An alarmist consensus is emerging among economic forecasters and commentators that the U.S. trade deficit in 1998 and 1999 will “soar,” “surge,” and reach “huge levels.” Prudent observers should treat this consensus, like others arrived at by economic forecasters, with a healthy degree of skepticism. As an eminent Nobel Prize-winning economist, Paul Samuelson, once noted, “Economists have correctly predicted nine of the last five recessions.”

The consensus forecast of a soaring U.S. trade deficit is very likely to be wrong once again. Moreover, even if the forecast were closer to the mark than it is likely to be, its limited significance would not warrant the alarm that commentators are sounding. As Walter Wriston and I wrote in these pages some months ago (June 19, 1997), the trade deficit is one of the least significant indicators of the economy’s vitality and health.

In any event, the consensus view that the trade deficit—to be more precise, the current account deficit, which measures the excess of payments for imports of goods and services (including capital services), over earnings from the corresponding exports—will soar is based on several seemingly persuasive arguments.

First, U.S. markets will experience a “flood” of cheap exports from Asia in the wake of the deep depreciation of many of the Asian currencies by more than 50 per cent, and of the Japanese yen by more

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than 25 per cent. Second, so the argument runs, U.S. exports to Asia including Japan, which represented about 25 per cent of global U.S. exports, will decline sharply for a number of reasons stemming from Asia’s financial turmoil: the severe setback to economic growth in Korea and Southeast Asia; continued stagnation in Japan; the appreciated U.S. dollar, which makes U.S. exports more expensive to foreign buyers; the depleted holdings of dollar assets in the Asian countries (apart from Japan, China, Hong Kong, and Taiwan); and the austerity imposed on the Asian countries by the IMF-led bailout “conditionalities.”

The conclusion drawn by the consensus view is that the current account deficit, which was about $114 billion in 1997, approximately 1.4 per cent of the U.S. GDP, will jump to between $150 and $165 billion in 1998, representing perhaps 1.9 per cent of 1998 GDP.

These arguments are more impressive on first glance than on second thought. Counters to them are less obvious, but at least equally strong.

While exports to the United States from Asia will increase as a result of the price advantage conferred on Asian exporters—at least in the short run—by the depreciation of their currencies, it is by no means clear that the volume of these exports will increase by more than the decrease in their dollar prices. Unless their export volume increases by more than their export prices fall, the resulting dollar value of these exports will drop. For example, if the dollar prices of Asia’s exports to the United States of goods and services—ranging from agricultural products and toys to apparel, from consumer electronics and computers to cars—decline by, say, 20 per cent in 1998 compared to 1997, the volume of these exports bought by the United States will have to rise by more than 20 per cent for the U.S. trade deficit to be affected adversely.

Furthermore, exports to the United States depend not only on export prices, but on U.S. economic growth. That growth, which was more than 3.5 percent in 1997, is likely to be somewhat less than 3 percent in 1998. So, the boost provided by U.S. economic growth to U.S. imports from Asia, as well as from the rest of the world, will probably abate from what it was in 1997.
To be sure, exports from the United States are likely to fare poorly in most Asian markets in 1998. While the “conditionalities” of the IMF bailout packages point toward more openness of the beleaguered Asian economies, the slowdown in their economic growth, as well as their painfully straitened financial circumstances—even if eased somewhat by the IMF injection of liquidity—will erode their capacity to import from the United States and the rest of the world. On the other hand, resurgent growth in Latin America may provide at least a partial offset to reduced export markets in Asia. And in Japan, which does not suffer from the same financial stringencies as the Korean and Southeast Asian economies, there may be opportunities for U.S. exports to rise if Japan’s fiscal stimulus measures have an effect, and if some easing occurs in Japan’s neo-mercantilist protection of its domestic markets.

Finally, the consensus alarmism about the impending trade deficit ignores a crucial macroeconomic consideration. The U.S. current account deficit must exactly equal the shortfall in gross savings compared to gross investment in the American economy. The common sense of this equation is simply this: when the resources absorbed by domestic investment exceed those provided by domestic savings, the difference must be imported from abroad. Several major trends in the economy augur at least a modest increase in U.S. savings rates. One such trend is the potential federal budget surplus, foreshadowed by President Clinton’s State of the Union message at $10 billion for 1998. This could be still larger if something like $30–$40 billion of new spending for education, child care, and other discretionary programs were to be curtailed. It is also true, that the budget surplus envisaged by the president may turn out to be smaller for many reasons—for example, tax revenues may be less than estimated if economic growth slows down, the yield from the expected tobacco settlement may be less than anticipated, and so on. However, what is nearly certain is that the budget deficit of the past year and prior ones will shrink, whether or not a surplus is actually realized. Hence public dissaving will decrease, and U.S. gross savings will rise.

A second trend pointing in the same direction is the possible increase in the personal and household savings rates of the baby-boomers, triggered by their increased attention to and worries about the solvency of Social Security—quite apart from whether in fact these worries are justified.
While there are thus convincing reasons for expecting at least a slight boost in U.S. savings rates, there don’t appear to be consequential reasons for expecting a commensurate rise in U.S. investment. Somewhat slower economic growth in 1998 compared to 1997 probably foreshadows at most a constant, and perhaps lower, level of domestic investment.

So gross savings are likely to rise, while investment is not, and the current account deficit in the final analysis depends on the imbalance between investment and savings. Hence, there are compelling reasons for inferring that the current account deficit of $114 billion in 1997 won’t rise by much, if at all, in 1998.

Once again, the consensus view—in this case of an exploding current account deficit—is likely to be a false alarm, like the predictions of past recessions that didn’t happen.

Postaudit

While the analysis reads well, its forecast was plainly wrong, and by a wide margin. The U.S. current account deficit has steadily increased since 1997.