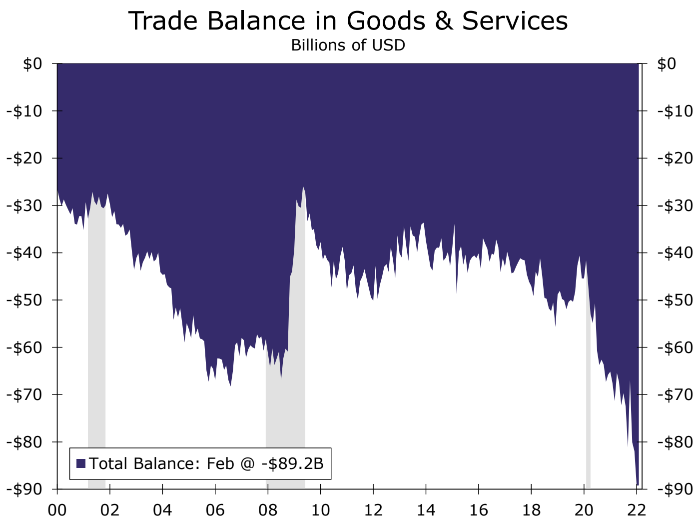
Economic Indicator — April 5, 2022

U.S. Trade Balance Holds Constant at Record Deficit in February

Summary

The U.S. trade balance held constant at a record deficit, but the steadiness of the U.S. trade balance is likely temporary. We expect the trade deficit to widen further over the coming quarters as U.S. businesses need to replenish inventories and exports look set to rise at only a moderate pace this year. The February data suggest net exports are still shaping up to be a considerable drag on first quarter growth.



Source: U.S. Department of Commerce and Wells Fargo Economics

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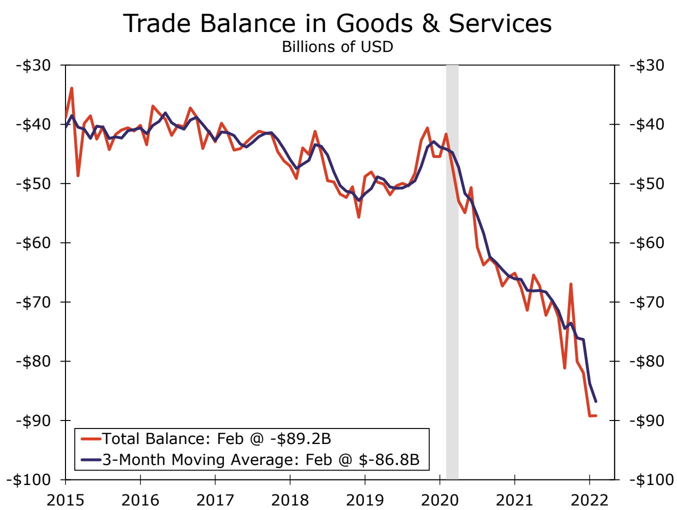
Some Time Away from Stabilization in Trade Balance

The U.S. trade balance more or less held constant at a record deficit in February (chart). The balance narrowed only marginally by $44 million to a deficit of $89.19 billion in February from an upwardly revised $89.23 billion in January. This marks the smallest movement in the deficit since the start of 2020, after two years of extreme volatility in the month-to-month data (chart).

There has been a clear widening in the trade balance since the start of the pandemic as a result of robust domestic demand for goods (chart). Even as some of this demand subsides in the near-term amid the return of services activities and soaring inflation, the need to replenish low levels of inventory should keep imports flowing into the U.S. At the same time, export growth should continue to moderately recover this year, but it's unlikely to be strong enough to offset the continued climb in imports. The slight narrowing in the February trade data thus likely does not demonstrate the start of a stabilization in the trade balance.

The narrowing was a result of the U.S. exporting more to its foreign trading partners than it brought in. In nominal terms, exports grew 1.8% in February while import growth was weaker at 1.3%. Exports received a solid boost from consumer goods (+6.7%), where pharmaceutical preparations accounted for most of the gain. The largest gain in imports came from a $1.9 billion gain in crude oil, accounting for nearly 60% of the overall gain in industrial supplies imports for February. Russia invaded Ukraine towards the end of the month and with the conflict unresolved this import component will likely remain elevated for some time. The services trade balance narrowed by $1 billion, in part reflecting temporary factors. There was a sizable gain in intellectual property imports, which may be tied to broadcasting rights for the Winter Olympics.



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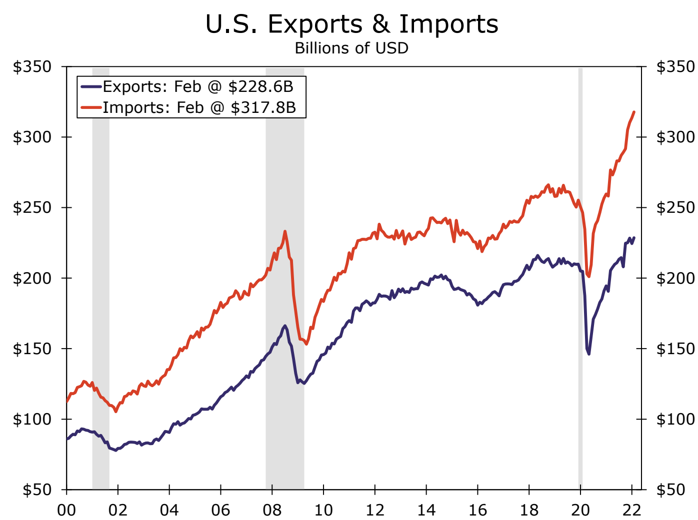

Source: U.S. Department of Commerce and Wells Fargo Economics

Overall net exports are still shaping up to be a considerable drag on first quarter growth. After adjusting for higher prices during the month, real goods exports *fell* 0.8% in February, while imports slid 1.0%. We currently forecast net exports subtracted 1.2 percentage points from growth in for the first quarter, and when considering these developments it seems that the drag could be even larger. While a precise estimate of the size of the drag depends on how trade flows evolve in March, one thing is fairly certain; *the first quarter will mark the seventh consecutive quarter where net exports were a drag on overall output.*

Quick Update on US Trade Policy

The Biden Administration recently renewed tariff waivers that expired at the end of 2020. The waivers now cover 352 products from China, or a little over 60% of the goods previously exempt from tariffs, retroactive to October 2021. In reviewing products for exclusion, the USTR considered alternative sources for goods, if supply chain disruptions affected product availability and the efforts of companies to secure new sources.

While the exclusions shouldn't have a large impact on overall trade, it seems a larger change in U.S. trade policy may be brewing. In her appearance before the House Ways and Means Committee last week, U.S. Trade Representative Katherine Tai emphasized new tools are needed to address unfair trade practices. China fell short of its purchase targets made under the Phase One trade deal last year and Tai said it's been difficult to conduct bilateral discussions to hold China accountable. The U.S. will continue to enforce the commitments made under the deal, but according to Tai options remain open to further incentivize China's compliance.

To date the Biden Administration has not made any *major* overhauls to preexisting trade policy. The administration has rolled back tariffs on steel imports from the EU, Japan and the UK up to a particular amount, in line with prior volumes (2015-17 for the EU and 2018-19 for Japan and the UK).

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