

CHAPTER OVERVIEW

3: The Whole Truth about Trade Imbalances

One of the most misinterpreted and misunderstood concepts in international finance is the implication of a country's trade deficit or surplus. Often it is incorrectly presumed that a trade deficit is problematic while a trade surplus is a sign of economic strength. This chapter walks the reader through a thorough investigation of trade imbalances—what they mean and how to interpret them. The chapter concludes that trade deficits can indeed be a big problem for a country, but not always. Trade surpluses can also be a sign of strength, but again, not always. Whether a trade imbalance for a particular country should be viewed as good, bad, or benign depends on many other economic circumstances. This chapter spells out what those circumstances are.

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