

City of London by Stephen Lewis

New period of instability?

World financial markets are likely to react unfavorably to the U.S. trade figures for April.

United States trade figures for April, due on June 14, could well usher in a new period of instability in world financial markets.

The March figures, which reported a \$9.8 billion monthly deficit on the U.S.A.'s merchandise trade, set up a rally in the U.S. dollar, but this will not be sustained unless the forthcoming figures confirm an improvement in the United States trading position.

The chances of this happening are not high.

The March figures were flattered by several favorable, and non-repeatable, special factors.

United States oil imports were depressed at the end of the winter but are likely to rebound.

The United States exported gold to Taiwan, as the latter country diversified its official reserve holdings out of U.S. dollars.

United States agriculture exports were bunched during the month.

The sum of all these special factors probably reduced the U.S. trade deficit by some \$1.5 billion from its underlying level.

In addition, seasonal influences could well have cut \$2 billion off the deficit.

If we add back these adjustments to the reported \$9.8 billion trade deficit, we arrive at a figure for the seasonally adjusted, underlying trade deficit of \$13.3 billion, no narrower than the average for the preceding five months.

Seasonal adjustment factors are

hard to assess, however. This has been one reason for the great uncertainty in world financial markets over the trend in United States trade.

The United States Department of Commerce has, accordingly, decided to revert to its practice up to 1986 of releasing seasonally adjusted trade data.

The first set of figures to be published in this form will be those for April. It is doubtful, however, whether this change in official procedure will really help the market's assessment of United States trading performance, and this, for two reasons.

First, the seasonal adjustment factors to be applied by the Department of Commerce are unlikely to be very accurate, given the year-to-year variation in seasonal conditions.

Secondly, the Department of Commerce will continue to release the seasonally unadjusted data, thereby confronting the financial markets with two sets of numbers each month and creating room for confusion.

Seasonal factors are not expected to have had much impact on April's trade numbers.

Publication of seasonally adjusted figures for the earlier months of the year, also promised by the Department of Commerce, will, however, present a less favorable picture of United States trade performance than the raw data did when they were released.

The international financial markets may well reassess their view of U.S. trade trends in the light of the

new seasonally adjusted figures and may conclude that the reduction in the deficit has been disappointingly small.

The dollar is at risk from the trade figures on two fronts at the same time.

The April deficit is expected to be wider than that recorded in March, and the publication of seasonally adjusted figures for January-March will probably undermine market optimism that the United States trade deficit is pulling round from the unsustainable levels of 1987.

Downward pressure on the dollar in the next few months will be met by strong international central bank support intervention.

The Bank of Japan especially is likely to resist a decline in the dollar's exchange rate, since this could destabilize financial markets generally, and create a climate in which dangerous anti-Japanese feeling might thrive.

While the Washington, D.C. administration remains pledged to dollar stability, the Japanese central bank will do its part to insure that a stable dollar/yen exchange rate is delivered.

With market optimism on U.S. trade evaporating, the Bank of Japan may well find itself accumulating a large volume of dollars from its market intervention through the remainder of this year.

After the American presidential elections next November, however, new political rules may well begin to apply, especially if, as seems likely, the incoming American administration is not committed to any particular level for the U.S. dollar.

The Bank of Japan would almost certainly be unwilling to provide support for the dollar singlehandedly.

City of London senior economist Stephen Lewis contributed this commentary to EIR's European Strategic Alert Service for June 6.