Debt ceiling debate casts spotlight on US risk profile

Jeremy Weltman Friday, September 08, 2017

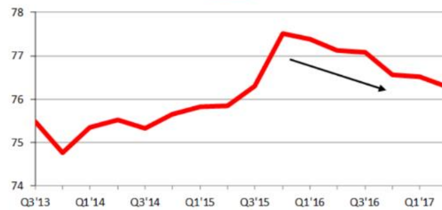
Failure to raise the debt ceiling is unlikely to present an immediate game-changer, but it questions whether the US is a prime, triple-A borrower and what it must do to stop the growing debt-load.

Heap of trouble: Experts believe the growth in federal debt highlights the US's 'inflated' triple-A rating

The US's country risk score of 76.29 out of a maximum 100 points – where a higher score is safer and a lower one is riskier – places it 15th in the global risk rankings, comprising 186 countries worldwide.

The US score has fallen by 18 points since the collapse of Lehman Brothers in 2007 precipitated the sub-prime banking crisis and it has fallen consistently for the past couple of years, after having previously shown some improvement:

Two-year score decline shows rising US risk
ECR scores out of 100 (lower score = higher risk)
Source: Euromoney Country Risk



Many of the US risk factors are favourable, but several have been downgraded this year, including currency stability and the government finances, along with almost all the political risk indicators since the Trump administration took over.

There are declines to structural risk factors, but not capital access where the US scores a maximum 10 points.

Yet by remaining within the second of Euromoney's five tiered categories, it raises the question of whether the US is in fact among the highest quality issuers, with the lowest level of credit risk, as suggested by triple-A ratings from Fitch and Moody's – but not S&P which downgraded to AA+ in 2011.

Immediate problem

The immediate problem is the potential failure to raise the debt ceiling, causing anxiety in the Treasury market. That would deal a shock blow, curtailing government spending and quite plausibly lead to recession.

The US fiscal year starts on October 1 and the pre-existing debt limit will be reached by mid-October, potentially causing a government shutdown, so a decision on the debt ceiling must be achieved soon.

Recent Articles

ECR survey results Q2 2020: Covid-19 crisis increases the economic and political risks for US, Japan, Europe and EMs

ECR survey results Q1 2020: China, US, Italy among 80 countries downgraded by risk analysts

ECR survey results Q4 2019: Risk down for Greece, Russia, Nigeria, but Argentina, Hong Kong, Turkey dive

Even a temporary, technical default could spark mayhem in the financial markets.

However, the US has been here before, and most ECR contributors believe Congress will reach an agreement.

"We already had a big hurricane hitting Texas, we might have another potential devastating one hitting Florida, so my guess is that Congress will not push for trouble in increasing the debt ceiling," says Lorenzo Naranjo at the University of Miami (UM).

Jana Grittersova, an assistant professor at the University of California (UC), agrees, adding: "Otherwise, the US federal government [US Treasury] will have to stop issuing Treasury notes and borrowing from its retirement funds, and might withdraw the funds ($800 billion) deposited with the Federal Reserve.

"The government would have to rely on its incoming revenues to finance current expenses [or default]."

Echoing these views, Delhi-based US economy specialist Sher Mehta says: "The probability of the US defaulting on its debt is low."

Longer-term considerations

So much for the immediate resolution, but what are the longer-term consequences of allowing the US debt to keep on rising?

One argument suggests very little.

The depth, safety and liquidity of the US debt market is all that matters, and the dollar retains its yield-advantages.

"Totalling $19 trillion, the US is the only major developed country that has a substantial debt, but also faces a notable increase in public debt burden," says UC's Grittersova.

"But the US benefits from its strong sovereign credit reputation, and [among other things] from the so-called 'exorbitant privilege': that is, the US is able to borrow at low interest rates because it is the issuer of the international reserve currency."

This seems unlikely to alter, as the trust is there, but UM's Naranjo adds: "Investors have started to realize that the stability of the US debt capacity not only depends on economic factors but also on political ones."

"Investors have started to realize that the stability of the US debt capacity not only depends on economic factors but also on political ones."

It is these political factors showing up in Euromoney's survey that are weighing on the US credit risk profile.

The prospect of higher yields might be avoided – Japan's experience suggests that will be the case – but US fiscal management is lax.

President Donald Trump favours fiscal stimulus, and with the deficit creeping higher it might reach $1 trillion by 2020, says Goldman Sachs, more than doubling the gap over five years.

Factoring in a disconcerting budget scenario, the growth in federal debt and worries about the US Treasury not being able to pay its debt on time, Mehta believes the US triple-A rating is indeed inflated.

Short-term plaster

What seems obvious, but is never really discussed, is the mere fact that when the debt ceiling is raised it is only providing a short-term sticking plaster, and means the government is still accumulating more liabilities.

ECR survey results Q3 2019: US, China, Canada, Mexico punished by tariffs

That points to higher long-term interest rates and a future fiscal adjustment with negative implications for the real economy.

And it means in the long-term the government will have to make financial institutional arrangements to impose stricter budget discipline to prevent these debt ceiling controversies and a debt crisis.

So, is the US a prime issuer?

Compare the US with Canada, lying ninth in the ECR survey on a score of 82.39 out of 100.

Canada has less sovereign debt, a far smaller and, in fact, narrowing government deficit and lower long-term interest-rate projections.

In that light, it becomes evident the US credit rating should be lower than Canada's.

And factoring in another term for Trump, these adverse fiscal metrics might persuade the rating agencies to reassess their views, regardless of the perennial debt-raising debate.

This article was originally published by ECR. To find out more, register for a free trial at Euromoney Country Risk.

EUROMONEY
COUNTRY RISK

The material on this site is for financial institutions, professional investors and their professional advisers. It is for information only. Please read our **Terms & Conditions**, **Privacy Policy** and **Cookies** before using this site.

in