

Sebastian Edwards

“Is the U.S. Current Account Deficit Sustainable? If Not, How Costly Is Adjustment Likely to Be?”

*Brookings Papers on Economic Activity 1:2005*, pp. 211-71

This paper analyzes the relationship between the U.S. dollar and the U.S. current account, dealing with issues of sustainability and the mechanics of current account adjustment. The analysis differs from other work in several respects. First, it emphasizes the dynamics of current account adjustment, going beyond computations of the real depreciation required to achieve sustainability. The analysis shows that, even if foreigners' net demand for U.S. assets continues to increase significantly, the current account deficit is likely to fall steeply in the not too distant future. Second, the paper uses international evidence to explore the likelihood of an abrupt decline in capital flows into the United States. Third, it analyzes the international evidence on current account reversals, to investigate the potential consequences of a sudden stop of capital inflows. This analysis suggests that adjustment of the U.S. external accounts is likely to result in a significant reduction in growth.

JEL codes: F02, F32, F37, F43