LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

April 4 2016

# CHECKING IN ON TRADE

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## KEY TAKEAWAYS

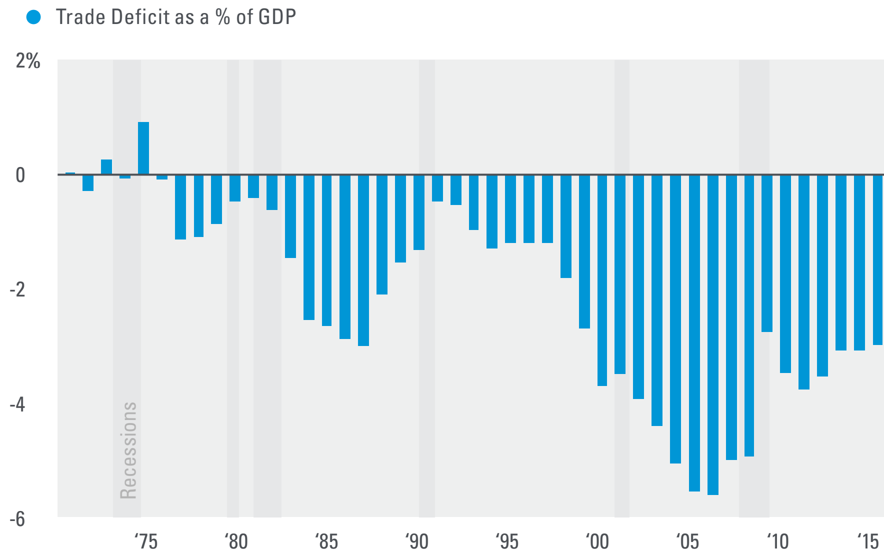
The U.S. trade deficit has been a drag on overall GDP growth.

However, the U.S. continues to steadily grow in its role as an exporter of services.

In addition, the goods the U.S. does export are generally of higher value.

The U.S. has run a trade deficit (importing more goods and services from other countries than it exports) since the mid-1970s, which acts as a drag on overall gross domestic product (GDP) growth [Figure 1]. Although the trade deficit narrows during recessions, when imports typically fall faster than exports, the trade gap has increased over time, and currently stands at around 3.0% of GDP. Along with the massive budget deficit, the trade deficit is one of the major economic challenges facing the U.S. and has fostered the oft-repeated conventional wisdom that "we don't make anything in the U.S. anymore." What's missing from this assessment, however, is the role of the U.S. as a net exporter of services and the increasing value of "good old American know-how." Here we focus on the details of what we import and export, and the impacts on the U.S. economy.

**1 EXPORTS CONTINUE TO ACT AS A DRAG ON OVERALL GDP**




Source: LPL Research, Haver Analytics 04/04/16

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

## INSIDE LOOK AT U.S. TRADE DEFICIT

The trade deficit is computed by adding up the value of all goods and services made in the U.S. and shipped to other countries (which adds to GDP), and subtracting the value of all goods and services from abroad purchased in the U.S. (which is subtracted from GDP). Our large deficit on the goods side ($775 billion in 2015*) more than offsets the trade surplus we have on the services side of the ledger ($246 billion in 2015) [Figure 2]. Combined, our goods and services trade deficit was $530 billion in 2015, or 3% of GDP.

The composition of the deficit on the goods side (what we import) contributes to the notion that "we don't make anything in the U.S. anymore," while the "hidden" surplus on the service side gets little attention. The United States Bureau of the Census will release the February 2016 data on U.S. imports and exports this week (Tuesday, April 5, 2016), and our trade deficit is likely to get some attention from pundits and politicians, especially during the already contentious election season.

## CONSUMER ITEMS DOMINATE U.S. GOODS IMPORTS

In 2015, the U.S. exported $1.5 trillion worth of goods and imported $2.3 trillion, leading to the $775 billion trade deficit on the goods side. The list of our top 10 imported items on the goods side is full of consumer and consumer-related items, such as vehicles ($348 billion), energy ($170 billion), computers and electronic equipment ($120 billion), pharmaceuticals ($108 billion), apparel ($94 billion), furniture ($34 billion), and the somewhat deceiving "miscellaneous manufactured goods" category. This category of imported goods—which includes household items like jewelry, sporting goods, toys and games, office supplies, etc.—is found in the grocery stores and big box discount stores we shop in every day. We imported $115 billion of these goods in 2015 and exported just $45 billion, increasing the trade deficit by $69 billion. Although this category is not the main driver of our overall trade deficit, it is certainly one of the most visible manifestations of it, and contributes to the overall perception that goods aren't being produced in the U.S. anymore.

**2 GOODS VS. SERVICES: IMPORTS, EXPORTS, AND THE DEFICIT/SURPLUS**

| | Imports | Exports | Net |
|---|---|---|---|
| Goods | $2.3 Trillion | $1.5 Trillion | -$775 Billion |
| Services | $502 Billion | $748 Billion | +$246 Billion |

Source: LPL Research, U.S. Bureau of Economic Analysis, Haver Analytics 04/04/16

Annual 2015 data shown above.

*Import and export data on both goods and services is available monthly, but for ease of comparison we will limit our discussion to the annual data for 2015.

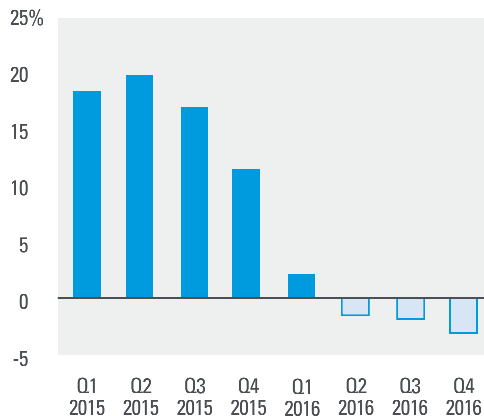
## GOOD OLD AMERICAN KNOW-HOW DOMINATES OUR SERVICE EXPORTS

What is not as visible to most Americans (and to most pundits and media outlets) is that the U.S. is a net exporter of services, and that our service exports are growing rapidly, as consumers and businesses around the world demand America's intellectual property, expertise, and culture. In 2015, the U.S. exported $748 billion of services, and imported just $502 billion, for a trade surplus on the services side of $246 billion. Although this is not enough to offset the $775 billion deficit on the goods side, our trade advantage in services is noteworthy. At $748 billion dollars, service exports were at an all-time high in 2015, and have nearly tripled in the past 10 years. This figure towers above our imports in the "miscellaneous manufactured goods" category noted above, and yet it gets very little attention. The U.S. runs large and persistent trade surpluses in many key service areas including education, intellectual property, travel, insurance, consulting, legal, telecommunications, and financial services—all

## WHERE DOES THE U.S. DOLLAR FIT IN?

The U.S. dollar soared 18% versus the currencies of its major trading partners since we last wrote an in-depth report on the U.S. exports sector in the summer of 2014. The relentless rise in the U.S. dollar through the end of 2015 from mid-2014 began to reverse in the first quarter of 2016, leaving the dollar just 3% higher versus the currencies of its major trading partners over the past year. (For more on this shift in the dollar, see the *Weekly Economic Commentary*, "From Headwind to Tailwind?") This reversal aligns with our expectation that the dollar may begin to stabilize as central bank policies and their outcomes become clearer, as noted in our *Outlook 2016: Embrace the Routine* publication. A stabilizing dollar should help to boost exports, removing a key headwind for the manufacturing sector and profits of U.S. corporations.

**3 AS THE U.S. DOLLAR STABILIZES, IT SHOULD HELP TO BOOST EXPORTS**




Source: LPL Research, FactSet 04/01/16

Estimates are based on consensus estimates as calculated by Thomson Reuters.

The U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar. The DXY Index does this by averaging the exchange rates between the U.S. dollar and six major world currencies.

Past performance is no guarantee of future results.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

of which are part of what we like to call "good old American know-how." In a future edition of the *Weekly Economic Commentary*, we'll explore the U.S. advantage in good old American know-how in further detail, and what it means for the economy and for certain segments of the labor market.

> What is not as visible to most Americans is that the U.S. is a net exporter of services, and that our service exports are growing rapidly.

In general, the charge that "we don't make anything in the U.S. anymore" isn't true; but because many of the items we see and use every day around the house, in the car, or at the office are not made here, it's easy to draw that conclusion. To say it another way, we see the items we import (and in many cases, previously made here) but don't regularly see the things that we export; this is either because they are intangible (consulting services, for example) or do not show up in the stores we regularly shop in. When was the last time you saw a giant jet engine or an MRI machine in your local store? Adding to the misperception is that those items we import most tend to be very labor intensive, but generally not very expensive, while those we export are higher valued added. Over time, the U.S. economy—along with most other developed market economies—has made a transition away from producing low value added, commodities goods toward the production and export of high value added goods (MRI machines and jet engines) and services (legal, consulting, education, intellectual property such as software, etc.). Although this shift has occurred over the past 40 to 50 years, the labor market dislocations of the Great Recession have amplified the impact to many workers in the goods-producing sector. ■

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