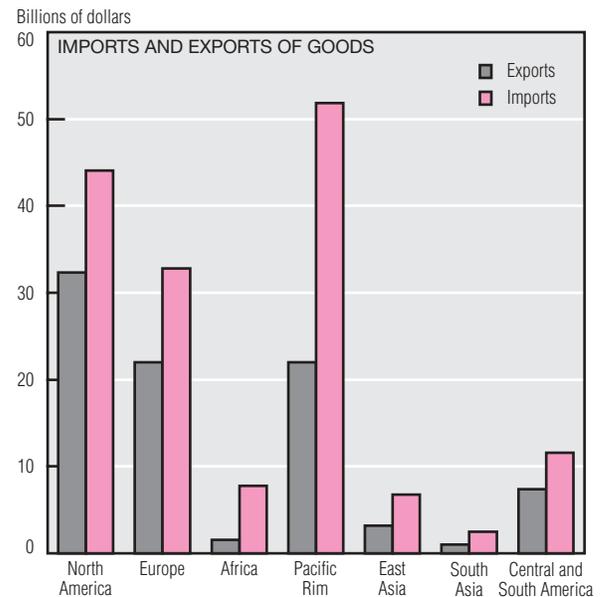
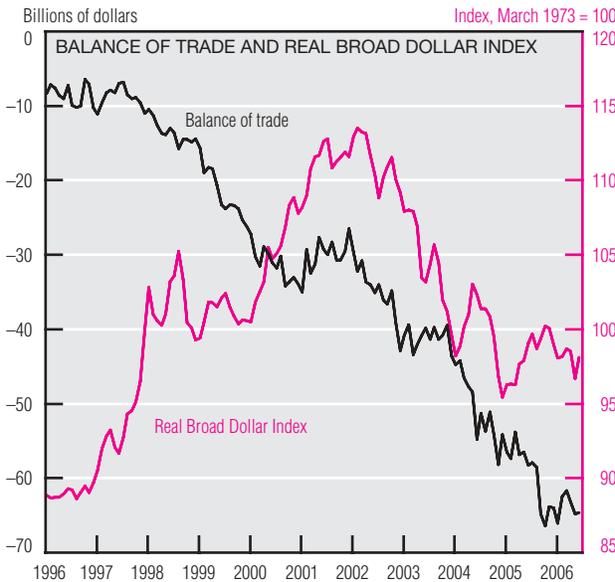
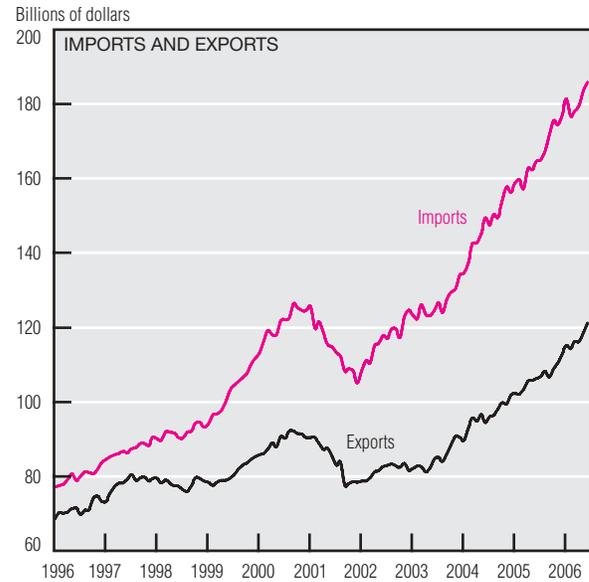
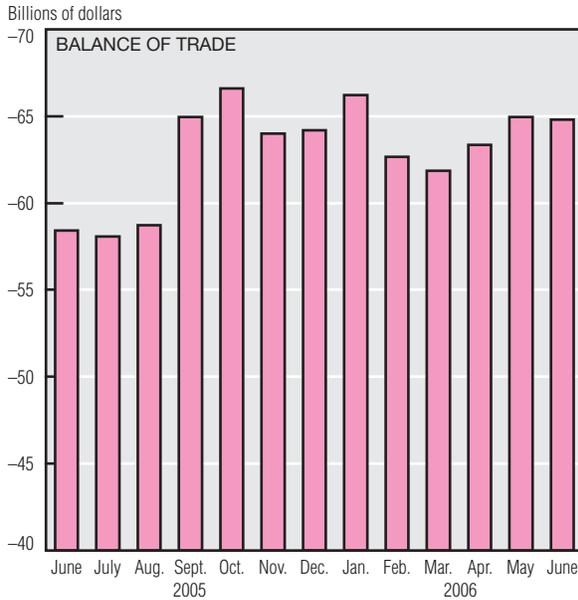


The U.S. Trade Balance



SOURCES: U.S. Department of Commerce, Census Bureau; and Board of Governors of the Federal Reserve System, "Foreign Exchange Rates," *Federal Reserve Statistical Releases*, H.10.

The nominal U.S. trade deficit reached an all-time high of \$66.6 billion in October 2005. Many believe that Hurricane Katrina caused imports and exports—which generally move in the same direction—to diverge as imports increased and exports decreased, creating a sizable jump in the trade deficit. The deficit remains far above its pre-Katrina level, although it has fallen in four of the last eight months. In June, it narrowed slightly from \$65.0 billion to \$64.8 billion.

While \$0.2 billion is not a substantial one-month decrease, in real terms the June deficit is down more than 4% from its peak.

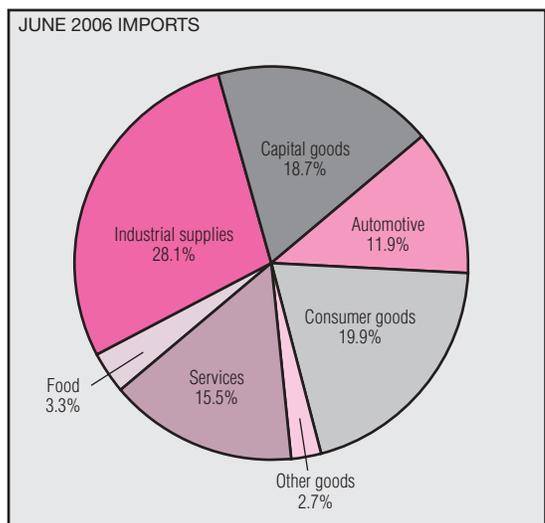
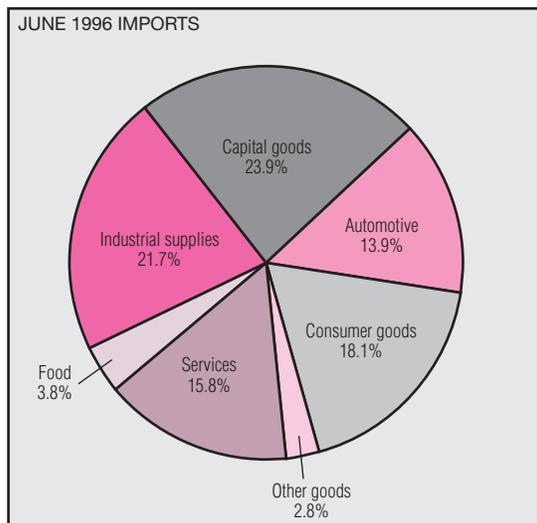
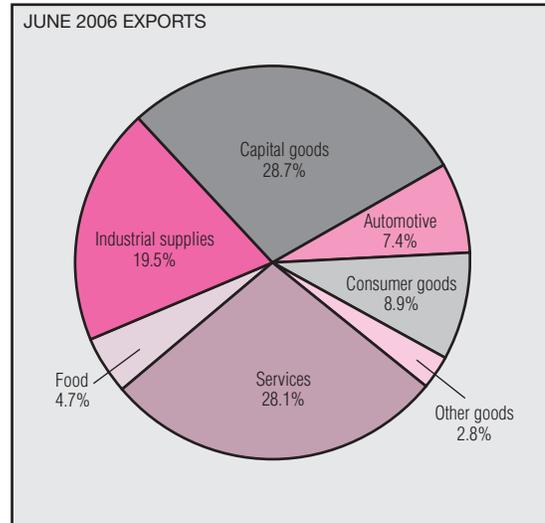
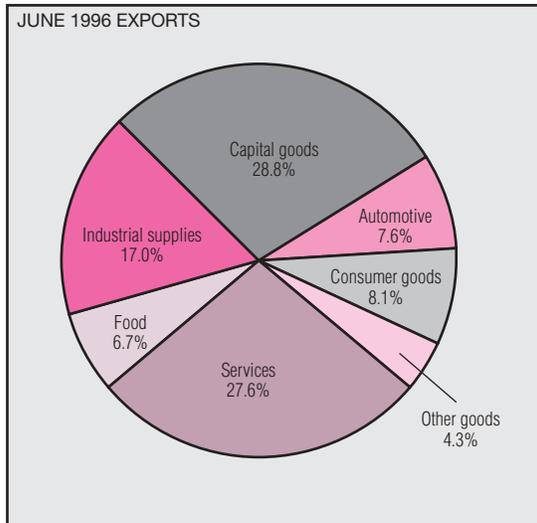
The June deficit decrease occurred because export growth (2.0%) exceeded import growth (1.2%). Export growth, which fell after Katrina, has strengthened again, attaining an average monthly rate of nearly 1.3%. This rate is strong in the sense that export growth over the past 10 years has averaged only 0.5% a month. In

contrast, import growth following Katrina has been close to its trend of the past 10 years: Since last September, import growth has averaged 0.8% per month, compared to the 10-year average of 0.7%.

From 2002 through 2004, the dollar depreciated sharply. At the same time, the U.S. trade deficit continued to widen. This may seem counterintuitive: One would expect that as the dollar's value falls relative to other currencies, foreign demand for U.S.

(continued on next page)

The U.S. Trade Balance (cont.)



SOURCE: U.S. Department of Commerce, Census Bureau.

goods would increase and U.S. demand for foreign goods would decrease. One possible explanation for a growing trade deficit during a period of dollar depreciation is that the U.S.'s strong economic growth stimulated foreigners' appetite for our assets. Holding all else constant, an increase in foreigners' holdings of U.S. assets would worsen the trade balance.

In June, the Pacific Rim region was the largest exporter of goods to the

U.S., with Europe and the North American region not far behind. On the other hand, the largest importer of U.S. goods was the North American region, while Europe and the Pacific Rim were virtually tied for imports of U.S. goods.

Interestingly enough, the composition of our export products has not shifted significantly in the last 10 years. Aside from a decrease in food and other goods as a percent of exports and an increase in industrial

supplies, little has changed. Imports have been slightly more dynamic over the last 10 years. Industrial supplies and consumer goods have increased substantially as a share of total imports, whereas capital goods and automotive imports have declined. Still, considering how much the U.S. economy has changed in the last 10 years, it is surprising that the overall makeup of our imports and exports has changed so little.