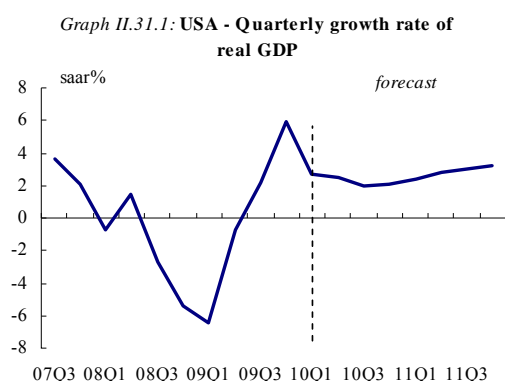


31. THE UNITED STATES OF AMERICA

Settling into subdued recovery mode

Since the presumed end of the Great Recession in the summer of 2009 the output of the US economy has expanded at a decent pace. The main contribution to GDP growth has come from the inventory cycle which saw a sharp fall in the recession-induced rate of destocking in the second half of last year. Final domestic demand has only increased slowly in spite of massive support from macroeconomic policies. Three quarters into the recovery the labour market, as well as the housing market, remain weak. Monetary policy continues at an ultra-accommodative setting and the ongoing fiscal stimulus has pushed the budget deficit to the highest level since World War II. The main point of the forecast is that the strong headwinds facing the US economy will result in a relatively subdued recovery until the end of next year. Output is projected to increase only moderately in the second half of 2010. Subsequently, GDP is expected to accelerate on a quarterly basis, but still less than in previous recovery episodes. Unemployment will remain at around the current level while disinflation continues throughout the forecast period.



A slow emergence from the 2008/09 recession

Economic growth resumed in mid-2009 thanks to strong doses of monetary and fiscal stimulus. Real GDP accelerated from an annualised growth rate of 2.2% in the third to 5.9% in the fourth quarter. Industrial production started to increase in July and the purchasing managers' index for the manufacturing sector has returned to readings consistently above 50 since August. Business activity in the services sector remained more subdued. Consumer spending increased at annual

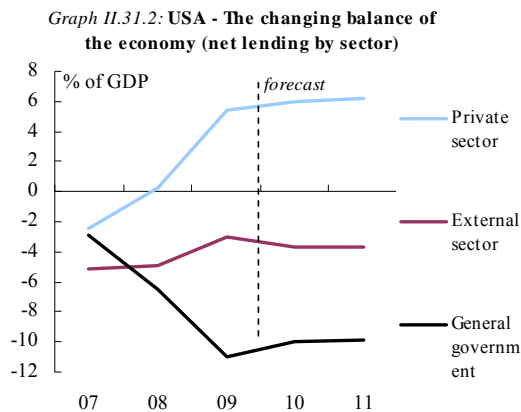
rates of 2.8% in the third and 1.7% in the fourth quarter following tax cuts and government incentives for car purchases. Business outlays for new equipment and software increased at a robust rate in the fourth quarter, but investment in non-residential structures continued to decline. Residential investment rose from an extremely low level in the second half of 2009 following 3½ years of uninterrupted decline. Both exports and imports have rebounded strongly since mid-2009. The strongest contribution to GDP growth came from the turnaround in the inventory cycle. Two thirds of the high growth rate in fourth quarter was due to the sharp decline in the rate of destocking while final domestic demand increased at an annual rate of just 1.5%.

In spite of renewed output growth, payroll employment changed little over the winter months. The unemployment rate rose to 10% in the fourth quarter of 2009 before receding slightly in early 2010. Apparently responding to the large negative output gap, inflationary pressures have clearly diminished in recent months with core CPI inflation falling to 1.1% y-o-y in March. The fiscal situation deteriorated further in 2009 with the deficit of general government rising to 11.6% of GDP in the middle quarters before receding somewhat in the final quarter. The current-account deficit fell below 3% of GDP in the first quarter of 2009, but has widened slightly again in the second half of the year.

Some high-frequency indicators pointed to a softening of economic activity in early 2010 although unusually severe winter weather complicates the interpretation of the data. Most importantly, following a clear downward trend between April and December last year, initial unemployment claims moved back up again in the first quarter. Various indicators for the housing market showed renewed signs of weakness. Consumer confidence continued to fluctuate in a range normally associated with recessions. Nevertheless, consumer spending has been surprisingly strong in recent months – at least according to currently available estimates – in spite of the weakness in household income and the loss of wealth during the recession. The mirror image of this is a renewed decline of the household saving rate in the first quarter following the rise during the recession.

Diminishing impact from inventories and fiscal stimulus

The economy was lifted out of recession in the second half of 2009 by strong, but temporary, boosts from the government's fiscal stimulus and from the inventory cycle. Certainly, inventories still declined, but at a lower rate than previously, particularly in the fourth quarter. In early 2010 the inventory cycle should move to the phase in which stocks will increase again, but the pace of the changes is likely to be significantly smaller than at the end of last year. The forecast projects that the positive contribution to GDP growth will diminish gradually this year and next as the inventory/sales ratio stabilises.



The fiscal stimulus was mainly contained in the *American Recovery and Reinvestment Act (ARRA)* which was adopted in February 2009. Its total budgetary cost of more than \$860 billion (6.0% of current annual GDP) will predominantly be spent in 2009-11. ARRA started to contribute significantly to GDP growth in the second quarter of 2009 and reached a peak impact in the following quarter (with an estimated 3-4 pps. contribution to the annualised growth rate). The impact remains significantly positive, but at a diminishing rate, until around mid-2010 when it turns negative. However, Congress has passed (or is in the process of passing) significant additional stimulus measures. Already last November fiscal measures costing \$46 billion were adopted (a prolongation of a tax credit scheme for homebuyers and a two-month extension of unemployment benefits). In March the "Jobs Bill" was passed and two more stimulus bills are close to adoption. The additional spending is for extending unemployment benefits and related health insurance subsidies for unemployed workers, Medicaid funding for states, a highway

infrastructure programme, and for tax breaks for business conditioned on additional hiring. Overall, the various bills sum up to around \$200 billion (1.4% of current annual GDP) of additional federal spending until the end of 2011. This is likely to postpone the time when the impact of the combined fiscal stimulus legislation on GDP growth turns negative towards the end of 2010. In 2011, the emerging fiscal drag from the fiscal stimulus will be worsened by the expiration of the 2001/2003 tax cuts. Although the Administration's budget foresees the extension of these cuts for all but the top two tax brackets, it will nevertheless result in an estimated \$30 billion increase in paid income tax in 2011. Assuming this, fiscal drag would subtract around 1 pp. from annual GDP growth in 2011.

Cyclical momentum is also facing other headwinds

The recovery is currently at the crucial point where employment growth resumes. Although hourly wages are close to stagnation, a lengthening work week and rising employment can be expected to translate into higher real-consumer spending since recent data suggest that households are not inclined to increase their saving rate. Together with recovering business investment in equipment and software, mutually reinforcing growth of employment and consumption is expected to provide the cyclical momentum for output growth when the temporary boost from stimulus and inventories fade out later this year. However, this dynamism is expected to be relatively weak because the two preceding recessions suggest that employment will only increase sluggishly in this phase of the business cycle. At the same time, net exports are expected to remain broadly neutral in terms of contribution to GDP growth.

The upturn of the economy is supported by the extremely accommodative stance of monetary policy as the Federal Reserve has maintained the target range for the federal funds rate at 0-0.25% since late 2008 and continues to anticipate that economic conditions are likely to warrant this exceptionally low level for an extended period. Although overall financial conditions have eased significantly over the past year, credit availability for households and small business remains relatively restricted. This is likely to curb the growth of consumer spending as well as residential and non-residential investment.

Another serious headwind is the suppressed state of the housing market. The number of vacant homes is only just beginning to recede from a level that has been substantially above its longer-term trend and the rate of home foreclosures remains very high. These factors will probably depress both residential investment and house prices into 2011.

Net result of opposing forces: a subdued recovery

The balance and sequence of driving forces and headwinds suggests that quarterly GDP growth will moderate to close to 2% at an annual rate in the second half of 2010 when fiscal stimulus and the inventory cycle lose much of their power while employment growth is still weak. Next year, the recovery should be able to pick up some steam with quarterly annualised GDP growth rising gradually to 3.2% at the end of the forecasting period. This, however, will be far from sufficient to close the output gap. Such a growth profile would result in annual average growth of 2.8% in 2010 (heightened by a large carry-over from 2009) and 2.5% in 2011. This would represent a very subdued performance by historical standards and in view of the depth of the preceding recession.

In this scenario, the unemployment rate will remain around the current level of just below 10%

throughout the forecast period. The large slack in resource utilisation should push headline inflation decisively below 1% by next year. The household saving rate will remain at the current level, i.e. about 2 pps. higher than before the recession. The fiscal deficit of general government will narrow to 10% of GDP this year and slightly further in 2011. The current-account deficit will widen to 3.7% of GDP this year and next, not at least because of the higher oil price.

Risks

The risks associated with this forecast appear to be balanced between upside and downside. The main upside risk to GDP growth is that employment could increase faster than expected in a pattern similar to recovery periods before the 1990s. On the downside, there is risk that the households saving rate resumes its upward crawl which was discontinued when the recovery started in mid-2009. Another major downside risk is related to the housing market where it is conceivable that foreclosures accelerate in a way which leads to further significant decline in house prices.

Table II.31.1:

Main features of country forecast - THE UNITED STATES

	2008			92-05	Annual percentage change					
	bn USD	Curr. prices	% GDP		2006	2007	2008	2009	2010	2011
GDP	14441.2		100.0	3.3	2.7	2.1	0.4	-2.4	2.8	2.5
Private consumption	10129.9		70.1	3.7	2.9	2.6	-0.2	-0.6	2.1	1.3
Public consumption	2386.8		16.5	1.5	1.2	1.5	3.4	1.9	2.3	2.7
Gross fixed capital formation	2667.1		18.5	5.7	2.3	-1.4	-4.2	-14.8	0.3	4.3
of which : equipment	1264.9		8.8	7.4	8.2	1.5	-4.4	-14.0	6.7	4.5
Exports (goods and services)	1831.1		12.7	5.2	9.0	8.7	5.4	-9.7	11.3	8.1
Imports (goods and services)	2538.9		17.6	8.2	6.1	2.0	-3.2	-13.9	10.1	5.7
GNI (GDP deflator)	14583.1		101.0	3.5	3.5	0.9	-0.2	-2.7	2.7	2.4
Contribution to GDP growth :										
Domestic demand				3.8	2.7	1.8	-0.4	-2.9	1.9	2.1
Inventories				0.1	0.1	-0.3	-0.4	-0.6	1.0	0.3
Net exports				-0.5	-0.1	0.6	1.2	1.0	-0.1	0.1
Employment (*)				1.3	2.1	1.1	-0.5	-3.8	-0.4	0.6
Unemployment rate (a)				5.4	4.6	4.6	5.8	9.3	9.7	9.8
Compensation of employees/head				3.8	4.1	3.7	2.6	0.7	1.5	0.7
Unit labour costs whole economy				1.7	3.5	2.7	1.7	-0.7	-1.6	-1.1
Real unit labour costs				-0.4	0.2	-0.2	-0.5	-1.8	-1.8	-1.2
Savings rate of households (b)				-	-	4.5	5.4	7.0	6.8	7.0
GDP deflator				2.1	3.3	2.9	2.1	1.2	0.2	0.1
General index of consumer prices				-	3.2	2.8	3.8	-0.4	1.7	0.3
Terms of trade of goods				-0.2	-0.8	-0.1	-5.7	5.8	-4.6	-0.6
Trade balance (c)				-3.6	-6.5	-6.1	-6.0	-3.8	-4.5	-4.5
Current account balance (c)				-3.0	-6.0	-5.2	-4.9	-3.0	-3.7	-3.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-3.1	-6.0	-5.2	-4.9	-3.0	-3.8	-3.8
General government balance (c)				-2.6	-2.0	-2.7	-6.4	-11.0	-10.0	-9.9
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				64.5	61.2	62.2	70.7	84.0	93.6	102.5

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

(*) Employment data from the BLS household survey.