Euler Hermes Economic Research

Country Report

United States

Warming up

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Executive summary

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- Q1 GDP data were severely affected by the cold winter, implying economic growth should not exceed 1.9% in 2014. We expect GDP growth to get close to potential only in 2015 (+2.9%), thanks to stronger domestic demand.
- Monetary policy will remain accommodative until 2015 (short-term rates at 0%), especially given that good employment data mask underlying difficulties in the labour market (unemployment dropped to 6.3% in April but mostly due to falling participation rate).
- Manufacturing sector will continue to improve despite the freeze in activity caused by the severe winter, but the housing market remains at risk as suggesting by the deteriorating advanced indicators.

Severe winter sharply dragged down GDP growth in Q1 2014

After reaching +1.9% in 2013, GDP growth dropped to -2.9% q/q AR in Q1, a consequence of the unusually cold winter. The main drags on economic activity were investment, which fell by -4.2% (mainly due to construction) and external trade (exports declined by -8.9% and imports grew by +1.8%). Private consumption, the main driver of growth in the US, slowed down to +1%.

A spring rebound is expected, but economic growth will remain below potential

Disappointing data in Q1 led us to revise our forecasts down and we now expect GDP growth to reach +1.9% in 2014 (versus +2.8% previously). Economic activity should mainly be driven by private consumption as suggested by the improving household situation (decreasing unemployment, higher income, improved consumer confidence). In 2015, strong domestic demand should allow GDP growth to reach +2.9%.

Monetary policy: tapering is not tightening

In January 2014, the Fed started to taper its asset purchase program which will end completely by

Table 1: Key economic forecasts

USA		share	2012	2013	2014	2015
GDP		100%	2.8	1.9	1.9	2.9
Consumer Spending		68%	2.2	2.0	2.3	2.8
Public Spending		19%	-1.0	-2.2	-0.9	0.8
Investment		15%	8.3	4.5	3.9	5.4
Construction		3%	12.9	12.2	3.2	6.4
Equipment		12%	7.3	2.7	4.1	5.2
Stocks	*	0%	0.2	0.1	0.0	0.1
Exports		13%	3.5	2.7	3.2	6.1
Imports		15%	2.2	1.4	3.9	6.1
Net exports	*	-3%	0.1	0.1	-0.2	-0.2
Current account	**		-461	-400	-459	-468
Current account (% of GDP)			-2.8	-2.4	-2.6	-2.6
Employment			1.8	1.0	1.4	0.7
Unemployment rate			8.1	7.4	6.5	6.8
Wages			1.5	2.0	2.4	2.5
Inflation			2.0	1.5	1.7	1.9
General government bala	**		-1061	-560	-555	-545
General government balance (% of GDP)			-6.5	-3.3	-3.2	-3.0
Public debt (% of GDP)			101.2	103.3	104.1	103.2
Nominal GDP	**		16 245	16 800	17 349	18 162

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

Sources: National statistics, Euler Hermes

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end-2014. However, the Fed will still be buying securities and will likely maintain short-term rates at 0% through 2015. Therefore, monetary policy remains accommodative and should continue to prop up business activity for a while. Two potential downsides are a strengthening dollar which could harm export competitiveness, and the rise in interest rates which have slowed the housing market recovery.

Housing is still at risk

As soon as Fed alluded to QE tapering (May 2013), mortgage rates climbed rapidly, driving down housing affordability. The severe winter accentuated the downside risks weighing on the housing market, as shown by the deterioration of most of the advanced indicators: home builder confidence (NAHB index) dropped from 56 in January to 45 in May, and y/y sales of existing and new homes are down 6.8% and 4.2% respectively. Moreover, higher mortgage rates, rising prices and tight inventories are conditions which cannot be easily cured by improving spring weather.

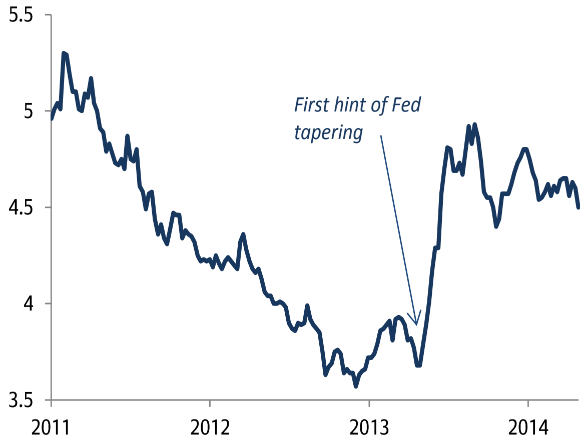
Improving labor market, but some difficulties remain

The labor market has shown significant improvement in the past few months: the unemployment rate dropped from 7.9% in early 2013 to 6.3% in April 2014 and the economy created around 200k jobs per month on average since early 2013.But these positive figures must be put into perspective especially in regard to the evolution of the participation rate: it has continuously decreased since 2008, largely explaining the fall in the unemployment rate.

Re-industrialization of the US is right on track

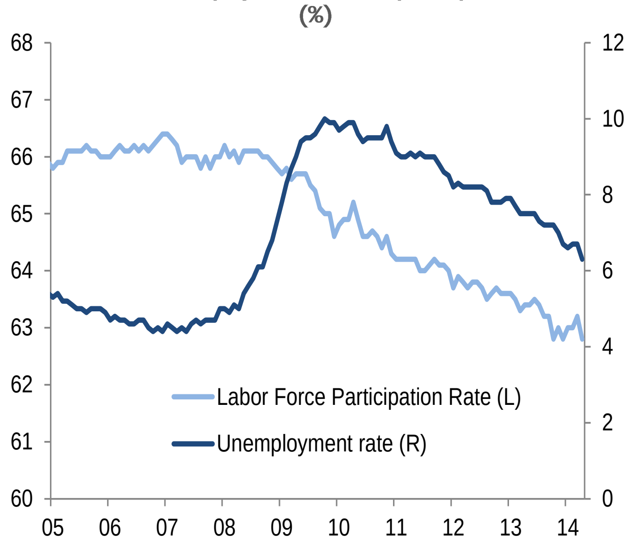
The manufacturing sector has benefited from low labor cost compared to other industrialized countries and cheap energy thanks to shale gas extraction and the ongoing business "reshoring" is likely to continue. After a drop in January due to the cold winter, advanced indicators for the manufacturing sector all improved during the following months. The ISM Manufacturing Index reached 55.4 in May (gaining 4.1 points since January) and the new order index rose to 56.9 (from 51.2 in January); industrial production increased by +2.4% y/y in Q1. Moreover, Fed tapering may drive up long-term rates (increasing the spread between long and short-term rates), which would increase bank lending profits. Therefore, banks may be more likely to ease credit conditions, providing a further boost to industry and the entire economy.

Chart 1: 30-year mortgage rate (%)



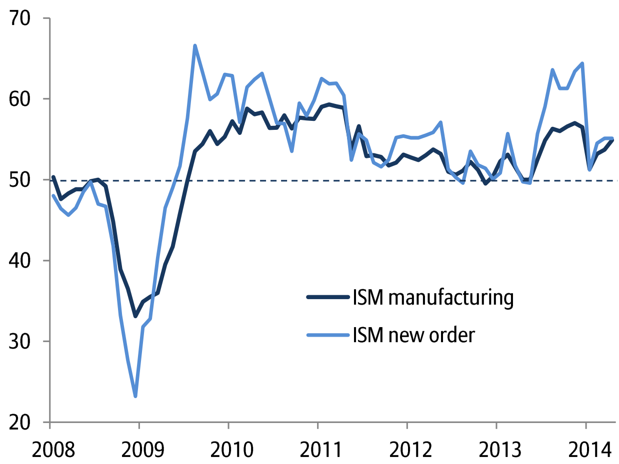
Sources: Bloomberg, Euler Hermes

Chart 2: Unemployment rate and participation rate (%)



Sources: IHS Global insight, Euler Hermes

Chart 3: ISM Index (manufacturing and new order)



Sources: IHS Global insight, Euler Hermes

General Information

GDP	USD16800Bn (World ranking 1, 2013)
Population	313.91 million (World ranking 3, World Bank 2012)
Form of state	Federal Republic
Head of government	Barack H. Obama (Democratic party)
Next elections	2014 Congressional, 2016 Presidential

Strengths

- High-income economy, strong domestic market
- Flexibility of the labour market
- International role of the dollar
- Decreasing energy cost and decreasing energy dependence
- Improving productivity
- Low labour cost compared to others industrialized countries
- Reactive and credible monetary authorities

Weaknesses

- High structural unemployment
- Declining participation rate in the labour market
- High public debt
- Weak confidence
- Housing market at risk
- Political uncertainties

Trade structure

By destination / origin

Exports		Rank		Imports
Canada	17%	1	17%	China
Mexico	12%	2	14%	Canada
China	8%	3	12%	Mexico
Japan	5%	4	6%	Japan
Germany	4%	5	5%	Germany

By product

Exports		Rank		Imports
N.E.S. Products	9%	1	16%	Crude Oil
Refined Petroleum Products	8%	2	6%	Cars And Cycles
Engines	5%	3	5%	Computer Equipment
Precision Instruments	4%	4	5%	Telecommunications Equipment
Plastic Articles	4%	5	4%	Refined Petroleum Products

Source: Chelem

Risk Dimensions

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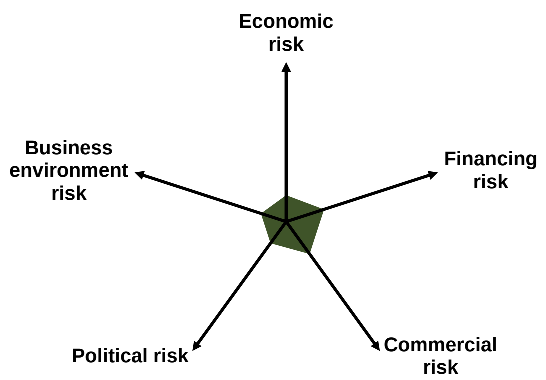

Source: Euler Hermes

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