Euler Hermes Economic Research

Country Report

United States

Growth to continue below trend as consumer lags

General Information

GDP	USD17.4bn (World Ranking 1, World Bank 2014)
Population	319mn (World Ranking 3, World Bank 2014)
Form of state	Federal Republic
Head of government	Barack Obama (Democrat)
Next elections	2016 Presidential, Congressional, Gubernatorial

Strengths

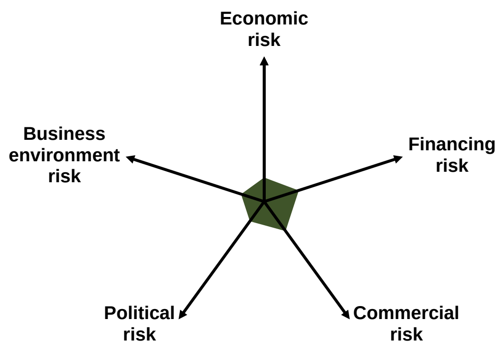
- World's largest economy
- Politically stable
- High per capita GDP
- Low unit labor costs
- High data transparency
- Reserve currency
- Large oil and gas reserves
- Diverse GDP
- Strong dollar lowering inflation, interest rates

Weaknesses

- High public debt, persistent budget deficits
- Persistent trade and current account deficits
- Structural unemployment
- High corporate tax rate
- Tightening monetary policy
- Bloated Federal Reserve balance sheet
- Erratic housing market
- Uptick in bankruptcies and tighter lending conditions
- Strong dollar widening persistent trade deficit

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Canada	17%	1	19%	China
Mexico	13%	2	16%	Canada
China	9%	3	13%	Mexico
Japan	5%	4	6%	Japan
Germany	4%	5	5%	Germany

By product (% of total)

Exports		Rank		Imports
Refined Petroleum Products	10%	1	13%	Crude Oil
Engines	9%	2	7%	Cars And Cycles
Precision Instruments	5%	3	5%	Computer Equipment
Plastic Articles	4%	4	5%	Telecommunications Equipment
Pharmaceuticals	4%	5	4%	Refined Petroleum Products

Source: Chelem (2013)

Economic Overview

Continued slow growth

2015 turned out to be yet another year of disappointing growth dragged down by a negative first quarter, sputtering consumption, a slump in manufacturing, slowing exports and large inventory builds. For 2016 we expect to see continued slow growth as the strong dollar will continue to weigh on net exports, manufacturing is unlikely to return to strong growth, and most importantly consumption is likely to remain below trend. Currently consumers have strong tailwinds yet are not spending as much as one would expect. Consumer confidence is hovering around 100 which is typical of a strong economy, energy prices are continuing to fall, and real disposable personal income is growing at a rapid +3.9% y/y pace. Yet despite these positives, consumption is lagging at +2.7% y/y with the difference going largely to increased savings. Since the current combination of positives is unlikely to improve significantly, it's also unlikely that consumption will outperform in 2016. As a result we forecast +3.0% growth in consumption for all of 2016.

Key economic forecasts

U.S.		share	2014	2015	2016	2017
GDP		*100%*	**2.4**	**2.5**	**2.5**	**2.4**
Consumer Spending		*68%*	**2.7**	**3.1**	**3.0**	**2.6**
Public Spending		*18%*	**-0.6**	**0.8**	**1.7**	**1.6**
Investment		*17%*	**5.3**	**4.2**	**3.4**	**2.8**
Construction		*3%*	**1.8**	**8.5**	**5.8**	**2.4**
Equipment		*13%*	**6.2**	**3.1**	**2.9**	**2.9**
Stocks	*	*0%*	**0.0**	**0.1**	**-0.1**	**0.0**
Exports		*13%*	**3.4**	**1.4**	**3.3**	**4.3**
Imports		*16%*	**3.8**	**5.2**	**4.1**	**4.0**
Net exports	*	*-3%*	**-0.2**	**-0.6**	**-0.2**	**-0.1**
Current account	**		**-390**	**-448**	**-420**	**-607**
Current account (% of GDP)			*-2.2*	*-2.5*	*-2.2*	*-3.1*
Employment			**1.6**	**1.7**	**1.2**	**1.2**
Unemployment rate	***		**6.2**	**5.3**	**4.6**	**3.9**
Wages			**2.3**	**1.8**	**2.3**	**2.6**
Inflation			**1.5**	**0.2**	**1.4**	**1.9**
General government balance	**		**-488**	**-539**	**-655**	**-489**
General government balance (% of GDP)			*-2.8*	*-3.0*	*-3.5*	*-2.5*
Public debt (% of GDP)			*104.6*	*104.8*	*104.9*	*103.7*
Nominal GDP	**		17,348	17,961	18,726	19,547

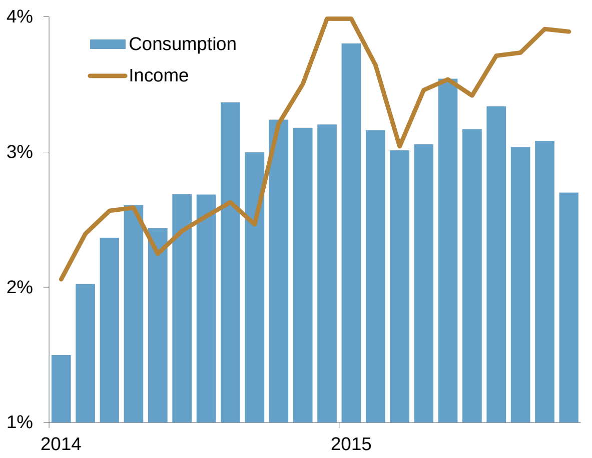
Change over the period, unless otherwise indicated: * contribution to GDP growth
** USD billions; *** Yearly average

Sources: National sources, IHS, Euler Hermes

Inflation held down by energy

The sharp fall in energy prices has driven headline inflation as represented by the Personal Consumption Expenditures (PCE) index down to only 0.2% y/y, but the core is running at 1.3% y/y, still well below the Fed's 2% target. However the Fed is anticipating that energy prices will bottom in 2016, thereafter creating a base effect which will induce inflation, at least in energy, with hopes that it will spread throughout the economy and justify their tightening decision. Wage inflation continues to hover around 2.2% y/y, and as the labor market tightens, the Fed will also be looking here for a boost to inflationary pressures.

Consumption and income growth (y/y%)

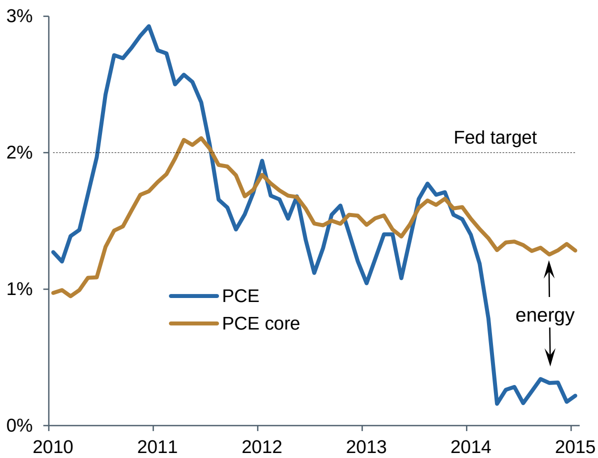


Sources: BEA, IHS, Euler Hermes

Public finances

A tentative budget agreement was reached in October which would lift some spending caps, increase spending by USD80bn over the next two years, and suspend the debt ceiling until 2017. It was a bi-partisan accord, but as the actual legislation to enact the spending is approached in December, partisan politics has re-emerged putting the agreement at risk, and perhaps pushing the vote into 2016. As usual the plan has no significant entitlement reform and results in a gross debt/GDP ratio continuing out at virtually 100% for the next ten years. The failure to address entitlement spending has led to forecasts from government actuaries that Medicare, the national health insurance program for those over 65, will no longer be able to pay all of its claims by 2030, and the Social Security program will face the same dilemma in 2034.

Fed Funds target rate (%), PCE and PCE core inflation (y/y%)

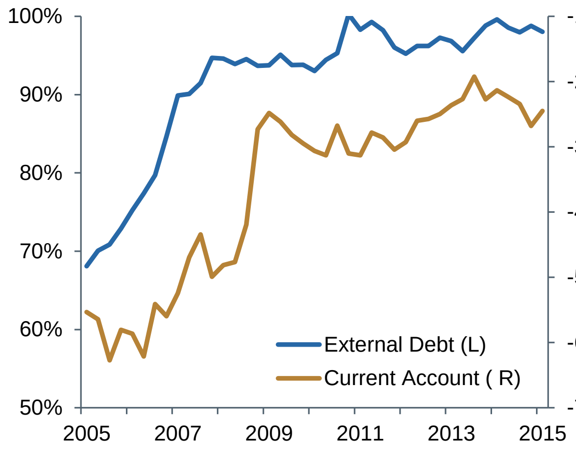


Sources: BEA, Fed, IHS, Euler Hermes

Current account deficit and external debt

The U.S. has run a virtually uninterrupted string of trade deficits, and as a result, current account deficits since 1983. The current account deficit as a percentage of GDP shrank to -1.9% in Q4-14, the smallest in 16 years. However over the past five quarters is has opened back up to -2.4% as a combination of a weak global economy and a strong U.S. dollar have pressured exports. As Federal Reserve policies diverge from most of the world's other central banks, it is expected that the U.S. dollar will remain at elevated levels and continue to weigh on exports and therefore on the current account deficit as well. As a result the expected rise in the current account deficit will require continued financing. However relatively high real interest rates, the strength of the U.S. dollar and of the U.S. economy in general should facilitate debt financing.

Current account and external debt (% of GDP)

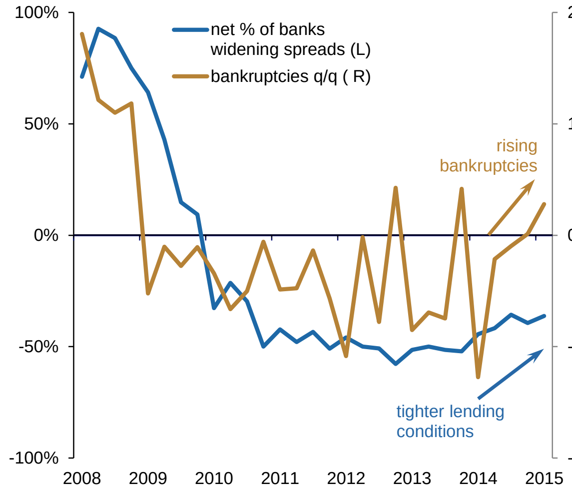


Sources: BIS, BEA, IHS, Euler Hermes

Other risks

There are several risks to the forecasts. Business bankruptcy filings rose +2.8% q/q in Q3-15 after inching up 0.1% in Q2. It was the first time bankruptcy filings have increased for two consecutive quarters since the end of the recession six years ago. Bankruptcies have fallen ever since the end of the recession and reached an historic low in Q1-15 (outside of a distortion due to a change in bankruptcy law in 2005), leading to sustainability questions. Bank lending conditions are highly correlated to bankruptcy filings and we expect to see conditions continue to tighten as the Fed raises rates. Euler Hermes proprietary Payment Behavior Index (PBI) showed a similar increase in slow payment in Q3. Other risks include holiday sales which are expected to underperform last year, a continued slump in manufacturing caused by low energy prices and the strong dollar, and the beginning of the first Fed tightening cycle in over 11 years which could have adverse effects on the financial markets.

Bankruptcies (%y/y) and lending conditions



Sources: National sources, IHS, Euler Hermes

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