Alex Bernshteyn

Current Account Deficit

CURRENT ACCOUNT DEFICIT: An imbalance in a nation's balance of payments current account in which payments received by the country for selling domestic exports are less than payments made by the country for purchasing imports. In other words, imports (of goods and services) by the domestic economy are greater than exports (of goods and services). This is generally a not desirable situation for a domestic economy. However, in the wacky world of international economics, a current account deficit is often balanced by a capital account surplus, which is generally considered a desirable situation. If, however, the capital account does not balance out the current account, then a current account deficit contributes to a balance of payments deficit.

The current account is how much a country sends to foreign countries in shopping, gifts and paying interest on loans.

What the country pays out minus what the others pay in is the current account balance. If the amount paid out is more than amount paid in this is called a deficit. (If out is less than in then it is a surplus.)

If a country is sending out more money for shopping, gifts and interest payments than the foreigners are sending back the result is that those foreigners have money that they are going to put somewhere. Either they hold the money or they purchase an asset or investment with it. These movements of money come under the heading of Capital & Financial. So in general whatever movement of money isn't put under the heading of Current Account goes instead under the heading of Capital & Financial.

Forgetting about the money for a moment, if some foreign country sends us stuff they expect something in return. If they don't want the stuff that we make (our goods and services) then they will want to buy some of our land or our companies or some bonds or just lend the money through the banks or they will hold the cash.

If we continually import more goods and services than we export we will have to continue handing over assets of some kind to make up the difference (or we have to hope that the foreigners will just paper their living rooms with our currency).

If they hold the currency then our money supply falls and the value of our currency rises. This would seem to make our currency a good speculation and so the foreigners may see holding our currency as a reward in itself, but within our country the fall in the money supply would require prices and wages to fall or some of the economy would be squeezed out. The likelihood is that the central bank would print money to prevent the deflation, but this would increase the total amount of our currency in the world and would not give the foreigners a self re-enforcing reason to hold the currency. When they finally start spending it (or lending it) there will be inflation as that money comes back into circulation and the central bank may or may not be willing to reduce and thereby rebalance the money supply.

If the foreigners spend our money on buying assets (such as holiday homes in our country) or investments such as ownership of our shopping malls and companies there may be a political reaction about this foreign ownership. Also there may be a physical limit to these things because unlike goods and services they tend not to be so easy to produce.

If our country is relatively undeveloped or if for some special reason there are lots of investment opportunities that have not yet been taken then the foreigners may wish to make such new investments. Again there may be a limit to the number of such worthwhile investments, because it is rare for a country to have massive numbers of worthwhile investments except in unusual times or when some new technology has been invented and has not yet saturated its market.

Any rich open market country which runs a large current account deficit is probably doing something that cannot be sustained because it is unlikely that such a country has lots of unexploited new investment opportunities and so it has to pay for this deficit by selling its land or its companies or by going deeper into debt.

If the country goes deeper into debt to pay for its current account deficit this deepens the deficit because paying interest is part of the current account. Therefore each year the amount of new debt is greater than each previous year. At some point lenders will say no.

If the country has a massive amount of capital assets for sale (such as beach front condos) and massive companies forming a huge pool of stock market equity and debt that foreigners can buy for decades to come then such a country can run a current account deficit matched by a capital & Financial account surplus for a very long time. If it goes on long enough all the companies and all the land will belong to foreigners and then the current account deficit will stop, but probably this would have produced a political outrage long before.

So sooner or later current account deficits will disappear and the easiest way for this to happen is that foreigners just try to swap the foreign currency back into their own and to do so they have to sell it cheaply to entice someone else to buy it. This falling in the exchange rate makes exporting to our country seem less attractive and makes buying from us (whether capital or current) more attractive.

So the most likely result is an eventual fall in the exchange value of our currency.