Research Report on USA

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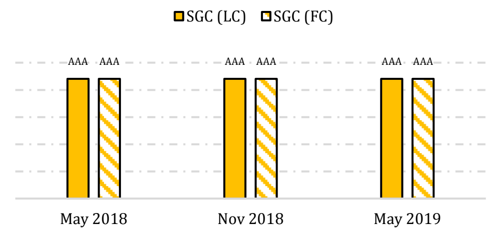
Ratings

Sovereign Government Credit (LC)	AAA
Sovereign Government Credit (FC)	AAA
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of USA

Macro indicators	2016	2017	2018
Gross gov. debt, USD bn	19 993	20 698	21 677
Nominal GDP, USD bn	18 707	19 485	20 494
Real GDP growth, %	1,6	2,2	2,9
Gross gov. debt/GDP, %	106,9	106,2	105,8
Deficit (surplus)/GDP, %	-3,9	-3,8	-4,3
Inflation rate, %	2,2	2,2	2,0
Current Account Balance/GDP, %	-	-	-2,3
External debt, USD bn	-	-	19 766

Development indicators	2018
Inequality adj. HDI	0,92*
GDP per capita, USD th	62,6

Default indicator	03.05.2019
5-Year CDS spread, Bp	16,7
10Y Gov Bond Yield, %	2,53

Source: RAEX-Europe calculations based on data from the IMF, WB.
* Figure for 2017.

Summary

Our confirmation of the United States' credit ratings in both national and foreign currency with a stable outlook is based on the country's exceptionally strong macroeconomic profile as well as the unique roles of USD and U.S. financial system, which offset increasing fiscal and debt risks.

The economy keeps benefiting from the current fiscal policy, showing a stronger real GDP growth than most peers[1]. However, as a result of this policy, the U.S. fiscal position continued to worsen, as shown by rising debt and wide deficit levels. In addition, uncertainty regarding the debt and fiscal policy is a strong negative factor for the country's credit rating.

The economy's leverage remains high; however, this risk is mitigated by solid banking system metrics, as well as highly developed and liquid stock and bond markets. Moreover, the inflation level declined in 2018, while the monetary policy became more cautious, it still shows high effectiveness and independence, supporting the rating.

The economy keeps benefiting from the government fiscal policy. The U.S. real GDP growth accelerated in 2018 and reached 2,9% as compared to 2,2% in 2017 mostly supported by the fiscal stimulus, including Tax Cuts and Jobs Acts. This level of growth is one of the highest among the large advanced economies, such as Australia, Canada, Germany, France, UK and EU. The mentioned policy has also had a material positive effects on the U.S. labor market. The unemployment rate of 3,9% in 2018 reached the lowest level since 2000, when it stood around the same figure, and broke the 2007 pre-crisis metric of 4,6%.

However, we expect that in the mid-term perspective the U.S. economy will slow down its growth pace due to the limits of the fiscal stimulus effects, the aging population, rising internal imbalances, such as wealth inequality, as well as increased uncertainty about global economy perspectives (see graph 1). Therefore, we consider the long-term growth rates to be close to 2%, while unemployment rate to stabilize around 3,6%. Despite this, we believe that the U.S. macro position, including levels of per capita GDP, diversification and technological development, will remain a credit strength in the mid and long-term perspective.

[1] The following countries and unions were compared: Australia, Canada, Germany, France, UK and EU.

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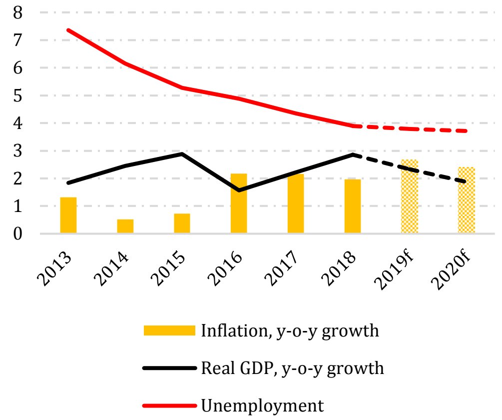
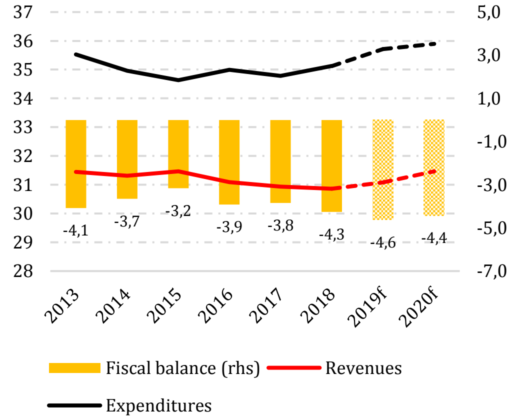
Graph 1: Macroeconomic indicators, %



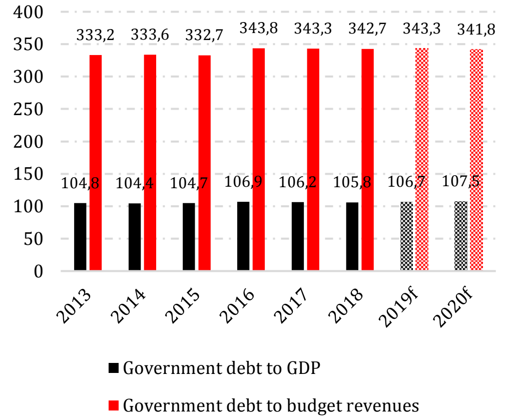
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF

Graph 3: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the IMF

Deteriorating fiscal and debt position as well as policy uncertainty remain key risk factors. After the slight improvement of the U.S. fiscal balance in 2017, the budget deficit is set to widen in 2018 calendar year to 4,3% almost in line with our previous expectations. This is the largest deficit since 2012 (see graph 2). At the same time, in the 2018 fiscal year (FY, ending in September 2018), the federal budget deficit widened for the third consecutive year in a row to USD 779 bn or 3,8% of GDP as compared to 3,4% in 2017FY, driven mostly by a sharp decline in corporate tax revenues and rising interest burden.

We expect the budget deficit to increase further in 2019. The U.S. budget deficit widened to USD 691 bn in the 1H of 2019FY or by 15% compared with the October-March period of the previous FY due to ongoing effects from tax cuts. This trend will remain unchanged at least until the end of FY in September 2019. The 2020 deficit is subject to different politically related decisions such as intensification of arguing between executive and legislative authorities by the end of 2019 FY and presidential elections in 2020. However, in the longer perspective, we expect rising deficits due to needs of age- and infrastructure-related expenses, and low-income people support spending.

The above mentioned deficits keep pushing the debt load up. Overall government debt is expected to increase by 4,7% to USD 21,6 tn and to remain high at around 106% of GDP and 343% of budget revenues in 2018 calendar year (in IMF definition) (see graph 3), while U.S. Treasury data shows even higher growth of 7,2% for the same period[2].

After the end of the longest shutdown of U.S. federal government in January 2019, the agreement of funds provision was reached, while the debt limit was reimposed in March 2019. We expect the Treasury to keep using extraordinary funds within the next months, however the current weak political coherence creates a significant risk of materialization of the second federal government shutdown in October 2019. At the same time, due to the track record of similar "last minute" agreements and potential damage for the U.S. economy, we expect the debt ceiling to be raised in autumn 2019. Nevertheless, the fiscal and debt policy uncertainty creates a pressure on the country's credit rating.

The significance of the U.S. financial system and its soundness support the credit rating, while overall leverage level is a risk. The U.S. banking system keeps showing strong performance with a positive ROA, declining level of NPLs and rising regulatory capital to risk-weighted assets ratio (see graph 4). According to the Federal deposit insurance

[2] The growth of total debt including intragovernmental holdings.

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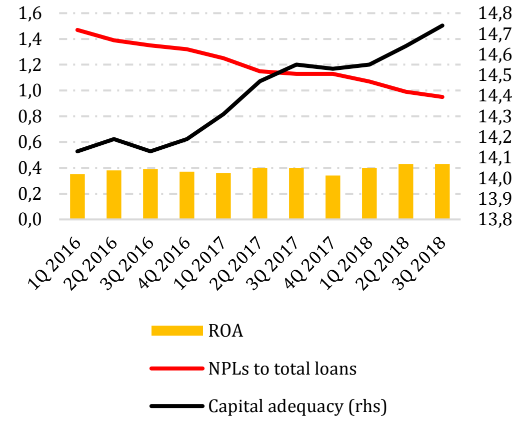
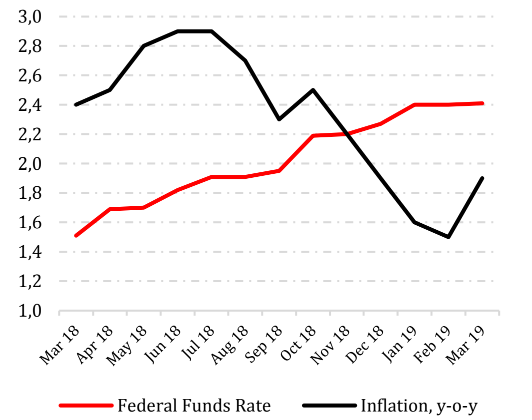
Graph 4: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the IMF

Graph 5: Base rate vs inflation rate, %



Source: RAEX-Europe calculations based on data from the FED

corporation (FDIC) the U.S. FDIC-insured institutions showed an increase in net income by 44,1% up to USD 236,7 bn in 2018, primarily due to a decline in applicable taxes resulting from the 2017 tax law; while income adjusted for tax-reform effects increased only by 13,6%. In addition, the noncurrent rate[3] kept declining in 2018, showing the lowest level over the last decade.

The level of U.S. economy leverage remains high, as shown by the volume of domestic credit to GDP of more than 240%, posing a risk, but this is partly mitigated by abovementioned sound banking system position. Therefore, we can expect a higher resilience to economic shocks when the downside phase of the economic cycle occurs.

Despite a decline of stock market capitalization in 2018, the U.S. still has the most developed and liquid stock market in the world, with a market capitalization of listed companies around 150% of GDP by end 2018. In addition, the financial system is characterized by exceptionally deep and liquid U.S. treasury market. Together with the status of USD as a key reserve currency, the soundness and global importance of U.S. financial system have an exceptionally strong positive effect on the country's credit rating.

Inflation remains low while monetary policy became more cautious. The inflation rate remains below the Federal Open Market Committee's target of 2% since the beginning of the year (see graph 5), and it is not expected to hike significantly over 2019. The Federal Reserve left interest rates unchanged on the 1 May meeting, showing the patient approach, despite strong performance of the economy. We still expect that FED can increase the interest rates during 2019, while 2020 dynamic will strongly depend on the global and U.S. economy performance. Nevertheless, both factors – inflation and monetary policy effectiveness, remain strong credit positive for the rating.

External position slightly deteriorated. Preliminary data for 2018 shows widening current account deficit of 2,6% of GDP, mostly triggered by increase in foreign trade deficit, that reached USD 622,1 bn (3% of GDP), the largest deficit after 2008, caused by strong domestic demand for imports as well as a strong USD and retaliatory tariffs weighing on exports. At the same time FDI inflows is estimated to drop from 1,42% of GDP in 2017 to 1,23% in 2018, mostly caused by drop of FDI balance with Asia-Pacific countries, especially Japan, and Canada. Due to growing internal demand as well as still not fully solved trade spat with China, we expect further deterioration of U.S. external position by the end of 2019.

[3] Noncurrent loans – loans with 90 days or more past due or in nonaccrual status.

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https://raexpert.eu/reports/Press_release_USA_03.05.2019.pdf

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