Letter

Current accounts: it's not as simple as 'wine for cloth' anymore

From Ilan Strauss, New York, NY, US

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Claire Jones cannot be held solely responsible for perpetuating the widely held myth that a country's current account largely reflects its balance of trade with other countries in goods and services (" Germany to record world's largest surplus for third year", August 21). Yet gone are the days when global intercourse was confined to countries trading "wine for cloth". Increasingly, what is traded across borders in enormous quantities are financial assets: debt and equity "papers" issued by overseas governments and corporations.

These papers entitle the (now foreign) owner to a stream of future dividend, interest, and reinvested earnings income flows. It is these foreign investment income flows that can dominate a country's current account balance. IMF data confirm this.

Looking more closely at the current account surpluses of Germany, Japan and the Netherlands — the three biggest offenders according to Ms Jones — foreign investment income matters to all of them.

Japan's current account surplus has almost nothing to do with its foreign trade in goods and services. In fact during the past five years it has tended to run a deficit in overseas goods and services trade, turning into a small surplus only recently (since 2016). Its sizeable current account surplus is instead due to its considerable surplus in foreign investment income (the primary income account). This stems from Japan having a larger ownership position in other countries, relative to foreign ownership in its economy. As a result Japan receives more investment income from foreign companies and governments than it pays out to the foreign owners of its own debt and company shares. In fact 87 per cent of Japan's current account surplus in the past three years (2015-17) was due to this positive net foreign investment income position.

Germany's case is not as extreme but still salient. More than 20 per cent of Germany's current account surplus over the previous three years was due to its surplus in primary income (dominated by net foreign investment income flows). In the case of the Netherlands, a major hub through which multinationals route their investments, primary and secondary income accounts have had the opposite effect: the current account surplus has reduced by about 16 per cent over the past three years.

The changing nature of global trade today, from "wine for cloth" to intangible ownership entitlements, is reflected in the changing composition of the current account. Goods and services trade, though still significant, will matter less and less over time to the current account balance.

It is this reality that economists and financial commentators need to acknowledge and then understand.

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