Jesse Conway

Homework 9

Adv. Macro

The health of the international sector in relation to the United States is best understood through the current account deficit and trade dynamics. Factors such as tariffs, interest rates, economic growth, and the strength of the dollar all play interrelated roles in driving changes in this sector. This past year, increases in the interest rate to 2.5% caused a global currency crisis and a consequential strengthening of the US dollar. Further, global trade tensions prompted by President Trump’s increase on various import tariffs have raised uncertainty regarding the future of trade relationships with some of the US’s largest trade partners, specifically China. While these tariffs were aimed at decreasing the widening trade deficit with China, retaliation tariffs and increased demand for goods before tariffs increase further drove the deficit to reach record breaking levels in the fall. The deficit is perhaps the largest factor plaguing the international sector. In order to better understand what the future of the international sector will look like, I will analyze the current trends in five variables: the trade weighted US dollar index, net exports as a share of GDP, foreign direct investment, income receipts on US assets abroad, and the exchange rate with China.

Since 1980, the United States has run a trade deficit, which grew substantially from 1995 to 2005. The majority of this deficit comes from the trade relationship with China, making up 66% of the imbalance in imports and exports. In total, the current account deficit reached $124.1 billion in 2018, 2.5% percent of total GDP. OECD predicts this to grow to 2.9% in 2019 and 3.3% in 2020.

Net exports, a key factor in trade balance, has grown increasingly negative. In the past few years, net exports as a share of GDP has remained relatively constant around -3%. Historically, the US has been a net exporter since the 1980’s, and this imbalance has shown an increasingly negative trend since. Key factors in driving net exports are the strength of the US dollar, tariffs, consumption and GDP growth.

The trade weighted US dollar index measures the relative strength of the US dollar compared to large global trade partners. When the dollar is relatively strong, we expect imports to become cheaper and exports to become more expensive and vise versa. Therefore, if the index value is high we would expect relatively more imports and fewer exports. Factors that can affect the strength of the dollar are economic growth and changes to the interest rate. This past year we saw severe inflation in developing countries partially in response to changes to the US interest rate, making the dollar relatively stronger in 2018. Historically, this variable appears to exhibit cyclical trends around a relatively constant value. In 2019 and 2020, both ING and Wells Fargo forecasts that the dollar will decrease in strength.

Another factor relating to the current account deficit is income receipts on US assets abroad. When these are doing well, it is a positive factor for the current account balance. They experienced a strong upward growth trend prior to the 2008 recession, in which income receipts dropped significantly. They have experienced more steady upward growth since this period.

Another central variable to the international sector is foreign direct investment (FDI). The United States received upwards of $4 trillion dollars in 2017, which came mostly from the UK, Japan, and Canada. However, FDI, which has maintained relatively stable upward growth historically, has appeared to slow after a sharp incline around 2014. This poses issues for employment and growth in the US. Further, because trade tensions is a factor affecting FDI, concerns regarding whether recent political tensions will negatively affect FDI have arisen.

Another important factor for understanding the international sector is the exchange rate between China and the US. Because China is our largest trade partner, as well as the largest source of the trade deficit, understanding the relative exchange rate between the US and China is helpful in understanding how imports and exports will change in the future. In the last 5 years, the Chinese Yuan has decreased in strength relative to the US dollar. Throughout 2017, the Yuan began to strengthen, reaching a peak in early 2018. However, in the last year, the dollar became relatively stronger again, perhaps in relation to the global currency crisis.