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Market Facts

Trends In U.S. Trade Weights

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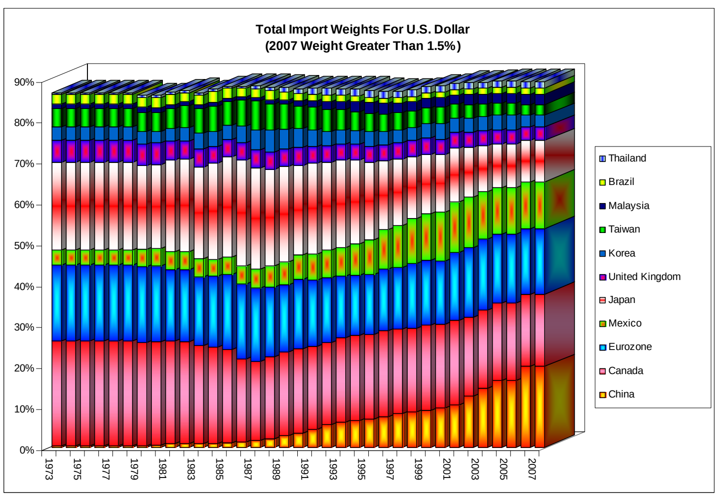
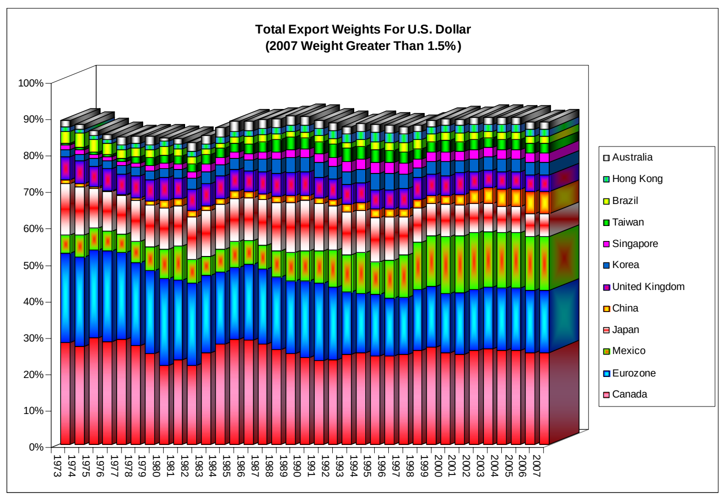
We introduced the theme of currency impacts on trade flows in a January 2005 Market Facts and continued it in greater detail in a February 2007 Special Report. Now that the dollar has stabilized near its lows after a prolonged decline and after export growth has been given credit as a bright spot in the economy, let's take a brief look at the Federal Reserve's weights for imports and exports (left- and right-hand charts, respectively). Only countries whose trade weights are greater than 1.5% of the total are displayed; the remainder provides the balance to 100%.

The growth of China (orange-yellow) in the U.S. import mix remains the dominant feature of the import chart despite the ongoing revaluation of the yuan. Along with Mexico (green-red), it has captured Japan's former market share. Both Canada and the Eurozone (red-white and blue-turquoise, respectively) have seen their weights remain stable even as their currencies have appreciated significantly against the dollar in recent years.

The dominant feature in the export mix is the growth of Mexico as a customer of the U.S. In addition, China's weight in the U.S. export mix has grown as well, while Japan's weight has shrunk. None of these changes in export weights are particularly significant, and none have a ready currency explanation. Indeed, the best explanation for the change in export weights is the economic growth of the destination market. If a stronger currency somehow pulled in more exports from the U.S., we certainly would see the export weights of both Canada and the Eurozone rising over time.





Conclusion

Net exports as a percentage of GDP hit a nadir of -5.86% in the fourth quarter of 2004; this deficit has narrowed to -3.38%. This deficit level is roughly equal to that seen at the start of 2000, a time when the Federal Reserve's broad trade-weighted dollar index stood near 115 as opposed to 95 today. While trade balances required far more than a univariate and contemporaneous currency explanation, it is instructive to note an 18.1% decline in the trade-weighted dollar over 8½ years produced no change in net exports.

In addition, while the euro gets the headline attention in the currency market, the first and third largest export customers of the U.S. are Canada and Mexico, partners in the North American Free Trade Agreement. And yet we have national politicians campaigning with threats to abrogate NAFTA unilaterally. We also have national politicians who favor raising the costs of imports from China via accelerated revaluation of the yuan. Neither proposal makes any sense whatsoever, and if either is based on the presumption currency changes are deterministic in relative trade weights, they are based on assumptions invisible in 35 years of data.

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