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ABOUT BILL SULLIVAN

William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a weekly report on credit market trends and maintaining a regular schedule of conference calls that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.

Mr. Sullivan is the familiar voice that JVB features on our weekly conference call, where he discusses the economy and the events that affect the marketplace.

He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.

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JVB FINANCIAL

Weekly Commentary

by Bill Sullivan, JVB Chief Economist

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Export Revival: More apparent than real?

Many factors have combined to spur optimism regarding the U.S. economy's prospects over the next year or so. Indeed, the ongoing healing process in the nation's credit market has encouraged investors to believe that the worst in the financial meltdown is in the past and that a platform for growth has been established. In addition, the massive stimulus that has been provided by the Federal Government is viewed as a distinct positive for the overall outlook. Supplementing these forces is the judgment that the international picture has turned around and that rising export activity will be a source of strength for business firms in the quarters ahead. Admittedly, there are signs that the environment for trade is no longer in a downward spiral, but the actual pace of improvement may not be as extensive as the headline figures would suggest.

The perception that trade has become a major plus for the U.S. economy is based upon the recent performance of foreign shipments by domestic producers. According to Commerce Department data, exports have now increased in each of the last four months, rising by $6.8 billion or 8.5% to $86.8 billion. The August reading was highest thus far this year and occurred against the backdrop of tentative evidence that the global recession was loosening its grip on major industrialized countries as well as several key emerging markets. Notwithstanding the apparent rebound in trade, it should be noted that the upturn in exports since the April, 2009 low has been narrow in scope and may largely reflect rising prices for many products as compared to a higher number of units actually being shipped abroad.

The revival in export activity over recent months has been a byproduct of rising shipments for industrial materials and automotive supplies. Since April, exports of food and consumer goods have edged a bit higher while capital goods (excluding autos) have moved somewhat lower over this period. Approximately two-thirds of the export increase from the second quarter low has been in the industrial supply component which rose to $25.7 billion during August. Among the products that have logged impressive gains since April are fuel oil, chemicals, petroleum, plastics and non-monetary gold. Given the recent rally in the commodities market, there is little doubt that some of the export gains in the last few months are representative of higher prices and don't necessarily indicate that a measurable increase in unit volume has occurred. As a result, the support for real Gross Domestic Product (G.D.P.) expansion from the rising pattern of export activity may prove marginal at best.

Despite the sharp decline in global economic activity over the last year or so, trade has given a boost to real G.D.P. for three consecutive quarters. In particular, the nation's trade gap in real terms peaked at $479.2 billion during the July-September, 2008 interval. Over the next nine months, the flow of red ink shrank by nearly $150.0 billion, a development that is treated as a

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positive for the Gross Domestic Product measure. To provide perspective, without the narrowing in the net export component, inflation adjusted G.D.P. would have contracted at a 5.5% annual rate over the latest three quarters for which data are available, much deeper than 4.2% contraction for the aggregate series.

Unlike recent quarters, the trade component probably added very little to G.D.P. growth during the summer months and may have conceivably acted as a modest drag on general activity, depending on the assumptions that the Commerce Department utilizes for the September period. The potential for an outright deletion from growth is captured in the non-petroleum trade position for July and August. Available input pegs the monthly average deficit at $23.9 billion versus $22.1 billion for the April-June interval, as imports have reaccelerated as well. In each of the three quarters that the trade component had been a plus in the G.D.P. series, the non-petroleum deficit had shrunk, suggesting that overall activity will benefit minimally from the recent upturn in exports, especially in real terms.

Another impediment to a major resurgence in trade over the next few years is the maintenance of historically tight lending standards. Clearly, a significant share of U.S. exports involves credit sensitive durable goods such as civilian aircraft and machinery. The volume of trade in these key segments is not only affected by currency valuations, the availability of lendable funds also plays an important role. At present, the credit markets, despite the recent healing process, are far removed from the generous standards that helped propel monthly exports to almost $118.0 billion or about 35% above the August, 2009 pace. Until a more relaxed lending posture does surface, the credit setting could prove to be another impediment to any near term surge in export business for U.S. manufacturers. ■

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