John Williams'

# Shadow Government Statistics

*Analysis Behind and Beyond Government Economic Reporting*

**COMMENTARY NUMBER 417**
**December 2011 and Annual Trade Deficit**

**February 10, 2012**

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**Annual Trade Deficit Widened to $558 Billion in 2011, from $500 Billion in 2010,**
**A Negative for Both the U.S. Dollar and the U.S. Economy**

**Trade Could Pressure GDP Revision to Downside**

**More Jobs Lost to NAFTA**

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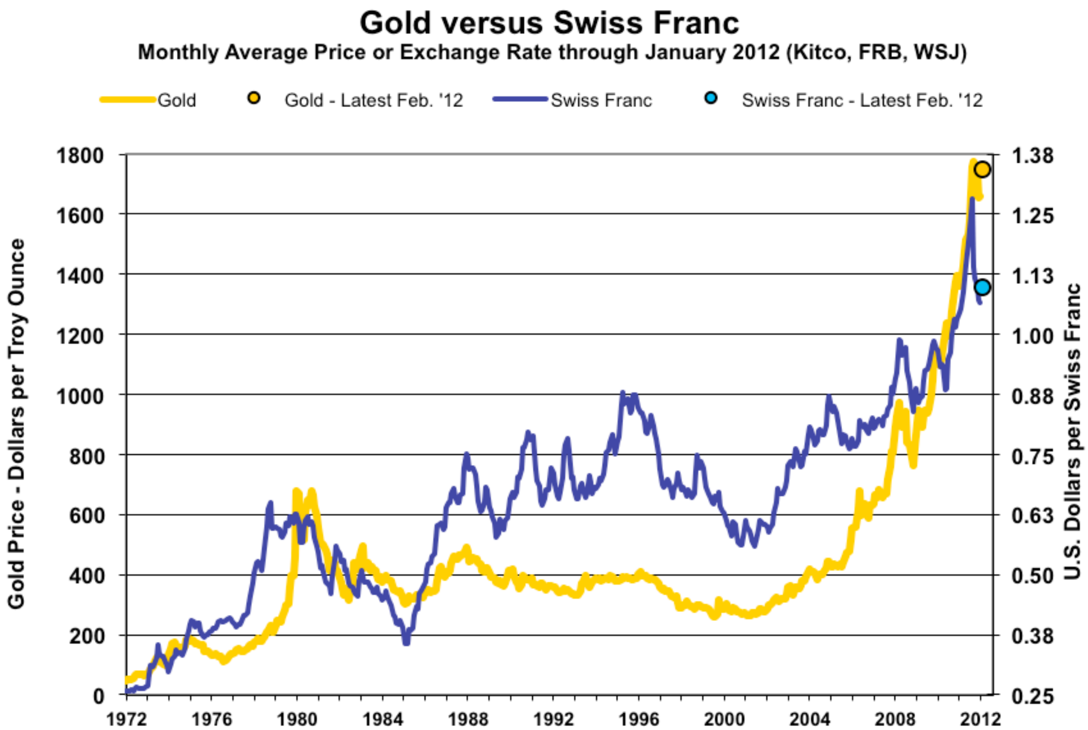
*PLEASE NOTE: The next regular* Commentary *is scheduled for Wednesday, February 15th, covering January 2012 retail sales and industrial production. A subsequent* Commentary *on Friday, February 17th, will cover January housing starts, CPI and PPI.*

*Best wishes to all — John Williams*

***Opening Comments and Executive Summary.*** One of the more important, long-range underlying variables impacting the exchange rate value of the U.S. dollar is the net foreign trade position of the United States. In the post World War II era, the U.S. trade position first fell into net deficit in 1971. By the late-1970s, widening annual trade shortfalls had become perpetual, as had the resulting structural deterioration in the U.S. economy and the foreign exchange weakness of U.S. dollar.



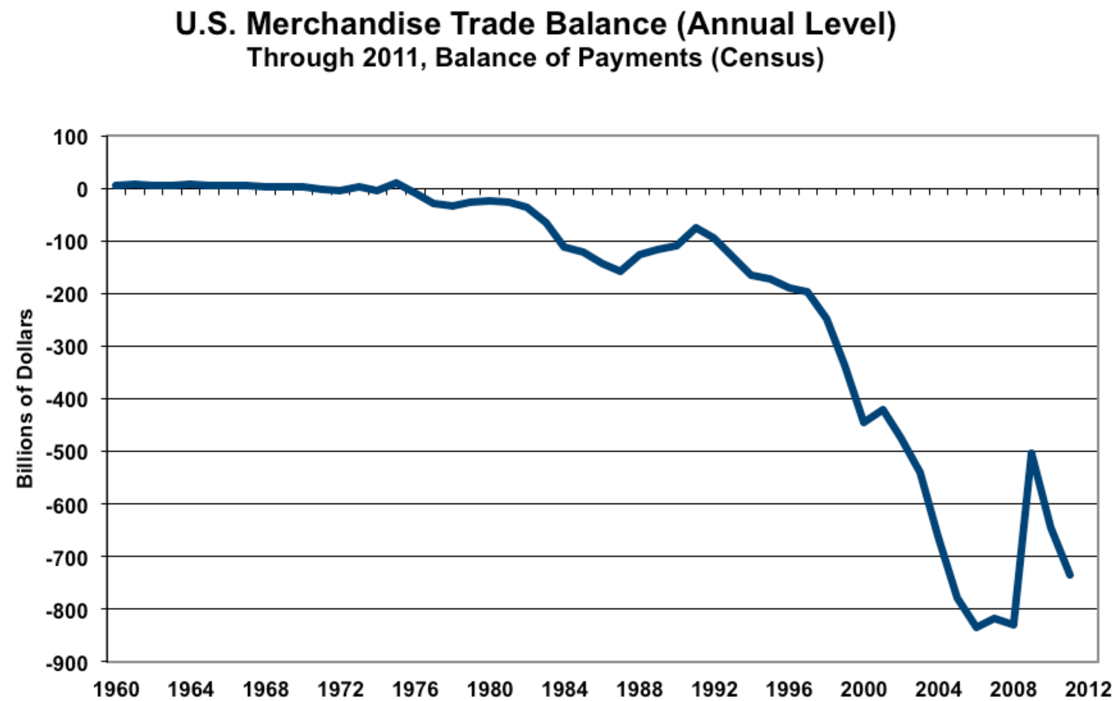

At present, the underlying fundamentals could not be much worse for the U.S. dollar. Beyond trade, the key factors, relative to other major currencies, could not be much worse. Despite any political and financial hype in the markets, the U.S. economy is relatively weaker, interest rates are lower, inflation is higher and fiscal policy and political stability all are relatively much worse than are seen relative to the other major currencies. Along with the Federal Reserve's strategy to debase the U.S. dollar; the long-range U.S. fiscal insolvency and lack of political will to address same; and the still-deteriorating, record lack of confidence of the U.S. public in the U.S. government; will be of significantly greater import to global currency stability than what likely will be relatively short-lived difficulties in the euro area.

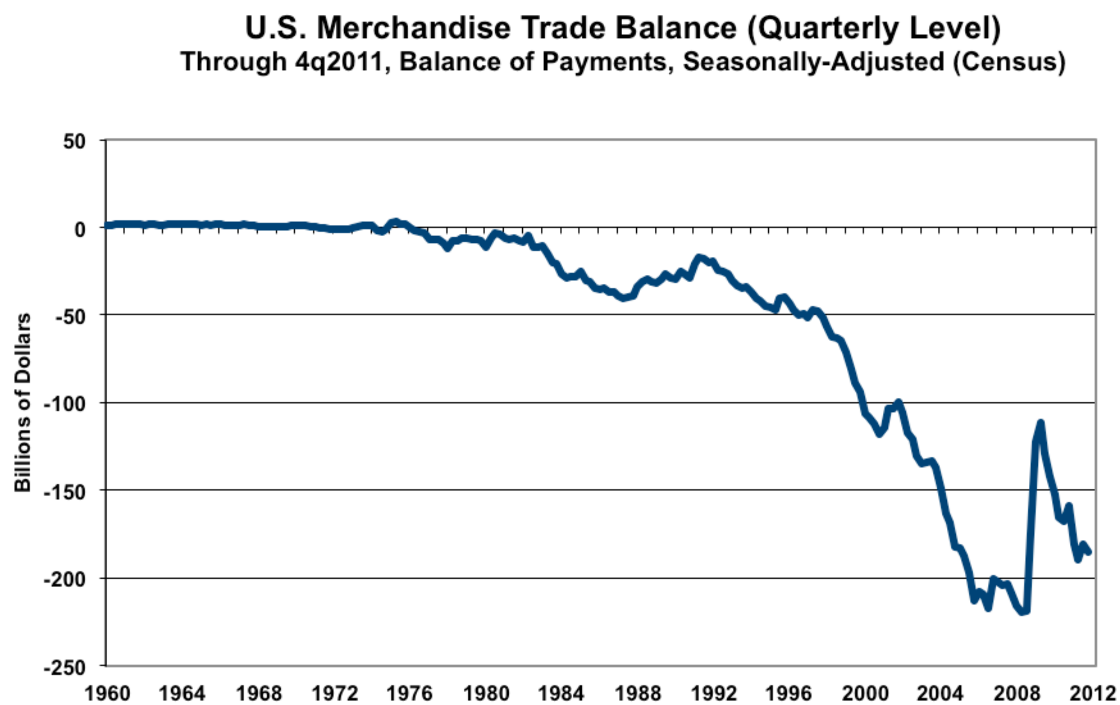
Many of these issues, however, tie back to the abysmal U.S. trade picture. Consider the loss of higher paying jobs to offshore competition, which has been a major contributing factor to the structural income problems currently besetting U.S. consumers. The effects from that have helped to drive the ongoing domestic systemic-solvency and economic crises, as is discussed more fully in *Hyperinflation 2012*.

***U.S. Trade Deficit.*** Today's (February 10th) publication of the December 2011 and Annual 2011 trade data show a deteriorating trade picture on both a quarterly and annual basis, as plotted in the following graphs. Other than for the effects of wild gyrations in oil prices following the 2008 financial crisis, the trade deficit has seen regular deterioration since the 1970s. The nominal (not inflation-adjusted) series is most closely tied to dollar movement. The more that excess dollars are pumped into the global markets, the weaker will be the U.S. dollar.

The real (inflation-adjusted) trade deficit also is deteriorating. A widening real trade deficit subtracts from real economic activity, as reported in the GDP, while real trade deficit improvement is a plus to real GDP activity.


U.S. Merchandise Trade Balance (Annual Level)
Through 2011, Balance of Payments (Census)
Billions of Dollars
100
0
-100
-200
-300
-400
-500
-600
-700
-800
-900
1960
1964
1968
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012


U.S. Merchandise Trade Balance (Quarterly Level)
Through 4q2011, Balance of Payments, Seasonally-Adjusted (Census)
Billions of Dollars
50
0
-50
-100
-150
-200
-250
1960
1964
1968
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012

Much of the U.S. trade deterioration during the last four decades as been due to domestic trade and other policies that have driven U.S. manufacturing offshore. As shown in the following table, the top eight U.S. deficits by trading partner—with the exception of Mexico and Japan where the deficit changes were little more than statistical noise—widened sharply in 2011, at the cost of lost U.S. production and jobs.

**U.S. 2011 Trade Deficit by Country (Excess of $30 Billion)**

| 2011 Rank | 2010 Rank | Country/Group | 2011 Deficit $ Billion | 2010 Deficit $ Billion | Related Trade Group |
|---|---|---|---|---|---|
| 1 | 1 | China | 295.5 | 273.1 | |
| 2 | 2 | Mexico | 65.6 | 66.4 | NAFTA |
| 3 | 3 | Japan | 62.6 | 60.1 | |
| 4 | 4 | Germany | 49.3 | 34.3 | EURO |
| 5 | 5 | Canada | 35.6 | 28.5 | NAFTA |
| 6 | 9 | Saudi Arabia | 33.7 | 19.9 | OPEC |
| 7 | 6 | Ireland | 31.6 | 26.6 | EURO |
| 8 | 8 | Venezuela | 30.9 | 22.1 | OPEC |
| | | ---- | ---- | ---- | |
| | | OPEC | 126.9 | 95.6 | |
| | | NAFTA | 101.2 | 95.0 | |
| | | EURO Area | 88.5 | 65.6 | |

Source: U.S. Bureau of the Census

Of particular note, in terms of bad trade policies related to U.S economic health, is NAFTA, the trade group including the United States, Canada and Mexico. Initially the U.S. had a small surplus with the NAFTA members, but that has turned into a deficit that topped $100 billion in 2011. Irrespective of any hyped jobs-creation that came from the NAFTA deal, U.S. economic activity has suffered a net decline and a loss in employment, thanks to the regional "free trade" pact. Another 50,000 jobs likely were lost in 2011, on top of at least 850,000 jobs lost in prior years, due to the treaty.

Net of inflation considerations, the relative deterioration in the fourth-quarter trade deficit versus the third-quarter, with the December and resulting full fourth-quarter reporting now in place, is suggestive of some downside pressure on the upcoming February 29th revision to fourth-quarter GDP.

**Hyperinflation Watch.** Beyond the trade and dollar issues covered in today's *Commentary*, the hyperinflation outlook just was updated fully in *Hyperinflation 2012*. The economic and inflation outlooks remain unchanged.

## REPORTING DETAIL

### U.S. TRADE BALANCE (December 2011 and Annual Data)

**Annual, Quarterly and Monthly Trade Deficit Deteriorations Have Negative Implications for the U.S. Economy and Dollar Exchange Rate.** Both adjusted and not adjusted for inflation, the U.S. trade deficit deteriorated in December 2011, in fourth-quarter 2011 and in the full year 2011. Those results have negative implications for the foreign exchange value of the U.S. dollar, as well as for inflation-adjusted estimates of U.S. economic activity, such as the GDP. Going forward, underlying fundamentals favor ongoing deterioration in the U.S. trade balance.

***Nominal (Not-Adjusted-for-Inflation) Trade Deficit.*** The Bureau of Economic Analysis (BEA) and the Census Bureau reported today (February 10th) that the 2011 the annual trade shortfall in goods and services, on a balance of payments basis, widened to $558.0 billion, from $500.0 billion in 2010, and from $381.3 billion in 2009. On the goods side, the 2011 merchandise trade deficit widened to $737.1 billion, from $645.9 billion in 2010, and from $505.9 trillion in 2009. The merchandise detail has a relatively hard paper trail behind its reporting. On the services side, the 2011 surplus widened to $170.0 billion, from $145.8 billion in 2010, and from $124.6 billion in 2009. The services series largely is guessed at, with supporting documentation of limited accuracy.

The details on a quarterly and annual basis for the merchandise trade deficit are graphed, and a table showing the ranking of the worst U.S. goods and services trade deficits, by country, are shown in the *Opening Comments and Executive Summary.*

Monthly Detail. As has become the standard caution here for the monthly detail, heavy distortions likely continued in the seasonal adjustments, much as has been seen in other economic releases, such as retail sales, where the headline number reflects month-to-month change. As has been discussed frequently (see *Hyperinflation 2012* for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets still should not be relying heavily on the accuracy of monthly headline data.

That said, the nominal, seasonally-adjusted monthly trade deficit in goods and services for December 2011, on a balance of payments basis, widened to $48.8 billion from a revised $47.1 billion (previously $47.8 billion) in November, and from a $40.5 billion deficit in December 2010. That reporting was in the general context of revisions to all earlier months in 2011, with a slight downside bias evident in those revisions.

Against the revised November numbers, the seasonally-adjusted December trade balance reflected higher levels of both exports and imports, but the volume of imports increased by a greater amount. Rising oil prices and increased physical oil import volume were factors in the import increase.

Crude Oil and Energy-Related Petroleum Products. For the month of December 2011, the not-seasonally-adjusted average price of imported oil rose to $104.13 per barrel, up from $102.50 in November, and was up from $79.79 in December 2010. For the year, the average 2011 import price was $99.78 per barrel, up from $74.67 in 2010.

In terms of not-seasonally-adjusted physical oil imports, December 2011 volume averaged 8.998 million barrels per day, up from 8.874 million in November 2011, but down from 9.147 million in December 2010. For the year, the average 2011 import volume was 9.108 million barrels per day, down from 9.252 million barrels per day in 2010.

***Real (Inflation-Adjusted) Trade Deficit.*** Adjusted for seasonal factors and net of oil price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the reported December merchandise trade deficit came in at $47.7 billion, a larger deficit than the revised $47.0 (previously $47.5) billion reported for November. That was in the context of revisions to all prior monthly reporting for 2011. On an annual basis, the real merchandise trade deficit was slightly larger, at $566.4 billion in 2011, versus $556.9 billion in 2010, and against $487.8 billion in 2009.

Based on today's reporting, the annualized fourth-quarter real trade deficit—used as a base for the GDP's net export account—would be $554.4 billion, versus the prior $549.2 billion suggested for the fourth-quarter by November's reporting. That is up from the revised third-quarter estimate of $548.2 billion (previously estimated at $552.0 billion). To the extent that the current data are reflected in the first revision to the fourth-quarter GDP on February 29th, the trade numbers should put some downside pressure on that revision. It is possible that the bulk of that revision could be held off until the GDP benchmark revision at the end of July.

**Week Ahead.** Adjusting to the stronger-than-expected reporting of January's labor data, consensus expectations for upcoming economic releases appear to have been boosted. That sets up potential downside surprises for near-term economic reporting, given much-weaker underlying economic fundamentals and reality.

Accordingly, recognition of an intensifying double-dip recession as well as an escalating inflation problem remains sporadic. The political system would like to see the issues disappear until after the 2012 election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, problems that have horrendous implications for the markets and for systemic stability.

Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

***Retail Sales (January 2012).*** Due for release on Tuesday, February 14th, retail sales are a fair bet to show weaker growth than market expectations, net of revisions. The consensus outlook here, as well as in other economic data due in the week ahead, appears to have been boosted by faux strength in the January labor data. Seasonal-adjustment distortions remain a major factor in reporting of questionable month-to-month changes.

***Industrial Production (January 2012).*** Due for release on Wednesday, February 15th, industrial production reporting also likely will be surprised, on the downside of expectations, net of revisions. Again, as with other economic data due out this week, the consensus outlook appears to have been boosted by strength in the January labor data.

***Residential Construction (January 2012).*** Housing starts are due for release on Thursday, February 16th. Expectations here also appear to have been boosted by the labor data, and perhaps by expectations of a seasonal-adjustment boost resulting from unseasonably-mild winter weather in many areas of the country. To the extent there is a gain, it should not be statistically significant, with the bottom-bouncing pattern of recent years continuing.

***Producer Price Index—PPI (January 2012).*** The January PPI is due for release on Thursday, February 16th. With higher oil prices and likely minimal distortion from oil-price seasonal adjustments, and with spreading inflation outside the energy area, monthly inflation in this regularly-volatile series should be on the strong-side of market expectations.

***Consumer Price Index—CPI (January 2012).*** Due for release on Friday, February 17th, the January CPI-U also could see an upside surprise to consensus estimates (0.3% per MarketWatch.com). Gasoline prices rose month-to-month by 3.4% in January 2012, versus December, per the Department of Energy, and seasonal-adjustment distortions to gasoline prices should be minimal for January. Inflationary pressures likely continued to spread outside the energy area.

Year-to-year total CPI-U inflation would increase or decrease in January 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.40% gain in the adjusted monthly level reported for January 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2012, the difference in January's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from December 2011's reported annual inflation rate of 2.96%. For example, a 0.4% gain in the January 2012 CPI would leave annual inflation near 3.0%.

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