

Trade Deficits, Monetary Policy, and Blowing Asset Bubbles

Chronic and large US current-account trade deficits lead to vulnerable and bloated domestic asset values—no, that it is not the proposition of Trump Administration China-bashers, but rather the [conclusion](#) of the globalist International Monetary Fund.

The short story: Big and sustained current-account trade deficits axiomatically produce large capital inflows to the US. That Niagara of inflowing capital seeks a home in stocks and bonds, and moreover, can leverage up to buy real estate.

But the resulting lofty asset values are unstable, and risk a “Hyman Minsky moment.” That type of moment is economist-talk for when the investment-market decides Fat City is over. In 2008, night settled on Fat City when the US Federal Reserve started to raise interest rates—in part, due to soaring property values.

Of course, once property values began to decline, then lenders pull back.

But property is a credit-dependent asset—snowballing declines are not only possible, but likely in some scenarios. The sensible stance of any single loan officer—“Now is not the time to lend on property”—becomes a self-fulfilling prophecy when adopted by banks across the nation. See 2008. Add on, the US financial system is heavily exposed to real estate. If property values collapse, so can the financial system, which has borrowed short to lend long. Again, see 2008.

Solutions

To avoid destabilizing asset collapses, the US should pursue a balanced trade picture, advocates the IMF (!). Sounding like President Donald Trump, the IMF says the US should open up global export markets. (How exactly to open up export markets is left undefined).

And sounding like the globalist organization that it is, the IMF helpfully suggests the US should lower labor costs to become more globally competitive.

Blowing Asset Bubbles?

Obviously, large and chronic US current-account trade deficits (the norm in recent decades) place the Fed into a quandary. The Fed can stand by and “validate” the inflated asset values—in which case it will be accused of “blowing asset bubbles” to serve this or that nefarious President or interest group. Also, standing by and accommodating while asset value teeter and totter at stratospheric levels is unnerving.

But the option for the central bank is to tighten up on the monetary noose. In that case, again see 2008.

Conclusion

Economists as disparate as David Glasner and Paul Krugman have said if there is any idea that is sacred in conventional macroeconomics, it is “free trade.”

And many others in the orthodoxy decry “easy money.”

In lugubrious combination, the macroeconomic orthodoxy appears intent on obtaining unstable and high US asset values (due to foreign capital inflows incurred by trade deficits) that are sometimes shredded by tight money, and ensuing Great Recessions.

Maybe the IMF is right. The US should seek a balanced trade picture. Large and chronic trade deficits put the Fed into an untenable position.
