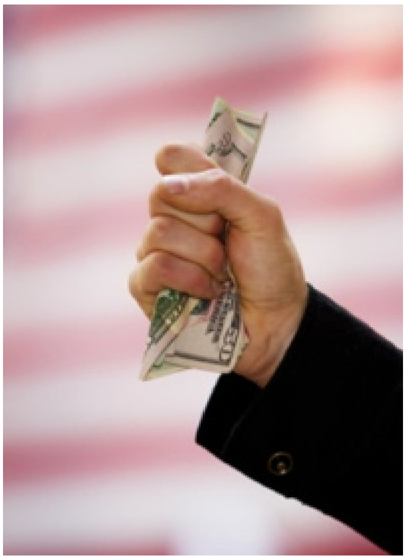
# U.S. Credit Rating Still at Risk



Credit rating agencies like Moody's issue opinions as to the credit worthiness of debt issued by various entities including governments, with 'credit worthiness" being defined as the ability to pay interest on and ultimately pay back the debt. Those ratings directly affect the interest rates offered in the issuance of that debt, and changes in a credit rating will impact the market value of the debt before it is retired.

Standard and Poor's rating agency revised its outlook on U.S. debt back in April to "negative" from "stable" because the United States has "very large budget deficits and rising government indebtedness, and the path to addressing these is not clear to us." And another rating agency, Fitch Ratings, warned in June that they would be putting the U.S. on "ratings watch negative" if the debt ceiling weren't raised.

As the clock ticked down to the August 2 deadline, S&P placed the U.S. rating on "CreditWatch with negative implications," and added that "Owing to the dynamics of the political debate on the debt ceiling, there is at least a one-in-two likelihood that we could lower the long-term debt rating on the U.S. within the next 90 days."

Such downgrades would impact not only the sovereign debt Treasury securities sold by the federal government, but also other financial institutions directly or indirectly linked to the government, including Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and the Federal Farm Credit Banks, as well as bonds issued by Israel and Egypt that are guaranteed by the United States.

Standard and Poor's also expressed concern that the budget deal wouldn't change the fiscal calculus very much, adding "If we conclude that Congress and the Administration have not achieved a credible solution to the rising US government debt burden and are not likely to achieve one in the foreseeable future, [then] we may lower the long-term rating on the US by one or more notches into the AA category."

Following the enactment of the debt-ceiling deal, Fitch Rating also expressed concern about the government's ability to reduce its spending significantly. Fitch said the United States "must also confront rough choices on tax and spending against a weak economic backdrop if the budget deficit and government debt is to be cut to safer levels over the medium term." Fitch also expressed its concern about the continuing and increasing weakness in the economy: "The downward revisions of the GDP [Gross Domestic Product, approaching zero] were bigger than we expected and [are] a source of concern. There could be a rating action which could include a revision of the outlook."

The rating agencies have serious credibility problems of their own, stemming from their misreading of the credit worthiness of financial institutions and investment securities prior to the start of the recession in 2007. A Senate investigations panel concluded that the rating agencies continued to give their highest credit ratings to mortgage-backed securities months after the housing market started to collapse. Staff members wrote:

> Perhaps more than any other single event, the sudden mass downgrades of residential mortgage-backed securities and collateralized debt obligations [by the agencies] were the immediate trigger for the financial crisis.

This leads experienced economic journalists like James Henry to dismiss such opinions from ratings agencies out of hand. He said, "Investors don't have to hold their breath for pronouncements from ratings agency bureaucrats to assess credit risk or determine interest rates. Financial markets do a pretty good job of repricing innumerable debt instruments every day." Besides, rating agencies have "under-predicted almost every major debt crisis that we've had in the past fifty years, [including] the Third World Debt crises of the 1980s, the Japan debt crisis of the late 1980s, the Asian and Russian debt crises of 1997-99, the Argentine debt crisis of 2001-02, the global banking crisis of 2007-2009, and the Euro-debt crises of the last two years – as well as private corporate debt fiascos like Enron and AIG."

Bill Gross, the founder of Pacific Investment Management Company (PIMCO) and manager of the world's largest bond mutual fund, has urged investors to ignore rating agencies' judgments, describing the agencies as "an idiot savant with a full command of the mathematics, but no idea of how to apply them."

Other owners of substantial amounts of U.S. government debt, however, aren't quite so glib in their judgments. China, currently holding more than $1 trillion of U.S. Treasuries, criticized Congress for failing to cut government spending even after passage of the debt-ceiling agreement. The country's central bank said it would "closely observe" the implementation of the act, noting that it essentially "failed to defuse Washington's debt bomb for good."

What the agencies are discovering, if they haven't already, is that the much-touted Budget Control Act of 2011 does not "control the budget": it in fact guarantees continued unlimited government spending into the future, with precious little restraint anticipated, resulting in the further erosion of the country's economic and fiscal standing. Eventually, perhaps sooner than later, the rating agencies will officially recognize the fact, and issue substantial downgrades reflecting the real condition of the country's finances.