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UNITED STATES

The trade balance improves in spite of oil prices

HIGHLIGHTS

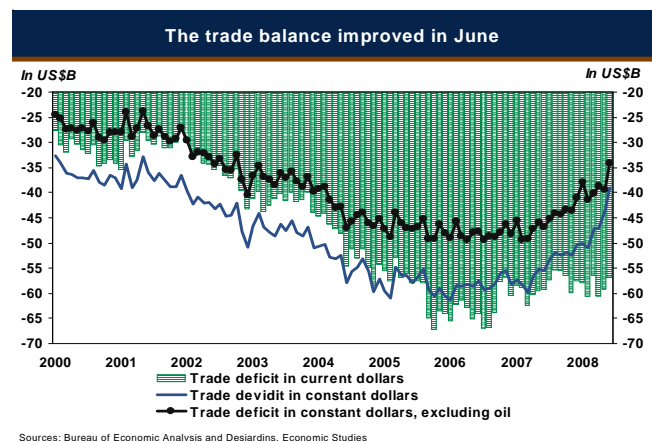
- The goods and services trade balance improved in June, going from -US\$59.2B in May to -US\$56.8B.
- Exports rose 4.0% in June, with all of the major categories of exports benefiting.
- Imports advanced 1.8% following the previous month's 0.3% increase. The increase primarily stems from the rise in oil prices.
- The trade balance improved significantly when price fluctuations are excluded. The real trade deficit went from -US\$43.5B to -US\$39.1B.

COMMENTS

The consensus forecast was for the trade balance to deteriorate again, as the sharp increase in oil prices per barrel could have made the value of imports shoot up. This was in fact the case: oil imports jumped US\$5.7B (+14.6%). Luckily, the gain in exports and softness in other types of imports more than offset the situation. The trade deficit expressed in current dollars thus fell for a second straight month, going to its lowest point since March.

The improvement is even greater in constant dollars, i.e. once price effects are excluded. Real imports were down 0.6% in June (-2.1% if petroleum products are excluded), whereas exports still gained 4.0%. This led to the best one-month improvement in the real trade balance since March of 2005 and the smallest real trade deficit since December 2001. Note, however, that the weakness in real imports also reflects fairly sluggish domestic demand.

According to the advance estimate of the national accounts for Q2 of 2008, foreign trade contributed 2.4 percentage points to the annualized 1.9% growth. This means that, without the contribution from net exports, the real GDP would have declined. What's more, June's numbers are even better than what the Bureau of Economic Analysis had estimated for that month. So, net exports could lead to an upward revision with the next estimate of Q2's GDP.



Implications: U.S. foreign trade will continue to benefit from the greenback's weakness, even though it has been getting some of its strength back in the last few weeks. The American dollar has gained 6% against the major currencies from its mid-July low, but it is still 36% below its 2002 peak. Foreign trade is slow to adjust to currency movements and the trade balance should continue to improve over the coming quarters. What's more, if it lasts, the decline in oil prices will help the constant dollar trade deficit improve further. The improvement is, however dependent on solid economic growth among U.S. trade partners, which does not seem as certain.

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