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S&P Discusses U.S. Debt Downgrade

During an S&P conference call this morning the ratings agency explained Friday's downgrade of U.S. debt from AAA to AA+ with a negative outlook. The primary reasons cited for the downgrade were the political setting as well as the deteriorating fiscal position. The political setting took precedence, with the recent debt deal illustrating that U.S. officials are unwilling to take the take serious action to improve out fiscal situation. As a result the S&P outlook is that our fiscal situation, even under the most optimistic scenarios, will continue to deteriorate. S&P evaluates sovereigns on [five "pillars"](#) that include political, economic, external, fiscal and monetary risk, this downgrade represents deterioration in only the political and fiscal risk categories.

The S&P decision was based upon a baseline scenario that saw U.S. debt increasing as a portion of GDP to 74% in 2011, 79% by 2015, and 85% in 2021. In addition to this they provided a more optimistic scenario that assumed the Bush tax cuts lapsing. Under this scenario U.S. debt to GDP is expected to reach 74% by the end of 2011, 77% in 2015, and 78% in 2021. This scenario would be consistent with a AA+ rating with stable outlook. In addition S&P presented a scenario incorporating risks to the downside. These risks include slower than expected economic growth, growing interest expenses, and a failure to implement the current deficit reduction plan. Under this scenario net debt to GDP is expected to reach 74% in 2011, 90% by 2015, and 101% by 2021.

During the call, John Chambers the head of S&P's sovereign rating committee, noted the five countries that have lost, and then regained the AAA rating: Canada, Australia, Finland, Sweden and Denmark. In order to gain back the AAA rating, all of the countries had to undertake significant fiscal consolidation as well as economic reform.

S&P also commented on the status of various European sovereigns including France and the UK. S&P noted that although some fiscal indicators for France are worse than the U.S., the French government has shown significant political will to improve their fiscal situation. By passing pension reform against popular will, the French government has reduced future entitlement burdens without taking away present economic support. S&P sees French debt as having peaked as a portion of GDP and expects it to decline slightly in the future. S&P also seemed confident in the rating of the UK following the austerity deal that was implemented last year. They did note that the British rating was dependent on holding to that austerity plan. The US differs from other AAA countries in that our debt to GDP is expected to increase over the near and long term.

S&P noted that later today they would make announcements of downgrades of other entities related to the U.S. government, specifically noting GSE's, insurers, and clearinghouses as industries of interest. As of 11am S&P announced that Fannie Mae and Freddie Mac as well as prominent clearinghouses have been downgraded. They did however stress that there is no "sovereign ceiling" meaning that companies rated AAA will not automatically be downgraded with the U.S. debt. In addition to this S&P noted that they expect very little forced selling of Treasuries as a result of investment protocols that require AAA holdings.

[See S&P's release.](#)

[See S&P's methodology and assumptions for sovereign government ratings.](#)

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American Bankers Association, 1120 Conn. Ave NW, Wash. DC 20036