The U.S. trade deficit shrank from $29.2 billion in July to $27.1 billion in August. This reflects a monthly improvement for goods, both exports and imports, in the balance of goods and services. Under some circumstances, a decreasing trade deficit might be a positive development; the recent decline in U.S. imports, however, probably reflects declining domestic incomes, while the improvement in U.S. exports is hard to reconcile with declines in foreign GDP. Thus, the improvement in U.S. exports might not be sustainable.

From early 1995 until the current slowdown began, the U.S. trade balance was deteriorating while U.S. growth rates were generally rising. The recent coincidence of deficit improvements and slower U.S. growth is consistent with U.S. GDP movements leading the rest of the world (otherwise, monthly U.S. exports would be falling and the trade balance not changing much). The prospect that slower U.S. growth could spread worldwide may explain why the improved trade balance has not been loudly applauded.

The dollar’s value abroad also affects the trade balance. An improving trade deficit, accompanied by a strengthening dollar, is a change from the last five years, when the balance deteriorated and the dollar strengthened. That five-year record could be explained by viewing capital inflows into the U.S. (the counterpart of a current account deficit) as a sign that foreigners wished to invest here. This may still be so, but an improved trade balance, all things being equal, implies a smaller current account deficit and smaller capital inflows.

a. Foreign GDP growth is the trade-weighted average growth rate for the top 15 U.S. trading partners in 1992–97: Canada, Japan, Mexico, Germany, U.K., China, Taiwan, Korea, France, Singapore, Italy, Hong Kong, Malaysia, the Netherlands, and Brazil.
b. The Broad Dollar Index is a trade-weighted average of the foreign exchange values of the dollar against 26 important trading partners, including those in the euro area.