First Trust
Monday Morning OUTLOOK

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Thoughts on Trade

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When the report on international trade came out earlier this month, protectionists were up in arms. Through February, the US' merchandise (goods only, not services) trade deficit with the rest of the world was the largest for any two-month period on record. "Economic nationalists" from both sides of the political aisle, think this situation is unsustainable.

Meanwhile, some investors ran for the hills when President Trump started announcing tariffs on steel, aluminum, and other goods, thinking this was the reincarnation of the Smoot-Hawley tariffs that were a key ingredient of the Great Depression.

We think the hyperventilating on both sides needs to stop.

In general, nothing is wrong with running a trade deficit. Many states run large and persistent trade imbalances with other states and, rightly, no one cares. We, the authors, run persistent trade deficits with Chipotle and Chick-fil-A, and we're confident these deficits are never going away.

Running a trade deficit means the US gets to buy more than it produces. In turn, we have this ability because investors from around the world think the US is a good place to put their savings, leading to a net capital inflow that offsets our trade deficit. Notably, foreign investors are willing to invest here even when the assets they buy generate a low rate of return. As a result, this process can continue indefinitely.

It's important to recognize that free trade enhances our standard of living *even if other countries don't practice free trade*. Let's say China invents a cure for cancer and America invents a cure for Alzheimer's. If China refuses to give their people access to our cure, are we better off letting our people die of cancer? Of course not!

Imposing or raising tariffs broadly would not help the US economy. Nor would imposing tariffs on specific goods, like steel or aluminum. Giving some industries special favors will only create demand for more special favors from others. It'll grow the swamp, not drain it.

All that said, we understand the frustration policymakers have with China, in particular, which has been levering access to its huge market to essentially steal foreign companies' trade secrets and intellectual property. It has a long-term track record of not respecting patents or trademarks.

In theory, letting China into the World Trade Organization was supposed to stop this behavior. But no company wants to bring a WTO case against China when it thinks China would respond by ending its access to their markets and letting in competitors who are more willing to be exploited.

In addition – and this is very important – China is unlike any of our other trading partners in that it is a potential major military rival in the future. There is a national security case to be made - even if one takes a libertarian position on free trade in general - that the US could accept a slightly lower standard of living by limiting trade with China, if the result is a lower standard of living for China as well.

And China doesn't have much room to fire back at recent US proposals (none of the tariffs targeted specifically at China have been implemented, by the way). Last year, China exported $506 billion in goods to the US, while we only sent them $130 billion.

That gives our policymakers room to raise tariffs on China much more than they can raise them on us. If so, China would generate fewer earnings to turn into purchases of US Treasury debt. Yet another reason for fear among bond investors. However, don't expect China to outright dump Treasury securities in any large amount. They own our debt because it helps them back up their currency, not as a favor to the US.

We're certainly not advocating a trade war. But an approach that focuses narrowly on China's abusive behavior could pay dividends if it moves the world toward freer trade.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-16 / 7:30 am	Retail Sales – Mar	+0.4%	**+0.3%**	+0.6%	-0.1%
7:30 am	Retail Sales Ex-Auto – Mar	+0.2%	**+0.1%**	+0.2%	+0.2%
7:30 am	Empire State Mfg Survey - Apr	18.4	**20.3**	15.8	22.5
9:00 am	Business Inventories – Feb	+0.6%	**+0.6%**	+0.6%	+0.6%
4-17 / 7:30 am	Housing Starts – Mar	1.266 Mil	**1.245 Mil**		1.236 Mil
8:15 am	Industrial Production – Mar	+0.4%	**+0.5%**		+0.9%
8:15 am	Capacity Utilization – Mar	77.9%	**78.0%**		77.7%
4-19 / 7:30 am	Initial Claims Apr 14	230K	**230K**		233K
7:30 am	Philly Fed Survey – Apr	21.0	**21.3**		22.3