



Fitch Places United States' 'AAA' on Rating Watch Negative Ratings Endorsement

Policy

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Fitch Ratings-New York/London-15 October 2013: Fitch Ratings has placed the United States of America's (U.S.) 'AAA' Long-term foreign and local currency Issuer Default Ratings (IDRs) on Rating Watch Negative (RWN). The ratings of all outstanding U.S. sovereign debt securities have also been placed on RWN, as has the U.S. Short-term foreign currency rating of 'F1+'. The Outlook on the Long-term ratings was previously Negative. The U.S. Country Ceiling has been affirmed at 'AAA'.

Fitch expects to resolve the RWN by the end of Q114 at the latest, although timing would necessarily reflect developments and events, including the duration of any agreement to raise the debt ceiling.

KEY RATING DRIVERS

In line with Fitch's previous statements, the RWN reflects the following key rating drivers and their relative weights:

High

- The U.S. authorities have not raised the federal debt ceiling in a timely manner before the Treasury exhausts extraordinary measures. The U.S. Treasury Secretary has said that extraordinary measures will be exhausted by 17 October, leaving cash reserves of just USD30bn. Although Fitch continues to believe that the debt ceiling will be raised soon, the political brinkmanship and reduced financing flexibility could increase the risk of a U.S. default.

- Although the Treasury would still have limited capacity to make payments after 17 October it would be exposed to volatile revenue and expenditure flows. The Treasury may be unable to prioritise debt service, and it is unclear whether it even has the legal authority to do so. The U.S. risks being forced to incur widespread delays of payments to suppliers and employees, as well as social security payments to citizens - all of which would damage the perception of U.S. sovereign creditworthiness and the economy.

- The prolonged negotiations over raising the debt ceiling (following the episode in August 2011) risks undermining confidence in the role of the U.S. dollar as the preeminent global reserve currency, by casting doubt over the full faith and credit of the U.S. This "faith" is a key reason why the U.S. 'AAA' rating can tolerate a substantially higher level of public debt than other 'AAA' sovereigns.

Medium

- The repeated brinkmanship over raising the debt ceiling also dents confidence in the effectiveness of the U.S. government and political institutions, and in the coherence and credibility of economic policy. It will also have some detrimental effect on the U.S. economy.

The 'AAA' rating reflects the U.S.'s strong economic and credit fundamentals, including:

- Its highly productive, diversified and wealthy economy; extraordinary monetary and exchange rate flexibility; and the exceptional financing flexibility afforded by the global reserve currency status of the U.S. dollar and the depth and liquidity of domestic capital markets - in particular the U.S. Treasury market. The U.S. sovereign credit profile also benefits from the respect for property rights, the rule of law and a high degree of social stability.

- Fitch continues to judge that the U.S. economy (and hence tax base) remains more dynamic and resilient to shocks than its high-grade rating peers. Fiscal and macroeconomic risks emanating from the financial sector

are generally low and diminishing and becoming supportive of, rather than a drag on, economic growth. Fitch forecasts economic growth to pick up from 1.6% in 2013 to 2.6% in 2014 and to average 3% over 2015-17, before reverting to its assumed long-run trend growth rate of 2.25%. The projected recovery is supported by easing headwinds from private sector debt deleveraging, a pick-up in the housing market and a gradual decline in unemployment.

- The 'AAA' rating also reflects the halving of the federal budget deficit since 2010, which is now approaching a level consistent with debt stabilisation. The Budget Control Act passed in August 2011 implied significant fiscal consolidation and Congress and the Administration have adhered to the automatic spending cuts - the sequester - specified under the Act in the absence of agreement on an alternative and equivalent set of deficit-reduction measures. In addition, the passage of the American Taxpayer Relief Act on 1 January 2013, which implied a tax increase of more than USD600bn, has also contributed to the deficit reduction effort.

- Fitch's medium-term fiscal projections imply federal and general government (which includes states and local governments) gross debt stabilising next year and over the remainder of the decade at around 72% and 104% of GDP, respectively. This is below the 80% and 110% thresholds that Fitch previously identified as being inconsistent with the U.S. retaining its 'AAA' status.

- Nevertheless, public debt stabilisation at such elevated levels still render the US economy and public finances vulnerable to adverse shocks and in the absence of additional spending reform and revenue measures, deficits and debt will begin to rise again at the end of the decade. The U.S. is the most heavily indebted 'AAA' rated sovereign, with a gross debt ratio equivalent to double that of the 'AAA' median.

RATING SENSITIVITIES

The RWN reflects the following risk factors that may individually or collectively result in a downgrade of the ratings:

- Failure by the government to honour interest and/or principal payments on the due date of U.S. Treasury securities would lead Fitch to downgrade the U.S. sovereign IDR to 'Restricted Default' (RD) until the default event was cured. We would also downgrade the rating of the affected issue(s) to 'B+' from 'AAA', the highest rating for securities in default in expectation of full or near-full recovery. Debt securities approaching maturity or those with approaching coupon payments would be vulnerable to a downgrade. The Country Ceiling would likely remain 'AAA'.

In the event of a deal to raise the debt ceiling and to resolve the government shutdown, which Fitch expects, the outcome of a subsequent review of the ratings would take into account the manner and duration of the agreement and the perceived risk of a similar episode occurring in the future. It would also reflect Fitch's assessment of the following main factors:

- The impact of the debt ceiling brinkmanship and government shutdown on our assessment of the effectiveness of government and political institutions, the coherence and credibility of economic policy, the potential long-term impact on the U.S. sovereign's cost of funding and cost of capital for the economy as a whole, and the implications for long-term growth.

- Our assessment of the prospects for further deficit-reduction measures in future years necessary to contain government deficits in the face of long-term spending pressures and place public debt on a downward path over the medium to long term.

KEY ASSUMPTIONS

Fitch continues to believe that an agreement will be reached to end the current political impasse and raise the U.S. debt ceiling. Even if the debt limit is not raised before or shortly after 17 October, we assume there is sufficient political will and capacity to ensure that Treasury securities will continue to be honoured in full and on time.

Fitch's federal debt projections reflect its economic and fiscal policy assumptions and were detailed in the Special Report, 'U.S. Medium-Term Fiscal Projections - An Update' (dated 28 June 2013; see link below). Subsequent to that analysis, the Bureau of Economic Analysis revised the level of GDP up by around 3.4% due to revisions in the way GDP is calculated, including reclassifying spending on R&D and intellectual property as

investment. This has had the statistical effect of lowering debt/GDP ratios, but has not significantly affected the trajectory of debt dynamics or its sensitivity to shocks. Since the June review, Fitch has revised down its forecasts for GDP growth for 2013 to 1.6% from 1.9% and for 2014 to 2.6% from 2.8%.

Fitch's medium-term fiscal projections incorporate assumptions regarding the medium-term growth potential of the US economy and do not incorporate potential upside benefits from shale gas or downside risks emanating from the eurozone and elsewhere. They draw heavily upon Congressional Budget Office (CBO) projections, including CBO assumptions and judgements regarding the take up of various benefits as well as the rate of growth of health care spending.

Financial sector risks are currently judged to be low as reflected by Fitch's stable outlook for the U.S. banking sector.

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Additional information is available on www.fitchratings.com

Applicable criteria, 'Sovereign Rating Criteria' dated 13 August 2012 and 'Country Ceilings' dated 09 August 2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research: United States of America - Rating Action Report

Sovereign Rating Criteria

Country Ceilings

U.S. Medium-Term Fiscal Projections – An Update

Thinking the Unthinkable - What if the Debt Ceiling Was Not Increased and the US Defaulted?

Additional Disclosure

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