6 APRIL 2021

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United States : the recovery plan paves the way for a record trade deficit

As the world's largest importer and second largest exporter of goods, the United States (U.S.) has run a trade deficit since the early 1970s. This trade deficit has regularly been a source of tension in economic and trade policy debates. Most recently, President Donald Trump's administration has reignited this debate, arguing that it costs U.S. jobs and reflects unfair trade practices by partner countries. Despite escalating trade tensions and tariffs that were intended to reduce this imbalance in trade in goods, Donald Trump leaves a legacy of a larger trade deficit to President Joe Biden's administration than when he entered the White House four years earlier. After a year 2020 in which trade flows were disrupted by the COVID-19 pandemic, the trade deficit even reached a record high of more than 900 billion U.S. dollars (USD).

After a 3.5% contraction in 2020, Coface forecasts that U.S. GDP will rebound by 5.7% this year, which would allow the country to return to its pre-crisis level as early as mid-2021, before most advanced economies. This more powerful rebound in the U.S. than in its major trading partners is expected to be driven by an unprecedented fiscal response to the crisis: the USD 1.9 trillion "American Rescue Plan" package, passed in March 2021, will bring the total fiscal response to the crisis to an amount equivalent to 27% of U.S. GDP, more than any other mature economy. In addition, with the vaccine rollout moving forward at a high pace, a «boom» in U.S. consumption, supported by these massive government transfers and the lifting of restrictions to curb the spread of COVID-19, is expected. The positive outlook for U.S. consumption is expected to fuel strong import volumes that would contribute to a widening trade deficit. Using an analysis based on the historical estimate of a potential output trade balance, we estimate that the deficit could be as much as USD 56 billion higher than it would have been without the stimulus package. Bilateral deficits with Mexico, but also with Germany, South Korea, Brazil or India could increase accordingly.

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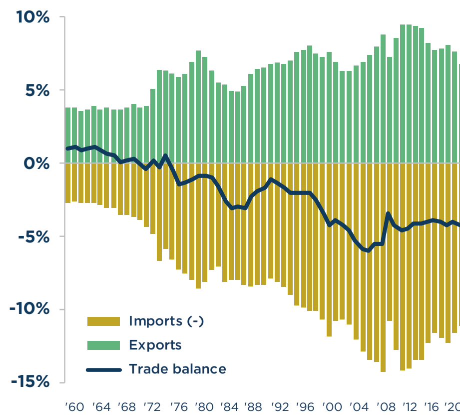
FOR TRADE

A persistent trade deficit for five decades

The U.S. trade balance has been negative since 1975 **(Chart 1)**. This period follows a century (1870-1970) of trade surplus, supported by the expansion of mass production of manufactured goods and machinery. The turning point in the 1970s can be linked to the end of the gold standard and the collapse of the Bretton Woods system, which made the USD the world's reserve currency. This new status has since fueled demand for the U.S. currency, maintaining a strong dollar that raises the cost of exports and reduces the cost of imports.

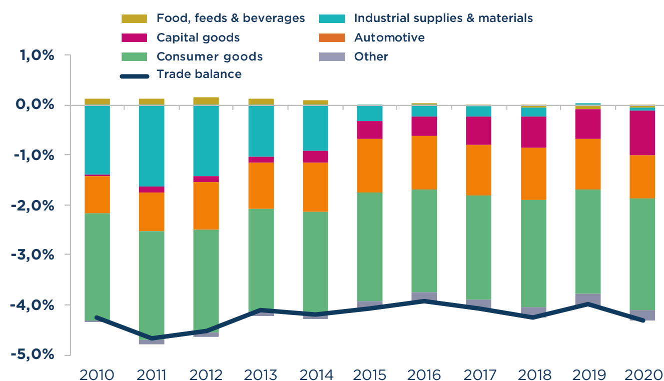
CHART 1
United States, Merchandise Trade Balance as % of GDP

Sources : U.S. Census Bureau, Refinitiv Datastream, Coface



A trade deficit implies insufficient national savings (private and public) to finance national investment: if a country saves more of its total production than it invests, it has additional production to sell to the rest of the world; otherwise, as in the case of the United States, a country needs to import. Foreign capital inflows allow the country to consume more than it produces. These trade deficit considerations imply a structural trade deficit in the United States.
Historically, the origin of this deficit is the considerable imports to satisfy U.S. consumption, as confirmed by the trade balances by end-use category of the goods. It has contributed 50 percent of the total deficit over the past 10 years **(Chart 2)**.
Since 2015, the main development has been the decline in the weight of industrial supplies and materials in the trade deficit. The shale oil and gas boom has been a major contributor to this development, reducing U.S. energy dependence. According to the Energy Information Administration, the country became a net exporter of natural gas in 2017, and a net exporter of crude oil and petroleum products in late 2019. Although capital goods are the most important export sector (34% of the total between 2010 and 2020), their growth has been supplanted by that of imports, penalized, in the last two years, by Boeing[1] woes and the COVID-19 pandemic. The contribution of food products to this deficit is much more marginal, with the country benefiting from its position as the world's largest exporter of corn and second largest exporter of soybeans.

CHART 2
United States, Trade balance by end-use category as % of GDP, 2010-2020



Sources : U.S. BEA, Department of Commerce Refinitiv Datastream, Coface

Mixed results for the trade war

Donald Trump's presidency has highlighted China's considerable weight in the trade deficit. Between 2010 and 2020, it accounts for about 44% of the total. But, the country's trade balance is not just about this bilateral relationship: out of 228 partners, the U.S. had a negative balance with 98 of them in 2020. More importantly, the country has a negative trade gap with most of its major trading partners: of the 10 countries with which the United States trades the most, it is positive only with the United Kingdom **(Chart 3)**.

CHART 3
United States, Contribution to the trade balance with its 10 trading partners, 2016-2020, USD billion

Sources : U.S. Census Bureau, Refinitiv Datastream, Coface

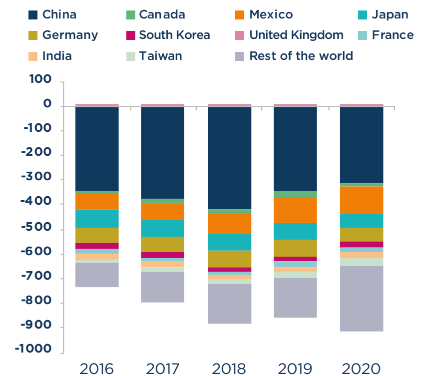


Chart 3 shows that, despite its still considerable weight, the deficit with China has narrowed over the past two years: from a record level of nearly USD 420 billion in 2018, it fell to USD 345 billion the following year, then to USD 310 billion in 2020. However, this reduction has not helped Donald Trump achieve his 2016 campaign goal of significantly reducing the overall trade deficit. Whether expressed in real terms, nominal terms or as a percentage of GDP, it has even always been higher than the one he inherited when he arrived at the White House.
The trade war between China and the United States, characterized by rising tariffs between the world's two largest economies **(see Box)**, has thus had mixed results. In 2018, when tariff barriers targeting USD 200 billion of Chinese imports were put in place, the deficit with China reached a record level, contributing to a higher overall deficit (USD 875 billion, 4.2% of GDP). This development can be explained by the tax reform[2] (November 2017) of the Donald Trump administration, which increased the federal budget deficit and stimulated investment, and thus, increased the gap between savings and investment. The following year, the fading impact of this legislation reduced this gap, resulting in a lower deficit (4% of GDP).
The impact of the tariffs was felt in the bilateral deficit with China, down 18% in 2019, but nearly three quarters of this decline was offset by the balance of trade with the rest of the world. The deficit widened notably with Mexico, Vietnam, Taiwan, South Korea, Malaysia, Thailand, Singapore, Switzerland, Ireland and France. These dynamics of offsetting bilateral deficits were confirmed in 2020, as despite a 10% drop in the trade gap with China, the total deficit reached its highest level since 2012 at 4.3% (USD 904 billion, a record).

1 - Following two crashes in October 2018 and again in March 2019 involving the Boeing 737 Max, the aircraft was suspended from flight by certification authorities in March 2019 After modifying the aircraft, the Federal Aviation Administration (FAA), the U.S. agency regulating civil aviation, authorized its return to service in November 2020.
2 - Tax cuts and Jobs Act, adopted in November 2017.

Of course, 2020 figures cannot be separated from the COVID-19 pandemic. The crisis resulted in a 9% decline in the value of U.S. trade flows: -13% for exports; -6% for imports. This is less than the 23% decline in 2009, but still significant.
Against this backdrop, the implementation of the Phase One[3] trade agreement is difficult to assess. By the end of 2020, China has not met its target of purchasing an additional USD 64 billion in agricultural, energy, and manufactured goods compared to a 2017 baseline. Out of a total of USD 159 billion[4] in promised commodity purchases, China met only 59 percent of this target by the end of the year **(Chart 4)**. Energy purchases are particularly far from their target (37% of the target met).
In the context of the pandemic, concerns about the supply of medical products needed to manage the health emergency have been a major theme. In the United States, as in the rest of the world[5], this has resulted in an increase in measures to limit exports of these products and a temporary removal of some import barriers. As a result, the trade deficit for COVID-19 products increased by 9% **(Chart 5A)**. This trend is particularly linked to the increased need for personal protective equipment (PPE), for which imports were multiplied by 2.4. One trading partner in particular benefited from this increased demand, accounting for more than two-thirds of U.S. PPE imports: China **(Chart 5B).**

The stimulus plan will increase the trade deficit

After the shock of the COVID-19 pandemic crisis, another major shift in macroeconomic balances is taking place with the massive stimulus package, dubbed the "American Rescue Plan".
Adopted in March, it is estimated at nearly USD 1.9 trillion (9% of GDP), of which more than a third will be injected directly into the economy in 2021 , This amount will be in addition to the nearly USD 4 trillion authorized by Congress in 2020 to respond to the crisis.
Government transfers to households, thanks to measures such as the payment of USD 1,400 checks to the lower-income households and the Child Tax Credit, will increase household income. Given the rapid progress of the United States in the rollout of the COVID-19 vaccine (more than a quarter of the population had received at least one dose by the end of March), Coface therefore anticipates a strong rebound in private consumption, which will push growth to 5.7% in 2021, after a contraction of 3.5% last year. According to our scenario, the country would thus be one of the first countries to return to its pre-pandemic level of activity, by mid-2021.
While it will boost growth, Joe Biden's stimulus plan should also result in a higher trade deficit, as the strong growth of the U.S. economy relative to its main trading partners fuels demand for foreign goods.

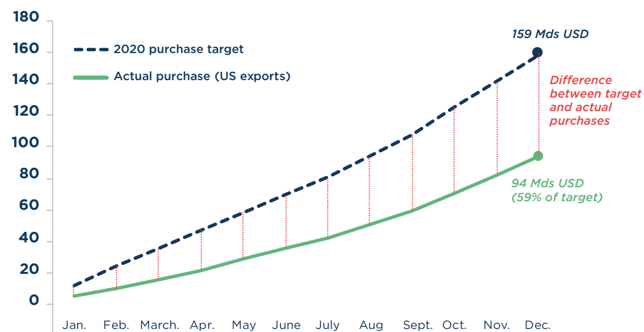
JOE BIDEN'S TRADE POLICY

Joe Biden became president of the United States on January 20, 2021, succeeding Donald Trump, whose "America First" policy has been characterized by rising trade tensions and tariff barriers, particularly with China.

President Biden's campaign and early actions signaled that trade policy would take a lower profile. It is part of his broader foreign policy, summarized by the slogan "America is back". In this vein, the trade policy agenda, released in early March, indicates that restoring U.S. leadership in the world and repairing partnerships and alliances are priorities of the Biden administration. The agreement between the U.S. and the European Union to suspend tariffs imposed in the dispute over subsidies to aircraft manufacturers is the first concrete action in this direction.

On the other hand, the first indications on the position towards China are more firm. This is reflected in the administration's trade agenda, which makes it a priority to address "coercive and unfair" trade practices. The battle against China's technology sector and the protection of intellectual property will be key issues, while the goal of reducing the bilateral trade deficit is downplayed. The president and his administration have signalled no intention to reduce tariffs in the trade war, which could therefore be used as negotiating leverage in future bilateral discussions.

CHART 4
U.S. Exports to China of All Goods Covered by the Phase One Agreement, 2020, in USD billion, Cumulative Values



Sources : Chad P. Bown. US-China Phase One Tracker: China's Import Purchase. PIIE Chart, Peterson Institute for International Economics

CHART 5A
United States, Trade balance of COVID-19 related products, USD billion

Sources : U.S. Census Bureau, Trade Map, USITC, Coface

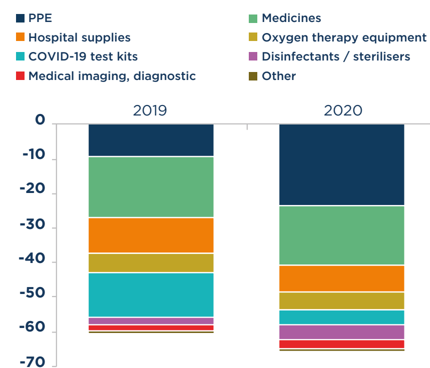
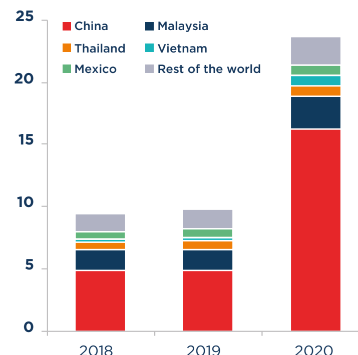


CHART 5B
United States, PPE imports, USD billion

Sources : U.S. Census Bureau, Trade Map, USITC, Coface



3 - Signed on January 15, 2020, by U.S. President Donald Trump and Chinese Vice President Liu He, it postponed the implementation of tariffs on approximately USD 200 billion of Chinese imports and reduced some of them in exchange for China's commitment to purchase USD 200 billion of U.S. agricultural, energy, manufactured goods and services, as well as addressing some U.S concerns about intellectual property practices.
4 - As of mid-October 2020, the World Trade Organization had identified 335 COVID-19-related trade measures in 112 countries. Source: *World Trade Organization. Overview of Developments in the International Trading Environment. Annual Report by the Director-General (30 November 2020)*
5 - List of 114 products established by Coface on the Harmonized System (HS) nomenclature at the tariff line level (HS-10). The list is based on the U.S. International Trade Commission (USITC) report.

To measure the impact of this scenario, we measure a "potential output trade balance" based on the methodology of Stefan Papaionou and Kei-Mu Yi **(see Box 2).**

METHODOLOGY FOR CALCULATING THE POTENTIAL OUTPUT TRADE BALANCE

The potential output trade balance, which we denote PTB, is calculated as follows for the top 25 U.S. trading partners (about 85% of the country's total trade):

PTB = Potential output exports - Potential output imports

$$PTB = \sum_{c=1}^{n} \frac{X_c}{1 - g_c s_{row}} - \sum_{c=1}^{n} \frac{M_c}{1 - g_{us} s_{us}}$$

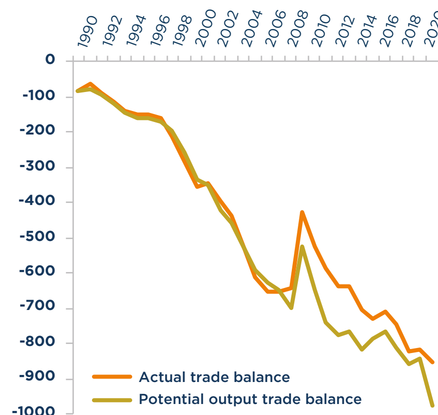
where :
- Xc : U.S. exports to countries c
- Mc : U.S. imports from countries c
- g : output gap for the United States *(us)* or partner country c.
- s : elasticity of import demand to changes in activity for the United States *(us)* and the rest of the world *(row)*

The output gap *(g)* is a measure of the difference between actual GDP and "potential" GDP. The latter corresponds to the theoretical sustainable production capacity of a country according to its resources (labor, capital, technology). For available countries, we use data from the OECD. For the others, we derive the potential GDP using a Hodrick-Prescott filter to calculate the output gap.
The elasticity *(s)* of import demand is set at 2 for the United States and 1.6 for the rest of the world, taking the average of a ratio of import growth to GDP growth (Source: IMF).

The potential output trade balance is a theoretical measure of the level of the trade balance that would have been achieved if all economies had reached their potential output level. Since it depends essentially on the difference in the output gap between the United States and its partners, the difference between this theoretical trade balance and the actual balance is an indication of the responsibility of cyclical economic factors on the trade deficit.
Our calculations **(Chart 6)** reveal two distinct periods. Between 1990 and the financial crisis (2008-2009), the difference between the potential output trade balance and the actual one is relatively marginal: the main variations between the two measures are between 1997 and 2000; and in 2005-2006, when the US economy was more dynamic than that of its partners. These two periods are characterized by a positive output gap for the United States, signalling an "overheating" economy; they also preceded two recessions.

Since 2008, the potential output trade deficit has been higher than the observed one. This is due to a U.S. economy hit hard by the Great Financial Crisis (and thus a negative output gap), when U.S. trading partners, and particularly China and other Asian partners, have been running closer to their respective potentials. At full potential, the U.S. trade deficit could have been up to USD 154 billion larger in 2011. In the wake of the few countries that recorded positive growth rates last year (China, Taiwan, Vietnam), the potential output measure of the deficit widened faster than the actual one, interrupting the gradual reduction in the gap between the two measures of the trade balance.
For 2021, using Coface's latest forecasts, the U.S. negative output gap should start to close faster in the U.S. than in its trading partners: we estimate that it will close between 0.4 and 1.1 points faster. Based on this assumption and considering the history of the potential trade balance, this would mean that the deficit will be between 2.2% and 6.0% higher in 2021 than if the U.S. economy were to rebound at a similar pace to its partners. If the trade deficit still exceeds USD 900 billion, this would mean that the stimulus package could be responsible for a larger deficit in the range of USD 19-56 billion.
Our analysis suggests that it will contribute to the deficit with Mexico, but also with Switzerland, Saudi Arabia, India, South Korea, Brazil, or Germany. On the other hand, the effect will be more muted on the balance with other trading partners, notably Canada. On the other hand, the strong rebound of China, Taiwan, and Vietnam should more than offset an increase in import demand from the United States.

CHART 6
United States, Actual trade balance vs potential output trade balance with its 25 main trading partners, 1990-2020, USD billion



Sources : U.S. Census Bureau, OCDE, FMI World Economic Outlook, Coface

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