Credit Rating Agency

# U.S. Trade in January

## Implications of the declining deficit

**United States of America**

**Economic Report** **March 12, 2020**

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**HR Ratings comments on the possible implications of the declining deficit as seen in both nominal and real dollar terms and the changes in the relative importance of the US's different trading partners.**

US trade through January continued to show a decline in the deficit on goods and services, driven by the decline in the goods deficit while the small services surplus remained relatively stable. For its part, the shrinkage of the goods deficit is due both to the important attainment of a small petroleum surplus, after years of deficits, and to the reduction in the non-petroleum deficit. The reduction in the much larger non-petroleum goods deficit is due substantially more to a reduction in imports and less so to any strengthening of exports.

The decline in the deficit raises the question as to whether it is the result of some weakening in US growth, pulling in fewer imports, or whether a longer term structural change in the economy's propensity to import has taken place. It is still too early to answer that question, although it does appear that the weakness in imports is disproportionate to the moderation in growth. Much probably depends upon whether current policies to limit the dependence on China continue. The significant extent of the change in the direction of the deficit also raises the question of how to measure its relative importance. In nominal dollar terms, nothing of great import has happened. However, in real dollar terms the deficit has risen substantially, lending some justification to the measures taken to reverse its growth.

**Table 1: Quarterly Trade Balance (millons of USD)**

| | Quarterly Data | | | Annualized Change | |
|---|---|---|---|---|---|
| | **Jul-19** | **Oct-19** | **Jan-20** | **vs. July** | **vs. Oct.** |
| **Total** | **(162,259)** | **(152,698)** | **(137,744)** | **-21.57%** | **-33.78%** |
| Goods | (226,235) | (215,164) | (201,451) | -18.18% | -23.16% |
| Petroleum | (8,265) | 551 | 989 | n.a. | 938.0% |
| Non-Petroleum | (214,388) | (212,215) | (199,101) | -3.99% | -22.52% |
| Net Adjustment | (3,581) | (3,500) | (3,339) | -8.75% | -17.17% |
| Services | 63,975 | 62,467 | 63,707 | -9.10% | 8.18% |

Source: HR Ratings w ith data from the US Census Bureau, partially retrieved from FRED, Federal Reserve Bank of St. Louis. Data are seasonally adjusted. Changes are annualized vs. the immediately prior period.

Another development in US trade flows is the notable change in the relative importance of different trading partners, especially in terms of US imports. The decline in Chinese participation is dramatic, and it began before the emergence of the Covid-19 pandemic. Accompanying the decline in Chinese market share has been an increase in participation on the part of the two other members of the USMCA trading arrangement[1].

The recent (March 9) collapse of the price of petroleum, especially in conjunction with Covid-19, raises, of course, serious questions about the course of economic activity over the next months or even quarters. For the US, the drop in oil prices raises questions about the viability of the US's newly acquired equilibrium or even surplus in its petroleum trade balance. Will heavily indebted producers be able to survive the lower price at which they will have to sell their production, assuming that the current situation prevails and no early truce between Russia and Saudi Arabia is reached. Indeed, it may very well be that Russia's aim may be to expose the financial vulnerability of US production to lower prices.

[1] United States, Mexico and Canada.

### The declining deficit: Services and goods, both petroleum and non-petroleum

Table 1 above shows the sharp drop in the US trade deficit in the quarter that ended in January falling to US$137.7bn, a 34% annualized fall from the October quarter which itself had seen a 21.6% decline vs. July. For the petroleum sector, the increase in the surplus vs. October to US$1.0bn was modest, although a surplus, nonetheless. The dramatic improvement was in the October quarter with the movement from a deficit of US$8.3bn in July to a small surplus of US$0.55bn.

The improvement, however, was not limited to the petroleum trade. The non-petroleum goods deficit in the January trimester fell 22.5% vs. the October quarter, when the deficit had already fallen a relatively modest 4% vs. the July period. For its part, the relatively small services surplus did not experience any significant change.

**Table 2: Quarterly Trade Levels (millions of USD)**

| | Quarterly Data | | | Annualized Change | |
|---|---|---|---|---|---|
| | Jul-19 | Oct-19 | Jan-20 | vs. July | vs. Oct. |
| **Exports** | **627,058** | **621,774** | **625,746** | **-3.33%** | **2.58%** |
| Goods | 414,670 | 410,030 | 410,528 | -4.40% | 0.49% |
| Petroleum | 44,565 | 45,521 | 47,820 | 8.86% | 21.78% |
| Non-Petroleum | 368,319 | 362,845 | 361,150 | -5.81% | -1.86% |
| Net Adjustment | 1,786 | 1,664 | 1,558 | -24.65% | -23.15% |
| Services | 212,389 | 211,744 | 215,218 | -1.21% | 6.73% |
| **Imports** | **789,318** | **774,472** | **763,489** | -7.31% | -5.55% |
| Goods | 640,904 | 625,196 | 611,981 | -9.45% | -8.19% |
| Petroleum | 52,831 | 44,970 | 46,832 | -47.50% | 17.62% |
| Non-Petroleum | 582,708 | 575,060 | 560,251 | -5.15% | -9.91% |
| Net Adjustment | 5,365 | 5,166 | 4,898 | -14.03% | -19.19% |
| Services | 148,414 | 149,276 | 151,510 | 2.34% | 6.12% |

Source: HR Ratings w ith data from the US Census Bureau, partially retrieved from FRED, Federal Reserve Bank of St. Louis. Data are seasonally adjusted. Changes are annualized vs. the immediately prior period.

Table 2 provides more detail as to how these trade balances evolved by showing the relative growth of exports and imports. Petroleum exports rose substantially in both quarters although especially strongly in January with a 22% annualized advance. For their part, petroleum imports retreated 47.5% in July explaining the move from a large deficit to a small surplus. In the January quarter the increase in exports was largely offset by the rise in imports.

As for non-petroleum goods, exports have been weak, declining 5.8% in the October quarter vs. July and retreating an additional 1.86% in January. Imports, however, have fallen even more sharply, and at an accelerating rate, declining 5.15% and 9.91% in January. Although there was some weakness in US fixed investment in the second half of the year, it was not comparable to the retreats in imports. Nominal fixed investment grew at annualized rates of 2.17% and 1.45% in 3Q vs. 2Q and in the fourth quarter. For their part, consumer goods spending remained relatively robust with increases of 3.61% and 3.65%.

Tables 3 and 4 present a somewhat longer term perspective of the evolution of US trade relationships, presenting the changes in the January 2020 quarter with the same period a year earlier (YoY), and changes for the twelve-month (LTM) period ending in January 2020 vs. that ending in January 2019.

For the quarter, the deficit declined by 18% YoY, with reductions of 124% in the petroleum deficit, converting into the surplus we saw previously, and a 9.9% drop in the non-petroleum goods deficit. The services surplus advanced 5.83%. For its part, GDP growth in this same period was a moderate 3.97%, all in nominal terms.

**Table 3: Annual Trade Balance in (millions of USD)**

| | Quarterly Data | | LTM Data | | Changes | |
|---|---|---|---|---|---|---|
| | Jan-19 | Jan-20 | Jan-19 | Jan-20 | Quarter | LTM |
| **Total** | **(168,271)** | **(137,744)** | **(629,384)** | **(607,946)** | **-18.14%** | **-3.41%** |
| Goods | (228,469) | (201,451) | (885,928) | (859,800) | -11.83% | -2.95% |
| Petroleum | (4,095) | 989 | (43,985) | (12,471) | -124.2% | -71.6% |
| Non-Petroleum | (220,957) | (199,101) | (829,274) | (833,864) | -9.89% | 0.55% |
| Net Adjustment | (3,416) | (3,339) | (12,668) | (13,464) | -2.25% | 6.28% |
| Services | 60,197 | 63,707 | 256,544 | 251,854 | 5.83% | -1.83% |

Source: HR Ratings w ith data from the US Census Bureau, partially retrieved from FRED, Federal Reserve Bank of St. Louis. Data are seasonally adjusted.

On an LTM basis, the overall deficit in goods and services fell a modest 3.41%, exclusively due to the 72% drop in the petroleum deficit. The decline in the goods deficit in the second half of 2019 still is not strong enough to show a decline on an LTM basis, but rather a 0.55% increase. However, if current trends continue an LTM decline should be registered in a quarter or two.

**Table 4: Annual Trade Levels (millions of USD)**

| | Quarterly Data | | LTM Data | | Changes | |
|---|---|---|---|---|---|---|
| | Jan-19 | Jan-20 | Jan-19 | Jan-20 | Quarter | LTM |
| **Exports** | **619,933** | **625,746** | **2,505,031** | **2,500,305** | **0.94%** | **-0.19%** |
| Goods | 413,323 | 410,528 | 1,678,334 | 1,651,561 | -0.68% | -1.60% |
| Petroleum | 43,243 | 47,820 | 177,209 | 182,343 | 10.58% | 2.90% |
| Non-Petroleum | 368,274 | 361,150 | 1,492,974 | 1,462,079 | -1.93% | -2.07% |
| Net Adjustment | 1,807 | 1,559 | 8,152 | 7,139 | -13.72% | -12.43% |
| Services | 206,610 | 215,218 | 826,699 | 848,745 | 4.2% | 2.7% |
| **Imports** | **788,205** | **763,489** | **3,134,414** | **3,108,251** | -3.14% | -0.83% |
| Goods | 641,792 | 611,981 | 2,564,262 | 2,511,364 | -4.64% | -2.06% |
| Petroleum | 47,338 | 46,832 | 221,192 | 194,815 | -1.07% | -11.92% |
| Non-Petroleum | 589,231 | 560,251 | 2,322,249 | 2,295,943 | -4.92% | -1.13% |
| Net Adjustment | 5,223 | 4,898 | 20,821 | 20,604 | -6.22% | -1.04% |
| Services | 146,413 | 151,510 | 570,155 | 596,889 | 3.48% | 4.69% |

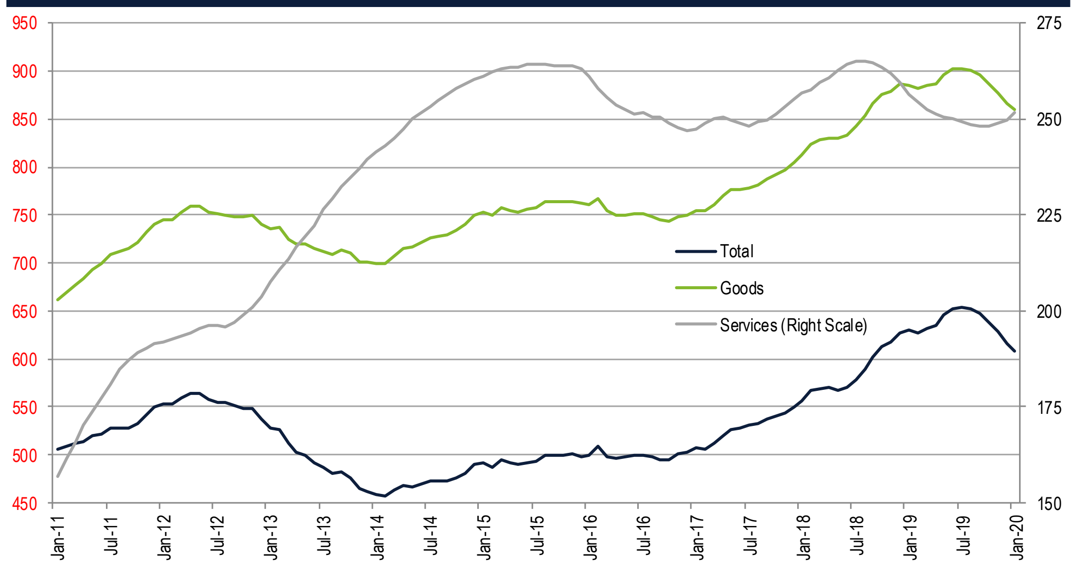
Source: HR Ratings w ith data from the US Census Bureau, partially retrieved from FRED, Federal Reserve Bank of St. Louis. Data are seasonally adjusted.

On a year-over-year quarterly basis Table 4 shows substantial declines in goods imports, including the 4.92% drop in non-petroleum imports. The 11.9% LTM reduction in petroleum imports is especially significant.

Graphs 1 and 2 show the evolution of the different deficits on a longer-term basis. Graph 1 presents the overall deficit as well as the goods deficit and the services surplus, albeit on a different scale; all on an LTM basis. Graph 2 displays the total goods deficit, in conjunction with the balances on its petroleum and non-petroleum components. However, in Graph 2 the data are presented on a quarterly basis, beginning in 2011.

The decline in the goods deficit (green line) beginning in the second half of 2019 is clearly distinguishable. Also readily apparent, is the advance in the LTM goods deficit beginning in 2017. That increase is associated with a rebound in GDP growth. LTM GDP growth for 2016 fell to a nominal low of only 2.53% through the third quarter. Previously It had reached a strong 4.90% expansion through 1Q15. The rebound in that began in 2017 reached a peak of 5.43% by the end of 2018. This surge in growth helped lead to the rise in the goods deficit seen in Graph 1. Growth finished 2019 at 4.11%[2].

**Graph 1: Trade balance on goods and services in billions of nominal USD (LTM)**

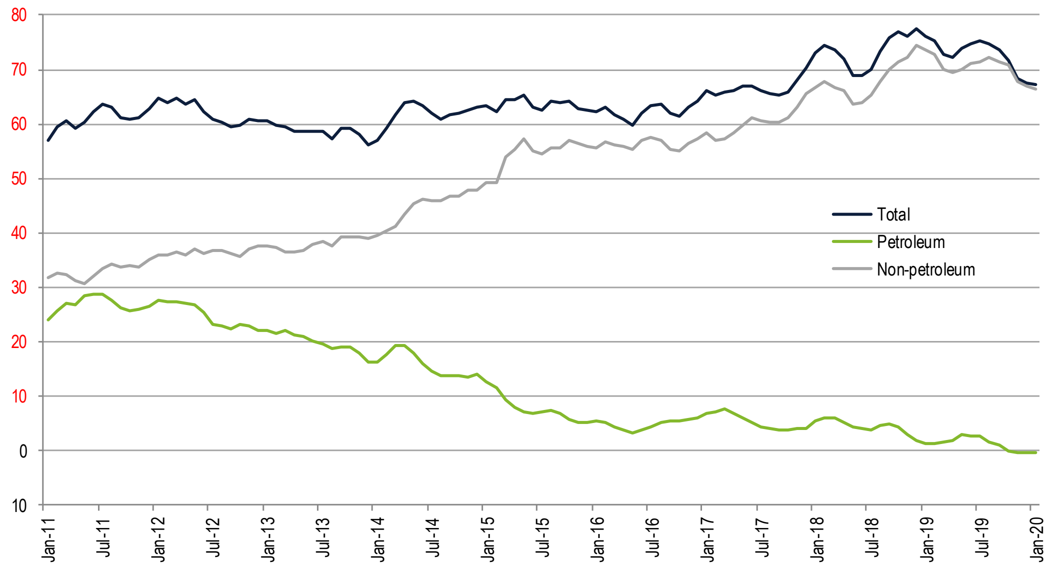



Source: HR Ratings with data from the USs Census Bureau, with data retrieved from FRED. Data are seasonally adjusted.

Graph 2 shows the evolution of the petroleum and non-petroleum components of the goods deficit. The scales are different, and the data are presented on a three-month-moving average basis. However, the graph shows the rise in the total goods deficit beginning in late 2016. Significant, is the fact that although the total trade deficit remained relatively flat prior to that time it was only because the petroleum deficit began its long-term decline. The non-petroleum deficit (gray line) continued its largely uninterrupted ascent, accelerating in 2017 and reaching its peak, along with the total goods deficit, in the fourth quarter of 2018. Its descent began in the first quarter of 2019 becoming apparent in the LTM metric in Graph 1, in the middle of last year.

[2] It is important to appreciate that we are using nominal data in this analysis as the trade numbers are also in nominal USD. However, in graphs 3 and 4 we present trade and GDP data which show the important differences in the evolution of these variables between nominal and real 2012 dollars.

**Graph 2: Average Monthly US Trade Balance of Goods in in billions of USD (3MMA)**




Source: HR Ratings w ith seasonally adjusted data from the US Census Bureau.

## Measuring the deficit in nominal and real dollar terms

The apparently inexorable increase in the non-petroleum goods deficit was what helped Donald Trump to be elected in 2016 and produced the confrontation with China. The conclusion that China is a threat more than a partner appears now to have become more widely accepted in the United States.

The decline in the deficit raises the questions as to whether it represents some significant structural change in the economy, reducing its propensity to import, or whether it is simply the consequence of some moderation of growth, especially in the second half of 2019. To the extent to which it might be structural depends in large part on whether the confrontation with China continues beyond the “Phase 1” agreement signed late last year and the eventual impact of the revised USMCA trade agreement.

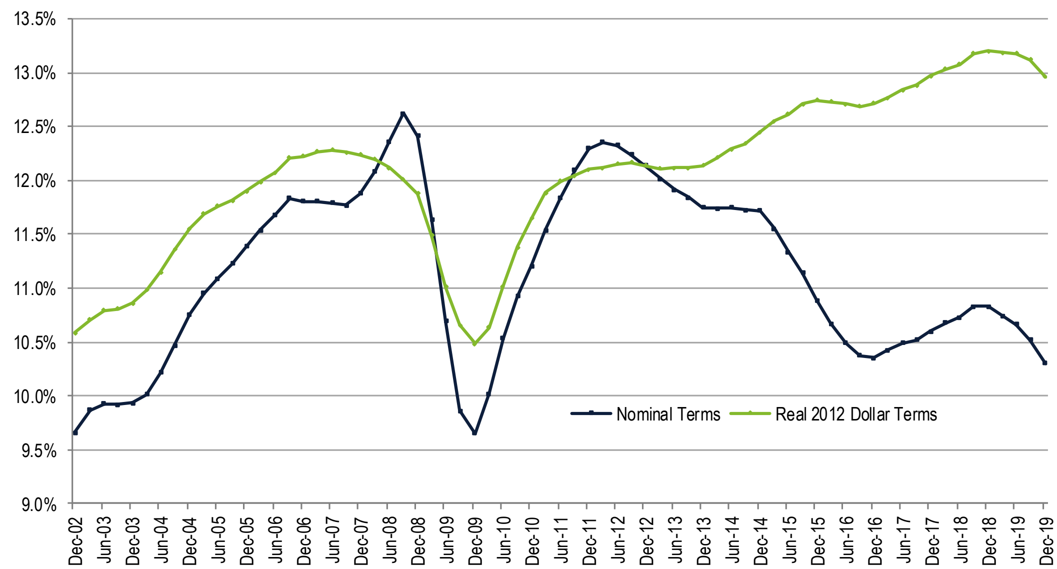
For now, however, in order to approach the question of the significance of the current decline in the deficit we need to examine it more directly in the context of the evolution of the overall economy. One metric which helps to place the trends in perspective is the economy’s propensity to import measured as the relationship between goods imports and aggregate demand[3]. From 4Q16 through 4Q18, a period of rapid growth, goods imports as a percentage off aggregate demand (all on an LTM basis) rose from 10.35% to 10.83%, but by the end of 4Q19 had fallen back to 10.3%. However, it is relevant to point out that the ratio had been as high as 12.35% back in the first quarter of 2012. Thus, in contrast, the decline in the second half of 2019 appears inconsequential, as can be seen in the black line in Graph 3.

However, these ratios are in nominal dollar terms. If we look at the relationship in real 2012 dollar terms the conclusions can be substantially different. The results of these two different perspectives are seen in Graph 3. In nominal dollar terms we have been seeing a steady decline in the propensity to import. The decline in the last few quarters appears significant

[3] GDP plus imports.

but the tendency to import, as seen in the black line, even during the 2017 advance was substantially below levels after the 2008 financial crisis. If imports are negative for the economy, then the US has been on the right track for years.

**Graph 3: Imports of goods as a percentage of aggregate demand (LTM)**




Source: HR Ratings based on seasonally adjusted data from US BEA. Aggregate demand = GDP plus imports.

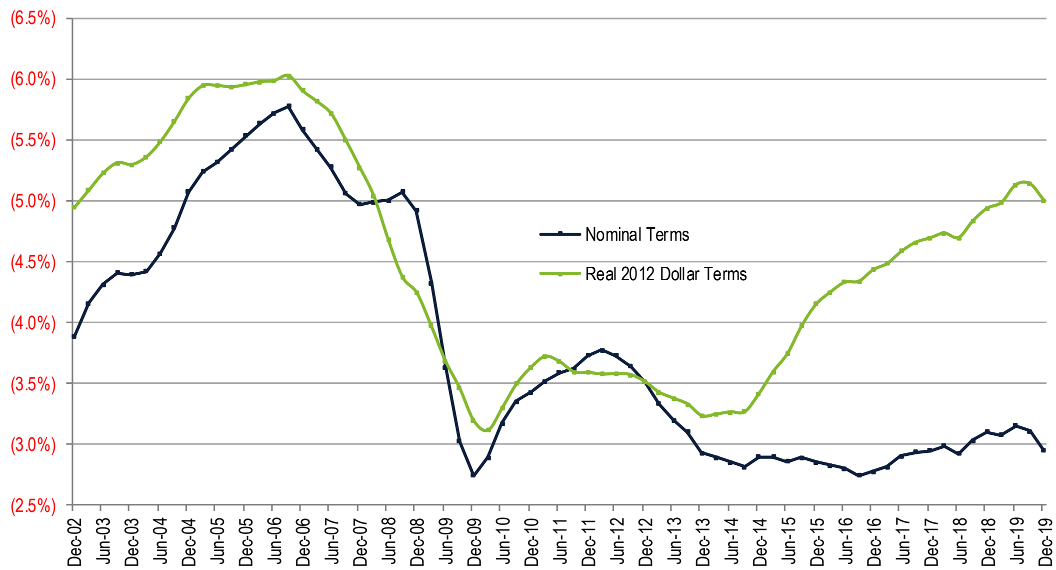
However, that is only part of the story. As the green lines show, in real dollar terms the tendency to import has been on a long term upward trend only temporarily interrupted by the financial crisis. From this perspective, the decline over the last few quarters appears to be highly significant and largely without parallel over the time period seen in the graph, assuming, of course, that the US is not about to fall into a recession caused by previous financial excesses.

In Graph 4 we use net exports as a percentage of GDP to examine the evolution of foreign trade. In nominal terms the deficit remains substantially lower than where it was before the financial crisis. Furthermore, in general terms it has been relatively stable from around 2013 onwards, although we again see a recent change in direction. However, as was the case in the previous graph, the same relationship measures in real dollar terms tells us a very different story. Although still lower than where it was before the crisis, since 2013 it has increasingly become larger, and only with the last couple of quarters has the trend been reversed.

The discrepancy between the trends in nominal and real 2012 dollars is largely explained by the fact that changes in trade patterns and manufacturing processes have led to low levels of inflation, and at times deflation, in the production of goods. Thus, in nominal terms the relative decline in the price of goods has lowered their monetary value, hiding their growing impact in real dollar terms.

The data suggest that something important may be happening in terms of the structure of US trade. Whether it indeed is structural requires a few more quarters of data, and also will depend on what policy measures are taken by the next administration. There is also the question of the dimension of the problem; indeed, whether it is a problem at all, depending upon how one measures the size of trade in the economy.

**Graph 4: Net exports as percentage of GDP in nominal and real terms (LTM)**




Source: HR Ratings based on seasonally adjusted data from US BEA.

## Changes in trading partners: China, Mexico and Canada

Apart from the evolution of the US's trade deficit an additional key area of analysis is the composition of its major trading partners and changes in their relative importance. Perhaps the most notable case, not surprisingly, is China which has seen its share of US goods exports rise while its share of US goods imports declines, with a substantial reduction in its trade surplus with the US. Tables 5 - 7 show the results for the quarter that ended in January 2019 and January 2020, presenting changes both in absolute and relative terms of imports, exports and the trade balance.

China's surplus (Table 7), the largest by far of any other trading partner, declined 29% in the quarter. It is important to note that this change began well before the outbreak of the Covid-19 epidemic. The first quarter in which China´s surplus fell was in the trimester that ended in March 2019 vs. 1Q18.

**Table 5: US Goods quarterly exports breakdown in millions of USD**

| | Jan-19 | Jan-20 | Change | Participation Jan-19 | Participation Jan-20 | Chg. in bps. |
|---|---|---|---|---|---|---|
| Mexico | 64,351 | 60,808 | -5.51% | 15.95% | 15.12% | -82 |
| Canada | 69,537 | 68,357 | -1.70% | 17.23% | 17.00% | -23 |
| China | 24,885 | 26,194 | 5.26% | 6.17% | 6.51% | 35 |
| Japan | 19,968 | 18,202 | -8.85% | 4.95% | 4.53% | -42 |
| Germany | 14,369 | 14,321 | -0.33% | 3.56% | 3.56% | 0 |
| South Korea | 13,964 | 15,196 | 8.82% | 3.46% | 3.78% | 32 |
| Others | 196,474 | 199,048 | 1.31% | 48.69% | 49.50% | 81 |
| **Total US** | **403,549** | **402,125** | **-0.35%** | **100.0%** | **100.0%** | **n.a.** |

Source: HR Ratings based on information from the US Census Bureau. Data are not seasonally adjusted.

In the context of the recently approved trade agreement among the United States, Mexico and Canada[4] (USMCA), the evolution of US trade with those two countries is especially relevant. In the case of Mexico, its share in US goods exports has declined largely due to its own negligible growth during 2019. Mexican goods imports from the US declined an important 5.5% YoY in the quarter that ended in January. Its share in US exports fell 82 bps in the same period. Modest Canadian growth probably also explains the 1.7% fall in US exports.

**Table 6: US Goods quarterly imports breakdown in millions of USD**

| | Jan-19 | Jan-20 | Change | Participation Jan-19 | Participation Jan-20 | Chg. in bps. |
|---|---|---|---|---|---|---|
| Mexico | 84,458 | 85,149 | 0.82% | 13.50% | 14.24% | 74 |
| Canada | 73,039 | 77,934 | 6.70% | 11.67% | 13.03% | 136 |
| China | 134,077 | 103,418 | -22.87% | 21.43% | 17.29% | -414 |
| Japan | 36,508 | 33,427 | -8.44% | 5.83% | 5.59% | -25 |
| Germany | 31,322 | 30,471 | -2.72% | 5.01% | 5.09% | 9 |
| South Korea | 19,743 | 19,212 | -2.69% | 3.15% | 3.21% | 6 |
| Others | 246,646 | 248,540 | 0.77% | 39.41% | 41.55% | 214 |
| **Total US** | **625,793** | **598,151** | **-4.42%** | **100.0%** | **100.0%** | **n.a.** |

Source: HR Ratings based on information from the US Census Bureau. Data are not seasonally adjusted.

Table 6 is especially interesting showing the 414bps drop in China’s share of US imports while both North American treaty partners experienced significant increases in their market share, with Canada’s rising 136pbs and Mexico’s advancing 74bps.

[4] The United States and Mexico have formally approved the agreement. We expect Canada´s approval in the short-term.

**Table 7: US quarterly goods trade balance breakdown in millions of USD**

| | Jan-19 | Jan-20 | Change | Participation | | Chg. in bps. |
|---|---|---|---|---|---|---|
| | | | | Jan-19 | Jan-20 | |
| Mexico | 20,107 | 24,341 | 21.06% | 9.05% | 12.42% | 337 |
| Canada | 3,502 | 9,577 | 173.48% | 1.58% | 4.89% | 331 |
| China | 109,191 | 77,224 | -29.28% | 49.13% | 39.39% | -974 |
| Japan | 16,540 | 15,226 | -7.95% | 7.44% | 7.77% | 32 |
| Germany | 16,953 | 16,149 | -4.74% | 7.63% | 8.24% | 61 |
| South Korea | 5,779 | 4,017 | -30.49% | 2.60% | 2.05% | -55 |
| Others | 50,172 | 49,492 | -1.36% | 22.58% | 25.25% | 267 |
| **Total US** | **222,244** | **196,026** | **-11.80%** | **100.0%** | **100.0%** | **n.a.** |

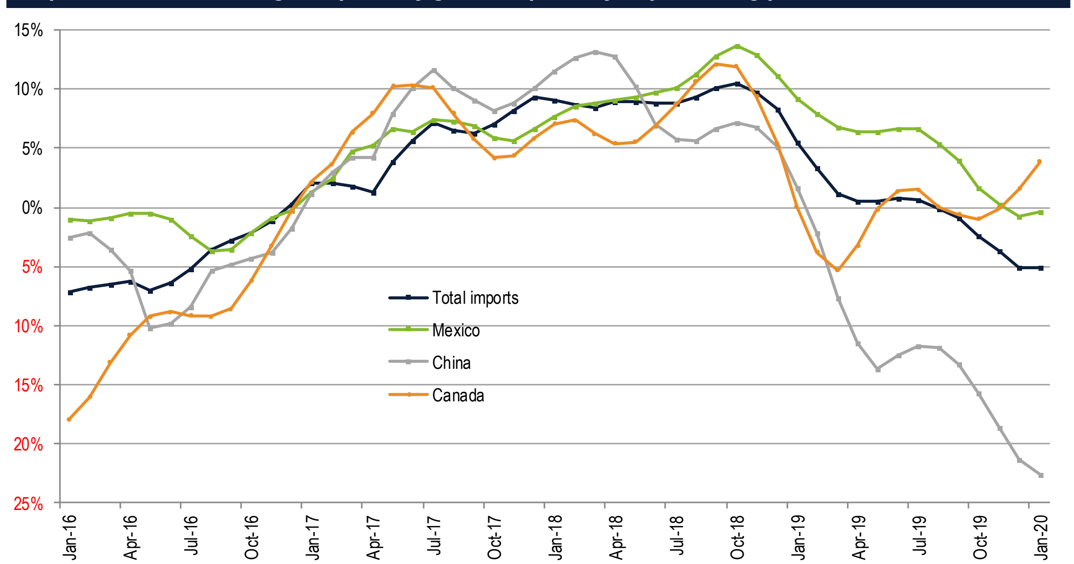
Source: HR Ratings based on information from the US Census Bureau. Data are not seasonally adjusted.

The combination of relatively weak imports from and stronger exports to the US helped both Mexico and Canada to increase their goods surplus with the US showing increases of 21% and 173%, respectively, even as the US overall deficit fell 11.8% in the quarter.

Although the increase in the deficit with Mexico and Canada is probably not entirely to president Trump's liking the overall evolution of US trade is positive for his overall objectives: a smaller overall deficit, an especially smaller deficit with China, the US's major geopolitical competitor, and increasing ties with the US's two neighbors.

In Graph 5 we show the trends in US goods imports, presenting the quarterly YoY change in overall US goods imports and imports from Mexico, Canada and China. There we see Mexico's outperformance even as US import growth falls and becomes negative. The graph also shows Canada´s surge in exports beginning in the spring of last year. Finally, the falloff in China's exports to the US has been dramatic.

**Graph 5: US annual change in quarterly goods imports by major trading partner**




Source: HR Ratings with data from the United States Census Bureau.

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