Reasons for a current account deficit

1. **Overvalued exchange rate**. This makes exports more expensive and imports cheaper.
2. **Declining competitiveness**, If prices rise in the UK relatively more than in the Eurozone, these higher UK prices will lead to lower demand for UK exports.
3. **Fast economic growth**. If there is a rapid growth in consumer spending, this will lead to higher import spending. In the UK, we tend to have a high marginal propensity to import, which means growth leads to a big rise in imports.
4. **Low savings ratio**. Lower savings tends to cause higher consumer spending on imports.
5. **Capital inflows**. Large inflows of foreign capital enable the country to afford more imports and run a current account deficit.

Impact of current account deficit

A current account deficit needs to be financed by a surplus on the financial / capital account. This could involve:

- Attracting direct foreign investment into the economy (long-term capital flows).
- Attracting short-term flows of money into the banking sector e.g. hot money flows.

Potential problems of current account deficit

1. **Potentially unsustainable.** If a current account deficit is financed through borrowing, this can be unsustainable in the long term and countries will be burdened with high interest payments.
2. **Foreign claim on UK assets**. If the deficit is financed by attracting long-term investment, foreigners will have an increasing claim on UK assets, which they could require return of at any time.
3. **Depreciation**. A current account deficit is likely to cause depreciation in the exchange rate, leading to higher import prices and lower living standards.
4. **Reflection of economic weakness.** It could be argued a persistent deficit in the current account suggests fundamental weaknesses in the economy, such as:
    - Declining competitiveness, due to higher labour costs or declining productivity.
    - Lack of productive capacity/ infrastructure in the UK.
    - Declining comparative advantage in many manufactured goods.

    These factors could adversely effect job creation in the UK and lead to lower growth.