

United States Business Forecast Report Q2 2014

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Abstracts

Core Views

Our view for gradual strengthening in the US economy through end 2014 continues to play out, driven by a tightening labour market and sustained growth in the cyclical components of the economy, notably the residential housing sector and business investment in equipment. Data have been particularly strong in recent months, and we acknowledge that risks are weighted to the upside.

We believe that a falling reliance on energy imports and an uptick in global demand for US goods and services will support a further narrowing in the current account deficit, from our estimate of 2.6% of GDP in 2013 to 2.2% by 2017. That said, we highlight the risk of stronger-than-expected US private consumption in 2014, which could boost imports more than we expect.

Congressional negotiators have reached a fiscal deal that could avoid a repeat of the October federal government shutdown in the US. While a positive step, we caution that the deal is relatively small in scope and may not provide a blueprint for future bipartisan compromise. Furthermore, it does nothing to address the federal debt ceiling, which must be raised by mid-February to avoid a default.

We believe that 2014 will see considerable normalisation in US monetary policy, with sustainable economic growth allowing the US Federal Reserve (Fed) to wind down its current asset purchase programme (QE3). We forecast that the economy will improve sufficiently for the Fed to begin hiking rates by end-2015.

US President Barack Obama's low approval ratings lead us to believe that he will have limited success advancing his domestic agenda in 2014, and that Republicans are likely to retain control of the House of Representatives and pick up seats in the Senate in the

November midterm election. Indeed, if Republican gains are large enough, they could wrest control of the upper chamber from Democrats, further reducing Obama's ability to affect policy in the final years of his second term.

Key Risks To Outlook

Upside Risks To Growth Forecast: As we have mentioned, we believe that risks are firmly weighted to the upside across the US economy. The most likely of these risks, we believe, is that a greater-than-expected improvement in the labour market or consumer sentiment leads to much stronger demand for goods and services. In addition to stronger real PCE growth, such an outcome would likely lead to stronger business investment in capacity and support further housing market growth, potentially pushing US real GDP growth above 3.0% this year.

Downside Political Risks Remain: We see some downside risk from the political situation in Washington. If Republicans and Democrats re-enact the fall 2013 government shutdown or debt ceiling debate, consumer and business confidence could take another blow, dragging down growth in 2014.

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Obama's Foreign Policy In 2014: Risks Outweigh Opportunities

US President Barack Obama's best chance for achieving a foreign policy success in 2014 lies with maintaining and consolidating the very tentative rapprochement with Iran initiated last year, although the chances of a breakthrough are far from guaranteed. The biggest risks probably stem from East Asia, where Sino-Japanese tensions are riding high, and North Korea looks set to become more unpredictable amid signs of a power struggle.

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US President Barack Obama's low approval ratings lead us to believe that he will have limited success advancing his domestic agenda in 2014, and that Republicans are likely to retain control of the House of Representatives and pick up seats in the Senate in the November midterm election. Indeed, if Republican gains are large enough, they could wrest control of the upper chamber from Democrats, further reducing Obama's ability to affect policy in the final years of his second term.

Long-Term Politics

Tough Challenges In The Coming Years

The 2010s continue to be challenging for the US, mainly due to the aftermath of the 2007-2009 recession and several unresolved foreign policy issues. Meanwhile, two of the main trends in US politics will be the rise of the south-western states and Hispanic-Americans as key forces.

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Our view for gradual strengthening in the US economy through end 2014 continues to play out, driven by a tightening labour market and sustained growth in the cyclical components of the economy, notably the residential housing sector and business investment in equipment. Data have been particularly strong in recent months, and we acknowledge that risks are weighted to the upside.

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State & Local Government Fiscal Improvement To Support Jobs & Growth

Stronger revenue growth and slower expenditure growth have led to a sustained improvement in US state and local government finances, a trend that we expect to continue throughout 2014. As a result, we believe state and local governments will provide a tail wind to the labour market by being net creators of jobs, as well as help eliminate the total public sector drag on real GDP growth.

Fiscal Policy II

Deal May Avoid Another Shutdown, But Future Progress Uncertain

Congressional negotiators have reached a fiscal deal that could avoid a repeat of the October federal government shutdown in the US. While a positive step, we caution that the deal is relatively small in scope and may not provide a blueprint for future bipartisan compromise. Furthermore, it does nothing to address the federal debt ceiling, which must be raised in early-2014 to avoid a default.

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