MARKET COMMENTARY

U.S. Exports and Economic Growth

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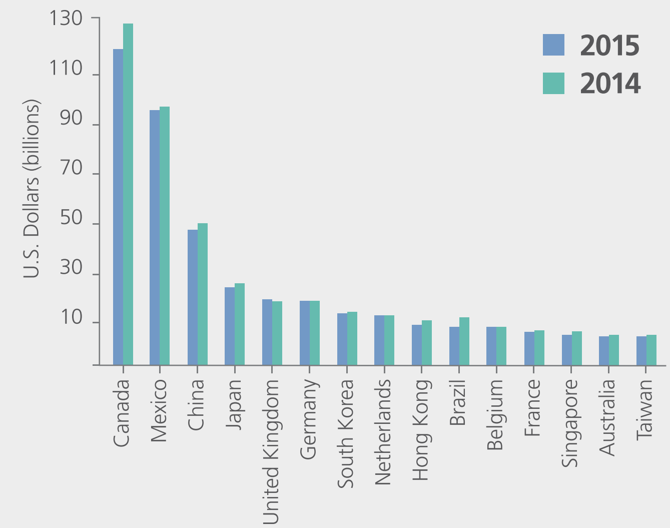
Declining U.S. exports can put a damper on further economic growth, thus slowing the path toward higher interest rates in the near future.

The U.S. economy has been growing at a solid pace, unlike many advanced economies. Growth in terms of real gross domestic product (GDP) is widely expected to continue, leading to further improvement in the job market. Given its own forecast of steady growth, the Federal Reserve is poised to raise interest rates. My forecast differs slightly: I expect slow and shallow interest rate increases due to the deteriorating trade balance.

The trade balance, technically known as net exports (exports minus imports), is a component of the overall GDP along with household consumption, investment by firms and government purchases. I believe that the trade balance will deteriorate and become a drag on U.S. growth due to declining exports. Additionally, U.S. imports will rise. This will further deteriorate the trade balance, because U.S. economic growth implies higher demand for goods and services, including those imported from foreign producers. Moreover, the recent strength of the U.S. dollar has made imports relatively cheap compared to U.S. production. The following content will focus on U.S. exports and their impact on the economy.

Figure 1: U.S. Exports of Goods to Major Partners



Note: Data sets for each year include the months of January through May only.
SOURCE: U.S. Department of Commerce, accessed July 2015.

U.S. EXPORTS

Exports were a locomotive of growth for the U.S. economy from 2002 until the worldwide Great Recession of 2008 – 2009. When the world economy started growing after this major downturn, U.S. exports resumed an upward path. Both before and after the Great Recession, U.S. exports were boosted by the growth of foreign economies, particularly by strong growth in big emerging markets such as China, India and Mexico. Further, the U.S. dollar depreciated against most major currencies before and after the Great Recession, making U.S. exports less expensive and, thus, more attractive to foreign markets. (The U.S. dollar did rise during the second half of 2008 and early 2009, because it was seen as a "safe haven" in the global financial storm.)

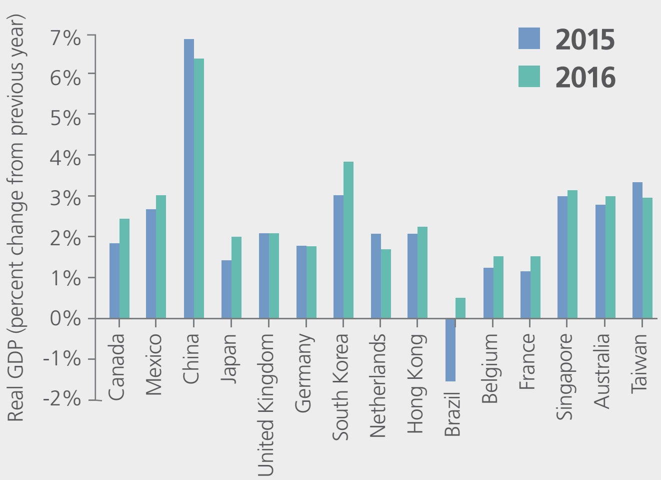
As shown in Figure 1, U.S. exports from January to May 2015 have been lower versus their comparable 2014 period for most of the largest U.S. markets. Given these declines, overall U.S. exports in the latest month reported were down 4.6 percent since their peak in October 2014. Further, exports of goods (manufactures and commodities) are down 7.7 percent since their peak last year.

INCOME, RELATIVE PRICE AND EXCHANGE RATES

Two main factors account for the decline in exports to key markets and, thus, in total U.S. exports. As mentioned earlier, the impacts of income and relative price are crucial to trade flows. The change in a nation's income, as shown by its economic growth or recession, influences its imports. Therefore, if a nation that is a key market for U.S. exports falls into recession or has stagnant economic growth, said nation would import fewer U.S. goods and services.

Second, exchange rate fluctuations drive changes in the price of a nation's products relative to prices in its trade partners. The U.S. dollar has gained value against most of the world's currencies during the past year. This appreciation of the dollar has hurt the United States' ability to export, as it makes U.S. products more costly to potential foreign buyers. The U.S. dollar is up roughly 20 percent against the currencies of the major U.S. markets, including Europe, Japan, Mexico and Canada. Among major markets, only China's currency has held its value versus the U.S. dollar, while Brazil's has declined 40 percent.

Figure 2: Forecast GDP Change in the Top 15 U.S. Export Markets



SOURCE: Economist Intelligence Unit, accessed July 2015.

As shown in Figure 1, U.S. exports have declined in 13 of the 15 largest markets. The only clear increase has been in the United Kingdom, due to Britain's significant economic recovery. A sharp decline in exports to Brazil is apparent due to a recession and a plunge in the Real's purchasing power. U.S. exports to Canada and Mexico — the No. 1 and No. 2 largest importers of U.S. goods and also our North American Free Trade Agreement partners — are down significantly also due to the major appreciation of the U.S. dollar. Both of these nations are suffering slow economic growth, as seen in Figure 2.

Listing the top 15 U.S. export markets in order, Figure 2 depicts economic growth forecasts for 2015 and 2016. Most of these nations face moribund growth with forecasts below trend. Only China will have GDP growth above 3 percent. However, U.S. exports to China are constrained by China's slowdown from its earlier double-digit economic growth. More important, the expected continuation of weak growth in five of the six largest U.S. markets implies that foreign trade will drag U.S. growth below its long-term potential.

IN BRIEF

The more expensive U.S. dollar and the disappointing economic growth abroad during the past year show how trade can harm U.S. economic growth. In four of the past five quarters, deterioration of the U.S. trade balance has pulled growth down. In three of those quarters, the GDP growth rate in the United States would have been higher by 1 to 2 percent. Crucially, economic growth would have been 1.7 percent, rather than a slight decline in the first quarter of 2015, if not for the negative impact of exports falling while imports rose.

As I stated at the beginning, my forecast is that the U.S. economy will grow and the Federal Reserve will commence raising interest rates. However, interest rates may rise slowly due to a continuing negative impact of trade on U.S. economic growth. In particular, weak economic growth abroad and the widespread rise of the U.S. dollar's cost to foreign consumers should continue to threaten U.S. export growth.

ABOUT THE AUTHOR

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