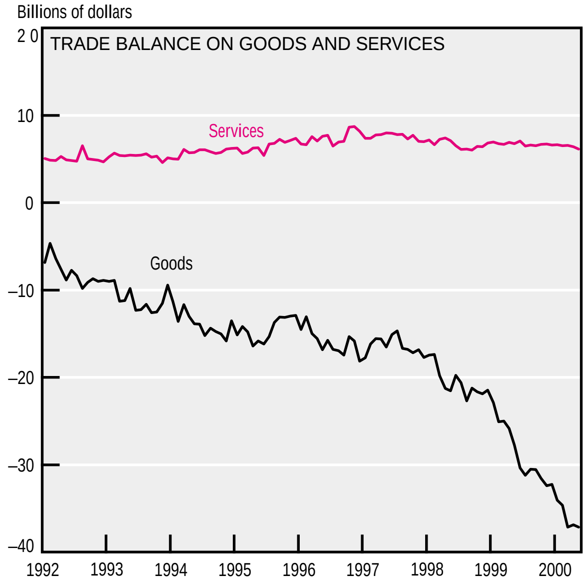
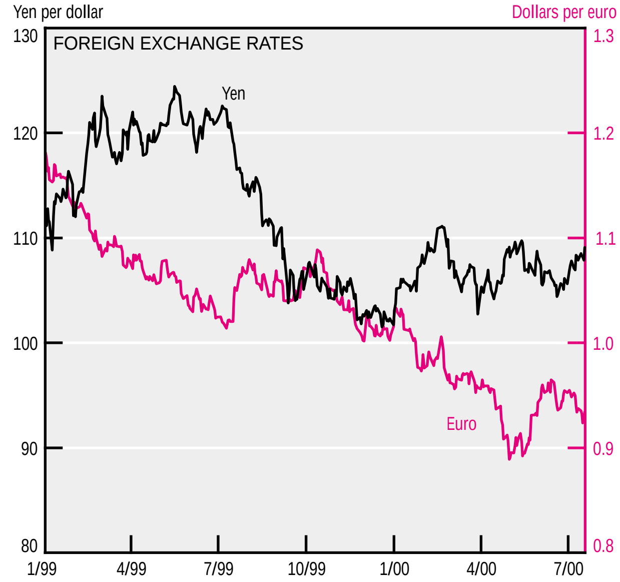
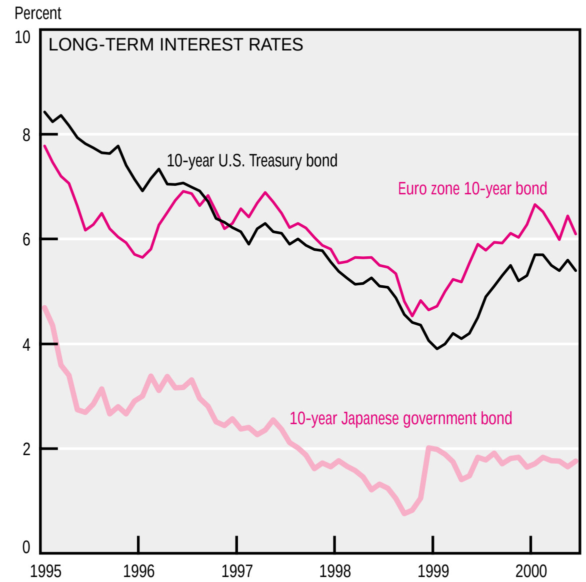
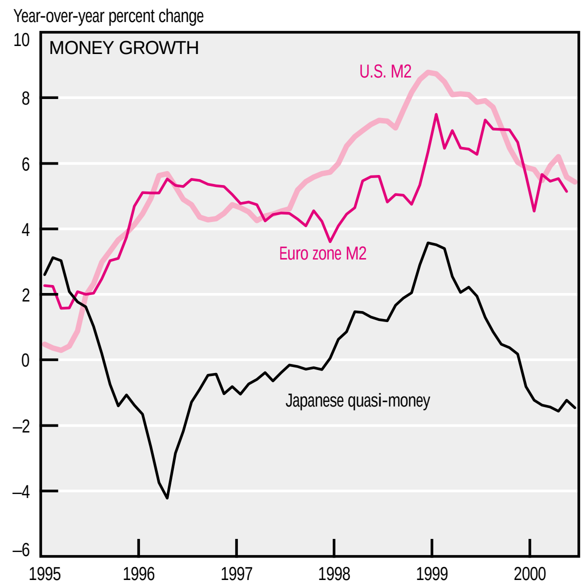
The Dollar and International Trade









SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Bank of Japan; European Central Bank; Japan Securities Dealers Association; and Statistical Office of the European Communities.

The U.S. goods deficit increased $0.3 billion in May, reaching $37.2 billion, while the services surplus decreased $0.3 billion to $6.1 billion. Goods exports decreased more than goods imports, with capital goods accounting for most of the decline. The decrease in the services surplus resulted mainly from declines in travel and other transportation.

The dollar has held firm against the yen since March because of the fragility of Japan's economic recovery. The dollar has weakened against the euro since May but seems to have been supported by market sentiment in favor of a "soft landing" scenario for the U.S. economy. While long-term interest rates in the euro zone exceed those in the U.S., and money growth rates for the two regions are tracking closely, expectations for higher money growth and inflation in Europe could support the dollar.

Continued weakness in Japan's economy dampens hopes for higher interest rates there that might support the yen. However, capital inflows could increase if there were news of renewed economic vigor and higher rates. Although Japan's energy import prices have risen, its overall inflation picture remains unclear; this bears on the assessment of the current monetary policy stance.