is 2.3% (still)
- *So, even after trade war with China…no change*.
- Source: FRED
- https://fred.stlouisfed.org/

Japan's CA

- Historically surplus (e.g. 3.9% of GDP in 2010).
- Very small in 2011-2014 (about 1%)
- In 2017, CA surplus/GDP = about 4%.
- Good right?
- Also, remember growing exports, with stagnant GDP also raises the CA/GDP!
- Source: www.tradingeconomics.com from Min of Finance, Japan

Japan's CA (March 2020 update)

- In 2018, 3.5% (www.tradingeconomics/MOF)

Why do some worry about it?

- In absolute terms, it is HUGE
- Some worry that as the largest economy, it is not good to be the largest debtor
- Related to 2nd point, UK was not a net debtor in 19th century
- Economists **Setser** and **Roubini** think we should worry
- **Levey** and **Brown** think we are worrying too much

First: Why is it so large?

- Recall: (X-M)=(S-I)+(T-G)
- 1) T is less than G
- 2) S is less than I, part 1
- 3) S is less than I, part 2
- 4) Foreign Central Banks (e.g. China and Japan) are buying huge amounts of US debt

Big questions

- 1) Can this huge deficit last forever?
- 2) If it cannot, how will it adjust?
- 3) When/if it adjusts, will it adjust fast or slow?

Two possible adjustment scenarios

- “Hard landing” (Setser/Roubini)
  - Rapid dollar depreciation
  - Rapid US GDP decline and rising unemployment
  - Therefore, global recession/depression
- “Soft Landing” (Levey/Brown)
  - Gradual decline of dollar
  - US and other governments intervene to allow smooth adjustment; no recession

Levey and Brown: “Don`t Worry”

- 1) Foreign central banks (China/Japan) will continue to finance US deficit/debt
- 2) Even if foreign banks “pull out”, US and other private investor will fill that gap
- 3) If there is a crash, it would hurt EU and Japan (and China?) far worse than the US, therefore they (the other countries) won`t let a crash of the dollar occur

Setser and Roubini disagree

- They feel Levey and Brown are wrong about all three assumptions above
- Thus, the US must act NOW to correct CA (through fiscal and other measures)

Is the US CA deficit different?

- The US CA deficit is as big as some LDCs that experienced crises
- However, there is at least big difference: US debt is its own currency, dollars!
- When Mexico and Thailand and others had huge CA deficits, and foreign debt they borrowed in dollars; therefore a peso or baht crash hurts them badly (as debt must be paid back in $)
- For US, who lends $-denominated debt, and must pay back the debt in dollars, this is easy to do. Simply print more US$! If the dollar falls, the value of the debt gets smaller!

Read my notes!

- Make sure to read the more detailed notes for Current Account Notes
- Try to read the two papers by Setser/Roubini and Levey/Brown