The U.S. merchandise trade deficit narrowed to $10.4 billion in February, but has clearly widened over the current business expansion. The U.S. maintains deficits with nearly all regions of the globe. Trade balances ultimately reflect countries' saving and investment decisions. Deficit countries consume more resources than they produce and pay for these resources by borrowing from foreigners. Thus, economic factors that affect the trade balance must also affect saving and investment decisions.

Although their direct connections to saving and investment seem remote and tenuous, relative rates of economic growth and real exchange rates often act as proximate—though imprecise—determinants of the trade balance. Holding other factors constant, estimates suggest that U.S. exports keep pace with imports only when foreign economies expand at twice the U.S. rate. Over the next two years, growth patterns will probably not meet this condition. Economists expect foreign economic activity to expand approximately 2.3% and 2.7%, respectively, during 1997 and 1998, while U.S. economic growth is projected to rise 2.8% and 2.0% over the same years. This year's sharp appreciation of the real trade-weighted dollar (8%) compounds the implication of these economic growth projections for the U.S. trade deficit.