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The Top Five Risks Facing the U.S. in 2016

More than six years after the Great Recession (December 2007-June 2009) ended, a variety of risks plague the global economy as we are off to a volatile start to 2016. In the advanced world, the U.S. and the UK are leading growth while the euro zone and Japan struggle to achieve sustained expansion. More worryingly, emerging markets, which provided a backstop for global decline in the initial years of recovery following the recession, are now losing steam, led by a slowdown in China. Against this backdrop, Dun & Bradstreet's U.S. Economics team has identified the following top headwinds to the U.S. economy:

THE STRENGTH OF THE GREENBACK

Between July 2014 and December 2015, the broad trade-weighted value of the U.S. dollar surged by a whopping 20%, rising much faster and more sharply than anticipated. A stronger dollar makes U.S. exports more expensive for the rest of the world, while it makes imported goods cheaper for us. With the U.S. Federal Reserve breaking rank with other major central banks in the world, and choosing to raise interest rates, capital will continue to flow out of other markets into the U.S. dollar, keeping it strong over the near term. The greenback's strength will be further reinforced by geopolitical crises and episodes of investor anxiety about global growth, prompting a flight to the safety of the dollar. Manufacturing has already borne the brunt of the strong dollar, and will be one of the worst hit industries. But other industries could also face impediments if cheap imports start cutting into their market share. Finally, the strong dollar is weighing on corporate profits of large multinational companies, which will, in turn, reduce their capex allocations.

OIL PRICE SLUMP

Global commodity prices and the U.S. dollar move in opposite directions. Nowhere is this downward pressure more visible than in the crude oil market, where dollar strength is exacerbating the price slump brought on by the combination of persistent oversupply and declining demand. The price of a barrel of West Texas Intermediate (the U.S. benchmark) crude oil has fallen more than 70% from its latest peak in June 2014, dropping (temporarily) below the psychological mark of $30. With prices expected to remain low for an extended period of time, the decline in capex in the U.S. oil and gas industry, particularly in shale, will only worsen in 2016. Employment in related industries will also face higher attrition. Dun & Bradstreet forecasts a deterioration in business conditions, and a rise in failures, particularly in the exploration and production segments of the industry. Finally, a broader systemic risk is lurking around the corner in the form of bad energy sector loan portfolios of financial institutions.

SPILLOVERS OF THE CHINESE SLOWDOWN

One major reason for the drop in global commodity demand has been the ongoing slowdown in the Chinese economy, as the government tries to engineer a smooth transition away from investment and manufacturing toward consumption and services. While this does not directly affect the U.S., even a planned and modest slowdown in the Chinese economy could trigger less orderly and more protracted slowdowns in other emerging markets overly dependent on China to buy their commodity exports. A sharper-than-expected slowdown in emerging markets could, in turn, weigh on overall global growth and investor sentiment, and thereby hurt U.S. growth prospects.

INADEQUATE POLICY RESPONSE

Although the domestic economy continues to grow at a steady pace, policymakers need to look beyond the near term and plan for the longer run. Most of the heavy lifting in the policy space was done by monetary policy during and after the recession. Fiscal policy needs to do more to complement that and sustain growth; but given that we are in an election year, the risk is high that political disunity will prevent such policies from being enacted. Policy paralysis could be particularly costly, because monetary policy has exhausted almost all its ammunition, and would be a lot more limited if the current expansion stalls in response to external shocks.

DIVERGENCE CAUSES VOLATILITY

Global financial volatility has spiked in the first few weeks of 2016, as result of several factors including the first rate hike by the U.S. Federal Reserve, the contagion spreading from the crashes in the Chinese stock market to other bourses, and the general increase in concern about the slowdown in global growth. While there will be sporadic episodes of wild swings in volatility, the general level of volatility in global financial markets will be elevated in 2016. This is due to the divergence in global trends, and the uncertainty that it triggers; the U.S. central bank is raising rates, while other central banks are pushing the limits of quantitative easing; the dollar is appreciating, while the euro is losing ground. Large divergences like these contribute to uncertainty among investors and erode confidence, and will affect the U.S. operating environment. Businesses need to be clear about their strategy and their risks and opportunities.

For more information on Dun & Bradstreet's Economics insights, contact:

Bodhi Ganguli, *Senior Economist, Country Risk Services*
103 John F Kennedy Parkway, Short Hills, NJ 07078
gangulib@dnb.com • 973-921-5961