Policy Note

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 <u>before or during the Memorial Day weekend</u>.** 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

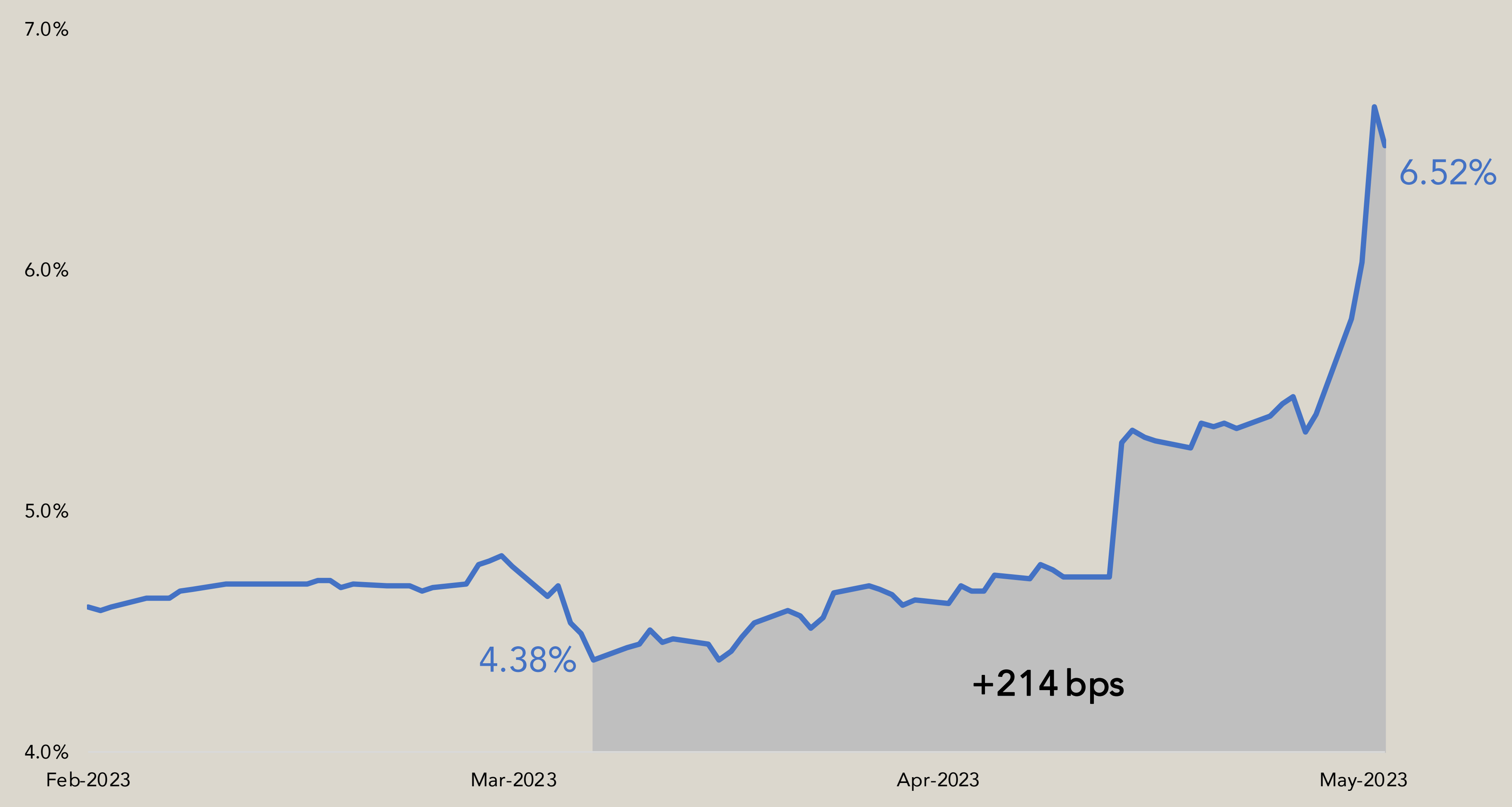
2. **Policy actions that Fitch views as "inconsistent with a AAA rating include:**
   - Failure to raise the debt ceiling
   - Avoiding default by non-conventional measures such as minting a trillion-dollar coin
   - Invoking the 14th Amendment to avoid default

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.

US short-term T-bill yield



Source: (1) Bloomberg. Data as of May 25, 2023.

Global Corporate & Investment Banking Capital Markets Strategy Team



Tom Joyce
Managing Director
Tom.Joyce@mufgsecurities.com
(212) 405-7472

Hailey Orr
Director
Hailey.Orr@mufgsecurities.com
(212) 405-7429

Stephanie Kendal
Associate
Stephanie.Kendal@mufgsecurities.com
(212) 405-7443