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Research Report on USA

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Introduction

The United States of America remains one of the leading countries in the world with a highly diversified economy and a strong financial sector. Despite limits on indebtedness imposed by debt ceilings, the US government found its way to increase the gross government debt over time in an attempt to cover its ever increasing expenses. From a fiscal perspective, the US government showed a significant improvement by reducing the fiscal gap by 9 p.p. of GDP over the last six years. While the financial sector remains in a sound position and the country still shows sound macro indicators, the negative first quarter growth rate brought concerns about the prospects of the US economy.

Deficit figures continued to narrow in recent years. Over the last six years the US government showed high commitment to balance the fiscal budget as deficit/GDP ratio declined from 14% in 2009 to 5% in 2014 (see graph 1). At the beginning of May this year the Republican-led congress passed the 2016 budget (3,8 trillion USD), which if enacted, would encourage further balancing of the US fiscal balance at the same time that would cut 5 trillion USD in social, education and health programs over the next decade. As expressed by congress members, the idea behind this budget blueprint is to balance the fiscal budget by the year 2024 without raising taxes. Based on this, we expect a further decline in the US fiscal deficit by the end of 2015 which would come as a combined effect of higher fiscal revenues as well as lower expenses.

Government debt still growing despite reaching debt ceiling. While the USA has one of the highest levels of creditworthiness in the world and would find no obstacles in obtaining funds, the US congress has the power to restrict the total amount of debt that can be issued by the government. Since the implementation of the debt ceiling in 1917, a history of rough negotiations between the congress and the government emerged. Total US government debt, which has a long lasting history of consecutive and prolonged increases, finished the year 2014 with a historical record of 18,2 trillion USD (see graph 2). This figure represented 105% of annual GDP and 333% of budget revenues and lays a little above the current debt ceiling of 18,113 trillion USD. Despite the part of the debt subject to limit (18,112 trillion USD) standing slightly below the debt ceiling by the end of

Main Economic Indicators of USA

Macro indicators	2012	2013	2014
Gross pub. debt, bill USD	16549	17341	18250
Nominal GDP, bill USD	16163	16768	17419
Real GDP growth, %	2,3	2,2	2,4
Gross gov. debt/GDP,%	102,4	103,4	104,8
Deficit (surplus)/GDP,%	-8,6	-5,8	-5,3
Inflation rate,%	1,8	1,3	0,9
Curr. Account balance/GDP,%	-3,3	-2,8	-2,9

Development indicators	2014
Inequality adj. HDI	0,8
GDP per capita (Thou. of USD)	54,6

Default indicator	11.06.2015
5-Year CDS spread (Bp)	17
10Y Gov Bond Yield, %	2,4

Sources: RAEX (Europe) calculations based on data from IMF, Deutsche Bank, Bloomberg

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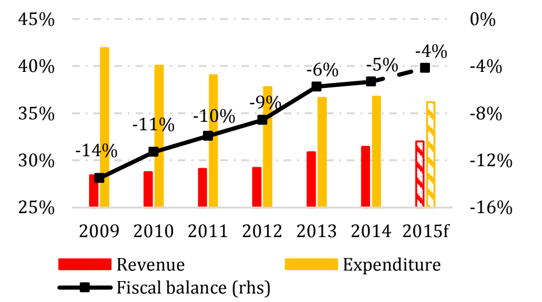
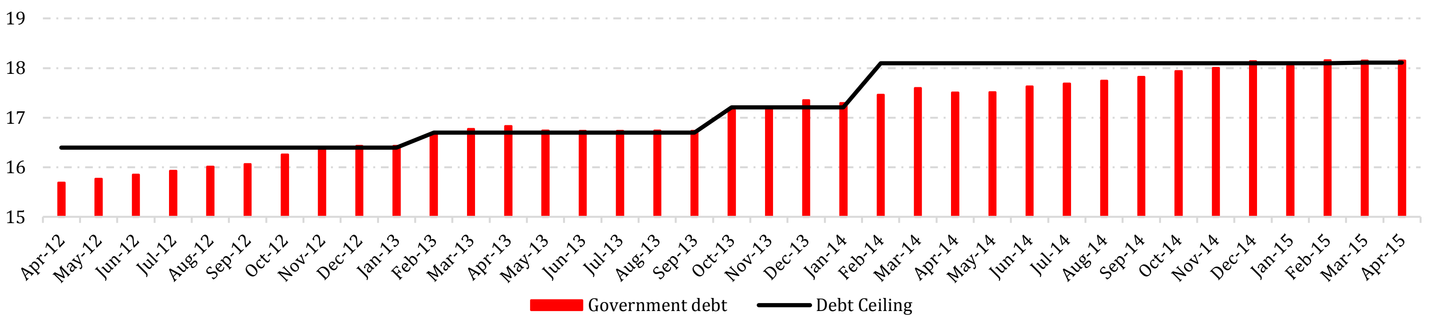
Graph 1: US Fiscal balance performance



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

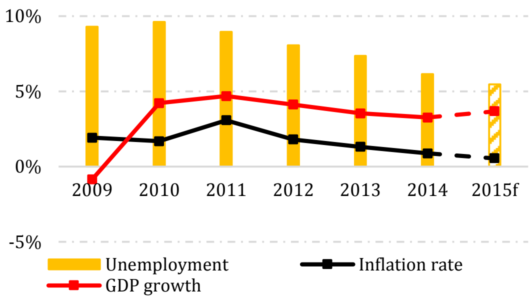
April, a stronger than expected tax revenues will give policymakers more time to haggle an increase to the debt limit. Given the recent catch-up of the debt to the current ceiling, we expect that a new round of negations will take place to make room for further indebtedness of the US government by November or December this year. If this happens, the US government will see its debt indicators increase by the end of 2015.

Graph 2: US Government debt dynamics (Trillion USD)



Source: RAEX (Europe) calculations based on data from the US department of the treasury

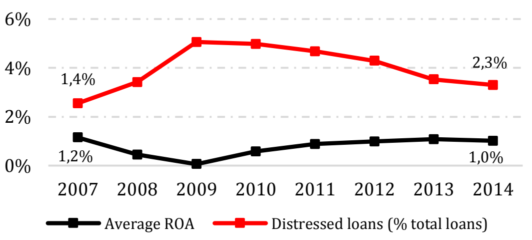
Graph 3: Macroeconomic indicators performance



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

Main macroeconomic indicators remain solid, but with uncertain prospects. Since 2009, the US economy has shown a significant recovery evidenced by the sharp decline in the unemployment and inflation rates as well as positive GDP growth rates (see graph 3). Even though the 2015 end-of-year prospects seem encouraging, recently released GDP growth figures brought concern in this respect. The United States had a weaker start this year than what was initially expected, as economic activity contracted by 0,7 percent during the first quarter of 2015. This result was not only influenced by poor trade performance and continued caution by businesses and consumers, but also by harsh weather in some parts of the country and labor disputes at West Coast ports.

Graph 4: US Bank sector performance



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

The US financial market still shows signs of improvement. The US banking sector ended the year 2014 with a further decline in the share of distressed loans to total loans and a positive ROA (see graph 4). These figures are close to the ones in place before the outbreak of the financial crisis in 2008 and are proof of the significant improvement that this industry had over the last six years. The stock market has also shown signs of recovery with a steady increase of the S&P index over the last six years and a market capitalization of listed companies/GDP value higher than those evidenced before 2008 (see graph 5). The almost zero interest rate in the banking sector motivated investors to allot funds in stocks, which

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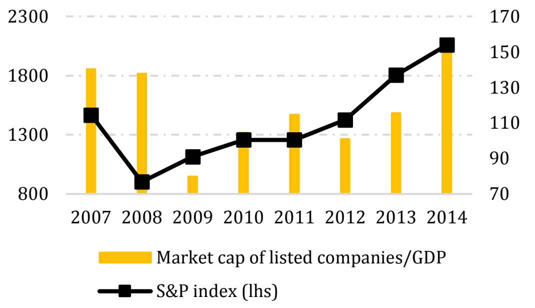
Graph 5: US stock market performance



Source: RAEX (Europe) calculations based on data from S&P and World Bank

partly explains the high development of this market in recent years. In this regard, the high level of the S&P index could be interpreted as an overvaluation of the stock market and might be creating a bubble. However, the aforementioned effect is not correlated with the growth of low-quality assets which could potentially lead to a panic situation. The Agency will keep this on watch for further developments.

Conclusion

The United States of America still remains a country with an outstanding creditworthiness, one of the highest in the world. Government's efforts to reach a fiscal balance have been fruitful and the recently passed 2016 budget is expected to further narrow the fiscal gap as well as to balance the fiscal budget throughout the following decade. While total output contracted during the first quarter of 2015, the overall stance and prospects of the main macroeconomic indicators remain strong. Even though gross debt reached the current debt ceiling, we expect that a round of negotiations between the government and the congress will make room for further debt increase.

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