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U.S. deficits more stable than many think-study at
 Tue Feb 15, 2005 06:09 PM ET
 WASHINGTON, Feb 15 (Reuters) - The effect of a weaker dollar on the value holdings may be providing a buffer preventing immediate and dramatic adjustr record U.S. current account deficit, a new study showed on Tuesday.

A discussion paper for the Centre for Economic Policy Research said the scale of assets held by foreigners and foreign assets held by U.S. residents means the va effect on national accounts of dollar depreciation is huge.

But national income and balance of payments accounts do not take account of tl at present.

The study's authors, Pierre-Olivier Gourinchas at the University of California, E and Helene Rey of Princeton University, say wealth transfers to the United Stat from a dollar fall allow trade deficits to persist for longer without a crisis.

Their study, which looked at the past 50 years of external accounts and exchange shifts, said at the moment almost all of U.S. foreign liabilities are in dollars but percent of U.S. foreign assets are in foreign currencies.

And the latter are mostly currencies of the main financial centers such as the eu sterling and not those of other big U.S. trading partners like China, India, Russi

As a result, the study estimates a 10 percent fall in the dollar -- independent of a price move -- transfers about 5 percent of U.S. national income from the rest of the United States.

It compares this to a 2003 trade deficit in goods and services of 4.4 percent of n income.

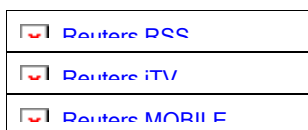
It said transfers of wealth via valuation effects, when an economy is as leverage capital as the United States, significantly alter the need to run future trade surpl

"When the dollar weakens, it has a stabilizing effect independent of the exchang impact on the underlying trade account," Gourinchas told Reuters.

"It makes the situation much less dramatic than if you just look at the current ac numbers, where you might conclude we need this enormous adjustment on the t

While the broad trade-weighted dollar has fallen about 28 percent since early 20

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euro has risen about 46 percent since then and the pound about 31 percent.

Some economists say even more of a dollar depreciation is needed to cap the current account deficit of nearly 6 percent of national income because dollar losses in 2002 have had little or no effect on the trade deficit.

Federal Reserve chairman Alan Greenspan and others have argued the currency trade may be operating with a lag of two years or more as foreign exporters take profit margins in favor of market share.

"What we are pointing out is that you are already getting a big benefit from that depreciation," said Gourinchas.

The study found that about 30 percent of the adjustment toward making U.S. exports more sustainable is realized through valuation effects.

Gourinchas said the fear that correcting the deficit requires a sudden interest rate shock to import demand and a domestic recession should be tempered.

"The dynamic we're emphasizing is that doesn't need to happen immediately," he said. "You can run a more sustained trade deficit for a longer period of time, and perhaps a bigger one, because dollar depreciation is making the United States slightly richer than the rest of the world."

"It provides a buffer until a readjustment takes place."

Gourinchas stressed this was still a temporary stabilizer and did not obviate the eventual trade adjustment.

And he said the major long-term problem is how to convince foreigners to keep accumulating U.S. assets which are continually eroded by dollar losses.

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