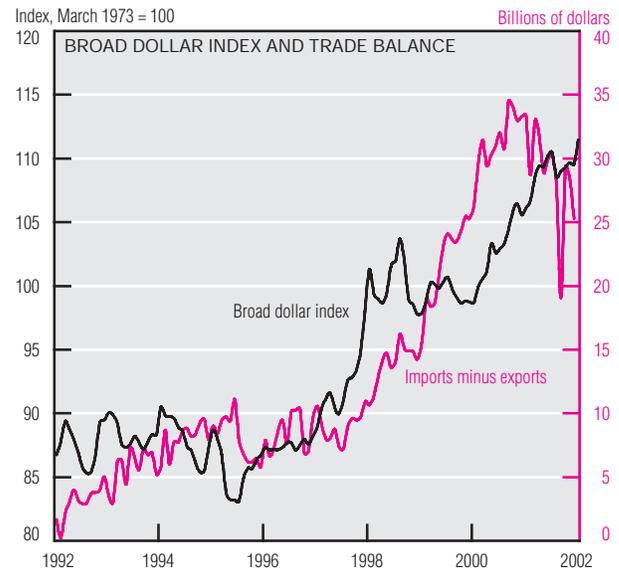
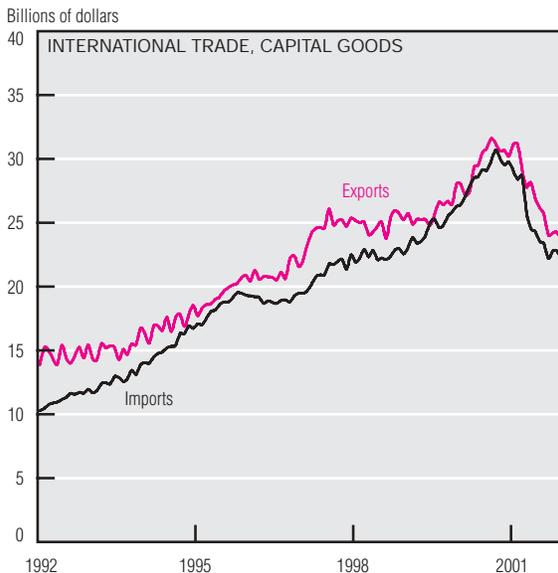
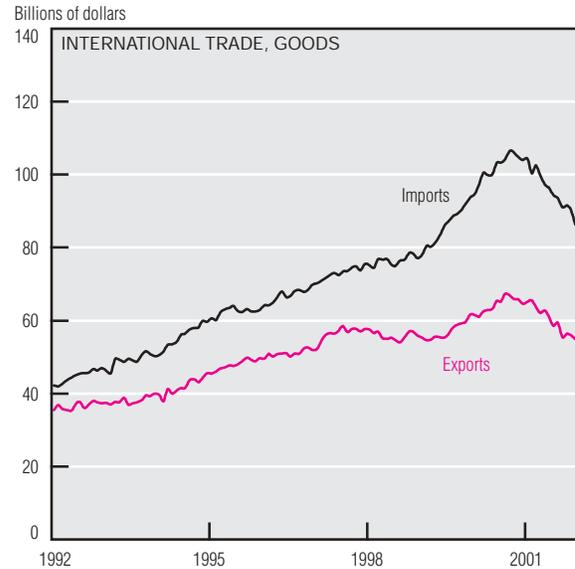
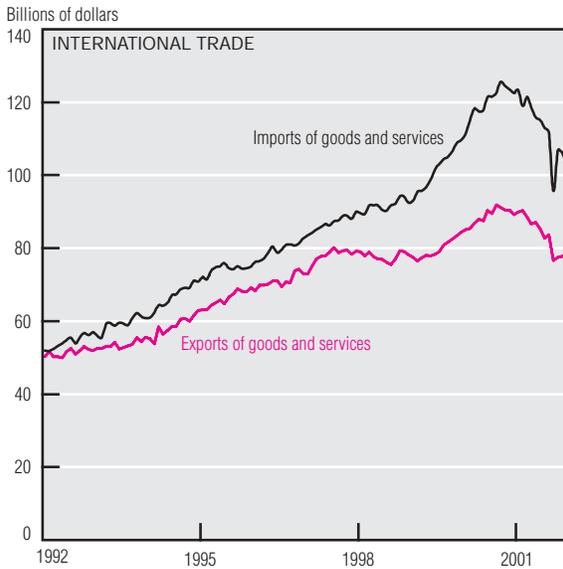


The Trade Balance



SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

The December trade deficit of \$25.3 billion was \$3.3 billion less than in November, primarily because of a \$3.1 billion decline in imports. Of the two components of the trade balance, the goods balance declined \$2.9 billion and the services surplus increased \$0.3 billion. Notably, consumer goods declined \$1.3 billion and industrial supplies and materials fell \$1.2 billion.

The U.S. continues to run a slight surplus on capital goods, although both exports and imports in this category weakened in December. Capital

goods imports are considered to offer a potential boost to productivity because they may include technologically sophisticated items.

Import declines are best seen as a reflection of weak demand and income, rather than an indication of movements in exchange rates or prices. Thus, the general decline in exports and imports over the last year may indicate a worldwide slowdown in economic activity.

In theory, the persistent U.S. trade deficit should be ameliorated by a decline in the dollar's real exchange

rate. The real dollar combines the effects of changes in the nominal exchange rate (foreign currency units per dollar), domestic prices, and foreign prices. The real dollar rises if its nominal value increases (the dollar "strengthens"), if U.S. prices rise, or if foreign prices fall. The dollar's continued real appreciation would not seem to support improvement in the U.S. trade position; the stabilization of the trade balance in 1996, for instance, was preceded by a decline in the real dollar.