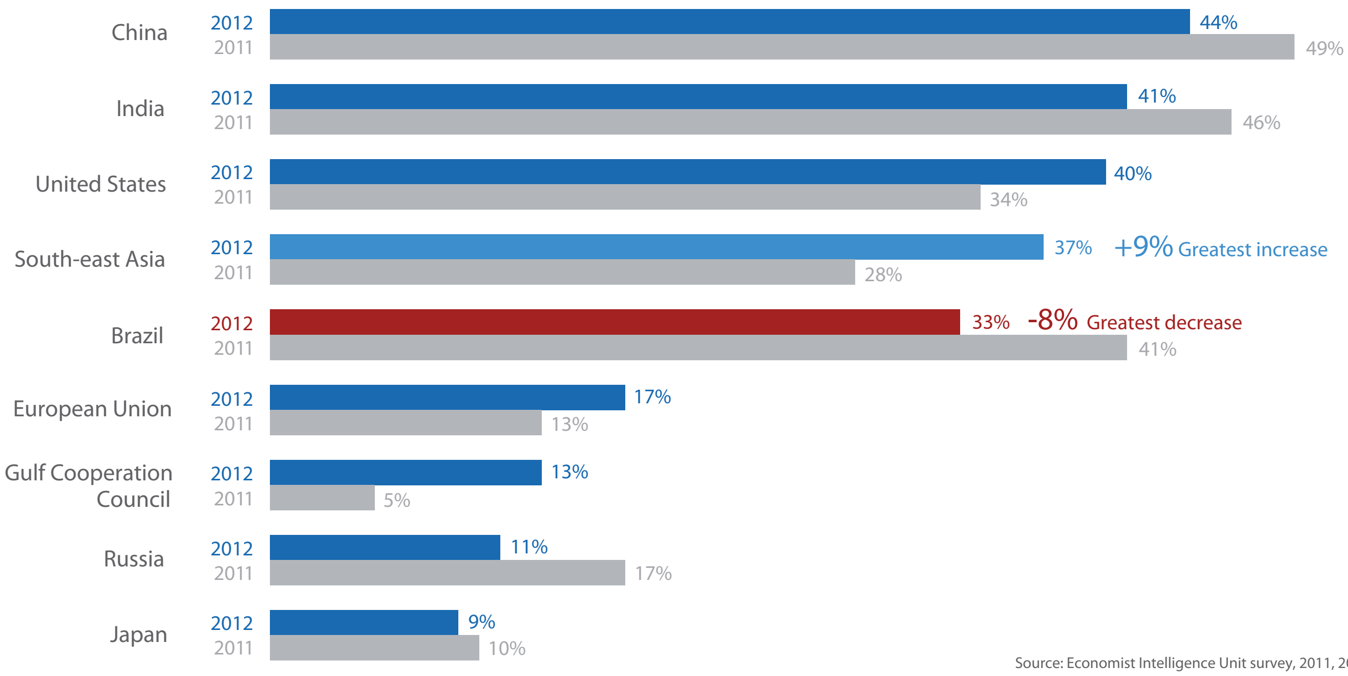
4 The US: Risk/reward target

Investors are taking heart from the US economy's modest upturn. The US economy, by almost any measure, remains weak: the unemployment rate is alarmingly high (above 8%), housing prices continue to fall, and debt levels are elevated. However, the economy grew at an annualised rate of 3% in the fourth quarter of 2011, its fastest rate in six quarters. This was buoyed by unexpectedly strong consumer spending, although much of the new activity was attributed to inventory replenishment. The stockmarket has responded strongly to these positive signs: by mid-March the S&P 500 had posted an 11% advance from the start of the year.

Q Which of the following regions and countries offer the best potential for asset price growth over the next twelve months?
(% of respondents)



Source: Economist Intelligence Unit survey, 2011, 2012

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The EIU forecasts US GDP growth of 1.9% for 2012, a 0.2% improvement over 2011. Japan, which is in disaster reconstruction phase, is the only other leading economy within the OECD where growth is expected to be stronger this year than in 2011. In this year's survey the US has jumped from fourth to third place for asset price growth, with slightly more than 40% of respondents placing it among their top three markets, just behind China (44%) and India (41%) and ahead of South-east Asia (37%). "The US is the place with respect to the risk/reward trade-off," says Jaya Shankar, executive director of HDIL Securities Ltd in India, noting also that Standard & Poor's downgrade of US Treasury securities last year did not lead to investors abandoning the US dollar, reflecting in part the unrivalled depth of the US capital markets.

But the optimism with which investors appear to have greeted these positive signs may be misplaced: while the US economy has gained ground in the last six months and another recession in the short term seems unlikely, most economic indicators have not displayed the consistent upswing that might have been expected during a normal recovery from recession.

Some see the impending presidential election as a positive force, discouraging either political party from engaging in more of the budgetary brinksmanship that punctuated 2011. The administration of Barack Obama plans no further fiscal tightening in 2012, but a series of fiscal deadlines just after the election, including the expiration of the Bush administration's tax cuts and the due date for the massive spending cuts mandated under last year's deal to raise the federal debt ceiling, would tend to encourage both parties to once again attempt a grand bargain that could result in significant deficit reduction. Whoever wins the presidency in November will face pressure to cut federal spending in 2013. If the economic recovery continues, the pressure to cut federal spending—and borrowing—to avoid a "crowding out" of private investment will intensify. The result would be fiscal belt-tightening, which could hinder a faster economic recovery—at least in the short term. ■