Beyond the Border

A Look at the Top U.S. Trading Partners

The U.S. economy grew 1.1 percent in the second quarter of this year, down from 2.7 percent in the first quarter. How much of a role has international trade played in determining that growth, and what is it likely to contribute in the future? Over the past 14 years, U.S. trade (exports plus imports) as a share of gross domestic product (GDP) increased from 8.8 percent to 17.8 percent. As the role of trade becomes more significant in the U.S. economy, our trading partners' economies have a greater effect on the U.S. economy. This column examines what is happening now in the economies of the largest U.S. trading partners and what 1996 may hold.

Canada represents nearly 22 percent of U.S. trade and is the top U.S. trading partner. Because the United States accounts for more than 80 percent of Canadian merchandise exports, Canada's economic fortunes are closely tied to those of the United States. In second-quarter 1995, Canada's real GDP fell 1 percent after a large drop in exports to the United States. Capacity utilization declined in the second quarter as business inventories rose from already-high levels. Consumers also spent less on big-ticket items. Probably the biggest source of uncertainty has been Quebec's quest for secession. Before the vote, the secession referendum caused some uneasiness in financial markets, as everyone tried to anticipate the outcome. Despite current weak economic conditions, forecasters expect real GDP to grow 3.1 percent in 1995 and 2.5 percent in 1996.

Japan's economy appears to be in a state of uncertainty. Although real GDP grew 3.1 percent in the second quarter after declining 0.1 percent in the first quarter, other economic signals paint a different picture. Industrial production and capacity utilization have been falling and unemployment rising. Difficulties in the Japanese banking industry are adding to the economy's woes, and the government recently introduced its sixth stimulus package since 1992 in hopes of jump-starting the economy. Blue Chip forecasters predict growth of 1 percent for 1995 and 2.3 percent for 1996.

Mexico, the United States' third largest trading partner, is still recovering from the December 1994 peso devaluation. The country's real GDP fell 7.8 percent in the first quarter of 1995, but only 3.1 percent in the second quarter, on a seasonally adjusted, quarterly change basis. A bright spot is the drop in interest rates on *cetes*, peso-denominated debt issued by the Mexican government. The interest rate on 28-day *cetes* was 40.6 percent on October 19, down dramatically from the 80-percent high in April.

Mexico's economic indicators show some negatives, however. Industrial production continues to fall and is nearing the lowest rate of the 1990s, while unemployment is rising to the highest rate of the decade. Although Mexico recently repaid $700 million of its debt to the United States, financial markets continue to rain on Mexico's parade. From September 4 to October 18, Mexico's Bolsa stock exchange deteriorated 10 percent and the peso fell 7 percent. For the year, the Organization for Economic Cooperation and Development (OECD) expects Mexican real GDP to decline by 3 to 4 percent. Growth should resume in 1996, however, at a rate of 2.5 percent.

Germany experienced 2.2-percent growth in the second quarter, down from 2.9-percent growth in the first quarter and 3-percent growth for 1994. The unemployment rate remains high, while industrial production dropped significantly in August after steadily increasing in the past four months. Competitive pressures, however, are helping liberalize some parts of the economy. For example, laws preventing retail stores from selling past 6 p.m. are being challenged, and there is a movement to ease the tax burden on businesses. The OECD expects real GDP to grow by 2.9 percent in 1995 and 2.7 percent in 1996.

The *United Kingdom* experienced real GDP growth of 1.8 percent in the second quarter, down from 2.6 percent in the first quarter. Analysts attribute the slowdown to a sharp drop in exports. On a more positive note, the unemployment rate has been steadily decreasing over the past two years. Capacity utilization remains far above average, and industry surveys have reported more than half of all firms are working at full capacity. Real GDP is expected to grow 3 percent in 1995 and 2.6 percent in 1996.

So, what does this all mean for U.S. exports and growth? This year, U.S. exports to Japan, Germany and Canada have surpassed 1994 levels, while exports to Mexico and the United Kingdom have lost ground. The outlook for next year is somewhat mixed as well. Mexico is expected to start its recovery next year, although uncertainty is still undermining the economy.

Canada, Germany and the United Kingdom should grow at a healthy rate in 1996. Forecasters expect Japan's global trade surplus to continue to decline throughout 1995 and 1996. Given Japan's weakness, however, its imports from the U.S. may be weak.

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