MOODY'S

**Rating Action:** **Moody's changes outlook on United States' ratings to negative, affirms Aaa ratings**

10 Nov 2023

New York, November 10, 2023 -- Moody's Investors Service (Moody's) has today changed the outlook on Government of United States of America's (US) ratings to negative from stable and affirmed the long-term issuer and senior unsecured ratings at Aaa.

The key driver of the outlook change to negative is Moody's assessment that the downside risks to the US' fiscal strength have increased and may no longer be fully offset by the sovereign's unique credit strengths. In the context of higher interest rates, without effective fiscal policy measures to reduce government spending or increase revenues, Moody's expects that the US' fiscal deficits will remain very large, significantly weakening debt affordability. Continued political polarization within US Congress raises the risk that successive governments will not be able to reach consensus on a fiscal plan to slow the decline in debt affordability.

The affirmation of the Aaa ratings reflects Moody's view that the US' formidable credit strengths continue to preserve the sovereign's credit profile. First, Moody's expects the US to retain its exceptional economic strength. Further positive growth surprises over the medium term could at least slow the deterioration in debt affordability. Second, the US' institutional and governance strength is also very high, supported in particular by monetary and macroeconomic policy effectiveness. While the adjustment of the US economy and financial sector to higher-for-longer interest rates is underway, policymakers have facilitated the transition through transparent and effective policy. Finally, the unique and central roles of the US dollar and Treasury bond market in the global financial system provide extraordinary funding capacity and significantly reduce the risk of a sudden spiraling of funding costs, which is particularly relevant in the context of high debt levels and weakening debt affordability.

The US' long-term local- and foreign-currency country ceilings remain unchanged at Aaa. The Aaa local-currency ceiling reflects a small government footprint in the economy, relatively predictable and reliable institutions, very low external imbalances and moderate political risks, all of which reduce the risks posed to non-government issuers by government actions or shocks that would commonly affect the government and the private sector. The foreign-currency ceiling at Aaa reflects the country's strong policy effectiveness and open capital account which reduce transfer and convertibility risks to minimal levels.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

RATIONALE FOR OUTLOOK CHANGE TO NEGATIVE FROM STABLE

ABSENT POLICY ACTION, FISCAL STRENGTH WILL DECLINE

The sharp rise in US Treasury bond yields this year has increased pre-existing pressure on US debt affordability. In the absence of policy action, Moody's expects the US' debt affordability to decline further, steadily and significantly, to very weak levels compared to other highly-rated sovereigns, which may offset the sovereign's credit strengths explained below.

Past increases in interest rates by the Federal Reserve will continue to drive the US government's interest bill higher over the next few years. Meanwhile, although the government's revenue base will rise in line with the economy as a whole, in the absence of specific policy action, this will occur at a much slower pace than the rise in interest payments.

Moody's expects federal interest payments relative to revenue and GDP to rise to around 26% and 4.5% by 2033, respectively, from 9.7% and 1.9% in 2022. These projections factor in Moody's expectation of higher-for-longer interest rates, with the average annual 10-year Treasury yield peaking at around 4.5% in 2024 and ultimately settling at aroun 4% over the medium term. The debt affordability forecasts also take into account Moody's expectations that, absent significant policy changes, the federal government will continue to run wide fiscal deficits of around 6% of GDP near term and to around 8% by 2033, the widening being driven by higher interest payments and aging-related entitlement spending. By comparison, deficits averaged around 3.5% of GDP from 2015-2019. Such deficits will raise the US federal government's debt burden to around 120% of GDP by 2033 from 96% in 2022. In turn, a higher debt burden will inflate the interest bill.

For a reserve currency country like the US, debt affordability - more than the debt burden - determines fiscal strength. As a result, in the absence of measures that limit the size of fiscal deficits, fiscal strength will increasingly weigh on the US' credit profile.

FISCAL RISKS ARE EXACERBATED BY ENTRENCHED POLITICAL POLARIZATION UNDERSCORING RISING POLITICAL RISK

At a time of weakening fiscal strength, there is an increased risk that political divisions could further constrain the effectiveness of policymaking by preventing policy action that would slow the deterioration in debt affordability. These risks underscore rising political risk to the US' fiscal position and overall sovereign credit profile.

Recently, multiple events have illustrated the depth of political divisions in the US: renewed debt limit brinkmanship, the first ouster of a House Speaker in US history, prolonged inability of Congress to select a new House Speaker, and increased threats of another partial government shutdown due to Congress' inability to agree on budgetary appropriations. In Moody's view, such political polarization is likely to continue. As a result, building political consensus around a comprehensive, credible multi-year plan to arrest and reverse widening fiscal deficits through measures that would increase government revenue or reform entitlement spending appears extremely difficult.

While the US' Aaa rating takes into account relative weaknesses with regards to the quality of the country's legislative and executive institutions and fiscal policy effectiveness compared to other Aaa-rated sovereigns, there is a risk that these weaknesses take greater credit relevance because the deteriorating debt affordability trend would call for a mor significant and effective fiscal policy response.

In particular, the US' lack of an institutional focus on medium-term fiscal planning, either through legislated fiscal rules aimed at improving the fiscal balance or general bipartisan consensus on the need for fiscal consolidation, is fundamentally different from what is seen in most other Aaa-rated peers such as in Government of Germany (Aaa stable) and Government of Canada (Aaa stable). Meanwhile, the more short-term focus of US fiscal policymaking, along with limited fiscal flexibility - because a very large portion of nondiscretionary budgetary spending is on mandatory entitlement programs and debt service (around 75% of total outlays), exacerbates already fractious bipartisan politics around a relatively disjointed and disruptive budget process. As annual debt service costs continue to rise, fiscal flexibility will diminish even further.

RATIONALE FOR AFFIRMATION OF Aaa RATINGS

The affirmation of the Aaa ratings reflects Moody's view that, despite rising fiscal pressures and political risk, the US' formidable credit strengths continue to preserve the sovereign's rating, in particular exceptional economic strength, high institutional and governance strength, and the unique and central roles of the US dollar and Treasury bond market in the global financial system.

The US is the world's largest economy and the center of global trade and finance, supported by flexible markets and open trade and financial regimes. The US is the only sovereign to which Moody's assigns an economic strength score of "aaa," the highest score possible, reflecting the sheer scale of the economy (nominal GDP was nearly $26 trillion in 2022), consistent resilience to shocks, and the unique role that the economy plays globally. The resilience of the economy has again been demonstrated in recent years. Comparatively rapid productivity growth and a high degree of technological innovation reinforce the US economy's competitiveness and contribute to GDP growth rates that outpace those of many high-income countries, which Moody's expects to continue. Moody's also expects the US economy and the sovereign's credit profile to remain resilient to shocks, including from current challenges related to inflation and tightening financial conditions. US GDP growth could exceed Moody's baseline expectations, if the economy is able to maximize productivity benefits from new and emerging technologies. In turn, positive growth surprises would support government revenue, even if fiscal policy remained unchanged, thereby helping to slow the deterioration in debt affordability.

Moody's expects US institutions, including the Federal Reserve, to effectively manage these challenges. More generally, the strength of US institutions and governance provides strong support to the economy and its resilience to shocks, underpinned by independent institutions, a high regard for the rule of law, constitutional separation of powers and high levels of transparency. In particular, US monetary and macroeconomic policy has demonstrated a long history of effectiveness. While the adjustment of the US economy and financial sector to higher-for-longer interest rate is underway, policymakers have facilitated the transition through transparent and effective implementation of policies. Moody's expects the Federal Reserve to ultimately achieve its dual mandate, although through a process that will result in a more pronounced slowdown in demand and may involve some pockets of banking sector stress in the near term.

As mentioned above, other aspects of policymaking are less robust than in many Aaa-rated peers, particularly with regard to fiscal policy. This is reflected in Moody's weaker assessments of quality of legislative and executive institutions, and fiscal policy effectiveness.

Due to the global dominance of the dollar as a reserve currency, Moody's considers the US to have significantly higher capacity to carry a larger debt burden than other sovereigns globally. While by some metrics, the role of the US dollar in global trade and financial transactions has diminished, its dominance remains extraordinary. Today, the US dollar is the world's preeminent reserve currency, with around 58% of global foreign exchange reserves held in dollar-denominated assets as of the end of 2022. Meanwhile, the US Treasury bond market is by far the deepest and most liquid government securities market in the world. A significant proportion of Treasury securities are held by non-residents, reflecting their preeminent safe-haven status, which has been confirmed through recent global shocks. The global benchmark roles of the US dollar and Treasury bond market insulate the US sovereign from many downside risks. In particular, they remove all but the most extreme liquidity and balance of payments risks, despite a rising debt burden, by removing the risk of spiraling debt costs.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

The US' ESG Credit Impact Score is CIS-2, indicating that ESG considerations are not material to the rating. For the US, this reflects moderately negative exposure to social risks and a strong governance profile that supports the sovereign's resilience and capacity to respond to shocks.

At the federal level, the US' exposure to environmental risks is neutral-to-low (E-2) reflecting the country's relatively limited exposure across all categories, including physical climate risk, carbon transition, natural resources management, waste and pollution.

The US' exposure to social risks is moderately negative (S-3), driven mainly by demographics and socioeconomic inequalities. Over the longer term, an aging population and rising healthcare costs will increase age-related entitlement spending and contribute to increased pressures on the sovereign's weakening fiscal position. If left unaddressed, relatively high income inequality, along with wealth and opportunity disparities, could exacerbate political divisions and further increase political risks and social unrest, contributing to a faster decline in US fiscal strength.

The US' very strong institutions and governance profile (G-1) supports its overall sovereign credit rating and is reflecte in both a strong institutional framework and demonstrated policy effectiveness, especially with regards to monetary and macroeconomic policy.

SUMMARY OF MINUTES FROM RATING COMMITTEE

GDP per capita (PPP basis, US$): 76,343 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 1.9% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 6.5% (2022)

Gen. Gov. Financial Balance/GDP: -4.4% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: -3.8% (2022) (also known as External Balance)

External debt/GDP: 90.3% (2022)

Economic resiliency: aa1

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 07 November 2023, a rating committee was called to discuss the rating of the United States of America, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has materially changed. The issuer's susceptibility to political event risk has materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The US' rating is Aaa, which is already at the top of Moody's rating scale. An upgrade to a higher rating is therefore not possible. Moody's could change the outlook back to stable if it expected the government to adopt fiscal policy measures that helped to slow the expected deterioration in debt affordability and decline in fiscal strength, for example by contributing to a structural narrowing of primary fiscal deficits through increased government revenues or reduced spending. The outlook may also change to stable if it became increasingly likely that the US' growth potential is durabl higher than Moody's currently estimates, which would boost government revenue and slow the deterioration in debt affordability.

The US rating would face downward pressure if Moody's were to conclude that policymakers were unlikely to respond to the country's growing fiscal challenges over the medium term, through measures to increase government revenue or structurally reduce spending to slow the deterioration in debt affordability. Under this scenario, a downgrade would reflect higher confidence that the deterioration in debt affordability and fiscal strength was likely to undermine the US' economic strength and/or the role of the US dollar and Treasury bond market. A weakening of institutions and governance strength, such as through deterioration in monetary and macroeconomic policy effectiveness or the quality of legislative and judicial institutions, could also strain the rating. Such an outcome would weigh on the sovereign credit profile, particularly if it were to reduce confidence that the US dollar and Treasury bond market will retain their unique and central roles in the global financial system, which currently bring considerable support to the rating.

LIST OF AFFECTED RATINGS

..Issuer: United States of America, Government of

Affirmations:

.... Issuer Rating, Affirmed Aaa

.... Senior Unsecured Notes, Affirmed Aaa

Outlook Actions:

....Outlook, Changed to Negative from Stable

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

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