REUTERS

Dollar relief from trade looks temporary

Wed Apr 12, 2006 12:21 PM ET

By Jamie McGeever

NEW YORK (Reuters) - The dollar's spike up after the latest U.S. trade data reflects some relief that February's deficit was narrower than expected, but the underlying U.S. trade position continues to cast a shadow over the currency.

Although not as wide as many analysts had feared, February's gap of $65.7 billion was still the third biggest on record, while China's latest trade figures released on Tuesday suggest the U.S. deficit could widen again in March, analysts say.

With the U.S. deficit in the first three months of 2006 well on track to be the widest quarterly shortfall ever, the structural issues blighting the dollar show no sign of going away.

"Overall, I don't see much structural change, and don't see how the dollar can get much relief from these numbers," said Axel Merk, manager of the Merk Hard Currency Fund in Palo Alto, California.

"The trade deficit is still huge. It (today's report) doesn't change the underlying pressures," Merk said.

The dollar's respite was indeed brief. The euro slid around 55 pips to $1.2065 <EUR=> shortly after the figures were released, but within two hours it was back up above $1.2100.

One currency trader said the dollar's initial bounce was "a bit of an overreaction to a marginally better number that is still huge," while another said: "$65.7 billion (deficit) is good? That is comical."

A Commerce Department report showed that the U.S. trade deficit narrowed to $65.7 billion in February from a revised and new record of $68.6 billion in January. Economists were expecting a shortfall of $67.5 billion.

Still, February's deficit was the third widest on record. This underscores the fact that the United States needs to attract huge amounts of foreign capital to fund its overspending to stave off a steeper fall in the dollar and a sharper rise in interest rates.

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But trade data from Beijing on Tuesday suggested the U.S. trade data for March will show a widening deficit again.

China's trade surplus ballooned to $11.2 billion in March -- usually a slow month for Chinese exporters -- from $2.45 billion in February, putting thorny U.S.-China bilateral trade and currency issues squarely in the spotlight before Chinese President Hu Jintao's visit to Washington later this month.

The U.S. trade deficit with China last year hit a record $201 billion, which, in the eyes of many in Washington, is a direct result of Beijing holding down its currency, the yuan.

"China has already reported their March trade data and the surplus was over $11 billion in March. So we will see that filter through to the U.S. trade data in March," said Brian Garvey, currency strategist at State Street in Boston.

"In the next several months, we might see some record highs in the trade deficit with the rise in oil prices as well," he said.

On Wednesday, U.S. crude oil futures <CLc1> were inching back up to $70 a barrel. The NYMEX May crude oil contract <CLK6> hit a session high of $69.60, close to the record futures price of $70.85 reached last August after Hurricane Katrina struck New Orleans.

"The U.S. trade balance continues to worsen on a trend basis," Citigroup currency strategists wrote in a research note on Wednesday. "As such, today's improvement ... is not the beginning of a new positive-dollar trend. We forecast a continued widening in the U.S. current account and expect it to weigh on the dollar in the medium term."

The trade account makes up around 90 percent of the current account, the broadest measure of U.S. trade with the rest of the world.

The record $723.6 billion U.S. trade deficit last year was worth around 5.8 percent of gross domestic product, while the record current account gap of $805 billion was worth around 6.4 percent of GDP.

Economists consider both these percentages of GDP to be unsustainable over the long term.

(Additional reporting by Kevin Plumberg)

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