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Massive trade deficit should narrow in 2015

Paul Davidson May 6, 2015

A massive trade deficit that hammered the U.S. economy in the first quarter is expected to shrink this year as the effects of a strong dollar moderate and global growth picks up.

That should aid a national economy that's also poised to gain momentum as consumers spend more of their savings from cheap gasoline.

"What emerges is an economy and export sector that are in fact gathering more steam," says **Bernard Baumohl,** chief global economist of the Economic Outlook Group.

Hard to tell by looking at Tuesday's ugly report from the Census Bureau. The trade deficit in March jumped $15.5 billion, or 43%, to $51.4 billion, highest since October 2008. Economists expected a smaller increase to $41.7 billion.

For the first quarter, the manufacturing deficit alone surged 30% after growing by 14% in the fourth quarter, according to an analysis by Ernie Preeg, a senior adviser for MAPI, the manufacturing industry's research arm.

The total trade gap subtracted 1.9 percentage points from U.S. growth in the quarter, says Barclays Capital economist Jesse Hurwitz. That, he predicts, will turn the government's meager 0.2% first-quarter growth estimate into a 0.3% contraction.

A strong dollar is holding down exports by making U.S. goods and services more expensive for overseas buyers. At the same time, it's making imports a bargain for U.S. consumers.

In March, imports rose 7.7% to $239.2 billion, on increased deliveries of consumer and capital goods, and motor vehicles and parts. Exports edged up just 0.9% to $187.8 billion.

Some economists see bright spots. A big reason imports soared is that they were inflated by the clearing of shipment backlogs at West Coast ports after a labor dispute was settled in February, Hurwitz says. He expects those effects to fade.

Exports, meanwhile, rose in March for the first time in three months, **Baumohl** notes. A measure of manufacturer' export orders – a gauge of future shipments – increased sharply in April after falling for several months.

And Inflation-adjusted shipments of goods rose 1.5% in the first quarter compared to the year-ago period despite a 17% surge in the dollar against a basket of currencies since last July.

Baumohl and Hurwitz say the brunt of the greenback's advance is over.The dollar has drifted down 4% since early March, in part because a pickup in economic activity in the euro zone has increased investment in the region, bolstering the euro vs. the dollar. Unemployment in the region fell for the fourth straight month and consumer prices ticked up in April after several months of deflation, or falling prices.

The improving euro zone economies — particularly in Germany, Spain, the Netherlands and Portugal — should lift U.S. exports, **Baumohl** says.

Hurwitz still expects the dollar to rise further this year if, as expected, the Federal Reserve begins to raise interest rates for the first time since 2006. At the same time, the European Central Bank is pushing down its rates, drawing investments to rising U.S. bond yields. But Hurwitz says the Fed move will be far more modest, with the Fed expected to bump up rates gradually.

Hurwitz projects the monthly U.S. trade deficit will shrink to about $45 billion by the end of the year and shave about 0.3 percentage points off growth in the second, third and fourth quarters. He expects the economy to grow an average annual rate of 2.7% in those quarters.

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