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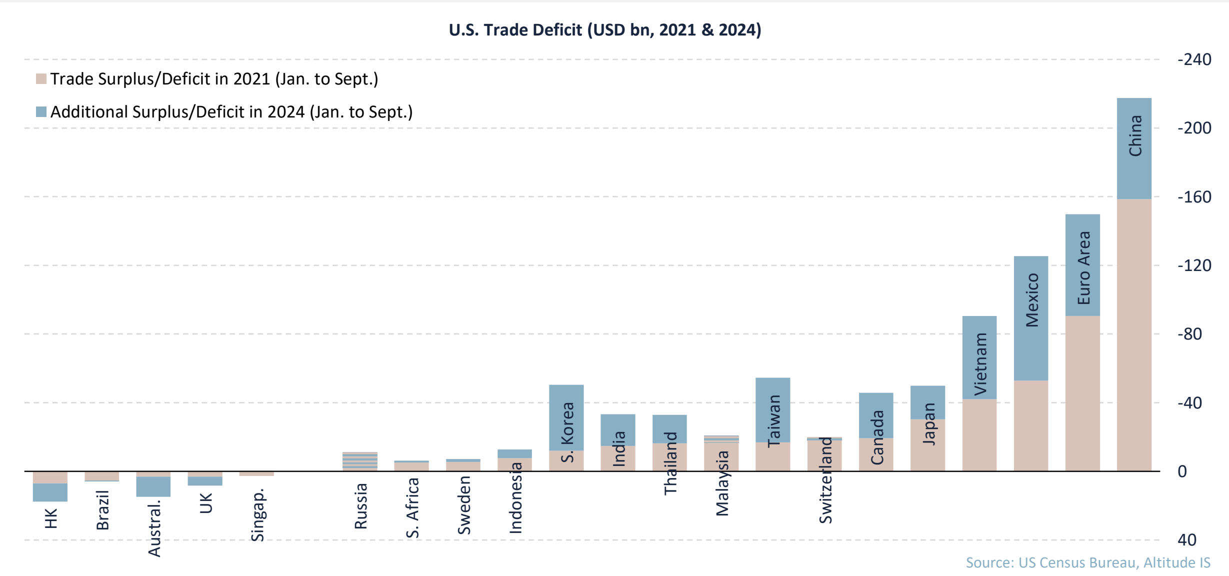
"CAN DONALD TRUMP REDUCE THE US TRADE DEFICIT?"

- US trade deficit hits record high
- It has many causes, but it is not linked to services or oil
- External imbalance reflects weak savings in the United States
- This situation favours economic growth but weakens the dollar

CHART OF THE WEEK: "Where does the US trade deficit come from?"



FINANCIAL MARKET ANALYSIS

The news almost went unnoticed, but the United States has just published a record trade deficit: -660 billion dollars since 1st January, including -84 billion dollars in September alone. This could represent 4.8% of Gross Domestic Product (GDP) by the end of the year. **Is this something to worry about? Can Donald Trump do anything about it?** During his campaign speeches, true to his protectionist line, the future president envisaged increasing tariffs on imported products, as well as taxes on American companies that relocate their production abroad. Conversely, companies that produce locally would benefit from tax breaks and lower energy costs. This stance follows on from his first presidency, when he introduced tariffs on various products to reduce the trade deficit, particularly with China. However, despite these efforts, the trade deficit continued to worsen, raising questions about the real effectiveness of such measures.

Readers familiar with the concept of the trade deficit or wishing to get to the heart of the matter can go directly to section B. Those interested in the impact on the exchange rate should refer to section C.

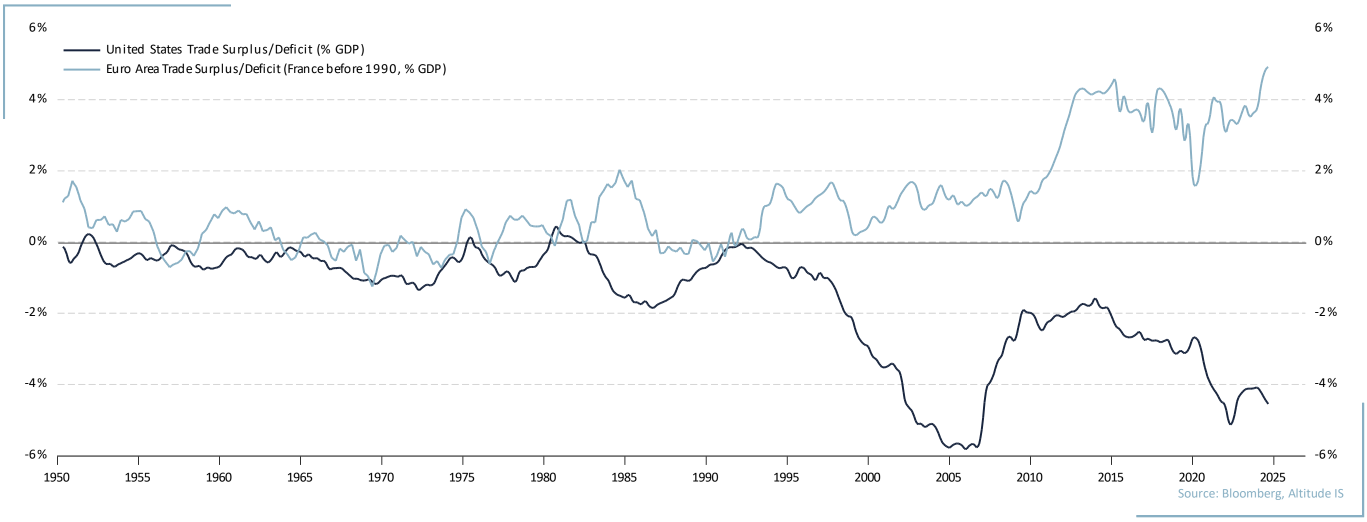
A. How is a trade deficit created? A more complex question than it might seem.

A country's trade balance is the difference between its exports and imports of goods and services. If it is positive, the country has a surplus. If it is negative, the country has a trade deficit. Nothing could be simpler on a first reading. A positive balance suggests a country in good health, in a position of competitive dominance. On the other hand, a negative balance suggests a sluggish economy, suffering on the global market. However, economic terms are misleading: the use of positive and negative qualifiers is correct from an accounting point of view, but it does not imply anything obvious about the health of the economy. Economists like to say that, like cholesterol**, there are good and bad trade deficits.**

The trade deficit is the result of a combination of many factors, which can be divided into four main categories, two good and two bad:

1- **Demand that exceeds production capacity:** When a nation develops rapidly or becomes wealthier, its domestic demand for certain production or consumer goods surges, and with it its imports. So, a trade balance in the red does not necessarily mean a weak economic situation. On the contrary, this phenomenon helps to explain why the United States, whose economic growth is more dynamic than that of the Eurozone or Japan, suffers from a colossal trade deficit with these countries (see Chart of the Week & Fig. 2).

Fig. 2 - Trade deficit, US and Eurozone



Source: Bloomberg, Altitude IS

2- **Improved price competitiveness:** By purchasing resources or intermediate goods abroad at a lower cost than at home, companies can increase their profitability. This allows them to cut costs or improve the quality of their production and, ultimately, increase their sales and margins. For example, when General Motors imports its brakes from Canada, the American carmaker generates a trade deficit for the United States, but this import helps it to produce cheaper cars and sell more of them. Similarly, when Apple imports the skeleton of its computers from Asia, it gains in price competitiveness, but the design, software and marketing remain *Made in USA*, developed and produced by American workers whose wages can rise thanks to the savings the company makes on Asian components. Other multinationals, particularly in technology and pharmaceuticals, choose to locate their headquarters in Ireland to take advantage of attractive tax rates and produce at lower cost. These companies also contribute to a trade deficit.

3- **An unfavourable competitive position on international markets:** Conversely, in some cases, a trade deficit can be a sign of economic weakness, particularly deindustrialisation. Foreign production is so cheap or of such better quality that imports displace domestic production, helping to destroy jobs and increase the country's unemployment rate.

4- **Excessive price rises:** Finally, the disparity in the trade balance can be caused by a surge in prices or a significant appreciation in the national currency. In both cases, domestically produced goods and services will appear relatively expensive by international comparison, putting the brakes on exports and facilitating imports. These situations are only likely to be temporary, since the slowdown in sales will tend to reduce inflationary pressure or cause the exchange rate to depreciate.

In all cases, the national accounts state that **the trade deficit reflects another imbalance, that between savings and investment:** X-M=S+(T-G)-I. If an economy has a trade deficit, it is because it invests more than it saves. It finances its excess investment by using part of foreign savings (see Fig. 3): it borrows from the rest of the world (see Fig. 4). This is what Ben Bernanke, the former Chairman of the Fed, defined back in 2005 as the *Global Saving Glut*.

Fig. 3 - Savings rates in the US and Europe

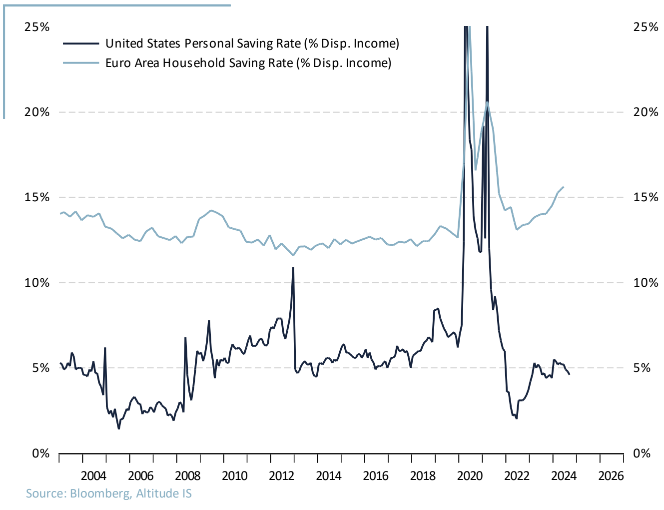
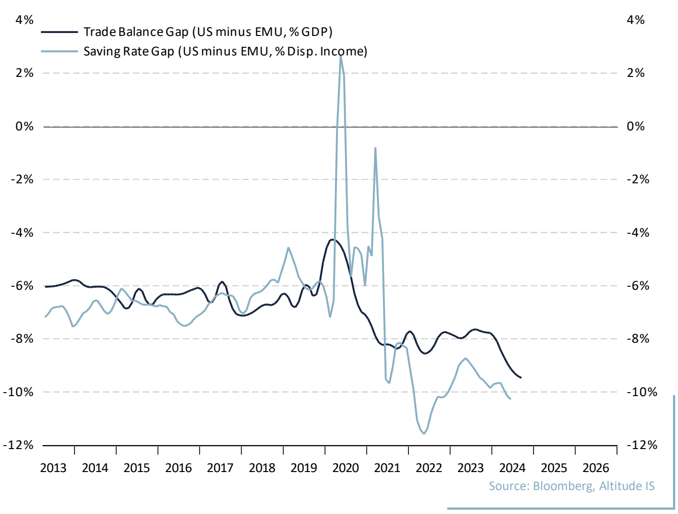


Fig. 4 - Trade deficit & savings deficit



During his first term in office, Donald Trump had already sought to reduce the US trade deficit by increasing customs duties. His administration never succeeded because it was confronted with the reality of accounting.

Restoring the US trade balance required an increase in private savings. However, by taking measures to encourage businesses to invest and households to spend, the Trump administration automatically caused savings to fall. Over the last four years, Joe Biden has had to deal with the same problem, and it is highly likely that Donald Trump, in his second term, will still not be able to find the solution. **The difficulty lies in rebalancing the US trade balance without the increase in savings generating an economic slowdown in the United States... or, by a knock-on effect, at global level.**

B. What is special about the US trade deficit?

In the first nine months of the year, the United States recorded a trade deficit of USD -660 billion. Historically, and once again this year, **this deficit is mainly due to trade in goods** (-881 billion), while services show a very clear positive balance (+221 billion). **Unsurprisingly, China**, at which Donald Trump has often pointed the finger**, accounts for a third of the imbalance** (see this Chart of the Week). Next comes the Eurozone, led by Germany and also Ireland, Italy and France. Between the two big neighbours, Mexico and Canada, we find Japan, the inevitable Vietnam, along with Taiwan and South Korea, which have tripled their balances since 2021. At the other end of the spectrum, and this is worth noting because it is not often mentioned, the United States exports more than it imports to Hong Kong, Brazil, Australia and its great European ally, the United Kingdom.

Fig. 5 - US trade deficit, with and without oil

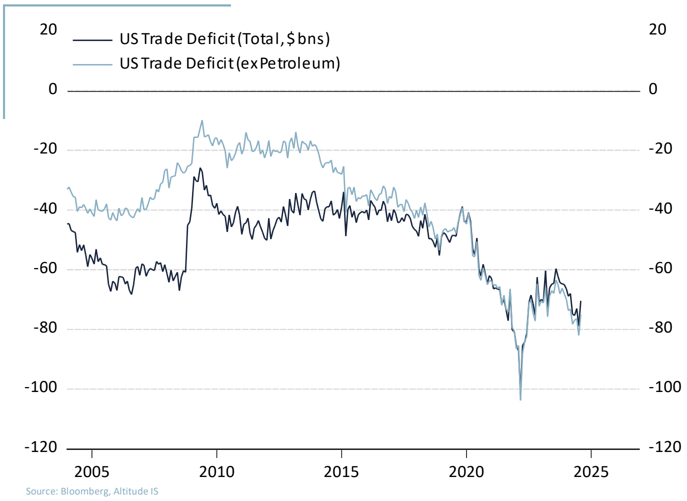
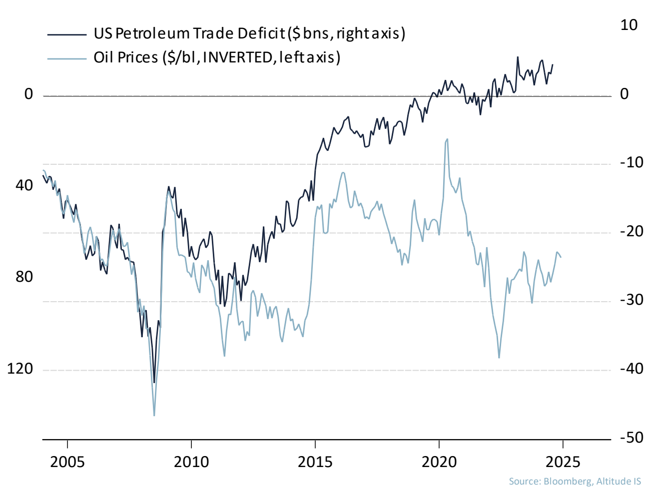


Fig. 6 - US oil deficit & oil prices

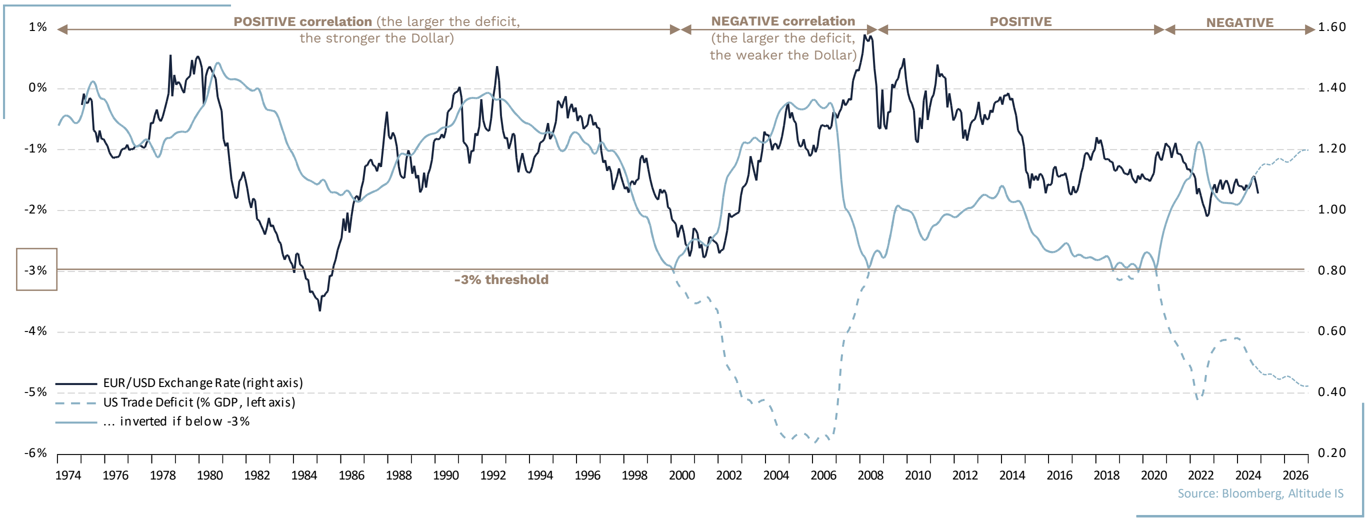


At this stage of the analysis, it is interesting to break down the deficit by category**. Contrary to historical experience and popular belief, the US trade deficit is not growing because of the oil bill.** On the contrary, it is linked exclusively to non-energy goods (see Fig. 5). At the end of the 2000s, after the Great Financial Crisis (GFC), under the impetus of George W. Bush and then under the presidency of Barack Obama, the United States supported shale oil production. The results have been convincing, with the oil deficit falling from -386 billion in 2008 to a surplus of +42 billion in 2024. Since 2020, with the exception of the mismatch between the oil extracted and the oil consumed, the United States has been self-sufficient in fossil fuels. At current oil prices, without this increase in production capacity, the US oil deficit would be around -300 billion a year (see Fig. 6), adding to the existing external imbalance.

C. Trade deficit and exchange rate: a two-way relationship

On the financial markets, the trade deficit is important. It is, for example, a significant variable in our econometric models for forecasting the evolution of the US dollar. It is not the most important variable, but it is interesting. As we described in Part A, a trade deficit can mean that domestic demand exceeds production capacity, that the economy is booming. In this specific case, as in the 1975-1999 period, a trade deficit goes hand in hand with an inflow of capital into the United States and, ultimately, an appreciation of the dollar (see Fig. 7). **On the other hand, if the trade deficit becomes too large,** as has been the case since 2000 when it has exceeded -3% of GDP, investors believe it is the result of a loss of international competitiveness. Capital flees, **the relationship is reversed, and the dollar falls as the deficit increases.**

Fig. 7 - US trade deficit and EUR/USD exchange rate



Conclusion:

The trade deficit is not an easy economic variable to grasp. It should not be seen as a problem, even if economists will always prefer balance to either surpluses or deficits. The US trade deficit has many causes, but it is not linked to services or oil.

It will persist as long as Americans are able to live beyond their means and import cars, electrical devices, drugs and advanced technology products.

Donald Trump will try to fix it as soon as he takes office but, as in his first term, he will be constrained by his refusal to increase American savings. As long as the trade deficit remains excessive, the dollar will be under pressure.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2024 Year-to-Date (%)	2023 (%)	2022 (%)
Equities							
World (MSCI)	854.1	55.24	1.4%	0.5%	19.7%	22.8%	-17.9%
USA (S&P 500)	5 969	61.49	1.7%	2.1%	26.7%	26.3%	-18.1%
USA (Dow Jones)	44 297	65.44	2.0%	3.3%	19.5%	16.2%	-6.9%
USA (Nasdaq)	19 004	57.43	1.8%	2.4%	27.4%	44.7%	-32.5%
Euro Area (DJ EuroStoxx)	497.3	46.23	0.1%	-2.4%	8.4%	19.5%	-11.4%
UK (FTSE 100)	8 262	59.05	2.5%	-0.2%	10.6%	7.7%	4.6%
Switzerland (SMI)	11 717	43.99	0.8%	-3.7%	8.6%	7.1%	-14.3%
Japan (Nikkei)	38 780	46.07	-0.9%	-0.3%	16.3%	31.0%	-7.3%
Emerging (MSCI)	1 087	35.03	0.2%	-4.7%	8.9%	10.2%	-19.8%
Brasil (IBOVESPA)	129 126	48.87	1.0%	-0.6%	-3.8%	22.3%	4.7%
Mexico (IPC)	50 430	39.59	0.0%	-3.4%	-9.9%	22.4%	-5.8%
India (SENSEX)	79 956	47.76	2.0%	-1.2%	10.9%	20.3%	5.8%
China (CSI)	3 848	44.43	-2.6%	-2.2%	16.0%	-9.1%	-19.8%
Com. Services (MSCI World)	120.1	47.74	-0.1%	1.1%	26.7%	38.1%	-35.3%
Cons. Discretionary (MSCI World)	406.0	57.37	0.9%	4.7%	16.0%	29.5%	-31.5%
Cons. Staples (MSCI World)	281.2	49.31	1.9%	-2.1%	7.5%	3.2%	-6.0%
Energy (MSCI World)	263.9	65.91	2.5%	3.8%	12.6%	6.0%	34.5%
Financials (MSCI World)	185.3	67.50	1.1%	4.1%	28.6%	16.4%	-9.2%
Health Care (MSCI World)	363.8	32.69	1.4%	-6.0%	5.6%	4.1%	-5.7%
Industrials (MSCI World)	395.9	55.93	1.5%	1.0%	18.4%	22.5%	-12.6%
Info. Tech. (MSCI World)	761.5	54.86	1.7%	-0.1%	30.5%	51.4%	-30.9%
Materials (MSCI World)	331.8	40.62	2.2%	-4.7%	-0.1%	12.6%	-11.0%
Real Estate (MSCI World)	1 010	50.83	1.9%	-0.9%	5.7%	5.3%	-26.6%
Utilities (MSCI World)	170.0	50.48	1.7%	-2.2%	19.0%	1.6%	-3.8%
Bonds (Bloomberg)							
World (Aggregate)	3.67%	32.59	-0.1%	-1.8%	-1.3%	5.7%	-16.2%
USA (Sovereign)	4.43%	39.18	0.1%	-0.9%	0.8%	4.1%	-12.5%
Euro Area (Sovereign)	2.67%	60.44	0.4%	0.8%	2.0%	7.1%	-18.5%
Germany (Sovereign)	2.15%	61.32	0.6%	0.9%	0.9%	5.6%	-17.8%
UK (Sovereign)	4.37%	50.78	0.7%	-1.3%	-2.3%	5.6%	-17.1%
Switzerland (Sovereign)	0.51%	67.06	0.5%	1.3%	4.9%	7.9%	-12.5%
Japan (Sovereign)	0.86%	27.78	-0.1%	-0.7%	-2.0%	0.9%	-2.8%
Emerging (Sovereign)	6.99%	52.16	0.6%	0.2%	7.3%	11.0%	-17.4%
USA (IG Corp.)	5.25%	42.06	-0.1%	-0.4%	2.5%	8.5%	-15.8%
Euro Area (IG Corp.)	3.18%	61.74	0.3%	0.3%	4.4%	8.2%	-13.6%
Emerging (IG Corp.)	6.46%	42.78	0.0%	-0.2%	7.1%	6.7%	-14.9%
USA (HY Corp.)	7.24%	63.22	0.2%	0.7%	8.2%	13.4%	-11.2%
Euro Area (HY Corp.)	5.75%	79.28	0.0%	0.4%	7.3%	12.1%	-10.6%
Emerging (HY Corp.)	8.45%	66.22	0.7%	1.3%	14.5%	13.1%	-12.4%
World (Convertibles)	449.7	70.73	1.9%	2.8%	11.7%	12.3%	-18.2%
USA (Convertibles)	617.7	76.56	2.8%	4.7%	13.7%	14.6%	-20.1%
Euro Area (Convertibles)	230.8	71.65	0.5%	2.5%	13.7%	7.3%	-11.1%
Switzerland (Convertibles)	251.1	24.39	-3.0%	-4.2%	-6.7%	5.8%	-19.1%
Hedge Funds (Bloomberg)							
Hedge Funds Industry	1 584	75.70	n.a.	-0.5%	9.3%	7.8%	-6.9%
Macro	1 323	64.00	n.a.	-1.7%	5.8%	1.6%	1.3%
Equity Long Only	2 212	67.58	n.a.	-2.0%	12.0%	15.9%	-16.4%
Equity Long/Short	1 657	75.44	n.a.	-0.2%	12.7%	7.7%	-10.7%
Event Driven	1 702	74.10	n.a.	-0.4%	7.3%	7.3%	-4.7%
Fundamental Equity Mkt Neutral	1 625	93.24	n.a.	0.7%	10.6%	6.6%	2.3%
Quantitative Equity Mkt Neutral	1 643	81.99	n.a.	-0.4%	8.4%	7.8%	-2.0%
Credit	1 584	87.01	n.a.	0.2%	7.7%	8.1%	-5.0%
Credit Long/Short	1 607	90.10	n.a.	0.5%	8.6%	11.2%	-1.4%
Commodity	1 759	82.29	n.a.	2.4%	12.7%	7.3%	10.5%
Commodity Trading Advisors	1 314	51.99	n.a.	-3.2%	5.6%	-3.6%	5.3%
Volatility							
VIX	15.24	41.85	-5.6%	-16.3%	22.4%	-42.5%	25.8%
VSTOXX	17.97	47.35	4.4%	-3.5%	32.4%	-35.0%	8.4%
Commodities							
Commodities (CRB)	533.4	n.a.	-0.3%	0.1%	4.5%	-8.0%	-4.1%
Gold (Troy Ounce)	2 668	n.a.	2.2%	-2.9%	29.3%	13.1%	-0.3%
Silver (Troy Ounce)	30.69	n.a.	-1.5%	-9.0%	29.0%	-0.7%	2.8%
Oil (WTI, Barrel)	71.71	n.a.	7.0%	-0.5%	0.1%	-10.7%	4.2%
Oil (Brent, Barrel)	76.09	n.a.	3.6%	0.4%	-2.0%	-4.5%	5.5%
Currencies (vs USD)							
USD (Dollar Index)	107.07	67.83	0.7%	2.7%	5.7%	-2.1%	8.2%
EUR	1.0453	30.70	-1.4%	-3.2%	-5.3%	3.1%	-5.8%
JPY	154.59	42.45	0.0%	-1.5%	-8.8%	-7.0%	-12.2%
GBP	1.2573	32.66	-0.8%	-3.0%	-1.2%	5.4%	-10.7%
AUD	0.6507	41.74	0.0%	-1.5%	-4.5%	0.0%	-6.2%
CAD	1.3968	43.37	0.3%	-0.5%	-5.2%	2.3%	-6.8%
CHF	0.8913	33.45	-0.9%	-2.7%	-5.6%	9.9%	-1.3%
CNY	7.2468	30.41	-0.2%	-1.7%	-2.0%	-2.8%	-7.9%
MXN	20.409	41.46	-1.0%	-2.1%	-16.8%	14.9%	5.3%
EM (Emerging Index)	1 744.8	33.20	-0.1%	-1.1%	0.3%	4.8%	-4.3%
XBT	98 124	n.a.	3.9%	47.0%	130.8%	157.0%	-64.3%

Source: Bloomberg, Altitude Investment Solutions

Total Return by asset class (Negative \ Positive Performance)

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