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The Upshot
ECONOMIC TRENDS

It Now Looks as if the Economy Shrank in the First Quarter

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Last fall when the dollar was soaring on global currency markets, it seemed only a matter of time before it started to increase the United States trade deficit and dampen growth.

The time has come. In March, the trade deficit widened by $15.5 billion to $51.4 billion. That was influenced by the end of a West Coast ports disruption that fueled a surge in imports (which subtracts from economic growth), but even for the full first three months of the year, the nation’s trade deficit is more than 5 percent higher than a year before.

The new trade data had analysts scurrying to downgrade their estimates of how fast the overall economy grew in the first three months of the year. Now an outright contraction looks likely. Just last week, the Commerce Department reported an 0.2 percent annual growth rate in the first quarter, which already reflected a steep drag from trade.

Incorporating the new March trade data, the damage now looks even worse. Barclays now estimates that gross domestic product fell at an 0.3 percent annual rate last quarter; Macroeconomic Advisers estimates a negative 0.4 percent; and Goldman Sachs has marked its estimate down to a retraction of 0.5 percent.

A single quarter of slightly negative G.D.P. does not a recession make, of course. But the downdraft that the economy is experiencing from the strong dollar, while predictable, is disappointing nonetheless. The good news, such as it is, is that the damage should be at least partly self-correcting.

The dollar index (which measures the value of the dollar against six other major currencies) rose about 25 percent from the start of July 2014 through March 13. The effect of that stronger dollar is still rippling through all sorts of trade arrangements, from American exporters struggling with de facto higher costs to imported goods looking cheaper in the United States and thus gaining advantage over domestic-made goods.

The strength of the dollar was driven by the sense that the United States economy was the pillar of strength in the global economy. Finally, the economy was accelerating out of its long post-crisis slump. That confidence led the Federal Reserve to plot a mid-2015 interest rate increase, even as the European Central Bank and Bank of Japan were pushing toward greater stimulus.

This disconnect — tighter money in the United States combined with easier money abroad — fueled the steep rise in the dollar. But as it looks more and more like the strong dollar really is crimping American economic growth, that possibility seems to be scaring the Fed off from a rate hike in the near future.

It now appears that the odds of a rate hike at the Fed’s June meeting are minuscule, and that a September hike is far from a sure thing. The growing sense that the Fed will bide its time, combined with some signs of life in the European economy, has driven a roughly 5 percent decline in the dollar since March 15. In other words, the fact that the strong dollar is pinching growth has made the dollar a little less strong, which should help limit the economic damage in the months ahead.

So here’s the optimist’s way of reading the March trade data and ensuing downgrade of first-quarter growth: Sure, it’s disappointing. But a big part of it really is a one-time issue from the resolution of West Coast ports disruptions. And it may be just what we needed to keep the Fed in a cautious mode and thus keep the dollar from getting stronger still.

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