INTERNATIONAL GROUP OF RATING AGENCIES
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Research Report on United States of America

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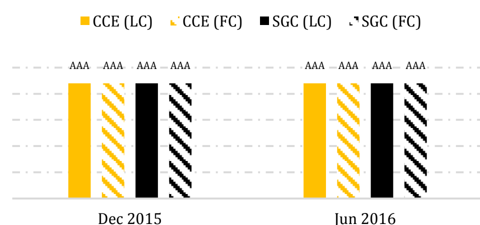
Ratings

Sovereign Government Credit (LC)	AAA
Sovereign Government Credit (FC)	AAA
Country Credit Environment (LC)	AAA
Country Credit Environment (FC)	AAA

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of the United States

Macro indicators	2013	2014	2015
Gross gov. debt, USD bn	17463	18211	18993
Nominal GDP, USD bn	16663	17348	17947
Real GDP growth, %	1,5	2,4	2,4
Gross gov. debt/GDP, %	104,8	105,0	105,8
Deficit (surplus)/GDP, %	-4,4	-4,1	-3,7
Inflation rate, %	1,3	0,6	0,8
Current Account Balance/GDP, %	-	-	-2,7
External debt, USD bn	-	-	48,9

Development indicators	2015
Inequality adj. HDI	0,76
GDP per capita, USD th	55,8

Default indicator	03.06.2016
5-Year CDS spread, Bp	20
10Y Gov Bond Yield, %	1,8

Source: RAEX (Europe) calculations based on data from the IMF, WB, UN

Summary

The ratings of the USA were confirmed at 'AAA' level reflecting the country's advanced and diversified economy, as well as the global reserve status of the USD and the international importance of the US financial markets. Macroeconomic fundamentals remain favorable for the country and we expect this trend to remain in the mid and long run.

The high and increasing loads of government and private debt present one of the major risks for the United States. Fiscal deficit narrowed in 2015 and we expect it to keep improving in the short term. However risks can arise from newly elected administration policies, such as medical care and defense.

The US financial markets keep showing a strong position despite banks' meager profitability. Full normalization of the monetary policy is still overdue, but a hike in the interest rates is likely to materialize in the mid run. This would ultimately improve banks' profits.

Favorable macroeconomic position. The US macroeconomic metrics kept improving during 1Q 2016 as real GDP grew by 1,9% and inflation slightly increased but remained low at 0,9% annually, while unemployment stood at 5%. The Agency expects real GDP growth to close 2016 around 2,4% driven by still low energy prices and low interest rates environment in the short run.

The output gap[1] narrowed by 2% in 2015 (as percentage of potential output) and is expected to decline by another 2% by end 2016 according to the Fed's forecasts. This, combined with higher inflation rates, will drive a hike in the interest rates.

Strong stance of the financial system. The prolonged low interest rate environment combined with fears of a global slowdown halted the profitability of the US banking system. The sector has reported a weak average quarterly ROA of around 1% since 1Q 2012 and we expect this trend to remain in the mid run. However, a potential increase in the interest rates and a recovery of global economic conditions are likely to improve bank's profitability in the long run.

[1] The output gap is the difference between actual GDP or actual output and potential GDP. A positive (negative) difference is called an inflationary gap and indicates that the growth of aggregate demand is outpacing (lags) the growth of aggregate supply, possibly creating inflation (deflation).

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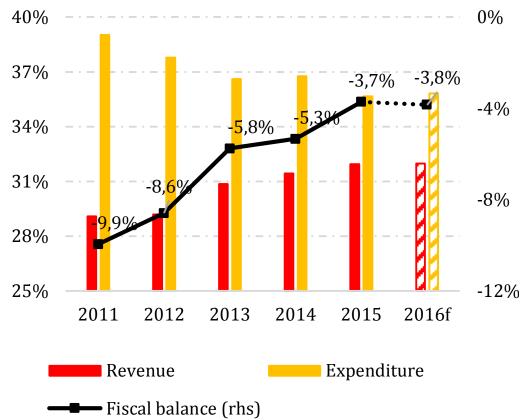
Private credit kept recovering after the 2008 financial crisis, but current figures at 248% of GDP could be showing signs of overleveraging in the private sector and could potentially become a risk for the economy in the long run. Non-performing loans at 1,8% of total loans portfolio, remain low and continue to decline. Average capital adequacy ratio, while declining, was at 11,6% in 2015 and remains above the 8% threshold required by Basel III.

Graph 1: US Fiscal balance, % GDP



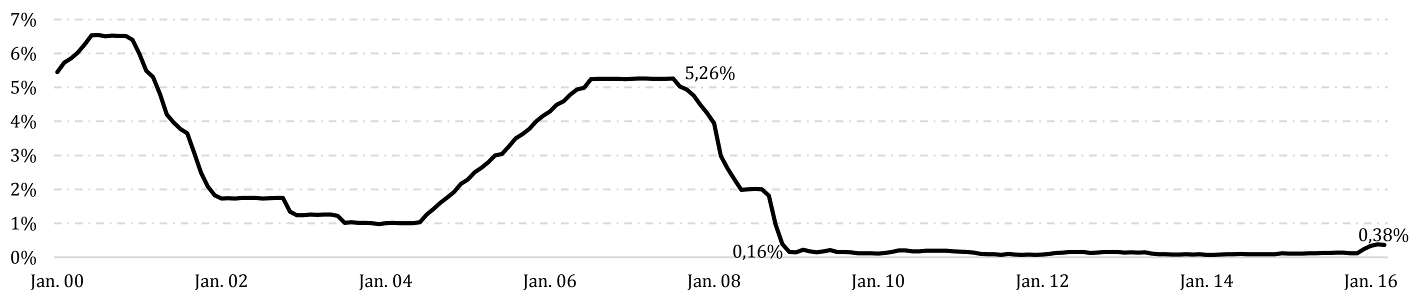
Source: RAEX (Europe) calculations based on data from the IMF

Fueled by global unpredictable macro conditions and low commodity prices, the US stock market had a period of high volatility between 3Q 2015 and 1Q 2016. However, the sector remains strong with market capitalization of listed companies at 140% of GDP in 2015.

Improving fiscal performance. The US fiscal deficit continued narrowing as it reached 3,7% of GDP by the end of 2015. This is consistent with the trend observed since 2009, when it stood at 14% of GDP. Such a decline resulted from increased fiscal revenues driven by better economic conditions, as well as a steady decline of public expenses (see graph 1). We can expect this tendency to prevail, though risks can materialize from newly elected administration policies, such as medical care and defense.

Monetary policy remains loose. The Fed made a drastic move by increasing the target funds rate to a 0,25-0,5% interval in December 2015. Such decision marked a change in the US monetary policy since the aftermath of the 2008 financial crisis, when the Fed decreased the funds rate close to zero. However, full monetary normalization is still overdue and current levels remain well below those observed in pre-crisis years (see graph 2).

Graph 2: Federal Funds Rate 2000-16, %



Source: RAEX (Europe) calculations based on data from the Federal Reserve

The inflation rate declined in recent years driven by low commodity prices, however, this trend is likely to revert fueled by higher oil prices and sustained growth rates. In this sense, we expect the real GDP growth rate to remain strong and the inflation rate to catch up with the Fed's target at

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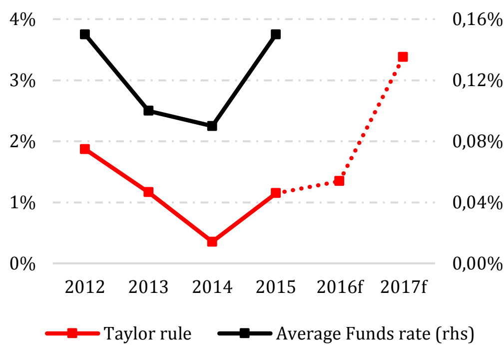
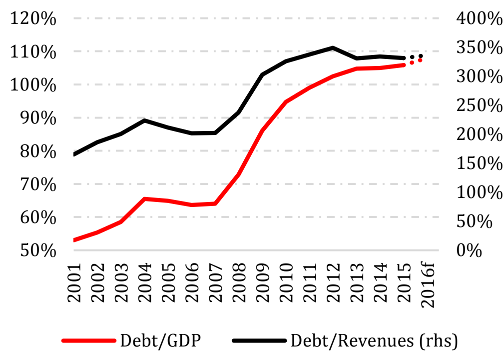
Graph 3: Average Fed funds rate vs. Taylor rule, %



Source: RAEX (Europe) calculations based on data from the Federal Reserve, IMF

Graph 4: US government debt metrics, %



Source: RAEX (Europe) calculations based on data from the IMF

2% in the short and mid run. As predicted by the Taylor rule[2], this will likely encourage the Federal Open Market Committee to raise the Fed funds rate during 2016 and 2017 (see graph 3).

Debt rising but trend could revert. The US government debt recorded a new maximum at USD 19,3 tn. in March 2016, which represents 107,6% of the 2015 nominal GDP. This result is in line with the steady positive trend observed over the past eight years in the US debt (see graph 4). The suspension on the debt limit until March 2017 allows the government to issue as much debt as needed, which we expect will until the end of the current administration.

The future debt development will essentially depend on the next elected president. Even though all running candidates made declarations pro debt reduction during the campaign, the track record shows that democrat-led administration tends to introduce policies that require increase in public spending. However, a clearer path of the debt will only be evidenced after the 2016 presidential elections.

Privately-held debt represents a larger risk for the country than government debt. Total private debt at 255% of GDP in 2015 increased steadily since 2011, partly motivated by low interest rates in the financial markets. Still, a hike in the market interest rates and a sustained GDP growth rate could together contribute to alleviate the burden of the private debt in the long run.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

http://www.raexpert.eu/reports/Press_release_USA_03.06.2016.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.

[2] The Taylor rule is an interest rate forecasting model invented and perfected by famed economist John Taylor in 1992. The formula used for the Taylor rule is the following: $i = P + r + 0{,}5*(Y - Ypot) + 0{,}5*(P - Ptarg)$, where "i" is the Fed funds rate, "P" is the inflation rate, "r" is the real federal funds rate (generally at 2%), "Y" is the real GDP, "Ypot" is the potential real GDP and "Ptarg" is the Fed's target inflation rate (set at 2%).

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