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Research Update:

United States of America 'AAA/A-1+' Ratings Placed On CreditWatch Negative On Rising Risk Of Policy Stalemate

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Overview

- Standard & Poor's has placed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the United States of America on CreditWatch with negative implications.
- Standard & Poor's uses CreditWatch to indicate a substantial likelihood of it taking a rating action within the next 90 days, or in response to events presenting significant uncertainty to the creditworthiness of an issuer. Today's CreditWatch placement signals our view 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 rating on the U.S. within the next 90 days. We have also placed our short-term rating on the U.S. on CreditWatch negative, reflecting our view that the current situation presents such significant uncertainty to the U.S.' creditworthiness.
- Since we revised the outlook on our 'AAA' long-term rating to negative from stable on April 18, 2011, the political debate about the U.S.' fiscal stance and the related issue of the U.S. government debt ceiling has, in our view, only become more entangled. Despite months of negotiations, the two sides remain at odds on fundamental fiscal policy issues. Consequently, we believe there is an increasing risk of a substantial policy stalemate enduring beyond any near-term agreement to raise the debt ceiling.
- As a consequence, we now believe that we could lower our ratings on the U.S. within three months.
- We may lower the long-term rating on the U.S. by one or more notches into the 'AA' category in the next three months, if we conclude that Congress and the Administration have not achieved a credible solution to the rising U.S. government debt burden and are not likely to achieve one in the foreseeable future.
- We still believe that the risk of a payment default on U.S. government debt obligations as a result of not raising the debt ceiling is small, though increasing. However, any default on scheduled debt service payments on the U.S.' market debt, however brief, could lead us to revise the long-term and short-term ratings on the U.S. to 'SD.' Under our rating definitions, 'SD,' or selective default, refers to a situation where an issuer, the federal government in this case, has defaulted on some of its debt obligations, while remaining current on its other debt obligations.
- We may also lower the long-term rating and affirm the short-term rating if we conclude that future adjustments to the debt ceiling are likely to

be the subject of political maneuvering to the extent that questions persist about Congress' and the Administration's willingness and ability to timely honor the U.S.' scheduled debt obligations.

Rating Action

On July 14, 2011, Standard & Poor's Ratings Services placed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the United States of America on CreditWatch with negative implications.

Rationale

The CreditWatch action reflects our view of two separate but related issues. The first issue is the continuing failure to raise the U.S. government debt ceiling so as to ensure that the government will be able to continue to make scheduled payments on its debt obligations. The second pertains to our current view of the likelihood that Congress and the Administration will agree upon a credible, medium-term fiscal consolidation plan in the foreseeable future.

On May 16, 2011, the U.S. government reached its Congressionally mandated ceiling for federal debt of $14,294 billion. Since then, the government has undertaken exceptional measures to avoid breaching the debt ceiling. Secretary of Treasury Timothy Geithner wrote, "The unique role of Treasury securities in the global financial system means that the consequences of default would be particularly severe.... Even a short-term default could cause irrevocable damage to the American economy." The Treasury currently estimates that it will have exhausted these exceptional measures on or about Aug. 2, 2011, at which time it will either have to curtail certain current expenses or risk missing a scheduled payment of interest or principal on Treasury securities held by the public.

Standard & Poor's still anticipates that lawmakers will raise the debt ceiling by the end of July to avoid those outcomes. However, if the government is forced to undergo a sudden, unplanned fiscal contraction--as a result of Treasury efforts to conserve cash and avoid default absent an agreement to raise the debt ceiling--we think that the effect on consumer sentiment, market confidence, and, thus, economic growth will likely be detrimental and long lasting. If the government misses a scheduled debt payment, we believe the effect would be even more significant and, under our criteria, would result in Standard & Poor's lowering the long-term and short-term ratings on the U.S. to 'SD' until the payment default was cured.

Congress and the Administration are debating various fiscal consolidation proposals. At the high end, budget savings of $4 trillion phased in over 10 to 12 years proposed by the Adminstration, (separately) by Congressional leaders, as well as by the Fiscal Commission in its December 2010 report, if accompanied by growth-enhancing reforms, could slow the deterioration of the U.S. net general government debt-to-GDP ratio, which is currently nearing 75%. Under our baseline macroeconomic scenario, net general government debt would reach 84% of GDP by 2013. (Our baseline scenario assumes near 3% annual real growth and a post-2012 phaseout of the December 2010 extension of the 2001 and 2003 tax cuts.) Such a percentage indicates a relatively weak government debt trajectory compared with those of the U.S.' closest 'AAA' rated peers (France, Germany, the U.K., and Canada).

We expect the debt trajectory to continue increasing in the medium term if a medium-term fiscal consolidation plan of $4 trillion is not agreed upon. If Congress and the Administration reach an agreement of about $4 trillion, and if we to conclude that such an agreement would be enacted and maintained throughout the decade, we could, other things unchanged, affirm the 'AAA' long-term rating and A-1+ short-term ratings on the U.S.

Standard & Poor's takes no position on the mix of spending and revenue measures that Congress and the Administration might agree on. But for any agreement to be credible, we believe it would require support from leaders of both political parties.

Congress and the Administration might also settle for a smaller increase in the debt ceiling, or they might agree on a plan that, while avoiding a near-term default, might not, in our view, materially improve our base case expectation for the future path of the net general government debt-to-GDP ratio. U.S. political debate is currently more focused on the need for medium-term fiscal consolidation than it has been for a decade. Based on this, we believe that an inability to reach an agreement now could indicate that an agreement will not be reached for several more years. We view an inability to timely agree and credibly implement medium-term fiscal consolidation policy as inconsistent with a 'AAA' sovereign rating, given the expected government debt trajectory noted above.

CreditWatch

Further delays in raising the debt ceiling could lead us to conclude that a default is more possible than we previously thought. If so, we could lower the long-term rating on the U.S. government this month and leave both the long-term and short-term ratings on CreditWatch with negative implications pending developments. If Congress and the Administration agree to raise the debt ceiling (with commensurate fiscal adjustments), we aim to review the details of such agreement within the next 90 days to determine whether, in our view, it is sufficient to stabilize the U.S.' medium-term debt dynamics. If we conclude that the agreement would likely achieve this end, all other things unchanged, we would expect to affirm both the long- and short-term ratings and assign a stable outlook.

If a debt ceiling agreement does not include a plan that seems likely to us to credibly stabilize the U.S.' medium-term debt dynamics but the result of the debt ceiling negotiations leads us to believe that such a plan could be negotiated within a few months, all other things unchanged, we expect to affirm both the long- and short-term ratings and assign a negative outlook, pending review of the eventual plan. If such an agreement is reached, but we do not believe that it likely will stabilize the U.S.' debt dynamics, we, again all other things unchanged, would expect to lower the long-term 'AAA' rating, affirm the 'A-1+' short-term rating, and assign a negative outlook on the long-term rating.

Following today's CreditWatch listings for the long- and short-term credit ratings on the U.S. government, Standard & Poor's will issue separate media releases concerning affected ratings in the funds, government-related entities, financial institutions, insurance companies, public finance, and structured finance sectors.

Related Criteria And Research

- U.S. Weekly Financial Notes: Lesson Of The Week--Expect The Unexpected, July 8, 2011
- Sovereign Ratings Criteria, June 30, 2011
- 2011 Midyear Credit Outlook: Unresolved Economic And Regulatory Issues Loom Large, June 22, 2011
- Global Aging 2011: In The U.S., Going Gray Will Likely Cost Even More Green, Now, June 21, 2011
- United States of America 'AAA/A-1+' Rating Affirmed; Outlook Revised To Negative, April 18, 2011
- Fiscal Challenges Weighing On The 'AAA' Sovereign Credit Rating On The Government Of The United States, April 18, 2011
- A Closer Look At The Revision Of The Outlook On The U.S. Government Rating , April 18, 2011
- Banking Industry Country Risk Assessments, March 8, 2011
- Behind The Political Brinkmanship Of Raising The U.S. Debt Ceiling, Jan. 18, 2011
- U.S. Government Cost To Resolve And Relaunch Fannie Mae And Freddie Mac Could Approach $700 Billion, Nov. 4, 2010,
- Global Aging 2010: In The U.S., Going Gray Will Cost A Lot More Green, Oct. 25, 2010,
- Après Le Déluge, The U.S. Dollar Remains The Key International Currency," March 10, 2010,
- Banking Industry Country Risk Assessment: United States of America, Feb. 1, 2010

Ratings List

CreditWatch/Outlook Action

	To	From
United States of America (Unsolicited Ratings)		
Federal Reserve System		
Federal Reserve Bank of New York (Unsolicited Ratings)		
Sovereign Credit Rating	AAA/Watch Neg/A-1+	AAA/Negative/A-1+

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