percent against the US dollar and more against offshore currencies. With international liabilities in excess of $300 billion, the Canadian economy appears unable to sustain current account deficits at current levels. A sustained reduction in the fiscal deficit combined with an offsetting monetary expansion, which maintained a stable expansion in nominal income, would help accelerate the process of turning around Canada's current account deficit.

Shifting trade tides

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Similarly, the pattern of Canadian trade is affected by the exchange rate alignment among the major industrial countries. During the 1970s when the U.S. dollar was low, Canada earned all of the trade surplus required to service its substantial international liabilities as well as to cover the deficit on current services transactions from offshore trade. During the 1980s with the strong U.S. dollar, Canada obtained all of the necessary trade surplus from trade with the United States and ran a trade deficit with the rest of the world. Although the process could be irregular, depending upon the budgetary policies that emerge from the continuing struggle between the U.S. administration and the Congress, during the 1990s the United States will be obliged by mounting foreign debt service requirements to continue to make progress in reducing its trade deficit. Thus, Canada will need to look to offshore markets for growing export opportunities.

The natural tendency for the U.S. trade deficit to be unwound during the 1990s could be reinforced by shifts in macroeconomic policy. The lingering recession in Europe and Japan has depressed domestic demand in those economies. However, Europe is running modest current account deficits in the early 1990s. At the same time, Japan is increasing investment in infrastructure, which will tend to reduce Japan's trade and current account surpluses. Emerging markets in Asia and Latin America are magnets for investment and will need to import capital goods and consumer durables to fuel their growth.

In addition to swings in global trade and payments flows, there will be renewed pressures for expansion of Canada's net exports of goods and services during the 1990s. Sustained progress in reducing government budget deficits would help accelerate this turn around. However, external macroeconomic pressures to moderate Canada's own external imbalance will be intense in the 1990s. Of course a new wave of expanding fiscal deficits (structural budget deficits adjusted for levels of capacity utilization) could delay this adjustment process, but this would only increase Canada's vulnerability as one of the largest per capita international debtors in the world.[5]

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Moving towards current account balance for the Canadian economy, at the same time that the U.S. economy is unwinding its large trade deficit, could lead to large swings in the pattern of Canadian trade. Canada will remain heavily dependent upon the U.S. market and achieving a higher share in that market may be the primary channel for the adjustment in

[5] Only Belgium, Ireland and Italy have higher debt to GDP levels and in the case of Italy much of the debt is held domestically.