

An additional USD88bn of U.S. exports in 2015

December 2, 2014

Dan North (Senior Economist, North America)

✉ dan.north@eulerhermes.com

David Semmens (Head of Macroeconomic Research)

✉ david.semmens@eulerhermes.com

Mahamoud Islam (Economist for Asia)

✉ mahamoud.islam@eulerhermes.com

Sarah Bosse-Platiere (Junior Economist)

✉ sarah.bosseplatiere@eulerhermes.com

Executive summary

- U.S. Exports expected to grow +5% in 2015 or an additional USD88bn, in spite of tepid global GDP growth and continued dollar appreciation. Biggest export gains from Mexico, China, and Canada, mostly in Chemicals, Mechanical, Agrifood and Energy sectors.
- Natural gas exports to rise rapidly driven by sharp price difference between U.S and other countries, and by completion of Panama Canal Expansion.
- Trade deficit with China to shrink slightly due to pivot in focus towards domestically driven economy, rising wages and slowly appreciating currency.

Forecasts for U.S. Exports Growth

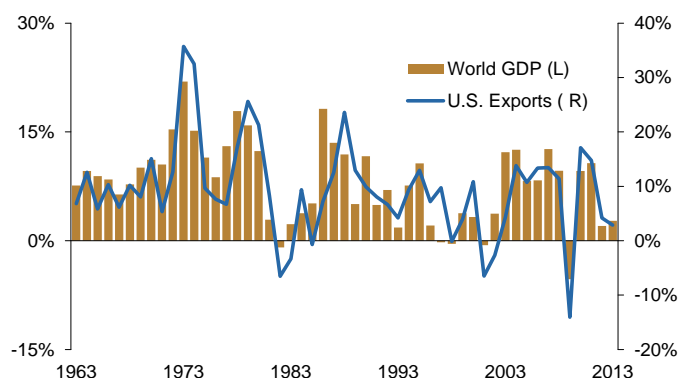
Global growth and its effects on exports

Demand for U.S. exports is highly sensitive to the strength of the global economy. As shown in Figure 1, the two move in virtual lock-step. Unfortunately the global economy is about to enter its fourth straight year of lacklustre growth. Euler Hermes forecasts real GDP growth in Advanced Economies of only +2.0% in 2015 and +4.3% in Emerging Economies. Assuming an approximate inflation rate of +1%, nominal GDP growth would only be about +4%, well below the long-term average of +8%. Figures 1 and 13 shows the historical relationship between World GDP growth and U.S. export growth, indicating that a +4% nominal GDP growth rate would translate into a +4.4% nominal growth rate in U.S. exports.

The Manufacturing Renaissance

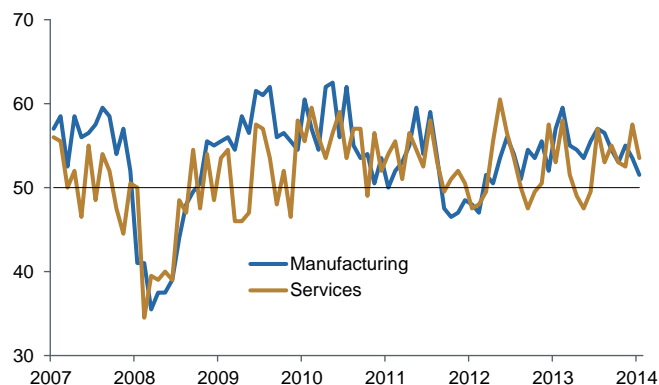
The Institute of Supply Management (ISM) Manufacturing and Non-Manufacturing monthly surveys are carefully watched economic variables, indicating expansion when they are over 50. Each survey has 10 components, including "new export orders," which reflect what industry based survey participants are seeing and are a useful leading indicator of actual export growth. As shown in Figure 2, since the end of the recession in 2009, both of these indices have been above 50 most of the time. The manufacturing new orders index has remained above 50 for almost two years. The services index has been above 50 since March 2014 and as of October 2014 is at a robust 53.5.

Figure 1: World GDP vs U.S. Exports (year/year growth)



Sources: World Bank, Census, Euler Hermes

Figure 2: ISM Survey, New Export Orders



Sources: ISM, IHS, Euler Hermes

Similarly, the Manufacturers' Alliance for Productivity & Innovation (MAPI) conducts a quarterly survey including an Outlook for Export Orders component. As shown in Figure 3, that component has not been below 50 in six quarters, and as of Q3-2014 stands at a very strong 65.

What destinations and sectors will benefit most?

Given a growth forecast of U.S. exports of +4.4% based on world GDP growth, and +5.6% based on the U.S. dollar, an average of +5% can be used to make more detailed projections. A +5% increase in goods exports in 2015 would be an additional +USD88B. The breakdown of this additional +USD88B is shown in Figures 4 and 5. As might be expected the biggest gains in exports go to the top three importing countries, Canada, Mexico, and China. After that however the gains go more to smaller regions and countries and less to the more traditional markets of Japan and Europe. This pattern reflects the rapid growth rates in these emerging markets, and provides U.S. exports with a beneficial increase in diversification. Figure 5 shows the breakdown of the +USD88B by Industry. Not surprisingly, textiles and steel/iron show the least gains as the U.S. has become a much smaller player on the global stage in these industries. At the opposite end of the spectrum nearly half the gains come from chemicals, perhaps due to the cost advantage provided by cheap natural gas, and to mechanical products such as industrial equipment and machinery, both industries where U.S. products are leaders.

Natural Gas Exports Increasing: A value chain springboard for growth

The recent development of horizontal drilling and hydraulic fracturing (fracking) technology has opened vast new reserves of natural gas in the U.S. This new found supply has driven the price of natural gas in the U.S. to between USD2.00 and USD4.00 per million British Thermal Units (MMBtu), while its global competitors pay around USD8.00 to USD10.00 in Europe and USD12.00 to USD16.00 in Asia. As such producing natural gas at USD4.00 and selling it abroad for USD8.00 to USD16.00 makes the prospect of exporting natural gas very attractive, and unlike crude oil there is no ban on exporting natural gas. It is expected that US energy companies will start exporting natural gas to the rest of the world by the end of 2015. While local prices may rise as a result of a less captive US market, the economic benefits would be likely to significantly outweigh the costs. At least four terminals have already been granted approval to export natural gas while several others are in the approval process. As shown in Figure 6, the revenues from exporting natural gas could be significant, growing from USD16B or 0.1% of GDP in 2012, to USD420B or 0.9% of GDP in 2040. As a percentage of all goods exports, revenues from natural gas exports could grow from 1.0% in 2013 to 4.3% in 2040. Annualized revenue growth over that period could average a very strong +12.3%.

Figure 3: Manufacturers' Alliance for Productivity & Innovation Survey, Outlook for Export Orders

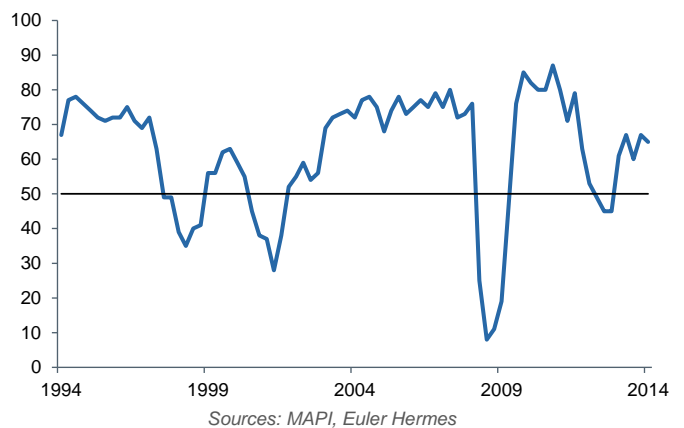


Figure 4: 2015 Potential Export Gains by Country (USD billions)

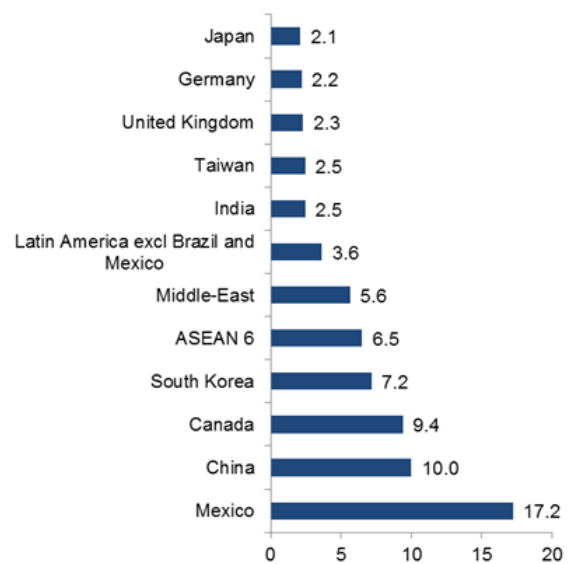
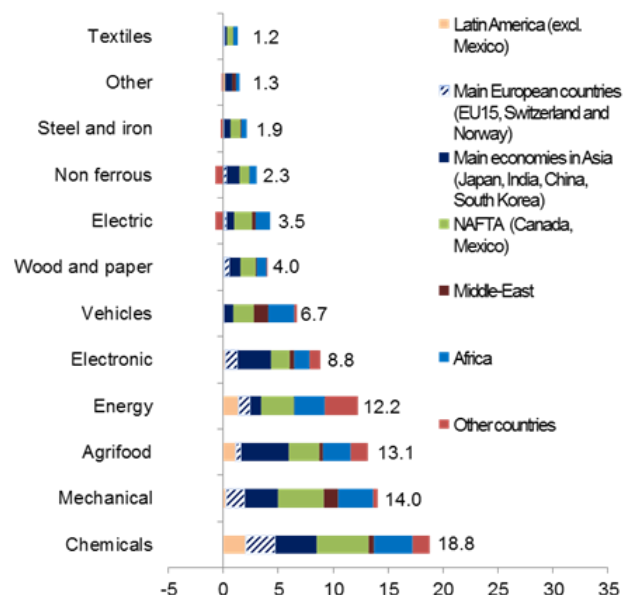


Figure 5: 2015 Potential Export Gains by Sector and Region (USD billions)



Expansion of Panama Canal Likely to Boost Trade

By 2016 the expansion of the Panama Canal should be completed, allowing wider and deeper vessels to transit the canal. The expansion of the canal will allow larger ships to carry exports from the U.S. through the canal, significantly reducing costs, and making those exports more competitive. The new ships will carry three times the volume of the older ships, and combined with the additional capacity of a new set of locks and wider channels, the Panama Canal Authority estimates that total volume of cargo transiting the canal could double as a result of the expansion. The Authority also stated that trips to East Asia from the Sabine Pass facility in Louisiana will be cut by -32% from 63.6 days to just 43.4 days. Liquefied Natural Gas (LNG) exports in particular will benefit as those ships are currently too big to transit the canal. According to the Energy Information Agency, the Panama Canal expansion will "... provide passage for up to 80% of global shipping of (LNG). It currently allows passage of only a small percentage of LNG shipping." And while those shipment volumes are small, they are growing much more rapidly than either petroleum or total volume transiting the Panama Canal, as shown in Figure 7. On the East Coast, Baltimore and Norfolk are already capable of handling the "post-Panamax" ships while New York, Miami, Savannah, GA, Gulfport, MS, and New Orleans, LA, among others, have undertaken large-scale projects to upgrade their facilities.

Focus on China

The U.S and China are dependent on each other in at least two ways. First, they represent important export markets to each other. The U.S and Hong Kong are virtually tied as China's largest destination for exports at 17% each. And as previously noted, 8% of all U.S. exports go to China. Furthermore each country provides a significant amount of Foreign Direct Investment (FDI) to the other. However the U.S. has been running a merchandise trade deficit with China since 1983. As shown in Figure 8, in 2013 the U.S. ran a merchandise trade deficit of USD689B, of which USD319B was with China. In September of 2014 alone the trade deficit with China was USD36B compared with a monthly average of only USD27B in 2013. Economists point out that a trade deficit is offset by investment from the other country of a similar order of magnitude. However the persistent and worsening trade deficit with China has proven to be a political irritation which endangers potential trade agreements (even those excluding China) and raises questions of sustainability in the long run.

Perhaps in recognition of that unsustainability, China has been migrating away from an economy whose exports account for 26% of GDP, and more towards a domestically driven economy. (By comparison, in the U.S. only 14% of GDP comes from exports.) In fact exports in China have come down significantly from their peak of 39% in 2006.

Figure 6: Natural Gas Export Revenues

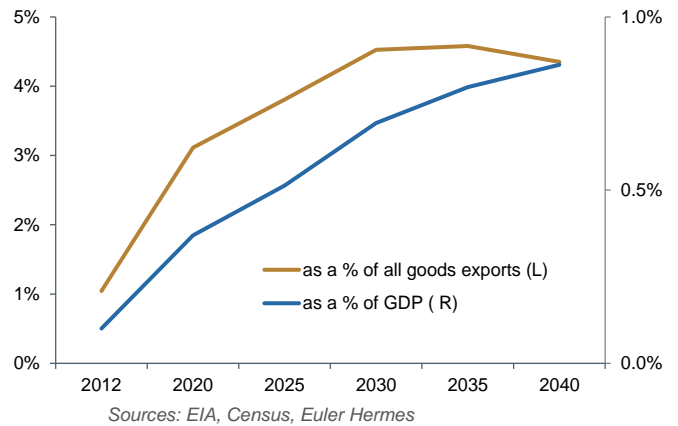


Figure 7: U.S. Tonnage Transiting Panama Canal (year/year growth)

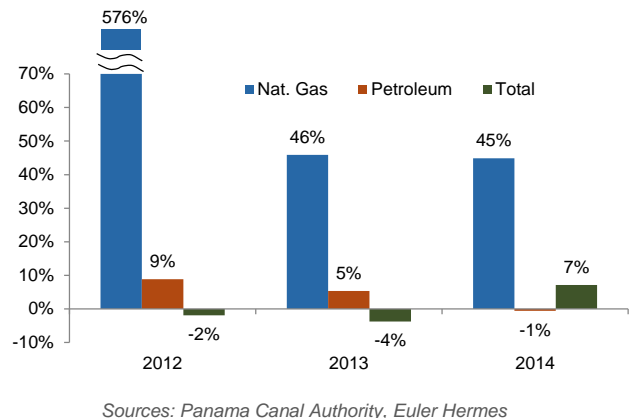
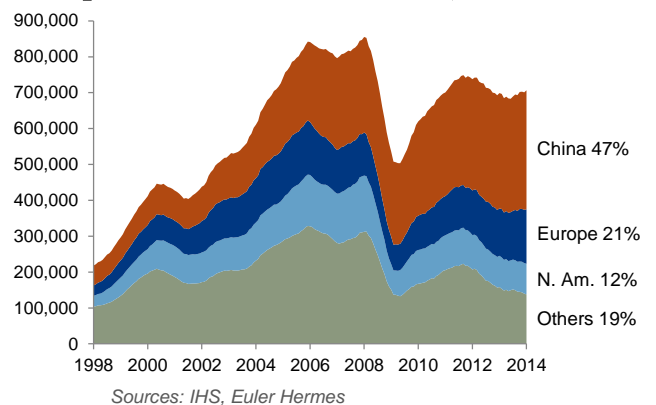


Figure 8: U.S. Merchandise Trade Deficit, USD millions



There are several other factors which could contribute to a shrinking trade deficit with China in the future. Manufacturing wages in China are growing much faster than in the U.S., while American workers are still three times as productive. The result as shown in Figure 9 is that the effective wage advantage the Chinese have had for years is now rapidly shrinking to the point where jobs are coming back to the U.S.—especially given the energy price advantage as evident in natural gas. Expectations of a slowly appreciating currency in the long run will compound the decline of competitiveness in Chinese exports. The manufacturing sector in general is expanding more rapidly in the U.S. than in China as shown by their respective Manufacturing Purchasing Managers' Index (PMI) (above 50 indicates expansion) in Figure 10. These factors will act to reduce the trade deficit with China, but it is likely to take years, if not decades to bring it down to more sustainable levels, much less reverse it.

Free Trade isn't Free

To further promote U.S. exports, more Free-Trade Zones, which greatly reduce the burdens of customs, regulations, tariffs, and taxes to promote free trade should be licensed. Two major trade agreements, the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP) are currently being negotiated as show in Figure 11. They would both lower barriers to trade and allow increased access to new markets, boosting exports. However populist sentiment in the U.S. against free trade makes passage of either of these agreements unlikely any time soon. In addition there are strong pockets of opposition to the TTIP in Europe over several issues, including among others (1) fears of eroding consumer, environmental, and labor laws, (2) concerns over provisions allowing foreign investors to sue E.U. governments over laws affecting profits, and (3) strident opposition to allowing U.S. food imports which might include genetically modified organisms (GMO) or other food treatments not currently allowed in the E.U.

Risk #1

Dollar appreciation and its effects on exports

The value of the U.S. dollar also strongly influences growth in exports. When the dollar strengthens, U.S. exports become more expensive and less competitive, and as a result they grow more slowly. Figure 12 shows this relationship with the tan line being the value of the dollar, plotted inversely against the right axis, such that when the tan line goes down, the dollar is strengthening. Dollar movements lead actual export growth by two to three months with a strong correlation of almost 0.6. The dollar has risen +6% over the past year, mainly since the U.S. Fed is anticipated to tighten monetary policy in mid-2015. By comparison the European Central Bank (ECB), and the Bank of Japan (BOJ) are engaging in or anticipated to announce further QE to last the duration of 2015 and most likely beyond. Furthermore the Fed is expected to start raising short-term interest rates in mid-2015, well before the BOJ and ECB can even begin the discussion of higher rates.

Figure 9: Effective Wage Gap

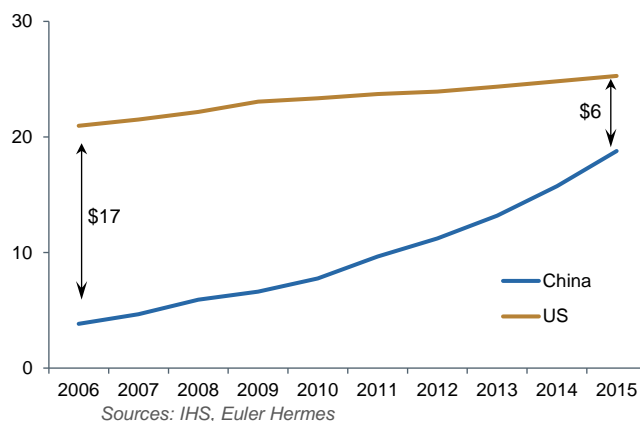


Figure 10: China and U.S. Manufacturing Purchasing Managers' Index (PMI)

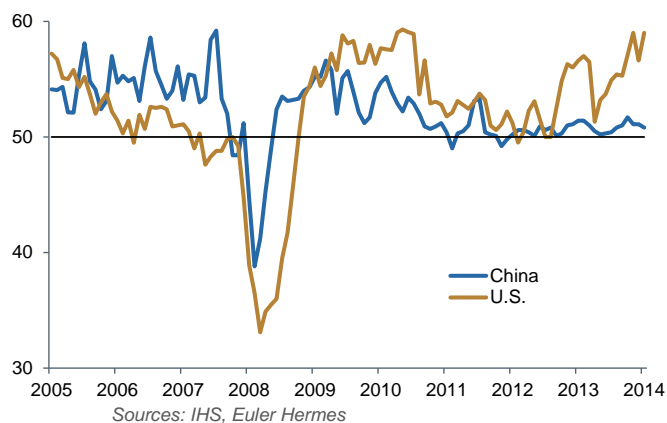


Figure 11: U.S. Free Trade Agreements

Existing Trade Agreements	Proposed Trans-Atlantic Trade and Investment Partnership (TTIP)	Proposed Trans-Pacific Partnership (TPP)
Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Rep., El Salvador, Guatemala, Honduras, Israel, Jordan, S. Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, Singapore	Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Rep., Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, U.K.	Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, S. Korea, Taiwan

Source: Euler Hermes

A tighter monetary policy makes a currency more attractive since it is normally associated with higher interest rates and a lower risk of inflation. Figure 13 shows the historical relationship between changes in the U.S. dollar and growth in U.S. exports. Expectations are that the U.S. dollar will gain around +3% in 2015, translating into a +5.6% nominal increase in U.S. exports.

Risk #2

Export financing

Export financing faces several challenges. Since the financial crisis, regulators have become heavy handed with banks, making them risk averse, and keeping lending conditions for exports tighter than might otherwise be. For instance even as the Fed's Quantitative easing (QE) programs have created unprecedented amounts of liquidity, most of it has remained unused as excess reserves in the banking system because the Fed has taken a tougher regulatory stance since the financial crisis. Furthermore, those excess reserves are likely to start shrinking as the Fed moves away from its QE experiment. Rising rates in 2015 may make financing either more expensive or more difficult to obtain, or both, especially given fragile global growth and geopolitical uncertainty.

Risk #3

Global Insolvencies

In 2014, business insolvencies as measured by the Euler Hermes Global Insolvency Index will fall -12% from 125 to 110 as shown in Figure 14. And although the Index is expected to fall again in 2015, it will be at a much slower pace, only -3%, and it will remain +12% above the pre-crisis level of 94 in 2007.

There are five groups of countries that should be monitored separately for insolvency risk:

Group 1: Countries with insolvencies at a (record) low level, but with factors limiting insolvencies that may not continue: U.S., Canada, UK, Japan, South Korea, Taiwan, South Africa, and to a lesser extent Sweden.

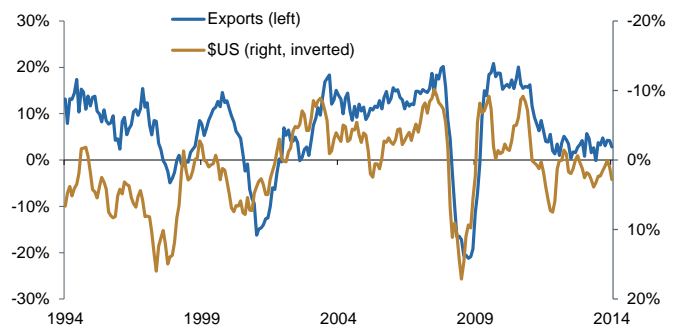
Group 2: Countries with insolvencies at a (record) low level in 2014, but expected to rebound in 2015: Germany, Austria and Hong Kong.

Group 3: Countries with (huge) progress but where risks are still very present, because the decreases in insolvencies take place after major surges: Denmark, Ireland, Lithuania, the Netherlands, Portugal, Spain, Turkey and to a lesser extent Switzerland; or because a rebound is expected in 2015: Belgium and Luxembourg.

Group 4: Countries with a (record) high level of insolvencies and are struggling to stabilize: France, Italy, Finland, Greece, Norway, Hungary, Czech Republic, Slovakia, Romania and Morocco.

Group 5: Emerging economies already facing uncertainties or a deteriorating trend: China, Russia, Brazil, Chile, Colombia and Poland.

Figure 12: USD vs Export Growth (year/year)



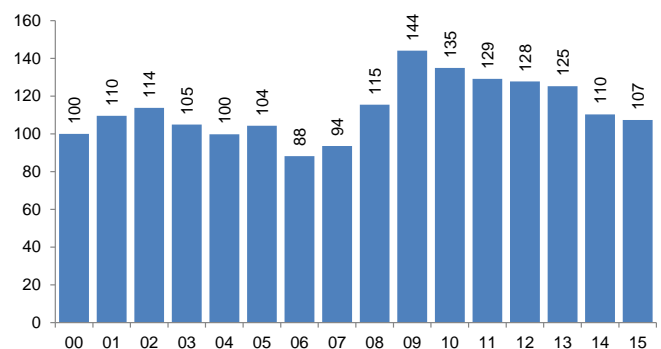
Sources: Federal Reserve (Broad \$ Index), Census, Euler Hermes

Figure 13; 2015 Year/Year Nominal Growth Rates of World GDP and USD vs. U.S. Exports

World GDP	U.S. Exports	\$US	U.S. Exports
2.0%	1.9%	-1.0%	8.5%
3.0%	3.2%	0.0%	7.8%
4.0%	4.4%	1.0%	7.0%
5.0%	5.6%	2.0%	6.3%
6.0%	6.8%	3.0%	5.6%
7.0%	8.0%	4.0%	4.8%
8.0%	9.2%	5.0%	4.1%
9.0%	10.4%	6.0%	3.3%

Source: Euler Hermes

Figure 14: Euler Hermes Global Insolvency Risk Index



Source: Euler Hermes