Further Evidence of a US Economic Recovery

On 14 October 2011 I wrote that the the Seeds of a US Economic Recovery had been sown and that it lay in the export sector. The robust trend in US exports and the trade balance continues to take hold.

In September, exports improved from 178 billion USD to 180 billion USD and the trade balance strengthened to -43 billion USD against a prior -45 billion USD and a forecast -46 billion USD. The numbers were the result of slightly improved exports but significantly slower imports. Exports to Canada and Mexico were mostly unchanged to slightly weaker. Exports to the European Union were sightly stronger. Exports to the UK were significantly stronger. Exports to the Pacific Rim continue to rise significantly in an encouraging trend.

Its still early days yet but clearly the weak USD is beginning to do the job. Manufacturing is gradually being brought back onshore and it is a matter of time before this manifests itself in employment data. Job vacancies grew over 7% in September.

The threat to the recovery lies in emerging market growth since this is also the current source of strength. The US does most trade within its own time zone, to the North and South. The current recovery is therefore sensitive to the prospects for Canada, South, Central and Latin America. While the direct trade with China is not as large as the importance many economists or investors place on it, the Americas are exposed to China through its voracious appetite for natural resources. A slowdown in China would threaten the Americas and indirectly as well as directly US exports. So far this is more a risk than a current reality, but it bears close monitoring.

In the meantime, flagging inflation numbers in China may provide the Chinese room for looser policy which would support the export driven US recovery. Balanced against this is the fact that food price inflation remains persistently high while the rest of the CPI basket is flat to deflating. Policy may be more sensitive to the specific components of the CPI than headline numbers. Anecdotal evidence of credit and liquidity shortages are also ominous signs that China’s tight fiscal and monetary policies may have overshot their mark.

Perversely, while European economies struggle with keeping the Euro together and the banking industry solvent, and this persistently spooks markets, it may have positive substitution effects for US products and services.

Since the 1980s US companies began to ‘offshore’ their operations either directly or through engaging foreign suppliers. The result was not only a chronically high and increasing trade deficit but also an increasing share of corporates’ share of GDP at the expense of labour’s share of GDP. Until 2008 this trend has been intact. With the financial crisis and a repricing of the USD as well as reduced availability of trade finance, this dynamic is being thrown into reverse. As manufacturing is brought back onshore the labour’s share of GDP will rise relative to corporate’s. It is still early days.

For now the tactical position is to be long US exporters and short domestics. This will change in future as the export recovery broadens to the rest of the economy.