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Weak Foreign Demand Pushes U.S. Trade Deficit to Record

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WASHINGTON -- A record trade deficit , declining leading economic indicators and rising claims for unemployment insurance all show an economy falling short of a sustained expansion.

The deficit in international trade in goods and services widened to a record $44.24 billion in December from a revised $40 billion in November, the Commerce Department said.

Exports fell 2.6% or $2.13 billion, the largest monthly drop since September 2001, while imports rose 1.7% or $2.11 billion. Exports were hurt by falling sales of capital equipment. Imports, on the other hand, rose across a broad range of categories. Petroleum imports declined but since December they have probably headed higher along with crude prices.

For all of 2002, the trade deficit reached a record $435.22 billion, 21.5% greater than in 2001, and a record 4.2% of gross domestic product. America's major trading partners, with important exceptions like Canada and China, have had even weaker economies than the U.S. "You have a very weak global economy which hurts our exports, but also encourages imports," said Ethan Harris, chief U.S. economist at Lehman Brothers. "If you're a foreigner trying to sell a product and your [other] markets are weak, you redouble your efforts in the U.S. market, which is the biggest and deepest."

The economy, which was in recession through most of 2001, grew at an annual rate of 3% through the first nine months of last year before slowing to a rate of about 1% in the fourth quarter. There have been some signs the economy was picking up in January, but since then the U.S. has had to contend with the rising prospect of war with Iraq, fear of terrorism and a major snowstorm.

The Conference Board, a nonprofit business research group, said its composite index of leading economic indicators, designed to foreshadow movements in the overall economy, eased 0.1% in January from December after three consecutive monthly gains.

Separately, the Labor Department said the number of U.S. workers filing initial applications for unemployment insurance benefits surged 21,000 last week to a seven-week high of 402,000. The four-week moving average, which smooths out weekly fluctuations, rose by 4,750 to 394,750. That level suggests that total employment is neither rising nor falling appreciably.

Also this week, both the New York and Philadelphia Federal Reserve banks said manufacturing activity in their regions slowed sharply in early February from January, though it continued to grow.

The G7 Group, a private New York-based economic and policy research group, in a report to be released Friday, said its quarterly business investment index suggests business spending remains stagnant. The index, consisting of economic and company survey data designed to track overall investment in equipment and buildings, fell to negative 28 from negative 17 last quarter.

The group said that indicates investment will expand at only a 0.6% annual rate in the current quarter, compared with 1.5% in the fourth quarter of last year. "Unsteady economic growth coupled with the numerous economic uncertainties that surround the U.S. confrontation with Iraq have prevented a much needed investment recovery from occurring," the group's report said.

Producer prices soared 1.6% in January, from December, the biggest monthly increase in 13 years. It largely reflected higher energy prices, but even excluding the volatile food and energy categories, prices were up 0.9%, the Labor Department said, the biggest such increase in four years. Much of that was due to a rise in new-car prices, which had fallen sharply in December.

Credit Suisse First Boston economist Jay Feldman said excluding cars, core producer prices have been rising at a steady 0.6% annual rate since the middle of last year, implying no notable upward or downward pressure on goods inflation.

"A weaker dollar, rising commodity prices and a strengthening factory sector should increase price pressures -- and perhaps pricing power," said economists at UBS Warburg.

A weaker dollar may also help on the trade front. Indeed, in recent surveys, manufacturers' purchasing managers said export orders have been improving.

China accounted for nearly a quarter of the country's trade deficit last year, at $103 billion. The U.S. sent goods and services to China valued at $22 billion last year, compared with $19.1 billion in 2001, while imports from China soared to $125 billion, from $102 billion the year before. China passed Japan to become the third-largest source of U.S. imports, after Canada and Mexico.

The mounting trade gap comes as President Bush attempts to advance the most aggressive trade liberalization effort in decades. U.S. trade officials are now negotiating free-trade deals with a collection of more than 40 countries, most of them in Latin America. Critics say these deals will serve to boost imports still more while doing little to enhance the strength of U.S. manufacturers, who continue to move operations in large numbers to cheaper locales like China.

Most of China's soaring exports to the U.S. come from American-backed factories now churning out everything from car bumpers to washing machines.

-- *Neil King contributed to this article.*