Euler Hermes Economic Research

Country Report

United States

A Recipe for Continued Moderate Growth

General Information

GDP	USD18,037bn (World ranking 1, World Bank 2015)
Population	321mn (World Ranking 3, World Bank 2015)
Form of state	Federal Republic
Head of government	Donald Trump (Republican)
Next elections	2018 Congressional, Gubernatorial

Strengths

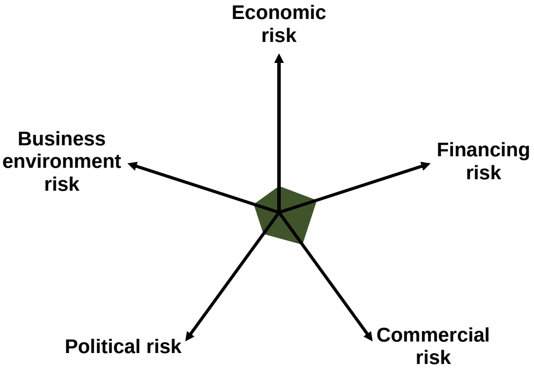
- World's largest economy
- Effective governmental checks and balances
- High per capita GDP
- Relatively low unit labor costs
- High data transparency
- Reserve currency
- Large oil and gas reserves
- Diverse GDP
- Strong dollar (lowers inflation, interest rates)

Weaknesses

- Political polarization, stagnation
- Structural unemployment
- Lack of skilled workers
- Low productivity
- High corporate tax rate
- High public debt, persistent budget deficits
- Soaring amount of, and defaults on, student loans
- Bloated Federal Reserve balance sheet
- Strong dollar (widens persistent trade deficit)

Country Rating

AA1



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
Canada	17%	1	21%	China
Mexico	14%	2	14%	Mexico
China	9%	3	13%	Canada
Japan	5%	4	6%	Japan
Germany	4%	5	6%	Germany

By product (% of total)

Exports		Rank		Imports
Refined Petroleum	6%	1	8%	Cars And Cycles
Engines	5%	2	6%	Crude Oil
Pharmaceuticals	4%	3	6%	Telecom Equip.
Plastic Articles	4%	4	5%	Computer Equip.
Precision Instruments	4%	5	4%	Electrical Apparatus

Source: Chelem

Economic Overview

Disappointment over Trump agenda

President Trump entered the White House with a pro-growth agenda of tax cuts, health care reform, increased spending, trade reform, and regulatory relief. As a result equity prices soared after the elections and well into the first months of this year on optimism that Trump's pro-growth policies will be implemented. Instead, much of Trump's agenda has been blocked in Congress by both Democrats and groups of Republicans. Perhaps most importantly for fiscal stimulus, major tax reform is now at risk for implementation in 2018. Other major initiatives have also stalled, although spending will increase in FY 2018. Equity prices have continued to increase on optimism that the agenda will succeed. However bond market prices have now become skeptical, and as a result, long-term yields and the yield spread have fallen to pre-election levels, reflecting lowered expectations for growth.

While (oil-related) investment spending is rebounding, the consumer remains muted despite professing great confidence. Real consumption growth will likely be somewhat lower this year than in 2016 since uncertainty in Washington is increasing, real disposable income growth is dampened by the pickup in inflation, and consumer credit growth remains well below average.

Thus, we expect GDP growth to be only 2.2% in 2017 and 2.3% in 2018, about the average rate during this recovery which has been slow historically

The Fed will continue to tighten

The Fed will continue to raise interest rates driven by an unemployment rate which is low and rapidly falling, the resulting higher inflation in the future, and the desire to normalize rates. We expect the Fed is most likely to raise interest rates a total of three times in 2017 to between 1.25% and 1.50%, still historically low, and in 2018 we expect another 2-3 hikes which would put the Fed Funds rate as high as 2.25%. While averages can be deceiving, the average Fed Funds rate since WWII has been 4.9%, and has been as high as 19%. In addition to raising rates, the Fed will start gradually reducing the size of its balance sheet which will also pressure long-term rates higher. However since monetary policy actions take 3-5 quarters to have full effect we do not expect Fed tightening to significantly affect the real economy in 2017 although some dampening effect could result in 2018.

Insolvencies to rise

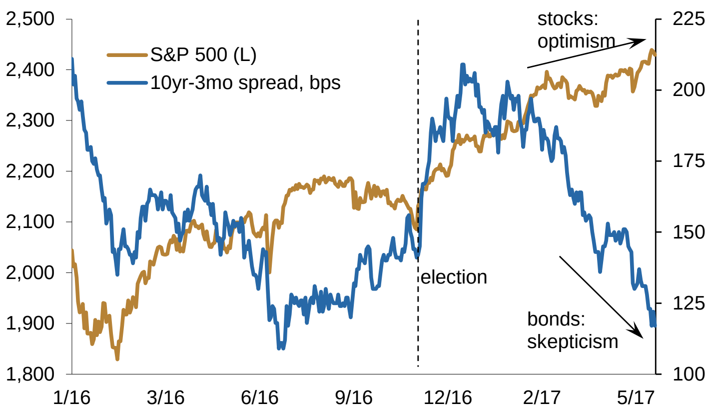
Business exuberance in the stock market has also spilled over into small and medium enterprises (SME's), as seen in the NFIB survey, where the percentage of respondents saying now is a good time to expand leapt a record amount after the election and has stayed there. Unfortunately when SME's expand too rapidly, they sell more goods every month but fail to collect outstanding receivables fast enough, so cash flow goes negative and insolvency results. Insolvencies also rise when long-term rates rise, which could result from the Fed's balance sheet reduction and future inflation. Therefore we expect business insolvencies to rise 5% in 2017.

Figure 1: Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	2.6%	1.6%	2.2%	2.3%
Inflation (%, end year)	0.1%	1.3%	2.2%	2.5%
Fiscal balance (% of GDP)	-2.5%	-3.2%	-3.2%	-4.3%
Public debt (% of GDP)	104.9%	105.8%	105.4%	105.6%
Current account (% of GDP)	-2.6%	-2.6%	-2.9%	-3.2%

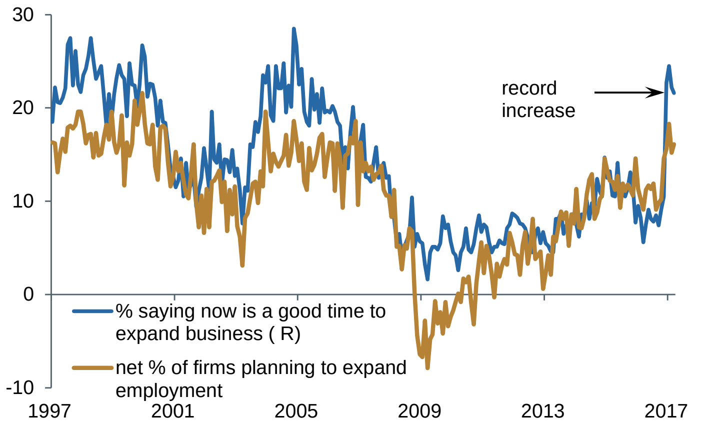
Sources: IHS, national sources, Euler Hermes

Figure 2: Stock and Bond Market Reactions



Sources: IHS, S&P, Federal Reserve, Euler Hermes

Figure 3 : National Federation of Independent Business (NFIB) Survey



Sources: IHS, National Federation of Independent Business, Euler Hermes

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