34. THE UNITED STATES OF AMERICA

Expansion moderates amid increasing risks

The expansion in the US economy is set to moderate as the cycle matures amid increasing external and political risks. The forecast for 2016 is revised down to 1.6% reflecting lower-than-expected growth in the first half of the year, largely due to weak investment and inventory correction. As these drags wane, growth is expected to pick up to 2.1% in 2017 and to slow again to 1.9% in 2018 in line with the cyclical moderation in domestic demand in a still favourable policy environment.

Exceptional weakness in the first half of 2016

After expanding by 2.6% in 2015 (the fastest rate since 2006), real GDP slowed visibly to 0.2% (q-o-q) and 0.4% (q-o-q) in the first and second quarter respectively, dragged down by the drawn-out adjustment of inventories and the exceptional weakness in capital spending. The negative contribution from net exports that weighed on growth in 2015, turned neutral in 2016 as imports also weakened. Household consumption remained the bright spot, boosted by low energy prices and the buoyant labour market, contributing an average of half-a-percentage point to growth in both quarters.

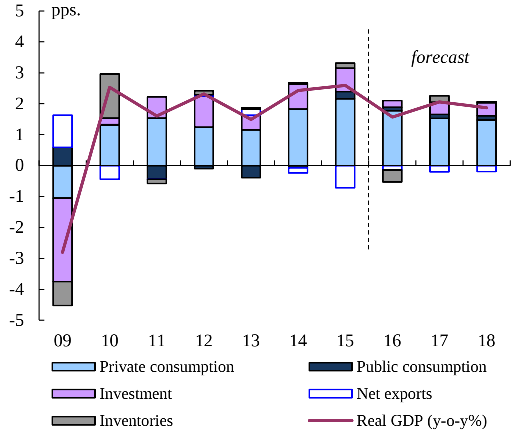
Consumption to remain the key growth driver

Private consumption is expected to remain the key driver of the US economy in the forecast horizon. It is set to benefit from the buoyant labour market, rising net wealth and supportive policy environment. Additional support is set to come from the projected gradual decline in the savings rate which rose significantly in 2015 as households decided to save large parts of windfall gains from cheaper energy. Nevertheless, following strong growth in 2015 and early 2016, household consumption is expected to moderate to around 2% by 2018, in line with the maturing cycle and the ensuing slowing employment as well as rising energy prices.

Business investment going through a weak spot

Business investment has been exceptionally weak since late 2015, as the contraction in equipment spending (since 2015-Q4) exacerbated the ongoing retrenchment in the energy sector. Slowing non-energy investment seems to be largely reflecting the weakness in manufacturing, which recently had to bear the brunt of the deteriorating competitiveness (strong dollar, narrowing energy price advantage), weak external demand, but also rising policy uncertainty ahead of the November elections. Outright contraction in the energy industry, weakness in many manufacturing sectors, combined with falling profits and uncertain near-term prospects have led many businesses to sharply cut their capital spending. This brought the momentum in non-residential investment in mid-2016 to its weakest since the Great Recession, with the outlook for 2016 broadly flat. While some of the recent drags are likely to fade gradually in 2017 and 2018 (i.e. impact of energy price declines and currency appreciation), business investment is expected to remain weak in the forecast horizon reflecting the persistently sluggish productivity growth, and the maturing US cycle. An additional fillip to investment in the near term is likely to come from restocking, following an extended period of inventory correction in 2015 and 2016.

Graph II.34.1: **US - Real GDP growth and contributions**



Trade slows sharply

Weak foreign demand and worsening competitiveness weighed on US exports since late 2014, with net exports subtracting as much as 0.7 pps. from growth in 2015. More recently however, the weakness spilled over to imports, partly reflecting falling demand from exporting sectors and the overall downturn in capital spending, but also the somewhat surprising weakness in consumer goods imports. Consequently, US trade in 2016 is likely to post its slowest expansion since 2009 and recover only gradually in 2017 and 2018. This strengthening is set to be underpinned on the export side by the projected pick-up in demand in key US trading partners (incl. Canada, EU and Brazil) and additionally supported, on the imports side, by the modest firming in investment.

Tightening labour market set to generate increasing wage and price pressures

Strong momentum in the labour market extended into the third quarter of 2016, with sustained solid job creation and the first meaningful pick-up in the participation rate in more than a decade. There is increasing evidence that the gradual tightening of the labour market generates modest but sustained upward pressures on wages and prices. Growth in average hourly earnings firmed to 2.6% (y-o-y) in Q3, the fastest since 2009. Inflation is also on the rise as rising energy prices have lifted headline indices to their 2-year highs and core inflation stabilised at around 2.2% and 1.7% (y-o-y), for the CPI and PCE, respectively. Both wage and price inflation are set to increase gradually to around 2% in 2017-18, as the drag from energy prices wanes, labour market tightens further and the output gap gets more positive.

Normalisation of monetary policy amid rising uncertainty and risks

Following the initial decision to lift interest rates by 25 bps. to 0.5% in late 2015, the Fed put the normalisation of monetary policy on hold, citing the unstable global outlook. While another interest rate hike is possible still in 2016, the challenge of calibrating the future pace of normalisation remains complex, given various, often conflicting signals on the US outlook. They include disappointing growth figures amid the still buoyant labour market and rising uncertainties in the US and worldwide.

Risks on the rise

Risks to the outlook deteriorated recently with the balance now firmly tilted to the downside. The central risk is related to potential adverse policy shifts following the November presidential and congressional elections and the related uncertainty. These developments may weigh on sentiment, extending the current soft patch in investment and trade, potentially depressing household consumption and jeopardising the projected firming of growth from 2017.

Table II.34.1:

Main features of country forecast - USA

		2015		Annual percentage change						
	bn USD	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		18036.6	100.0	2.4	1.7	2.4	2.6	**1.6**	**2.1**	**1.9**
Private Consumption		12283.7	68.1	2.7	1.5	2.9	3.2	**2.6**	**2.2**	**2.1**
Public Consumption		2604.9	14.4	1.5	-2.4	-0.7	1.6	**0.8**	**0.9**	**1.0**
Gross fixed capital formation		3576.6	19.8	2.2	3.0	4.2	3.7	**1.0**	**2.1**	**2.1**
of which: equipment		1227.3	6.8	4.5	3.3	4.6	3.1	**-0.9**	**2.3**	**2.1**
Exports (goods and services)		2264.3	12.6	4.4	3.5	4.3	0.1	**0.3**	**3.6**	**3.7**
Imports (goods and services)		2786.3	15.4	5.0	1.1	4.4	4.6	**1.2**	**4.1**	**4.0**
GNI (GDP deflator)		18242.3	101.1	2.6	1.7	2.3	2.3	**1.5**	**2.0**	**1.8**
Contribution to GDP growth:	Domestic demand			2.6	1.2	2.7	3.1	**2.1**	**2.1**	**2.0**
	Inventories			0.0	0.2	-0.1	0.2	**-0.4**	**0.2**	**0.0**
	Net exports			-0.2	0.3	-0.1	-0.7	**-0.1**	**-0.2**	**-0.2**
Employment				-	1.0	1.6	1.7	**1.7**	**1.0**	**0.5**
Unemployment rate (a)				6.0	7.4	6.2	5.3	**4.9**	**4.7**	**4.7**
Compensation of employees / f.t.e.				3.4	1.5	2.8	3.0	**2.1**	**3.5**	**4.0**
Unit labour costs whole economy				1.7	0.8	2.0	2.0	**2.2**	**2.4**	**2.6**
Real unit labour cost				-0.2	-0.8	0.2	1.0	**0.8**	**0.3**	**0.4**
Saving rate of households (b)				10.4	10.3	10.4	11.2	**11.1**	**10.8**	**10.5**
GDP deflator				2.0	1.6	1.8	1.1	**1.4**	**2.1**	**2.2**
Consumer-price index				2.4	1.5	1.6	0.1	**1.2**	**2.0**	**2.1**
Terms of trade goods				-0.4	0.7	-0.2	2.3	**0.0**	**-0.5**	**-0.8**
Trade balance (goods) (c)				-4.6	-4.4	-4.5	-4.4	**-4.2**	**-4.4**	**-4.6**
Current-account balance (c)				-3.8	-2.3	-2.3	-2.6	**-2.5**	**-2.6**	**-2.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.8	-2.3	-2.3	-2.6	**-2.5**	**-2.6**	**-2.7**
General government balance (c)				-5.0	-5.3	-4.9	-4.4	**-4.6**	**-4.2**	**-4.0**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				70.0	104.6	104.7	105.2	**108.1**	**108.5**	**108.4**

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

(*) Employment data from the BLS household survey.