How Does the US Trade Gap Affect the US Stock Market?

Although Trump wants to move manufacturing jobs back to the USA there are still lots of imported items that Americans buy. And as the dollar strengthens US products are more expensive overseas. Thus the USA has a trade gap. First a bit about the status of the trade gap and then how does the US trade gap affect the US stock market? *Bloomberg* says that while both imports and exports decreased in 2016 the **US trade gap widened**.

> *The U.S. trade deficit widened last year to the biggest since 2012 as exports fell more than imports, though a narrowing gap in December suggests demand is stabilizing overseas for American goods.*
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> *For all of 2016, the deficit increased 0.4 percent to $502.3 billion, including a wider annual gap with Mexico and a smaller one with China, Commerce Department figures showed Tuesday. The monthly shortfall shrank 3.2 percent to $44.3 billion. The median forecast in a Bloomberg survey of economists called for a deficit of $45 billion in December.*

As the economy improves, which it has been doing, people buy more. And much of that is from offshore. To the extent that consumers buy imported goods as opposed to made in America it increases the trade gap. To the extent that the dollar is too strong it makes American goods to expensive and no competitive offshore which also increases the trade gap. Until such time as this situation remedies itself how does the US trade gap affect the US stock market?

Where Does the Trade Gap Money Go?

One might assume that when the USA runs a trade deficit that the money is lost forever. However, that is really not the case. The *Carnegie Endowment* asks if Trump's advisor, Peter Navarro, is **wrong on trade**.

> *Whether the U.S. current account deficit is harmful or not to the U.S. economy depends on the assumptions we make about capital scarcity. In a world awash with excess capital and insufficient demand, the U.S. current account deficit is a drag on growth.*

Is this true? Here is what Navarro says.

> *When net exports are negative, that is, when a country runs a trade deficit by importing more than it exports, this subtracts from growth. In 2015, the US trade deficit in goods was a little under $800 billion while the US ran a surplus of about $300 billion in services. This left an overall deficit of around $500 billion. Reducing this "trade deficit drag" would increase GDP growth. These trade-related structural problems of the US economy have translated into slower growth, fewer jobs, and a rising public debt.*

And if growth is less the US stock market will fall. However, there is another opinion on this issue. Dan Ikenson, a trade policy specialist at the Cato Institute says this.

> *There is no inverse relationship between imports and GDP, as Navarro asserts. In fact, there is a strong positive relationship between changes in the trade deficit and changes in GDP. The dollars that go abroad to purchase foreign goods and services (imports) and foreign assets (outward investment) are matched almost perfectly by dollars coming back to the United States to purchase U.S. goods and services (exports) and U.S. assets (inward investment). Any trade deficit (net outflow of dollars) is matched by an investment surplus (net inflow of dollars). That investment inflow undergirds U.S. investment, production, and job creation.*

In this sense the USA is a lot better off than China with its opaque investment environment. Investors trust the USA, its legal system and its open markets. Money invested in the USA, versus Europe, China or Brazil helps the economy and helps the stock market. What will hurt the US stock market will be **trade policies** that start a trade war that shuts down trade and foreign investment in the USA.

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