

ECONOMICS: US PERSPECTIVES—MAY 13, 2011

Export Boom Continues to Lead US Recovery

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Although the pace of economic recovery slowed in the first quarter, exports are still the key growth driver, driven by robust demand from emerging markets. In our view, an export-led expansion can help narrow the US trade balance, revitalize the depressed manufacturing sector and create jobs.

Our forecasting framework for the current recovery has been based on the view that a “new mix” of growth drivers would revive the US economy, with the export sector playing a bigger role than ever before. So far, the export cycle has proved to be even stronger than we first expected, and has remained resilient amid weak economic growth.

In our view, disappointing preliminary gross domestic product (GDP) figures in the first quarter were due to transitory factors, such as a weather-depressed fall in construction activity and a budget-related delay in defense spending. The key drivers of the cycle—exports and capital spending—posted strong gains, and new data indicate that the GDP figures are likely to be revised higher.

Two years ago, when we first identified the potential for US exports to drive the economic recovery, our thesis was rooted in emerging-market economies, which were poised to drive the global growth cycle. In aggregate, emerging-market

economies are almost as large as the US and are growing more than twice as fast as the US economy. In addition, US manufacturing companies had products and a competitive edge that positioned them well to tap into the fast-growing markets. In time, we argued, a fast and broad export cycle would make a direct contribution to GDP while generating indirect spillover effects on investment and inventory building, to help the US economy recover.

Big Contribution to GDP

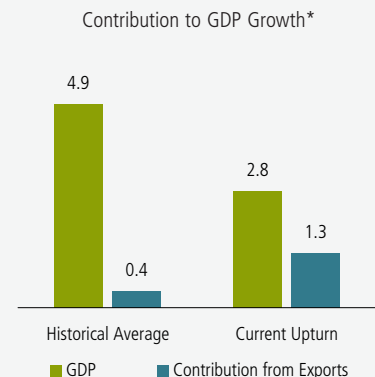
Indeed, since the expansion started in the third quarter of 2009 real exports of US goods and services have increased over 20%. Merchandise exports have jumped close to 30%—the largest gains since the late 1980s (**Display 1**). During this period, the surge in exports made a record contribution to the recovery, accounting for about half of overall real GDP growth during this period (**Display 2**). In the past, exports contributed less than 10% to economic recoveries at comparable stages.

Display 1
Exports Are Steaming Ahead...



As of March 2011
Source: Bureau of Economic Analysis and Haver Analytics

Display 2
...and Driving the Economic Recovery



As of March 2011
*GDP growth and contributions from exports during first seven quarters of recovery
Source: Bureau of Economic Analysis and Haver Analytics

Consumer-related industries have led the export gains, which may surprise those who believe US manufacturers don't make high quality consumer goods that are in demand worldwide. Exports of motor vehicles and parts have leapt 77% since the start of the recovery, admittedly from depressed levels in the recession.

In industrial materials and supplies, exports increased by 28%, led by chemicals. Capital goods exports—the largest category, accounting for approximately one-third of merchandise exports—advanced by 25% since the start of the recovery. That's particularly impressive considering weakness in civilian aircraft exports, which are nearly 10% below their level of the third quarter of 2009. Given the sluggish aircraft segment, rising capital goods exports highlight that the US has been exporting a lot of industrial machinery, construction and agricultural machinery, semiconductors and telecommunication equipment over the past two years.

Emerging Markets Are Key

In terms of destination, US merchandise exports are gradually shifting toward faster-growing emerging-market economies. At present, a record 55% of US merchandise exports are shipped to emerging economies (**Display 3**), about three percentage points higher than at the start of the economic recovery. We expect the emerging-market share of US exports to continue to rise in coming years since economies in these countries are growing two or three times faster than developed markets. In addition, to support their economic growth, emerging markets have an urgent need to import industrial materials and supplies as well as capital goods—two categories that account for about two-thirds of US merchandise exports.

We think the export outlook still looks solid. In April, the Institute of Supply Management (ISM) export orders index rose six points to 62 (**Display 4**). In the past 20 years, the export orders index has only reached or exceeded this level three times—all during the first four months of 2011. At current levels, the export orders index implies that exports will post double-digit growth in coming quarters. In March, nominal exports rose 4.6%, the largest one-month increase since 1994. Export gains in March were more than twice the assumptions in the preliminary first-quarter GDP report. In our view, this means there's a good chance that the 7.8% annualized gain for real merchandise exports will be raised to 10% or more.

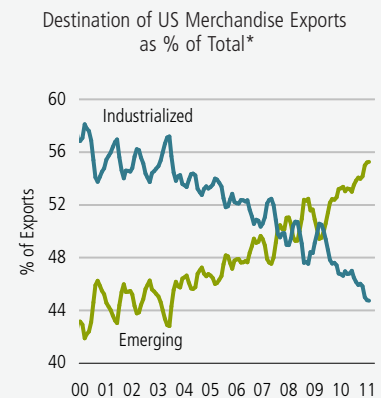
Companies Are Investing More

Strong export gains are triggering an investment/supply response by US manufacturing firms. Most of the current increased spending is on equipment to improve productivity and to enhance capacity. But several companies in the chemical, technology and transportation industries have announced plans to expand plants and to build new so-called greenfield facilities.

Of course, the US economy cannot rely solely on the export and capex engines for growth. Domestic demand growth and job creation is also needed to secure a sustainable long-term recovery. Payroll job growth has been increasing, with private payrolls rising by an average of 250,000 over the past three months. Real consumer spending has also rebounded with a 2.7% gain in the first quarter.

But an export-led expansion can help the recovery in many ways: it can narrow the trade balance, revitalize and enlarge the

Display 3
More Exports to Developing Economies



As of February 2011
Three-Month Moving Average
Source: Bureau of the Census and Haver Analytics

Display 4
Export Orders Remain Robust



As of February 2011
Source: Haver Analytics and Institute for Supply Management

depressed manufacturing sector, create jobs and promote innovation. We believe the export-led expansion has a long way to run, and pending free trade agreements with South Korea, Panama and Colombia should further strengthen the outlook. ■

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