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United States: 2010 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with the United States, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 28, 2010, with the officials of United States on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 12, 1010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of July 22, 1010, updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 26, 2010, discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

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INTERNATIONAL MONETARY FUND

UNITED STATES

Staff Report for the 2010 Article IV Consultation

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Nicolás Eyzaguirre and Tamim Bayoumi

July 2, 2010

EXECUTIVE SUMMARY

Context: The economy is recovering thanks to unprecedented macroeconomic policy stimulus, emergency financial stabilization measures, and a gathering cyclical upswing. But the expansion is subdued by historical standards, owing to balance-sheet headwinds in the financial and household sectors. And risks are tilted to the downside, notably those emanating from spillovers associated with sovereign strains in Europe.

Assessment: Authorities need to cautiously complete the exit from extraordinary policy support and decisively deal with long-term legacies, namely fiscal imbalances and (as identified in the Financial Sector Assessment Program (FSAP)) gaps in financial regulation, to secure stable medium-term growth, limit adverse international spillovers, and contain risks of new financial excesses.

Policy recommendations:

Macroeconomic stimulus: maintain stimulus in 2010 while the recovery is still gaining traction; but in 2011, make the planned down-payment on fiscal consolidation (with flexibility on the size of adjustment if risks materialize). Balance-sheet headwinds and tail risks (including deflation) call for a cautious monetary exit.

Fiscal stabilization: develop a credible plan for stabilizing debt/GDP over the medium term, which would entail a larger adjustment than under the authorities' budget path, without jeopardizing the recovery. A credible plan would have three elements—an upfront adjustment (the planned adjustment in 2011 would be appropriate under staff's baseline outlook), clear commitment to future measures (perhaps by enshrining targets in legislation), and further entitlement reforms—with tradeoffs among them if necessary, say in a downside risk scenario. Over the long term, the aim should be to put the debt ratio on a downward path.

Financial reform: banks remain vulnerable to shocks and will need additional capital to lend when credit demand recovers. Tighten regulation to lower systemic risks (with more robust consolidated supervision, stricter standards on systemic institutions to discourage systemic size and complexity, and an improved resolution mechanism), implement promptly steps to revitalize securitization, and quickly bring a macro-prudential focus to the council of regulators.

Authorities' views: Authorities have a more optimistic economic outlook than staff, and correspondingly see the required medium-term fiscal adjustment to be smaller, but broadly agree with the challenges ahead. Fiscal stabilization and strong implementation of financial reforms are priorities.

Analytical work: Background studies cover shocks to structural unemployment, risks of a jobless recovery, determinants of savings rate, debt accumulation and interest rates, the fiscal gap, and an evaluation of housing finance in the United States.

Staff: The team comprised David Robinson (head), Charles Kramer, Marcello Estevão, Nicoletta Batini, Oya Celasun, Andrea Maechler, Martin Sommer, Evridiki Tsounta, Grace Bin Li (all WHD), Francesco Columba, John Kiff (both MCM), and Ashok Bhatia (SPR). Brad McDonald and Mika Saito (SPR) contributed with advice on trade policy and Joseph Myers and Steve Dawe (LEG) with analysis on AML/CFT issues.

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I. BACKDROP: BACK FROM THE BRINK

1. **Thanks to a massive policy response to the worst financial crisis since the Great Depression, the U.S. economy is recovering, but further decisive policy action will be needed to address the policy challenges stemming from the crisis.** The 2009 Article IV consultation pointed to three such policy objectives: economic and financial stabilization; exiting extraordinary support; and dealing with long-term legacies of the crisis (fiscal sustainability and reforming financial regulation):

a. On *stabilization,* output is recovering thanks to an unprecedented macroeconomic policy response—policy rates cut to near zero and the largest peacetime fiscal expansion on record (Figure 1). This response, along with capital injections in major financial institutions, emergency lending, stress tests, and guarantees, has also stabilized financial conditions and broken the adverse macro-financial spiral (Figure 2, Figure 3). By the same token, however, economic and financial conditions remain dependent on policy support. And downside risks, including U.S. real estate markets and sovereign stress in Europe (and renewed market focus on fiscal sustainability), have increased.

b. On *exiting extraordinary support*, the authorities have largely—and deftly—exited their exceptional measures to stabilize the financial system, with few ripples in financial markets. Macroeconomic policies remain appropriately accommodative, although preparations for the exit are well advanced. In particular, the Fed has skillfully communicated its exit strategy, thus underpinning confidence in a smooth unwinding of monetary stimulus. Fiscal stimulus would remain in place this year, with the exit envisioned to begin in 2011.

c. On *long-term legacies*, progress has been made but more remains to be done. Draft financial reforms broadly address the issues raised in the FSAP assessment.[1] A major health care reform that dramatically expands coverage and introduces cost-containment measures has been passed, fiscal institutions have been strengthened, and the proposed budget incorporates structural measures that would make progress toward stabilizing the debt over the medium term. However, these measures are insufficient to stabilize debt over the medium term, and the effectiveness of health reforms in containing costs—a major driver of fiscal imbalances—is highly uncertain.

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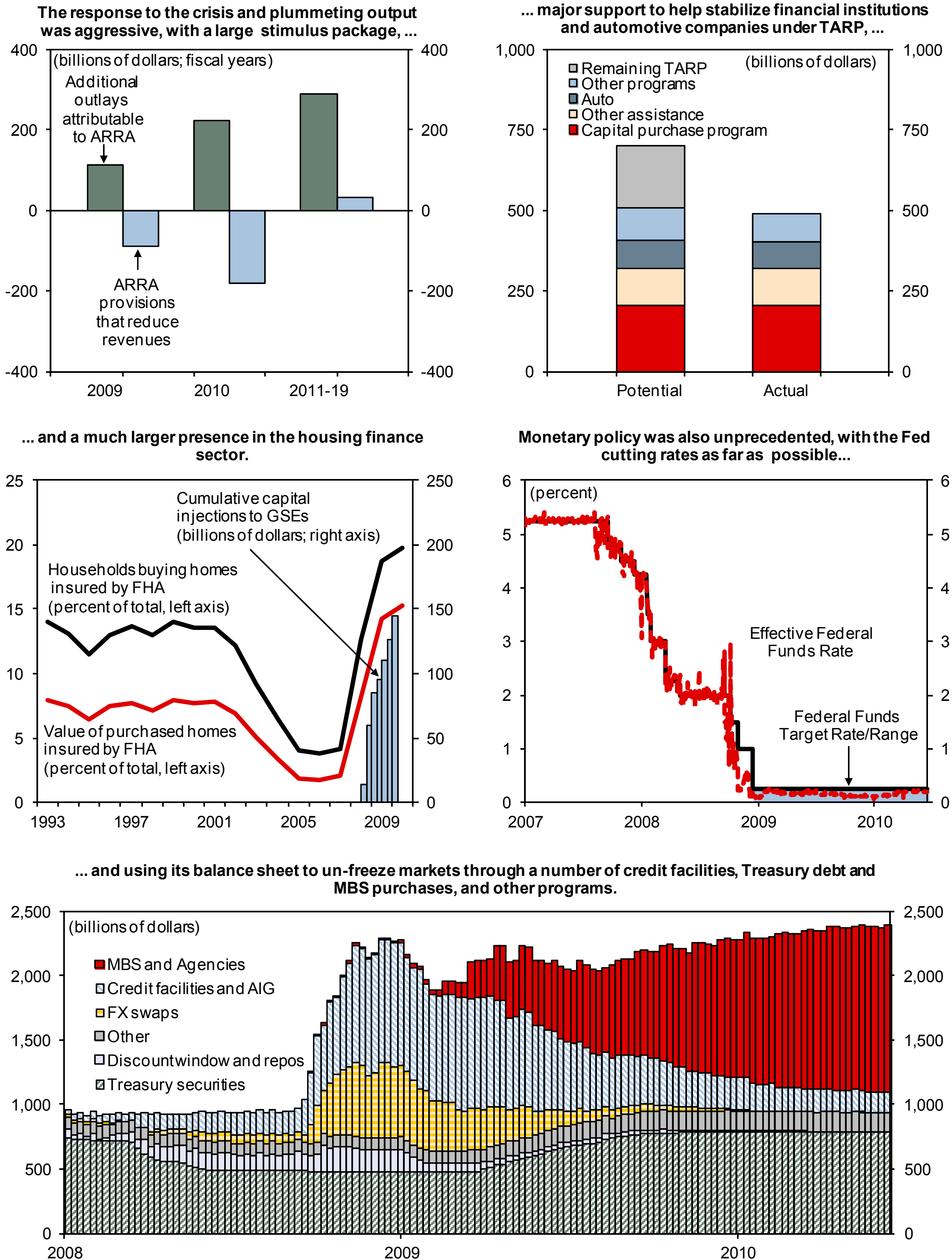
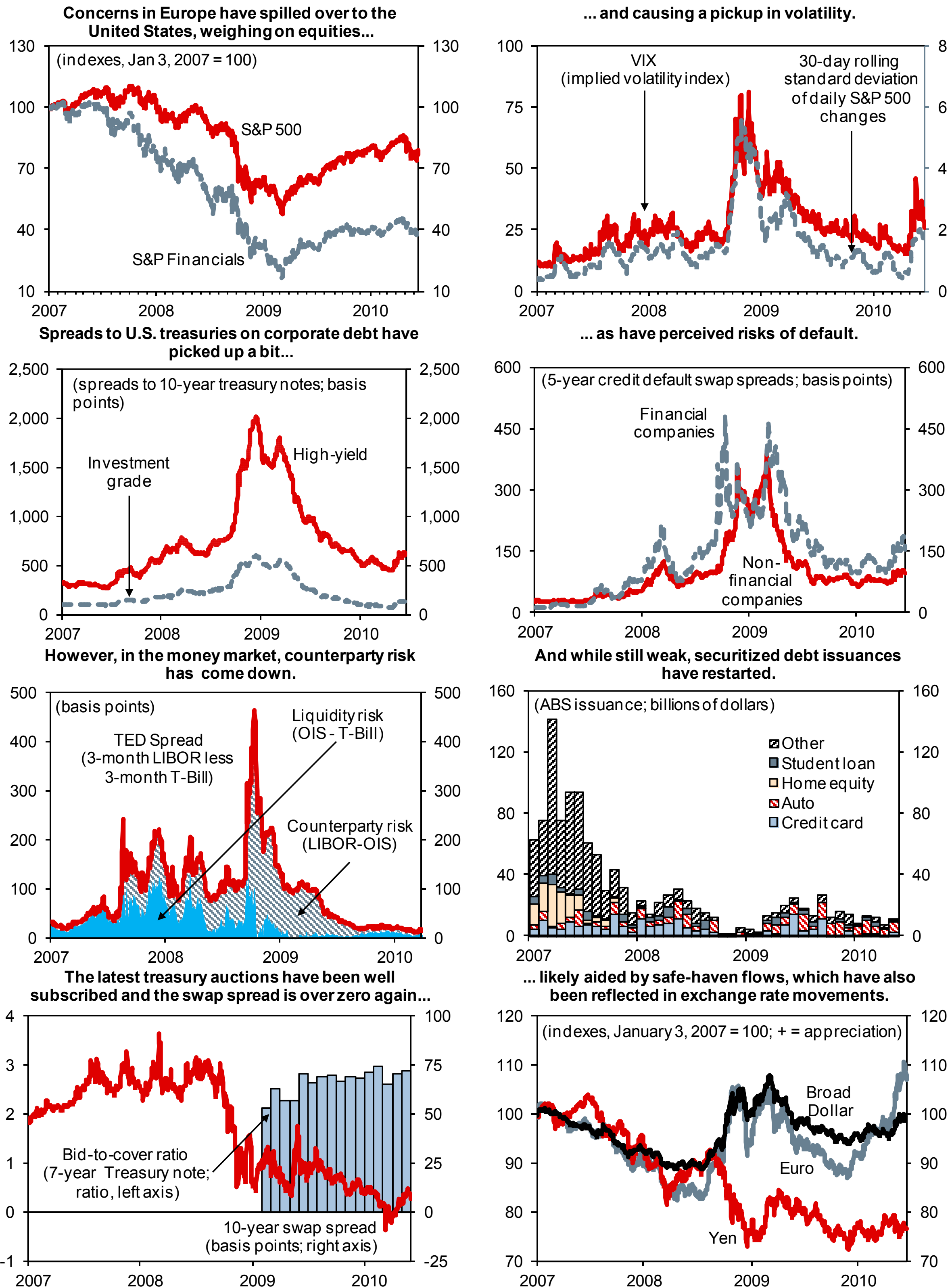
[1] Background on the FSAP process is available at http://www.imf.org/external/np/fsap/faq/index.htm.

Figure 1. Substantial Government Support to the Economy

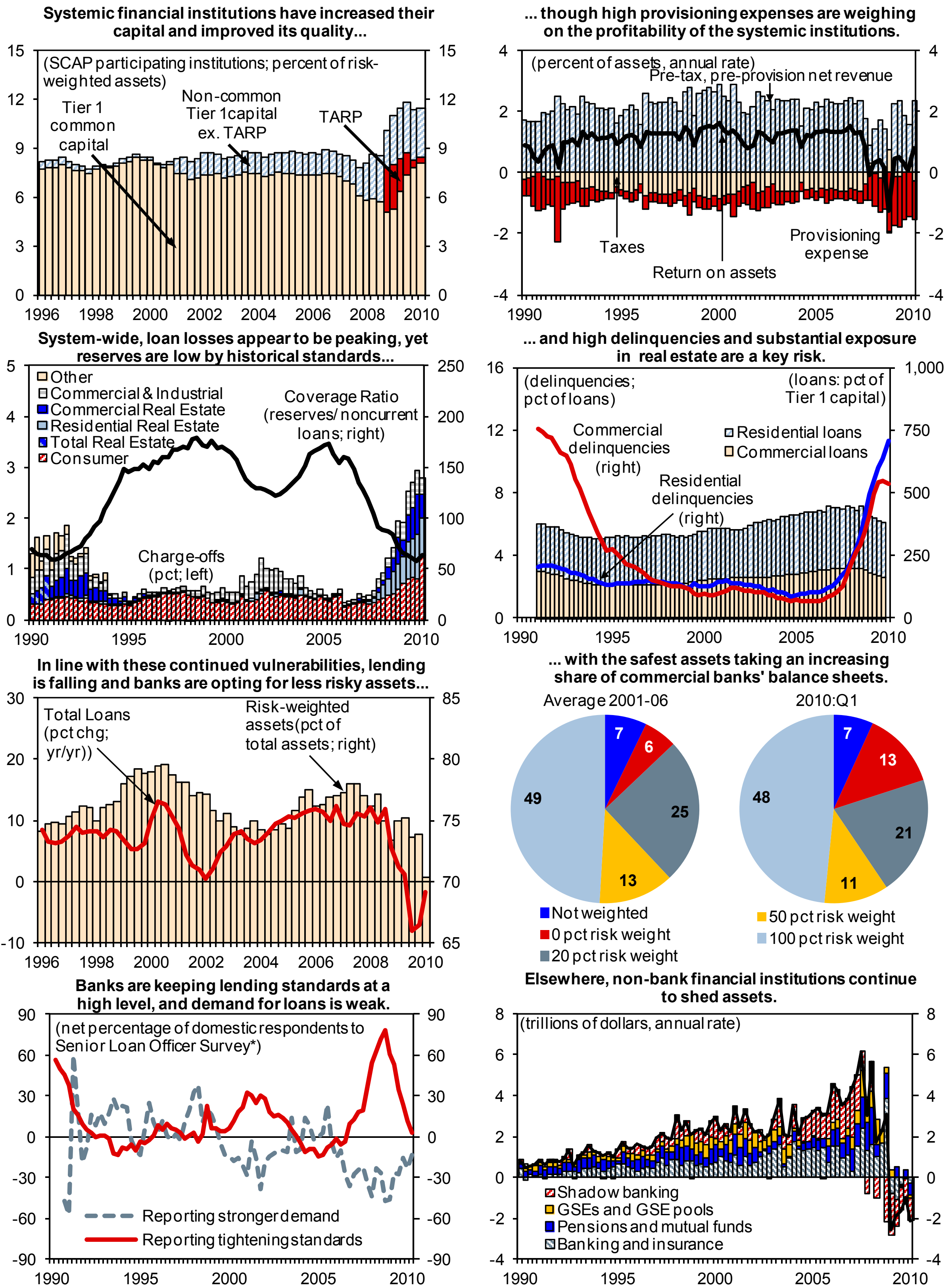


Sources: Congressional Budget Office, U.S. Department of the Treasury, Federal Housing Administration, Federal Housing Finance Agency, Board of Governors of the Federal Reserve System, Haver Analytics, and Fund staff estimates.

Figure 2. Recovering Financial Sector



Sources: Bloomberg, LP; Haver Analytics, Datastream, Board of Governors of the Federal Reserve System; and Fund staff estimates.



* Standards for loan classes weighted by the share of that loan category in the total.
Sources: Board of Governors of the Federal Reserve System, SNL Financial, Federal Deposit Insurance Corporation, Haver Analytics, and Fund staff estimates.

2. **The key policy challenge is to balance continued support for the recovery with progress in dealing with long-term legacies.** In the near term, macroeconomic policies should maintain support for growth, with monetary policy remaining accommodative as fiscal consolidation begins in 2011. Steps to strengthen the fiscal strategy are needed as well, to underpin credibility in medium-term fiscal sustainability; over the medium term, additional adjustment will be needed to stabilize debt, including further action on entitlements. And financial sector reforms must be implemented and operationalized strongly to prevent the reemergence of financial excesses over time.

II. Recovering Against Headwinds: Stimulus Versus Balance-Sheet Strains

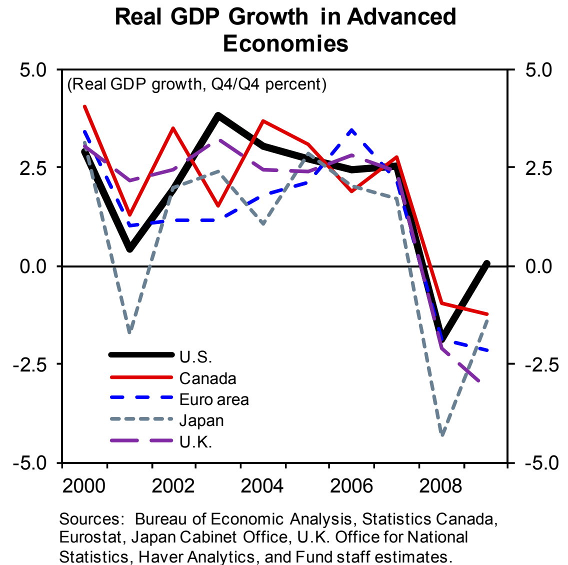
3. **Starting in the second half of 2009, massive macroeconomic stimulus overcame the prevailing balance-sheet strains, and the U.S. economy emerged from recession (Table 1).** Cumulative GDP growth totaled 1.9 percent (unannualized) over the second half, compared with a peak-to-trough decline of 3.7 percent, with a further rise of 0.7 percent (unannualized; 2.7 percent, annualized) in the first quarter of 2010. This turnaround reflected three main factors:

- **Unprecedented macroeconomic stimulus.** The Federal Reserve cut its target rate to an all-time low of 0–25 basis points, signaled that the rate would remain at exceptionally low levels for an extended period, and (via liquidity and credit-easing measures) doubled its balance sheet. In February 2009, the Administration launched the largest stimulus package on record—the American Recovery and Reinvestment Act of 2009—totaling about 5 percent of one year's GDP during 2009–11, with later measures adding to stimulus. Overall, stimulus added over 1 percent to growth in 2009, with a smaller effect expected in 2010, and negative contributions starting in 2011.

- **Emergency financial stabilization.** Financial conditions have improved substantially from highly stressed levels, on the back of measures to stabilize financial markets, capital injections, guarantees, and stress testing. The authorities have also expanded measures aimed at mitigating the surge in foreclosures. However, financial conditions remain on the tight side, especially for small and medium-sized enterprises that rely on financing from smaller banks (hit hard by commercial real estate losses), and for segments dependent on the still-weak private securitization markets.

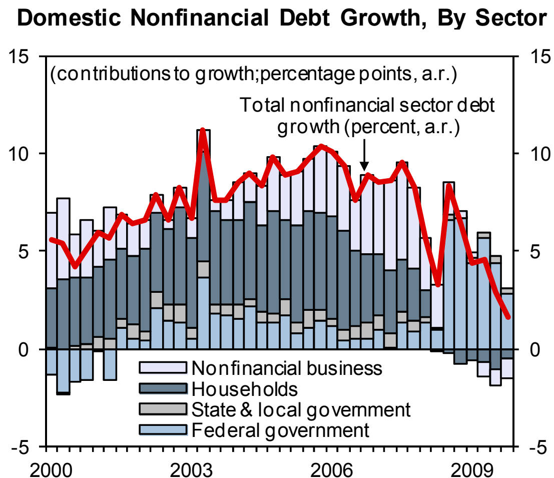
- **A strong inventory cycle**. As the crisis reached extreme levels, businesses slashed inventories, shaving 3¾ percent (seasonally adjusted at an annual rate) off GDP growth in the first half of 2009. In the second half, however, they sharply slowed the rate of depletion, with the result that inventories contributed a mirror-image 3¾ percentage points to growth in the fourth quarter, and a further 1½ percentage points in the first quarter of 2010.

4. **The result was a strong bounce in stimulus-related components of GDP (Figure 4**). Auto purchases surged in the third quarter of 2009 thanks to the "cash for clunkers" subsidy program, contributing a full ¾ percentage point to growth. Residential investment posted a strong increase through the first quarter of 2010, on the back of favorable financing conditions and tax breaks for home purchases, reversing an unprecedented 15 straight quarters of decline. Overall, the U.S. rebound was relatively strong compared with that in other G7 countries.



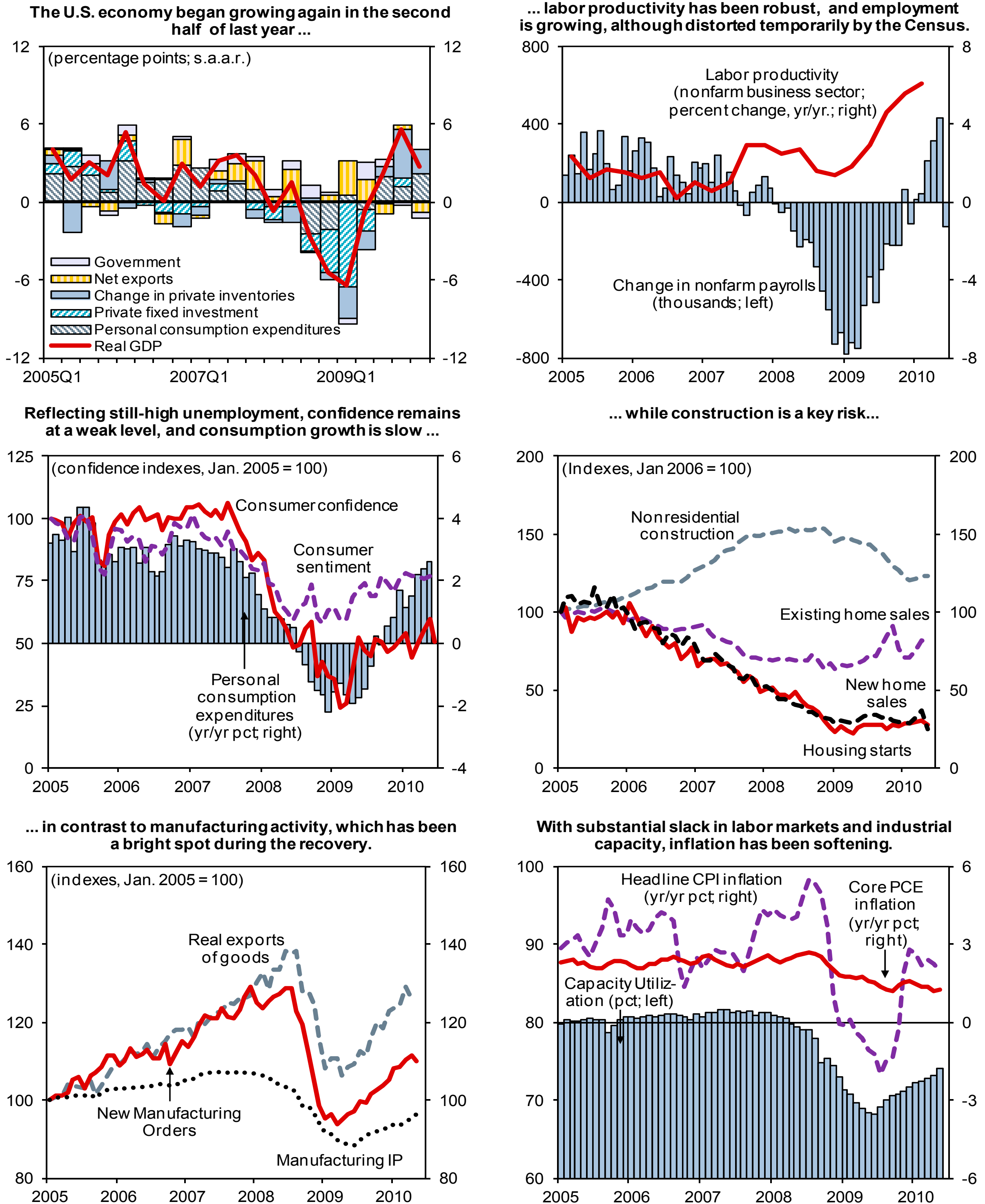
Sources: Bureau of Economic Analysis, Statistics Canada, Eurostat, Japan Cabinet Office, U.K. Office for National Statistics, Haver Analytics, and Fund staff estimates.

5. **But even with massive stimulus, the recovery is modest by historical standards (Figure 5).** The United States has traditionally enjoyed "V-shaped" recoveries thanks to its economic flexibility. But data thus far point to a more subdued recovery than in historical experience. A rough rule of thumb that the expansion is proportional to the contraction would imply an expansion of 6 percent per annum over 8 quarters of expansion, well above the rates projected by staff and others. And underneath the headline figures, selected sectors remain under stress: commercial real estate continues to contract, and state and local government spending is under pressure due to balanced-budget arrangements that effectively rule out a countercyclical response. Meanwhile, private sector deleveraging continues.

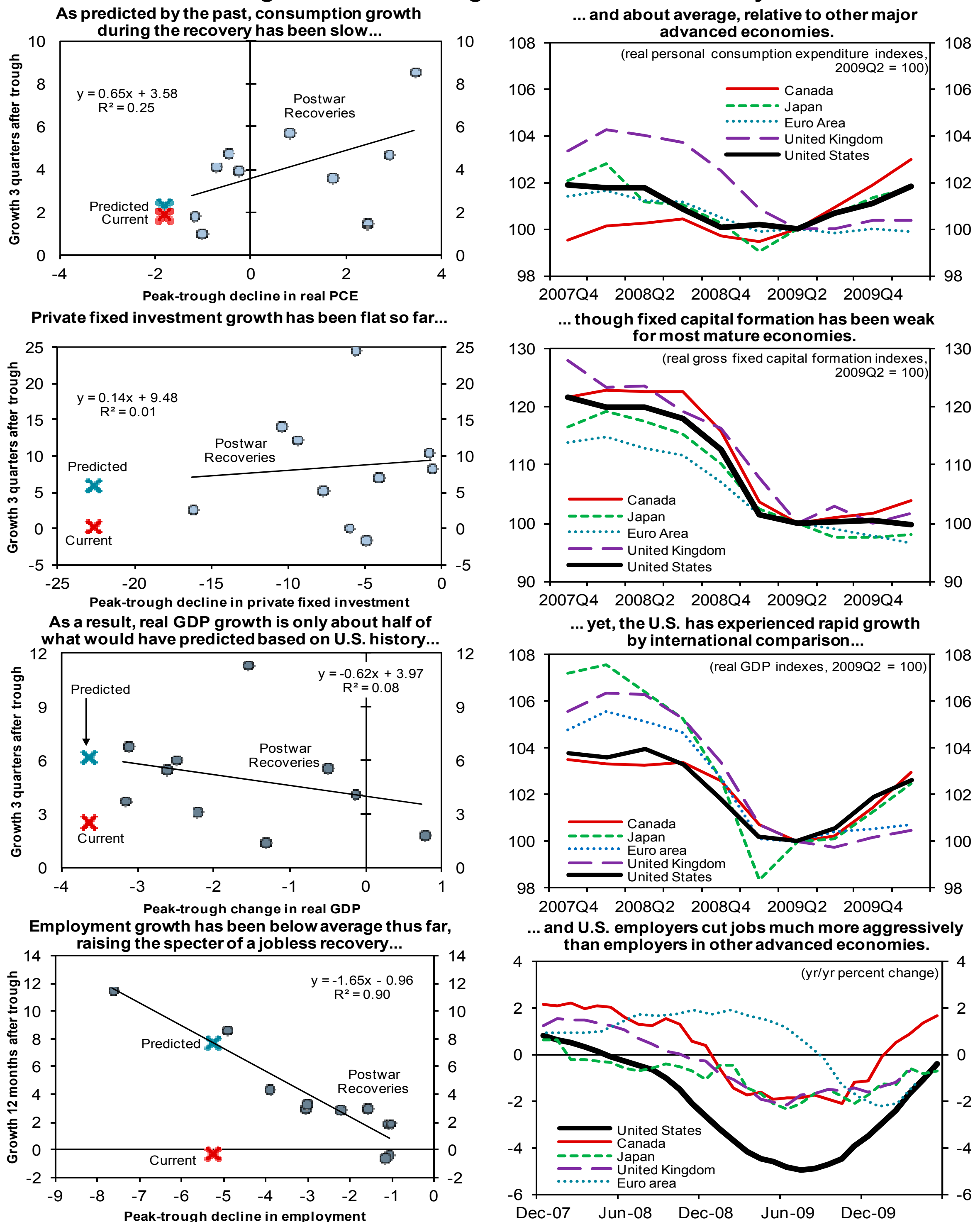


6. **The global collapse in trade brought about a sharp narrowing of the U.S. current account balance**. U.S. exports and imports both contracted sharply, with the result that the current account balances dropped precipitously from about 5 percent of GDP in the pre-crisis years to about 3 percent in 2009. The composition of financing shifted sharply as well, with sizeable flows into U.S. treasury securities amid a "flight to quality" (which also triggered a sharp appreciation in the dollar). More recently, trade and capital flows have recovered, but the current account remains modest relative to pre-crisis levels.

Figure 4. An Economy in Recovery



Sources: Bureau of Economic Analysis; Bureau of Labor Statistics; the Conference Board; Reuters/University of Michigan; U.S. Census Bureau; National Association of Realtors; Board of Governors of the Federal Reserve System; Haver Analytics; and Fund staff estimates.



Note: Dates of prior U.S. peaks and troughs determined by the National Bureau of Economic Research. For current episode, trough is 2009:Q2 (June).
Sources: Bureau of Economic Analysis; Statistics Canada; Eurostat; U.S. Office for National Statistics; Japan Cabinet Office; Bureau of Labor Statistics; Haver Analytics; and Fund staff estimates.

7. **With economic slack large, core inflation has remained low.** Against the backdrop of high unemployment and a wide output gap, headline CPI inflation has recently trended around 2 percent y/y, with some volatility owing to swings in fuel prices. Meanwhile, core inflation has declined significantly to about ½ percent on a 3-month SAAR basis.

8. **One striking feature of the recovery has been the persistent weakness in the labor market (Figure 6).** The unemployment rate is higher than in any postwar period save a brief point in the 1980s, while unemployment duration, the percent of long-term unemployed, and the number of involuntary part-time workers are all at record highs. The level of long-term unemployment is particularly worrisome, as it erodes labor skills and thus could add to structural unemployment while reducing lifetime earnings. Looking ahead, labor reallocation is apt to be slow, given the evidence of heightened skills and geographical mismatches, which are estimated to have raised equilibrium unemployment rates across states and in the nation as a whole (*Selected Issues Paper, Chapter I*). In addition, underwater mortgages (where debt exceeds the value of the house) seems to have been impeding geographical reallocation by making it difficult for homeowners to sell their houses so that they can move in search of better job prospects.

9. **Meanwhile, unemployment is feeding fragilities in the housing markets (Figure 7).** Housing starts have stabilized, but remain around historical lows, and well below the replacement rates implied by demographic trends. Broad measures of housing prices seem to have bottomed out, at 30 percent below peak, but register at best subdued growth. Meanwhile, mortgage delinquency rates continued to climb in the first quarter of 2010, and foreclosure supply remains large; in April 2010, distressed sales accounted for one third of existing home sales, and about 2.5 million houses were in foreclosure.[2] But even these figures understate housing stress, as mortgages in serious delinquency have run far ahead of foreclosures, against the background of enhanced foreclosure mitigation efforts, as well as indications that banks are struggling to process a backlog of foreclosures. As a result, some 1.7 million homes may be in the "shadow foreclosure" stock that could hit the market in the future, depressing home prices.[3] Negative equity problems could also hinder housing recovery and pose vulnerabilities, with more than 11.2 million residential properties with mortgages in negative equity at the end of the first quarter of 2010.[4]

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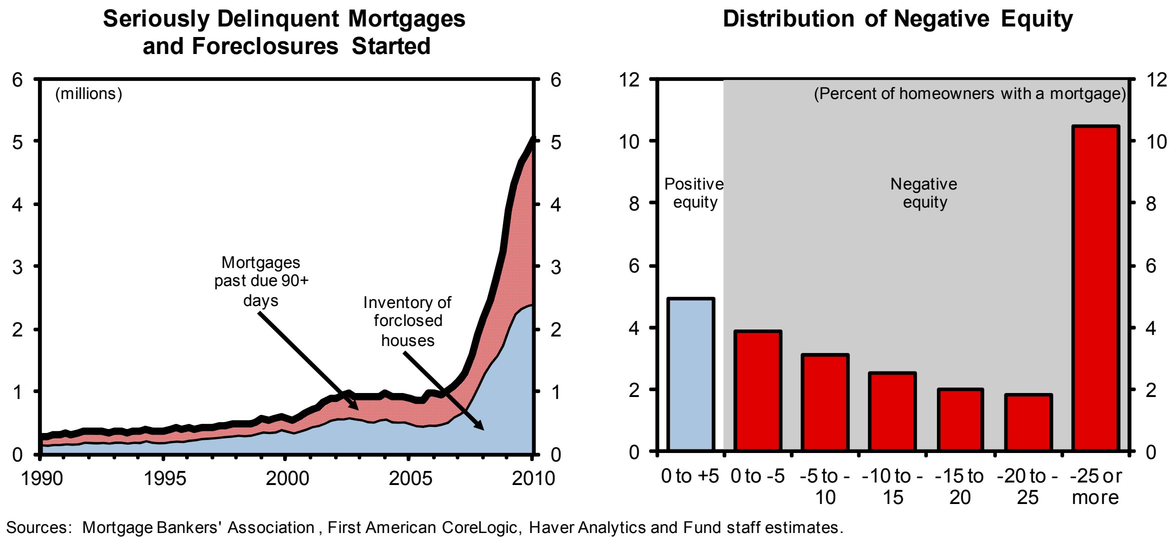
[2] There are about 130 million housing units in the United States.

[3] The Fed's June 2010 "Beige Book" noted that "tight credit, the elevated inventory of homes available for sale, and the "shadow inventory" of foreclosed properties on banks' balance sheets held back residential development in the New York, Cleveland, Atlanta, and Chicago Districts."

[4] There are over $600 billion in negative equity in home mortgage loans for which the borrower owes at least 25 percent more than what the house is worth.



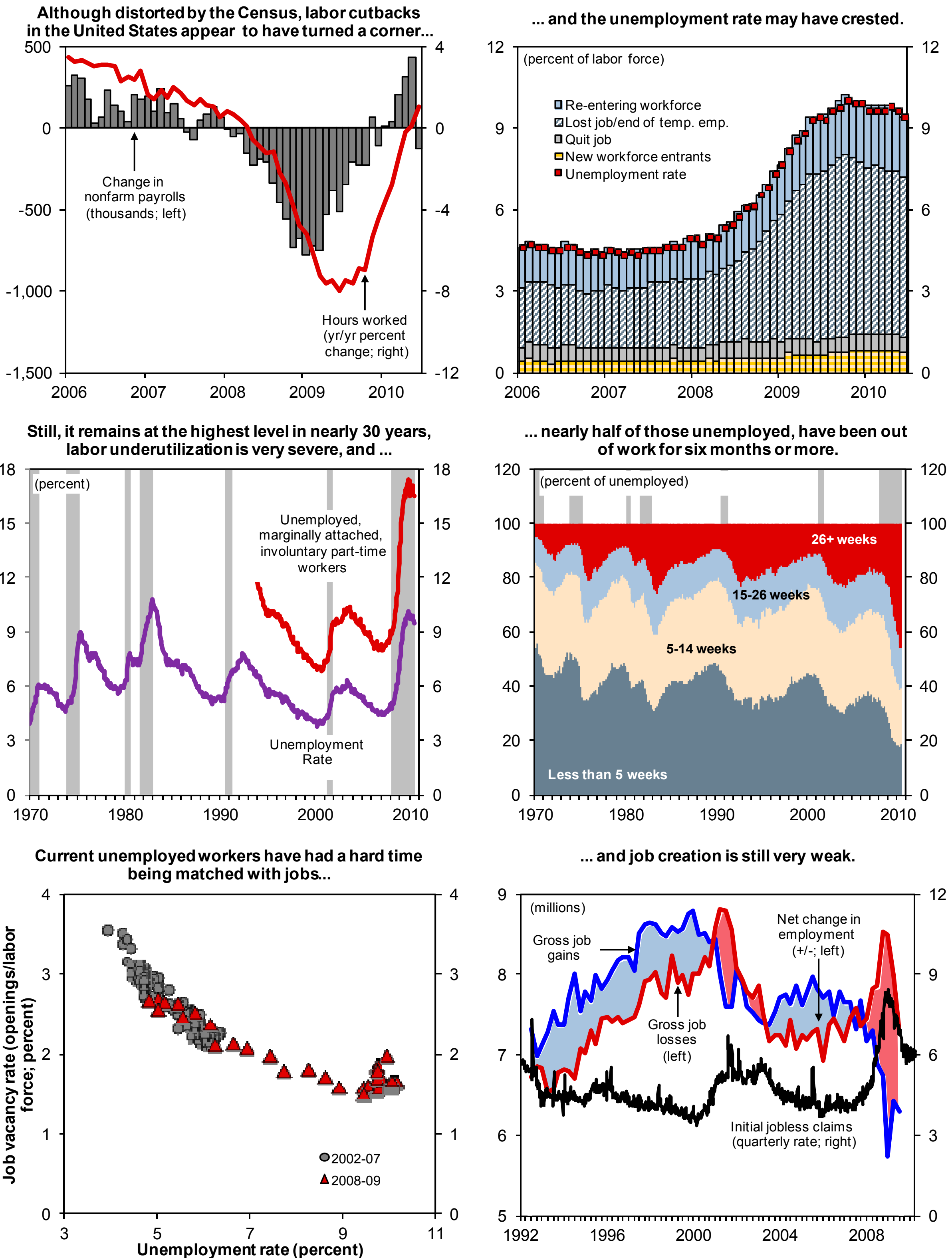
Sources: Mortgage Bankers' Association , First American CoreLogic, Haver Analytics and Fund staff estimates.

10. **On the other hand, corporate balance sheets have been relatively strong (Figure 8).** Corporate leverage has come down, and profits have rebounded notwithstanding the collapse in demand, as companies slashed investment and payrolls during the downturn. Accordingly, productivity surged, with annualized growth in nonfarm output per hour peaking at 7¾ percent in the third quarter of 2009, and unit labor costs dropping by 5 percent in the fourth quarter. Thanks to their strong balance sheets, large companies have been able to tap capital markets for equity and debt, bypassing the weakened banking system. As a result of this restructuring, the attendant strength in profits, and renewed access to capital markets, corporations have ramped up investment spending, supporting demand.

11. **Financial conditions have been volatile, with a Europe-related partial retrenchment after an initial recovery**. After bottoming out in March 2009, stock markets continued to rise steadily, recovering over 60 percent of what they had lost since the beginning of the crisis. But starting in early April 2010, concerns about contagion from the European sovereign debt crisis fueled a broad market sell-off, with sharply lower equity and commodity prices, wider corporate spreads, and a surge in market volatility. Short-term funding spreads shot up sharply, but remained well below Lehman-crisis levels. Meanwhile, a "flight-to-quality" has pushed the 10-year Treasury bond yield from 3.9 percent at end-April to below 3 percent in June, while the dollar has gained about 6.4 percent against the euro since end-April.

12. **Securitization activity has remained subdued, due to a combination of low demand and uncertainty about regulatory reforms**. In particular, weak house prices and record high delinquency rates continued to hold back the revival of private-label residential mortgage-backed securitization. Overall, ABS issuance totaled $53 billion over the first five months of 2010, similar to the amount during the same period in 2009 and compared with $431 billion in the same period of 2006.

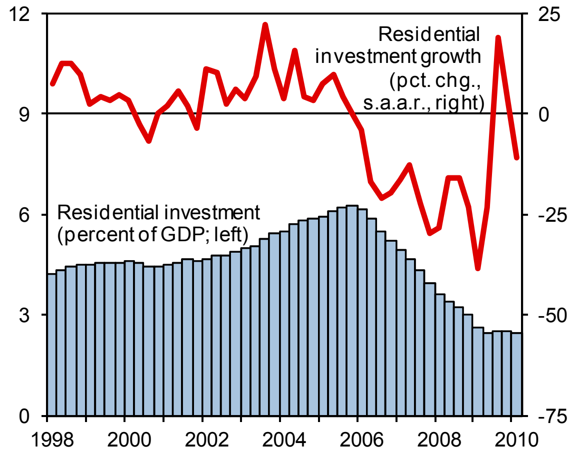
Figure 6. Labor Market Conditions



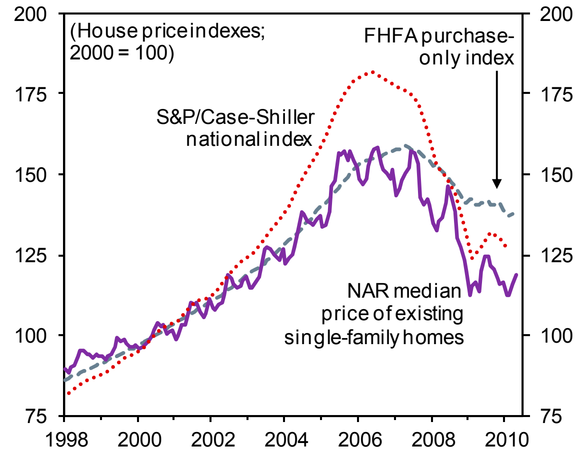
Sources: Bureau of Labor Statistics, Haver Analytics, and Fund staff estimates.

Figure 7. Housing Boom and Bust

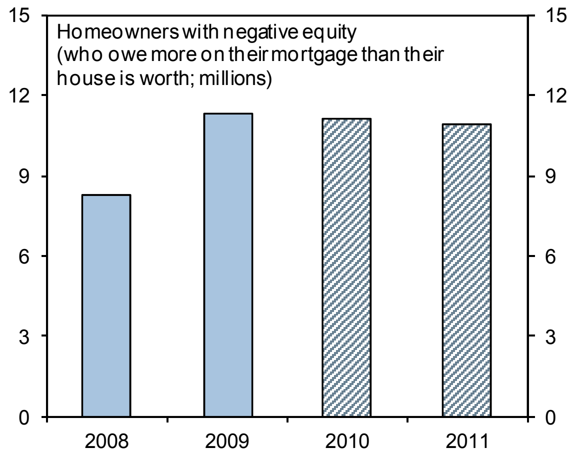
After 3½ years of uninterrupted contraction, residential investment appears to have nearly hit bottom.



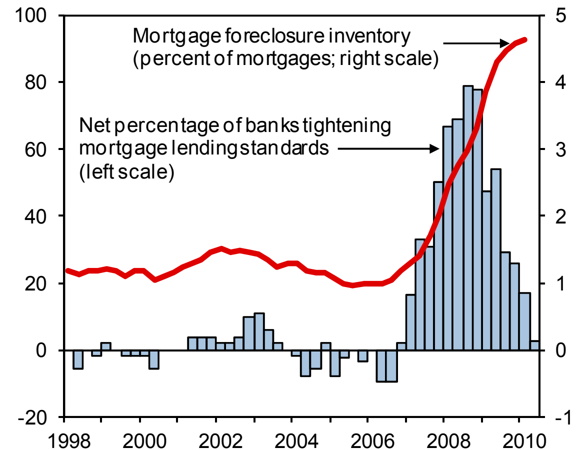
And house prices seem to be stabilizing.



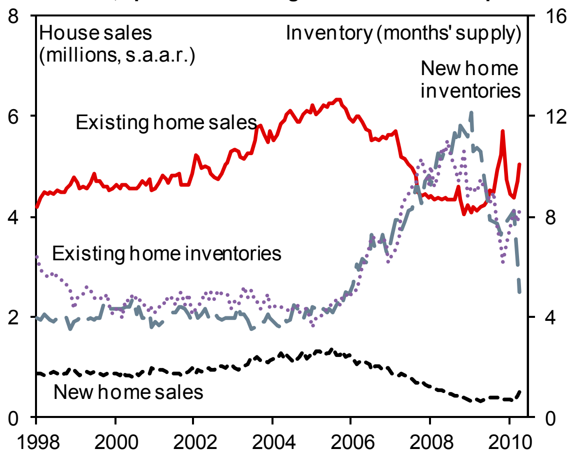
Nevertheless, a large number of U.S. households continue to be underwater on their mortgages...



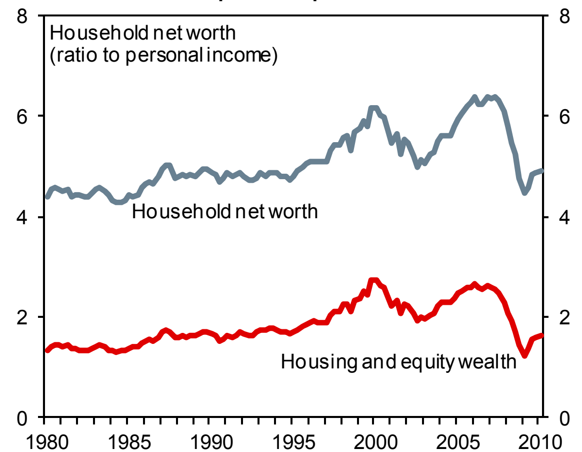
... which has boosted foreclosures and contributed to continued tightening in lending standards.



These factors have kept housing inventories high, and sales low, apart from fleeting stimulus-induced spikes.

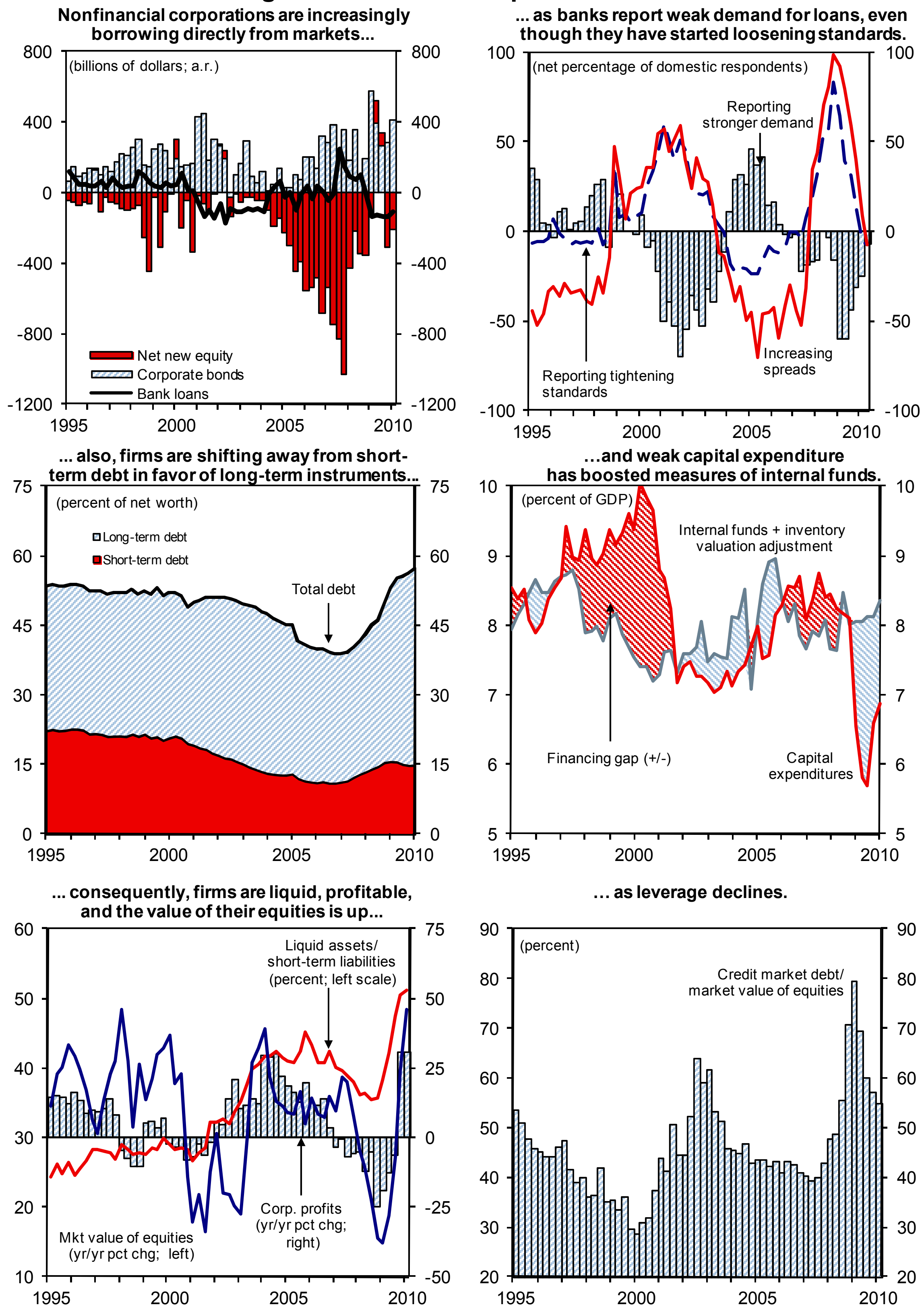


And households' wealth remains well below the pre-crisis peak.



Sources: Bureau of Economic Analysis; S&P/MacroMarkets, LLC; National Association of Realtors; Federal Housing Finance Agency; First American CoreLogic; U.S. Census Bureau; Mortgage Bankers Association; Board of Governors of the Federal Reserve System; Bloomberg, LP; Haver Analytics; and Fund staff calculations.

Figure 8. Resilient Corporate Sector



Sources: Board of Governors of the Federal Reserve System; Merrill Lynch; Bureau of Economic Analysis; Haver Analytics; and Fund staff calculations.

13. **Looking ahead, balance-sheet strains in the household, financial, and public sectors pose headwinds to growth.**

- **Household saving** has ranged above pre-crisis levels as households attempt to rebuild net wealth following a major shock (100 percent of GDP), albeit with some volatility (peaking at 6.4 percent in May 2009 before declining) (Figure 9). Households continue to deleverage, and saving may have further to rise before the process of balance-sheet repair is done (*Selected Issues Paper, Chapter II*).

- **Financial institutions** have managed to rebuild capital ratios, in part by shedding risk. But with default and charge-off rates still high, the accrual of fresh bad assets has run ahead of provisions. As a result, uncovered bad assets continue to rise to high levels. Moreover, FSAP analysis notes that under an adverse scenario almost half of bank holding companies experience some capital shortfall.

- **The public sector** balance sheet has expanded rapidly, with federal debt held by the public nearly doubling between 2007 and 2010 to 64 percent of GDP—the highest since 1950, when debt was inflated by the legacy of World War II.

III. The Outlook: Elevated Risks

14. **The staff's outlook is for a continued gradual recovery, with inflation contained but stubbornly high unemployment.** With financial conditions improving more than expected, global growth above expectations, and recent data having registered stronger than prior staff forecasts, staff projects GDP growth to rebound from -2.4 percent in 2009 to 3¼ percent in 2010 and about 3 percent in 2011,with renewed growth in consumption and a substantial upswing in business fixed investment. Inflation pressures would remain muted, against a backdrop of a sizeable output gap. The unemployment rate would decline only moderately, remaining above 9 percent in 2011.

15. **Over the medium term, potential growth would remain below trend for a period, with a permanent output loss owing to the financial crisis.** The staff's forecast is informed by analysis, including in the *World Economic Outlook,* that points to permanent output losses following financial and housing crises.[5] Similarly, analytical studies (including the accompanying Chapters I and III of the *Selected Issues* paper) indicate that labor-market adjustment is apt to be slow, and the forecast incorporates a temporary rise in structural unemployment. The forecast also factors in short-run effects from the sharp recent decline in investment (which weighs on capital accumulation). Over time, growth would move toward medium-term potential, estimated by staff at 2¼ percent.

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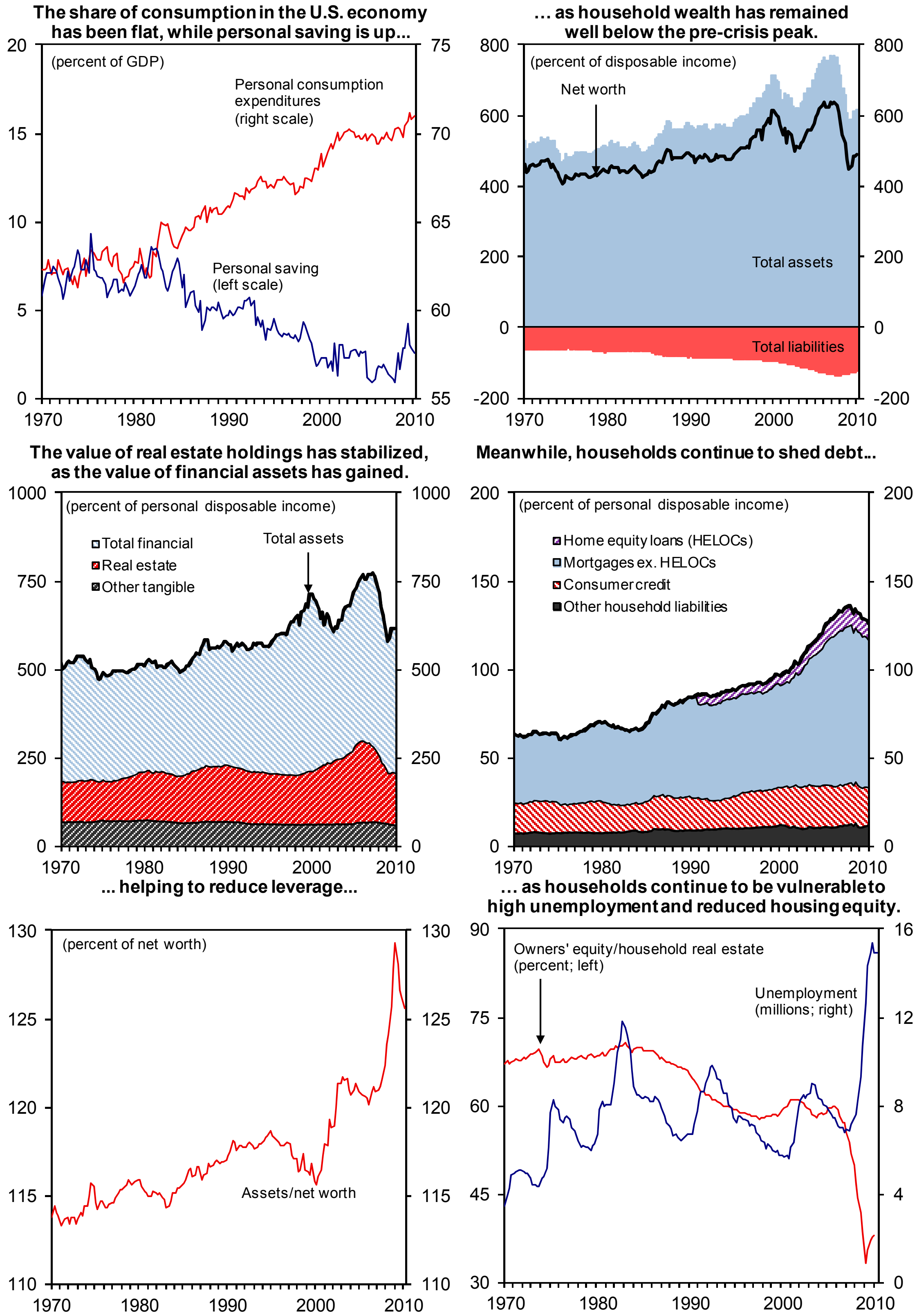
[5] See *World Economic Outlook*, September 2009, Chapter 4, and *World Economic Outlook*, April 2009, Chapter 3.

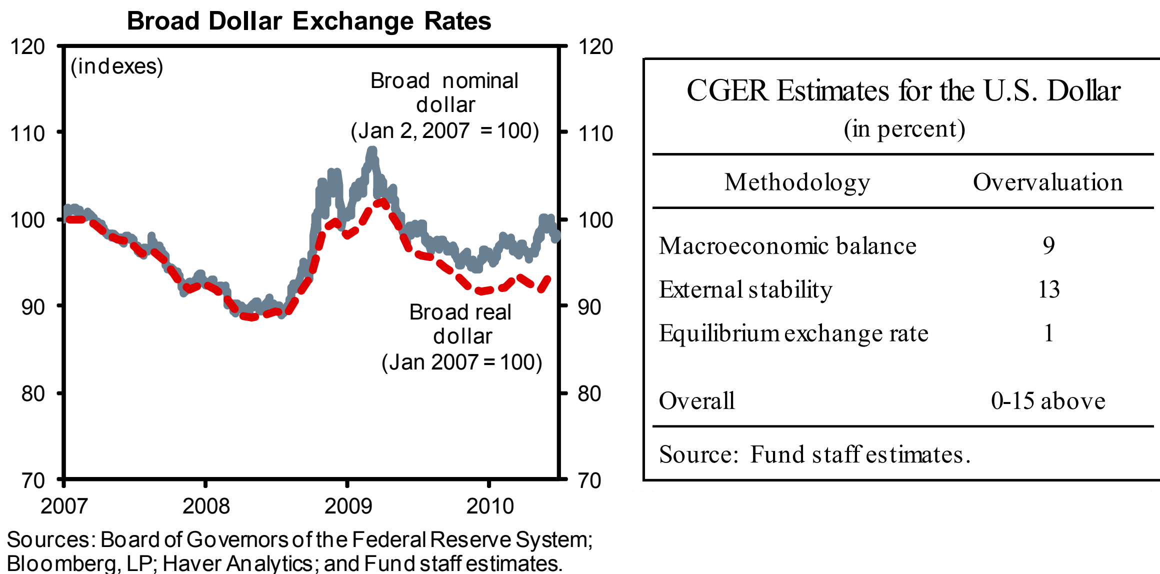
Figure 9. The Household Leverage Cycle



Sources: Board of Governors of the Federal Reserve System; Bureau of Economic Analysis; Bureau of Labor Statistics; Haver Analytics; and Fund staff calculations.

16. **Medium-term shifts in savings and investment would broadly offset each other, stabilizing the current account over the medium term (Table 2).** The current account shrank amid the crisis as rising private saving and falling private investment more than offset the increase in public dissaving. Over the medium term, household saving is expected to rise further, as households rebuild wealth lost in the financial and housing crisis, and save more in light of fiscal imbalances. Adding to the rise in national saving, the fiscal deficit would narrow as the cycle improves, stimulus expires and budgetary measures come into place. Private investment would rebound to around pre-crisis averages as a percentage of GDP. On balance, the current account would remain around 3½ percent of GDP over the medium term.

17. **In turn, the outlook for the U.S. external imbalance has implications for the dollar.** The current account would remain somewhat below long-run saving/investment norms as assessed by the Coordinating Group on Exchange Rates (CGER), which estimates the dollar to be about 9 percent above its medium-term equilibrium level on that basis.[6] The net foreign asset position implies that the dollar is about 13 percent above equilibrium, while the equilibrium exchange rate approach (an assessment based on fundamentals such as productivity differentials and terms of trade) finds the dollar to be close to equilibrium. In discussions, the authorities noted that the exchange rate remained market determined, and they did not take a view on its valuation relative to fundamentals.



Sources: Board of Governors of the Federal Reserve System; Bloomberg, LP; Haver Analytics; and Fund staff estimates.

CGER Estimates for the U.S. Dollar
(in percent)

Methodology	Overvaluation
Macroeconomic balance	9
External stability	13
Equilibrium exchange rate	1
Overall	0-15 above

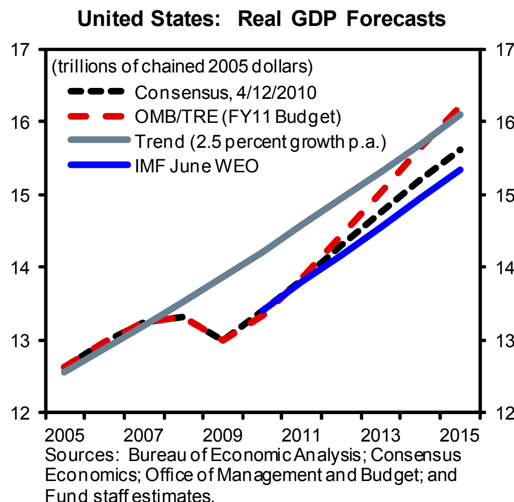
Source: Fund staff estimates.

[6] The estimates are as of end-March 2010; the dollar has subsequently risen in REER terms by about 3 percent.

United States: Medium-Term Outlook									
	Average			Projections					
	2000-07	2008	2009	2010	2011	2012	2013	2014	2015
	(percent change, unless otherwise noted)								
Real GDP	2.4	0.4	-2.4	3.3	2.9	2.8	2.8	2.6	2.6
Personal consumption expenditures	2.9	-0.2	-0.6	2.3	2.1	2.1	2.1	2.2	2.2
Gross private fixed investment	1.5	-5.1	-18.3	3.1	15.0	17.2	10.3	6.4	5.2
Change in private inventories 1/	0.0	-0.4	-0.9	1.3	0.3	0.0	0.0	0.0	0.0
Government consumption and investment	2.2	3.1	1.8	0.9	-1.1	-3.4	0.0	1.4	1.7
Net exports 1/	-0.3	1.2	1.2	-0.3	-0.5	-0.3	-0.2	-0.1	0.0
Potential GDP	2.7	2.1	1.9	1.6	1.6	1.9	2.0	2.1	2.2
Output gap 2/	-0.2	-1.7	-5.8	-4.3	-3.1	-2.3	-1.6	-1.1	-0.6
Consumer price inflation	2.7	3.8	-0.3	1.6	1.1	1.5	1.7	1.8	2.0
	(percent of GDP, unless otherwise noted)								
Investment rate	19.7	18.2	15.0	16.0	17.6	19.2	20.0	20.3	20.4
Private saving	15.0	15.2	17.3	19.3	18.8	18.2	18.6	19.0	19.7
Household saving rate 3/	2.6	2.7	4.2	3.5	3.1	3.1	4.2	4.9	5.3
Government saving	0.4	-2.6	-6.5	-6.8	-4.6	-2.5	-2.3	-2.5	-2.8
Current account balance	-5.0	-4.9	-2.9	-3.2	-3.4	-3.5	-3.6	-3.7	-3.6
	(percent)								
Yield on 3-month treasury bill	3.3	1.4	0.2	0.1	0.3	1.7	3.6	4.4	4.4
Yield on 10-year treasury note	4.7	3.7	3.3	3.6	4.7	5.9	6.4	6.5	6.5

Sources: Bureau of Economic Analysis; Bloomberg, LP; Haver Analytics, and Fund staff estimates.
1/ Contribution to real GDP growth, percentage points.
2/ Percent of potential GDP.
3/ Percent of personal disposable income.

18. **The authorities—to varying degrees—viewed staff's forecasts as too pessimistic.** Treasury and OMB officials cited the historical experience with V-shaped economic recoveries (which implied a stronger rebound than in even the Treasury's above-consensus forecasts). They believed that the crisis would not have lasting output effects, given the robust policy response and the flexibility of the U.S. economy, citing the recent strength in productivity as evidence for the economy's resilience. Looking ahead, they saw output returning to its long-term trend over the medium term, with potential growth in the 2½ to 2¾ percent range—just below the average for the ten years prior to the crisis.



Sources: Bureau of Economic Analysis; Consensus Economics; Office of Management and Budget; and Fund staff estimates.

19. **Overall, the mission saw risks as tilted to the downside in the near term, while the authorities saw them as more balanced (Figure 10).** The mission expressed concerns about the foreclosure backlog, which when realized could push down housing prices, aggravating negative macro-financial linkages[7] (Box 1). Macro-financial feedback could also occur via stress in commercial real estate: small to medium sized banks exposed to the sector could experience outsized losses, crimping credit provision to the SMEs that borrow from such banks. In addition, the sharp rise in government debt increased vulnerabilities to financial market sentiment. The authorities held a more sanguine view on domestic risks, noting ongoing foreclosure-mitigation efforts and heightened supervisory attention to commercial real estate exposures. On the upside, it was agreed that activity (notably housing and business fixed investment) could rebound faster from depressed levels, and confidence could recover briskly, spurring consumption spending. Risks from strains in Europe ranked high for both the mission and the authorities—and for the mission, tilted the balance to the downside. Both saw tail risks that financial stress would intensify, then spread to the U.S. financial system via interbank and derivatives markets. Deflation was another tail risk, given high economic slack.

IV. Policy Challenges: Completing the Exit and Addressing Legacies

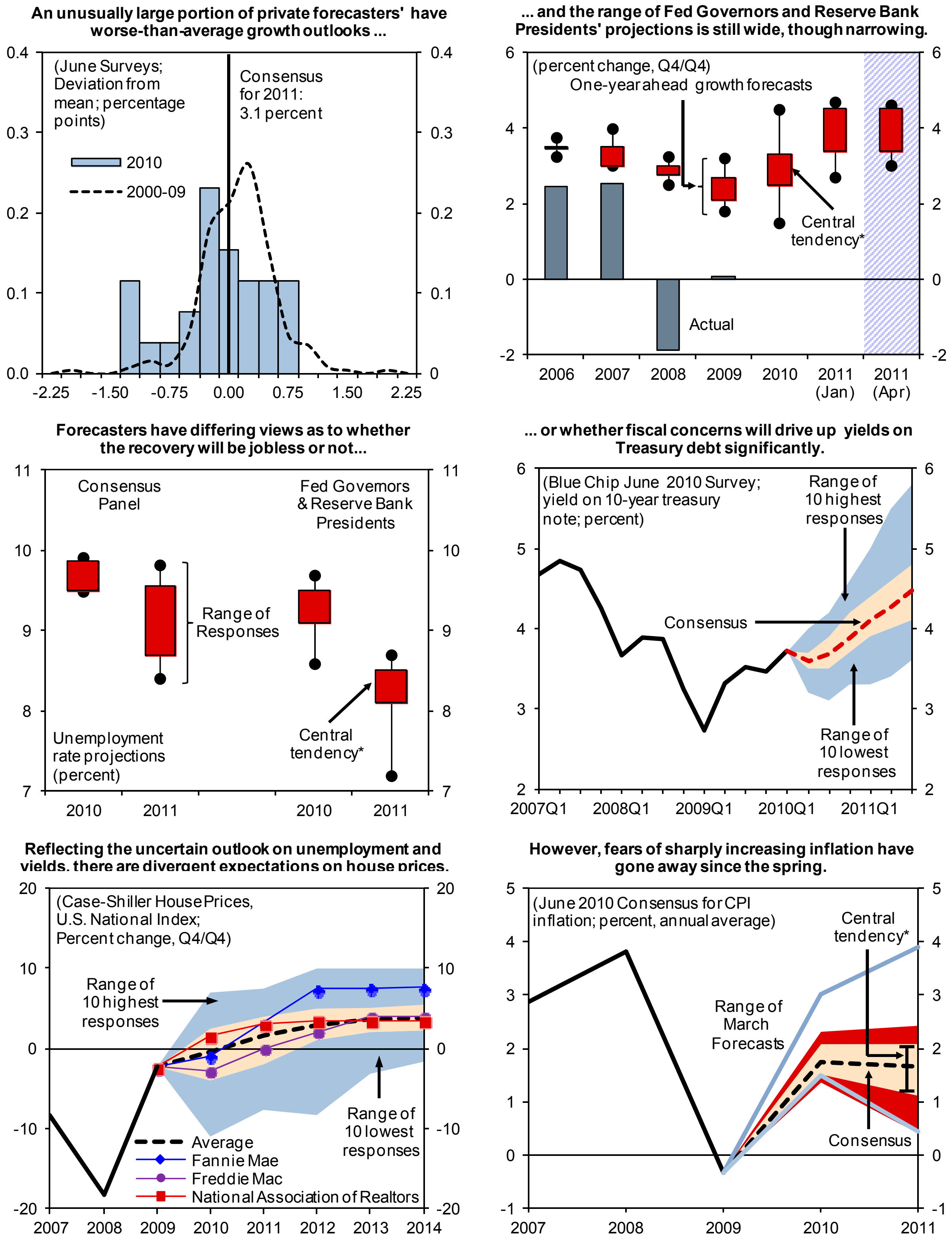
20. **Policies should focus on completing the exit and dealing with long-term legacies, to attain stable medium-term growth, limit international spillovers, and avoid future financial excesses**:

- **The near-term challenge is timing the exit from macroeconomic stimulus**. Given the remaining weaknesses in the economy, the authorities should maintain policy stimulus in 2010. The withdrawal of macroeconomic stimulus will need to be tuned to the speed of the recovery. However, given the risks posed by budgetary imbalances, the ground should be laid for fiscal consolidation, with a determined start made in 2011; meanwhile, monetary policy can maintain an accommodative stance to offset fiscal drag.

- **And steps are needed to deal with the legacies of fiscal imbalances and shortcomings in financial regulation.** A credible and strong consolidation plan is needed to anchor confidence in fiscal sustainability, particularly in light of the risk of an adverse reaction in bond markets if fiscal sustainability concerns heighten, and in view of high dependence on foreign inflows. And far-reaching financial sector reforms are required to avoid the re-emergence of financial excesses that could exacerbate future fiscal imbalances.

[7] A retrenchment in housing markets could also have fiscal implications; Fannie Mae and Freddie Mac estimate that a 5 percent drop in housing prices would result in $18 billion and $3 billion, respectively, in losses (so far they have received federal support totaling $145 billion as of end-March 2010).

Figure 10. Elevated Risks to the Outlook



* Central tendency excludes the three highest and three lowest responses.
Sources: Consensus Economics; Board of Governors of the Federal Reserve System; Blue Chip Financial Forecasts; MacroMarkets LLC; Standard & Poors; Bloomberg, LP; Haver Analytics; and Fund staff estimates.

Box 1. U.S. Housing Market: A Fragile Recovery

The housing market has stabilized, but most activity indicators remain near record low levels (Figure 7).

- *Housing starts* have bottomed in early 2009, stabilizing at historically low levels—around 600,000 per year—well below replacement levels implied by demographics, and almost one-fourth their peak.
- *Existing home sales,* on the other hand, have somewhat recovered from their record low levels in early 2009 (when they were down 38 percent from their peak levels), though their recovery has been particularly volatile—with data pointing to a massive retrieval following the expiration of the homebuyers' tax credit. Despite the increasing sales in the last year—aided by the most favorable affordability conditions in 40 years—they remain 20 percent lower than their peak levels.

The house price correction also appears near its end but foreclosures and negative equity remain a major concern. The Case Shiller 20-city composite price index (that takes into account non-conforming loans) has been rising since mid-2009; though it has experienced marginal declines in some of the recent months amid the expiration of the homebuyers' tax credits. Despite their ongoing improvement, house prices are 30 percent below their 2006-peak levels and are not expected to have a strong recovery in the coming quarters, with record-high foreclosures and underwater mortgages, and a large shadow inventory putting a drag on price growth. Specifically, according to Realty Trac, there have been 1.6 million foreclosure filings in the first five months of this year, with 2010 numbers estimated to surpass the record 2.8 million recorded in 2009. Overall foreclosure activity surpassed 300,000 for the last 15 straight months, despite reports that banks are intentionally forbearing foreclosures (with a shadow inventory estimated at between 1.7 and 7 million homes) and numerous policy measures enacted by the Administration. Over 11 million mortgage properties are now underwater, with an estimated negative equity value of $800 billion.

The Administration has undertaken numerous measures to tackle the foreclosure epidemic, but so far their impact has been below expectations, given the complexities of the problem and capacity constraints by servicers. The Home Affordable Modification Program (HAMP) which reduces monthly payments on existing first lien mortgages and provides financial incentives for servicers and investors to perform sustainable modifications had a slow start; now accounting for 350,000 permanent modifications out of the 1.5 million modifications extended through May. Particularly problematic have been second lien mortgages that lenders have been reluctant to write off (to be facilitated by the recently enacted Second Lien Modification Program), and heavy non-mortgage household debts. Short sales and deed-in-lieu are now encouraged for borrowers unable to complete a modification by the now launched Home Affordable Foreclosure Alternatives Program, while new welcome measures would be implemented by fall. These include the Alternative Principal Write-down Approach which subsidizes principal writedowns to mortgages over 15 percent underwater, while the Federal Housing Administration (FHA) offers a new refinance option allowing principal write-downs for non-FHA insured underwater mortgages. A temporary forbearance period of up to 6 months would also be offered to unemployed borrowers.

In case the housing market destabilizes again, more policy action would be warranted. Policy options could include expanding the loan modification program, including by providing additional incentives to investors and services and loosening some of the eligibility requirements, as well as increasing further the subsidies on principal writedowns. Allowing mortgages to be renegotiated in courts ("cramdowns") is another policy option, as staff advocated in the past.

A. Fiscal Stabilization

21. **The mission saw a key macroeconomic challenge as ensuring that public debt is put—and is seen to be put—on a sustainable path without jeopardizing the recovery** (Box 2). Under current policies, federal debt held by the public could rise from 64 percent to 95 percent of GDP by 2020[8] (Table 3). Thereafter, the rising impact of population aging and health-care inflation would push debt higher, swelling over 135 percent of GDP by 2030 and continuing to trend up thereafter. While Treasury interest rates were low owing to underlying economic weakness and flight to quality, over the medium term, these factors would unwind (Box 3 and *Selected Issues Chapter IV).* Thereafter, the trajectory for public debt could engender a rise in interest rates that would dampen U.S. growth and risk adverse spillovers to global financial conditions.

Staff Fiscal Projections for Federal Government (Current Policies)
(Percent of GDP, Fiscal Years)

	2010	2011	2012	2015	2020
Federal budget balance 1/	-11.0	-8.1	-5.3	-5.6	-7.3
Federal primary balance 1/	-9.8	-6.7	-3.4	-2.0	-2.3
Structural primary balance 2/	-7.6	-5.4	-2.5	-1.8	-2.3
Federal debt held by public	64.0	69.0	72.4	80.4	96.3

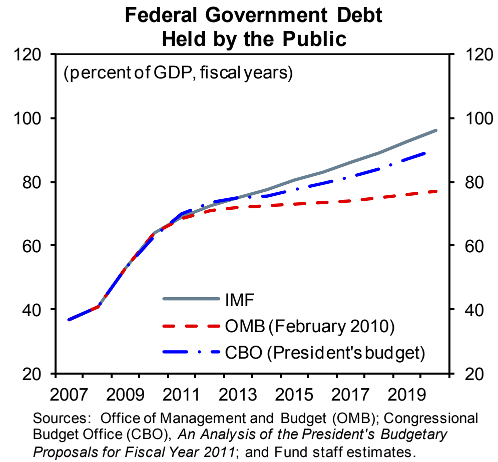
1/ Deficit estimates are adjusted for NPV costs of financial sector support.
2/ Excludes net interest, cyclical effects, and costs of financial sector support.
Source: IMF staff estimates.

22. **The authorities stressed their commitment to fiscal stabilization, as laid out in the draft FY2011 budget.** They aimed to halve the deficit by 2012, and achieve primary balance by 2015, with an objective to stabilize the debt just above 70 percent of GDP. Under their economic assumptions, the envisioned adjustment was highly ambitious—a decline of 8½ percent of GDP in the primary deficit by FY2015, and included measures such as a freeze on non-security discretionary spending and partial expiration of 2001 and 2003 tax cuts. Moreover, the budget would imply a sizeable up-front adjustment—2 percentage points of GDP—in FY2011. The results would be even more favorable should growth surprise on the upside—a nontrivial risk in the authorities' view, as they saw their forecasts as conservative.

[8] Staff fiscal projections adjust the authorities' budget projections for staff's growth, inflation, and interest-rate assumptions.

Box 2. Outlook for Federal Government Finances

Federal debt is on an unsustainable trajectory. Under the draft FY2011 budget, the federal primary deficit is projected by the authorities to shrink to about 1 percent of GDP in FY2015. However, federal debt held by the public would continue to rise, reaching 77 percent of GDP by the end of decade. The authorities have indicated their intention—including by establishing a fiscal commission—to find additional savings of about 1 percent of GDP. Under their macroeconomic assumptions, this strategy would eliminate the primary deficit and stabilize federal debt relative to GDP.



Sources: Office of Management and Budget (OMB); Congressional Budget Office (CBO), *An Analysis of the President's Budgetary Proposals for Fiscal Year 2011*; and Fund staff estimates.

The budgetary outlook is bleaker under the staff's more pessimistic macroeconomic assumptions. Since the financial crisis is expected to lead to a permanent loss of output and budgetary revenues, the primary deficit would remain around 2 percent in FY2015. Federal debt would exceed 95 percent of GDP by the end of the decade, approaching the levels last seen in the aftermath of WWII, putting upward pressure on interest rates. A primary balance would therefore be insufficient to stabilize debt—roughly a ¾ percent of GDP primary surplus would be needed instead. Phasing in further savings of about 2¾ percent of GDP starting from FY2013 would stabilize the federal debt held by the public around 75 percent of GDP.[1]

Macroeconomic Assumptions Underlying Budget Projections
(percent, unless indicated otherwise)

	2011-2015	2016-2020
Office of Management and Budget		
Real GDP growth	4.0	2.7
10-year nominal Treasury bond yield	5.1	5.3
IMF Staff		
Real GDP growth	2.7	2.3
10-year nominal Treasury bond yield	6.0	6.5
Consensus (April 2010 Survey)		
Real GDP growth	3.1	2.5
10-year nominal Treasury bond yield	5.1	5.4

Sources: Office of Management and Budget; Consensus Economics; and Fund staff estimates.

Additional measures will be necessary to put the debt ratio firmly on a downward path in the longer term given rapidly-growing health care costs and population aging. Bringing the federal debt-to-GDP ratio back to the pre-crisis level by 2030 would require a gradual adjustment in the primary balance of about 6 percent of GDP relative to the staff's baseline deficit projections.[2]

[1] The required adjustment would rise by about ¾ percentage point of GDP for each 1 percentage point increase in interest rates and decline by roughly ¼ percentage point for each 1 percentage point increase in output *level*.

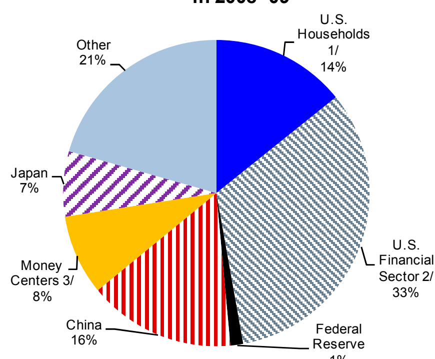
[2] This calculation incorporates potential savings from the recent health care reform, as assessed by the Congressional Budget Office (½ percent of GDP a year during the next decade). These savings are deemed highly uncertain.

Box 3. Who Will Finance the U.S. Federal Budget Deficits?

Fiscal financing costs have recently been restrained due to cyclical and safe haven factors, despite rapidly rising debt. The low required rate of return has so far been underpinned by factors such as higher private saving, weak corporate investment, subdued inflation, and a flight of investors to the relative safety of U.S. government bonds amid the sovereign bond market distress in Europe. Recent Fed purchases of Treasury debt (and closely-substitutable GSE debt) have also helped to hold down interest rates. Going forward, however, given the large expected T-bond issuances, financing conditions will tighten as private investment recovers and safe haven flows abate.

A detailed analysis of investment flows[1] suggests that, in the future, the bulk of T-bond purchases will need to be made by domestic investors. Foreign purchases will be dampened by unwinding safe-haven flows. In addition, WEO projections of reserve accumulation show limited purchases by official holders. Accordingly, domestic holders will need to take up the slack, implying a significant shift in their portfolio allocations. Indeed, absent such a reallocation, the projected supply of the Treasuries would exceed the hypothetical demand calculated on the basis of WEO forecasts for the key macroeconomic and financial variables by a significant margin—about 30 percent of GDP.

Net Purchases of U.S. Federal Publicly Held Debt in 2008–09



Sources: U.S. Department of the Treasury, *Treasury International Capital System*; Board of Governors of the Federal Reserve System, *Flow of Funds Accounts*; and Fund staff estimates.
1/ Includes hedge funds and nonprofits.
2/ Banks, Mutual Funds, Pension Funds, Insurers.
3/ Barbados, the Bahamas, Bermuda, Cayman Islands, Netherlands Antilles, Panama, Hong Kong, Ireland, Luxembourg, Switzerland, and United Kingdom.

Thus, over the medium term, higher real interest rates will likely be needed to encourage the implied portfolio shifts. Staff assumes—in line with the empirical literature—that one percentage point of GDP in excess supply increases long-term bond yields by 2–5 basis points. The debt effect could therefore raise long-term interest rates by 60–150 basis points. Adding this effect onto the yield increases due to normalization of monetary policy and term premia leads to the staff's medium-term projection for the 10-year bond yield of about 6½ percent—more than 1 percentage point above the forecast by the Office of Management and Budget. The eventual recovery in the housing sector and the attendant stronger issuances of closely-substitutable GSE-backed debt present an upside risk to the staff's medium-term projections. That said, the near-term movements in yields are highly uncertain as U.S. Treasury debt continues to benefit from its safe haven status.

[1] See Selected Issues Paper "The Financing of U.S. Federal Budget Deficits".

23. **The mission welcomed the authorities' commitment to fiscal stabilization but observed that much remained to be done to achieve it**. Staff's economic assumptions imply that a federal primary surplus of ¾ percent of GDP is required to stabilize debt, requiring roughly 2¾ percent in measures above those in the draft FY2011 budget. Part of this could be achieved through expenditure reductions, but revenue measures would also be needed. These could include relatively "growth friendly" options such as further cuts in deductions, particularly for mortgage interest; higher energy taxes; a national consumption tax; or a financial activities tax (which could also mitigate systemic financial risks). Looking beyond 2015, the aim should be to put public debt firmly on a downward path to rebuild the room for fiscal maneuver.

Decomposition of Changes in the Federal Budget Balance
Between Fiscal Years 2010–15
(percent of GDP)

Staff's estimate of the authorities' draft budget:	
Structural primary balance, fiscal year 2010 1/	-7.6
Structural primary balance, fiscal year 2015 1/	-1.8
Improvement in structural primary balance	5.8
Contributions to the improvement in the structural primary balance:	
Stimulus roll-off	3.2
Lower security-related spending	1.2
Planned tax provisions and savings in discretionary spending	0.9
Other	0.5
Memorandum items:	
Projected primary balance, fiscal year 2015	-2.0
Primary balance needed to stabilize debt during fiscal years 2015-20	0.8
Additional adjustment needed to stabilize federal debt	2.8

Source: Fund staff estimates.
1/ Excludes net interest, effects of economic cycle, and costs of financial sector support.

24. **The mission observed that the timing and composition of fiscal adjustment would need to be carefully designed to minimize the impact on demand while ensuring credibility**. A credible fiscal plan would have three elements:

- An upfront adjustment in FY2011;
- a clear commitment to the additional future measures needed, for example, by enshrining targets and/or measures in legislation, under credible economic assumptions; and
- further steps to address entitlement pressures, given the uncertain payoffs from health care reforms (Box 4), which hinged on difficult and/or untried measures; notably, reforms could address imbalances in social security, where the needed measures are well known and the payoffs more certain.

Box 4. Health Care Reform

The main challenge facing the U.S. health care system is an unsustainable rise in spending. The United States has the highest per capita health spending in the OECD (almost two times and a half the average) and spending continues to rise—rising over 40 percent in real terms in the past decade alone, with health spending expected to reach 28 percent of GDP in 2030 in the absence of reforms according to the CEA. Despite high spending, health outcomes in the United States are less favorable than in many OECD countries, and there are around 50 million non-elderly uninsured individuals.

High spending reflects soaring health-care costs. The Congressional Budget Office (CBO) estimates that in the last two decades annual per capital health costs growth rate exceeded per capita nominal GDP growth rate by 1.4 percentage points on average. Moving forward, in the absence of reforms, Medicare and Medicaid spending are projected to grow by 6.4 percent annually, while private health care costs would rise by 6 percent (both in real terms).

A health care reform launched in March aims to tackle these challenges. The reform will expand coverage to 32 million legal non-elderly uninsured (reaching insurance coverage to 94 percent of that population by 2019). The measures are largely financed by: (i) reductions in the growth of Medicare's payments to providers; (ii) increases in payroll taxes for Medicare and expanding Medicare tax on investment income; (iii) fees on the medical community and an excise tax on expensive health plans (in addition, the bill forbids insurance companies from denying coverage for pre-existing conditions).

The bill includes welcome cost containment measures. Such measures include the formation of insurance exchanges to spur competition between insurance plans; the "Cadillac tax" on expensive insurance plans, studies of comparative effectiveness of treatments; reducing Medicare payments to providers; standardization of insurance administration (starting in 2013), and the creation of the Independent Payment Advisory Board (IPAB); a bi-partisan committee mandated to provide cost-cutting recommendations (that could become law) whenever the Medicare *per capita* growth rate exceeds a target growth rate, starting in 2014. CBO projects savings of about 1 percent of today's GDP over this decade, with savings in the following decade of up to one-half percent of GDP per year.

However, the envisioned savings remain uncertain and would hinge on the implementation of many of the untried and/or politically difficult cost containment policies. In particular, the reform entails significant decreases in Medicare payment rates to health care providers that may prove difficult to implement (since others, in the past, had been substantially backloaded), while the "Cadillac tax" plans is deferred to 2018. IPAB's effectiveness also remains unclear since the Committee cannot recommend rationing of services or changing eligibility requirements. For these reasons, it will be essential for IPAB to monitor costs closely, and take remedial measures if needed.

25. **In the short run, the mission saw the budget's proposed fiscal tightening of 2 percent of GDP in 2011 as appropriate under the baseline outlook.** The budget "placeholder" for additional stimulus provided some flexibility to respond to risks, which if needed could be utilized to partially offset the fiscal drag from the fading effects of past stimulus (reducing growth by about ½ percentage point in 2011). In addition, if downside risks materialized, there existed some room to trade off a lower up-front adjustment with measures to strengthen medium-term credibility (such as further entitlement reforms, which would have little immediate impact on demand). The mission also saw a case for carefully targeted measures, to support job creation and (if the housing market weakened) foreclosure mitigation, although these should also be kept within the budget envelope.

26. **The authorities saw their plans as striking the right balance between near-term support for the recovery and medium-term credibility.** In the near term, they saw a need for additional stimulus to cushion the impact from the withdrawal of the 2009 stimulus package, particularly given the continued weaknesses in labor markets and state finances. Consistent with this, the budget incorporated a placeholder ($282 billion) to allow further stimulus over FY2010–12, within the overall envelope defined by the draft FY2011 budget.[9] For the medium term, the authorities saw their plan as strong and credible, as it incorporated a sizeable adjustment; moreover, market demand for treasuries remained brisk, and yields low (the authorities were taking the opportunity to increase the average maturity of debt, which was at the low end for peer countries). In this context, they saw legislated fiscal targets as unnecessary. However, they reaffirmed their commitment to stabilize debt over the medium term, and would adjust policy as needed to achieve that aim—for example, if growth undershot expectations (although they saw the staff-estimated adjustment as excessive, based on overly gloomy forecasts).

27. **The authorities saw two institutions—the Fiscal Commission and (on medical care) the Independent Payments Advisory Board (IPAB)—as playing key roles in shaping the medium-term adjustment**.

- The Fiscal Commission is considering all possible consolidation options to achieve the targeted 1 percent of GDP in savings needed to reach primary balance, with Social Security reforms among the options. The Commission is also deliberating appropriate medium-term and longer-term fiscal targets. The mission underscored that finding a super-majority of votes (14 out of 18 members) for the Commission to issue its final set of recommendations could prove challenging and the authorities should be actively considering a "Plan B". For example, the Administration could include in the subsequent budget any recommendations which had broad support or failed only by a narrow margin.

[9] The 2 percent adjustment during FY2011 is inclusive of this placeholder (e.g., it partially offsets the larger underlying fiscal withdrawal).

- The authorities stressed that the IPAB had a very powerful mandate—its recommendations will be implemented unless Congress votes them down. They also were optimistic about the likely fiscal savings from the new health care legislation, observing that past CBO scoring of health-care reforms had often erred on the low side, stressing the numerous measures now in place, and expressing confidence in the ability of the IPAB to push through tough cost-control measures. The mission noted that the envisioned savings remained highly uncertain, and would hinge on the implementation of many untried or difficult measures. Accordingly, the IPAB would play a key role in monitoring and remediating excess cost growth, and consideration should be given to other measures such as reducing tax exemptions for employer health insurance contributions if excess cost growth persisted.

28. **Meanwhile, state and local governments were under severe stress, with the risk of default by selected municipalities**. Balanced budget rules imparted a major procyclical impulse, only partly offset by higher transfers from the federal level. Weak revenues have forced local authorities to aggressively increase tax rates and cut services. Pressure to consolidate is likely to persist going forward, given the prospects for weak labor and housing markets and waning federal budgetary support. In addition, lower asset values have deepened financing gaps (estimated at over $1 trillion) in state and local pension and health care obligations, calling for reforms that would cover unfunded liabilities by streamlining benefits and raising contribution rates, while moving away from defined-benefit pension schemes.

B. Financial System: Health and Stability

Risks and balance-sheet strength

29. **The mission noted that the financial system was far stronger than a year ago, but might not be in a position to lend to support growth when credit demand revived.** Bank capital fell sharply during the crisis, then rebounded, thanks to private capital raising as well as public capital injections. But about half of the increase in risk-weighted capital ratios since the depths of the crisis reflected risk reduction—a shift from loans to Treasury securities—that would reverse as the recovery proceeded; risk weighted assets were now at an all-time low relative to total assets.

30. **The mission saw the financial system as still vulnerable to shocks.** FSAP stress tests showed that around one third of the top 50 BHCs would experience some capital shortfall under moderately-sized shocks to the economy. The mission also raised concerns about reports of rollover of loans to commercial real estate borrowers (a recent Fed survey had shown increased use of loan extensions), amid widespread weaknesses in the sector. Regarding residential real estate, the mission also noted the very high level of underwater mortgages posed risks of strategic defaults and further losses to banks and MBS investors. Moreover, financial instability in Europe—while a tail risk—could have a sizeable impact on

U.S. financial institutions (Box 5). Such risks could weaken financial-institution balance sheets and thereby add to headwinds to growth, especially in light of prevailing weaknesses (including elevated non-performing asset (NPA) ratios, subpar profits, and a historically low level of provisions relative to NPAs) (Table 4).

31. **Supervisory agencies were aware of the balance-sheet risks but saw them as well managed**. Supervisors were attentive to the risk that banks were evergreening CRE loans, and indeed, recently had concerns that banks were cutting exposures to viable borrowers. On residential real estate, the present rules limited the ability of banks to provision against the risk of strategic default in performing underwater loans (supervisors felt that most defaults were still driven by economic circumstances). Overall, these issues were well on supervisors' radar screens, the credit cycle was turning around, and banks had the balance-sheet strength to weather the rest of the cycle. While pockets of vulnerability remained, notably among small banks heavily exposed to CRE, these were under close monitoring.

32. **Against this background, the mission considered that banks would need to raise more capital to be able to lend as credit demand revived, and thus support the recovery.** Releveraging and risk taking by banks once net lending revived would necessarily be associated with either a decline in capital ratios—which (based on Tier 1 common capital) were not at especially high levels by historical standards, particularly for smaller banks—or an increase in the level of capital. In addition, the weak level of private-label securitization limited the ability of banks to offload risk from their balance sheets. Banks would also eventually need more capital to satisfy the coming higher regulatory capital ratios, in light of domestic and international initiatives to strengthen capital requirements. Supervisors were satisfied with the level of capital but did not want to see capital ratios decline. They believed the strong capital raising efforts of the banks have rebuilt system capital to levels sufficient to support credit growth (even in the SCAP adverse scenario), and they observed that markets remained open to the banks to increase capital further if they found themselves constrained. While they acknowledged that some individual institutions may be less well-positioned to absorb future losses through earnings they saw the staff's views as too pessimistic. In addition, they noted that banks have plans to expand lending and that profits will improve as provisioning eases with the turn in the credit cycle.

Box 5. U.S. Exposures to Europe

Financial market strains stemming from the sovereign pressures in Europe are being felt in U.S. markets. With risk aversion on the rise, interbank liquidity and credit spreads have climbed significantly, while CDS spreads for major U.S. financial institutions have picked up, and stocks have fallen. U.S. mutual funds have cut their exposure (via CP markets) to European banks, and shortened maturities, and there are indications that longer-term real money investors such as pension funds are also pulling back from European markets. Corporate bond spreads have widened out, and in May, corporate bond issuance fell sharply amid volatile market conditions. Meanwhile, flight to quality flows have lifted the dollar and pushed down treasury yields.

These financial market pressures raise the question of how exposed the U.S. economy is to Europe via trade and financial linkages. With relatively low trade openness, the United States has very limited export exposure to GIIPS, and modest exposures to the Euro area and the United Kingdom. Any further demand contraction in these economies would therefore have a noticeable but small impact on U.S. economic activity through the export channel.

United States: Exports to Europe
(percent of GDP, goods and services, unless otherwise noted)

	2009
GIIPS (goods) 1/	0.2
Euro area	1.9
United Kingdom	0.7

Sources: Bureau of Economic Analysis; IMF, *DOTS Database*; and Fund staff estimates.
1/ Greece, Ireland, Italy, Portugal, and Spain.

Financial linkages with Europe are much stronger, however. For instance, U.S. banks' claims on GIIPS are about 4 percent of financial assets but slightly more than 60 percent of Tier-1 capital. Claims on larger European economies, including the U.K., account for 30 percent of total assets, and close to 450 percent of tier-1 capital. Financial conditions in the U.S. could therefore tighten considerably if financial market strains were to spread from the GIIPS to the larger European economies, with potentially severe consequences for economic activity. In addition, there remain important uncertainties about possible channels of transmission—including derivatives markets, for which data are relatively limited.

U.S. Banks' Total Financial Claims on European Countries in 2009Q4 1/

	Billions of dollars	Percent of total assets	Percent of tier 1 capital
GIIPS 2/	643	4.1	57.1
Other continental Europe 3/	2,523	16.0	224.0
United Kingdom	2,015	12.8	178.9

Sources: Bank for International Settlements (Consolidated Foreign Claims of Reporting Banks, Ultimate Risk Basis), and Fund staff estimates.
1/ Includes derivatives, unused credit commitments, and guarantees.
2/ Greece, Italy, Ireland, Portugal, and Spain.
3/ Austria, Belgium, Denmark, France, Germany, Luxembourg, Netherlands, Slovakia, Slovenia, and Switzerland.

Regulatory reform

33. **During the mission, the Congress was considering a sweeping overhaul of financial regulation, covering many of the key priorities laid out in the FSAP analysis (Box 6)**:

- A broadening of the prudential regulatory perimeter to include all systemic institutions and markets;
- an interagency financial surveillance council (Financial Services Oversight Council or FSOC) charged with identifying and responding to emerging risks to financial stability;
- a strengthened resolution mechanism that covers non-banks and requires systemic institutions to prepare resolution plans ("living wills");
- tighter capital and liquidity ratios, with higher ratios for systemic institutions;
- risk retention ("skin in the game") for securitizations to improve incentives for sound underwriting and bundling;
- steps to improve transparency and counterparty risk management in the OTC derivatives markets;
- increased accountability and transparency for ratings agencies, particularly for the process of rating structured securitization products.

34. **The team underscored that assuming the legislation passed the key would be strong implementation**. In particular, the FSOC would need to quickly develop a common macro-prudential vision—a nontrivial task, given that only two of the nine voting members (Treasury and Fed) have a macroeconomic remit. To be effective, the FSOC would also need a culture of transparency and cutting-edge thinking on financial stability. To this end, regular, broad-based stress tests—along the lines of the SCAP stress test performed in 2009—and publication of periodic financial stability reports that include stress tests and identify financial stability issues would be helpful. The team saw strong roles for both the Treasury and Fed in the FSOC to integrate financial and macroeconomic analysis. And strong coordination across agencies would be essential, as the U.S. financial regulatory framework remained overly complex, leaving risks of gaps and duplication.

Box 6. Key Findings and Recommendations of the U.S. FSAP Assessment

The U.S. FSAP assessment took place at a critical juncture. With the financial system just recovering from a major crisis and with far-reaching reforms under deliberation in Congress, the team was presented with unique challenges in assessing systemic risk and unique opportunities to address regulatory issues.

The stability analysis points to remaining vulnerabilities. Capital buffers are thin and will likely remain under strain even in the baseline macroeconomic scenario, given the lagged effects of the economic downturn on credit quality, new regulatory demands, and continued deleveraging. Small and midsize banks seem particularly at risk given their exposures to the commercial real estate sector.

Against this backdrop, the FSAP team makes a number of specific policy recommendations:

- ***Crisis management, resolution, and safety nets****:* The team supports efforts to legislate a new resolution mechanism allowing regulatory intervention of large complex financial groups. The team also proposes measures to strengthen the deposit insurance system, and argues for the articulation of principles governing future Fed liquidity provision to nonbanks.
- ***Regulation and supervision****:* The team stresses the need to strengthen U.S. financial oversight in areas such as risk management and consolidated supervision. The regulatory perimeter needs to be widened to better encompass the shadow banking sector, especially in derivative, repo, and other off-exchange markets. Fed responsibilities for systemic financial infrastructures also need clarifying.
- ***Systemic oversight****:* The team welcomes proposals to establish an FSOC with a formal role for the Treasury, and with the Fed as its "lead executor," supervising all potentially systemic bank or nonbank financial groups. These steps should bring greater clarity to inter-agency processes for monitoring and limiting systemic risk. Strong implementation will be key.
- ***Supervisory architecture****:* The exceptional complexity of the U.S. supervisory system and the multiplicity of agencies involved risks gaps, overlaps, and inefficiencies. Accordingly, the team suggested bolder steps to streamline the system—going beyond those presently contemplated by the Congress—including establishing a single federal agency to supervise all commercial banks and thrifts, and a single agency to regulate all securities and derivatives transactions.

The FSAP team urges determined action to address the "too-big-to-fail" problem. It supports a range of measures under consideration by the authorities to discourage excessive size and complexity of financial groups, including: progressively stricter standards for capital, liquidity, and risk management; critical review of "living wills" with a view to simplifying complex group structures; credible contingency plans built around the new dissolution authority; and incentive-compatible compensation and governance rules.

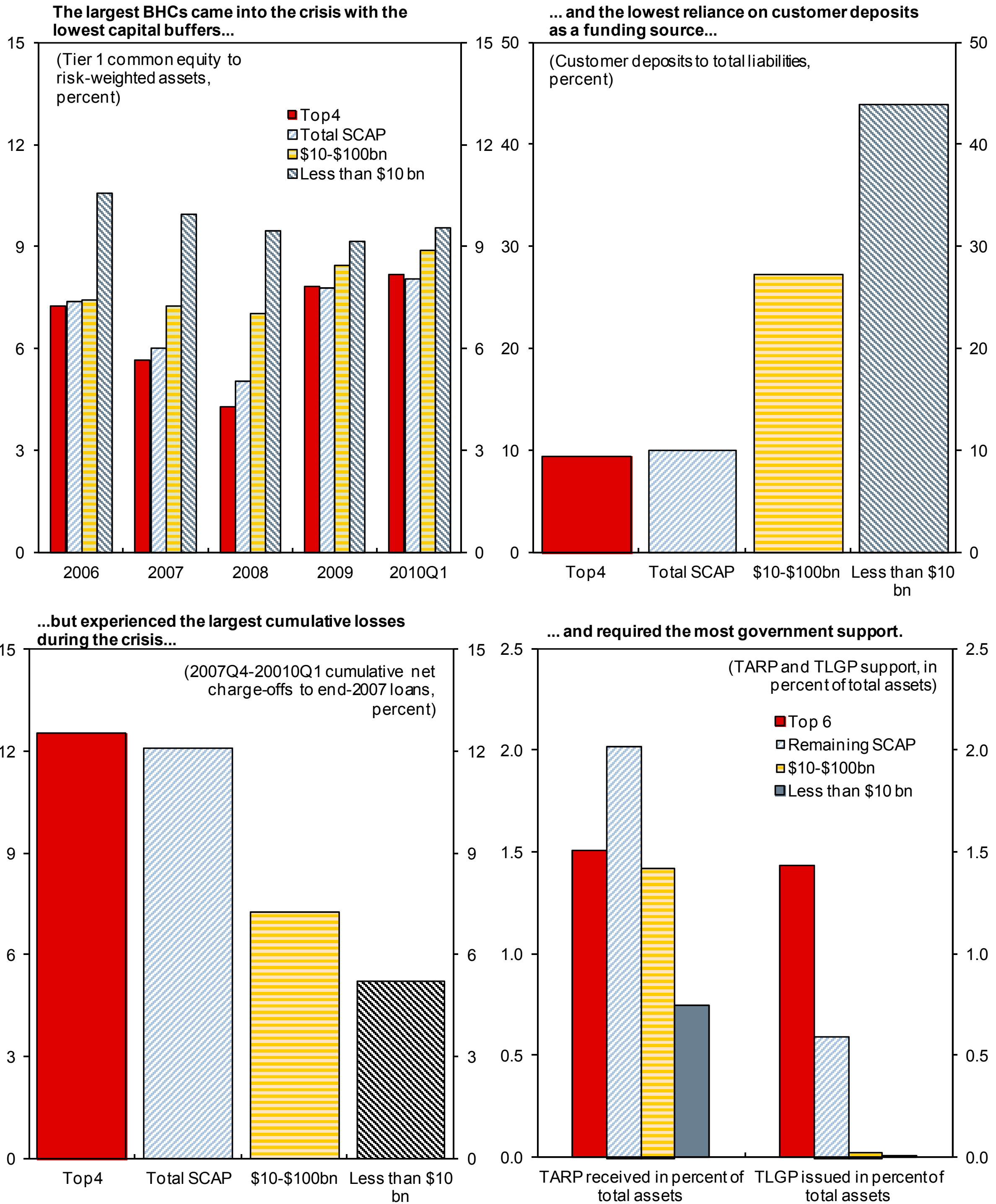
U.S. credit policies are also identified as a key reform priority. Longstanding measures to promote access to credit and home ownership—most notably through the housing GSEs—have skewed competition, complicated supervisory mandates, and fostered excessive risk taking. Early steps to addresses these issues and resolve the position of the housing GSEs are needed.

35. **Regulation of systemic institutions and markets would need to be especially rigorous, to contain the externality of systemic risk and mitigate moral hazard**. In particular, regulation of systemic institutions—including capital and liquidity ratios—should be tight enough to disincentivize systemic size and complexity (Figure 11). Similarly, "living wills" should be vetted thoroughly; if the will for a particular institution cannot be credibly implemented in a crisis, that institution should be streamlined (as allowed for in the legislation). Finally, the envisioned improvements in transparency of OTC derivatives markets will be essential, as will arrangements to centralize counterparty risk managements, to prevent these markets from serving as a channel of interbank contagion during crises. International coordination will be important, in the context of work by the Financial Stability Board and other fora on systemic firms, cross-border resolution, and capital standards.

36. **The authorities broadly agreed with these priorities, with differences on a few issues.** They observed that the multiplicity of regulators, while complicating coordination, also suited the diversity of the U.S. financial system, and even offered "multiple pairs of eyes" to diagnose financial issues. Moreover, attempting to reduce the number of regulators further would have faced practical constraints and risked delaying reforms. The FSOC would help with coordination among supervisors. In addition, features of the legislation—accountability to Congress, the Treasury secretary acting as chair—would help to promote the right culture in the FSOC. They saw living wills as a supervisory tool that could be used to understand the set of risks facing an institution, relate those risks to the firm's organizational and legal structure, and thus allow the planning of a more orderly resolution. The Fed was instituting organizational changes to bring a more comprehensive, multidisciplinary approach to its financial surveillance, as well as enhancing discussion of financial stability issues in its monetary policy meetings. It would likely produce an internal financial stability report initially, with publication as an option later.

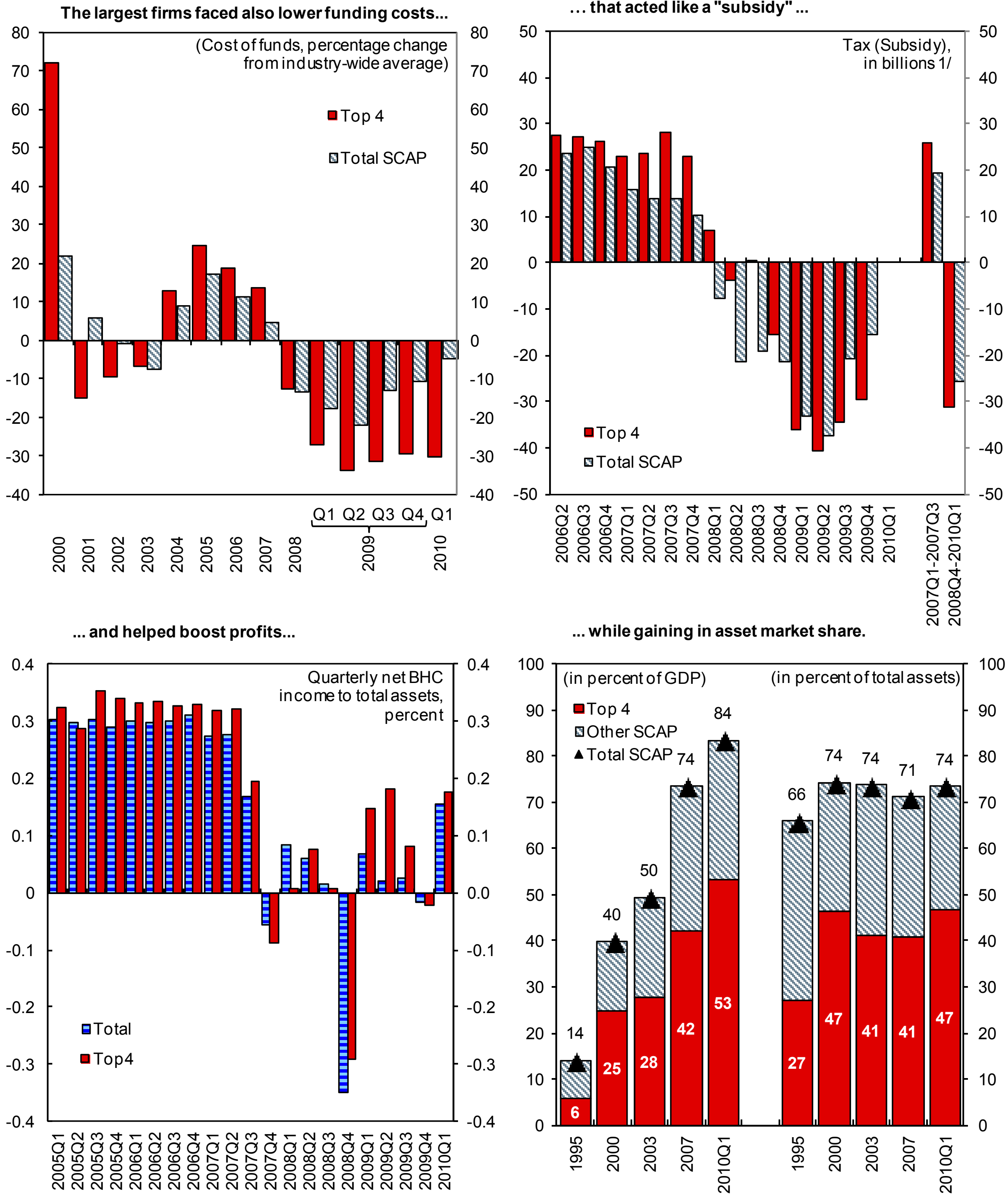
37. **The mission stressed that reforms to the framework for securitization should be prioritized to spur the return of this important market**. Draft legislation appropriately emphasized reform of the rating agencies, increased transparency and better-aligned incentives. The mission noted that, given the large role that securitization played in the past, and the potential to limits to bank balance sheets in creating credit, speedy implementation would be essential to avoid constraints on credit supply that could crimp the recovery. It would also be important to coordinate reforms domestically and internationally to ensure safe securitization and promote a level playing field.

Figure 11. How Different are "Too-Big-To-Fail" Bank Holding Companies?



Sources: SNL Financial and Fund staff estimates.

Figure 11. How Different are "Too-Big-to-Fail" Bank Holding Companies? (Cont'd)



Sources: SNL Financial and Fund staff estimates.

1/ Cost of funds relative to banks with assets less than $100 bn multiplied by average liabilities.

38. **The mission noted that the housing finance system, meanwhile, awaits further reform** (see *Selected Issues Chapter V*). The system is costly (enjoying the second single tax expenditure, almost $640 billion dollars over 2011–15, largely accruing to the better-off), inefficient and complex, with numerous interventions and subsidies that do not seem to translate into a sustainably higher homeownership rate. In this connection, the mission welcomed the ongoing review of the housing finance system, including the review of tax expenditures. It argued for reforms to the GSEs' ambiguous public/private status—which proved unsustainable—and saw benefits in streamlining the GSE's mandates and privatizing the retained portfolio, which had been the source of past losses and bore little relation to the core bundling and guaranteeing businesses. Those lines, which arguably could provide public goods, should be made explicitly public. The authorities noted that the ongoing review of the housing finance system would take up a number of these issues. In the meantime, it had become clear that a more balanced approach was needed, with greater market participation; in addition, the implicit GSE guarantees would be made explicit. Reforms would aim to ensure wide access to homeownership; protect consumers; preserve financial stability; and safeguard affordability for low- and middle-income borrowers.

C. Monetary Policy: Engineering a Smooth Exit

39. **The mission observed that the move toward the monetary policy exit had gone smoothly so far, thanks to deft management by the Federal Reserve**. In staff's view, in light of lingering financial strains, subpar growth, and risks to the outlook (including deflation), the Fed had appropriately maintained the policy target at an all time low while signaling that conditions would likely warrant exceptionally low levels of the policy rate for an extended period. Meanwhile, it had wound down most of its emergency facilities (the Term Asset Backed Securities Lending Facility expired on June 30, 2010, while it had revived its dollar swap facilities in light of interbank strains emanating from Europe) and also ended the $1.7 trillion Large-Scale Asset Purchase Program[10]—all without leaving noticeable ripples in markets.

40. **Federal Reserve officials considered that inflation remained subdued, and the downside risks had recently increased.** With inflation expectations well anchored and the Phillips curve relatively flat, the baseline was for moderate (but positive) inflation. They noted the downside risks to demand, including from Europe, which could exacerbate disinflationary pressures; that said, they saw little risk of a sustained period of outright deflation. In the event that further monetary stimulus were called for, policy responses could include a strengthened commitment to maintain ultra-low policy rates for an extended period, which would lower long-term interest rates as forward rate expectations fall. Expanding asset purchases and relaunching facilities to aid markets in case of renewed stress would be other options, which the Fed felt it could do quickly.

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[10] Under this program, the Federal Reserve purchased $1.25 trillion of agency MBS, about $175 billion of agency debt, and $300 billion of longer-term Treasury securities, as of March, 2010.

41. **The mission and authorities agreed that the Fed was well placed to manage the uncertainty surrounding the monetary exit**. The Fed was developing over time a well diversified tool kit for managing monetary conditions. Fed officials thought that increasing IOR could on its own tighten monetary conditions quite effectively, even if reserve levels remained elevated. They saw as the main uncertainty whether the IOR would pass through fully to comparable increases in the fed funds rate in the presence of high levels of reserves.[11] To help address this uncertainty, the Fed was in the process of developing and testing reverse repos against a broad range of collateral and with an expanded set of counterparties, as well as term deposits. The use of these tools would reduce reserves, tightening the relationship between IOR and other short-term rates. Other uncertainties included the level of reserves consistent with more normal operations further in the future. Officials did not anticipate the need for active asset sales at this stage; roll-off of securities could reduce excess reserves (which stood at about $1 trillion) by $340 billion through end-2011.[12] The mission agreed, noting the importance of continued skillful communication to manage expectations about the exit.

42. **As to the post-crisis operating framework,** the Fed saw several options—including a corridor or floor system—but felt it was too early to judge which would be preferable. As it moved through the exit, its experience would inform the choice of regime in the post-crisis world. The mission agreed, emphasizing the importance of continued clear communication about how the Fed saw the transmission mechanism and about its choice of policy targets. It also observed that it would be useful to transfer as soon as possible to the U.S. Treasury the assets purchased in the context of institution-specific support. Another issue is the interplay between the conduct of monetary policy and the Fed's expanded role in financial stability; the Fed Chairman has stated that if reforms proved inadequate or dangerous financial risks built up, the Fed must remain open to using monetary policy to address those risks, proceeding cautiously and always keeping in mind the inherent difficulties.

D. Role of the United States in the Global Economy

43. **The mission observed that a multilateral approach to economic policy management would be as important in the recovery as in the crisis**. It welcomed the authorities' continued work to coordinate with other policymakers in international fora. The mission also noted the authorities' efforts to promote international financial and economic stability (most recently through the Fed's redeployment of its dollar swap lines to foreign central banks, in response to dollar funding strains caused by sovereign stress in Europe).

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[11] The fed funds rate had remained below the IOR for some time, owing to unremunerated parties in the system, and limited arbitrage by banks.

[12] The Federal Reserve projects that about $200 billion of agency debt and MBS and $140 billion of Treasury securities will mature by the end of 2011.

44. **The mission stressed that the key contributions that the United States can make to global growth and stability are raising savings and strengthening the financial sector (Figure 12)**. Higher savings—in particular, through fiscal consolidation—can help to ensure that the current account deficit remains within sustainable levels, and avoid higher U.S. interest rates that would adversely affect global financial conditions. Strengthening the financial sector can both support U.S. growth and curtail the risk of future financial imbalances that could be detrimental to U.S. and global financial stability. That said, with household saving apt to rise over the medium term, the United States could no longer play the role of global consumer of last resort, underscoring the importance of measures to boost demand in current account surplus countries. With the U.S. dollar now (in the mission's view) overvalued from a medium-term perspective, this growth rebalancing would need to be accompanied by greater exchange rate flexibility elsewhere.

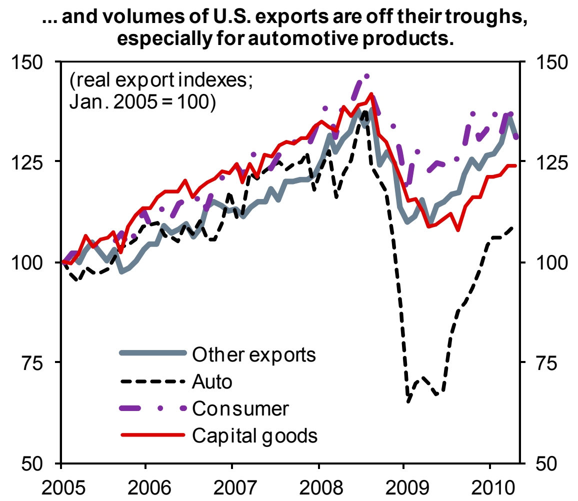
45. **The authorities agreed on the need for a global rebalancing of demand, which they did not see as underway at present**. Relatedly, they saw a substantial risk of deficient global demand, particularly if—as some were concerned—fiscal exits were unduly rapid and uncoordinated. In this connection, they saw the G-20 Mutual Assessment Process (MAP) exercise as a useful way to promote focused international discussions on global economic policy issues and encourage coordination. They agreed that U.S. fiscal consolidation had a large contribution to make over the medium term, and concurred that currency flexibility in surplus countries would be an essential ingredient of global rebalancing.

46. **The mission encouraged the authorities to redouble their efforts to conclude the Doha Round of trade negotiations.** Staff welcomed the limited U.S. recourse to protectionism (a notable exception being the safeguard measures against Chinese tires) and called on the Administration to continue to apply the Buy America provisions in the stimulus bill as narrowly as allowed and to roll back quickly discretionary import safeguard measures. Emphasis by the U.S. on a strong multilateral trade system with enhanced trade policy monitoring initiatives was helping to ensure that new trade measures were not a major drag on the global economic recovery; in this regard, the authorities' goal of doubling exports over five years—while ambitious in quantitative terms—sent an important and appropriate signal of the need to sustain and, where possible, to increase openness. An early conclusion of the Doha Round would support an increase in U.S. exports and help contain the risks of renewed protectionism. The authorities' focus in trade negotiations remained firmly on expanding jobs and economic growth by creating new export opportunities; present Doha Round offers, in their view, did this inadequately.

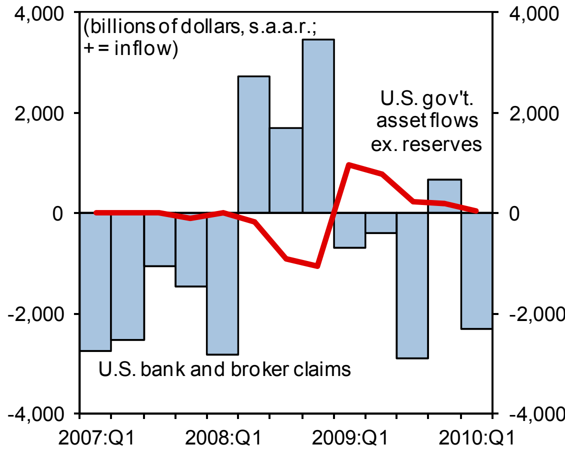
Figure 12. Trade, Financial Flows and the Dollar

U.S. Imports and exports have been recovering since worldwide trade collapsed at the start of the crisis...

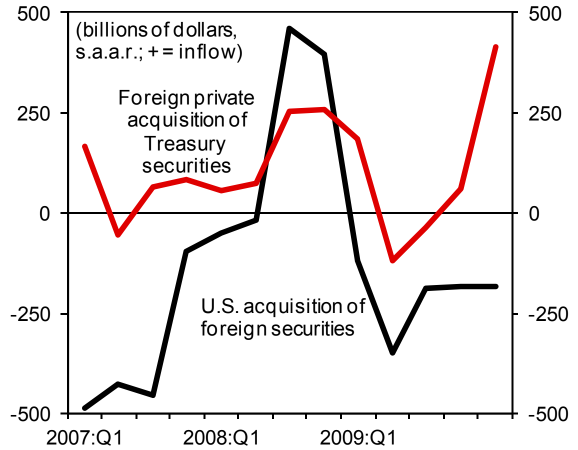
... and volumes of U.S. exports are off their troughs, especially for automotive products.



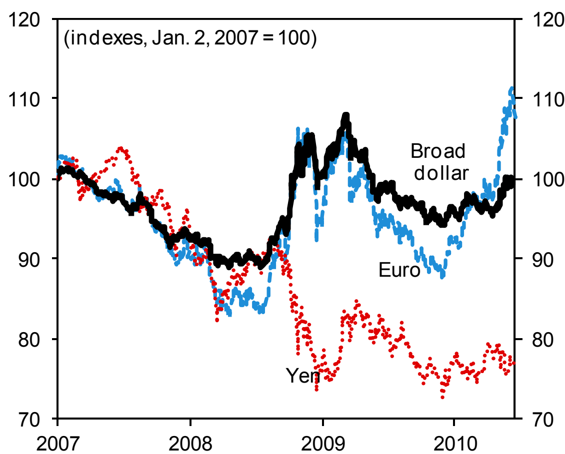
Improving market conditions allowed the Fed's swap lines to reduce , while U.S. bank outflows picked up...



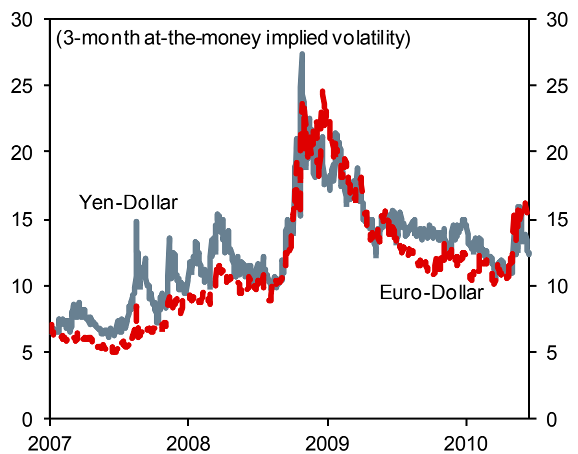
... and although U.S. residents' safe haven flows appear to have reversed, foreigners' purchases of treasuries are up...



... perhaps reflecting concerns about Europe, which also seem to be influencing recent exchange rate moves...



... and markets are signaling somewhat elevated fears of large movements in the U.S. dollar exchange rate.



Sources: Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Bloomberg, LP; Haver Analytics; and Fund staff estimates.

V. Staff Appraisal

47. **Aided by a massive policy response, economic recovery is underway, but further efforts are needed to secure a strong and durable expansion.** The crisis raised three main policy challenges: economic and financial stabilization; exit from extraordinary support; and dealing with long term legacies (fiscal sustainability and financial reform). With the recovery still dependent on policy support, sizeable downside risks to the outlook, and long-term legacies not yet fully addressed, further decisive action is needed to achieve stable medium-term growth and limit the risk of adverse international spillovers.

48. **In this context, the challenge is to balance continued support for the recovery with progress in dealing with long-term legacies.** Strong macroeconomic support remains appropriate for this year, given the remaining weaknesses in demand, stubbornly high unemployment, and lingering financial strains. On the fiscal side, stimulus should be maintained in 2010 as planned, and the envisioned withdrawal in 2011 is appropriate under the baseline outlook. Monetary support can be sustained for an extended period, given quiescent inflation risks, and to help offset fiscal drag that would begin next year. If downside risks materialized, a smaller up-front fiscal adjustment could be undertaken, complemented by further measures to bolster medium-term credibility (such as entitlement reforms) and further monetary accommodation.

49. **A key challenge is to ensure that public debt is set on a credible, sustainable path.** Over the medium term, the debt/GDP ratio is set to rise over the medium term to levels not seen since the years immediately following the Second World War, with further upward pressures thereafter owing to swelling entitlement spending. The authorities' commitment to fiscal stabilization is welcome, but under staff's economic assumptions, a major adjustment will be needed to stabilize the debt/GDP ratio by 2015, entailing both expenditure and revenue measures. Against this background, it is important that the adjustment envisioned for 2011 is accompanied by an appropriately strong commitment to medium-term stabilization, including (e.g.) legislated targets and further steps on entitlements. Looking beyond 2015, fiscal policy should aim to put public debt on a declining path relative to GDP, to rebuild room for maneuver.

50. **On entitlements, the recent health-care reform provides a welcome basis for cost control, but the payoffs from its measures are highly uncertain**. Many of the envisioned measures are difficult, or untried—and the present unsustainable rate of health-care cost inflation presents the major risk to long-run fiscal stability. Accordingly, it will be essential for the Medicare cost commission (IPAB) to closely monitor health care costs; and the authorities should take remedial action if needed, such as cuts in exemptions for insurance premiums. In addition, further action should be taken on social security, where the needed measures are well known and the payoff more certain.

51. **The other major task for policy is financial sector reform.** Risk-based capital ratios have rebounded strongly, but in part due to de-risking, while the risks to banks remain sizeable. With private securitization markets still impaired, banks may lack the balance-sheet strength to lend strongly when credit demand recovers. In this context, it will be important that banks fully recognize the risks on their balance sheets and have sufficient capital to support the ongoing recovery.

52. **Draft legislation makes major steps to address regulatory gaps—the key now is prompt and strong implementation.** Priorities should include prudential rules that disincentivize systemic size and complexity, and steps to streamline systemic institutions that cannot be resolved under stress. In addition, financial surveillance under the FSOC needs to quickly develop a common macroprudential focus, as well as a culture of transparency and cutting edge analysis. Close coordination among regulatory agencies will be crucial, as the draft reform misses the opportunity to consolidate the overly complex array of U.S. financial regulators, leaving risks of gaps and duplication. Improving transparency and containing counterparty risks in OTC derivatives markets will also be essential. Moreover, steps are needed to revitalize private securitization, given its large role played in the past and the limits to bank balance sheets in creating credit. Relatedly, reforms to the housing finance system remain unfinished and the move to clarify the GSE's status as public entities is useful. Over time, their mandates should be streamlined to bundling and guarantees.

53. **The Fed is well placed to manage the uncertainty of the monetary exit**. Its expanded toolkit should allow it to navigate smoothly the uncertainties about the transmission mechanism and the efficacy of individual tools. In addition, it has credibly communicated its commitment to sustaining appropriately accommodative monetary conditions even as it has introduced tools to prepare for the later exit. Continued clear communication about its strategy and operations will be essential as the exit evolves.

54. **The United States has a key role to play in promoting a multilateral approach to economic policy management.** The authorities' leading role in multilateral fora is welcome, as are their efforts to promote international stability. For the medium term, the key contributions that U.S. economic policy can make to global growth and stability are fiscal consolidation (which would limit the external imbalance) and strengthening its financial sector. On the trade policy front, the U.S. authorities' limited recourse to protectionist measures is welcome and they are encouraged to redouble efforts to conclude the Doha round.

55. **Staff proposes to hold the next Article IV Consultation on a 12-month cycle.**

Table 1. United States: Selected Economic Indicators 1/
(percentage change from previous period, unless otherwise indicated)

			Projections					
	2008	2009	2010	2011	2012	2013	2014	2015
National production and income								
Real GDP	0.4	-2.4	3.3	2.9	2.8	2.8	2.6	2.6
Net exports 2/	1.2	1.2	-0.3	-0.5	-0.3	-0.2	-0.1	0.0
Total domestic demand	-0.7	-3.4	3.5	3.3	3.0	2.8	2.7	2.6
Final domestic demand	-0.4	-2.7	2.1	3.0	3.0	2.9	2.7	2.6
Private final consumption	-0.2	-0.6	2.3	2.1	2.1	2.1	2.2	2.2
Public consumption expenditure	3.0	1.8	0.8	-2.0	-3.7	0.1	1.6	1.8
Gross fixed domestic investment	-3.6	-14.5	2.8	12.3	13.2	8.3	5.4	4.6
Private fixed investment	-5.1	-18.3	3.1	15.0	17.2	10.3	6.4	5.2
Equipment and software	-2.6	-16.6	13.3	21.3	19.4	8.7	4.2	4.0
Nonresidential structures	10.3	-19.8	-14.3	-5.1	1.9	3.0	3.0	3.8
Residential structures	-22.9	-20.5	0.7	19.9	24.4	19.2	13.4	8.3
Public fixed investment	3.4	1.9	1.7	3.0	-1.6	-0.6	0.7	1.2
Change in private inventories 2/	-0.4	-0.9	1.3	0.3	0.0	0.0	0.0	0.0
Nominal GDP	2.6	-1.3	4.1	4.1	4.3	4.4	4.4	4.6
Personal saving rate (percent of disposable income)	2.7	4.2	3.5	3.1	3.1	4.2	4.9	5.3
Private investment rate (percent of GDP)	14.8	11.4	12.5	14.1	15.8	16.7	17.0	17.2
Employment and inflation								
Unemployment rate	5.8	9.3	9.7	9.2	8.4	7.6	6.9	6.3
Output gap (percent of potential GDP)	-1.7	-5.8	-4.3	-3.1	-2.3	-1.6	-1.1	-0.6
Potential GDP	2.1	1.9	1.6	1.6	1.9	2.0	2.1	2.2
CPI inflation	3.8	-0.3	1.6	1.1	1.5	1.7	1.8	2.0
GDP deflator	2.1	1.2	0.8	1.2	1.5	1.6	1.8	1.9
Government finances								
Federal government (budget, fiscal years)								
Federal balance (percent of GDP)	-3.2	-11.3	-11.0	-8.1	-5.3	-5.0	-5.2	-5.6
Debt held by the public (percent of GDP)	40.2	53.0	64.0	69.0	72.4	75.0	77.7	80.4
General government (GFSM 2001, calendar years)								
Net lending (percent of GDP)	-6.6	-12.5	-10.7	-8.0	-5.6	-5.4	-5.5	-5.9
Structural balance (percent of potential nominal GDP)	-4.7	-7.1	-8.0	-6.2	-4.5	-4.7	-5.2	-5.6
Gross debt (percent of GDP)	70.6	83.2	92.1	97.2	100.3	102.9	105.5	108.1
Interest rates (percent)								
Three-month Treasury bill rate	1.4	0.2	0.1	0.3	1.7	3.6	4.4	4.4
Ten-year government bond rate	3.7	3.3	3.6	4.7	5.9	6.4	6.5	6.5
Balance of payments								
Current account balance (billions of dollars)	-669	-378	-482	-531	-571	-612	-654	-657
Merchandise trade balance (billions of dollars)	-835	-507	-651	-735	-789	-834	-877	-911
Balance on invisibles (billions of dollars)	166	129	168	204	217	223	224	254
Current account balance (percent of GDP)	-4.6	-2.7	-3.2	-3.4	-3.5	-3.6	-3.7	-3.6
Merchandise trade balance (percent of GDP)	-5.8	-3.6	-4.4	-4.8	-4.9	-5.0	-5.0	-5.0
Balance on invisibles (percent of GDP)	1.1	0.9	1.1	1.3	1.3	1.3	1.3	1.4
Export volume 3/	5.9	-12.2	13.6	4.8	4.7	5.0	5.7	6.1
Import volume 3/	-3.9	-16.0	11.4	7.6	6.2	5.8	5.9	5.8

Sources: Haver Analytics and Fund staff estimates.
1/ Components may not sum to totals due to rounding.
2/ Contribution to real GDP growth, percentage points.
3/ NIPA basis, goods.

Table 1. United States: Selected Economic Indicators (Cont.'d) 1/
(percentage change from previous period, unless otherwise indicated)

			Projections					
	2008	2009	2010	2011	2012	2013	2014	2015
Saving and investment (percent of GDP)								
Gross national saving	12.6	10.8	12.5	14.2	15.7	16.3	16.6	16.9
General government	-2.6	-6.5	-6.8	-4.6	-2.5	-2.3	-2.5	-2.8
Private	15.2	17.3	19.3	18.8	18.2	18.6	19.0	19.7
Personal	2.0	3.2	2.6	2.3	2.3	3.1	3.7	4.0
Business	13.2	14.0	16.6	16.5	15.9	15.5	15.4	15.7
Gross domestic investment	18.2	15.0	16.0	17.6	19.2	20.0	20.3	20.4
Private	14.8	11.4	12.5	14.1	15.8	16.7	17.0	17.2
Fixed investment	15.0	12.3	12.0	13.3	15.1	16.0	16.4	16.6
Inventories	-0.2	-0.8	0.5	0.8	0.7	0.7	0.6	0.6
Public	3.4	3.6	3.5	3.5	3.4	3.3	3.2	3.2

Sources: Haver Analytics and Fund staff estimates.
1/ Components may not sum to totals due to rounding.

Table 2. United States: Balance of Payments

(billions of U.S. dollars, unless otherwise indicated)

			Projections					
	2008	2009	2010	2011	2012	2013	2014	2015
Current account	-669	-378	-482	-531	-571	-612	-654	-657
Percent of GDP	-4.6	-2.7	-3.2	-3.4	-3.5	-3.6	-3.7	-3.6
Goods and services	-699	-375	-500	-575	-605	-617	-617	-603
Merchandise trade	-835	-507	-651	-735	-789	-834	-877	-911
Exports	1,305	1,068	1,221	1,304	1,402	1,512	1,639	1,786
Imports	-2,140	-1,575	-1,872	-2,039	-2,190	-2,346	-2,516	-2,697
Services	136	132	151	160	184	217	261	309
Receipts	534	502	543	570	613	667	732	802
Payments	-398	-370	-392	-410	-429	-449	-471	-494
Income	152	121	137	159	150	125	87	74
Receipts	797	588	359	374	567	965	1,189	1,250
Payments	-645	-467	-222	-214	-418	-841	-1,102	-1,175
Unilateral transfers, net	-122	-125	-119	-116	-116	-119	-124	-129
Capital account transactions, net	6	0	0	0	0	0	0	0
Financial account	578	216	482	531	571	611	654	657
Private capital	557	-740	260	299	329	358	388	380
Direct investment	-23	-134	-70	-78	-84	-90	-97	-104
Outflows	-351	-269	…	…	…	…	…	…
Inflows	328	135	…	…	…	…	…	…
Securities	222	-173	270	311	317	330	345	359
Other investment	357	-433	60	66	96	118	141	125
U.S. official reserves	-5	-52	0	0	0	0	0	0
Foreign official assets	551	449	222	232	242	254	265	277
Other items 1/	-525	559	0	0	0	0	0	0
Statistical discrepancy	85	163	0	0	0	0	0	0
Memo item: Current account excluding petroleum	-283	-178	-234	-264	-297	-331	-367	-359

Sources: Haver Analytics; and Fund staff estimates.

1/ Includes net financial derivatives.

Table 3. United States: Federal and General Government Finances

(percent of GDP)

	2008	2009	Projections 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Federal Government					(budget basis; fiscal years)								
Revenue	17.5	14.8	14.8	16.7	18.0	18.5	19.0	19.0	19.3	19.4	19.5	19.6	19.6
Expenditure	20.7	26.1	25.8	24.8	23.3	23.6	24.2	24.6	25.2	25.4	25.6	26.4	26.9
Noninterest 1/	18.9	24.8	24.6	23.4	21.4	20.9	21.0	21.0	21.3	21.2	21.1	21.6	21.9
Interest	1.8	1.3	1.2	1.3	1.9	2.7	3.3	3.6	3.9	4.2	4.5	4.8	5.0
Balance 1/	-3.2	-11.3	-11.0	-8.1	-5.3	-5.0	-5.2	-5.6	-5.9	-6.1	-6.2	-6.8	-7.3
Primary balance 2/	-1.4	-8.6	-9.8	-6.7	-3.4	-2.3	-1.9	-2.0	-2.0	-1.9	-1.7	-2.1	-2.3
Primary structural balance 3/	-1.4	-5.4	-7.6	-5.4	-2.5	-1.7	-1.5	-1.8	…	…	…	…	…
Debt held by the public	40.2	53.0	64.0	69.0	72.4	75.0	77.7	80.4	83.3	86.2	89.0	92.4	96.3
Net debt held by the public	36.7	46.7	56.3	62.0	64.7	66.9	69.2	71.8	74.7	77.6	80.4	83.9	87.8
General Government					(GFSM 2001 basis; calendar years)								
Revenue	32.2	30.4	30.5	32.2	33.5	34.3	34.8	35.0	…	…	…	…	…
Total expenditure 1/	38.9	42.9	41.3	40.2	39.1	39.6	40.3	40.9	…	…	…	…	…
Net lending 1/	-6.6	-12.5	-10.7	-8.0	-5.6	-5.4	-5.5	-5.9	…	…	…	…	…
Primary balance 2/	-4.7	-10.7	-9.1	-6.2	-3.3	-2.3	-1.9	-1.9	…	…	…	…	…
Primary structural balance 3/	-2.8	-5.4	-6.4	-4.5	-2.2	-1.7	-1.6	-1.7	…	…	…	…	…
Gross debt	70.6	83.2	92.1	97.2	100.3	102.9	105.5	108.1	…	…	…	…	…
Net debt	47.2	58.3	65.7	71.3	74.4	77.1	79.9	83.0	…	…	…	…	…

Sources: Office of Management and Budget; Haver Analytics; and Fund staff estimates.

1/ Includes staff's adjustments for one-off items, including the costs of financial sector support.

2/ Excludes net interest.

3/ Excludes net interest, effects of economic cycle, and costs of financial sector support. In percent of potential GDP.

Table 4. United States: Indicators of External and Financial Vulnerability
(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
External indicators									
Exports of goods and services (percent change)	-6.1	-2.7	4.3	13.6	10.6	13.4	13.5	11.5	-14.6
Imports of goods and services (percent change)	-5.5	2.1	8.3	16.8	12.9	10.9	6.3	8.0	-23.3
Terms of trade (percent change)	2.8	1.5	-1.3	-1.7	-4.0	-1.2	0.6	-4.9	7.8
Current account balance	-3.9	-4.3	-4.7	-5.3	-5.9	-6.0	-5.1	-4.6	-2.7
Capital and financial account balance	4.0	4.7	4.8	4.5	5.6	5.8	4.5	4.3	1.2
Of which:									
Net portfolio investment	3.3	4.4	4.1	6.1	4.9	5.7	5.4	1.7	5.4
Net foreign direct investment	0.2	-0.7	-0.8	-1.4	0.6	0.0	-1.0	-0.2	-0.9
Net other investment 1/	0.4	1.0	1.5	-0.1	0.0	0.4	0.2	2.5	-2.9
Official reserves (billion dollars)	68.7	79.0	85.9	86.8	65.1	65.9	70.6	77.6	130.8
Central bank foreign liabilities (billion dollars)	0.1	0.1	0.2	0.1	0.1	0.1	0.1	1.4	2.4
Official reserves (months of imports)	0.6	0.7	0.7	0.6	0.4	0.4	0.4	0.4	0.8
Net international investment position 2/	-18.2	-19.2	-18.8	-19.0	-15.3	-16.4	-13.6	-24.2	-19.2
Of which: General government debt 3/	11.9	13.6	15.4	17.5	18.7	20.4	22.6	28.5	31.0
External debt-to-exports ratio	1.9	2.1	2.1	1.9	1.5	1.5	1.2	1.9	1.7
External interest payments to exports (percent) 4/	23.7	20.7	18.9	20.5	25.9	32.6	35.8	28.2	23.0
Nominal effective exchange rate (percent change)	5.2	0.0	-6.4	-5.0	-2.6	-1.5	-4.3	-3.6	5.9
Real effective exchange rate (percent change)	5.7	-0.2	-6.4	-4.7	-1.3	-0.4	-3.9	-3.4	4.9
Financial market indicators									
General government gross debt	54.7	57.1	60.4	61.4	61.6	61.1	62.1	70.6	83.2
Average maturity of privately-held federal debt (months)	70.0	64.0	60.0	58.0	57.0	58.0	57.0	46.0	52.0
Federal privately-held debt maturing within one year	9.1	9.2	9.9	9.7	9.3	8.5	9.2	16.7	16.9
Three-month Treasury bill yield (percent)	3.5	1.6	1.0	1.4	3.2	4.8	4.5	1.4	0.2
Three-month Treasury bill yield (percent, real)	0.6	0.0	-1.2	-1.2	-0.1	1.6	1.6	-2.3	0.5
Equity market index									
(percent change in S&P500, year average)	-16.4	-16.5	-3.2	17.3	6.8	8.6	12.7	-17.3	-22.5
Banking sector risk indicators (percent unless otherwise indicated) 5/									
Total assets (in billions of dollars)	6,552	7,077	7,602	8,416	9,040	10,092	11,176	12,309	11,846
Total loans and leases to assets	59.3	58.7	58.3	58.3	59.5	59.3	59.3	55.6	54.9
Total loans to deposits	88.7	88.6	88.0	87.7	88.6	88.9	90.6	84.6	78.0
Problem loans to total loans and leases 6/	1.4	1.5	1.2	0.9	0.8	0.8	1.3	3.0	5.5
Nonperforming assets to assets	0.9	0.9	0.8	0.6	0.5	0.5	0.9	1.8	3.4
Loss allowance to:									
Total loans and leases	1.9	1.9	1.7	1.5	1.3	1.2	1.4	2.3	3.3
Noncurrent loans and leases	132.4	127.1	145.7	174.6	170.2	144.4	101.2	77.8	59.2
Return on equity	13.2	14.4	15.3	13.7	12.9	13.0	9.1	1.3	0.9
Return on assets	1.2	1.3	1.4	1.3	1.3	1.3	0.9	0.1	0.1
Total capital to risk-weighted assets	12.7	12.8	12.8	12.6	12.3	12.4	12.2	12.7	14.2
Core capital ratio	7.8	7.8	7.9	7.8	7.9	7.9	7.6	7.4	8.6

Sources: IMF, *International Financial Statistics;* Federal Deposit Insurance Corporation; and Haver Analytics.
1/ Includes net financial derivatives.
2/ With FDI at market value.
3/ Excludes foreign private holdings of U.S. government securities other than Treasuries.
4/ External interest payments: income payments on foreign-owned assets (other private payments plus U.S. government payments).
5/ FDIC-insured commercial banks.
6/ Noncurrent loans and leases.

INTERNATIONAL MONETARY FUND

UNITED STATES

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

July 12, 2010

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II. Statistical Issues 4

Annex I. United States: Fund Relations
(As of April 30, 2010)

I. **Membership Status**: Joined 12/27/45; Article VIII

II.	**General Resources Account:**	**SDR Million**	**Percent Quota**
	Quota	37,149.30	100.00
	Fund holdings of currency	29,579.52	79.62
	Reserve position in Fund	7,568.63	20.37

III.	**SDR Department:**	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	35,315.68	100.00
	Holdings	36,881.95	104.44

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangements:** The exchange rate of the U.S. dollar floats independently and is determined freely in the foreign exchange market.

VIII. **Payments Restrictions.** The United States accepted Article VIII of the IMF's Articles of Agreement and maintains an exchange system free of restrictions and multiple currency practices with the exception of limited restrictions on certain payments and transfers imposed for security reasons. The United States currently administers approximately 30 economic sanctions programs, which restrict certain payments and transfers for transactions against particular foreign governments, entities, and individuals. The United States administers, inter alia, sanctions programs relating to Burma, Cuba, Iran, North Korea, and Sudan, and continues to block certain previously frozen assets of the former Yugoslavia. Several other sanctions programs, including those relating to Côte d'Ivoire, Liberia, Somalia, Syria, Western Balkans, and Zimbabwe are "list-based" programs, affecting only members of certain government regimes and other individuals and groups whose activities have been determined to threaten the foreign policy or economy of the United States. The United States also implements similar list-based sanctions programs against: narcotics traffickers; terrorism-related governments, entities, and individuals; and proliferators of weapons of mass destruction.

IX. **Article IV Consultation**. The 2009 Article IV consultation was concluded in July 2009 and the Staff Report was published as IMF Country Report 09/187. A fiscal ROSC was completed in the context of the 2003 consultation. An FSAP was conducted during the Fall of 2009 and Spring of 2010. The FSSA will be discussed at the board, together with the 2010 Article IV Consultation, on July 26, 2010.

The 2010 Article IV discussions were conducted from May 11–June 28. Concluding meetings with Chairman Bernanke of the Board of Governors of the Federal Reserve System and Treasury Secretary Geithner occurred on June 21 and 28. A press conference on the consultation was held on July 8, 2010. The team comprised D. Robinson (Head), C. Kramer, M. Estevão, O. Celasun, A. Maechler, M. Sommer, N. Batini, E. Tsounta, and G. Bin Li (all WHD); A. Bhatia, B. McDonald, and Mika Saito (all SPR); F. Columba and J. Kiff (all MCM); and J. Myers and S. Dawe (LEG). Ms. Lundsager (Executive Director) and Mr. Lin (Advisor) attended some of the meetings. Outreach included discussions with the private sector and think tanks. The authorities have agreed to the publication of the staff report.

Annex II. Statistical Issues

Statistical Issues: Comprehensive economic data are available for the United States on a timely basis. The quality, coverage, periodicity, and timeliness of U.S. economic data are adequate for surveillance. Coverage of international capital flows in external sector statistics has been improved, with the June 2007 releases of BOP and IIP data on financial derivatives. The United States has subscribed to the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Dissemination Standard Bulletin Board (DSBB).

United States: Table of Common Indicators Required for Surveillance

(As of June 30, 2010)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]
Exchange rates	June 25	June 28	D	W	W
International reserve assets and reserve liabilities of the monetary authorities[1]	June 25	June 30	W	W	W
Reserve/base money	June 23	June 24	B	W	W
Broad money	June 16	June 24	W	W	W
Central bank balance sheet	June 23	June 24	W	W	W
Interest rates[2]	same day	same day	D	D	D
Consumer price index	May 2010	Jun. 17	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	2010 Q1	Jun. 10	Q	Q	Q
Revenue, expenditure, balance and composition of financing[3] – central government	May 2010	June 10	M	M	M
Stocks of central government and central government-guaranteed debt	May 2010	June 4	M	M	M
External current account balance	2010 Q1	June 17	Q	Q	Q
Exports and imports of goods and services	Apr. 2010	June 10	M	M	M
GDP/GNP (3rd release)	2010 Q1	June 25	Q	M	M
Gross External Debt	2010 Q1	June 17	Q	Q	Q
International Investment Position[5]	2009	June 25	A	A	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2]Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3]Foreign, domestic bank, and domestic nonbank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[6]Daily (D), Weekly (W), Biweekly (B), Monthly (M), Quarterly (Q), Annually (A); NA: Not Available.

Statement by the IMF Staff Representative on the United States
July 22, 2010

1. **This note reports on information that has become available since the staff report (SM/10/189) was issued and does not alter the thrust of the staff appraisal**.

2. **Incoming data since the completion of the Article IV consultation in mid-June point to a continued but subpar recovery, with further downside risks to the staff's forecast**. First-quarter GDP growth was revised down by 0.5 percent (saar), mainly owing to weaker final demand. Recent data also indicate softening consumer confidence, dwindling tailwinds from the inventory cycle, weak private sector employment growth, and reduced housing activity on the expiry of the homebuyer tax credit. In addition, imports picked up strongly relative to exports in June, although this could partly be attributable to temporary factors such as the expiry of an export VAT rebate in China. All told, activity in the second quarter has been weaker than expected, with GDP growth in the second quarter of 2010 tracking below the WEO estimate. On fiscal policy, the Senate has approved another temporary extension of unemployment benefits, and the authorities plan to unveil their mid-session budget update on Friday, July 23.

3. **The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 was cleared to be signed into law by President Obama**. Most major provisions of the Dodd–Frank Act—the new inter-agency Council, the resolution mechanism for systemic financial firms, the wider regulatory perimeter and stronger consolidated supervision, and the new regulatory framework for derivatives market—are in line with U.S. FSAP recommendations, which was conducted as this law took shape. That said, as flagged in the FSAP, the U.S. regulatory system remains complex, and the effectiveness of the reform will hinge on its implementation.

4. **Risk aversion continues to drive financial conditions**. Stock prices have fallen below end-2009 levels, the dollar remains elevated relative to the start of the year, and Treasury yields have declined on flight to quality. Consumer credit fell in June and a Fed survey recorded easier credit terms, although terms remained tighter than at end-2006. Second-quarter earnings for financial institutions were largely disappointing, with meager trading revenues, and continued high (albeit easing) credit costs.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/101
FOR IMMEDIATE RELEASE
July 30 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with the United States

On July 26, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United States.[1]

Background

Thanks to a massive policy response, the U.S. economy is recovering from the worst financial crisis since the Great Depression. Monetary policy has maintained a highly accommodative tilt, with policy rates near zero and asset purchases that have helped to ameliorate financial strains. Fiscal policy has been very stimulative, with the American Recovery and Reinvestment Act imparting stimulus of about 5 percent of GDP during 2009–2011, supplemented by measures targeted to housing, labor and auto markets. Meanwhile, measures to stabilize financial markets, capital injections, guarantees, and stress testing dramatically improved financial conditions. As a result, GDP grew an average 4 percent (seasonally adjusted annual rate) in the second half of 2009 before slowing to 2.7 percent (saar) growth in the first quarter of 2010. The U.S. current account deficit shrank on the back of weak domestic demand, lower oil prices, and the cumulative effect of the depreciation trend in the dollar since early 2002.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the First Deputy Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

However, the economic recovery has been slow by historical standards—consistent with past experience in the aftermath of housing and financial crises—and the outlook remains uncertain. In particular, private demand has been sluggish, while the unemployment rate has receded only modestly from near post-Depression highs. As a result, inflation has remained contained, with core inflation easing amid wide economic slack. Recent market volatility from the sovereign crisis in Europe has tightened financial conditions somewhat despite safe-haven flows that have reduced Treasury yields. Looking ahead, risks are elevated and tilted to the downside (as clear from the most recent batch of economic indicators), with particular risks from a double dip in the housing market and spillovers if external financial conditions worsen.

Macroeconomic policies are set to remain accommodative in the near term. The draft FY2011 budget includes allowances for further targeted support for growth, while proposing measures aimed at reducing the deficit to 4 percent of GDP by the middle of the decade. A new Fiscal Commission will recommend measures aimed at further reducing the deficit to roughly 3 percent of GDP and stabilizing the ratio of debt to GDP over the medium term. Most of the special liquidity facilities have been phased out and the Fed ended its mortgage-backed securities purchase program without disrupting markets, while signaling continued low policy rates for an extended period.

Progress has been made in addressing long-term challenges. The health care reform widens coverage and introduces cost-containment measures, and seeks to reduce near-term deficits as well as the long-term fiscal gap. The financial regulation reform, which is broadly consistent with proposals in the IMF's Financial Stability Assessment Program, includes a broadening of the regulatory perimeter to all systemic institutions and markets, a new council of regulators to improve systemic risk detection and resolution, tighter prudential regulation parameters, and stronger resolution mechanisms for nonbank financial institutions.

Executive Board Assessment

Executive Directors noted the economic recovery underway in the United States, aided by a massive policy response. However, with recovery still dependent on policy support, rising downside risks, and substantial long-term fiscal and financial-sector challenges, further decisive action is needed to achieve stable medium-term growth and limit risks of adverse international spillovers.

Directors saw near-term tradeoffs between supporting recovery and addressing long-term legacies. Macroeconomic support remains appropriate for this year, given still-weak demand, high unemployment, and lingering financial strains, although the envisioned withdrawal in 2011 is appropriate. Monetary support can be sustained for longer, given quiescent inflation expectations and forthcoming fiscal drag. However, Directors saw scope for a smaller up-front fiscal adjustment if downside risks materialize, complemented by measures to bolster medium-term credibility.

Setting public debt on a sustainable path is a key macroeconomic challenge. Directors welcomed the authorities' commitment to fiscal stabilization, but noted that a larger than budgeted adjustment would be required to stabilize debt-to-GDP under staff's economic assumptions, requiring revenue and expenditure measures. They urged the authorities to accompany the 2011 adjustment with a strong commitment to medium-term stabilization, perhaps including further entitlement reform. Some Directors welcomed the creation of the Fiscal Commission and the Independent Payment Advisory Board as useful steps. A number of Directors encouraged the authorities to set debt-to-GDP on a declining path in the longer term.

Directors welcomed the health care reform, including enhanced coverage and measures to control costs, the key long-term fiscal risk. However, with payoffs highly uncertain, close monitoring of costs and remedial actions, if needed, will be essential. Further action is also necessary on Social Security, where needed measures are well known and payoff more certain.

Directors welcomed the FSAP assessment, which acknowledged that the financial system has strengthened but remains vulnerable to shocks. Private securitization is still impaired and banks may lack balance-sheet strength to support future credit demand. Accordingly, banks must fully recognize balance-sheet risks and have sufficient capital to support recovery.

Directors welcomed the major financial reform, which is broadly consistent with FSAP recommendations, but noted that strong implementation will be crucial. Close coordination among regulatory agencies is essential, as the reform missed the opportunity to consolidate the complex array of regulators. Directors also underscored the importance of containing counterparty risks in OTC derivatives markets; revitalizing private securitization; and moving ahead with reforms to the housing finance system, including the GSEs.

Directors saw the Federal Reserve as well placed to manage the monetary exit given its expanded toolkit. The Fed has credibly communicated its commitment to sustaining accommodative monetary conditions while preparing for the exit. Continued clear communication is essential as the exit evolves.

Directors saw a key role for the United States in promoting multilateral economic management. U.S. economic policy could help secure medium-term global growth and stability mainly through medium-term fiscal consolidation, which could also help reduce the current account deficit, and strengthening the financial sector. On trade policy, Directors welcomed the authorities' limited recourse to protectionist measures and encouraged them to redouble efforts to conclude the Doha round.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2010 Article IV Consultation with United States is also available.

United States: Selected Economic Indicators

(annual change in percent, unless otherwise indicated)

	2005	2006	2007	2008	2009	Projections 2010	2011
National production and income							
Real GDP	3.1	2.7	2.1	0.4	-2.4	3.3	2.9
Net exports 1/	-0.3	-0.1	0.6	1.2	1.2	-0.3	-0.5
Total domestic demand	3.2	2.6	1.4	-0.7	-3.4	3.5	3.3
Final domestic demand	3.3	2.5	1.7	-0.4	-2.7	2.1	3.0
Private final consumption	3.4	2.9	2.7	-0.2	-0.6	2.3	2.1
Public consumption expenditure	0.6	1.0	1.4	3.0	1.8	0.8	-2.0
Gross fixed domestic investment	5.3	2.5	-1.2	-3.6	-14.5	2.8	12.3
Private fixed investment	6.5	2.3	-2.1	-5.1	-18.3	3.1	15.0
Residential structures	6.2	-7.3	-18.5	-22.9	-20.5	0.7	19.9
Public fixed investment	-0.8	3.3	3.2	3.4	1.9	1.7	3.0
Change in private inventories 1/	-0.1	0.1	-0.3	-0.4	-0.9	1.3	0.3
GDP in current prices	6.5	6.0	5.1	2.6	-1.3	4.1	4.1
Employment and inflation							
Unemployment rate	5.1	4.6	4.6	5.8	9.3	9.7	9.2
CPI inflation	3.4	3.2	2.9	3.8	-0.3	1.6	1.1
GDP deflator	3.3	3.3	2.9	2.1	1.2	0.8	1.2
Government finances							
Federal government (budget, fiscal years)							
Federal balance (percent of GDP)	-2.6	-1.9	-1.2	-3.2	-11.3	-11.0	-8.1
Debt held by the public (percent of GDP)	36.9	36.5	36.2	40.2	53.0	64.0	69.0
General government (GFSM 2001, calendar years)							
Net lending (percent of GDP)	-3.2	-2.0	-2.7	-6.6	-12.5	-10.7	-8.0
Structural balance (percent of potential nominal GDP)	-2.3	-1.9	-2.3	-4.7	-7.1	-8.0	-6.2
Gross debt (percent of GDP)	61.6	61.1	62.1	70.6	83.2	92.1	97.2
Interest rates (percent)							
Three-month Treasury bill rate	3.2	4.8	4.5	1.4	0.2	0.1	0.3
Ten-year government bond rate	4.3	4.8	4.6	3.7	3.3	3.6	4.7
Balance of payments							
Current account balance (billions of dollars)	-748	-803	-718	-669	-378	-482	-531
Percent of GDP	-5.9	-6.0	-5.1	-4.6	-2.7	-3.2	-3.4
Merchandise trade balance (billions of dollars)	-784	-839	-823	-835	-507	-651	-735
Percent of GDP	-6.2	-6.3	-5.8	-5.8	-3.6	-4.4	-4.8
Balance on invisibles (billions of dollars)	36	37	105	166	129	168	204
Percent of GDP	0.3	0.3	0.7	1.1	0.9	1.1	1.3
Saving and investment (percent of GDP)							
Gross national saving	15.1	16.2	14.5	12.6	10.8	12.5	14.2
Gross domestic investment	20.3	20.5	19.5	18.2	15.0	16.0	17.6

Sources: Haver Analytics and IMF staff estimates.

1/ Contribution to real GDP growth, percentage points.