Executive Summary

U.S. exports plunged at an annualized rate of 64% in the second quarter as many foreign economies went into lockdown mode earlier this year. But as many of America’s major foreign trading partners have re-opened their economies, real exports of goods and services should begin to recover in the third quarter. Because export growth also depends on the real value of a country’s currency, the recent depreciation of the U.S. dollar should also help to boost American exports over the next year.

Overall, we forecast exports to rise nearly 9% in the second half of this year, which would still leave U.S. exports down 18% from the pre-virus Q4-2019 level. But if our forecast for global economic growth is correct, we look for momentum in exports to carry into next year, and forecast exports to grow about 10% between the end of this year and Q4-2021.

Exports Have Been Crushed by the Global Downturn

Economic theory posits that a country’s real export growth is largely dependent on two variables: foreign economic growth and the country’s real exchange rate. As Figure 1 makes clear, this theory is supported by empirical evidence. That is, there is a high degree of correlation between growth in U.S. exports of goods and growth in global industrial production (IP), which is a proxy for global economic activity.

Figure 1

Source: U.S. Department of Commerce, IHS Markit and Wells Fargo Securities

Many foreign economies went into lockdown mode earlier this year as the pandemic spread around the world. Consequently, global IP tumbled roughly 10% on a year-over-year basis, which is a major reason why American exports of goods nosedived nearly 20% in the second quarter. Furthermore,

Figure 2

There is a high correlation between growth in U.S. exports of goods and global industrial production.

Together we’ll go far
the weakness in goods exports was broad based. Real exports of autos and auto parts nosedived more than 70% between February and their nadir in May, and other major categories of goods exports weakened by 20% or more during that period (Figure 2). Real exports of services fell 19% (not annualized) between Q1-2020 and the second quarter. Real exports of goods bounced higher in June—data on real exports of services are not readily available on a monthly basis—but all major categories of real goods exports remain significantly below their February pre-virus levels. So where do we go from here?

**Exports Set to Rebound and Grow Modestly in 2021**

We look for real exports of goods and services to surge nearly 30% at an annualized rate in Q3-2020 (Figure 3) due to the re-openings that have occurred in most of America’s major trading partners over the past month or two. Although we forecast that export growth will slow somewhat in future quarters, we expect that exports will continue to trend higher, assuming major foreign economies do not go into lockdown mode again. On an annual average basis, we forecast that real exports of goods and services will grow 4.4% next year, which is roughly in line with our forecast for 2021 global GDP growth (Figure 4).¹

**Figure 3**

![Real Exports Chart]

**Figure 4**

![Real Global GDP Growth Chart]

Source: U.S. Department of Commerce, International Monetary Fund and Wells Fargo Securities

Revisiting Figure 1, it is clear that the relationship between U.S. real goods exports and global IP growth has changed. Real exports of goods have grown roughly in-line with global IP growth over the past decade, compared to about two times as fast during the 1990s and the first decade of the 21st century. As we discussed in a previous report, the lack of new multilateral trade deals and the topping out of the globalization process contributed to the deceleration in exports in the years leading up to the pandemic.² Given the current environment of trade restriction rather than trade liberalization, we think it is unlikely that U.S. export growth will exceed global IP growth in the foreseeable future.

When analyzing the outlook for overall U.S. exports, it is useful to understand the components of American exports. Other than the broad groupings of total goods and total services, we do not explicitly forecast the underlying categories of exports. Still, we can make some conclusions regarding the outlook for export growth based on particular observations in the face of COVID-19.

Let’s start with services, which account for roughly 30% of total exports. Travel services, which includes spending by foreign visitors in United States, have historically been the largest component of services exports at more than 20%. But with foreign travel to the United States negatively affected

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¹ Because there was a high level of exports in Q1-2020, the annual average level of exports in 2021 is only 4.4% higher than in 2020. If we measure export growth by the change between the fourth quarter of this year and the fourth quarter of next year, then we forecast that real exports of goods and services will grow 10.6% in 2021. See our Monthly Economic Outlook for details.

² See “Why is Global Trade Growing So Slowly?” (August 25, 2014), which is available on request.
by the pandemic, exports of travel services likely will exert headwinds on growth in total services exports. Likewise, exports of transportation services (10% of services exports), which includes airfares that foreigners pay to U.S. airlines, likely will struggle to rebound significantly. That said, American carriers of freight via land, sea and air should pick up as the global economy strengthens. Furthermore, other categories of services exports—like financial services and intellectual property charges—have not declined to nearly the same extent as travel and transportation and should pick up with broader global activity (Figure 5).

Figure 5

Source: U.S. Department of Commerce, IHS Markit and Wells Fargo Securities

Merchandise trade (i.e., trade in goods) accounts for the remaining 70% of U.S. exports. Although we similarly do not forecast the underlying categories of goods, we can analyze the behavior of exports in the prior two business cycles. Total real exports of goods bottomed in February 2002 and again in April 2009. Figure 6 shows the behavior of the major categories of exports leading to the trough in total goods exports and two years following that trough. The major takeaway from this chart is that cyclical categories—like industrial supplies and autos—weaken significantly but then rebound fairly quickly.

We expect a similar outturn today, which should be particularly evident in exports of automotive products. As noted previously, real exports of autos and auto parts tumbled nearly 75% between their pre-virus level in February and their bottom in May. Although the pullback in global demand clearly played a role, weakness in auto exports likely has more to do with shutdowns of American auto manufacturers for much of March and all of April. At the peak of closures, an industry source estimated that over 90% of U.S. auto production facilities were closed. A further, data released by the Federal Reserve Board showed auto assemblies nosedived 99% between February and April. But as auto manufacturers began to re-open at the end of May, auto exports picked up and were down only 40% in June relative to their peak. The marked improvement in June is also evident in the other major categories of goods exports (revisit Figure 2).

Another factor that should provide a modest boost to U.S. exports in the second half of this year and into 2021 is a weaker U.S. dollar. On a broad trade-weighted basis, the U.S. dollar has depreciated about 7% since March and we expect it to weaken further. We forecast that the trade-weighted value of the dollar against other major currencies will fall about 5% between now and the end of 2021 (Figure 7). At the margin, dollar depreciation should provide additional lift to U.S. exports, as a weaker dollar makes exports less expensive, and in theory more attractive, to foreign buyers. That said, growth in the rest of the world is a much larger influence on U.S. export growth

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3 According to the Alliance for Automotive Innovation, 93% of U.S. auto assembly plants were closed as of March 26, 2020. 89% of U.S. plants were cited closed as of May 6, 2020, but only 16% were closed as of May 20, 2020. No plants were reported closed as of June 17, 2020.

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A weaker dollar should also provide some lift to U.S. exports.

Cyclical goods categories should rebound fairly quickly.
today, and a weaker dollar will simply provide some extra wind in the sails of the rebound in exports.

**Figure 7**

**Trade Weighted Dollar**

Advanced Foreign Economies Dollar Index, 2006=100

**Figure 8**

**Europe Covid-19 New Cases & Deaths**

Combined New Cases & Deaths for Italy, Germany, Spain & France

Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

**Virus and Trade Tensions: Risks to the Outlook**

The uncertain evolution of the pandemic represents the biggest risk to our export forecast, just as it does to our overall economic outlook. New cases in the Eurozone, which accounts for roughly 15% of U.S. exports, have trended higher in recent weeks, although they remain well short of levels reached earlier this year (Figure 8). But if European countries need to impose new shelter-in-place restrictions to combat a significant acceleration in new cases, then U.S. exports to the Eurozone likely will take a renewed hit. The same holds true for other countries more generally. On the other hand, however, a speedy deployment of an effective vaccine that allows economic activity in most economies to return to “normal” later this year likely would boost U.S. export growth even more in 2021.

Outside of the virus itself, trade tensions with China represent another wildcard concerning our export forecast. The United States and China are still more or less in the midst of a trade war. The two nations came to a Phase One agreement earlier this year, but there are still many tariffs in place on both sides. President Trump has threatened to terminate the agreement if China does not adhere to its terms, and representatives from the two nations are soon set to meet and discuss the progress of the deal.

As a quick recap, the centerpiece of the deal was a commitment by China to buy an additional $200 billion of various goods and services, compared to 2017’s trade levels over the next two years. The target for this year was $137 billion worth of Chinese purchases of specific American goods. But the disruptions to trade that the pandemic has imparted means that China likely will be woefully short of target by the end of the year. Through June, China had purchased only $28 billion worth of these goods, meaning that it will need to average about $18 billion per month between now and the end of the year to meet the agreed-to target. At the high-water mark in 2017, China averaged about $6 billion per month of purchases of these goods.

China accounts for only about 7% of total U.S. exports, but its ability to fulfill its commitment to the Phase One trade deal has implications for our export forecast. If China dramatically accelerates its purchases to meet its previously agreed year-end targets then U.S. exports later this year would be stronger than we currently envision. However, a target miss by China that leads to a re-escalation of trade tensions and a levying of new tariffs or an increase of existing ones would present a significant downside risk to our export outlook for next year.
Conclusion: Exports to Regain Momentum, but COVID-19 in Control

Overall, we look for U.S. exports to gradually regain momentum as the global economy finds its footing in the second half of this year. Specifically, we forecast that real exports of goods and services will rise nearly 9% (not annualized) between their low in Q2-2020 and the end of the year. Even then, real exports at the end of this year would still be 18% below their Q4-2019 level. But we look for recent momentum in exports to carry into next year, and we forecast that exports will grow about 10% between the end of this year and Q4-2021.

That said, the export outlook remains highly dependent on the trajectory of COVID-19. If case counts begin to re-accelerate abroad, and dramatically crimp the economic recovery, we could be looking at a much weaker rebound in U.S. exports than we presently expect. The flip-side scenario is also plausible, where exports rise more than we forecast if the virus spread gets dramatically under control in coming months.
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