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THE U.S. TRADE DEFICIT: FURTHER REFLECTIONS

Markets have reacted sharply to the announcement on Friday, January 15, that the November 1987 U.S. trade deficit had declined to US$13.2 billion from 17.6 billion the previous month. Stock and bond markets rose. The U.S. dollar immediately strengthened by about five yen and is now almost ten yen above its low of a few weeks ago.

The change in the trade deficit is indeed good news, but market reaction has been excessive. In recent months, markets have tended to react to nominal figures rather than to real, seasonally adjusted figures. January 15 continues this tendency.

The U.S. trade deficit has been declining slowly in real, seasonally adjusted terms for some time. The November figure simply confirmed that trend. The good news was not in the exaggerated size of the number, but in the fine details:

- --exports were up strongly (9.4 percent);
- --exports of manufactured goods rose proportionately;
- --deficits with all key regions declined:
  - Japan by US$1 billion
  - Western Europe by $600 million
  - Taiwan by $550 million
  - South Korea by $250 million
- --oil imports declined by $300 million;
- --manufactured imports also declined.

The appearance of an overall decline of US$4.4 billion exaggerates the reality of the shift. First, random timing of certain purchases swelled the October deficit and reduced the November deficit. Second, seasonal factors always swell the October deficit, which reflects huge oil imports for the onset of winter and huge consumer imports for Christmas sales.

The December deficit is likely to be larger than November's, and the nominal decline thereafter could be relatively slow. Thus, there could be a negative reaction a month hence.

The gradual real decline in America's deficit implies that:

- --stock markets may suffer a reaction when this is digested;
- --the U.S. dollar is likely to decline substantially, perhaps after rising a bit further;
- --press reports that the heat is off Asian currencies to revalue should be ignored.

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