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Rogoff Sees World Wishing It’s America Year After S&P Downgrade
2012-08-05 23:01:03.0 GMT

By Rich Miller, Inyoung Hwang and Charles Mead

Aug. 6 (Bloomberg) -- Global investors can’t get enough American securities a year after Standard & Poor’s Corp.
downgraded U.S. government debt.

The dollar has outperformed its peers in the past 12 months, rising by 10 percent against a basket of six currencies.
U.S. stocks have been the best performing equity market in terms of dollars, with the Dow Jones Industrial Average advancing 14 percent. Treasuries also have done better since the S&P action late on Aug. 5, 2011, returning 6.7 percent to investors compared with 6.1 percent for other government bonds.

“We’re seeing negative data come in from a lot of parts of the world,” said Kenneth Rogoff, a professor at Harvard University in Cambridge, Massachusetts, and a former chief economist at the International Monetary Fund. “The rest of the world is looking at the United States and saying, ‘I wish we were the United States.’”

With the largest economy and deepest financial markets, the U.S. is seen as the safe haven for investors at a time when Europe is struggling to contain its sovereign-debt crisis and Chinese growth is slowing. Low yields -- 10-year Treasuries fell to a record 1.379 percent on July 25 -- show that most money managers have faith the government will meet its obligations, in spite of S&P’s decision to strip the securities of their AAA rating.

Token Gesture

The downgrade “was more a token gesture but didn’t mean anything to the credit quality of the U.S.,” said Paul Zemsky, the New York-based head of asset allocation for ING Investment Management, which oversees $160 billion.

S&P spokesman John Piecuch defended the company’s action.

“Credit ratings are an opinion on relative risk of default, not a prediction of market behavior,” he said in an e- mail. “We began downgrading Greece in 2004 and Italy in 2005 for example, but for several years markets continued to value their bonds nearly on par with those of Germany.”

U.S. businesses are benefiting from the rush into American securities by global investors. Fifteen of the top 20 companies worldwide in terms of market capitalization are American, led by Apple Inc. and Exxon Mobil Corp., according to data compiled by Bloomberg. That’s up from 11 a year ago. New to the top 20 from the U.S. are Coca-Cola Co., Wells Fargo & Co., Procter & Gamble Co. and Pfizer Inc.

Safety Preferred

U.S. corporate bonds also reflect investors’ preference for safety at a time of global economic trouble. Dollar-denominated bonds of high-grade borrowers have returned 8.4 percent since Aug. 5, 2011, exceeding the 7.8 percent return in the 12 months before S&P’s downgrade, according to Bank of America Merrill Lynch index data. Investment-grade corporate debt worldwide has returned 7.6 percent in the past year.

Companies are taking advantage of the record low bond yields, selling $103 billion of debt last month, the busiest July on record, data compiled by Bloomberg show. Bristol-Myers Squibb Co., Schlumberger Ltd. and Morgan Stanley all raised $2 billion each, the latter with its first fixed-rate 30-year debt in a decade.

"There was a lot of fear that the downgrade would result in higher interest rates overall within the U.S. because of the perceived lack of fiscal responsibility," said Thomas Chow, a money manager at Delaware Investments in Philadelphia with about $170 billion under management, including $130 billion of fixed- income assets. "The reality of it is that this world is based more on relative valuations."

Better Performing

While the U.S. has slowed, it's still performed better than most other advanced nations since the S&P move last year. The economy expanded at an average annual pace of about 2.5 percent from the third quarter of 2011 through the first quarter of 2012.

That's double the rate of Germany and more than five times that of France. It's also better than the U.K. and Italy, both of which are mired in recessions. Among the Group of Seven industrial nations, only Canada and Japan, which has been recovering from the ravages of the March 2011 earthquake and tsunami, grew more.

"The U.S. is the best-looking horse in the glue factory," said Nariman Behravesh, chief economist in Lexington, Massachusetts, for IHS Inc. "We have our problems, but the rest of the developed world has far, far worse problems."

While unemployment rose to 8.3 percent last month from 8.2 percent in June, U.S. employers added 163,000 workers, the Labor Department reported Aug. 3, exceeding the 100,000 median estimate of economists in a Bloomberg survey.

Housing Revival

Housing, the epicenter of the financial crisis in the U.S., is showing signs of life. Residential construction contributed 0.2 percentage point to economic growth in the second quarter and 0.4 point in the first, the biggest first-half role since 2005, before the 18-month recession that began December 2007.

Residential real-estate prices in 20 cities rose a seasonally adjusted 0.9 percent in May from April, the largest increase in almost three years, according to the S&P/Case- Shiller index of property values.

"It really has turned what was a big headwind for us into something of a tailwind," Karl Case, a professor emeritus at Wellesley College in Massachusetts and co-creator of the index, told Tom Keene and Ken Prewitt on Bloomberg Radio's July 31 "Surveillance."

On its own, S&P's downgrade doesn't seem to have mattered, with Treasury yields down and the stock market up, said Mohamed El-Erian, chief executive officer of Pacific Investment Management Co. in Newport Beach, California. Even so, the market moves should be seen against the backdrop of record monetary stimulus from the Federal Reserve, which has helped hold down yields, and the crisis in Europe, he said.

'Massive Outflows'

"There has been absolutely massive outflows out of Europe into Switzerland and the U.S.," said El-Erian, whose firm manages the world's largest bond fund.

He said the U.S. is stuck with a sluggish economy, with growth during the next 12 months likely to be 1.5 percent.
Europe's economy, though, probably will contract by that much over the same period, he added.

S&P lowered the U.S. long-term credit rating to AA+ last August after months of wrangling between President Barack Obama and congressional Republicans over whether to raise the federal-debt limit. While the impasse ended with Obama signing a debt- ceiling increase on Aug. 2, S&P downgraded the U.S three days later, citing political gridlock in Washington and the nation's long-term fiscal challenges.

Justified Reduction

Sixty-seven percent of global investors polled by Bloomberg the following month said the rating reduction was justified.
U.S. investors were less supportive, with 57 percent approving, compared with about three-fourths of respondents in Europe and Asia, according to the survey of 1,031 Bloomberg subscribers.

Democrats and Republicans are heading for another showdown at the end of the year, after the November election, when more than $600 billion in tax increases and spending cuts are slated to take effect in the absence of action by Congress.

Obama wants to raise taxes on households making $250,000 or more, while keeping them on hold for everyone else. Republicans say no taxes should go up.

"Both parties realize there is a fundamental mismatch between taxes and spending on entitlements," such as Social Security and Medicare, said Bob Bixby, head of the Concord Coalition, whose Arlington, Virginia-based nonprofit group advocates balanced budgets. "The next administration is going to have to deal with it."

Budget Deficit

The White House has forecast a $1.2 trillion budget deficit for the year ending Sept. 30, equivalent to 7.8 percent of gross domestic product. Outside of 2010 and 2011, that would be the biggest shortfall as a share of the economy since World War II.

The deficit in 2011 was $1.3 trillion, or 8.7 percent of GDP.

S&P said in June that political and fiscal risks could lead to a second downgrade by 2014. While Moody's Investors Service and Fitch Ratings have kept their top grades on the U.S., both have a negative outlook.

Not so global investors. In May, 46 percent of respondents in a Bloomberg poll chose the U.S. as one of the markets with the most potential during the next year, up from 31 percent a year earlier.

"We're overweight the U.S. relative to emerging markets and Europe in equities, and we keep thinking about when we should take that position off but can't find a good reason to do so," Zemsky said.

More Flexible

U.S. companies are more flexible than their counterparts in Europe, with an ability to lay off workers and "get productivity growth out of what remains," said Hayes Miller, who helps oversee about $48 billion as head of asset allocation in North America at Baring Asset Management Inc.

"That underlying flexibility allows companies to continue to grow profits and run returns on equities that are in excess of what the European economies are able to do," Boston-based Miller said.

American banks also have made more progress than those in Europe in rebuilding their balance sheets, he said.

"You can begin to see the return to normalcy for banks in the U.S. to have a capital structure to lend again to the private sector," Miller said.

Commercial and industrial loans have climbed about 15 percent in the past year, in spite of concerns voiced by JPMorgan Chase & Co. Chief Executive Officer Jamie Dimon that credit would be constricted by new regulations.

In terms of dollars, U.S. financial stocks have risen about 10 percent since S&P's action, compared with declines of about 8 percent for Asia and 16 percent for Europe.

"It's quite an ironic downgrade," said Brett Wander, chief investment officer in San Francisco for fixed income at Charles Schwab Investment Management Inc., which oversees about $200 billion. "Investors will pay a significant premium for safety, and there's probably no greater safe haven than the U.S., regardless of the rating that S&P assigns the country."

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