Recovery Side Effect: Trade-Deficit Concerns

What the recession giveth, the recovery taketh away.

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One welcome side effect of the recent downturn was a substantial narrowing of the U.S. trade deficit. In less than a year, from July 2008 through May 2009, the monthly deficit shrank from $64.9 billion to $25.7 billion.

That is a level not seen since 1999. And the full-year 2009 deficit of $378.9 billion was the smallest since 2001.

While the causes were worrisome—in particular, a slowing of imports due to slumping U.S. demand—it helped ease a strain on the nation's finances.

But, as the recovery progresses, that relief looks fleeting.

On Wednesday, the Commerce Department is expected to say the trade deficit widened in March for the fifth straight month, by about 2% to $40.5 billion, on a higher bill for imported oil alongside renewed demand for imported goods.

Although exports, a key source of U.S. economic growth, are up about 18% from their trough, imports have risen by about 23%.

Markets have so far interpreted the trade figures positively, underscoring the revival in global demand. But the buzz may soon wear off as old worries about the size of the deficit, and its sustainability, again weigh on investors.

After all, companies may be cash-flush, but households aren't saving as much as anticipated. The government deficit has also widened as a result of stimulus spending, as separate March budget figures due Wednesday afternoon will illustrate.

The current-account deficit—an even broader measure than the trade deficit reflecting the gap between what the U.S. spends and what it earns—has risen from a low of 2.76% of GDP in the second quarter of 2009 to 3.2% in the fourth quarter. It is seen topping 4% by mid-2011, according to IHS Global Insight.

"The structural issues haven't been resolved," says Brian Bethune, the group's chief U.S. financial economist, "and it means over time our external debt load is rising."

While there is little risk of a near-term funding problem, any complacency about the danger of rising debt levels ought to have been shattered by recent events in the euro zone. As the economic outlook brightens, the oft-ignored trade report ought to merit a closer look.

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