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OPINION | REVIEW & OUTLOOK

Trade Deficit Freak Out

The rising gap is the result of faster growth. There's no need to panic.

By The Editorial Board

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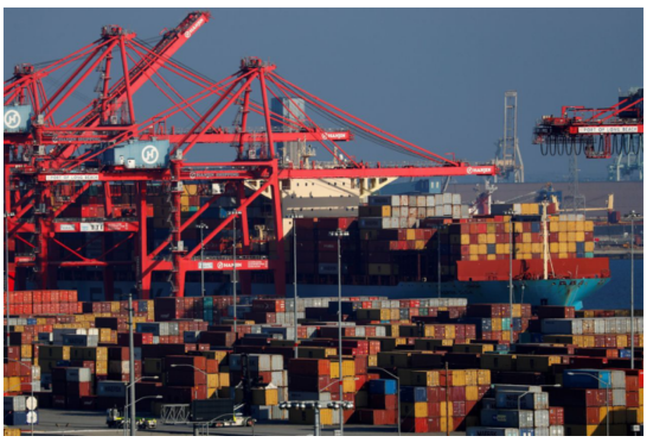

Ships and shipping containers are pictured at the port of Long Beach in Long Beach, Calif., January 30, 2019. PHOTO: MIKE BLAKE/REUTERS

Where's the Valium? Mass quantities may be needed to calm the apparent media panic over Wednesday's Commerce Department report that the U.S. trade deficit hit a record last year. Everyone can calm down, and President Trump can take a bow that his tax reform and deregulation are working as intended.

"In a Blow to Trump, America's Trade Deficit Hit a Record $891 Billion in 2018—the highest it's ever been," read a summary in one newspaper that seems to want Mr. Trump to blow up at the news. The trade deficit grew 12%

last year to $621 billion as imports rose $218 billion and exports climbed $149 billion. Excluding services, the gap increased to $891 billion.

This is not bad economic news. Imports grew faster than exports as the U.S. economy accelerated and much of the world slowed. The dollar grew stronger as capital flowed into the U.S., and the trade deficit grew to offset the larger capital inflows as it must by definition under the national income accounts.

Imports of industrial supplies rose $68.4 billion and capital goods increased $52.7 billion, which helped fuel a pickup in commercial construction and manufacturing. Fixed investment in structures and equipment climbed 5% and 7.5%, respectively, last year as businesses took advantage of lower corporate tax rates and 100% capital expensing.

Consumer goods imports also increased $46 billion, half of which came from pharmaceutical products. This isn't surprising since the consumer spending share of GDP ticked up 2.6% last year amid rising incomes and falling unemployment. Most Americans also paid less in taxes, which enabled them to spend more on foreign household goods ($3.4 billion), clothing ($2.4 billion), cell phones ($2 billion) and toys ($2 billion). Note: Higher sales of iPhones assembled in China will benefit U.S. employees and shareholders of Apple , which is investing $1 billion in a new Austin, Texas campus.

Note too that the trade deficit expanded in 2018 even as the U.S. unemployment rate fell. This gives the lie to the common political claim that a higher trade deficit means lost American jobs. Capital investment matters more to job creation than trade flows do.

Mr. Trump has a fixation with German-made cars, so it's worth highlighting that imports of passenger cars declined $2.5 billion as U.S consumers bought more trucks and SUVs produced at home. But since American trucks include foreign components, imports of auto parts increased $10 billion at the same time that truck exports rose $1.1 billion.

All of this reflects how U.S. manufacturers depend on global supply chains and underscores why it would be a mistake to impose tariffs on auto parts. The higher costs would flow to American manufacturers and ultimately be paid by consumers.

On a sour note, retaliatory tariffs by China took a bite out of Farm Belt exports including soybeans (which fell by $4 billion), wheat ($660 million) and vegetables ($290 million). Exports of iron and steel mill products also declined by $830 million as Canada and Mexico retaliated against the President's tariffs on steel and aluminum.

The main point is that a larger trade deficit is a benign byproduct of a healthier American economy. Supply-side policies revived animal spirits and gave the economy a second wind. Trade negotiations that further open foreign markets like China's to U.S. goods and investment can keep growth humming, but tariffs that retard growth in the name of reducing the trade deficit are destructive. The best way to respond to a trade deficit is to ignore it.

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