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Emerging Markets Continue to Propel US Industrial Output and Export Growth

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Solid US manufacturing shipment and inventory data bolster our economic growth forecast for the second quarter, and even the struggling aircraft sector is returning to life. In our view, emerging-market demand remains resilient to recent market turmoil and will continue to support US exports in the months ahead.

The US industrial sector started the spring quarter with plenty of momentum. Orders of durable goods rose 2.9% in April, extending a year-long string of gains. Over the past 12 months, new orders have advanced nearly 19%, the strongest rebound since 2000 **(Display 1)**. Excluding the transportation sector, it has been the best period for industrial orders since the early 1980s.

Shipments and inventory data were also impressive. Manufacturer shipments advanced 1.4% in April, following an even larger gain of 2.9% the previous month. Industrial companies bolstered their inventory in April, with stock positions rising $1.95 billion, or 0.7%, for a third consecutive monthly increase **(Display 2)**.

Manufacturing Output Remains Solid

Taken together, shipments and inventories are a good proxy for output growth. Based on the April data, we estimate that the durable goods manufacturing sector is increasing output at an annualized rate of 7% to 8% in the second quarter. Manufacturing output is poised to be a key contributor to overall US real GDP growth in the second quarter, which we still forecast at about 4% annualized.

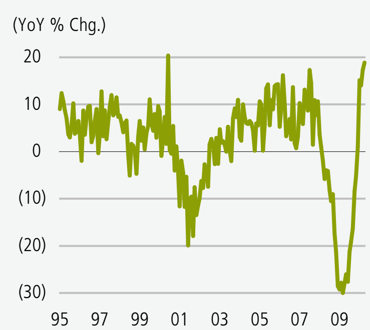
Sluggish Aircraft Sector Awakens

One of the more noteworthy features of the April report on manufacturing activity was the sharp rebound in commercial aircraft. This sector has lagged behind the recovery in the industrial sector due to production delays at Boeing as well as the slow rebound in travel. But business trends have started to improve in recent months, with monthly new orders for the overall commercial aircraft sector averaging about $8 billion per month—twice the average monthly order flow of 2009. In its first-quarter earnings call, Boeing indicated that order trends were beginning to improve and it was increasing production rates to keep pace with demand.

A sustained rebound in demand for commercial aircraft has wider ramifications for industrial production. It would trigger additional orders up and down the

Display 1
Strong Rebound in Orders

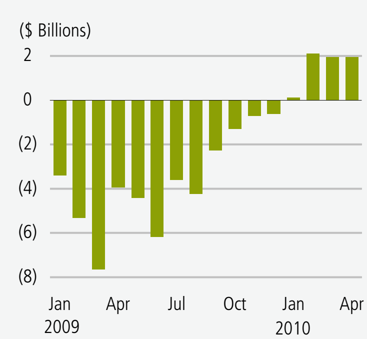
Order Bookings for Durable Goods Manufacturers



Source: Bureau of the Census and Haver Analytics

Display 2
Inventory Rebuilding Has Started

Change in Inventory Positions for Durable Goods Manufacturers



Source: Bureau of the Census and Haver Analytics industrial value chain, since the aircraft production process requires many parts and materials. In addition, growing demand for aircraft would add strength and breadth to the export cycle by helping the sector catch up with the rest of US industry. Exports of commercial aircraft and parts have slipped by 4.5% since the spring of 2009, while total real US merchandise exports have increased at an annualized pace of 22%. Since commercial aircraft and parts rank in the top five categories of the largest US exports, we believe a rebound in these products and parts would make a significant contribution to the export growth rate over the coming year.

US Exports Don't Rely on Europe

Our bullish view on the US export cycle and industrial sector recovery has recently been challenged by increased volatility in financial markets associated with fiscal solvency issues in Europe, and the abrupt decline in the value of the euro. Financial markets are worried that incremental fiscal contraction in Europe may reduce global growth, and the recent strengthening in the dollar versus the euro could eventually prompt market shifts and hurt US manufacturers.

Of course, the fiscal issues in Europe are serious and cannot be ignored. However, the global GDP recovery and the US export boom are not hinged on European growth trends. About 55% of all US exports are directed toward emerging markets today, while exports to Europe account for only 14% of the total, the lowest share since the early 1980s **(Displays 3 and 4)**.

This means that trends in emerging markets are much more important for global economic growth and US exports, and, at this writing, the recovery in developing countries is still on track. In the Asia ex Japan region, growth is running at a 10% annualized rate, while in Latin America—another key destination for US exports—GDP is growing at nearly 5% per annum. In fact, we think these regions are capable of maintaining growth rates close to these levels for the full year, as recent events in the global markets will delay monetary tightening in many of these economies.

Output Can Withstand Turmoil

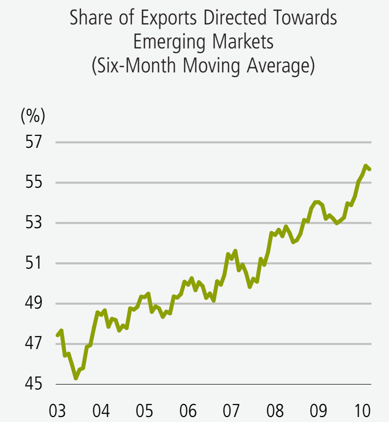
Over in Europe, as governments cut back on spending to address fiscal deficits, there will inevitably be an impact on regional growth patterns. However, we only expect fiscal tightening to shave a fraction of a percentage point from our previous forecasts for European GDP growth because the adjustments are occurring in countries that account for a relatively small share of Europe's GDP.

The European situation requires us to be on guard for a possible realignment of exchange rates. But although the relatively weak dollar helped promote US exports in the past, we don't think currency was the main factor behind the boom. In our view, US companies have captured a growing share of export markets due to improved long-term productivity gains on an absolute and relative basis.

Indeed, over the past decade US companies have improved productivity at twice the pace of their European rivals. As a result, we remain bullish on the primary drivers of the US economic recovery—industrial output and export growth—which look capable of overcoming the turmoil blowing in from Europe. ■

Display 3

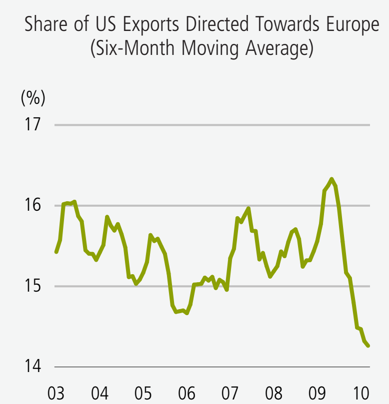
US Exports—Emerging Markets Are Important…



Source: Bureau of the Census and Haver Analytics

Display 4

…than Europe



Source: Bureau of the Census and Haver Analytics