FitchRatings

Fitch Affirms United States at 'AAA'; Outlook Revised to Negative

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Fitch Ratings-London/New York-28 November 2011: Fitch Ratings has today affirmed the United States (U.S.) Long-term foreign and local currency Issuer Default Ratings (IDRs) and Fitch-rated U.S. Treasury security ratings at 'AAA'. Fitch has also simultaneously affirmed the U.S. Country Ceiling at 'AAA' and the Short-term foreign currency rating at 'F1+'. The rating Outlook on the Long-term rating is revised to Negative from Stable.

The affirmation of the U.S. 'AAA' sovereign rating reflects still strong economic and credit fundamentals. U.S. sovereign liabilities, both the dollar and Treasury securities, remain the global benchmark and accordingly the U.S. credit profile benefits from unparalleled financing flexibility and enhanced debt tolerance, even relative to other large 'AAA'-rated sovereigns. The U.S. dollar's status as the pre-eminent global reserve currency and depth of the U.S. Treasury market render financing risks minimal and underpin a low cost of fiscal funding.

The U.S. economy remains one of the most productive in the world, reflected in levels of income per head that are substantially higher than that of major 'AAA' peers. Fitch's current assessment is that the U.S. economic recovery will regain momentum in the latter half of next year and into 2013, and that a period of above trend growth will be subsequently followed by growth of at least 2 and 1/4% over the long term. However, Fitch recognises that there is considerable uncertainty surrounding the economy's potential output and scope for a period of above trend economic growth. The longer productive capacity remains idle and unemployment high, the greater the likelihood that the loss of output (and tax receipts) is greater than currently estimated, with negative implications for the medium to long-term fiscal outlook.

Fitch's revised fiscal projections envisage federal debt held by the public exceeding 90% of national income (GDP) and debt interest consuming more than 20% of tax revenues by the end of the decade, and including the debt of state and local governments - gross general government debt will reach 110% of GDP over the same period. In Fitch's opinion, such a level of government indebtedness would no longer be consistent with the U.S. retaining its 'AAA' status despite its underlying strengths. Such high levels of indebtedness would limit the scope for counter-cyclical fiscal policies and the U.S. government's ability to respond to future economic and financial crises.

The Negative Outlook reflects Fitch's declining confidence that timely fiscal measures necessary to place U.S. public finances on a sustainable path and secure the U.S. 'AAA' sovereign rating will be forthcoming following failure of the Congressional Joint Select Committee on Deficit Reduction (JSCDR) to agree at least USD1.2 trillion of measures to cut the federal budget deficit over the next 10 years as mandated under the Budget Control Act passed in August (BCA 2011).

The failure of the JSCDR underlines the challenge of securing broad-based consensus on how to reduce the out-sized federal budget deficit. Agreement and implementation in 2013 of a credible medium-term deficit reduction plan that would stabilise government indebtedness in the latter half of the decade would relieve downward pressure on the U.S. sovereign ratings, though by postponing the difficult decisions on tax and spending until after forthcoming Congressional and Presidential elections, the scale and pace of required deficit reduction will consequently be greater. Conversely, failure to reach agreement in 2013 on a credible deficit reduction plan and a worsening of the economic and fiscal outlook would likely result in a downgrade of the U.S. sovereign rating.

The inability of the JSCDR to reach agreement will trigger USD1 trillion of automatic across-the-board cuts in mostly discretionary spending, split evenly between defence and non-defence programmes, beginning in January 2013. If implemented alongside the caps on discretionary spending specified under the BCA 2011, discretionary spending will decline to an historic low of 5.5% of GDP by 2021. Further deficit reduction will not be credible if it relies solely on further cuts in discretionary spending rather than reform to entitlements and taxation.

The Negative Outlook indicates a slightly greater than 50% chance of a downgrade over a two-year horizon. Fitch will shortly publish its revised economic and fiscal projections for the U.S. and will conduct a further review of its sovereign ratings in 2012. However, in the absence of material adverse shocks, Fitch does not expect to resolve the Negative Outlook until late 2013, taking into account any deficit-reduction strategy that emerges after Congressional and Presidential elections.

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Additional information is available at 'www.fitchratings.com'. The ratings above were unsolicited and have been provided by Fitch as a service to investors.

Applicable Criteria and Related Research:
--'Sovereign Rating Methodology', (Aug. 15, 2011);
--'Rating Linkages to the U.S. Sovereign Rating' (July 18, 2011);
--'U.S. Treasuries Expected to Remain Global Benchmark' (July 27, 2011).

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