INTRODUCTION

Several years ago, the United States was incurring modest trade deficits which were offset by more than $140 billion (U.S.) in payments from abroad on U.S. foreign investments. The U.S. budget was usually in deficit, but this was again more than offset by domestic savings. The net effect was a positive current account balance.

As the U.S. economy picked up steam after the 1981-82 recession, demand rose faster than output. Imports increased drastically to fill the gap. By the end of 1983, the trade deficit had ballooned to nearly $69 billion (U.S.). These events continued into 1985 resulting in a trade deficit of $148 billion (U.S.). The federal budget deficit more than doubled as a share of GNP, and savings fell to record lows.

Under this pressure, the U.S. dollar began to lose value on the international exchange market. By the end of 1987, the U.S. dollar had lost 48% of its value against the Japanese yen, 48% against the German mark, 44% against the Danish krona, 43% against the French franc and 39% against the Italian lira. In fact, the U.S. dollar had fallen against all major western industrialized countries except Canada. By the end of 1987, the trade deficit reached a record $171 billion (U.S.), as import prices rose faster than the fall in import volumes.

The 1988 third quarter figures show the value of U.S. currency stabilizing relative to most western industrialized countries. The past currency adjustments are only slowly being translated into changes in trade patterns. Exporters to the United States who were able to pare their profits for many months have been forced to raise prices. No immediate changes were reflected in the trade figures, as the dollar volumes were maintained while the unit volumes dropped.

The 1988 trade deficit estimates ($125 billion [U.S.]) suggest that the realignment of currencies is finally having the desired effect. Stubbornly high imports seem to be responding to the weaker U.S. dollar. However, some analysts believe that the U.S. dollar must fall further in order to get the trade deficit below the $100 billion (U.S.) level.

While the Canadian dollar has strengthened recently against the U.S. dollar, its value, for the most part, has moved in parallel with the value of the U.S. dollar relative to other international currencies. These developments should help stimulate two-way trade between Canada and the