

Economic Indicator — July 3, 2024

Despite Import Decline, Net Exports to Slice Q2 Real GDP Growth

Summary

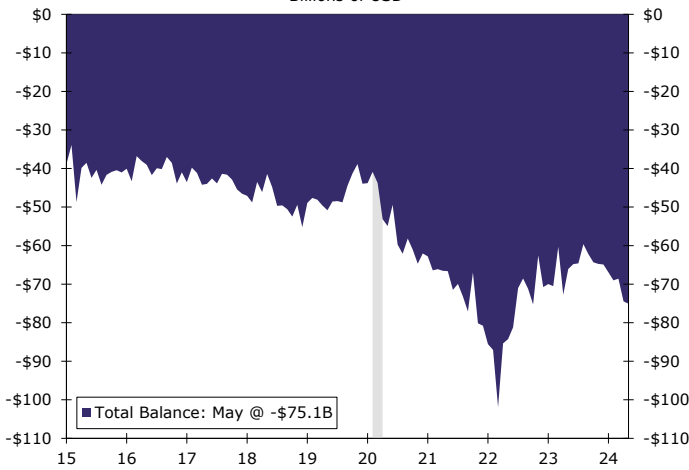
The U.S. international trade balance worsened for the second straight month in May, leaving the deficit at its widest position since late 2022. A resilient domestic U.S. economy and steady dollar strength are supportive of a widening deficit this year. Net exports are now tracking to slice a full percentage point or more from Q2 real GDP growth.

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Trade Balance in Goods & Services
Billions of USD

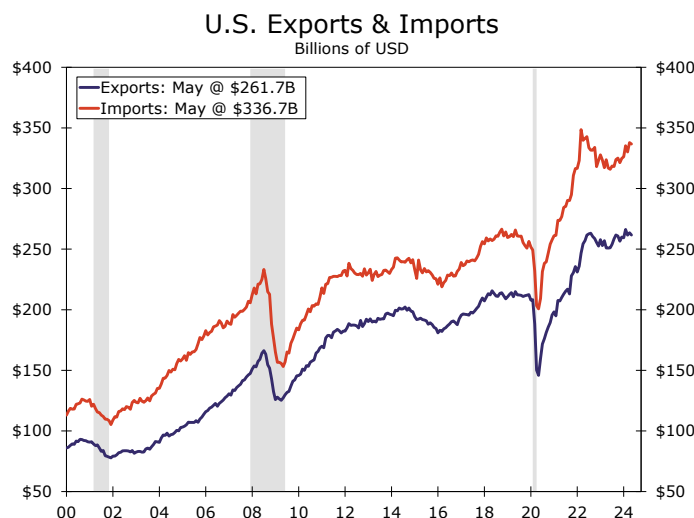


Source: U.S. Department of Commerce and Wells Fargo Economics

Un-Steady As She Goes

U.S. exports and imports both slipped by over \$1 billion in May, but the drop in exports was about 1.5 times as large as that in imports, which caused the deficit to widen. Specifically, the trade balance worsened to a deficit of \$75.1 billion in May, leaving the deficit nearly 16% larger than when the year started. The sharp adjustment lower comes down to the underlying resilience in U.S. demand and steady U.S. dollar strength, both of which leave imports more resilient than exports this year.

Continued spending among U.S. households and some stabilization in capex should help support import growth as inventory levels remain well managed and show little sign of being overstocked. Dollar strength is also supportive of imports but is a challenge for exports. The trade-weighted dollar index is up 4.1% since the start of the year, which leaves U.S. goods more expensive on the global market, weighing on demand for exports.



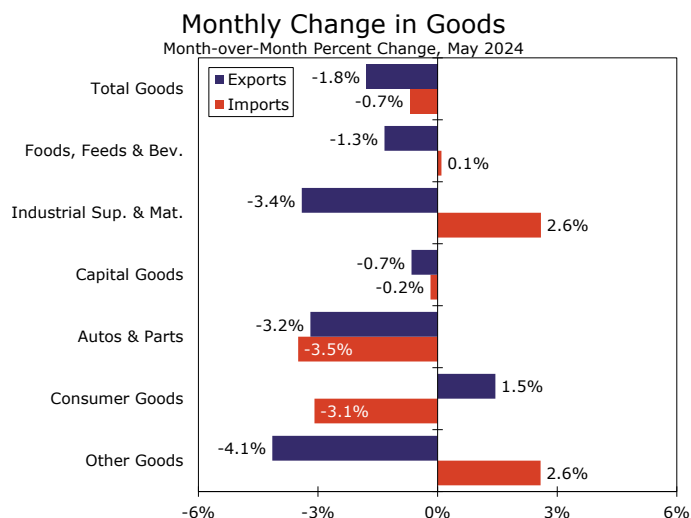
Source: U.S. Department of Commerce and Wells Fargo Economics

Imports may not be booming, but they are doing better than exports. Imports slowed in May, dropping \$1.2 billion, or by 0.3%. Most major categories of imports moved lower, but a majority of the weakness can be traced to consumer goods, and imports of pharmaceutical preparations specifically. This is a particularly volatile component on a monthly basis. Consider in May, pharmaceuticals slipped \$4.2 billion, which was enough to turn consumer goods and overall imports negative. Without that sharp drop, import growth could have been positive. Consumer goods imports are still up 5% on a year-ago basis and continued domestic demand remains supportive of growth. After rising for the first four months of the year, capital goods imports pulled back slightly in May. Industrial supplies imports were an area of strength, rising 2.6% amid a pop in crude oil imports.

On the flip side, the monthly decline in total exports (-\$1.8 billion) was largely driven by industrial supplies—specifically petroleum products, fuel oil and gold. That said, export weakness was broad-based with modest decreases in autos, capital goods and food. On an annual basis, exports were up 4.3% in May.

While economic activity has recently shown signs of softening, U.S. domestic final demand remains more robust than in other economies. For instance, real GDP in the Eurozone and Canada was up 0.4% and 0.5%, respectively, on a year-ago basis in the first quarter, compared to 2.9% in the United States. The differential in growth rates has contributed to the dollar's strength, as has diverging monetary policy positions. We suspect that dollar strength will continue in the coming months, as the Federal Reserve is expected to hold its policy rate higher than other major central banks. Given this dynamic, U.S. exports are set to remain relatively expensive to the country's key trading partners.

The dollar's strength poses a headwind to U.S. real GDP growth. Through May, net exports are tracking to be a fairly considerable drag on Q2 headline growth. Real goods exports slid 0.9% in May while real goods imports fell a more modest 0.4%. These data present downside risk to our current forecast and suggest net exports could subtract a full percentage point or more off Q2 real GDP growth.



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

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