



Covid-19 exacerbates United States' vulnerabilities

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Update on the United States, April 2020, Frankfurt

Covid-19 exacerbates United States' vulnerabilities

Executive summary

- **The United States (AA/Stable) faces a severe health crisis with major economic implications**
 - Covid-19 cases are rapidly increasing in the US which is becoming the global epicentre of the pandemic
 - Lower healthcare capacities relative to other advanced economies leave the country more exposed to a health crisis
 - Despite strong fiscal and monetary policy responses, the economic shock will push the US into a deep recession 2020

- **The Covid-19 pandemic will exacerbate pre-existing structural weaknesses**
 - Declining potential growth due to lower multifactor productivity, lower labour contribution and higher social inequalities
 - High and rising public debt due to persistent fiscal deficits and rising mandatory expenditures
 - Contingent risks due to elevated healthcare and pension obligations
 - Political polarisation prevents bipartisan solutions to address the country's structural weaknesses

- **Inherent credit strengths mitigate impact on the United States' sovereign rating**
 - A wealthy, competitive, and diversified economy provides significant buffers
 - USD unparalleled status as the world's global reserve currency ensures continuous demand for US debt securities



Covid-19 exacerbates United States' vulnerabilities

The Covid-19 pandemic will have a significant impact on the US

➤ Covid-19 pandemic exacerbates US social, economic and fiscal vulnerabilities

Credit strengths

- Wealthy and competitive economy
- Global reserve currency status
- Institutional checks and balances
- Deep, liquid capital markets

Credit weaknesses

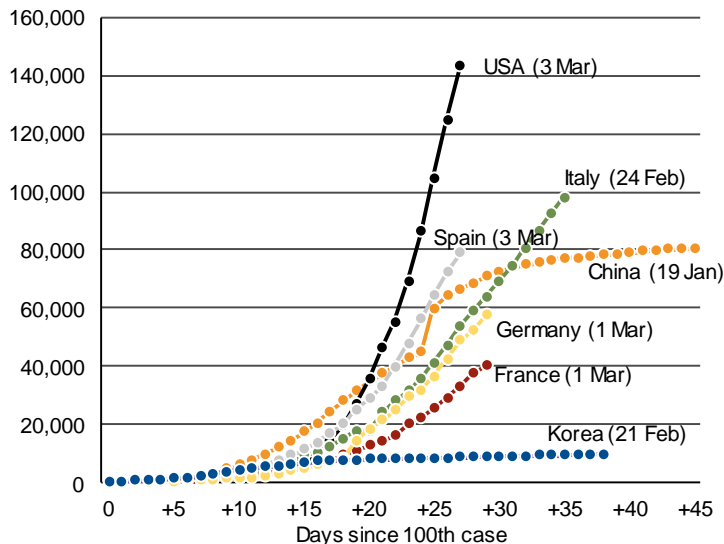
- Weakening potential growth outlook
- High and rising public debt burden
- Elevated contingent liabilities
- Polarisation and policy uncertainty

Covid-19 exacerbates United States' vulnerabilities

The United States is headed for severe health crisis

Confirmed cumulative Covid-19 cases

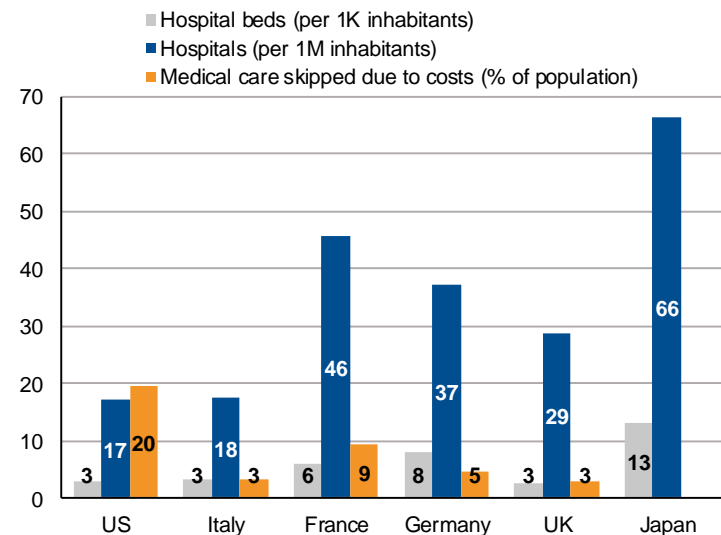
Daily cumulative confirmed cases



N.B. The date at which each country had 100 confirmed cases is in brackets.
Source: ECDC, Scope Ratings GmbH

Healthcare capacities

% of population, per inhabitant



N.B. 2018 figures or latest available data; No survey data for Japan
Source: OECD, Scope Ratings GmbH

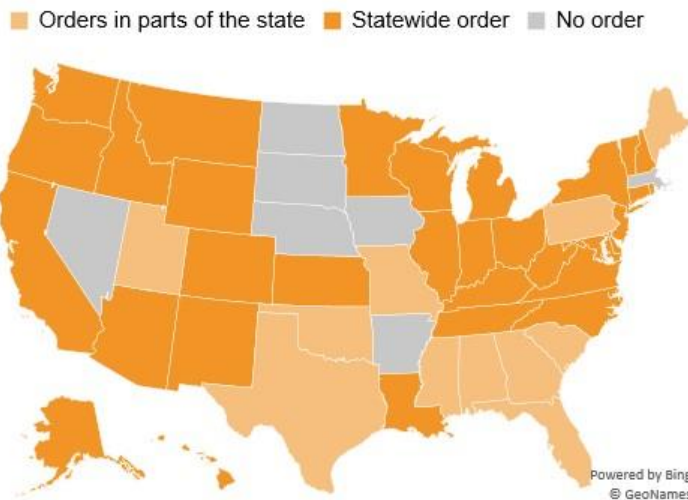
➤ Rapidly increasing Covid-19 cases and lower healthcare capacities relative to peers

- Confirmed Covid-19 cases in the US have increased over four-fold in the last week
- Significant strain to the US healthcare system given lower hospital capacities and insurance coverage rates than peers

Covid-19 exacerbates United States' vulnerabilities

Patchwork of containment measures and lagging testing

Stay-at home orders at the state level

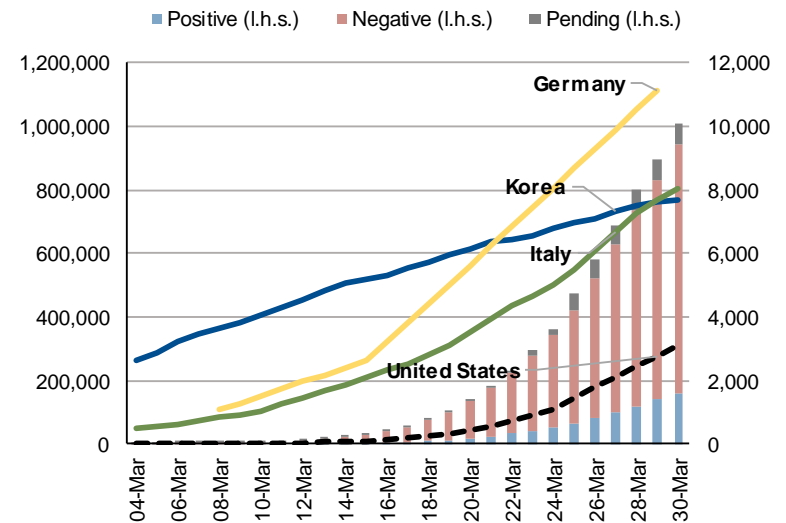


As of 31 March 2020

Source: New York Times, Scope Ratings GmbH

Covid-19 testing

Tests concluded (l.h.s.), tests per 1mn people (r.h.s.)



N.B. As of 31 March 2020

Source: The Covid Tracking Project, Scope Ratings GmbH

➤ National social distancing guidelines and patchwork of state/local containment measures:

- Closures of schools and non-essential businesses (theatres, restaurants, shopping malls etc.) depend on the state
- 'Stay-at-home' orders restricting movements of individuals (at state or local level): 8 out of 10 Americans
- Ramping up of testing to around 3,000 tests per 1 million inhabitants but still lagging other affected countries

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The US economy faces a synchronised four-dimensional shock

➤ A four-dimensional economic shock:

1. **Supply shock:** sharp reduction in labour supply, supply chain disruption
2. **Demand shock:** external demand drops, reduced domestic activity, unemployment rises
3. **Uncertainty shock:** drop in business and consumer confidence, delayed investment, discretionary spending and hiring
4. **Financial market disruption:** Volatility, rising refinancing costs, liquidity shortages, drops in oil prices

➤ Impact per industry:

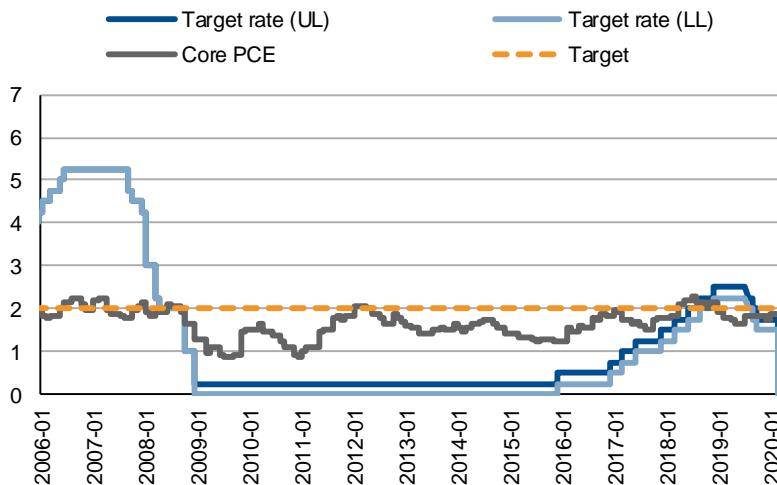
Limited impact
Agriculture, utilities, ICT, health, education, public administration
Medium impact
Construction, manufacturing, financial and business services
High impact
Real estate, arts & entertainment, transportation, oil and gas

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The monetary and fiscal response

Federal funds, target and core inflation

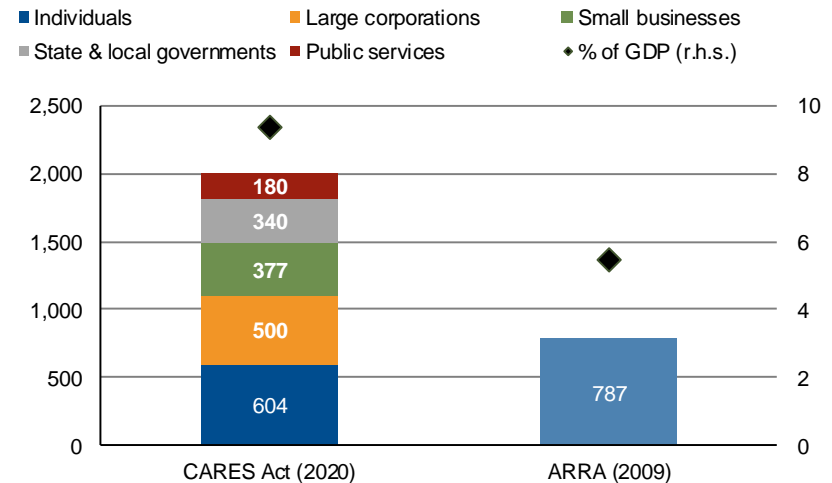
%



Source: Federal Reserve, Scope Ratings GmbH

Fiscal stimulus package per recipient

USD bn



Source: Scope Ratings GmbH

➤ Significant easing of monetary policy

- Policy rates lowered by 150bps to 0-0.25%
- Relaunch of QE: unlimited purchases of Treasury and agency securities (previously USD 700bn)
- Expansion of money market operations

➤ Historic USD 2trn support package

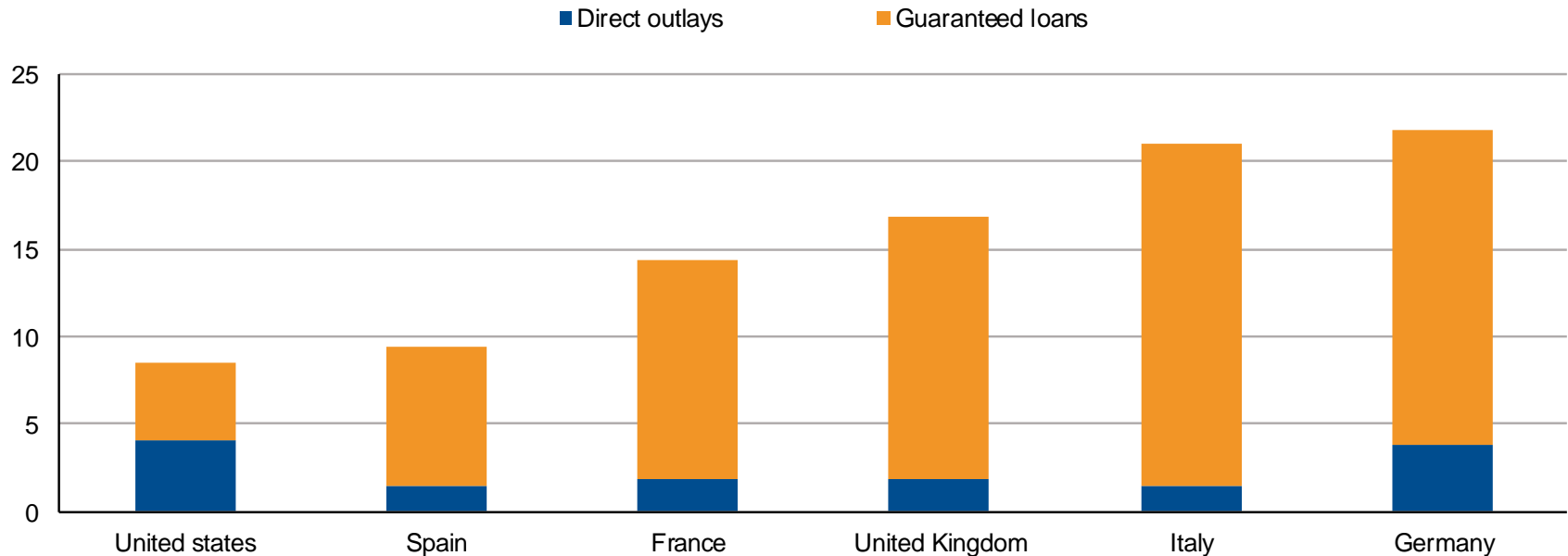
- Cash payouts to households (USD 300bn)
- Small business loans (USD 350bn)
- Support for mid-to-large companies (~ USD 500bn)
- Expansion of unemployment insurance (USD 250bn)

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Comparing fiscal packages across countries

Cross country comparison of fiscal packages

% of GDP



Source: Scope Ratings GmbH

➤ More direct fiscal support, less loan guarantees relative to other major economies

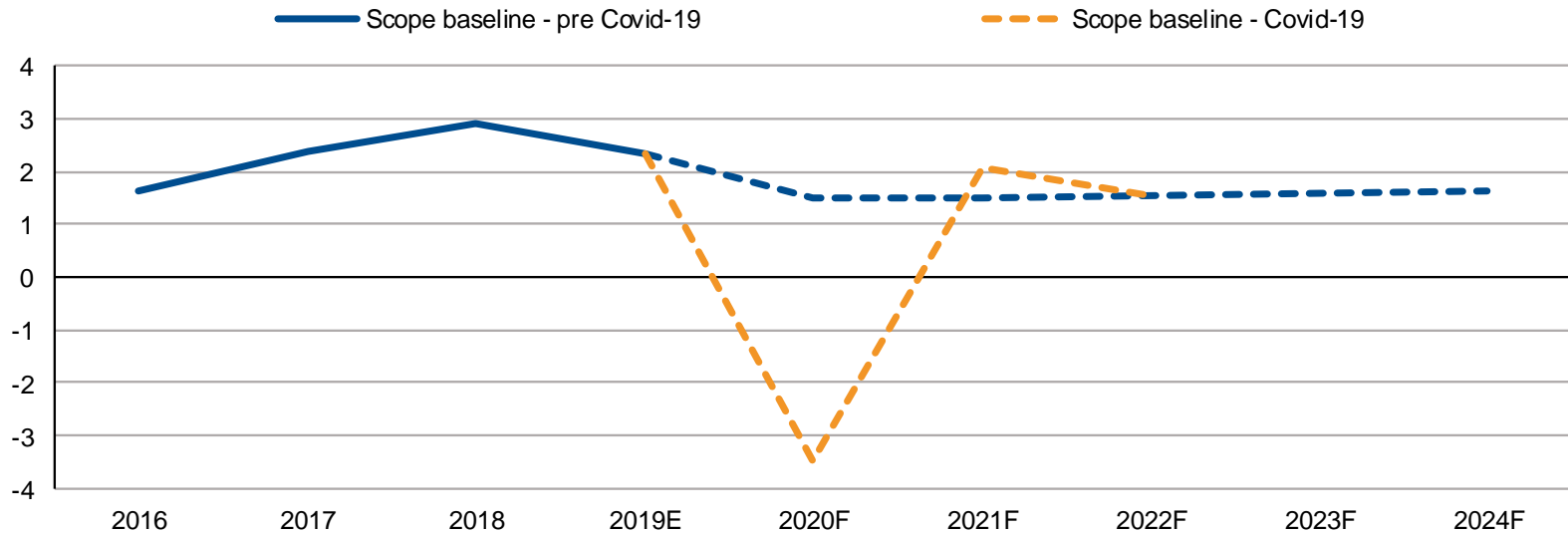
- The CARES Act provides for about USD 800 bn (4% of GDP) in direct outlays
- Less extensive loan guarantee programme (~ USD 900; 4.5% of GDP) than in major European countries

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The United States to enter a recession in 2020

Scope's real growth forecasts for the United States

%



Source: Scope Ratings GmbH

➤ Downward revision to 2020 growth

- Revised forecast from 1.5% real growth to -3.5% real growth in 2020
- Recovery in 2021 (2.1%) followed by gradual return to potential in 2022-24 (~1.6%)

➤ Baseline assumptions

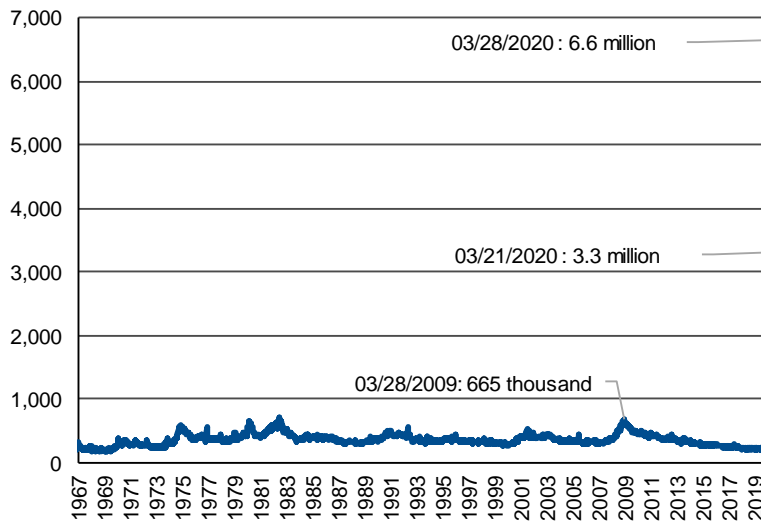
- Covid-19 pandemic is relatively contained within China's borders by end-March
- Lock-down is maintained in the US until end-April
- Downside risks to the outlook remain

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Downside risks: labour market turmoil and high corporate indebtedness

Weekly jobless claims

Thousand initial claims



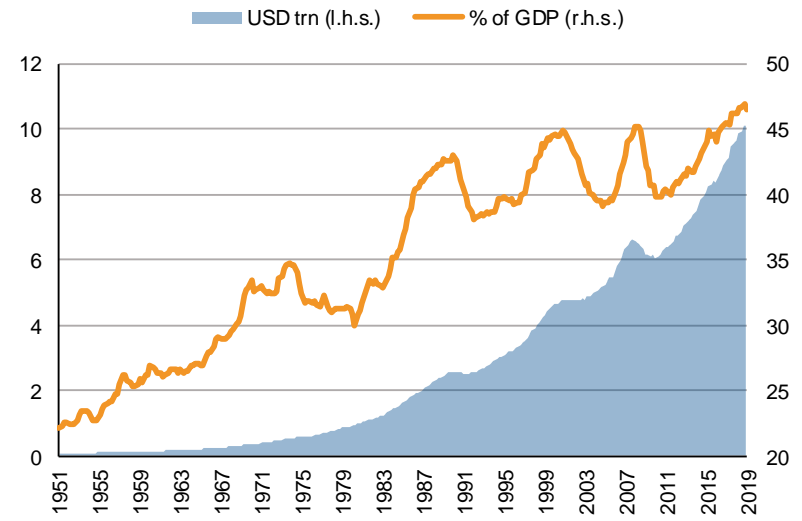
Source: Bureau of Labor Statistics, Scope Ratings GmbH

➤ Labour market shows vulnerabilities

- New jobless claims reached all-time high of 10m in the two weeks to 28 March
- One third of US jobs are at risk ([McKinsey](#))

Non-financial corporate debt

USD trn (l.h.s.); % of GDP (r.h.s.)



Source: Federal Reserve, Scope Ratings GmbH

➤ Corporate debt poses risks

- Corporate debt reached USD 10trn (47% of GDP) in Q3 2019
- Credit quality has deteriorated with large shares of BBB- rated debt ([OECD](#))



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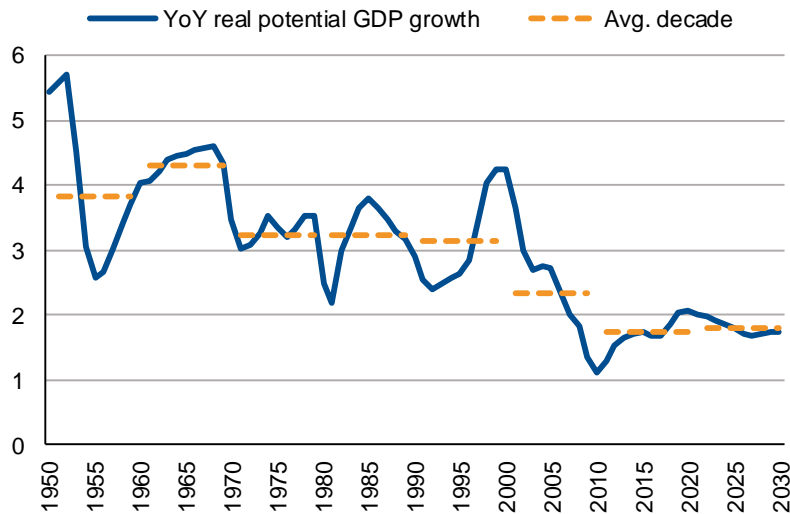
- Weakening potential growth outlook
- High and rising public debt burden
- Elevated contingent liabilities
- Polarisation and policy uncertainty

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Weakening potential growth outlook due to lower productivity...

Real potential GDP growth

Y-o-Y % change

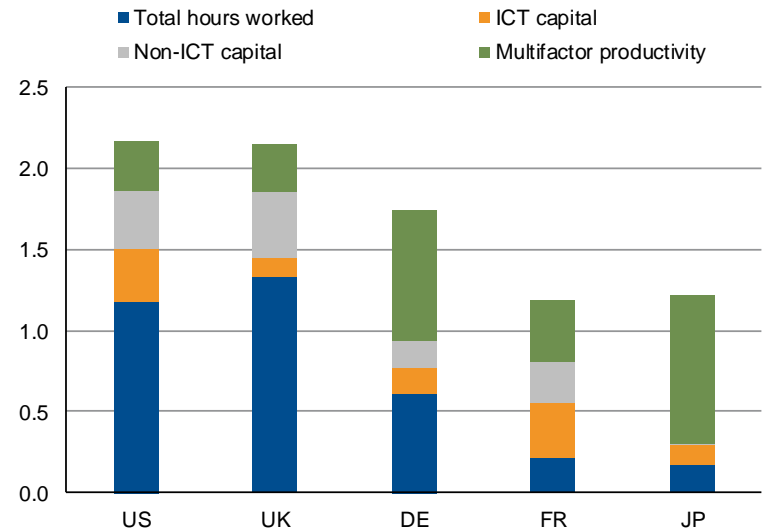


Source: CBO

➤ Causes

- Dwindling impact of IT revolution?
- Slower 'Schumpeterian' forces? Lack of competition?
- Slowdown in global trade?
- Skills mismatch? Access to education?

Contribution to real GDP growth



N.B. Averages for Japan are for 2013-17
Source: OECD

➤ Impact

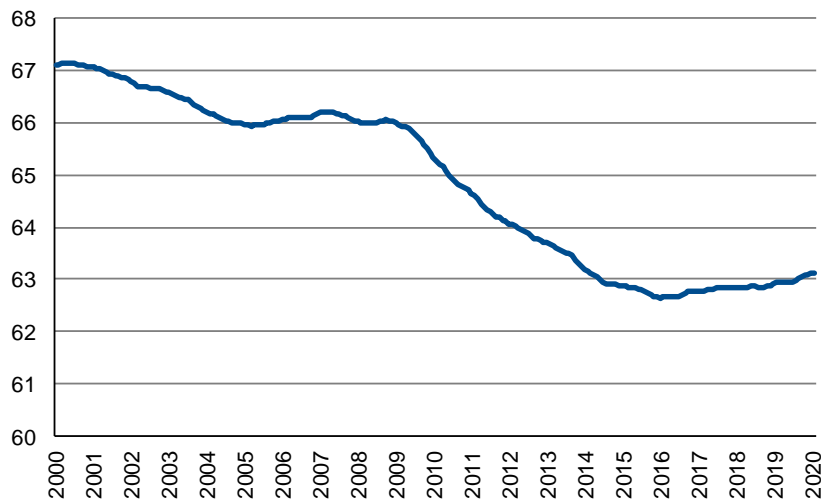
- Lower growth contribution from multi-factor productivity

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... and a lower growth contribution from labour going forward

Labour participation rate

12-month rolling average, %



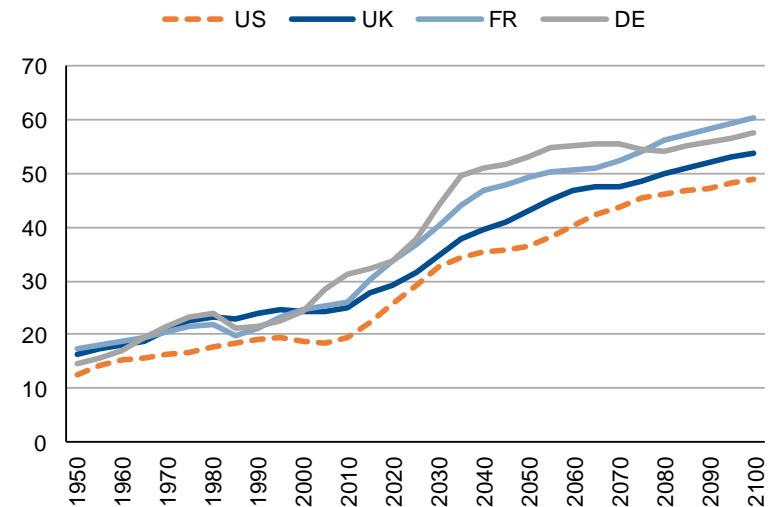
Source: Census Bureau

➤ Causes

- Demographics
- Institutional factors
- Declining opportunities for low-skilled workers

Old age dependency ratio

%



Source: UN

➤ Impact

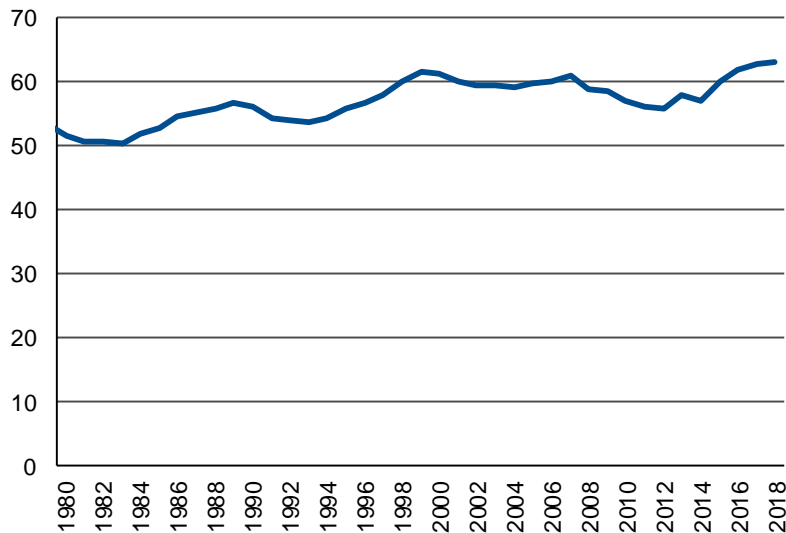
- Lower growth contribution from labour

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Income stagnation and inequality also dampen growth outlook

Income stagnation...

Real median household income, USD ('000s)



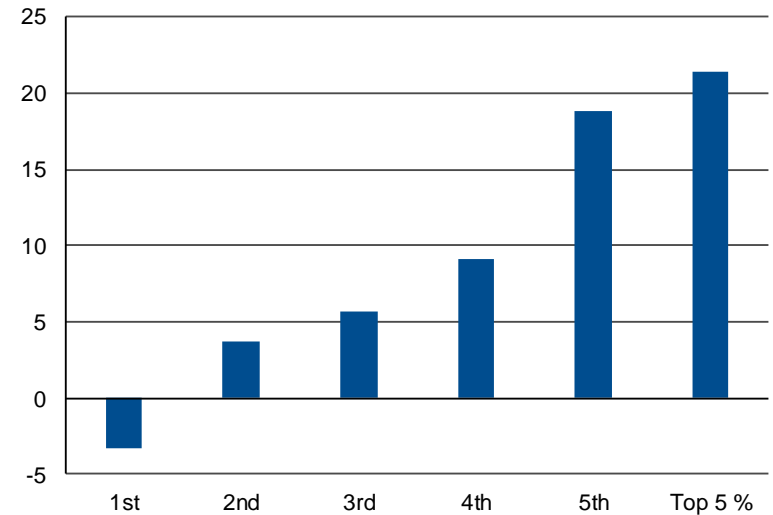
Source: Census Bureau

➤ Causes

- Automation of tasks
- Exposure to trade
- Decline in union representation

... and rising income inequality

1998 to 2018, % change per quintile



NB: Real mean household income
Source: Census Bureau

➤ Impact

- Curbs consumption
- Weighs on labour supply
- Creates disparities in education system
- Undermines social cohesion



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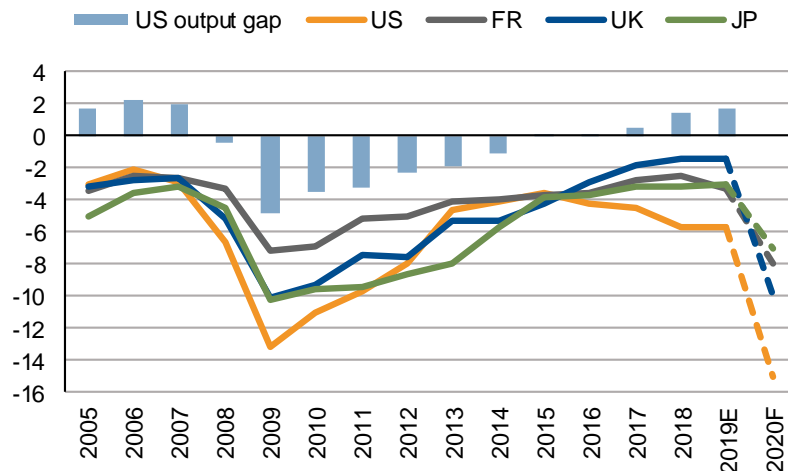
- ✓ Weakening potential growth outlook
- **High and rising public debt burden**
- Elevated contingent liabilities
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Continuous fiscal deficits and rising debt level

Fiscal balances

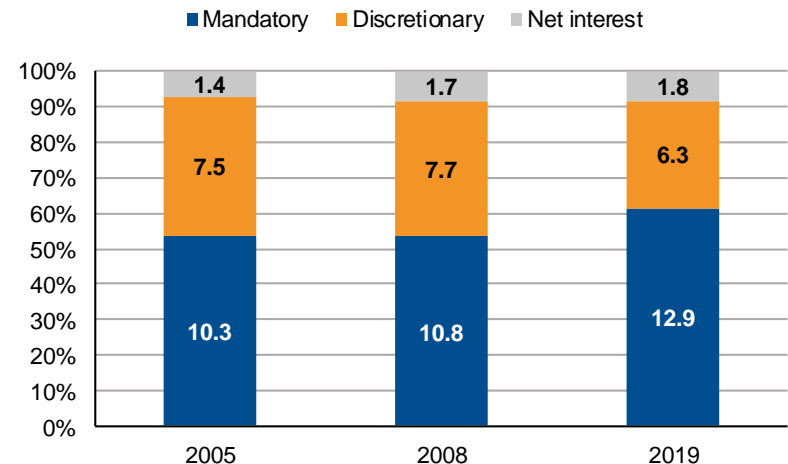
% of GDP



N.B. The dashed lines represent Scope's baseline forecasts for 2020
Source: IMF, Scope Ratings

Increasing mandatory spending

% of total outlays, % of GDP (labels)



Source: Congressional Budget Office

➤ Strongly pro-cyclical policies pre-crisis leave fiscal vulnerabilities unaddressed

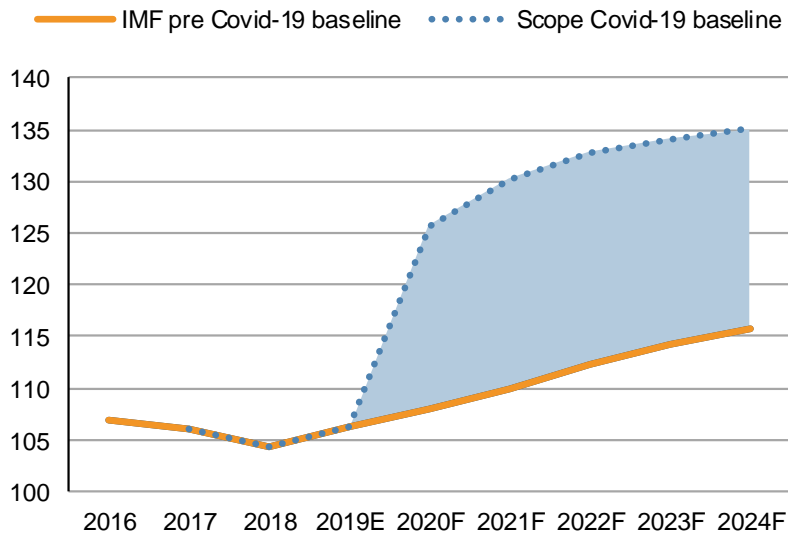
- Tax Cuts and Jobs Act widened the deficit and provided only a temporary growth boost
- Increasing mandatory (social security and healthcare) and interest spending leave less room for discretionary spending
- Covid-19 will further increase budget deficit to -15% of GDP in 2020, weakening fiscal fundamentals

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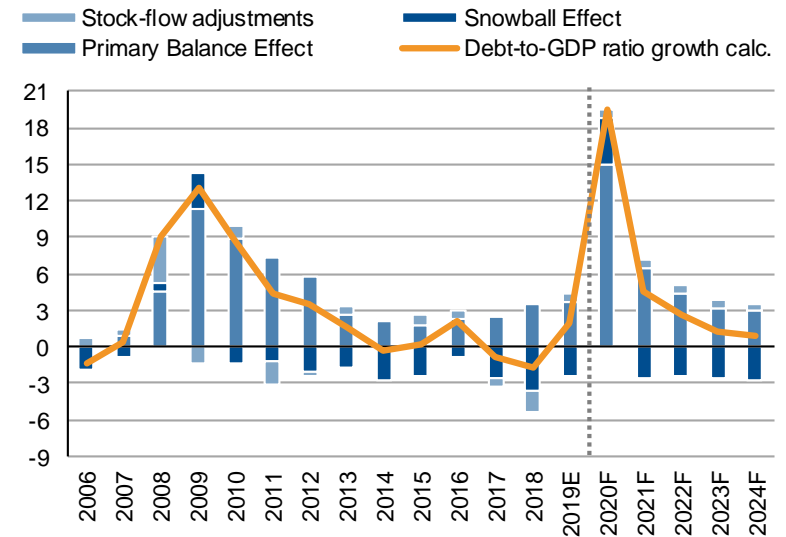
Continuously rising public debt trajectory

Debt sustainability analysis

Debt, % of GDP



Contribution to change in debt, % of GDP



Source: IMF, Scope Ratings GmbH

Scenario	Time period	Real GDP growth (%)	Primary bal. (% of GDP)	Real eff. int. rate (%)	Debt, end period (% of GDP)
History	2014-2018	2.5	-2.4	0.2	104.3
IMF baseline (pre Covid-19)	2019-2024	1.8	-3.4	-0.1	115.8
Scope Covid-19 baseline		0.9	-6.0	-0.2	135.0



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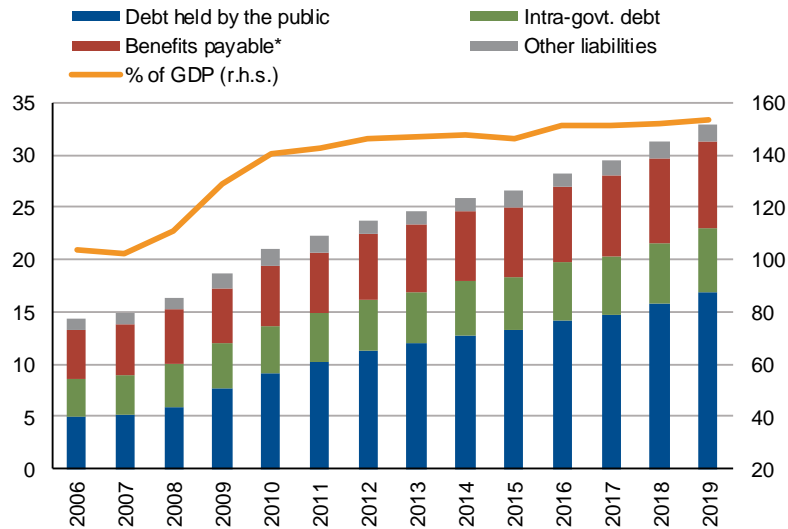
- ✓ Weakening potential growth outlook
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- **Elevated contingent liabilities**
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Elevated contingent liabilities

Direct liabilities

USD trn, % of GDP (r.h.s.)

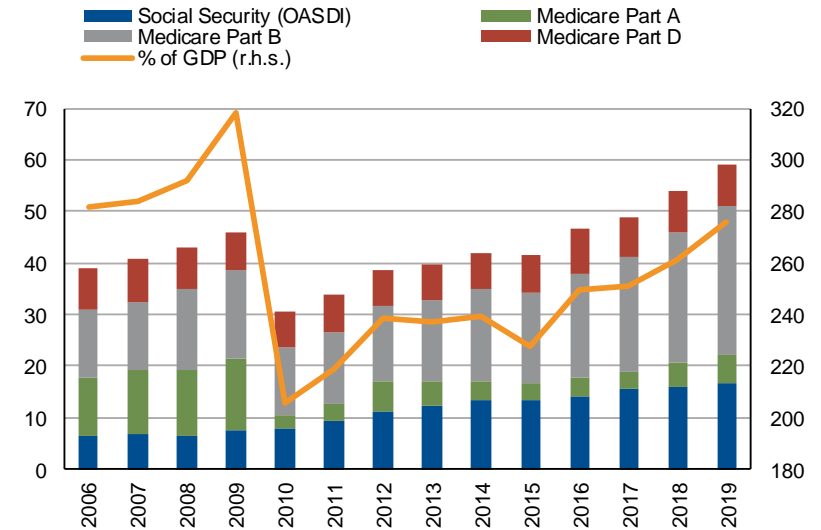


*Federal employees & veteran benefits payable

Source: Financial Reports US government, Scope Ratings GmbH

Social Security and Medicare Obligations

USD trn, % of GDP



N.B. Figures show the NPV of healthcare obligations for a 75-year horizon.

Source: Financial Reports US government, Scope Ratings GmbH

➤ High and rising pension- and health-care liabilities

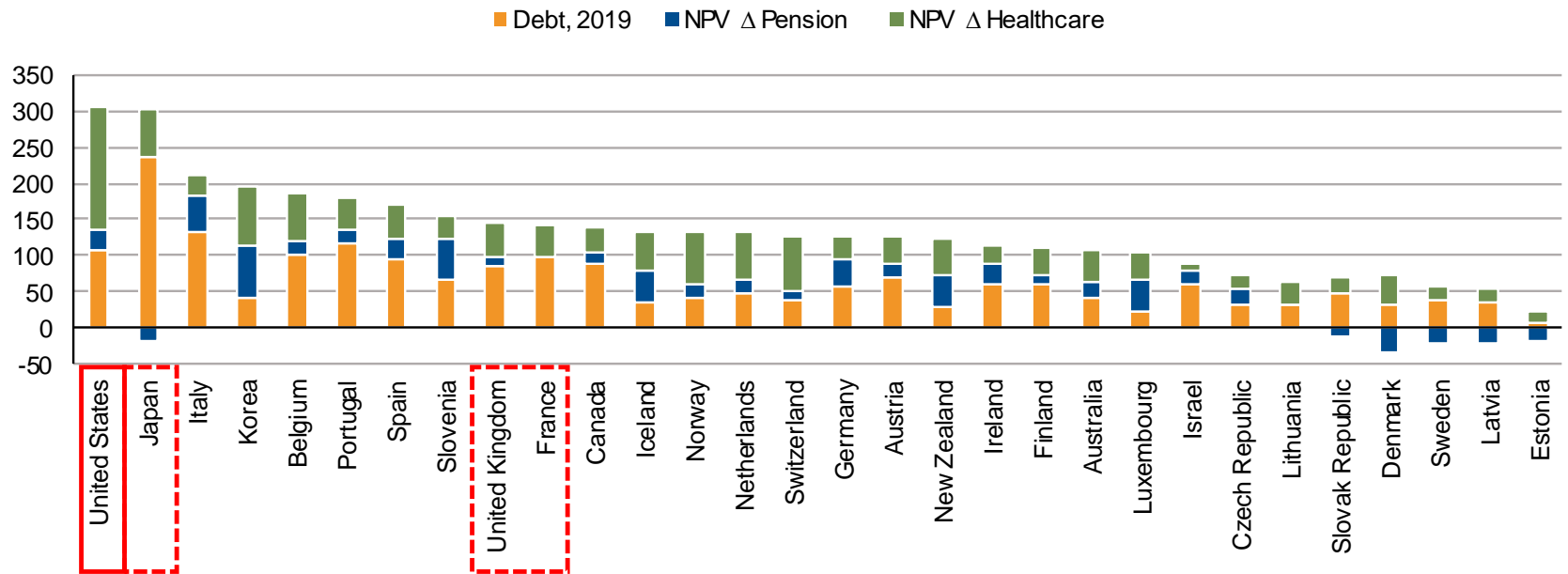
- Urgent need to implement reforms to the numerous benefit programmes
- Covid-19 pandemic will increase health-related costs

Covid-19 exacerbates United States' vulnerabilities

Elevated contingent liabilities relative to peers

General gov't obligations, including NPV of future pension and healthcare obligations

% of GDP



N.B. Pension projections rely on authorities' estimates when these are available; For NPV calculations, a discount rate of GDP growth + 1% is used for each economy.
Source: IMF Fiscal Monitor October 2019



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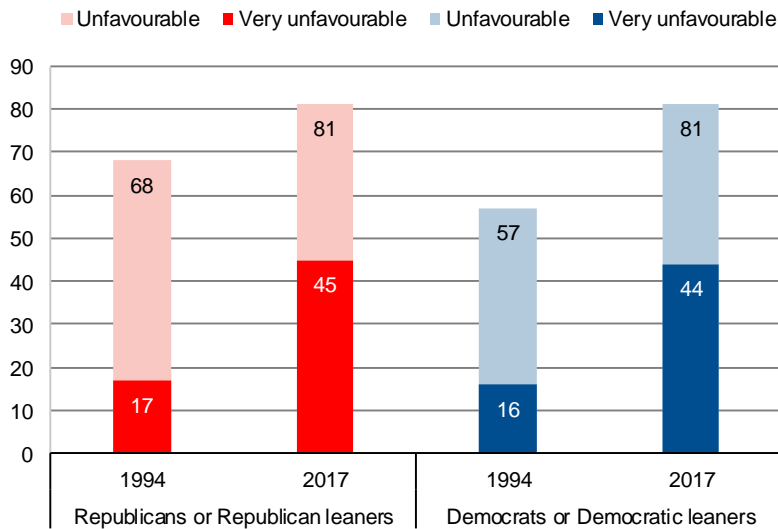
- ✓ Weakening potential growth outlook
- ✓ High and rising public debt burden
- ✓ Elevated contingent liabilities
- **Polarisation and policy uncertainty**

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Political polarisation at the expense of bipartisan solutions

Partisan animosity is on the rise

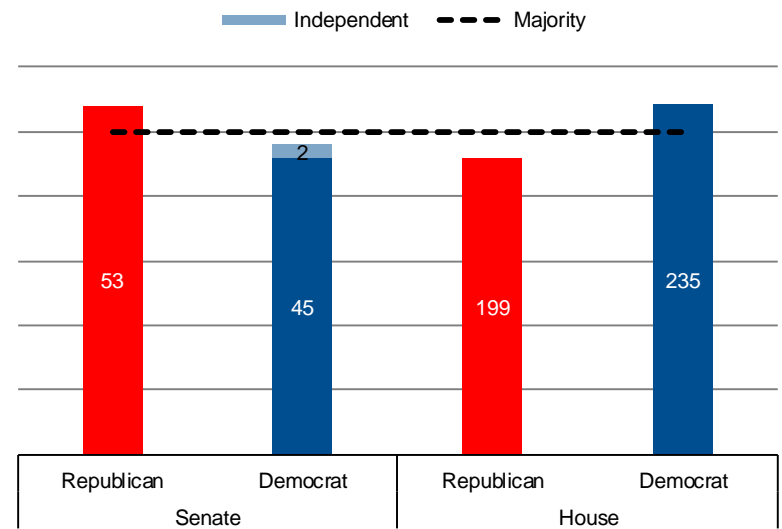
Opinion of opposing party, % of respondents



Source: Pew Research Center, Scope Ratings GmbH

Composition of Congress

Senate and House seats



Source: US Congress; US Senate

➤ Political polarisation in the United States is a long-term trend

➤ 116th US Congress

- Failed impeachment procedure
- Longest government shutdown in US history from 22 December 2018 until 25 January 2019
- Brinkmanship around debt ceiling debates creates periodic risk of debt non-repayment

Covid-19 exacerbates United States' vulnerabilities

Polarisation to extend beyond the US presidential elections in 2020

➤ **3 November 2020 presidential elections**

- Outcome highly uncertain:
 - Polarised political environment
 - Voter mobilisation (or lack thereof)
 - Depth of US recession
 - Speed and timing of labour market recovery (if any) key factors
- Trade tensions with China likely to persist under either Republican or Democratic Presidency

➤ **Regardless of the presidential elections, Congress most likely to remain divided**

- Democrat-controlled House and Republican Senate unlikely to lead to a new bipartisan spirit

➤ **Political polarisation to persist, leaving structural weaknesses unaddressed**



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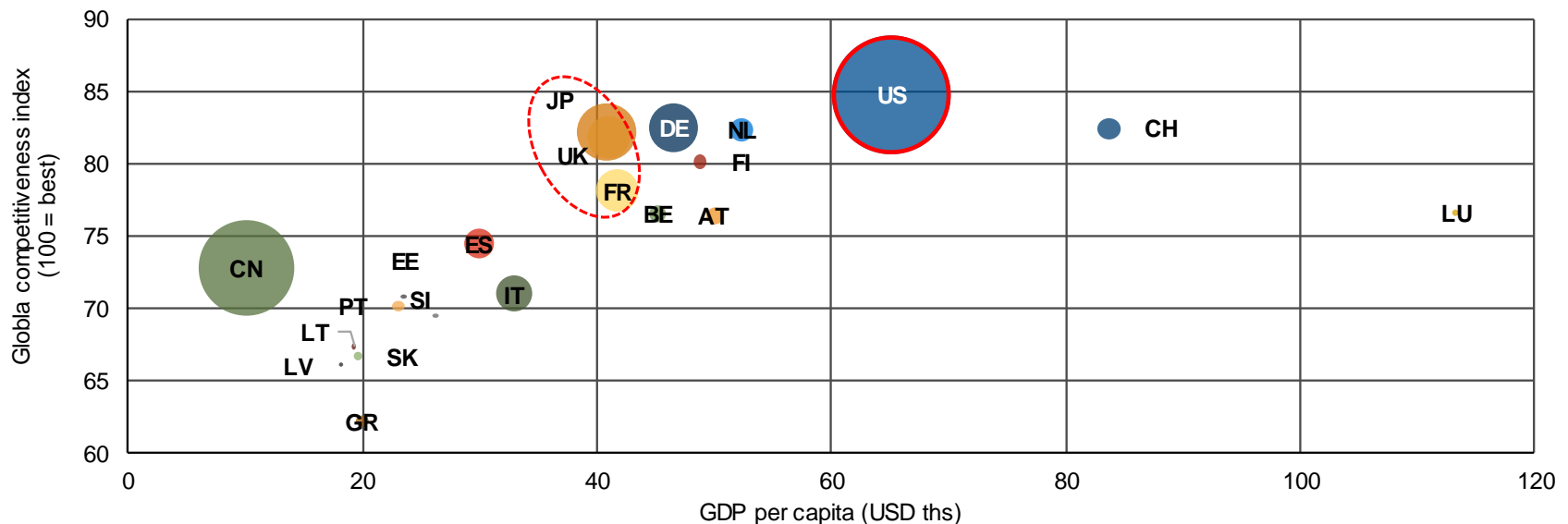
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A wealthy, diversified and competitive economy

A wealthy, diversified and competitive economy

Global competitiveness Index (y axis); GDP per capita (x axis), USD ths; share in world GDP (bubble size)



N.B. The Global Competitiveness Index is a three-year average
Source: World Economic Forum, IMF, Scope Ratings GmbH

➤ Economic size, wealth and competitiveness support the United States' AA rating

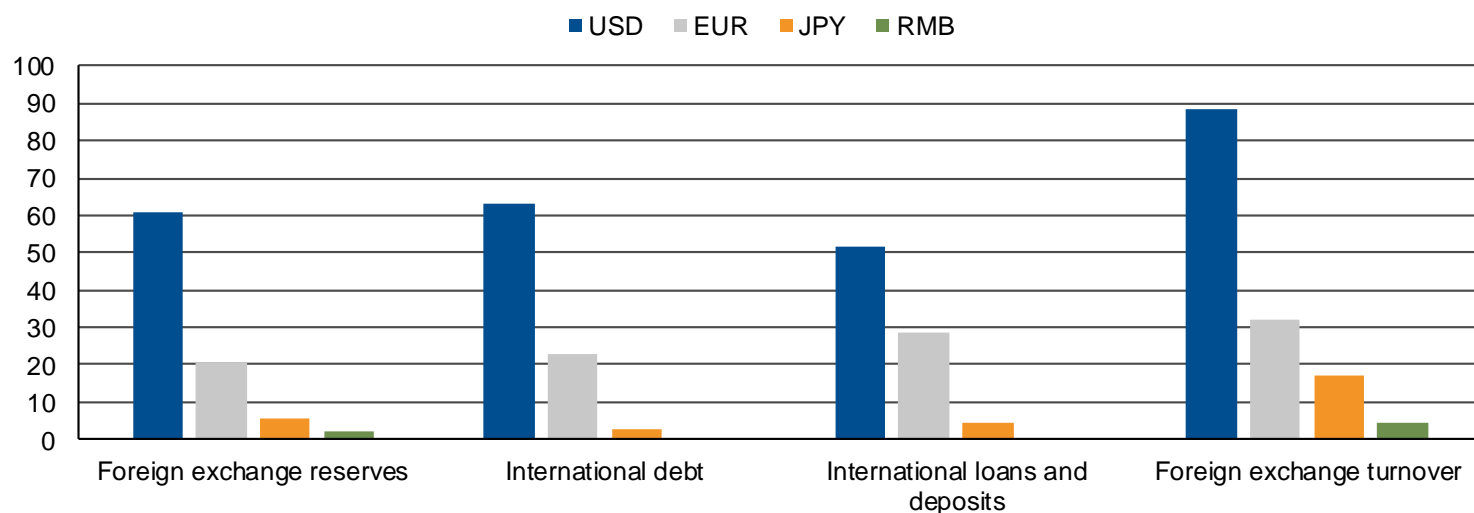
- High GDP per capita (USD 65,111)
- A large and diversified economy (representing about 25% of world GDP)
- Among the most competitive economies in the world (ranked 2nd on the [Global Competitiveness Index](#) in 2019)

Covid-19 exacerbates United States' vulnerabilities

Unparalleled global reserve currency status

Currency composition

% of total



Source: IMF, BIS, ECB, Scope Ratings GmbH

➤ Scope Qualitative Scorecard (QS)

- Excellent - Market access and funding sources
- Excellent - External debt sustainability
- Excellent - Resilience to short-term shocks

➤ Analyst Judgement

- 2-notch additional rating uplift outside of the QS



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Credit weaknesses are offset by important credit strengths

Credit strengths

- ✓ Wealthy, competitive economy
- ✓ Global reserve currency status
- ✓ Institutional checks and balances
- ✓ Deep, liquid capital markets

Positive rating-change drivers

- Improved potential growth outlook
- Debt trajectory on downward path
- Reduction in contingent liabilities

Credit weaknesses

- ✓ Weakening potential growth outlook
- ✓ High and rising public debt burden
- ✓ Elevated contingent liabilities
- ✓ Polarisation and policy uncertainty

Negative rating-change drivers

- Reduced global role of the US dollar
- Deterioration in public finances
- Weakening fiscal framework

Additional research

- ✓ [Rating action release – July 2019](#)
- ✓ [Sovereign Outlook 2020 update: Covid-19 pandemic creates high risks, triggers deep recession](#)
- ✓ [US slowdown increases risk of still-wider fiscal deficits ahead of 2020 election](#)
- ✓ [US-China trade war increases systemic economic risks, but China more vulnerable than US](#)
- ✓ [US debt ceiling deadline highlights weak fiscal framework amid deteriorating public finances](#)
- ✓ [US public finance vulnerabilities: Is the dollar's reserve currency status really enough?](#)
- ✓ [US Fiscal Outlook: Politically polarising tax cut boosts short-term growth, raises deficits](#)
- ✓ [US Government Obligations & Contingent Liabilities: A High and Rising Fiscal Risk](#)
- ✓ [Polarisation in US Politics is Leading to Policy Inaction and Uncertainty](#)
- ✓ [The Unparalleled Status of the US Dollar in an Evolving Global Environment](#)



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