Many analysts fret that the U.S. trade balance will deteriorate significantly over the next year or so. This seems a safe bet. Many of the same analysts predict that further declines in net exports must slow overall economic growth, but while slower growth is likely, the connection to the trade deficit seems misguided.

U.S. net exports have deteriorated since 1991, largely in response to relatively fast economic growth at home. Since 1991, growth abroad has averaged 3.2% per year, while U.S. growth has averaged 2.3%. Typically, the growth differential must approach two percentage points (in favor of our trading partners) before the U.S. trade deficit begins to narrow. Recent forecasts of growth here and abroad anticipate a rather narrow differential over the next two years, implying no improvement in the trade balance because of relatively slower U.S. growth.

Since 1991, the dollar has appreciated approximately 20% on a real effective basis against our 15 major trading partners. Any such rise reflects either a nominal appreciation of the dollar, a higher inflation rate in the U.S. than abroad, or both. As the dollar appreciates on a real effective basis, the foreign price of U.S. goods rises and the U.S. price of foreign goods declines. Recent forecasts of exchange-rate movements (notorious for their inaccuracy) and global inflation rates suggest that the real effective dollar will depreciate 3.6% over 1998 and 1999.