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Economics Group

Special Commentary

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Will U.S. Export Growth Strengthen Anew?

Executive Summary

The year-over-year growth rate in U.S. (real) exports slipped into negative territory in Q3-2015 and it remains there today. Sustained contraction in (U.S.) exports usually is associated with periods of global recession. The global economy is not in recession at present, but slow global growth clearly has depressed growth in American exports, which tend to be cyclically sensitive. The appreciation of the dollar over the past two years has also weighed on export growth.

Unfortunately, we do not foresee a sea change in the underlying fundamentals that would lead to significantly stronger export growth, at least not anytime soon. Economic growth in many of America's major trading partners likely will remain lackluster through the end of next year, and we project that the dollar will resume a modest upward trend in coming quarters. In addition, a return to robust growth in exports of capital goods, which account for nearly 40 percent of total American exports, does not seem likely due to deceleration in investment spending in many developing economies, especially in Asia. Exports should grind higher in coming quarters, but a return to double-digit rates of export growth does not appear to be in the cards.

U.S. Export Growth is Currently Recession Like

It would not be much of an exaggeration to state that U.S. export growth has crashed over the past year or so. Indeed, the value of American exports of goods and services was down 4 percent on a year-over-year basis in Q2-2016 (Figure 1). Although lower export prices are playing a role in depressing the nominal value of American exports—the export price deflator was 2.8 percent lower on a year-ago basis in the second quarter—the volume of exports has weakened as well, down 1.2 percent in Q2. The current degree of weakness in American exports usually is associated with periods of global recession.

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Figure 1

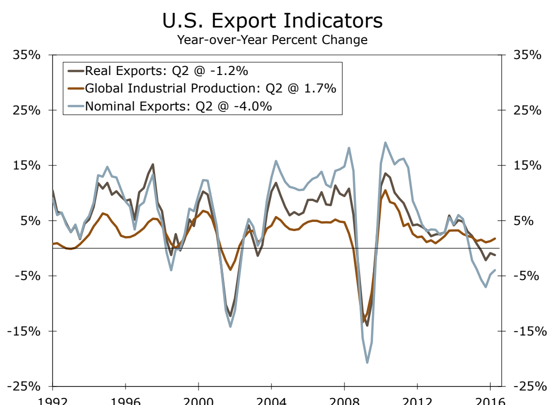
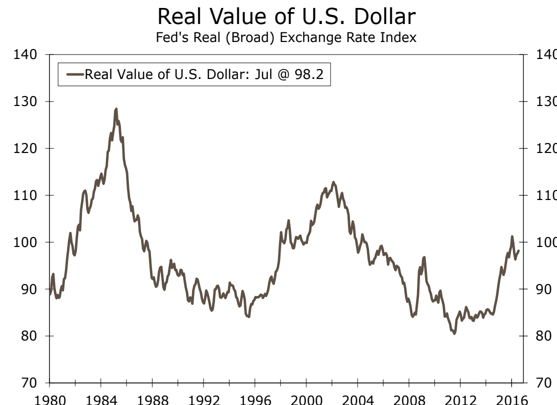


Figure 2



Source: IHS Global Insight, the Federal Reserve and Wells Fargo Securities

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If we define "global recession" as periods in which growth in global industrial production (IP) turns negative, then the global economy is not technically in recession at present. That said, global IP growth has weakened over the past two years, and it is one of the major reasons why growth in U.S. real exports has turned negative. As Figure 1 makes clear, there is a fair degree of correlation between growth in global IP and growth in real exports.

The value of the U.S. dollar has helped to pull export growth lower as well.

The value of the U.S. dollar has helped to pull export growth lower as well. As shown in Figure 2, the real trade-weighted value of the dollar rose about 20 percent between mid-2014 and early 2016. Although the real exchange rate has edged a bit lower in recent months, the price competitiveness of U.S. exports of goods and services has eroded over the past two years, which has contributed to weakness in export growth over that period.

Still, U.S. export growth seems to be unusually weak at present. Global IP growth has slowed over the past two years, but it has not turned negative. And U.S. export growth did not turn negative on a sustained basis during other periods of significant dollar strength in the mid-1980s (not shown in Figure 1) and the late 1990s. In our view, compositional effects, both in terms of product type and destination, are contributing to weakness in American exports at present.

Composition of American Exports

Capital goods account for the largest proportion of total U.S. exports.

Twenty years ago, industrial supplies and materials represented the largest single category of U.S. exports, accounting for 32 percent of real American exports of goods (Figure 3). Capital goods exports were a close second with a 31 percent share. Exports of automobiles and parts and exports of consumer goods, which each had a 12 percent share, and agricultural goods (13 percent) were much smaller. Due to robust growth over the past two decades, the category of capital goods has taken over the #1 spot with a 39 percent share.[1] Although industrial supplies and materials are less important today than they were 20 years ago, they still account for 29 percent of total U.S. exports of goods.

The hallmark of capital goods and industrial supplies and materials is that both categories of exports are very sensitive to the economic cycle. Everything else equal, the slowdown that has occurred in global IP growth would tend to depress exports of industrial supplies and materials as well as capital goods more than exports of consumer goods, which tend to be less cyclically sensitive.[2] Thus, the composition of American exports by type is playing a role in depressing the rate of overall export growth.

Figure 3

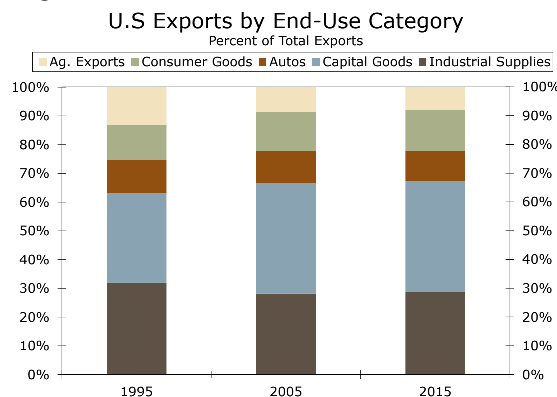
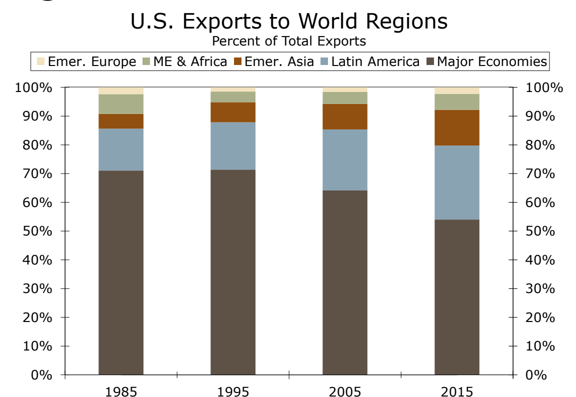


Figure 4



Source: IHS Global Insight and Wells Fargo Securities

[1] **Between 1994-Q1 and 2008-Q2, when American exports peaked ahead of the global financial crisis, real exports of capital goods trebled, significantly outpacing growth in the other major categories of exports.**

[2] **On a year-ago basis, real exports of industrial supplies and materials were down 1.5 percent in Q2 while capital goods exports were off 4.5 percent. Real exports of consumer goods were down only 0.4 percent.**

The destination of American exports also appears to be contributing to the recent slowdown in their overall growth rate. As shown in Figure 4, roughly one-half of the exports of the United States are destined for other advanced economies, which have grown at a painfully slow rate over the past two years. For example, real GDP in the Eurozone grew only 0.9 percent in 2014 and 1.6 percent in 2015, while the Japanese economy contracted 0.1 percent in 2014 and grew only 0.6 percent in 2015. It's difficult to achieve robust export growth, everything else equal, when one half of your exports are destined for slow growing economies.

Figure 4 makes clear that the developing world has become a more important destination for American exports over the past two decades. But the developing world, which grew robustly in the decade preceding the global financial crisis and again in the immediate aftermath of the crisis, has downshifted in recent years. According to the International Monetary Fund (IMF), real GDP in the developing world grew about 4 percent in 2015 and the IMF looks for a similar rate of growth this year. This represents the slowest two-year stretch for the developing world since the bursting of the tech bubble depressed growth in many Asian developing economies at the turn of the century.

The developing world has become a more important destination for American exports over the past two decades.

Speaking of emerging Asia, the region experienced very rapid economic growth in the early years of the current century as investment spending accelerated markedly (Figure 5). The strong growth in American exports of capital goods during that period that was noted previously was driven, at least in part, by robust growth rates of capital investment in emerging Asia. However, investment spending in emerging Asia has decelerated over the past few years, which has weighed on U.S. exports of capital goods. For example, the value of American exports of machinery and transport equipment to China fell nearly 5 percent last year following consecutive years of double-digit growth in 2013 and 2014.

Figure 5

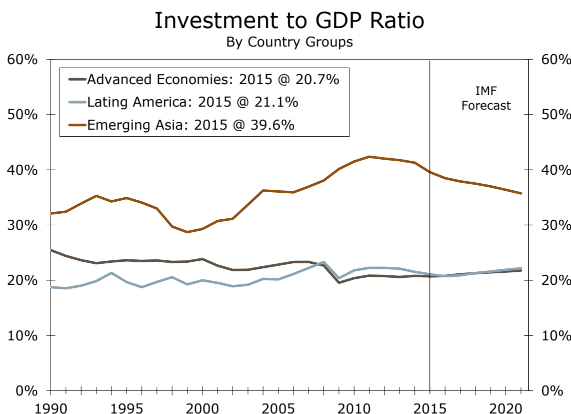
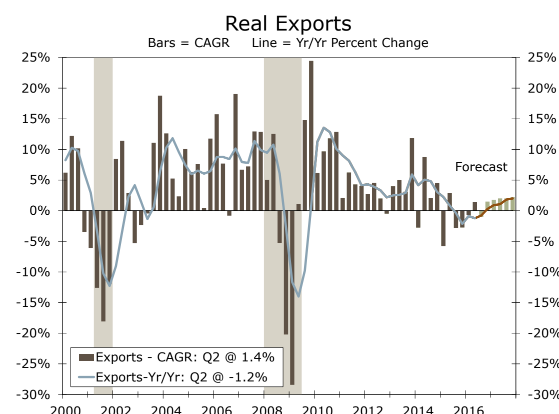


Figure 6



Source: International Monetary Fund, IHS Global Insight, U.S. Department of Commerce and Wells Fargo Securities

Will Strong Export Growth Return Soon?

Real exports of goods and services have essentially been flat on balance since the end of 2015. We forecast that real exports will start to grow again on a sustained basis at the end of this year, but we believe that export growth in 2017 will remain sluggish when compared to growth rates that were achieved during the last decade and in the early years of the current expansion (Figure 6). For starters, economic growth in the rest of the world likely will remain lackluster for the

We believe that export growth will remain sluggish in the foreseeable future.

foreseeable future.[3] Moreover, we forecast that economic growth in China will slow further in coming years as investment spending in that economy continues to decelerate.

The value of the dollar likely will be a slight negative for U.S. export growth as well. As shown in Figure 2, the real exchange rate has weakened a touch this year. However, we look for the greenback to appreciate modestly versus many foreign currencies in coming quarters as the Federal Reserve slowly tightens monetary policy.

Net exports likely will exert a drag on GDP growth in coming quarters.

Our forecast calls for real exports of goods and services to fall 0.7 percent in 2016, the first year of contraction since 2009, before growing at a lackluster rate of only 1.5 percent in 2017. On the other side of the ledger, we look for real imports to grow 1.1 percent this year and 4.7 percent next year. Because we expect imports to grow faster than exports between now and the end of 2017, when our forecast currently ends, we forecast that net exports (the difference between exports and imports) will exert a modest drag on overall GDP growth over that period.

Conclusion

The year-over-year growth rate in U.S. exports slipped into negative territory in Q3-2015 and it remains there today. Sustained contraction in exports usually is associated with periods of global recession. The global economy is not in recession at present, but slow global growth clearly has depressed growth in American exports, which tend to be cyclically sensitive. The appreciation of the dollar over the past two years has also weighed on export growth.

Unfortunately, we do not foresee a sea change in the underlying fundamentals that would lead to significantly stronger export growth, at least not anytime soon. Economic growth in many of America's major trading partners likely will remain lackluster through the end of next year, and we project that the dollar will resume a modest upward trend in coming quarters. In addition, a return to robust growth in exports of capital goods, which account for nearly 40 percent of total American exports, does not seem likely due to deceleration in investment spending in many developing economies, especially in Asia. Exports should grind higher in coming quarters, but a return to double-digit rates of export growth does not appear to be in the cards.

[3] **Between 1980 and 2015 global GDP growth averaged 3.5 percent per annum. We project that global GDP will grow only 2.7 percent this year and 2.9 percent in 2017. See our *Monthly Economic Outlook*, which is posted on our website, for details.**

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