

Global Economic Commentary

SAVING : INVESTING : PLANNING

March 2012

In our opinion, the trend in revising forecasts upwards will continue well into the spring.

Exports: The main game in town

Upward growth revising phase

Here in the U.S., eurozone-induced recession concerns having for the most part faded, consensus has been on an upward growth revising phase for the past three months or so. Initially growth estimates were revised up for Q3 '11, followed by Q4 '11, and most recently for all of 2012. In fact consensus growth estimates for 2012, which a year ago were hovering around 3.3% (with our forecast at 3.5%), dropped to a low of 1.8% back in November (with some forecasters predicting recession in the first half and sub 1% growth overall for 2012). As recently as last week, estimates have been revised up to 2.2% growth for 2012 with some estimates as high as 3.6%. We brought our growth projections down to 2.6% back in September and remain confident that the underlying trends impacting economic growth here in the U.S. are healthier than perceived and projected by consensus.

Underlying trends

What underlying trends are we talking about and where might consensus have it wrong? We have argued for some time, and continue to do so today, that the theme of this business cycle (and many future ones to come) is likely to be rooted in demand for finished goods and services. Additional drivers will be infrastructure and social spending coming from outside of the U.S. in general, and the growth economies of Asia and Latin America specifically. In other words, exports and business investments that are tied to exports—and later the trickle down to peripheral sectors and domestic spending that result from income growth in general - will be the story and path of growth. The recent rise in growth expectation is primarily rooted in the belief that the strengthening in employment and corresponding increase in personal income will lead to greater spending and lower savings. The result will be a positive feedback into business investment and payrolls. There is significant historical precedent and empirical evidence supporting this line of thinking as it relates to U.S. economic cycles, so it is understandable that it remains the primary perspective of the consensus. But it is deeply rooted in the domestic demand story. Is this time different? We believe so.

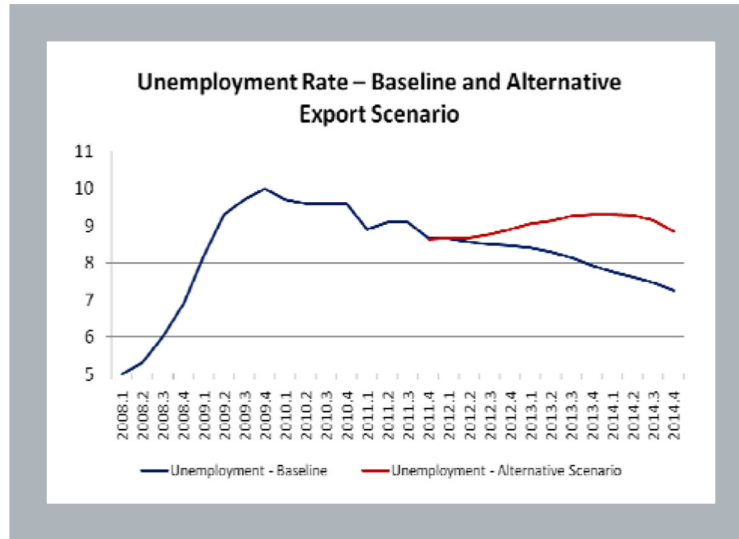
Exports and the U.S. economy

As we have discussed in the past, “gross” U.S. exports as a percent of GDP are now averaging approximately 11% — the highest levels ever — and if our forecasts are correct they will exceed 16% of GDP by 2016. In fact when looking at the running total contribution to growth, we forecast that the “gross” export contribution to total growth would be approximately 41% of GDP this cycle; this compares with 26.7% contributed in the last cycle, and the 21.6% contributed during the business cycle of the '90s (adjusted to the same time frame for proper apples to apples comparison).

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In fact, when looking at the importance of exports and the sensitivity of the U.S. economy to the external sector, the chart above (the results of a simulation we ran) speaks volumes. The two lines represent our baseline forecast for the unemployment rate (which assumes average real GDP growth of 3.15% and export growth of 8.0% through the end of 2014) and an alternative path which assumes exports growing only at the rate of real GDP growth for the same time horizon. In the alternative scenario, the unemployment rate would rise to 9.9% by late 2014 in comparison to our baseline forecast of 7.25% (presently at 8.3%). This difference represents 3.05MM jobs or roughly 2.25% of the employment base.

A competitive U.S. economy

Be it aerospace and chemicals, electronics and information technology, biotech and pharmaceuticals, telecommunications and media, infrastructure equipment and energy, the U.S. economy remains extremely competitive on a global basis and is likely to remain so for decades to come. The transition from demanding what others make to making what others need (not necessarily implying manufacturing) will not be easy, but the engine of growth in this cycle and subsequent ones will be the story of those sectors that succeed in that transition. Domestic demand and growth will follow but not lead.

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