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Economics Group

Special Commentary

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Wells Fargo 2017 International Business Indicator

International Business Indicator Jumps To All-Time High

Wells Fargo has been compiling its International Business Indicator (IBI) since 2014. The IBI is a composite indicator that measures the importance of the international component of a company's business as well as its intentions to increase or decrease international activity. The data that were used in the construction of the 2017 index were collected between November 14 and January 24 from 281 U.S.-based businesses that are active internationally. Thus, all the data were collected after the U.S. elections on November 8, 2016. (The complete report can be found at www.wellsfargo.com/indicator).

The index can range from a value of zero, which indicates an absolute negative outlook, to 100, indicating an absolute positive outlook. The IBI shot up from 65 in 2016 to 74 in 2017, which is the highest level recorded in the four-year history of the index (Figure 1). At its current level of 74, the IBI suggests that businesses generally have a sanguine view of overall business conditions over the next 12 months. Indeed, 84 percent of the respondents replied that the overall business outlook over the next 12 months was either "much better" or "somewhat better." Only 50 percent of respondents answered similarly in 2016.

The IBI rose in 2017 to the highest level in its 4-year history.

Figure 1

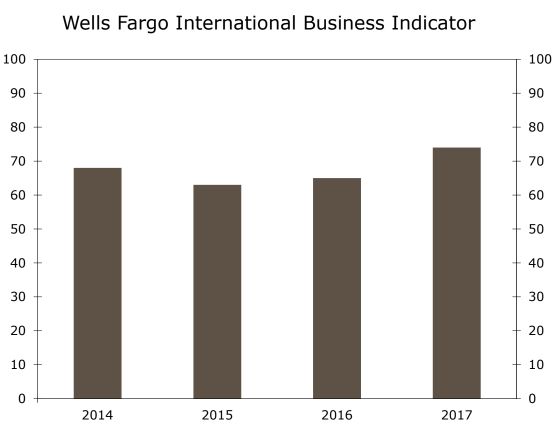
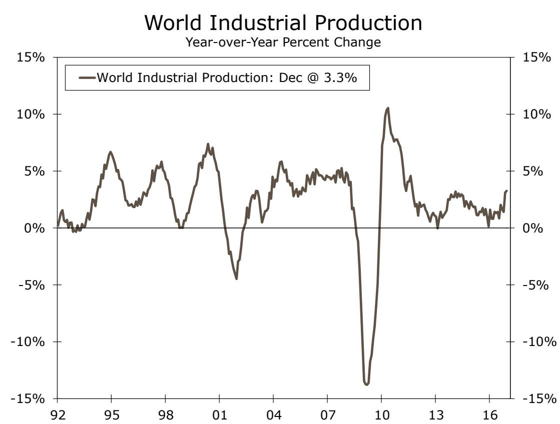


Figure 2



Source: IHS Global Insight and Wells Fargo Securities

The increase in the overall business outlook was attributable in part to more positive views about foreign economies with 72 percent of the survey participants saying that the international business outlook over the next 12 months would be either "much better" or "somewhat better." This increased optimism about the international business outlook is consistent with recent data that show acceleration in global economic activity in recent months. Global industrial production (IP) was up 3.3 percent in December, the strongest year-over-year rate of global IP growth in more than 5 years (Figure 2). Economic activity in China has been decelerating over the past few years, but growth in the world's second largest economy appears to have stabilized in recent quarters. The Eurozone appears to be picking up some steam, and real GDP growth in Canada, America's most important trading partner, has strengthened in recent quarters.

Most companies believe that the international component of their business will become more important to their financial success.

Not only did respondents have more optimistic views of the international business outlook but 81 percent also replied that the international component of their business would become either "much more important" or "somewhat more important" to their company's financial success. Only 54 percent answered similarly last year. A sizeable majority (63 percent) said that the share of their company's profits stemming from international business activity would increase over the next 12 months, and 59 percent look to source more products from overseas. Forty-one percent said that their company's international acquisitions would increase, up sharply from only 18 percent last year. More than 90 percent of the participants either strongly agree or somewhat agree with the statement that "for long-term revenue growth, U.S. companies should consider expanding internationally." There was nearly unanimous agreement that emerging markets represent the greatest opportunity for revenue growth.

Survey participants also had a more optimistic view of the domestic economy with 85 percent replying that U.S. business outlook was either "much better" or "somewhat better." Incoming data show that the U.S. economy generally remains resilient more than seven years after the last recession ended in June 2009. The level of U.S. real GDP at the end of 2016 stood more than 12 percent above its pre-recession peak, and the nation's unemployment rate has fallen to a 9-year low. The Federal Reserve feels confident enough in the economic outlook that it hiked rates in December and again in March. Most analysts look for it to tighten policy further this year.

The results of the recent elections may be playing a role in boosting sentiment.

The results of the recent elections may also be playing a role in boosting sentiment. Eighty-eight percent of the respondents in this survey said that the level of political stability in the United States would have a "very positive" or "somewhat positive" effect on their international business plans, up sharply from only 32 percent last year. The outlook for the regulatory environment in the United States also appears to have lifted spirits as 91 percent said that it would have a "very positive" or "somewhat positive" effect on their international business plans. Last year, only 26 percent responded similarly.

Downside Risk from Change in Trade Policy

In terms of specific foreign countries, China continues to lead the pack as a future growth "hot spot" for survey participants with 41 percent of respondents mentioning the country among their top three choices. (China has been the most frequently mentioned country as a future growth "hot spot" in the past three years.) Canada also garnered 41 percent of the top three choices with Mexico third at 32 percent. Interestingly, these countries seem to be most at risk from a change in U.S. trade policy by the Trump administration.

Respondents are concerned about growing negative attitudes toward trade pacts.

In that regard, survey participants acknowledged the downside risk to their outlooks stemming from a change in trade policy. When asked how concerned they were about the growing negative attitudes toward trade pacts, 72 percent of the respondents replied that they were "somewhat concerned" (Figure 3). The North American Free Trade Agreement (NAFTA) has been in existence for more than 20 years, and 74 percent of the survey participants said that it was either "very important" or "moderately important to their international business (Figure 4). Therefore, a re-write of NAFTA, should it occur, could have meaningful implications for the international business of the companies represented in the survey.

Furthermore, more than 40 percent of survey respondents said that the proposed Trans-Pacific Partnership (TPP), which is a free trade agreement among 12 Pacific Rim countries (including the United States), would be "very important" to their international business while 36 percent replied that it would be "moderately important" (Figure 4). However, the United States withdrew from TPP on January 23, 2017, a day before the survey period for this year's IBI ended. The Transatlantic Trade and Investment Partnership (TTIP), a proposed free trade agreement between the United States and the European Union, was also seen as having a potentially important effect for international business (Figure 4). Unlike TPP, TTIP has not yet been finalized, but the future of the latter is in serious doubt following the American withdraw from the former.

Figure 3

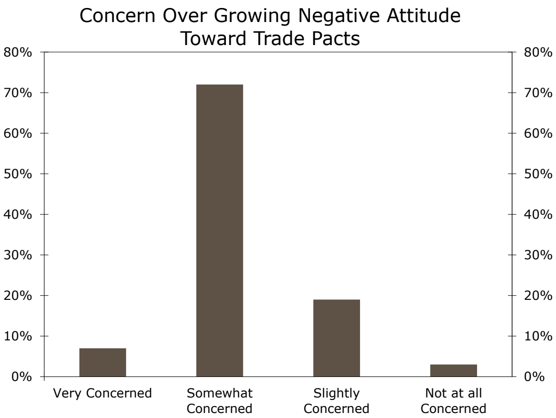
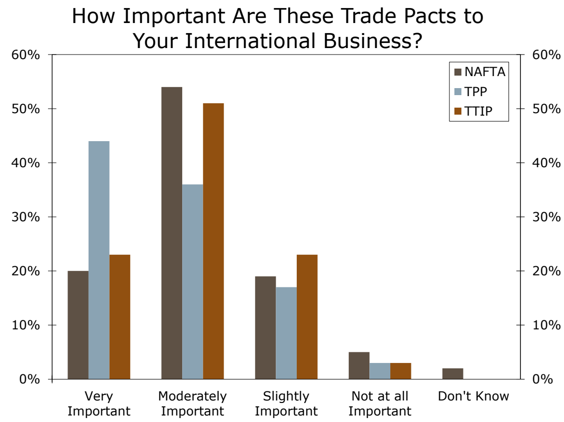


Figure 4



Source: Wells Fargo Securities

Brexit does not seem to be a major concern among most survey participants.

In contrast to the trade pacts noted above, Brexit (i.e., the eventual withdraw of the United Kingdom from the European Union) does not appear to be meaningful for most survey participants. While 33 percent of respondents said that Brexit would have "a great deal of impact" or "somewhat of an impact" on their international business over the next 1 to 2 years, 65 percent said that it would have "not too much of an impact" or "no impact at all" on their international business. When the time frame of Brexit was expanded to 3 years or more, 61 percent still said that it would not have a meaningful impact on their international business. Among respondents who said that Brexit would impact their business, many are taking a wait-and-see approach. That is, roughly one-half of these respondents said that they are either making contingency plans only or waiting for the final exit to change their business strategy.

Conclusion

Participants in the Wells Fargo International Business Indicator survey currently have the most upbeat assessment of their business prospects over the next 12 months than they have had at any time over the past four years. These results span both their domestic and their international business outlooks, and the upbeat assessment that is found in the survey is consistent with other indicators of business confidence in recent months. Not only did respondents have more optimistic views of the international business outlook but they generally believe that the international component of their business would become more important to their company's financial success.

That said, there is evidence from the survey to suggest that the outlook of survey participants could be dented if American trade policy should turn more protectionist. The vast majority of respondents said that they were "very concerned" or "somewhat concerned" by growing negative attitudes toward trade pacts. Furthermore, most participants noted that the proposed TPP would be "very important" or "moderately important" to their international business, but the United States formally withdrew from TPP essentially after the survey had been completed. Overwhelming majorities of participants also noted the importance of NAFTA and the proposed TTIP to their international business. The next round of the survey, which will be conducted later this year and early in 2018, will be important in determining what effect, if any, recent changes in U.S. trade policy are having on the outlook for international business.

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