MV Capital Management Weekly Market Flash

The Vanishing Trade Deficit

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If there were an equivalent of *People* magazine's "Sexiest Person of the Year" award for macroeconomic statistics, the trade balance would never be it. Unemployment, GDP, consumer spending…these are the celebrity metrics whose fortunes and failings we love to follow on Twitter feeds. The trade balance is sort of an afterthought. If we mention it at all it is usually to express the misguided notion that trade deficits are bad, while trade surpluses are good. That's a shame, because there are some useful insights to be gained from a study of recent trends in the U.S. trade numbers. They are insights that go beyond trade to argue why the overall American economy currently may be in its strongest condition for some time.

A Shore Thing

Since 2005 the current account deficit has fallen from 6.2% of GDP to 2.2%, the lowest level it has been since 1998. One of the prime movers is an increasingly favorable position for the U.S. in tradable goods – basically, tangible things produced in factories. For decades now U.S. production has been the victim of "offshoring" – the export of manufacturing to places like China and India with comparatively attractive wages and tax regulations. That has been reversing as of late. For example Whirlpool, a U.S. appliances manufacturer, recently "onshored" one of its signature Maytag production plants from overseas to Ohio. If you buy a Maytag washing machine now you are not contributing to the trade deficit, but rather adding a few hundred dollars to the domestic personal consumption expenditure line of the GDP account.

It's a Gas

Another development having a major impact on trade is the rise of domestic hydrocarbon production, much of which has to do with the extraction of natural gas and oil from non-traditional sources like shale. In the last five years the share of total U.S. energy consumption produced domestically has increased from 70% to 89%. That has come at the expense of traditional overseas suppliers like Saudi Arabia and Russia, whose fleets of tankers have long filled the tanks of our Esplanades and run up our import bills.

Trading Places (of Employment)

There are other sources of U.S. competitive advantage in trade that have been around for awhile: royalties and licenses from domestic intellectual property, for example. But what is notable about the more recent contributions of manufacturing and energy is that they create lots of jobs. Some of the frontier towns in the North Dakotan wilds, where shale oil production is in full swing, offer a near-guarantee of employment to visiting job seekers – not just in production but in the service economy that supports it. Despite the lackluster reading in the latest jobs report, there seems to be a case to make that unemployment may continue falling for the right reasons (more jobs as opposed to fewer participants).

Trade and the Global Economy

The Economist Intelligence Unit estimates that the U.S., Japan, Britain and Germany will contribute more to the global economy this year than will Brazil, Russia, India and China. Growth prospects are still rosier in China or India than France or Japan, to be sure. But the same trends that are having a positive impact on the U.S. trade balance are favoring sources of economic advantage in the developed world over those in emerging markets.

None of this necessarily foretells another blockbuster year in equity markets, which may slow down or pull back after last year's torrid pace. But the fundamental economic picture appears stronger today than it has for some time. That may keep secular market trends oriented more towards the bulls than the bears.

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