# The Seeds of a US Economic Recovery

The signing of a clutch of free trade agreements (with Korea, Colombia and Panama) is not a sign for a quick reversal in America's balance of trade into the black. It is, however, a step in the right direction

and a recognition that if the US is to engineer a sustained recovery, it has to become a more export oriented country. The low hanging fruit are its largest trading partners which, it may surprise some to learn, are its neighbours to the north and south; Canada, Central, South and Latin America.

Two forces are likely to drive a recovery in the US trade balance. One is that the consumer is flat on his back, the government is not much better off, and investment always needs a lead, but that the vendor financing provided by its trading partners' central banks is no longer as abundant, to the extent that the US government has resorted to using the Fed's balance sheet to effect what a Chapter 11 court might construe to be a fraudulent conveyance, as well as cornering the commercial banks and depository institutions, as well as Social Security, to financing the federal debt. Second is the currency which is expected to remain weak if not weaken further, and so improve US trade competitiveness.

It will not be a smooth recovery though, since Europe has similar ideas and the emerging markets have yet to be weaned off export dependence. It is not possible to have all countries net exporting.

The US has an advantage. It has the intellectual property to build things people want. So far it simply hasn't been making these at home. Where are Apple iPads, Callaway golf clubs, Gap T shirts, Ralph Lauren suits, Nike shoes, Caterpillar excavators, Johnson and Johnson's Tylenol made? Not in the USA. But people want them. Maybe its time to start actually making stuff at home. For many things, it will still be cheaper to make them abroad and nearby to their markets, but if the USD keeps depreciating, there may come a day when its cheaper for Nike to just make'em in the US of A. And as the Greenback weakens, more stuff will be made in the USA. One slightly cheeky gambit is for the USA to require all US companies to state the country of manufacture of all their goods regardless of where they are sold. There is a reason why the Chinese household who can afford it would rather buy Mead Johnson's Enfamil than a Mengniu equivalent, actual source of production notwithstanding. Might it encourage Coach to make bags at home? And it would be hard to argue that full disclosure is anti-competitive. Such policy will encourage the repatriation of manufacturing to the US boosting employment. In the interim prices may rise which may discourage domestic consumption but this is an acceptable side effect for more jobs and an improving trade balance.

The US needs trade and cannot afford bad relations with her trading partners. China's currency needs to be allowed to appreciate, but there are other considerations besides trade competitiveness. A drastic devaluation of the USD to the RMB would likely be construed by Beijing as a de facto default or at least a poor bargain for over two decades of funding US trade deficits. Similar currency issues have cropped up in Switzerland and Japan. It is remarkable that more noises have not been heard in Washington given the size of Japan's trade with the US. Perhaps the US is simply focusing on new markets.

China is still a nascent market for US exports and China is still an export economy. Its latest surge in economic growth has not been due to consumption, or for that matter exports, which have slumped since 2007. Investment and most notably government investment in infrastructure, has kept the Chinese miracle alive. In order for China to develop a more balanced economy it needs to distribute wealth and income more equitably. For all the queues outside the Louis Vuitton shops in Shanghai and Beijing (or indeed the Chinese shoppers outside the Bond Street and 101 avenue Champs Elysees stores), most Chinese households are still only just subsisting, at least by international standards. A Gini coefficient of 0.47 is evidence of the acute economic inequality that has built up in this Communist country. If for nothing else, there are limits to how far wealth distribution can diverge before they translate into non-commercial problems.

And China needs a more balanced economy if only for its own self interest. Relying on a single large customer has resulted in its being paid with a whole lot of vouchers whose exchangeability for real goods and services is now truly in question. China has effectively lent the US 10 boatloads of gold or Calvin Klein underwear for which it will only be able to recover 5 boatloads of the same, while being accused of being a currency manipulator at the same time.

Unfortunately, the analysis of China is more usefully approached from a political angle, which means understanding the Party. Will there be an attempt at more redistributive policies? Has the capitalist rot infected the Party? Does the Party understand the people, their needs and aspirations, their fears and frustrations? Does the Party have the depth and range of influence in social and economic policy? Did it ever? With a change of management around the corner these questions are doubly hard to answer. We have to make some sweeping assumptions of will and ability.

Assuming good faith, China will play by international and generally accepted rules. But even the Chinese are human, only more so. Expect them to be aggressive with their advantages and gradual with their concessions. Therefore while a stronger RMB is a long term eventuality, expect the appreciation to take longer than the markets expect. China will not endanger a whole slew of businesses who may not be able to manage currency volatility. And while China will become more consumption driven, expect them to fight tooth and nail in their export markets.

These are long term trends. More topically, the recent ISM data is encouraging. It seems to provide, granted incipient and not quite unequivocal evidence of a revival in exports. The latest US trade deficit was also less negative than expected with strong orders from Asia and the Americas. This bears watching closely. The seeds for recovery are already sown and will take hold. They lie in the normalization of trade which will boost the US economy more than markets expect. Apart from direct effects, investment is serially correlated to growth in whichever corner of the econo
my it hails.