



THE U.S. DEFICIT: A PERVERSE VIEW

Based on the dramatic decline in the U.S. merchandise trade deficit, the U.S. dollar has strengthened, U.S. bond prices have risen, and U.S. and other stock markets have risen. Before we get too enthusiastic, however, the trade numbers need to be seen in perspective.

Before seasonal adjustments, the July deficit was \$12 billion. After seasonal adjustment, it became \$9.5 billion, with an extra \$0.7 billion added onto the earlier estimate for June.

The June deficit was particularly large (\$13.2 billion), whereas the July deficit was particularly small (\$9.5 billion). The average for the two months (\$11.4 billion) was about the same as the average deficit for the five preceding months of 1988. In other words, there is no new cause for excitement. This is just a repetition of October-November 1987, when the appearance of a huge number and a small number were just statistical fluctuations to which markets overreacted.

Because we are dealing mainly with random fluctuations, next month's number is almost certain to disappoint.

Despite all this, the numbers do contain some good news. At a time when U.S. continues to experience strong economic growth, its trade deficit continues a trend of gradual improvement: July 1988 exports have grown 28 percent over July 1987, while imports have grown only 9 percent.

This steady improvement in the trade numbers should continue. If the U.S. economy weakens, the improvement could be much greater. Stock markets can properly take heart from that improvement--but only modestly, since the improvement will be offset substantially by steady deterioration in the service account.

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