

Fitch Downgrades the USA to AA+

Little, If Any, Effect on Banks, Insurers and Utilities

August 2, 2023

On August 1, 2023, Fitch downgraded the United States of America a notch to AA+ Stable. This action is almost twelve years to the day after S&P downgraded the USA to AA+. Moody's remains at Aaa Stable.

According to Fitch, this downgrade reflects “a steady deterioration in standards of governance over the last 20 years, including on fiscal and debt matters” and lack of a “medium-term fiscal framework” and a “complex budgeting process.” Fitch also notes that “tax cuts and new spending initiatives, have contributed to successive debt increases over the last decade.” Furthermore, “there has been only limited progress in tackling medium-term challenges related to rising social security and Medicare costs due to an aging population.” As to rising debt levels, Fitch remarks that the general government debt to GDP ratio “is over two-and-a-half times higher than the 'AAA' median of 39.3% of GDP and 'AA' median of 44.7% of GDP.” However, Fitch notes the USA’s “large, advanced, well-diversified and high-income economy, supported by a dynamic business environment,” in addition to the fact that “the U.S. dollar is the world's preeminent reserve currency, which gives the government extraordinary financing flexibility.”

Spectrum does not see this rating action by Fitch affecting the creditworthiness of the banks, insurers, utilities, REITs and corporates in which we invest. This downgrade will, however, affect the ratings of US Treasury debt, as well as the ratings of various states and municipalities, US Government-guaranteed debt, and the debt of US Government-Sponsored Enterprises (GSEs) and some corporates.

The USA has been in a bull market for bonds since the end of the high interest rate period in the early 1980s under Federal Reserve Chairman Paul Volker, only ending recently with the sharp interest rate hikes post-COVID to deal with spiking inflation. This long, continuous drop in the cost of borrowing helped mask the true cost of deficit spending. The cost of debt and deficits is becoming clearer, and is being exacerbated by new US Government spending to help fund a transition to renewable energy. That said, and as Fitch notes, the USA possesses several unique strengths. In addition, the USA is not alone, with many other developed and developing nations being saddled with deficits and heavy debt burdens, as well as nearly impossible to remedy demographic challenges.

It has been said the USA eventually does the right thing once all other avenues have been exhausted, and that will likely be the case here. And to repeat Fitch's comments, the dynamic, diversified and creative US economy is an enduring strength, and one not shared by many other nations – including very advanced ones. The USA's demonstrated capacity to create and export value is something to consider carefully. Just look at the market values of the world's largest companies, and where they are located.

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