



Why the United States is no longer AAA

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Update on the United States, March 2019, Frankfurt



Why the United States is no longer AAA

Inherent credit strengths but important rating constraints

➤ **On 21 September 2018, Scope affirmed the US sovereign rating at AA/ Stable**

Credit strengths

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

Credit weaknesses

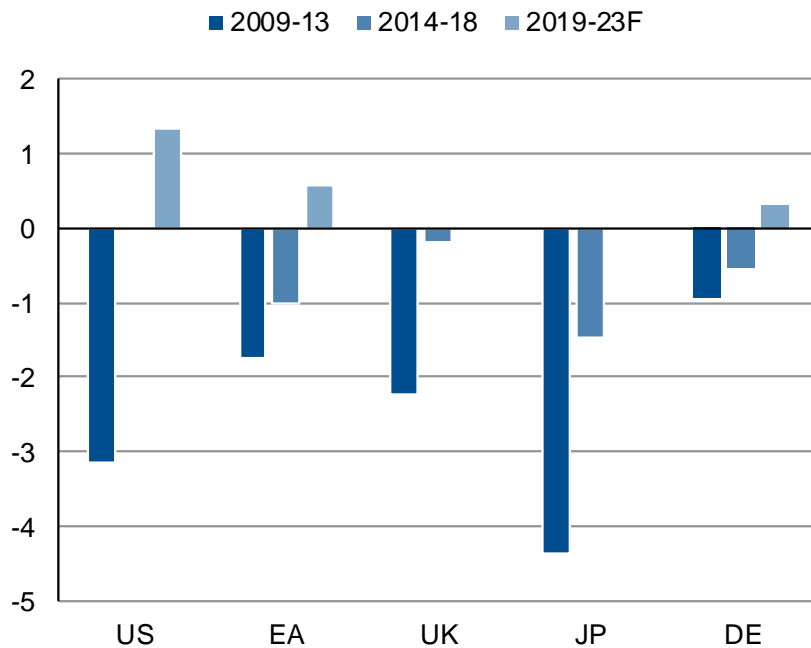
- Weakening potential growth outlook
- High and rising public debt burden
- Elevated contingent liabilities
- Polarisation and policy uncertainty

Why the United States is no longer AAA

Economy above full employment; Federal reserve normalising its stance

Output gap

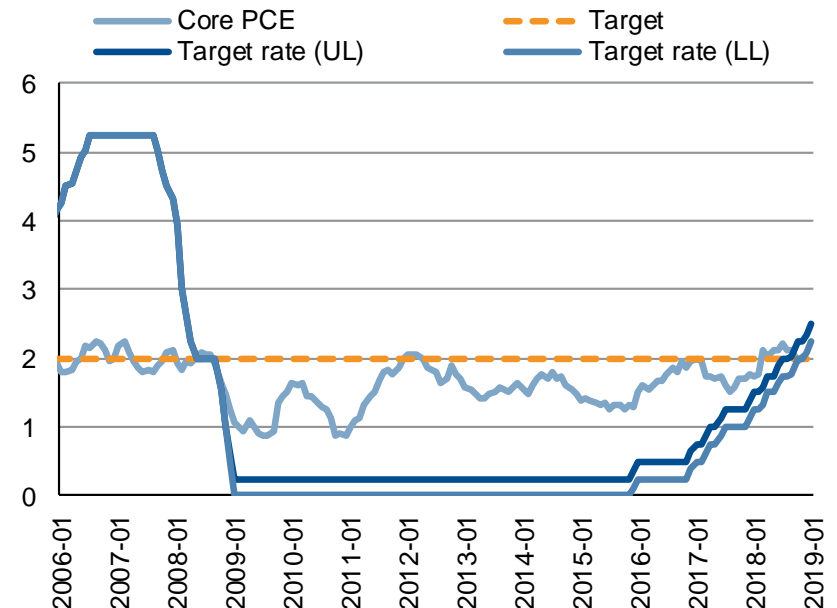
% of potential GDP



Source: IMF, Calculations Scope Ratings GmbH

Federal funds, target and core inflation

%



Source: Federal Reserve, Calculations Scope Ratings GmbH

➤ Gradual and slowing Fed-policy normalisation

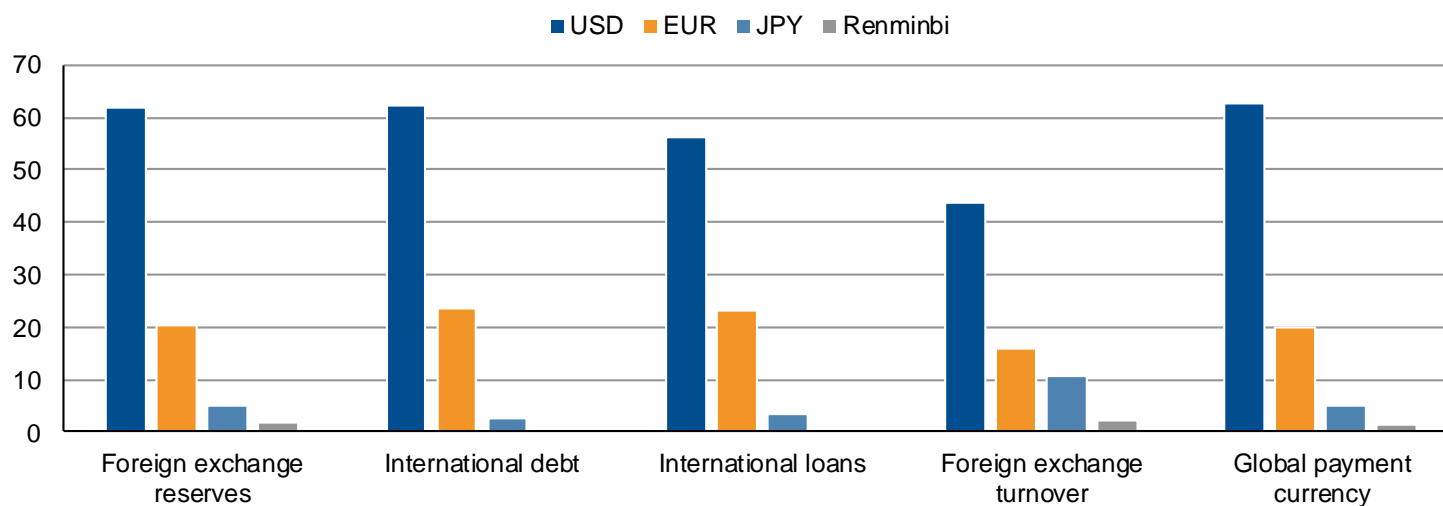
- Scope anticipates at least 1 and not more than 2 rate hikes in 2019; slowdown of balance sheet reduction

Why the United States is no longer AAA

Unparalleled global reserve currency status

Currency composition

% of total



Source: ECB

➤ 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
- Captures US dollar's unique global role and status



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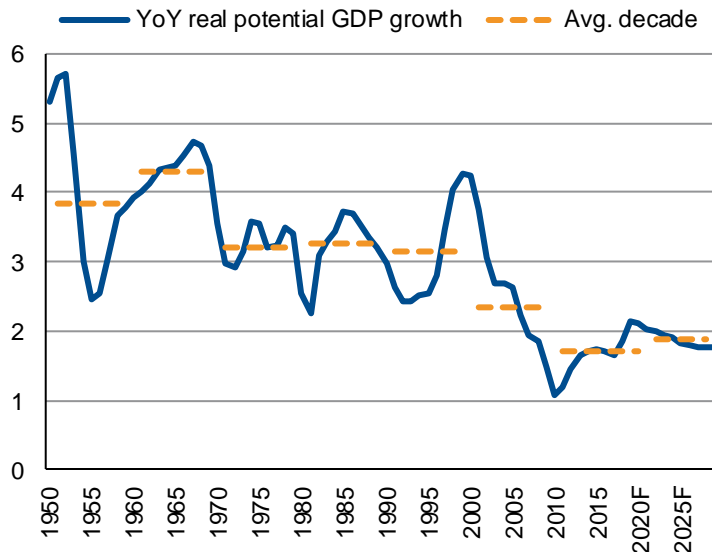
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Why the United States is no longer AAA

Weakening potential growth outlook due to lower productivity...

Real potential GDP growth

Y-o-Y % change



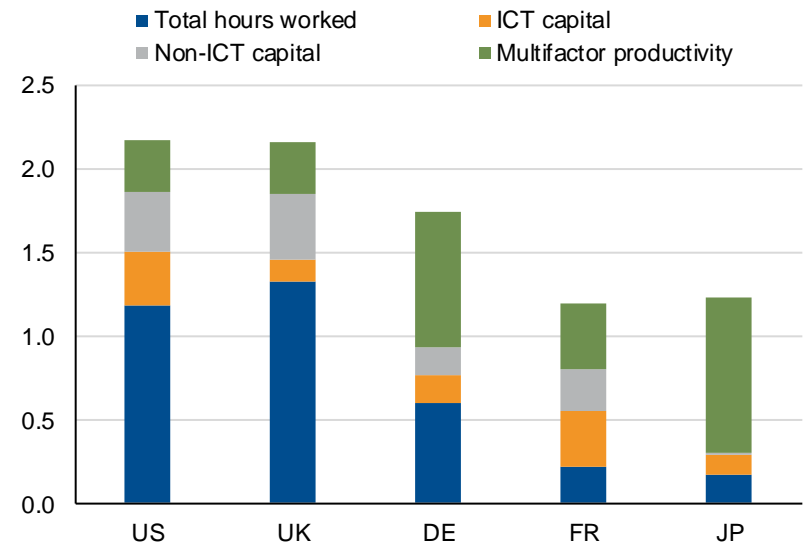
Source: CBO

➤ Causes

- Dwindling impact of IT revolution?
- Slower 'Schumpeterian' forces?
- Slowdown in global trade?

Contribution to real GDP growth

Avg. 2013-17, %



Source: OECD

➤ Impact

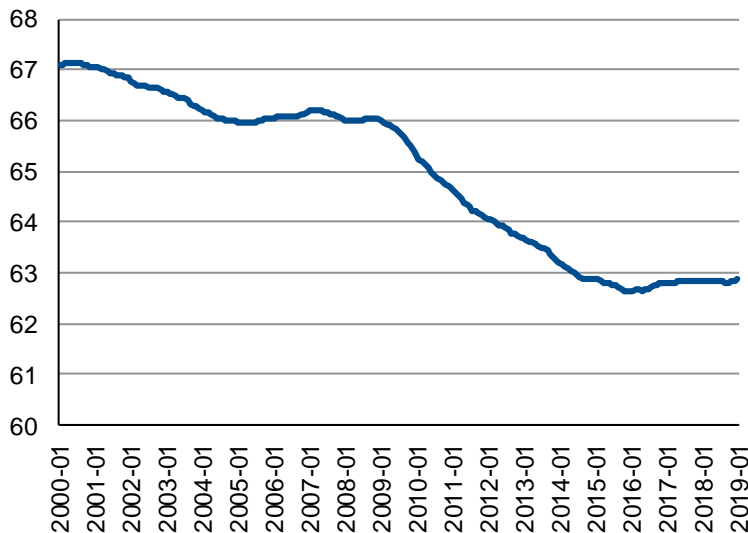
- Lower growth contribution from multi-factor productivity

Why the United States is no longer AAA

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

Labour participation rate

%



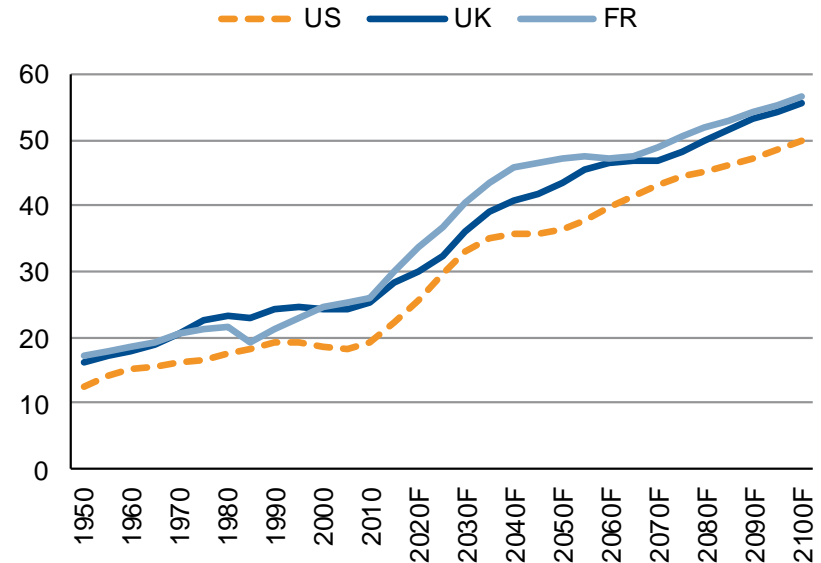
Source: Census Bureau

➤ Causes

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

Dependency ratio

Per 100



Source: UN

➤ Impact

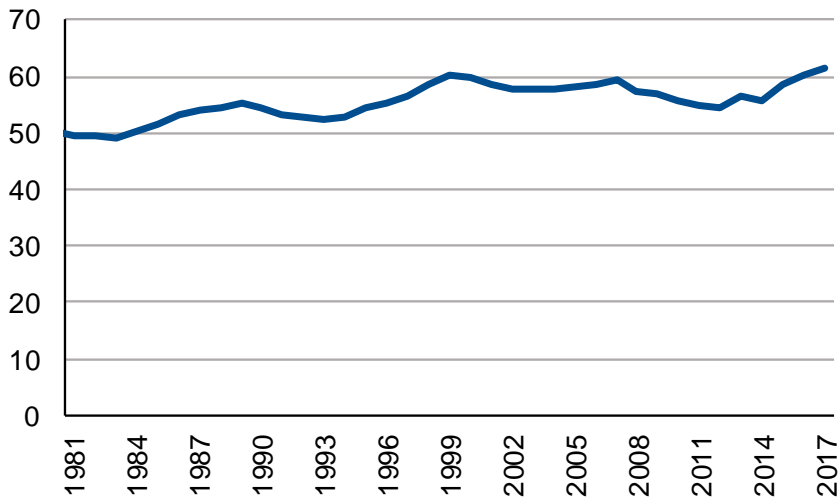
- Lower growth contribution from labour

Why the United States is no longer AAA

Income stagnation and inequality also dampen growth outlook

Income stagnation...

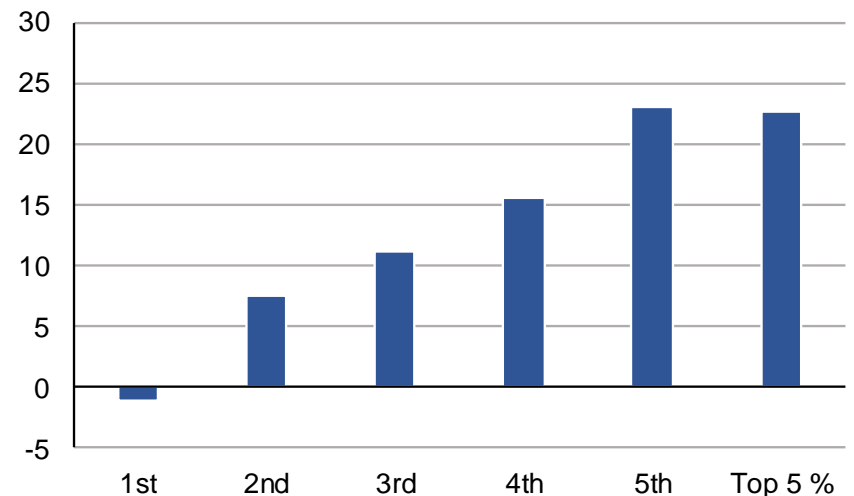
Real median household income, USD ('000s)



Source: Census Bureau

... and rising income inequality

1997 to 2017, % change per quintile



NB: Real mean household income
Source: Census Bureau

➤ Causes

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

➤ Impact

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



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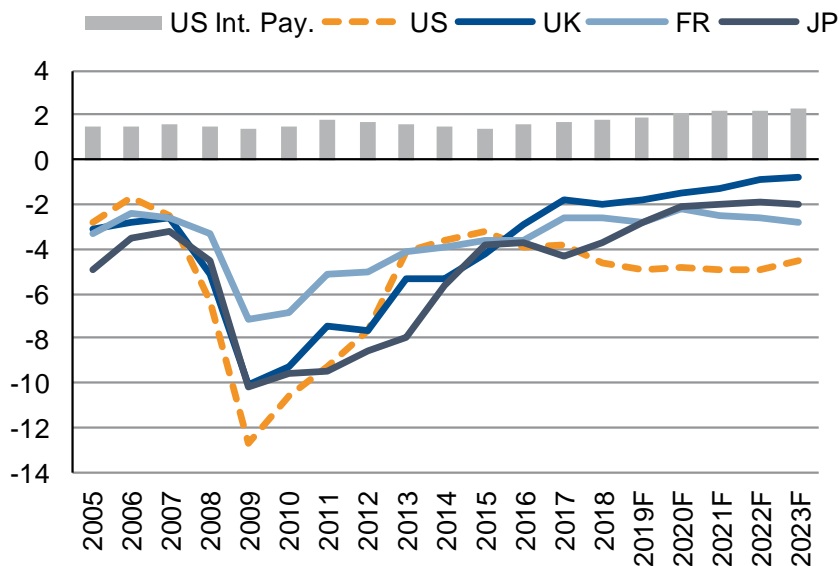
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Why the United States is no longer AAA

Continuous fiscal deficits and rising debt level

Fiscal balances

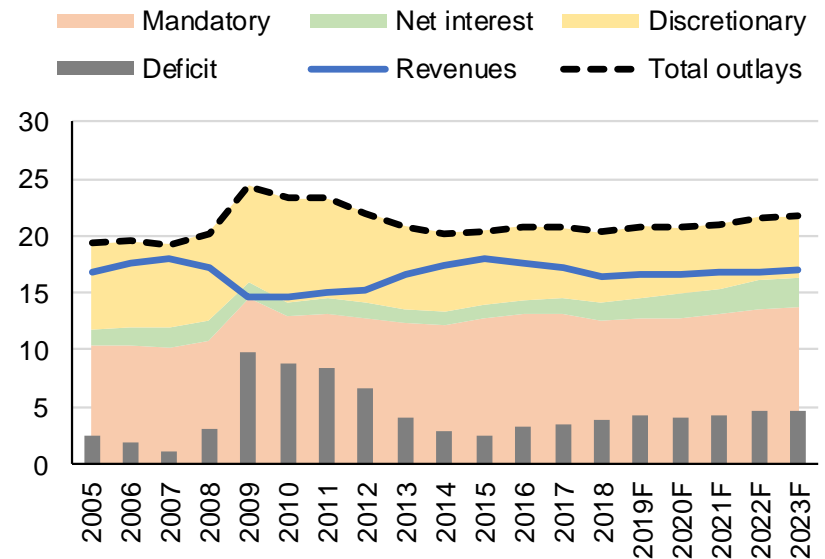
% of GDP



Source: IMF

Mostly a spending problem

% of GDP



Source: Congressional Budget Office

➤ Strongly pro-cyclical fiscal policies

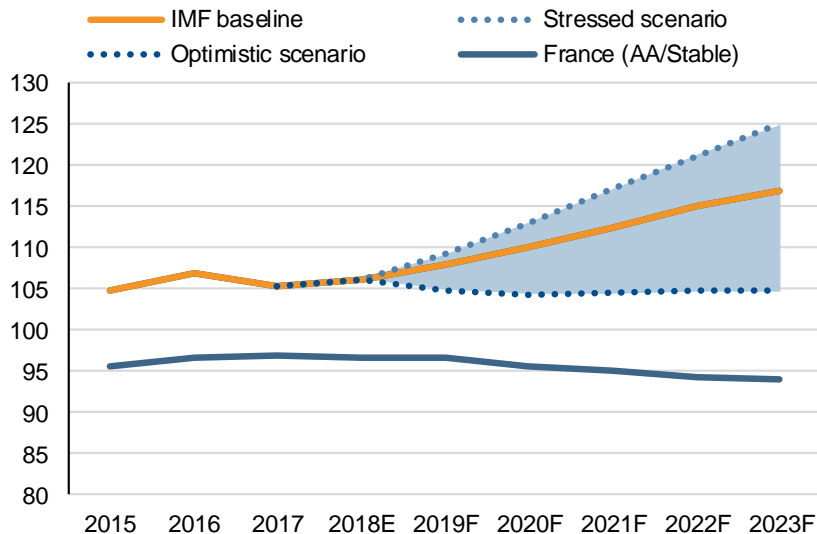
- Tax cuts via the Tax Cuts and Jobs Act only a temporary growth boost
- Higher mandatory (social security and healthcare) and interest spending; declines in discretionary spending
- Constant revenues, though expected to increase after 2025 given expiration of income tax provisions

Why the United States is no longer AAA

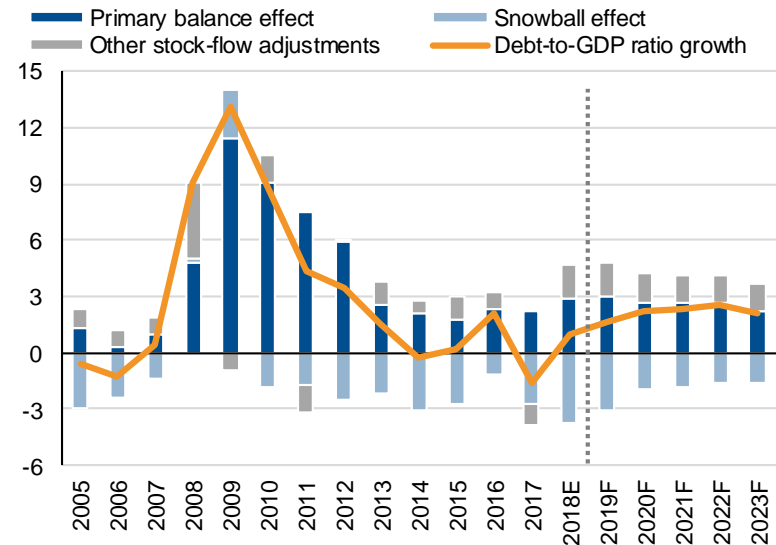
Debt sustainability challenges

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	2014-18	2.4	-2.2	-0.1	106.1
IMF baseline	2019-23	1.8	-2.7	0.0	117.0
Optimistic scenario		2.3	-2.2	0.0	104.7
Stressed scenario		0.8	-3.7	0.9	124.9



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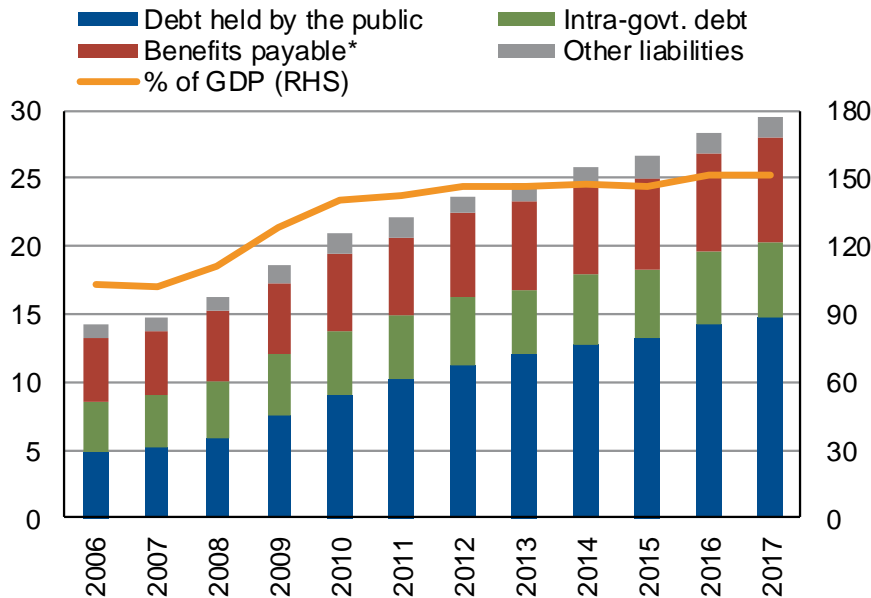
- ✓ Weakening potential growth outlook
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- **Elevated contingent liabilities**
- Polarisation and policy uncertainty

Why the United States is no longer AAA

Elevated contingent liabilities

Direct liabilities

USD trn, % of GDP

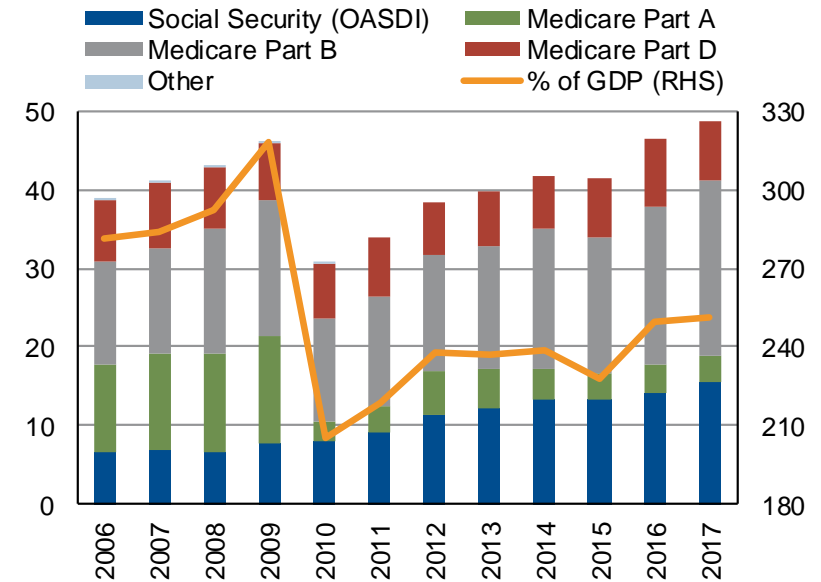


*Federal employees & veteran benefits payable

Source: Financial Reports US government, Scope Ratings GmbH

Social Security and Medicare Obligations

USD trn, % of GDP



Source: Financial Reports US government, Calculations Scope Ratings GmbH

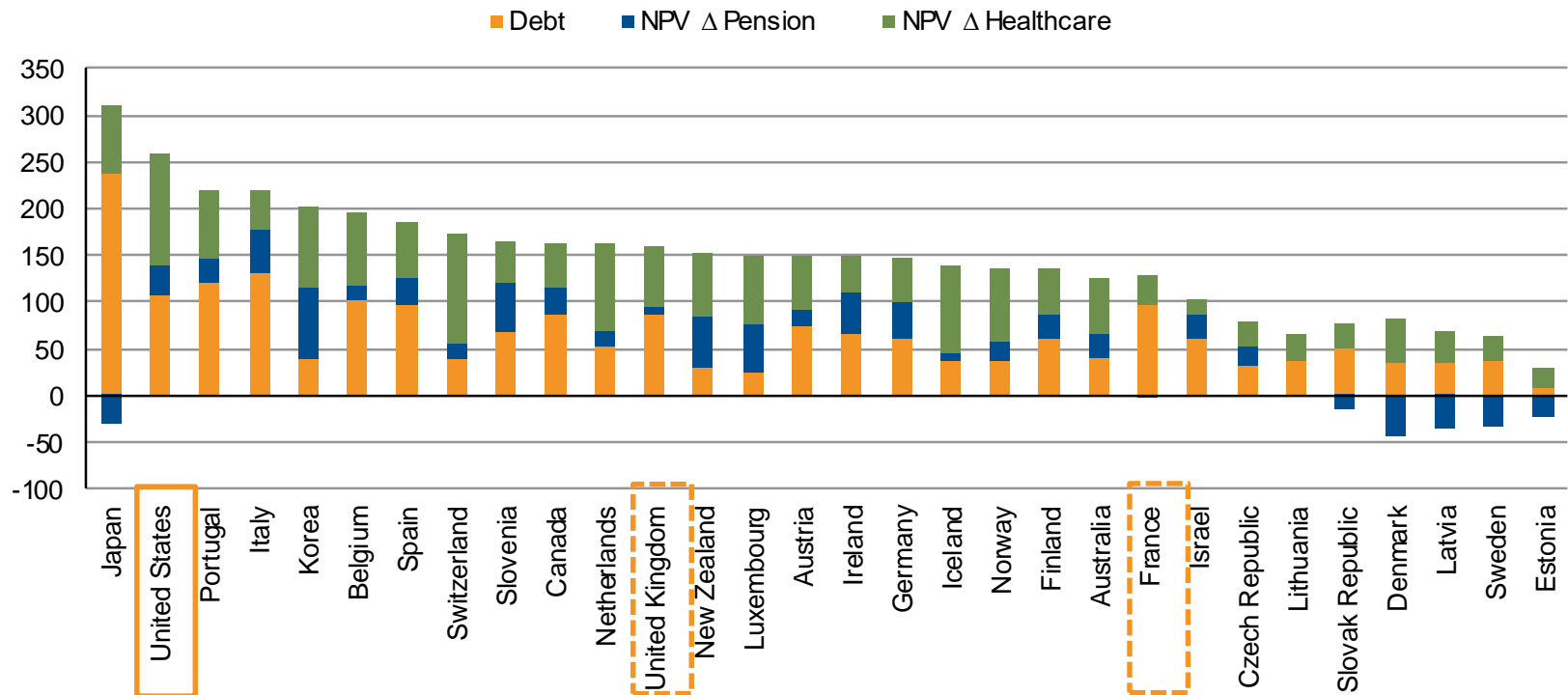
➤ High and rising pension- and health-care liabilities

- Urgent need to implement reforms to the numerous benefit programmes

Why the United States is no longer AAA

Elevated contingent liabilities

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



Source: IMF Fiscal Monitor October 2018



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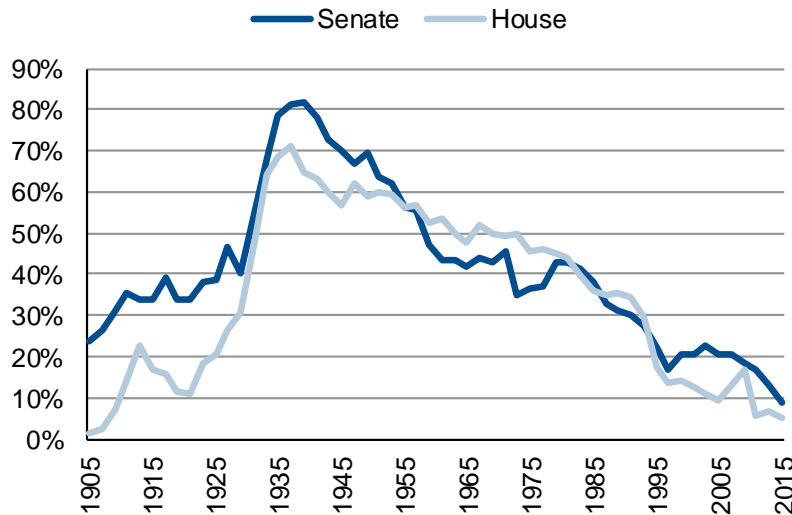
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Why the United States is no longer AAA

Political polarisation at the expense of moderates

Share of moderates

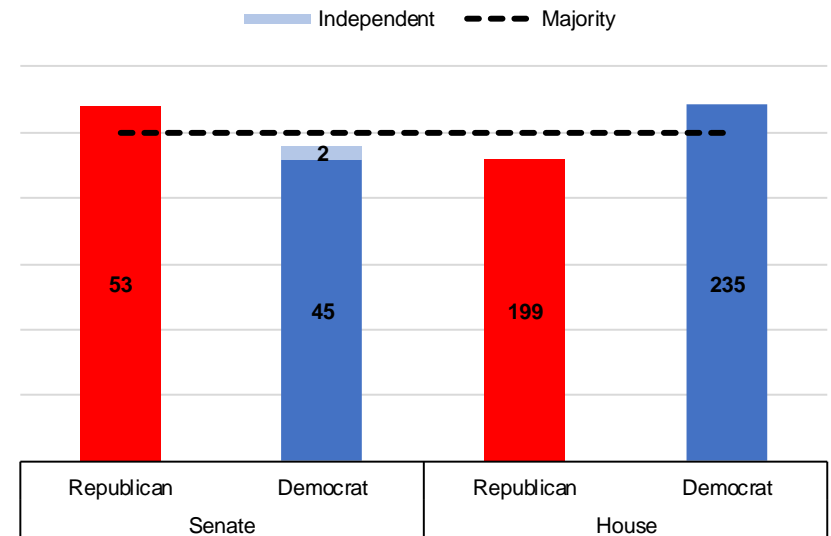
% of total Congress members



Source: https://legacy.voteview.com/political_polarization_2015.htm

Congressional elections

Senate and House seats



Source: US Congress; US Senate

➤ Political polarisation

➤ 116th US Congress

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

Why the United States is no longer AAA

Policy uncertainty and rising global risks

➤ Political polarisation

- Lack of bipartisan collaboration
- Delays, filibusters



Inability to address

- Weakening potential growth outlook
- High and rising debt level
- Pension and health-care liabilities

➤ America First Agenda

- Protectionist trade policies
- Unilateral decisions



Risk of

- Heightened global imbalances
- Trade war and financial stability risks
- America alone?

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Positive rating-change drivers

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

Credit weaknesses

- ✓ Weakening potential growth outlook
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- ✓ Polarisation and policy uncertainty

Negative rating-change drivers

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



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Additional research

- ✓ [Rating report – September 2018](#)
- ✓ [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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