Trade deficit ends dollar recovery

With the figure at $14.4 billion for May, speculative foreign capital could leave quicker than it came.

The U.S. Department of Commerce crushed the administration's hopes of a financial respite with its July 15 report that the U.S. trade deficit rose to $14.4 billion in May.

Days earlier, President Reagan used his weekly Saturday broadcast to pronounce that the United States had "turned the corner" on the trade deficit, warning against pending legislation for mandatory trade reprisals.

Getting tougher against trade partners now, Reagan said, was "a little like closing the barn door when the horse is trying to get back in. . . . Ironically, just at a time when we're making great progress, Congress is seriously considering legislation that could set us back. . . . Our country turned the corner on our trade deficit last fall, and the situation continues to improve."

For the past two months, Japanese monetary authorities have virtually force-fed funds into American markets. Now that the administration's arguments against retaliatory trade measures have slipped down the drain, the Tokyo-Washington agreements to prop up the dollar are in immediate jeopardy—along with the administration's ability to finance its deficit with foreign funds.

Late in June, Japan's monetary authorities engineered a sharp sell-off in the Tokyo bond market, which registered one of the largest one-week price declines ever.

Under the goad of their own finance ministry, Japanese investors "apparently found renewed interest in the American bond market. By the end of the week, spreads between the two countries had narrowed substantially from their levels earlier in the month. For example, the spread between ten-year Goverment benchmarks narrowed from over 600 basis points at their peak to less than 450 basis points," Salomon Brothers euphemized June 26.

The sell-off in Japanese securities markets prompted speculation that central banks had, for the moment, succeeded in establishing a trading range for the U.S. dollar.

"Right now, we are all talking for the time being of a stable market, and this could very well last through the summer," Rimmer De Vries of Morgan Guaranty Trust Company said on June 29.

"But it's not something that can last for very long."

Traders suggested at the end of June that the Group of 7 industrial countries, i.e., the United States, Japan, West Germany, France, Britain, Italy, and Canada, who spent $40 billion supporting the dollar this year, agreed on target zones for currency rates.

In fact, the content of the deal was obvious: The Japanese monetary authorities, alarmed by the boom in their securities markets, which had sent price-earnings ratios for most leading stocks into three digits, preferred to force securities prices down, and push funds into the United States.

In fact, the Japanese action constituted a strengthening of the Japanese markets—by reducing the danger of a speculative blowout—and a weakening of American markets, where the Dow-Jones industrial average proceeded to record hot-air highs.

That holding action formally dissolved on July 15, for two reasons. First, the United States trade deficit is a function of the collapse of American goods-producing capacity, not of foreign competitive advantage. Short of drastic reduction of output and living standards, nothing within the present monetary environment can reduce it.

Second, Washington's assurances to Tokyo that monetary and trade cooperation will be reciprocated by moderation in U.S. trade policy, are now worthless.

It is far from clear that even a presidential veto could now prevent a panicked Congress from putting a refurbished Smoot-Hawley tariff into law.

The Senate's vote on July 13 for mandatory retaliation against specific countries—as opposed to specific manufactures—was an unprecedented step in the wrong direction.

The United States now owes foreigners almost $340 billion, more than is owed by Brazil, Mexico, and Argentina combined. Most of that debt is very short-term.

"The United States's international trade position gives a stark perspective to what is at stake as the Senate prepares to consider trade legislation," said Senate Finance Committee chairman Lloyd Bentsen (D-Tex.), warning that overseas debt "may well mean a return to the days of the late 19th century, when British investors caused recessions in the United States by pulling their funds out of this country."

Bentsen may well address the problem by destroying, almost overnight, America's capacity to borrow. That will solve the problem fast, but not in a way most of us would like to live through.