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Research Report on United States of America

19 May 2017

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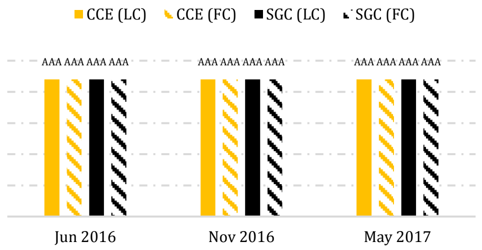
Ratings

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 USA

Macro indicators	2014	2015	2016
Gross gov. debt, USD bn	18302	19048	19934
Nominal GDP, USD bn	17393	18037	18569
Real GDP growth, %	2,4	2,6	1,6
Gross gov. debt/GDP, %	105,2	105,6	107,4
Deficit (surplus)/GDP, %	-4,0	-3,5	-4,4
Inflation rate, %	0,5	0,7	2,2
Current Account Balance/GDP, %	-	-	-2,6
External debt, USD bn	-	-	6,2

Development indicators	2015
Inequality adj. HDI	0,76
GDP per capita, USD th	56,1*

Default indicator	19.05.2017
5-Year CDS spread, Bp	22,8
10Y Gov Bond Yield, %	2,19

Source: RAEX (Europe) calculations based on data from the IMF, Census Bureau and DB. *2016 figure.

Summary

The United States 'AAA' ratings remain mainly underpinned by the country's supportive economic conditions and significant resilience to external and domestic shocks.

Given the still declining unemployment rate and inflation rates around the Fed's target, the Federal Open Market Committee (FOCM) increased the Fed Funds rate. While showing signs of monetary policy normalization, it increased the pressures on the government debt interest payments. This, coupled with the recent reintroduction of the debt limit in and a potential tax cut, is likely to widen the U.S. fiscal deficit over the next years.

The country's financial sector remains strong with a comfortable level of assets and increasing profitability metrics. A potential repeal of the Dodd-Frank could benefit the industry with lower regulations. However, this could also make financial markets more fragile and may put the economy at risk of another financial crisis in the long-run.

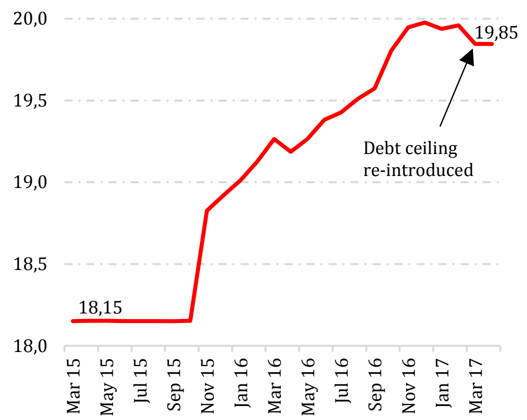
The country's trade deficit could narrow in the long run if some of the U.S. trade deals are renegotiated following the recent confirmation of Trump's trade nominee. However, such a move could potentially have a negative impact on prices and domestic supply.

Increasing fiscal pressure. Even though the U.S. government managed to narrow its fiscal deficit until 2015 as a result of lower interest expenses and higher revenues linked to stronger economic activity, the fiscal balance dropped by 1p.p to -4,4% in 2016 driven by lower fiscal revenues.

In our view, the recent and still expected interest rates hikes and the reintroduction of the debt limit in March 2017 (see graph 1) have increased the fiscal pressure. This, coupled with the government intentions to reduce tax rates, could potentially widen the fiscal deficit in the long run. However, a potential cut of the corporate tax rate could propel domestic investment and economic growth, ultimately increasing tax revenues.

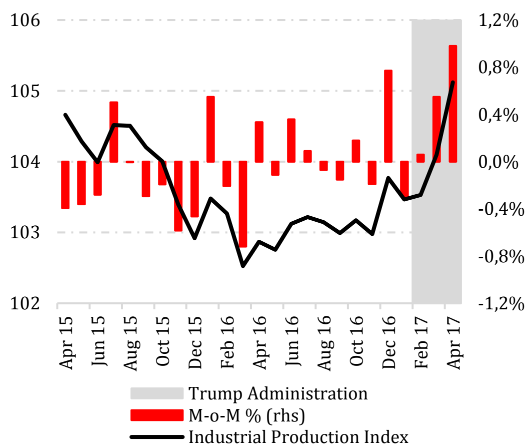
Encouraging macro conditions. The U.S. economy is one of the richest and best diversified in the world, with a GDP per capita in PPP terms well above its peers at around USD 58,3 th in 2016. The country also enjoys a high degree of development and competiveness, as it ranked 8th out of 108 countries in the Doing Business 2017 ranking prepared by the World Bank.

Graph 1: U.S. gross government debt, USD tn



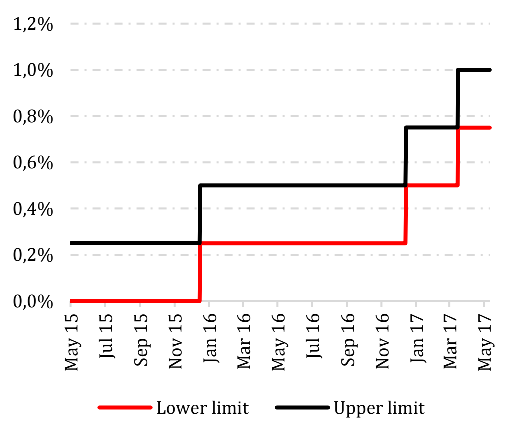
Source: RAEX (Europe) calculations based on data from the US Treasury

Graph 2: Industrial production index (seas. adj.)



Source: RAEX (Europe) calculations based on data from FRED

Graph 3: Lower and upper Fed Funds rate target, %



Source: RAEX (Europe) calculations based on data from FRED

Macroeconomic indicators have shown signs of improvement during the 1Q 2017, following the already positive trend observed through 2016. While real GDP grew by 1,9% y-o-y in 1Q 2017, the unemployment rate stood at 4,4% as of April 2017, recording the lowest rate since May 2007.

Furthermore, driven by an increase of all major industrial groups (manufacturing, mining and utilities), the industrial production index calculated by the U.S. Federal Reserve increased in April 2017 by 1% for three consecutive months (see graph 2). This, combined with a still growing consumer sentiment[1] at 97% in April 2017, supports our view that the U.S. economy is set to grow during 2H 2017.

The United States has constantly proved resilience to the volatility in financial markets, the appreciation of the USD against major world currencies and poor global growth and demand. However, the country still faces a number of challenges, such as the increasing expenditure on social security, raising poverty and inequality and ageing of basic infrastructure, which could become credit negative in the long term.

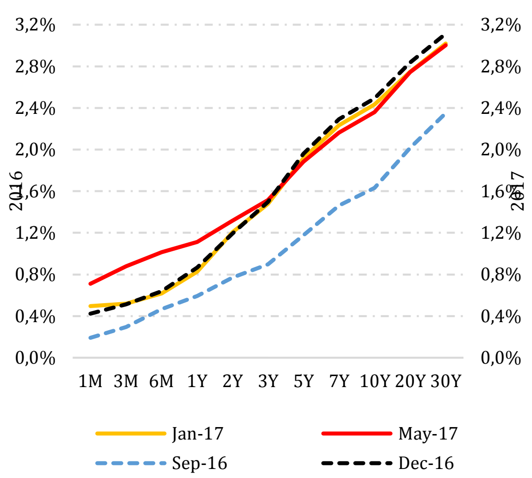
Political risks could be mitigated. We keep our view that politicking between the executive and legislative branches is likely to lower as Republicans continue to hold a majority of votes in both the Senate and the House of Representatives. While this could mitigate the risk of technical debt defaults through a possible new suspension of the debt limit, it increases the risk of higher fiscal spending and government debt increase.

Monetary policy towards normalization. As evidenced by the Taylor Rule in our research report as of 3rd June 2016[2], the (FOMC) decided to raise the Fed Funds rate by 25b.p. at the March meeting this year, adding to a 25b.p. tightening in December 2016 (see graph 3). Such decisions came after inflation rates showed a sustained positive trend since July 2017 (surpassing the 2% boundary in December that year), real GDP growth rate kept its upward trend through 1Q 2017 and unemployment rate stood at a record low for almost a decade at 4,4% in April 2017.

In our previous rating report we highlighted the fact that the yield on the long-term bonds had increased proportionally more than that of the short-term bonds, reflecting the perception of the market participants about the long-term policy uncertainty which emerged after the victory of Donald Trump as president-elect of the U.S. As the political landscape was reshaped after the presidential inauguration in late January, this trend reverted with the yield on short-term bonds increasing while that on long-term bonds remaining almost stable during 1H 2017 (see graph 4).

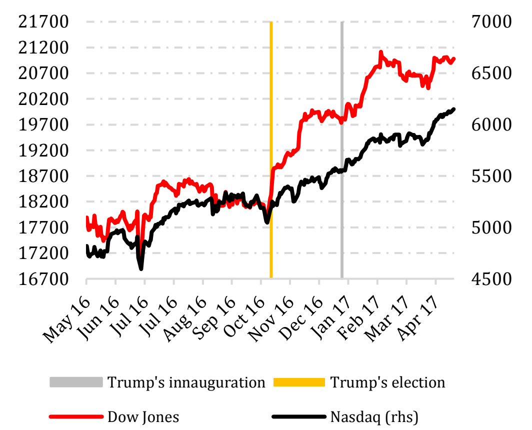
[1] University of Michigan: Consumer Sentiment© [UMCSENT], retrieved from FRED, Federal Reserve Bank of St. Louis.
[2] Research Report on United States of America June 3rd,2016 http://raexpert.eu/reports/Research_report_USA_03.06.2016.pdf

Graph 4: Average Treasury yield curve, % rates



Source: RAEX (Europe) calculations based on data from FRED

Graph 5: Major U.S. stock indexes



Source: RAEX (Europe) calculations based on data from FRED

We expect, in line with the FOMC, that economic conditions are likely to evolve in a way that will warrant a gradual increase in the Fed Funds rate during 2H 2017 and 2018.

Tailwind for the financial markets, with long-term risks. The stance of the U.S. banking sector remains strong with assets and credit to the economy at around 86,5% in 2016 and 237% of GDP in 2015 respectively. Banks were able to maintain positive levels of profitability despite facing an environment of low interest rates. However, the recent and expected hikes of interest rates are likely to increase banks' profitability in the upcoming months.

Since Donald Trump was elected president, the major stock indexes (Dow Jones and Nasdaq) have increased by 14% and 18% respectively, well above the 6% increase that both reported from January to October 2016 (see graph 5). Such increase was in part the result of the financial market's expectations of lower regulation and lower corporate taxes.

President Trump announced during his campaign that he would eliminate the Dodd-Frank (DF) act. In early May 2017, the U.S. House Financial Services Committee approved a bill, the Choice act, which could repeal significant parts of the DF act. The Choice act contains provisions to eliminate banks' bail-out and withdraw the Department of Labor fiduciary rule. If passed by the Senate, this statute would allow financial advisors to increase the number and range of products offered. In contrast, financial markets could become more fragile and crisis risks could emerge in the long run.

Uncertainty over trade. During his campaign Donald Trump stated that a number of trade deals, especially NAFTA, were going to be revised if elected, as the U.S. has a long-lasting record of trade deficits, which reached 2,7% of GDP in 2016. The recent confirmation of Trump's nominee for Trade Representative, Robert Lighthizer in May 2017, is likely to hasten the presentation of new trade proposals to the legislative branch. On the basis of Lighthizer's past declarations, we could potentially expect these proposals to highlight the country's need of higher tariffs on imports from Asian and Latin-American countries.

While a potential lower degree of foreign trade openness resulting from these actions could narrow the country's trade deficit, we are of the view that this could ultimately shorten demand and increase domestic prices. Additionally, given the size and complexity of the U.S. economy, we estimate that the time span required to negotiate new trade agreements could potentially be large, eventually introducing risks to the creditworthiness of the country.

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_19.05.2017.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.