# LECTURE XIII

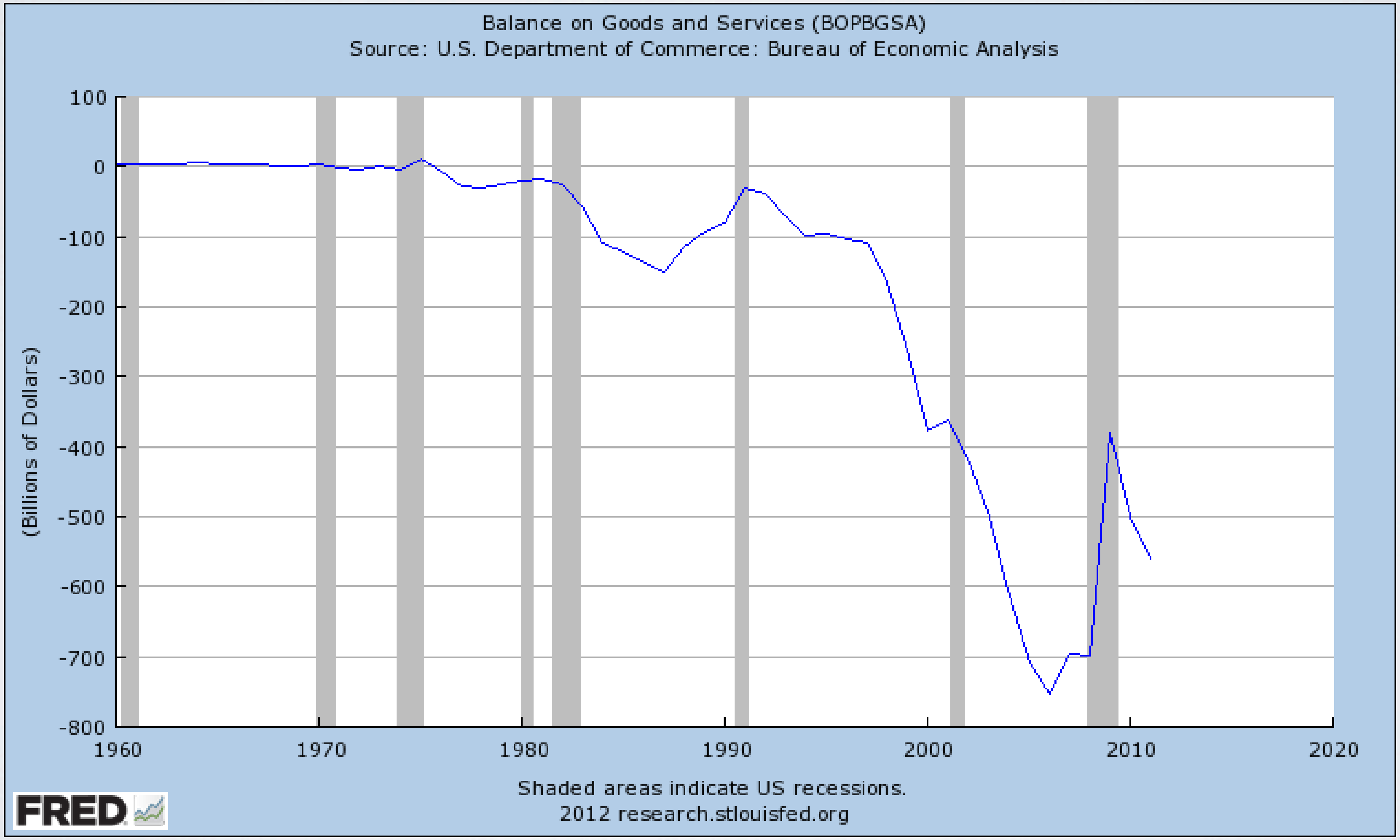
30 July 2012

# REVIEW

- Small Country Trade Review: Recitation 8 Practice Questions 5-7
- Large Country Trade Review: Recitation 9 Part A

# US DEFICIT

# US DEFICIT IN TRADE OF GOODS AND SERVICES



# CAUSES OF DEFICIT

- US services sectors actually export much more than import (so we have a trade surplus)
- Goods sectors are net importers
- What are some causes for this latter trend?

# CAUSES OF DEFICIT

1. US Economy grows faster than major trade partners

   - Economic growth implies increase in real income
   - With more income consumers demand more goods
   - Demand for more goods implies higher demand for imports since domestic sectors already do not supply many goods
   - Trade partners do not grow as fast, however, so their demand for imports (our exports) do not grow as quickly

# CAUSES OF DEFICIT

2. Increase in oil prices

- The US imports a lot of oil (from 2005 - 2008 about 5 billion barrels) and is about 8-10% of imports

- In 2005 price was $50 / barrel versus $65 in 2010

- In 2005 money spent on oil was $200 billion, $330 bil in 2007

# CAUSES OF DEFICIT

3. China

- China has a fixed exchange rate relative to US currency (generally)
- Relatively high price for US dollar increases US demand for Chinese imports increases and Chinese demand for US exports decreases
- This trend is support for argument of requesting China appreciate (increase value of) its own currency (though past appreciations have not addressed the trade deficit)

# CAUSES OF DEFICIT

4. Decline in US savings rate

- Recall that savings in the US are incredibly low (negative for the household, around .5% nationally in 2007)
- Has increased a bit in the crisis, but firms need more supply (of loanable funds) for investment so foreigners invest in US bonds
- Purchase of US assets by foreigners leads to the financial account surplus and in turn helps create the trade deficit (foreign money can buy more imports)

# REVIEW

- Large countries are so because their domestic supply and demand impact international prices
- The international price that clears the international market (import demand = export supply) is the price in equilibrium
- Countries that import more than they export (in terms of value of those goods and services) have a trade deficit
- The US has a large trade deficit, which is a function of domestic and international factors