Country report

UNITED STATES OF AMERICA

Summary

The US economic recovery is expected to continue this and next year, but is very dependent on continued fiscal and monetary stimulus. As a result of the further fiscal stimulus, the budget deficit is set to increase this year relative to 2010. Meanwhile, political decision making is hampered by the Republican majority in the House of Representatives that Democratic president Obama faces. Apart from current high budget deficits, the medium term challenge of reducing age related spending is big too. Given continued budget deficits in the years to come, the current account deficit is expected to remain sizeable. As such, with continued dependence on foreign financing a disorderly adjustment of the value of the US dollar, a sharp rise in interest rates and a quick reversal of the current account deficit remain key risks.

Things to watch:

- Government deficit and debt reduction, political efficacy
- Current account developments, further build up of dependence on foreign finance
- Extended period of low interest rates possibly leading to asset price bubbles and inflation

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United States of America

National facts	
Type of government	Federal Republic
Capital	Washington, DC
Surface area (thousand sq km)	9,826.675
Population (millions)	306.8
Main languages	English (82.1%)
	Spanish (10.7%)
Main religions	Protestant (51.2%)
	Roman Catholic (23.9%)
Head of State (president)	Barack H. Obama
Head of Government	Barack H. Obama
Monetary unit	USD

Economy 2010		
Economic size	*bn USD*	*% world total*
Nominal GDP	14658	23.51
Nominal GDP at PPP	14658	19.80
Export value of goods and services	1833	9.87
IMF quotum (in mln SDR)	37149	17.09
Economic structure	*2010*	*5-year av.*
Real GDP growth	2.8	1.0
Agriculture (% of GDP)	1	1
Industry (% of GDP)	22	23
Services (% of GDP)	77	76
Standards of living	*USD*	*% world av.*
Nominal GDP per head	47345	481
Nominal GDP per head at PPP	47345	405
Real GDP per head	42783	534

Social and governance indicators	rank / total
Human Development Index (rank)	4 / 169
Ease of doing business (rank)	5 / 183
Economic freedom index (rank)	9 / 179
Corruption perceptions index (rank)	22 / 178
Press freedom index (rank)	20 / 178
Gini index (income distribution)	40.8

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
Canada	19	China	20
Mexico	12	Canada	15
China	7	Mexico	11
Japan	5	Japan	6

Main export products (%)	
Capital goods (excl automotive)	37
Industrial supplies & materials	28
Consumer goods (non-food), excl automotive	14
Automotive vehicles, engines & parts	8
Main import products (%)	
Industrial supplies & materials	30
Consumer goods (non-food), excl automotive	27
Capital goods (excl automotive)	24
Automotive vehicles, engines & parts	10
Openness of the economy	
Export value of G&S (% of GDP)	11
Import value of G&S (% of GDP)	14
Inward FDI (% of GDP)	24.9

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economy on the mend

After having fallen 4% peak-to-trough during recession, US GDP has steadily improved since the second quarter of 2009 and regained pre-recession GDP by the end of 2010. But although GDP is back to its pre-recession level, employment growth has by no means been strong enough to make up for the job losses incurred. Of the 8¾ million jobs lost in recession only about 1½ million have been regained by March 2011. Job growth coupled with a stagnating labour force did lead to a fall in the unemployment rate since late 2010. But at 8.8% it is still almost double the 4.5% pre-recession low point. Although the wider economy is recovering and this is now also feeding through into the labour market, the housing market is still in the doldrums. Home sales are still at very low levels, foreclosures still very high and excess supply of housing remains large. House prices resumed their downward path in the second half of 2010, with the Case-Shiller national index reaching a new low point in the fourth quarter at 31.4% below the early 2006 level. Falling housing wealth is depressing consumption. Meanwhile, negative equity (house price below the value of the mortgage) is reducing labour mobility, thereby keeping unemployment relatively high. As such, the US economy is clearly still coping with the fallout of the housing market bust.

Dependence on policy support

We forecast economic growth of 3% in 2011 and 3¼% in 2012 (EIU estimates in the table below are a bit softer). This is in large part due to continued support from both monetary and fiscal policy. The Federal reserve bank is expected to keep the policy interest rate at the current record low throughout 2011 and is still in the process of quantitative easing with the aim of keeping down capital market interest rates. The government decided to extend a number of Bush-era tax breaks and to lower payroll taxes. As a result, the budget deficit is set to increase to about 10% this year, compared to 9% in 2010. This is in sharp contrast to developments in Europe, where all governments are bringing down their budget deficits.

Politics on the edge

Although the federal debt forecast for 2011 at 69% of GDP is low compared to both the UK and the euro zone average for general government gross debt (83.5% and 86.5% respectively), the general government debt for the US as reported by the IMF is expected to be 97.2% this year. Together with the high budget deficit this makes the current state of government finances very weak. And although the deficit is set to decrease in the years ahead, the proposed budget for fiscal year 2011/12 would bring the deficit down only to 7% in that year. Meanwhile, the political setup of a Democratic president and Senate Majority but a Republican majority in the House of Representatives makes passing budget bills a tough job. Democrats are reluctant to cut spending and Republicans oppose higher taxes, a toxic combination for the health of government finances. On April 8th, a partial shutdown of government services was avoided at the last hour, when agreement was reached on further cuts in spending for *this year's* budget (fiscal year 2010/2011, running from October 2010). The government still needs approval for a higher debt limit in the coming months to avoid having to default on its debt. So the political turmoil is expected to continue. Although a shutdown of government services cannot be ruled out (it last happened in 1995/1996 under President Clinton), we do not expect the US government to run into a serious debt default. Meanwhile, apart from the current budgets the US government also faces a medium term challenge in bringing down the costs of age-related spending. Although some progress on this front seems to be made, getting both parties to agree on a credible package will be equally hard.

Continued twin deficit

A combination of higher savings and lower investment has pushed the private sector (households, corporations, financial institutions) from being net borrowers to being net lenders. Unfortunately, the government has simultaneously become a bigger net borrower. For the country as a whole, the impact of renewed private sector net lending has been dominant, leading to a lower borrowing requirement from the rest of the world. This is visible in the sharp correction of the current account deficit, from 6% of GDP in 2006 to 3.2% of GDP in 2010. Even so, the situation of twin deficits (both a current account deficit and a government deficit) remains, and is expected to extend into the foreseeable future. The government deficit is expected to fall only gradually in the coming years. At the same time, with private investment recovering, private sector net lending capacity will fall. As a result, the current account deficit is expected to remain sizeable, although not as big as before recession. As such, the country as a whole will remain dependent on foreign financing. Despite the steep rise in borrowing, treasury yields are still low, with the 10-year rate below 4% and the 2-year rate below 1%. The US government is still benefitting from the special role of the US dollar in global financial markets, with US government debt still the world risk-free benchmark and the main safe haven in times of crisis. However, the extended period of low interest rates seen up until now can, if not managed correctly, potentially lead to inflation or inflated asset prices. A loss of confidence in the US economy and the US dollar can push up interest rates, which would lover potential economic growth. Though not our baseline expectation, the state of US public finances and the political stalemate has the potential to undermine global investor confidence. The recent assignment of a negative outlook on the AAA credit rating on US bonds is testimony to a slight shift in sentiment. With the continued existence of the current account deficit, a disorderly depreciation of the dollar and a quick current account reversal remains a key risk.

United States

Selection of economic indicators	2006	2007	2008	2009	2010	2011f	2012f
Key country risk indicators							
GDP (% real change pa)	2.7	1.9	0.0	-2.6	2.8	2.9	2.5
Consumer prices (average % change pa)	3.2	2.9	3.8	-0.3	1.6	2.1	1.9
Current account balance (% of GDP)	-6.0	-5.1	-4.7	-2.7	-3.3	-4.1	-3.9
Economic growth							
GDP (% real change pa)	2.7	1.9	0.0	-2.6	2.8	2.9	2.5
Gross fixed investment (% real change pa), SA	2.3	-1.8	-6.4	-18.3	3.8	6.0	5.3
Private consumption (real % change pa), SA	2.9	2.4	-0.3	-1.2	1.8	3.3	2.7
Government consumption (% real change pa), SA	1.4	1.3	2.8	1.6	1.0	0.8	0.9
Exports of G&S (% real change pa), SA	9.0	9.3	6.0	-9.5	11.8	6.6	6.5
Imports of G&S (% real change pa), SA	6.1	2.7	-2.6	-13.8	12.7	6.4	5.9
Economic policy							
Budget balance (% of GDP)	-1.9	-1.2	-3.2	-10.0	-8.9	-9.9	-7.6
Public debt (% of GDP)	37	36	38	54	62	69	72
Money market interest rate (%)	5.0	5.0	2.1	0.3	0.2	0.3	0.7
M2 growth (% change pa)	6	6	10	3	4	5	5
Consumer prices (average % change pa)	3.2	2.9	3.8	-0.3	1.6	2.1	1.9
Exchange rate LCU to USD (average)	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Recorded unemployment (%)	4.6	4.6	5.8	9.3	9.6	8.6	8.0
Balance of payments (mln USD)							
Current account balance	-802637	-718094	-668856	-378434	-488700	-626300	-623300
Trade balance	-839456	-823191	-834652	-506944	-645100	-760800	-765000
Export value of goods	1035868	1160366	1304896	1068499	1290600	1487100	1606600
Import value of goods	1875300	1983600	2139500	1575400	1936000	2248000	2372000
Services balance	80215	121092	135851	132035	148900	154500	161400
Income balance	48085	99555	151973	121420	137200	115800	122700
Transfer balance	-91481	-115550	-122028	-124945	-129700	-135800	-142500
Net direct investment flows	12916	-107190	4316	-90560	-53600	-48230	-19410
Net portfolio investment flows	NA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
External position (mln USD)							
Total foreign exchange reserves	55000	59524	66607	119719	n.a.	n.a.	n.a.
International investment position	-2191700	-1915700	-3493900	-2737800	n.a.	n.a.	n.a.
Total assets	14428100	18339900	19244900	18379100	n.a.	n.a.	n.a.
Total liabilities	16619800	20255600	22738800	21116900	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-6.3	-5.9	-5.8	-3.6	-4.4	-5.0	-4.8
Current account balance (% of GDP)	-6.0	-5.1	-4.7	-2.7	-3.3	-4.1	-3.9
Inward FDI (% of GDP)	1.8	1.9	2.2	0.9	1.2	1.4	1.5
International investment position (% of GDP)	-16.4	-13.6	-24.3	-19.4	n.a.	n.a.	n.a.

Source: EIU