



## A Good Economic Report

The National Association for Business Economics Business Conditions Survey<sup>1</sup> was released this morning. More than half the respondents reported rising sales for their companies, with expectations of continuing increases for the remainder of the year. Over one third reported rising margins with both prices and cost of materials rising. Job growth and wages grew over the past quarter and responding economists expected this to continue through the current quarter. All this is positive for the economy. It is also positive for the equity markets. Unfortunately, we live in very unusual political times. Market participants can easily become fixated on political problems and lose sight of what is occurring in the real economy.

The trade deficit expanded over the past quarter and that indicates a weakness in the U.S. economy. Not really! Unfortunately, many Americans and, what is worse, many politicians equate a trade deficit as losing and a trade surplus as winning. This is not the case. In order to understand, a few definitions are in order.

*Balance of trade: The difference between a country's imports and exports.*

*Balance of payments: A summary of all the transactions involving goods and services and the investment that all individuals, firms, and government of one nation makes with all other nations.*

*Capital and financial account: The section of a nation's balance of payments that records foreign purchases of assets in the United States and U.S. purchases of assets outside the United States.*

*Current account: The section of a nation's balance of payments that records its exports and imports of goods and services, its net investment income, and its net transfers.*

Sorry for what seems a digression, but these are important to know.

There are many reasons a country may have a trade deficit either a bilateral or overall. The most important thing to remember when a trade balance is announced, that it is not reflective of a contest where a deficit is losing and a surplus is winning. This view misses the point that both imports and exports are beneficial to a country and its citizens. Most trade deficits can be attributed to national savings and investment decisions. As the Federal Reserve Bank of St. Louis reports, trade and exchange rate policies can affect these decisions but not as much as people might think. In practice, they have a minor influence.<sup>2</sup> The perspective that trade balances reflect the differences between national saving and investment can help determine whether trade deficits are good or bad. If the borrowing is simply for consumption, clearly the deficit is not good, but if it is for investment, then the deficit can be quite positive. Productive investment leads to future production, jobs, and social welfare, a clear positive. So from this view, a deficit can be a positive.

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<sup>1</sup> I am a participant

<sup>2</sup> International Trade: Making Sense of the Trade Deficit, Scott A. Wolla, Ph.D.



Trade deficits lose jobs; it depends, most often not. Sixty percent of U.S. merchandise imports are capital goods or components and parts rather than finished goods.<sup>3</sup> Trade restrictions would interfere with supply chains, and production and cost jobs. Trade deficits do not always lead to job losses but more often lead to gains. The U.S. employment in manufacturing has been declining since the 1960's, as have all major industrial countries, even those with large trade surpluses.<sup>4</sup>

The important points to this are: trade policy such as tariffs are unlikely to create a trade surplus. It is very likely the United States trade deficit will continue to rise along with and because of the budget deficit. Trade is not the primary cause of job losses but creates jobs. A trade deficit can be helpful the same way a budget deficit can be useful depending on the use of the financing, and it is much easier for politicians to blame our trading partners, poor trade agreements and unfair trading practices than explaining how the trade equation really works, or to bring the budget closer to balance.

When we are thinking of U.S. economic relations, either with the rest of the world or bilateral, we have to think of all economic interaction, not just the balance of trade, but also the capital and financial account, which is in surplus.

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<sup>3</sup> Policy Brief, Peterson Institute for International Economics.

<sup>4</sup> Ibid.

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**The Week Ahead:**

- **MONDAY:** U.S. Markit US Manufacturing PMI expected at 55.2; U.S. Existing Home Sales m/m expected at 0.20%; Canada Wholesale Trade Sales m/m expected at 0.80%
- **TUESDAY:** U.S. New Home Sales m/m expected at 1.90%; U.S. Conf. Board Consumer Confidence expected at 126; U.S. S&P CoreLogic CS 20-City m/m SA expected at 0.68%
- **WEDNESDAY:** France Consumer Confidence 1Q 2018 expected at 100
- **THURSDAY:** U.S. Durable Goods Orders expected at 1.40%; Japan Tokyo CPI Ex-Fresh Food, Energy y/y expected at 0.50%; Japan Industrial Production m/m expected at 0.50%
- **FRIDAY:** U.S. GDP Annualized q/q expected at 2.00%; U.S. U. of Mich. Sentiment expected at 98; EC Economic Confidence expected at 112; UK GDP q/q expected at 0.30%