

US trade deficit hits new monthly record

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25 May 2000

The rise in the trade deficit to a record \$30.2 billion for the month of March is a further indication of the growing instability of the US financial system. The mounting trade gap, which is expected to hit \$432 billion this year if present trends continue, and the growing indebtedness of the US economy point to one of the motivations for the interest rate rises initiated by the US Federal Reserve over the past year.

Apart from seeking to push down wage demands, financial authorities in the US have lifted interest rates in order to ensure that the inflow of foreign capital needed to fund the trade gap continues.

However such a policy has its limits. As Fed chairman Alan Greenspan has noted on several occasions the widening trade and balance of payments deficit, which requires ever larger inflows of foreign capital to finance it, cannot be sustained indefinitely. At a certain point the US international debt will become so large that the US dollar will start to fall, leading to an outflow of capital, increased inflation and the emergence of recession.

A breakdown of the US trade position for the first three months of this year reveals that its position vis-à-vis its major trading partners has worsened significantly. Overall the trade deficit for the first quarter increased by 59.4 percent over the same period in 1999.

The trade gap with China rose by 22.8 percent over the quarter, by 16.5 percent with Japan, 18.5 percent with the Pacific Rim countries and by 91.6 percent with Western Europe.

In any other country, the existence of such a widening trade gap would bring about a sharp decline in the value of the currency. But the US enjoys considerable advantages due to the fact that the dollar functions as an international currency, and the US is regarded as a “safe haven” for global investment funds. Hence, it is able to finance its growing trade gap with an inflow of

capital from the rest of the world.

But this is leading to a sharp increase in the net indebtedness of the US economy. While official figures will not be released until the end of next month, it has been estimated that US net international debt has increased from \$1.2 trillion in 1998 to \$1.6 trillion at the end of 1999.

Figures on foreign capital inflow over the past decade show the increasing dependence of the US on this inflow to finance the trade gap, the escalation of the stock market and capital investment.

In the 10 years from 1983 to 1993, the net annual inflow of foreign capital averaged around \$88 billion a year, for a total of around \$900 billion. However after 1993 the inflow has accelerated rapidly. After averaging just under \$60 billion per annum in the period of 1990-93, the foreign capital inflow rose to around \$140 billion in 1994 and 1995, increasing to \$195 billion in 1996, and escalating to \$264 billion in 1997. Since 1998 the annual US demands on global capital are estimated to have increased by about \$100 billion to \$350 billion. In other words, in order to sustain its economy the US now has to suck in about \$1 billion per day from the rest of the world.

In lifting interest rates in order to try to sustain this inflow, the Federal Reserve Board is walking something of an economic tightrope. On the one hand, increasing interest rates are needed to make investment in corporate and treasury bonds more attractive to international capital. On the other hand, however, a rapid rise in interest rates threatens to collapse the stock market bubble, leading to an outflow of capital which has increasingly found its way on to Wall Street.

A sharp reversal of the capital inflow would see a further increase in US interest rates, a fall in stock market values and a decline in the value of the dollar, leading to increased inflation and a possible crisis of confidence in the dollar.

In the meantime, the interest rate rises initiated by the Fed are placing increased financial pressures on the other major capitalist countries, in particular Europe. Since its launch in January 1999 at a value of \$1.18, the euro has fallen to as low as 87 cents.

Countries with major balance of payments deficits such as Australia are also coming under increased pressure. With a net foreign debt of \$230 billion and a current account deficit running at more than 5 percent of GDP—a higher proportion than the US—Australia is heavily dependent on foreign capital inflows. But, as a recent analysis prepared by the ANZ Bank points out, competition for funds has sharpened as US demands have increased.

In 1998, the bank points out, Japan, East Asia and Europe had balance of payments surpluses of \$350 billion, making it relatively easy for Australia to finance its annual balance of payments deficit of \$18 billion. But since then these surpluses have fallen by about \$100 billion while US capital demands have increased by around the same amount.

The upshot has been a sharp fall in the value of the Australian dollar against the US currency, with the prospect of a further decline in the immediate future, and the threat of rising inflation.

Australian Treasurer Peter Costello has declared that the government should not lift interest rates to match the rises in the US, but should instead base its strategy on a decline in US growth. But such a strategy is also fraught with dangers.

A decline in the US growth rate sufficient to reduce its balance of payments deficit and claims on international capital flows could have far-reaching consequences for the entire world economy if it were to set off a crisis of confidence in the US dollar and precipitate a slide into recession.



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