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S&P CUTS U.S. OUTLOOK

The credit rating agency sends up a flare and hopes for action on Capitol Hill.

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Pessimism over America's ability to reduce its deficit. When one of the world's premier credit rating agencies issues a warning for America, global stock markets dip. On April 18, Standard & Poor's announced that its rating outlook for the United States was now "negative" instead of "stable". It was a landmark moment - S&P had never made such a declaration about America's fiscal profile.¹

While the U.S. still has the preferred AAA credit rating from Standard & Poor's, S&P credit analyst Nikola G. Swann put the possibility of an actual rating downgrade at 33% by 2013.^{1,2}

S&P more or less gave politicians a deadline. Swann's statement on behalf of Standard & Poor's put it this way: "In our macroeconomic forecast's optimistic scenario (assuming near 4% annual real growth), the [U.S.] fiscal deficit would fall to 4.6% of GDP by 2013, but the U.S.'s net general government debt would still rise to almost 80% of GDP by 2013. In our pessimistic scenario (a mild, one-year double-dip recession in 2012), the deficit would be 9.1%, while net debt would surpass 90% by 2013. Even in our optimistic scenario, we believe the U.S.'s fiscal profile would be less robust than those of other 'AAA' rated sovereigns by 2013. Our negative outlook on our rating on the U.S. sovereign signals that we believe there is at least a one-in-three likelihood that we could lower our long-term rating on the U.S. within two years."²

Translation: let's see some significant action, or we'll have no choice but to cut America's credit rating.

Moody's sees a "turning point" in the budget battle. An April 18 report from Moody's Investors Service sounded more optimistic. Moody's senior credit officer Steven Hess wrote in a note that considering the most recent budget proposals from the White House and the Republican leadership, the agency sees "the changed parameters of the debate, with broadly similar goals as to government debt levels, as a turning point that is positive for the long-term fiscal position of the U.S. federal government."¹

Moody's currently ranks the U.S. credit rating at Aaa with a "stable" outlook, and Hess noted that "either the president's revised proposal or the Republican proposal would improve the U.S. government's creditworthiness."¹

Geithner counters the S&P opinion. Shortly after the S&P report hit the streets, Treasury Secretary Timothy Geithner appeared on Bloomberg Television, remarking that he had "absolutely not" had to reassure any buyers of Treasuries about the

creditworthiness of America. Of course, the real reassurance would be bona fide action - some compromise that will pare between the \$4 trillion the White House wants cut over the next decade and the \$6.2 trillion Republican leaders want cut in the coming ten years. Raising the federal borrowing limit in the near future seems a given, as without that move the federal government could default on its debt in early July.^{3,4,5}

What would happen if the U.S. credit rating was cut? In a nutshell, the cause-and-effect would go like this. Global investors would regard Treasuries as riskier investments than they do now, and this would mean that the Treasury would be left paying higher interest rates on any freshly issued debt. That would imply higher interest costs for U.S. businesses and consumers - and food and energy prices are already strenuous enough as we speak.

Incidentally, along with its gloomy April 18 opinion on U.S. credit, S&P also revised its outlook from “stable” to “negative” for five insurers: New York Life, USAA, the Knights of Columbus, Northwestern Mutual and the Teachers Insurance & Annuity Association of America. The reason? These insurers are “are constrained by the sovereign rating on the U.S.”⁴

Can a deal be brokered before 2012? Good question. After all, John Chambers, chairman of the sovereign ratings committee at Standard & Poor's Ratings Services, cited “political gridlock” as a core reason for S&P's change of outlook. Symbolically, it would be nice to have one before fiscal year 2012, which begins in October.⁴

This has happened before. Major nations have faced warnings about credit rating downgrades in the past. We have: Moody's cut its outlook for the U.S. in 1996, reversed its opinion once the federal debt ceiling was raised.¹

In the last 22 years, S&P has changed its outlook to “negative” for five AAA-rated nations, including the United Kingdom in 2009. S&P's outlook on the U.K. returned to “stable” after an austerity plan was approved, and if we arrive at a plan to cut the deficit (a painful one, but a necessary one), our credit outlook may similarly improve.⁴



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Citations.

- 1 - marketwatch.com/story/sp-cuts-us-rating-outlook-to-negative-2011-04-18 [4/18/11]
- 2 - marketwatch.com/story/text-of-sps-downgrade-of-us-ratings-outlook-2011-04-18 [4/18/11]
- 3 - blogs.forbes.com/steveschaefer/2011/04/19/geithner-to-sp-look-at-our-borrowing-costs/ [4/19/11]
- 4 - online.wsj.com/article/SB20001424052748704004004576270693061767996.html [4/19/11]
- 5 - bbc.co.uk/news/world-us-canada-13135264 [4/19/11]