Fitch Places United States’ ‘AAA' on Rating Watch Negative

On Wednesday, May 24, Fitch Ratings placed the United States’ AAA Long-Term-Foreign-Currency Issuer Default Rating (IDR) on Rating Watch Negative. With a look-back to the S&P AAA downgrade in 2011, we believe this substantive development substantiates our view that, while Treasury cash balances may “in theory” be sufficient to make payments into early June, the market and rating agency implications of moving beyond the June 1 “x-date” may be prohibitive. In our view, Thursday June 1 should be treated by markets and Washington as a “real” deadline.

Further, and as we noted earlier this week, Republicans and Democrats may be much closer to a compromise framework than may be apparent. In fact, we believe details of an agreement may be close to final, with a potential announcement before or during the Memorial Day weekend. In this optimistic scenario, the procedural, review and voting requirements for a final agreement could still extend into next week, though completed by the June 1 deadline.

Notable observations from the Fitch rating action commentary includes:

1. Rationale for the “Ratings Watch Negative” action:
   • Political brinksmanship over the US debt ceiling
   • Failure to tackle medium-term US fiscal challenges
   • Growing longer-term US debt burden

2. Policy actions that Fitch views as “inconsistent with a AAA rating include:
   • Failure to raise the debt ceiling
   • Avoiding default by non-conventional measures such as minting a trillion-dollar coin
   • Invoking the 14th Amendment to avoid default

3. US Governance concerns highlighted by Fitch as relevant to the future direction of the rating:
   • The contested 2020 US Presidential election
   • Repeated political brinkmanship over the debt ceiling
   • Absence of a medium-term fiscal framework
   • Complex US budgeting process

4. Ratings implications of a debt default scenario (unlikely as this may be):
   • Sovereign IDR rating downgrade to Restricted Default (RD)
   • Affected debt securities downgraded to D
   • LT debt securities with payments due within 30 days downgraded to CCC
   • ST Treasury bills maturing within 30 days downgraded to C

As debt ceiling negotiations escalate, short term T-Bills maturing on June 6 briefly surged above 7% on May 24 before tightening closer to 6.50% today, yield levels closer to that of non-investment grade bonds.