SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Ratings

On August 1, one of three nationally recognized agencies downgraded the U.S. credit rating to AA+ from AAA. Among reasons cited by Fitch Ratings were an expected U.S. fiscal deterioration over the next three years, a high and growing U.S. government debt burden, and continuing government debt ceiling brinksmanship. Standard & Poor's downgraded the U.S. to the same AA+ level in 2011 and assigned a negative credit outlook in 2013. Moody's has maintained its highest credit rating for the U.S. Both Fitch and Moody's view the current U.S. credit outlook as stable. A review of sovereign debt levels, credit trends and relative ratings can provide perspective for economic activity and investing ahead.

PERSPECTIVE

Debt burdens in many developed countries have been on the rise for some time as shown in Chart I. Burden is measured by the ratio of government debt to GDP. Concern arises when this ratio reaches 100. Prior to the Great Recession, the ratio for many countries including the U.S. averaged well below 100. Upward trends emerged thereafter and were exacerbated notably during the pandemic. Sizable fiscal measures were implemented to offset policies that severely constricted economic activity. These measures were financed through debt. The U.S. debt burden has more than doubled from 61 to 133. While OECD projections are for a modest downward trend just ahead, the downgrade by Fitch Ratings reflects skepticism over this outcome.

The credit outlook for a sovereign country reflects many factors including the level of debt burden and its trend. Chart II shows consensus credit outlook trends among the three major rating agencies for well over 100 countries. The overwhelming majority of countries have stable outlooks, including the U.S. As the largest economy in the world, U.S. stability reflects in part broadly diversified sources of activity and a skilled labor force. Rates of real economic growth and inflation compare favorably to those of other developed countries. In addition, its outlook benefits from the U.S. dollar as the world's reserve currency. The U.S. economy has set a favorable high bar on many key measures, but the current high debt burden is not one.

The wide dispersion of country credit ratings is shown in Chart III. Only 9 countries hold the AAA sovereign credit rating: Australia, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden and Switzerland. For every country rated "investment grade" (BBB-rated or higher), another country is rated below, the debt of which is referred to euphemistically as high-yield or "junk". The debt of lower rated countries well could represent investment opportunities, especially if the credit trend outlook is favorable. Vietnam is an example. At the same time, to be monitored is the debt of a higher rated country with a negative trend outlook such as the United Kingdom.

INVESTMENT IMPLICATIONS

The credit rating of the U.S. remains high. Nevertheless, the high level of U.S. debt is a headwind to sustained growth and contained inflation especially as interest rates have risen. Rising government borrowing needs run the risk of increasing borrowing costs for individuals and businesses, thereby reducing overall economic activity. Any decisions by investors, domestic or foreign, to curtail allocations to U.S. government debt could further market dislocations. Addressing the issues that led to the recent credit downgrade should be a U.S. priority.

CHART I

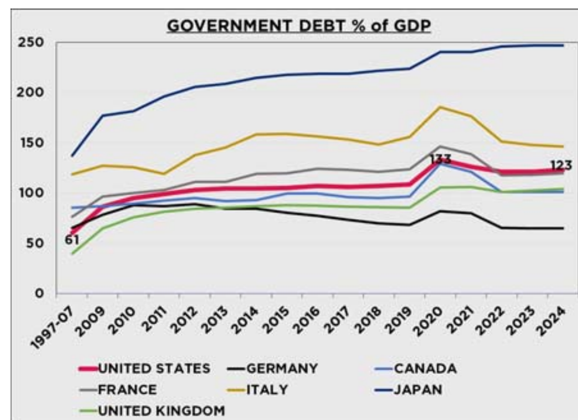


CHART II

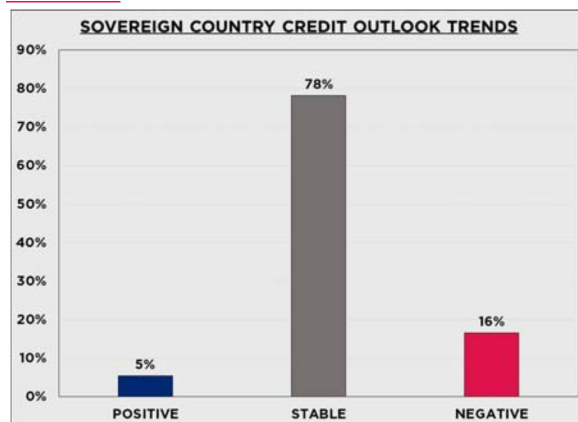
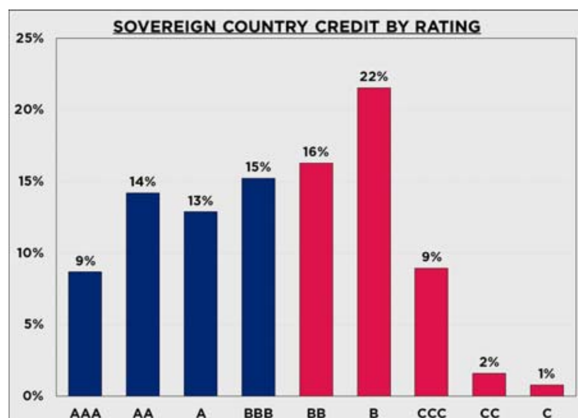


CHART III



©2023 Schlindwein Associates, LLC. All rights reserved. No portion of this report may be reproduced in any form without prior consent. The subject matter contained herein has been derived from sources believed to be reliable and accurate at the time of compilation. Opinions are presented without guarantee.