Changing Trade Weights For The U.S. Dollar

A major drawback of things like geologic processes is they are best viewed with time-lapse photography while we live in our own little fast-twitch world. It might be all well and good to know the U.S. and Europe are drifting apart at about two inches or five centimeters per year – yes, I know it seems faster sometimes – but if you stand on the beach and yell, “Whee!” you are going to attract some attention you might not want.

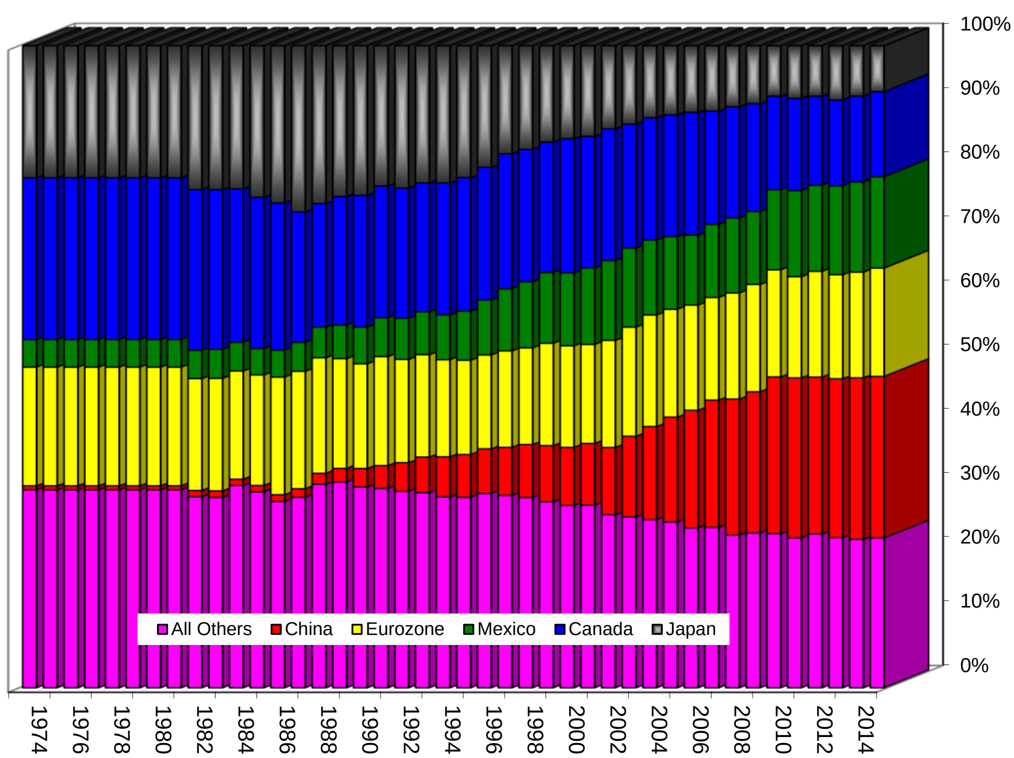
So it is with the Federal Reserve’s trade weights. They just got done crunching the numbers through 2014 for the weights that will be in effect through October 2016, and while the individual weights are of some minor note, their time-lapse since the dawn of the floating exchange rate era in 1973 tells a more interesting story.

Import Weights

If we display the import weights separated into the largest five exporters to the U.S. with all others aggregated, we see a continuation of the China’s long-term ascent at the expense of both Japan and Canada. China continues to have the largest single weight in U.S. imports at 25.1%; for comparison the combined totals for NAFTA partners Canada and Mexico are 27.4%. China’s weight in the U.S. import mix has slowed markedly since 2009 when it reached 24.4% en route to the present 25.1%. This period subsumes both the second revaluation of the CNY beginning in June 2010 and the slow U.S. economic recovery.

China long has feared reprising the Japanese experience of the late 1980s when it allowed a stronger yen and then encountered the slow economic growth of the early 1990s. It is premature to say whether China’s share of exports to the U.S. has peaked near the same 25.9% level Japan’s share did in 1986, but any supplier whose market share rises to more than 25% is likely to encounter rising domestic costs of production independent of currency appreciation. This certainly seems to be the case for China and has informed decisions ranging from the August 2015 devaluation to the end of the one-child policy.

Total Import Weights For U.S. Dollar

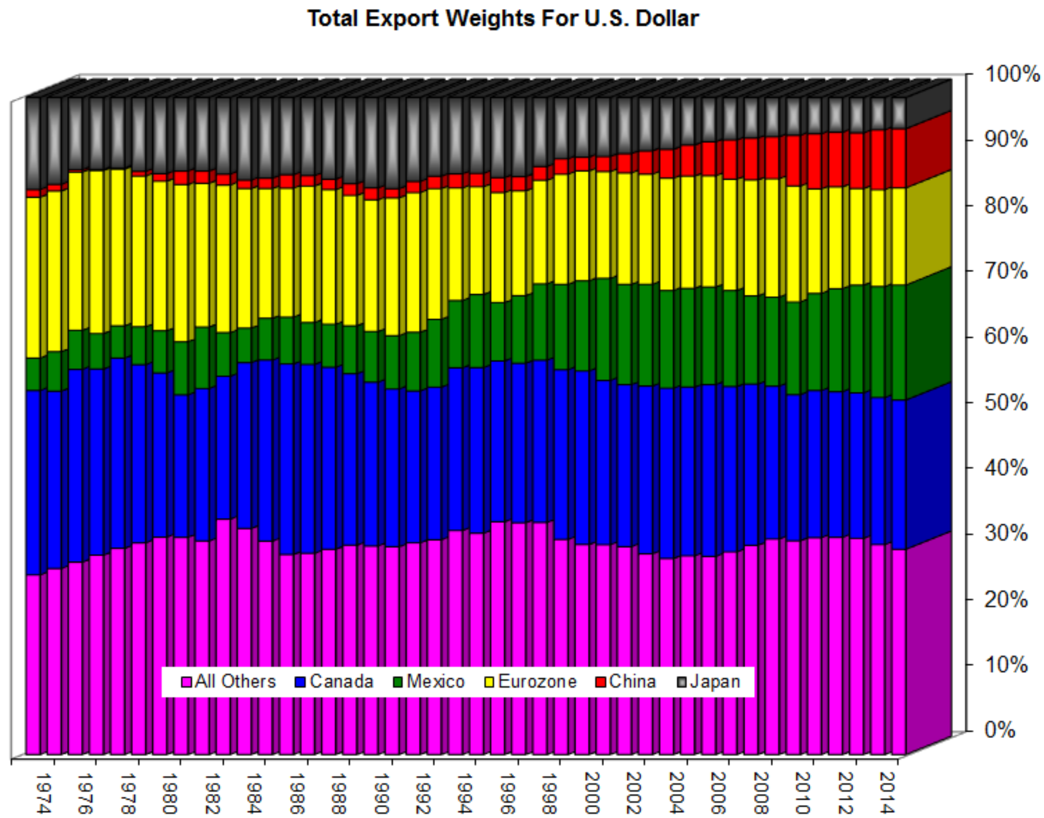


China's increasing share of U.S. imports continues to come at the expense of "all other" exporters. This aggregate has declined from 30.27% in 1995 to 23.33%; the chief contributors to this declining share have been the U.K., Korea, Taiwan and Hong Kong.

Export Weights

Now let's repeat the exercise for export weights. Japan has declined relatively as a market for U.S. exports and had been replaced in large part by increased weights for China and Mexico. However, China's role as an importer peaked at 9.1% in 2013 and has retreated to 9.0%; this reflects the slowdown in Chinese domestic growth. Mexico's weight now exceeds that of the much larger Eurozone.

If we disaggregate the "all others" category, we see the opposite phenomenon from above ceased after the financial crisis. The share accounted for by "all others" has increased from 29.83% in 2003 to 33.05% in 2011, but has retreated to 31.24% today.



The moral of the story is clear: Neither the U.S. nor any of its major trading partners have fixed patterns of trade with the U.S. Thirty years ago, Japan was viewed as a major threat to American manufacturing and China barely registered. Now China's ascendance appears to be slowing. Mexico, linked to the U.S. via a more-or-less free trade agreement and, um, mobile flows of production factors such as labor, has increased in importance as both a supplier and a customer. Those who design trade policies designed to fight the last war really ought to read what happens to countries whose generals fight the last war.