

Economic Views

United States

February 2012

View from the top

The United States ended 2011 with a string of encouraging economic news. Headline unemployment figures continued to decrease particularly during the second half of the year, while growth continued seemingly unaffected by the debt crisis in the Eurozone. Consumer and business sentiment indices have improved due to the better news on unemployment, prompting an increase in consumption – the foremost driver of economic growth in the US. We expect that the US expansion will continue to gather pace this year, albeit remaining below long-term rates.

We anticipate two key potential threats to the economic recovery: (i) uncertainty regarding the unravelling of the Eurozone crisis, which could severely damage the global financial system; and (ii) the lack of a credible medium-term fiscal plan, which calls in to question the medium to long term sustainability of the US deficit.

Key Metrics

Indicator	2011 ^e	2012 ^f	2013 ^f
GDP growth	1.7%	2.0%	2.3%
Inflation	3.0%	2.3%	2.4%
Base interest rate	0-0.25% [^]	◀▶	◀▶
General outlook		Neutral	Neutral

Source: US Bureau of Economic Analysis; Federal Reserve Bank of New York; PricewaterhouseCoopers forecasts (f); [^] End of period

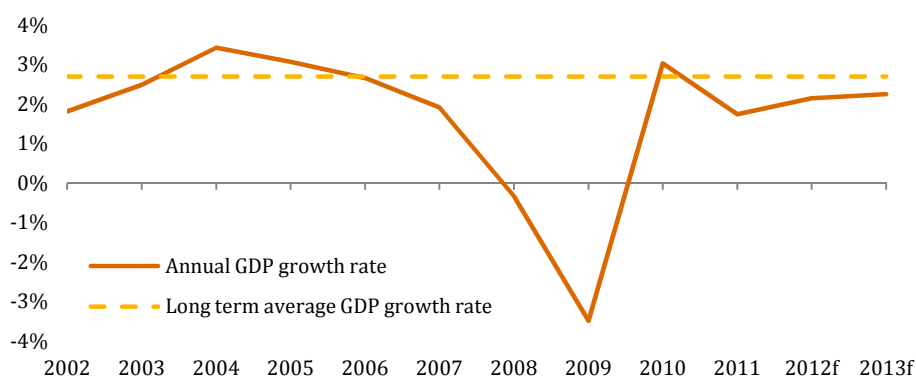
Key opportunities

- Recovering labour markets;
- Improved consumer and business sentiment;
- Low interest rates over the medium term.

Key threats

- Financial contagion from the Eurozone debt crisis;
- Higher exchange rate and reduced demand from the Eurozone;
- Medium term uncertainty around the fiscal deficit.

GDP Growth



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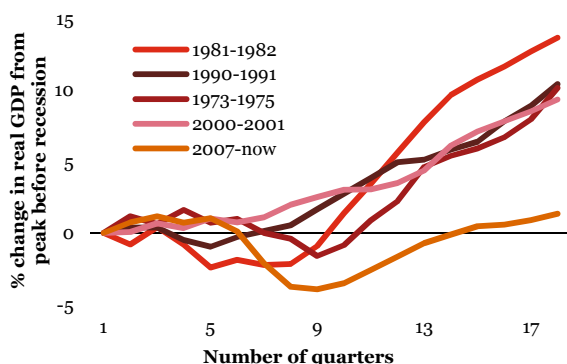
Source: US Bureau of Economic Analysis (BEA), PricewaterhouseCoopers forecasts (f)

Forecasts are updated regularly online at economics.pwc.com

Growth will be below the long-term rate for the foreseeable future

Four years on from the beginning of the recession in 2008, the US economy is still not out of the woods. Latest data confirms that the current economic recovery has been the slowest in the past few decades (see Chart 1 below). This can be partly attributed to the persistently high unemployment rate and debt over-hang, discouraging consumers from spending. Businesses have been unwilling to ramp up hiring despite improving profitability figures, choosing instead to increase the number of hours worked by their employees.

Chart 1: Current economic recovery in real GDP compared to previous slowdowns



Source: US Bureau of Economic Analysis, PwC analysis

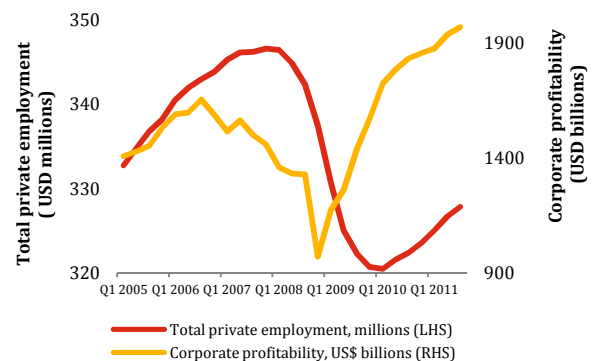
The inability of US policymakers to come to a consensus as to how best to tackle the US debt and deficit in the medium-term, and the fear of contagion from the Eurozone debt crisis have also contributed to an uncertain environment, making businesses and consumers nervous to spend cash.

However, recent economic data now suggests that labour market conditions improved considerably towards the end of the last year, particularly unemployment. Going forward, we anticipate that private sector growth will continue to gather momentum and resume its role in driving the economy.

The private sector will be crucial for growth in 2012

Despite sluggish economic conditions, US businesses have continued to fare well after the recession – the latest data indicates that corporate profits have increased for the 12th consecutive quarter (see Chart 2, top right). This is in contrast to the public sector which is projected to record a US\$ 1.3 trillion deficit in 2011.

Chart 2: Corporate profits and private employment



Source: US Bureau of Labour Statistics, US Bureau of Economic Analysis

Green shoots have appeared in some sectors of the economy with manufacturing industry performing particularly well; in fact US businesses have added more manufacturing jobs than the rest of the G7 put together since 2010.

This can be attributed to the significant decrease in the trade weighted dollar value by around 12% from the 2009 high, which has made American products more competitive. The flexible nature of the US labour market and the large number of unemployed has also put a downward pressure on costs; data suggests that US manufacturing costs have remained virtually constant over for the 13 quarters from 2008, whereas costs have increased by 6% in the European Union.

Businesses remain confident that this trend will continue – a survey by the Institute of Supply Management suggests that on balance purchasing managers in manufacturing are expecting an expansion in the future.¹ However a key challenge will be whether these businesses can maintain growth going forward in an environment where the dollar is likely to appreciate, and whether labour costs can be kept in check as the recovery gains momentum.

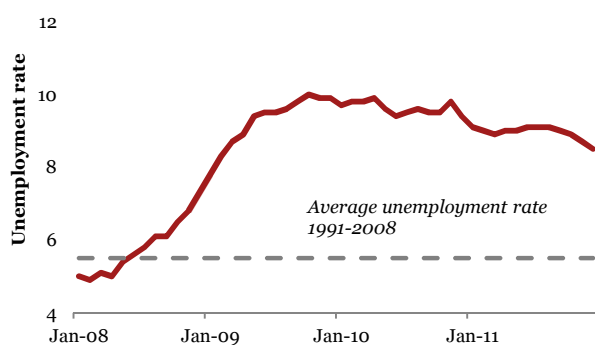
For the economy as a whole, it will also be important that business sector optimism gets translated into higher employment figures. If the recovery continues to be “job-less” or even “job-light”, then the positive trends in the business sector will not trickle through to the rest of the economy.

¹ A Purchasing Managers Index (PMI) above 50 suggests expansion; the figure for December was 53.9.

The labour market ended 2011 on a bright note, but will remain tough in 2012

One of the most closely watched statistics of 2012 will be unemployment, partly because it has political resonance in an election year and also because of the wide-ranging impact it has on the rest of the economy. Unusually for the US, the unemployment rate has reached a very high figure - around double the pre-recession average of 5.5%. However, the headline unemployment rate appears to be on a downward trend, moderating to 8.5% at the end of 2011, the lowest rate since February 2009 (see Chart 3 below).

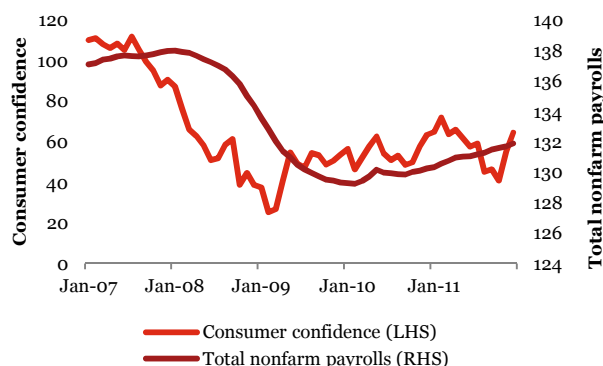
Chart 3: Unemployment rate



Source: US Bureau of Labour Statistics

New data released in December showed a meaningful acceleration in employment. In absolute terms, nonfarm payrolls have increased by 200,000 in the month of December, adding a total of 1.9 million jobs to the economy in 2011. This is positive news for the economy. As chart 4 below indicates, improving employment is associated with improving consumer confidence and spending.

Chart 4: Job market and consumer confidence



Source: US Bureau of Labour Statistics, The Conference Board

The large stock of unemployed workers will present American businesses and households with opportunities and threats in the near future.

The main benefit for business is that labour costs increases across all sectors of the US economy will continue to be low. This is in contrast to other OECD economies which have experienced around a 3% rise per annum since 2008. At face value, this would provide US businesses with a significant competitive advantage over their main competitors. However, a worrying feature of current trends is that the average duration of the unemployed is at 40.8 weeks or almost 9 months; the extra cost entailed in re-training workers could potentially offset some of the benefits from the erosion in real wages.

Since 2012 is an election year and there are still 6 million fewer jobs than at the pre-recession peak, we expect politicians to divert more resources to lowering the unemployment rate. On the back of delays in implementing the American Jobs Act, there have been some calls for the President to issue an executive order to overcome the legislative delay.

On balance, we anticipate that the extra resources and attention that will be diverted to the state of the labour market, both pre and post the November elections, will have a favourable impact on consumers and the economy as a whole, steadily decreasing the headline unemployment rate.

Eurozone debt worries

As events in the Eurozone escalate, there is an increasing likelihood that the US economy will be adversely affected.² The American economy would be impacted via three channels.

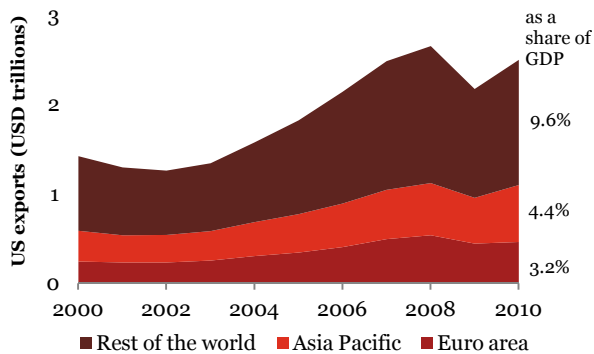
The first channel is via capital flows. Deteriorating economic prospects and investor concern are likely to lead to capital outflows from the region and a depreciation of the euro. The US is likely to benefit from this, as it is seen as a safe haven for capital. This will help keep interest rates low, but also the exchange rate strong, supporting domestic demand in the US. The recent expectations communicated by the Federal Reserve for low interest rates until late 2014 is all the more likely in this environment.

The second channel through which the US could be affected is via trade. A stronger dollar will undermine US business competitiveness in export markets. Weaker Eurozone demand would also hurt exports particularly to that region. Businesses that

² see 'What next for the Eurozone? Possible scenarios for 2012' available at www.pwc.co.uk/economics for our experts' view on the Eurozone crisis.

derive the majority of their revenue from abroad will have to adjust accordingly and look for opportunities in other regions of the world such as the BRIC economies or at home. However, the US is relatively well sheltered from a fall in trade with the Eurozone since exports to the region accounts for just 3.2% of GDP (see Chart 5, below).

Chart 5: Composition of US exports



Source: US Bureau of Economic Analysis

The third channel through which the US could potentially be impacted is via financial markets. Should the Eurozone debt crisis escalate, it could damage the wider global financial system. This would hurt US economic growth, as credit conditions would deteriorate, limiting access to credit for businesses and consumers alike. Experience from the 2008-09 credit crunch suggests that small and medium sized businesses will be particularly vulnerable.

The US election makes it unlikely for a medium-term fiscal plan to be enforced

The political deadlock and heated debates over the scale of the US deficit will continue to be a prominent theme in 2012, and a source of uncertainty.

November saw the failure of the bi-partisan “budget supercommittee” to reach a consensus on tackling the deficit. Automatic cuts will therefore start to be imposed in 2013. However, President Obama’s request to Congress for the debt ceiling to be raised by US\$1.2 trillion has added an extra layer of uncertainty.

Experience from last summer suggests that businesses were reluctant to step up hiring until there was a resolution to the debt ceiling debate. The US has just begun to see a sustained improvement in its labour market and consumer confidence – this momentum could be threatened should another episode of the debt ceiling debacle happen again. However, the level of drama seen last July is unlikely to be repeated again, as the Budget Control Act 2011 ensured that the President can

automatically raise the debt ceiling by US\$1.2 trillion unless more than two-thirds of Congress votes against it.

To overcome this political wrangling and uncertainty, US politicians need to agree a credible medium-term consolidation path for government spending. A consensus is unlikely until after the presidential elections in November. Since investors are more focused on the Eurozone crisis, the US has some breathing space, but in time investors will re-focus their attention on the deficit reduction strategy.

Modest economic outlook in 2012

Most forward-looking economic indicators in the US are encouraging. With the US labour market experiencing a recovery and optimism steadily rising amongst businesses and consumers, we expect that the US economy will continue to grow for the next two years.

There are downside risks – the possibility of the Eurozone debt crisis inflicting damage on the wider financial system and an uncontrolled US fiscal trajectory will be issues that will need to be tackled sooner rather than later.

However, the US economic model has shown itself to be more flexible and resilient than what many have given it credit for over the past year. We expect a modest economic outlook for the US with the economy projected to grow at 2% and 2.3% respectively.

Forecasts

GDP (annual % average)

	2011 ^e	2012 ^f	2013 ^f
Real growth (annual % change)			
GDP	1.7%	2.0%	2.3%
Consumer spending	2.2%	1.9%	2.4%
Government	-1.9%	-0.7%	-1.2%
Investment	6.9%	7.3%	6.9%
Exports	6.8%	2.9%	4.5%
Imports	4.8%	3.5%	4.4%
Contribution to growth (%)			
Consumer spending	1.5%	1.4%	1.7%
Government	-0.4%	-0.1%	-0.2%
Investment	0.9%	1.0%	1.0%
Exports	0.9%	0.4%	0.6%
Imports	-0.8%	-0.6%	-0.7%
Domestic demand	1.8%	2.2%	2.5%
Net exports	0.1%	-0.2%	-0.1%
Economic structure (% of GDP)*			
Consumer spending	70.7%	70.6%	70.7%
Government	18.8%	18.3%	17.7%
Investment	13.2%	13.9%	14.5%
Exports	13.3%	13.5%	13.7%
Imports	16.4%	16.7%	17.0%
Consumer price inflation			
CPI (annual % change, average)	3.0%	2.3%	2.4%

Source: US Bureau of Economic Analysis; PricewaterhouseCoopers forecasts (f);

*Component shares of GDP may not add up to 100% owing to stock building and statistical discrepancy.

Size of the economy

	2009	2010	2011	% of 2011 world total
Population (millions)	307	310	313	4.6%
GDP, current prices (US\$ billions)	13,939	14,527	15,065	21.5%
GDP, PPP terms (US\$ billions)	13,939	14,527	15,065	19.1%
GDP per capita, current prices (US\$)	45,348	46,860	48,147	
GDP per capita, PPP terms (US\$)	45,348	46,860	48,147	

Source: International Monetary Fund

Definitions

Base interest rate – The base interest rate for the US is the Federal Funds Target Rate

Base interest rate forecasts – ▲ increase; ▼ decrease; ◀▶ no change

BLS – Bureau of Labour Statistics

CPI – Consumer Price Index

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The team works with businesses and governments to identify and assess strategic opportunities and external risks. The team's consulting services combine strategic analysis of macro trends with strong quantitative techniques across four broad categories outlined below:

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We work with cities, regions and countries to create or update their economic vision blueprints and strategies.

Geographical market selection

We assist growing multinational companies to assess opportunities in new geographical markets.

Business scenario analysis

We use our knowledge of macro trends and our econometric toolkit to help companies understand the risks and opportunities in their business.

Economic impact analysis

We assist clients in demonstrating the value they bring to their host economies in the context of wider economic trends.

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