

Why the United States is no longer AAA

Alvise Lennkh
Director, Public Finance
a.lennkh@scoperatings.com

Giacomo Barisone
Managing Director, Public Finance
g.barisone@scoperatings.com



Update on the United States, October 2018, 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

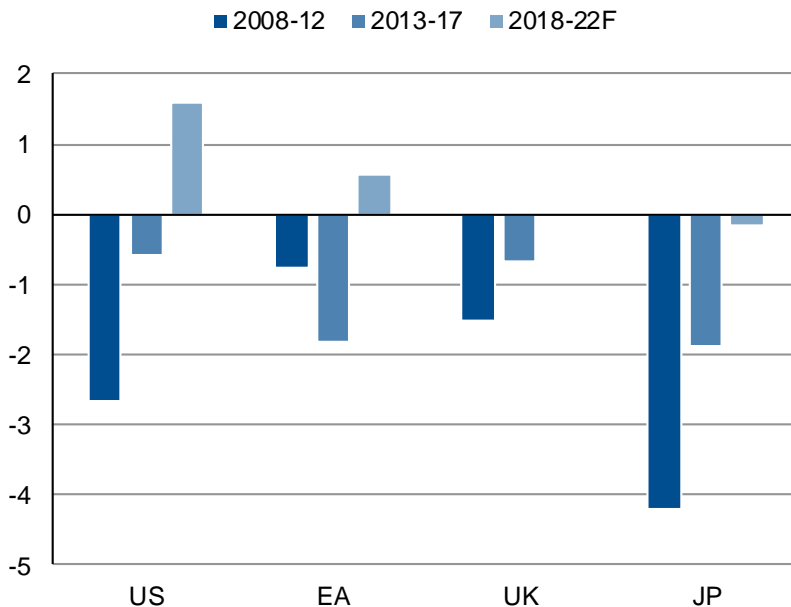
- Weakening potential growth outlook
- High and rising public debt burden
- Elevated contingent liabilities
- Polarisation and policy uncertainty

Why the United States is no longer AAA

Economy above full employment; Federal reserve normalising its stance

Output gap

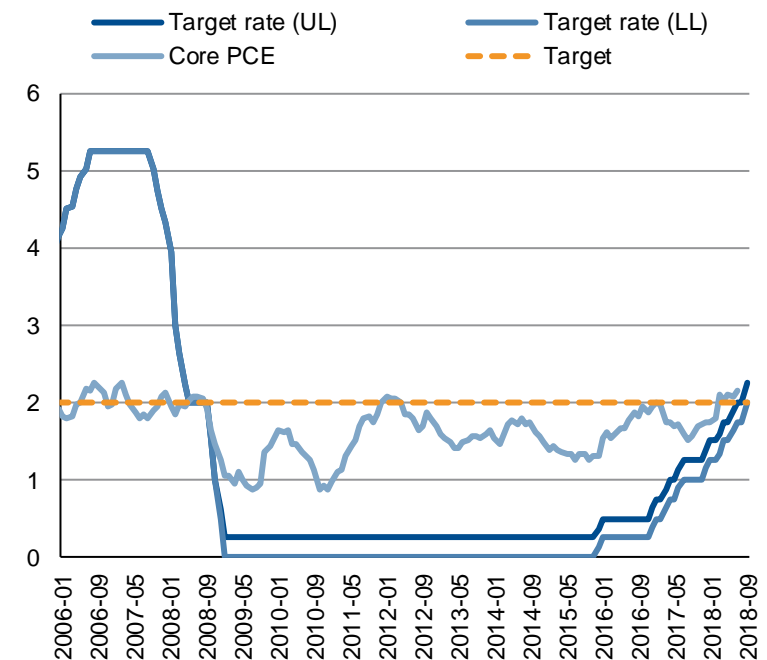
% of potential GDP



Source: IMF, Calculations Scope Ratings GmbH

Federal funds, target and core inflation

%



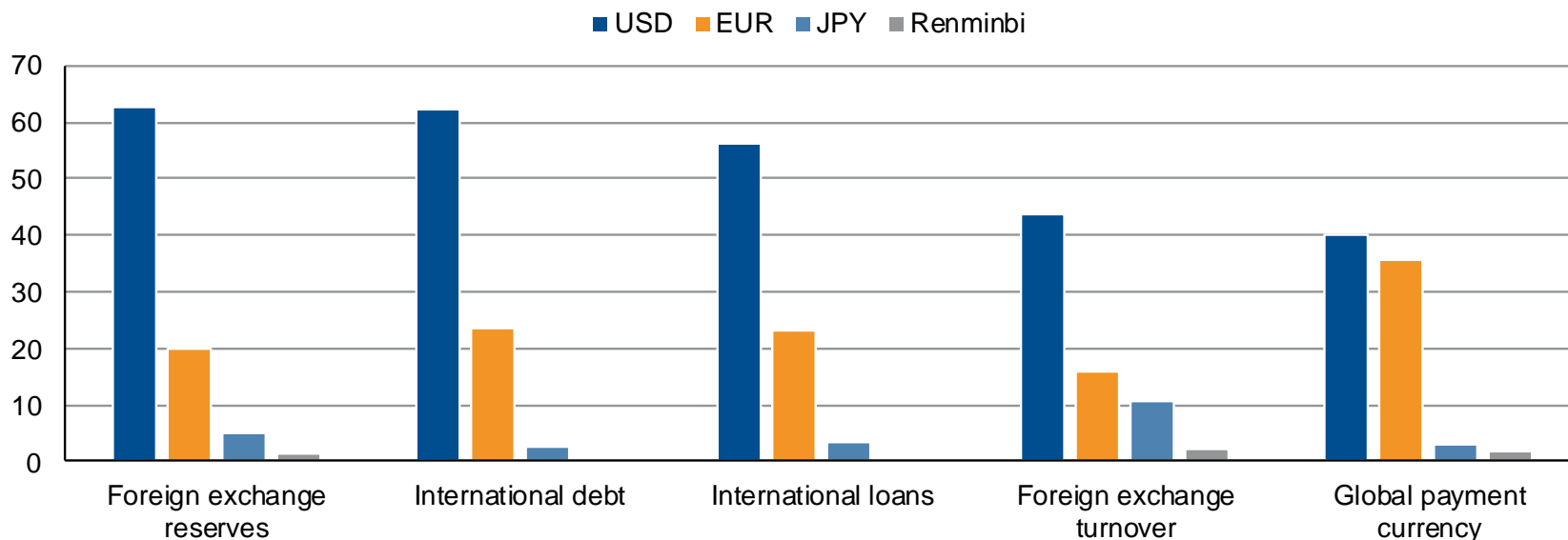
Source: Federal Reserve, Calculations Scope Ratings GmbH

Why the United States is no longer AAA

Unparalleled global reserve currency status

Currency composition

% of total



Source: ECB

➤ Qualitative Scorecard

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

➤ Analyst Judgement

- 2-notch additional uplift outside of the scorecard



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Credit weaknesses

➤ Weakening potential growth outlook

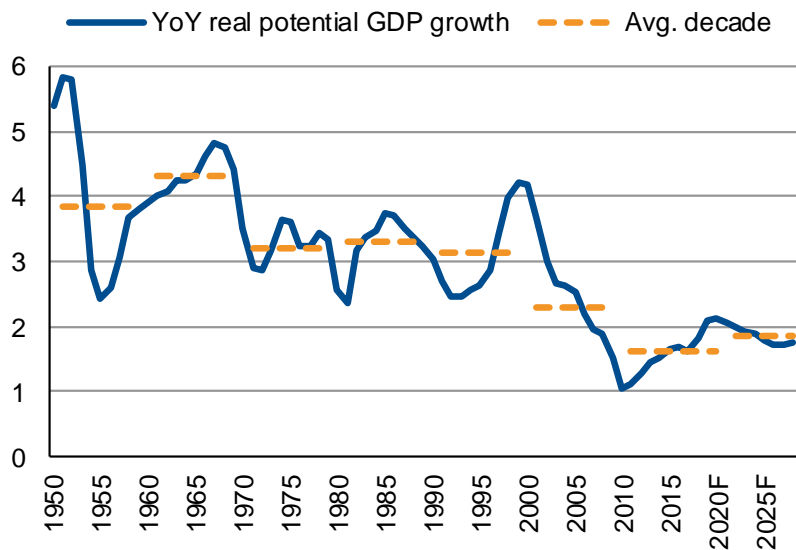
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Why the United States is no longer AAA

Weakening potential growth outlook due to lower productivity...

Real potential GDP growth

Y-o-Y % change



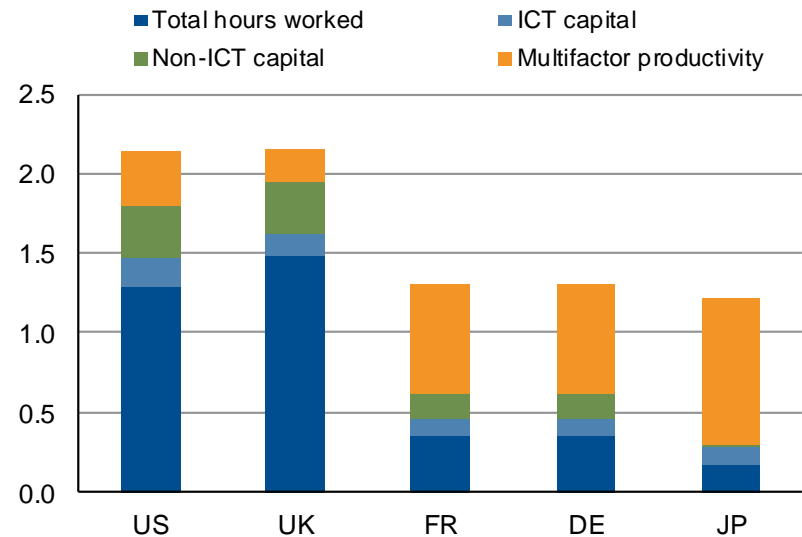
Source: CBO

➤ Causes

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

Contribution to real GDP growth

Avg. 2012-16, %



Source: OECD

➤ Impact

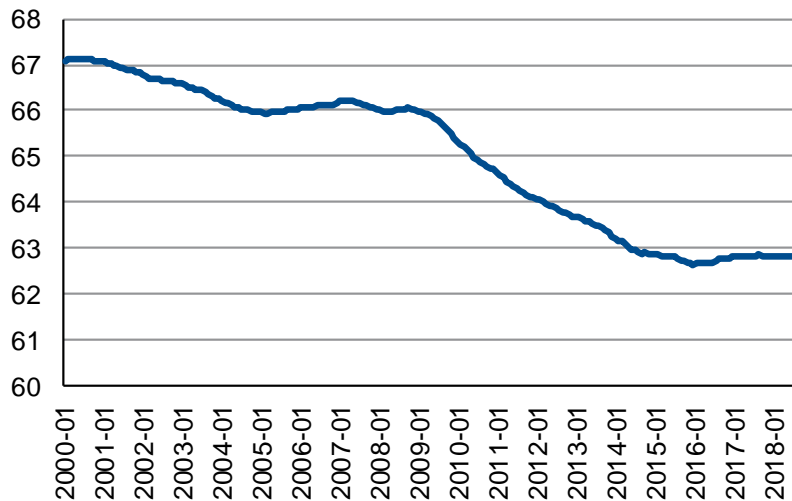
- Lower growth contribution from multi-factor productivity

Why the United States is no longer AAA

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

Labour participation rate

%



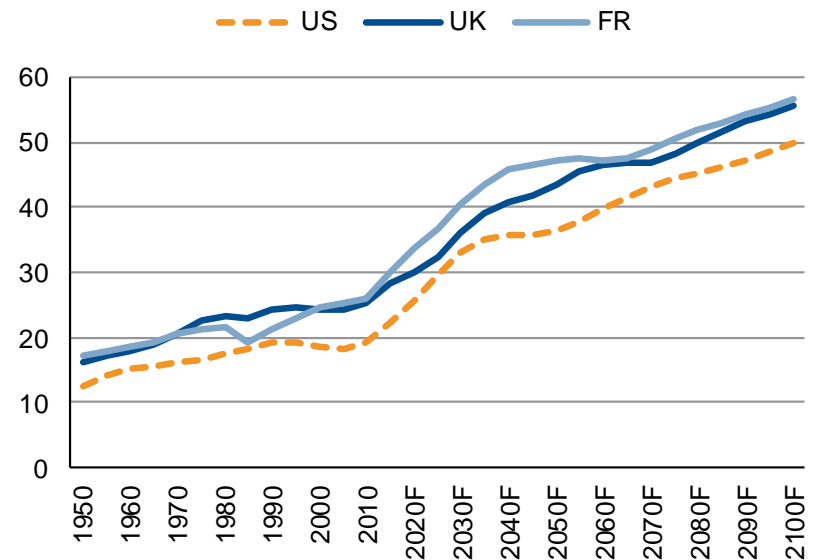
Source: Census Bureau

Causes

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

Dependency ratio

Per 100



Source: UN

Impact

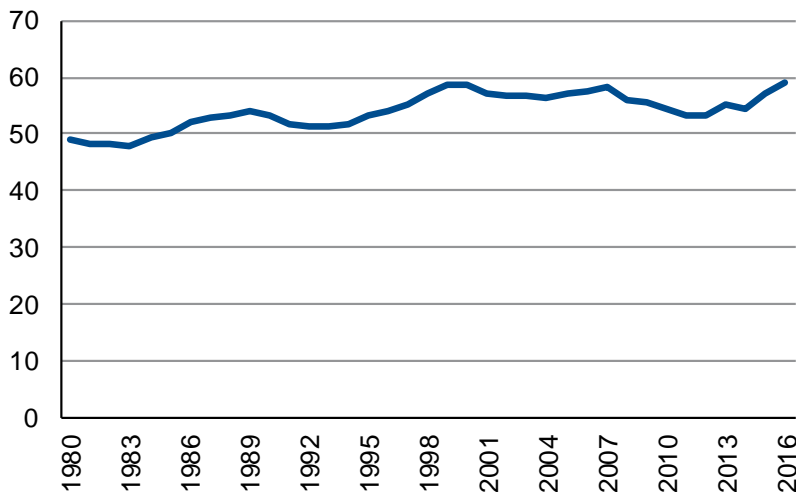
- Lower growth contribution from labour

Why the United States is no longer AAA

Income stagnation and inequality also dampen growth outlook

Income stagnation...

Real median household income, USD ('000s)



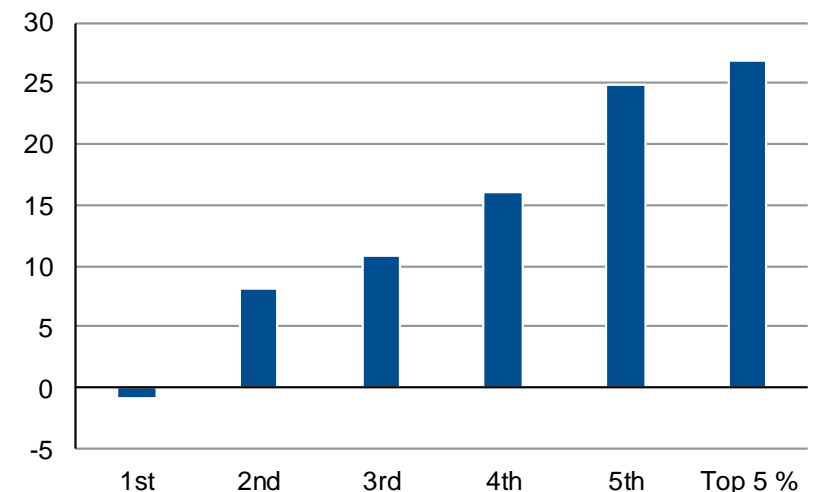
Source: Census Bureau

➤ Causes

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

... and rising income inequality

1995 to 2015, % change per quintile



Source: Census Bureau
NB: Real mean household income

➤ Impact

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



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Credit weaknesses

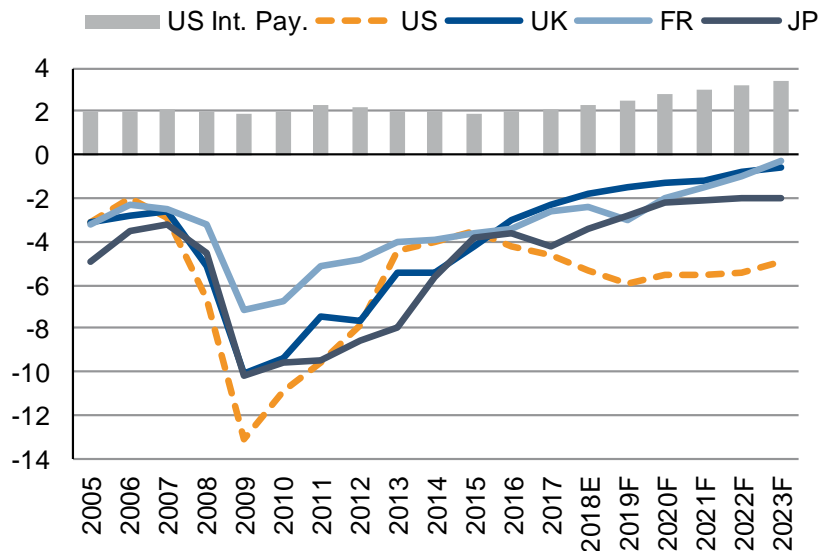
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Why the United States is no longer AAA

Continuous fiscal deficits and rising debt level

Fiscal balances

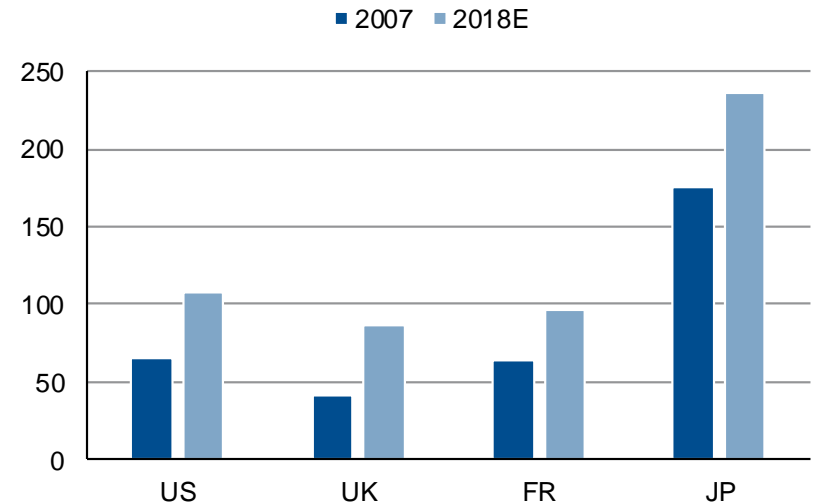
% of GDP



Source: IMF

General government debt

% of GDP



Source: IMF

➤ Strongly pro-cyclical fiscal policies

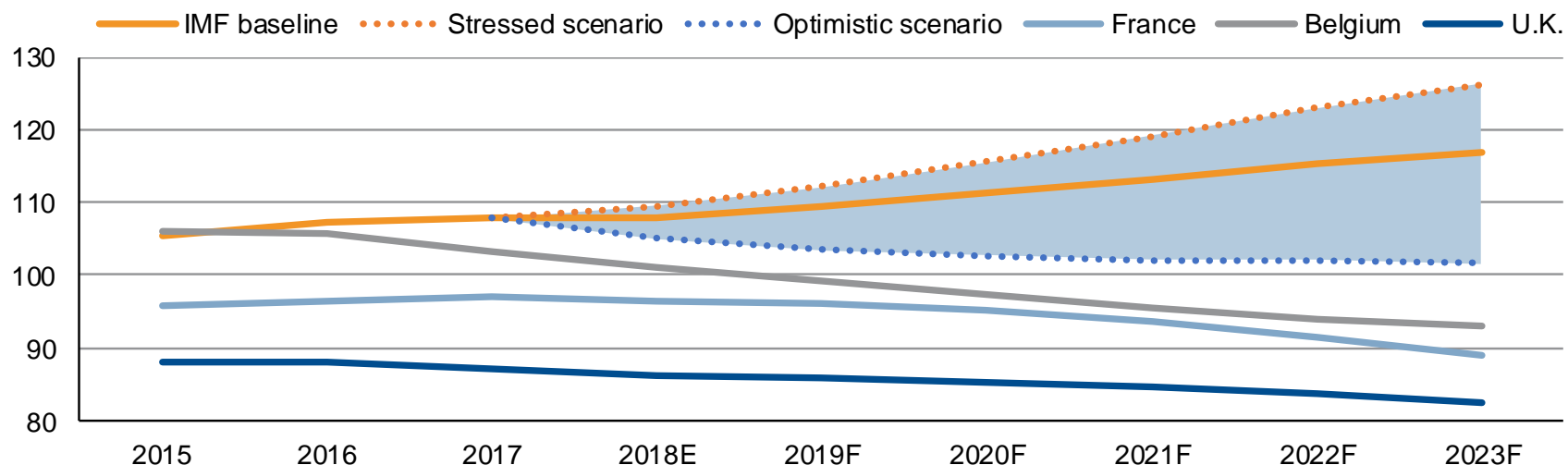
- Tax cuts via the Tax Cuts and Jobs Act
- Increases in defence and non-defence discretionary spending

Why the United States is no longer AAA

Debt sustainability concerns

Debt sustainability analysis

% 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	2013-17	2.2	-2.2	0.4	107.8
IMF baseline	2018-23	2.0	-2.6	0.6	116.9
Optimistic scenario		3.0	-1.6	0.6	101.6
Stressed scenario		1.0	-3.1	1.0	126.3



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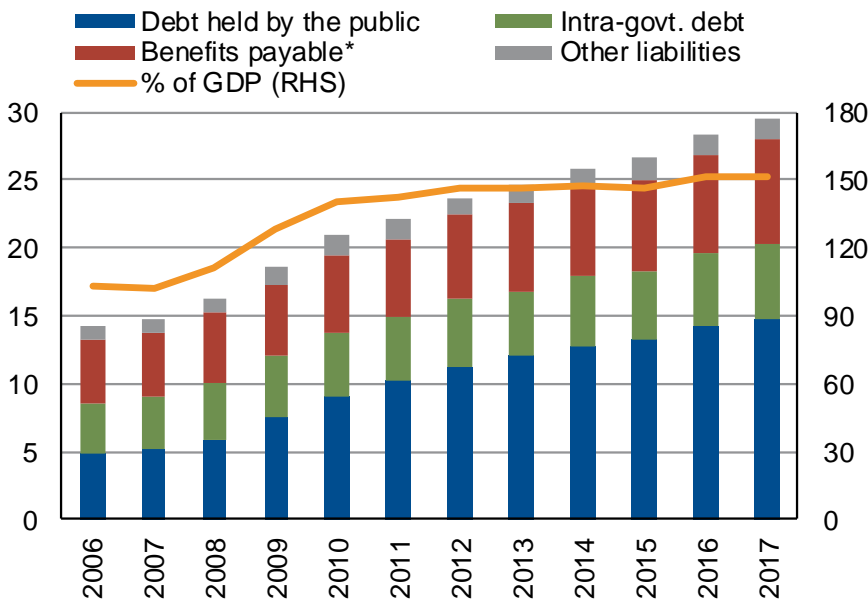
- ✓ Weakening potential growth outlook
- ✓ High and rising public debt burden
- **Elevated contingent liabilities**
- Polarisation and policy uncertainty

Why the United States is no longer AAA

Elevated contingent liabilities

Direct liabilities

USD trn, % of GDP

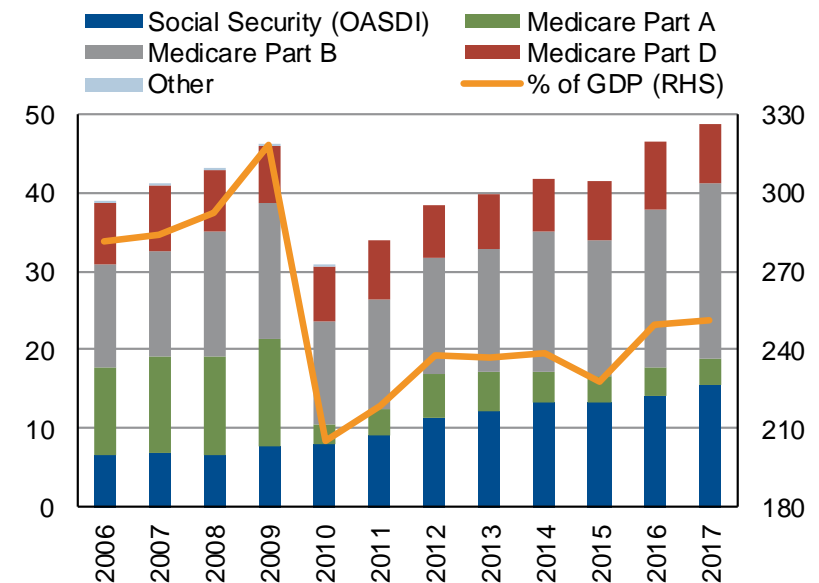


*Federal employees & veteran benefits payable

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

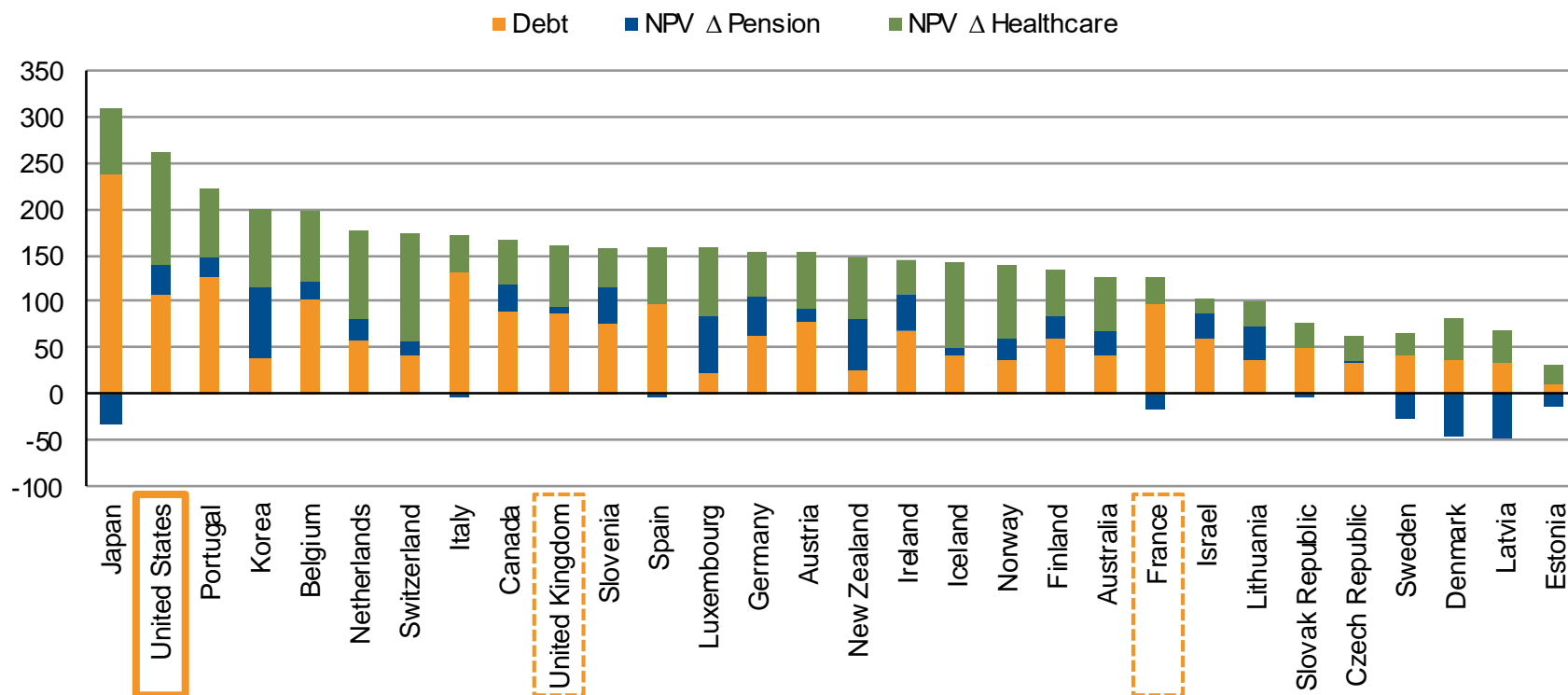
- Urgent need to implement reforms to the numerous benefit programmes

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 April 2018



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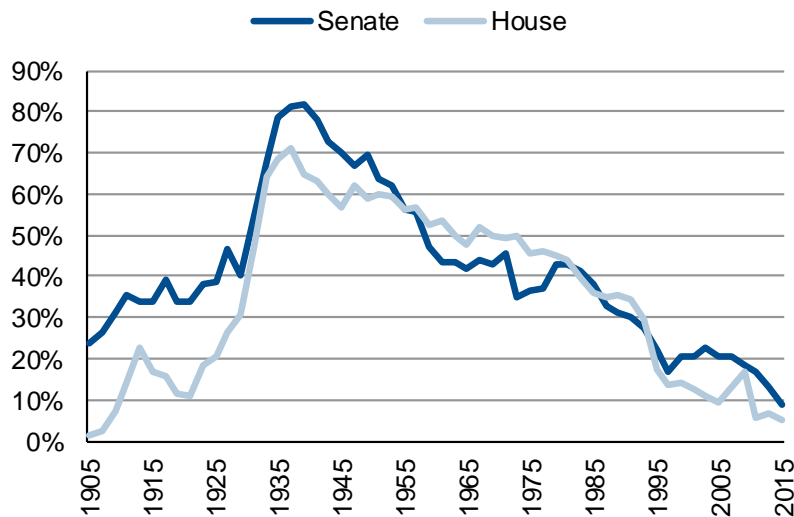
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Why the United States is no longer AAA

Political polarisation at the expense of moderates

Share of moderates

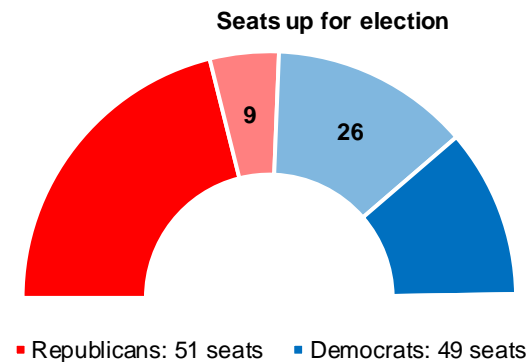
% of total Congress members



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

Congressional elections

Senate seats



Source: US Senate

➤ Political polarisation

- Among the electorate and in Congress

➤ November 2018 elections

- House and Senate elections unlikely to lead to new bipartisan spirit
- Senate most likely to remain with Republican majority; House uncertain

Why the United States is no longer AAA

Policy uncertainty and rising global risks

➤ Political polarisation

- Lack of bipartisan collaboration
- Delays, filibuster



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
- ✓ 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



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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](#)



BERLIN

Lennéstraße 5
10785 Berlin
Germany

+49 30 27891-0
info@scoperatings.com
www.scoperatings.com



FRANKFURT – GERMANY

Eurotheum
Neue Mainzer Straße 66-68
60311 Frankfurt am Main



LONDON – UK

2 Angel Square
EC1V 1NY London



MADRID – SPAIN

Paseo de la Castellana 95
Edificio Torre Europa
28046 Madrid



MILAN – ITALY

Via Paleocapa 7
20121 Milan



OSLO – NORWAY

Haakon VII's gate 6
0161 Oslo



PARIS – FRANCE

33 rue La Fayette
75009 Paris



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