20 May 2022 | Sovereign and Public Sector

United States of America
Rating Report

AA

STABLE OUTLOOK

Credit strengths	Credit challenges
• Large, diversified and wealthy economy	• Elevated level of public debt
• US dollar as leading reserve currency	• Misuse of debt ceiling instrument
• Globally leading economic institutions	• Rising political polarisation
• Well-capitalised banks; deep markets	• Financial-market vulnerabilities

Rating rationale:

Wealthy, competitive and diversified economy: the US benefits from the largest economy globally, with high wealth levels and significant economic diversification underpinning resilience to shocks. Its leadership in innovation is exceptional, supporting a medium-run growth outlook.

US dollar status of global reserve currency: the US dollar's role as a global reserve currency carries unparalleled advantages regarding funding flexibility, especially relevant during crises, reducing long-run debt sustainability risk from the debt build-up since 2020.

Sound economic institutions: the US benefits from a strong and resilient institutional framework protecting accountability and transparency of fiscal management. The credit ratings are supported by strong monetary and financial supervisory institutions, abetting macroeconomic stability.

Well-capitalised financial system: the US benefits from one of the world's most advanced and deep capital markets. The banking system is well capitalised with profitability recovering, while a strong financial-oversight framework anchors sound macroprudential policy making.

Ratings challenges include: i) challenging long-run public finances, with fiscal deficits remaining elevated and debt-to-GDP near record highs; ii) risks associated with the misuse of the debt-ceiling instrument; iii) political polarisation, hampering efficacy of economic policy making; iv) financial-system risk; and v) a weak external sector.

United States' sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		+2/3	
Public Finance Risk		25%	bb-		-1/3	
External Economic Risk		10%	ccc		+1/3	
Financial Stability Risk		10%	a		+1/3	AA
ESG Risk	Environmental Risk	5%	aa		0	
	Social Risk	5%	bb-		-1/3	
	Governance Risk	10%	a+		-1/3	
Overall outcome		a		+3	0	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• Removal of debt-ceiling instrument	• Inappropriate use of debt-limit instrument
• Growth potential increases and the public debt ratio stabilises through the cycle	• Weakening of public finance outlook
• Improvements in governance and reduction of polarisation	• Weakening in governance
	• Significantly reduced role for the US dollar as global reserve currency

Ratings and Outlook

Foreign currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

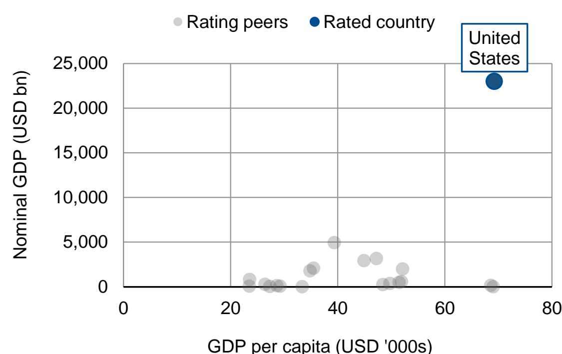
Domestic Economic Risks

- **Growth outlook:** The US economy had a relatively moderate contraction of 3.4% during 2020, less severe than that of peer economies and reflecting the largest discretionary fiscal response to the crisis of the world. The economic recovery was robust in 2021, with growth reaching 5.7% in the year. After strong growth of 1.7% QoQ in 2021 Q4, the US economy surprisingly contracted 0.4% in 2022 Q1, following an increase of imports and slowdown of the build-up of inventories, though with underlying momentum of private consumption and investment remaining strong. The US economy stands to be less affected by consequences of the Russia-Ukraine war than most economies, due to marginal direct trade exposure with conflicting parties and position as a more modest net energy importer. We expect growth to moderate, to 2.3% in 2022 and 2.5% in 2023 (reflecting cuts from 3.5% and 2.8% from our December 2021 economic forecasts), before gradually converging to a long-run potential rate of 2.0%. Favourable demographic and productivity trends compared with peers support a long-run growth outlook.
- **Inflation and monetary policy:** Inflation accelerated sharply since early 2021, with core personal consumption expenditure (PCE) price rises of 5.2% YoY in April 2022, slightly off a March 2022 level of 5.3%. Headline PCE rose to 6.6% in April, from 6.3% in March. Nominal wages have recorded robust growth at the same time (4.6% YoY in April), amid tightening labour markets, albeit at a slower pace than consumer prices, resulting in a decline of real wages. In response to inflationary pressure, the Federal Reserve has raised its policy rate by a cumulative 75bps since March this year and concluded net asset purchases early March. It has also laid out plans to initiate quantitative tightening starting 1 June 2022 and we expect rate hikes to 2.5-2.75% by end-2022 and 3-3.25% by end-2023.
- **Labour market:** The economic rebound was accompanied by a strong recovery in labour markets, allowing for sharp reduction in the unemployment rate, to a near-five-decade-low of 3.6% in April 2022 from a peak slightly under 15% as of April 2020. We see the unemployment rate averaging 3.7% in 2022 before 3.5% in 2023 – below the Federal Reserve's estimate of long-run unemployment of 4%. The labour market has grown increasingly tight over recent months, with record high job openings and workers quitting positions. However, labour-force participation remained subdued, at 62.2%, or 1.2pps under February 2020 peaks, indicating shortfalls of labour supply at a time when labour demand stands near historic highs.

Overview of Scope's qualitative assessments for United States' *Domestic Economic Risks*

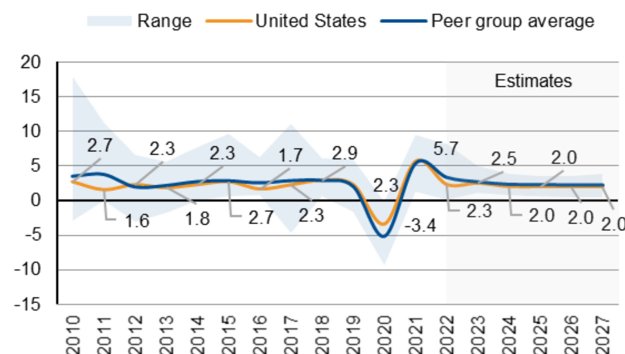
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential, supported by current structural reforms and investment
	Monetary policy framework	Strong	+1/3	Federal Reserve is a highly credible and effective central bank; independent monetary policy
	Macro-economic stability and sustainability	Strong	+1/3	Competitive and very diversified economy; flexible labour market

Nominal GDP and GDP per capita, USD '000s



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

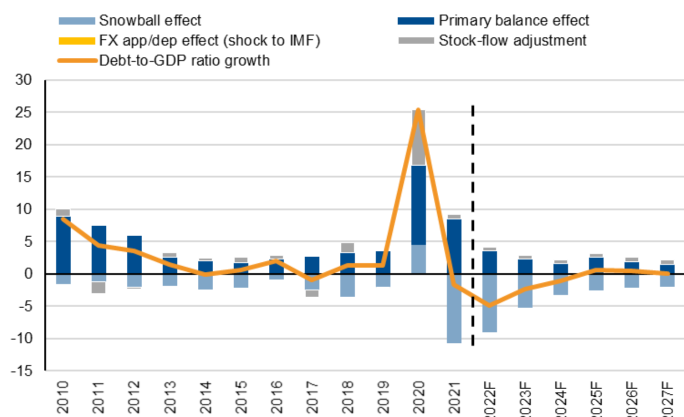
Public Finance Risks

- **Fiscal outlook:** The US government recorded high general government deficits already prior to the Covid-19 crisis, averaging 4.7% of GDP over 2010-19, despite strong economic growth over the period. Economic consequences of the Covid-19 pandemic and implementation of significant government fiscal support packages caused the headline deficit to jump to 14.5% of GDP in 2020. The strong economic rebound allowed for faster-than-expected deficit decline in 2021, to 10.2% of GDP, although remaining at an elevated level. We expect the economic recovery and phase-out of pandemic-related fiscal measures to support further reduction of the general government deficit, to 5.3% of GDP in 2022, before averaging a still elevated 5.0% of GDP over 2023-27, in part reflecting roll-out of the USD 1trn infrastructure bill passed in 2021.
- **Debt trajectory:** After spiking over 25pps in 2020, to 134.2%, the US' general government debt ratio declined moderately last year due to economic recovery, to 132.6%. We expect this ratio to drop further this year despite economic slowdown, to 128% – trimmed by elevated inflation, before edging sideways to around 127% by 2027. Additionally, contingent liabilities constitute a significant challenge to fiscal sustainability. The IMF estimates the net present value of healthcare and pensions spending changes of nearly 148% of GDP over 2021-50, the most significant rise projected for any advanced economy globally.
- **Debt profile & market access:** The US benefits from its status as the global benchmark issuer, anchoring unparalleled funding flexibility, including, importantly, during periods of global economic crisis. Annual gross financing needs are expected to remain elevated, however, of around or above 30% of GDP medium run. High financing requirements associate with a comparatively low average maturity of treasury securities of circa 5.9 years. Financing conditions of the United States remain accommodative on historical basis, despite 10-year funding yields having risen circa 230bps since August 2020 to 2.85% at time of writing, driven by an adverse inflation outlook and expectation of further monetary policy tightening.

Overview of Scope's qualitative assessments for United States' *Public Finance Risks*

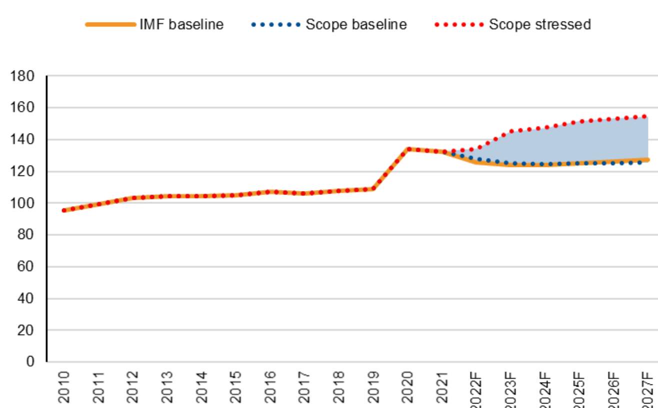
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Fiscal policy framework	Weak	-1/3	Weak fiscal framework including politicisation of the debt limit
	Debt sustainability	Weak	-1/3	Elevated debt ratio and challenges to long-run debt sustainability; high contingent liabilities from pensions and healthcare obligations
	Debt profile and market access	Strong	+1/3	Global benchmark issuer status and excellent government market access; below-average maturity of debt and elevated gross financing needs

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

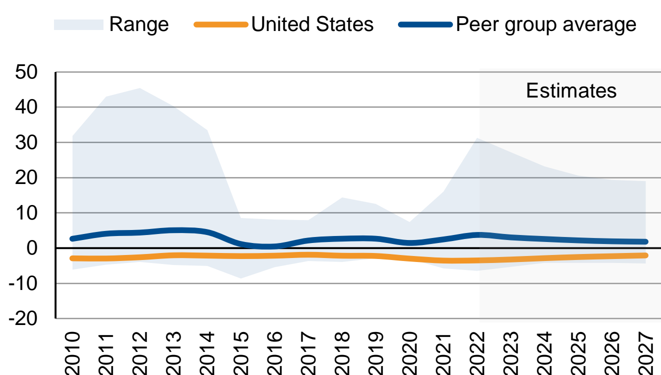
External Economic Risks

- **Current account:** The US economy's external position is characterised by annual current account deficits, which averaged 2.1% of GDP pre-crisis over 2015-19. The current account deficit widened to 3.6% of GDP in 2021, given strong domestic demand raised by budget stimulus. Exports of goods had returned to above pre-pandemic levels by 2H-2021, however, owing to strong performance of industrial goods and food & beverages exports, while services exports remained subdued, largely owing to weak tourism receipts, which still stood at less than half of pre-pandemic levels. Direct trade exposure to Russia and Ukraine is moderate but the war should nevertheless weigh on trade performance due to the weaker demand of EU partners. The IMF expects the current account deficit to improve gradually over the coming years, moderating to a near 2% of GDP deficit by 2027.
- **External position:** Gross external debt as a share of GDP increased slightly from 96% as of end-2019 to 102% by end-2021. One third of external debt is owed by the general government sector with only a moderate share reflecting financial-sector liabilities (15%). Around two thirds of external debt is on long-term basis. The US is a net debtor economy, with a net international investment liability position having nearly doubled to 79% of GDP by end-2021, from 39% in 2017.
- **Resilience to external shocks:** External-sector vulnerabilities are mitigated by the dollar's global reserve currency status. On basis of the IMF's COFER data, around 59% of the world's aggregate foreign-exchange reserves were allocated in dollar as of Q4 2021, well above allocations in euro (20.6%) or yen (5.6%), although significantly below levels of dollar hegemony as of 2000 (reflecting 71% of global allocated reserves then). Long-run challenges to the dollar-based global monetary order could stem out of side-effects of the present freeze of Russia's foreign-currency reserves as well as from roll-out of China's Cross-Border Interbank Payment System, although we do not deem such factors as constituting material risks to dominance of dollar over any near-term forecast horizon.

Overview of Scope's qualitative assessments for United States' *External Economic Risks*

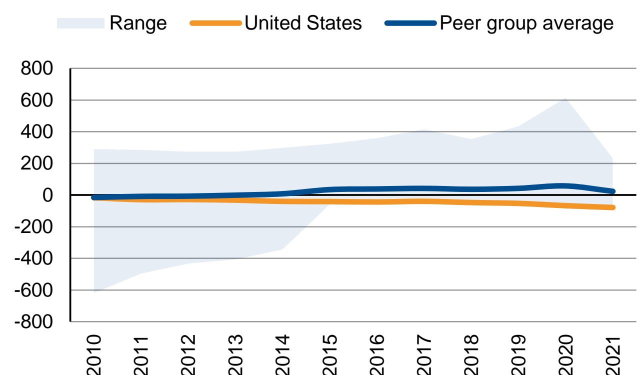
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Neutral	0	Diversified export base; moderate current account deficits
	External debt structure	Strong	+1/3	Relatively low external debt; most foreign assets in foreign currency, whereas liabilities are in US dollar
	Resilience to short-term shocks	Neutral	0	US dollar as a global reserve currency shields against short-term external shocks

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

Net international investment position (NIIP), % of GDP



Source: IMF WEO, Scope Ratings GmbH

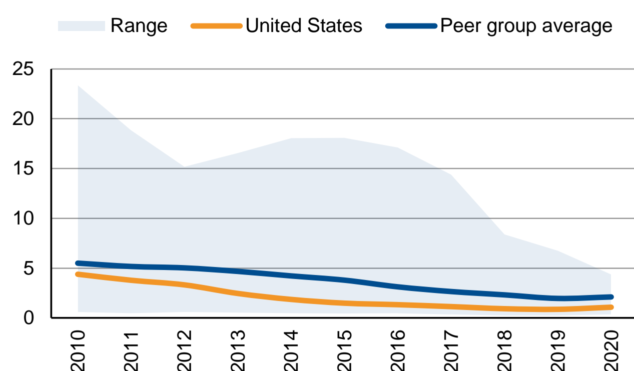
Financial Stability Risks

- **Banking sector:** The United States benefits from one of the most advanced and deep financial markets globally. Banks are soundly positioned, with adequate capitalisation (aggregate tier 1 capital ratio of 14.8% of risk-weighted assets as of Q4 2021) and high asset quality as reflected in a non-performing loan (NPL) ratio of under 1% entering the present economic slowdown. According to the Federal Reserve's latest stress testing, all 23 large banks' capital adequacy proved resilient under a severe stressed scenario. Profitability has returned to pre-pandemic levels and remains stronger than systems of similarly-rated European countries. Challenges with relation to compressed interest margins remain but ought to ease medium run as interest rates rise. Funding risks are limited, although structural vulnerabilities persist in some types of money market funds as well as in bond and bank loan mutual funds. Direct exposures to the Russian financial system are small, but US credit institutions could face additional risk from heightened market volatility as well as from weakening of the global economic outlook.
- **Private debt:** Non-financial private debt levels are elevated: 160% of GDP as of Q3 2021, up from 151% five years before. While this composite level might compare favourably against those of most peer economies, household debt, of 81% of GDP, is comparatively high. Compared to their pre-crisis levels, debt service to income ratios of the household sector have moderately improved, to 7.5% as of 2021 Q3 (-0.5pps), with debt service to income similarly dropping as regards the non-financial corporate sector, to 40.4%, after peaking during the Covid-19 crisis at 42.9% in Q2 2020.
- **Financial imbalances:** The escalation of the war in the Ukraine and subsequent deployment of western sanctions against Russia, which came at a time of near-historic asset-price valuations, resulted in sharp rise of volatility within bubbly US financial markets. Housing prices have continued to rise rapidly, however, over recent months, under a context of strong housing demand and constrained supply. Mortgage loan-to-value and debt-to-income ratios have not deteriorated, which indicate housing price increases were not driven by speculative activity.

Overview of Scope's qualitative assessments for United States' *Financial Stability Risks*

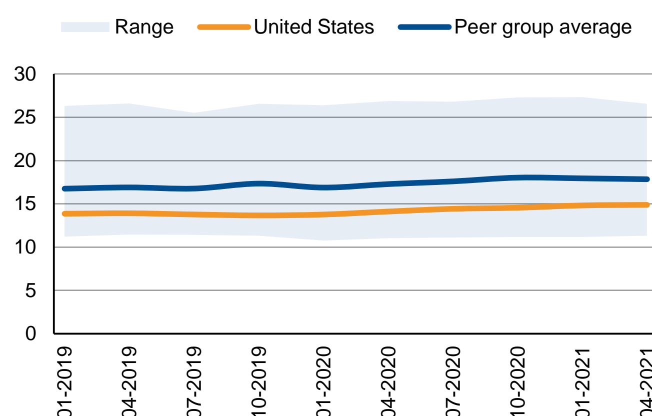
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Banking sector performance	Neutral	0	Efficient banking sector with sizeable capital buffers and strong asset quality; recovering profitability
	Banking sector oversight	Strong	+1/3	Sophisticated financial-regulatory system and strong financial governance framework under the Federal Reserve Board, Federal Deposit Insurance Corporation and Securities and Exchange Commission
	Financial imbalances	Neutral	0	Corporate debt risks; significant financial risks from current asset-price volatility amid Federal Reserve rate hike cycle

Non-performing loans (NPLs), % of total loans



Source: IMF WEO, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF WEO, Scope Ratings GmbH

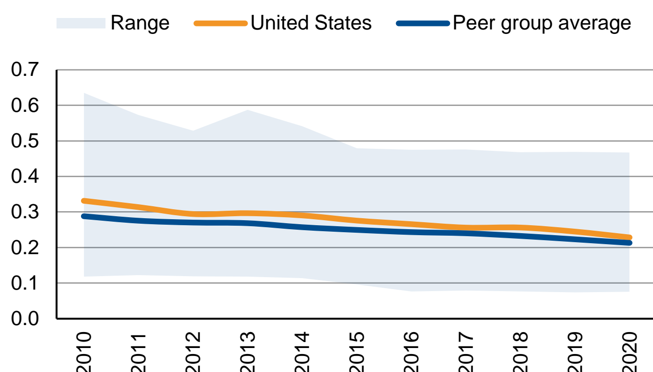
ESG Risks

- **Environment:** The US faces significant costs amid transition to a greener economic model, as the most carbon intensive economy of its ratings peer group. The United States is, moreover, vulnerable to natural disasters such as earthquakes, drought, floods, hurricane and wildfires. Under the Joseph R. Biden administration, the United States re-joined the Paris Climate Accords and committed to significant investment and measures addressing climate change and promotion of the green economy. The Biden administration targets 50-52% reductions from 2005 levels as far as net greenhouse gas emissions by 2030, a carbon-free power sector by 2035 and net-zero emissions by 2050, via electrification of buildings as well as energy and climate investment. Nevertheless, absent introduction of a price for carbon, government emissions objectives might prove hard to achieve and costly for government finances.
- **Social:** Troubling social outcomes challenge long-run political and macroeconomic stability. These include decline of labour-force participation since the Covid-19 crisis, a polarised distribution of income and wealth, long-standing racial disparities and elevated poverty. Moreover, the Covid-19 crisis exposed weaknesses under the healthcare system, which is the most expensive of the world and presents unequal access to and quality of care. The administration's Build Back Better Act specifically targets many social-system weaknesses although the bill has been blocked in the Senate. Ageing dynamics, furthermore, pose a challenge, albeit comparing favourably against those of many peer advanced economies.
- **Governance:** The US benefits from strong democratic institutions, with transparent and accountable governance frameworks and processes. Nevertheless, political polarisation increasingly challenges tolerance for political compromise and the government's capacity to effectually execute reform. President Biden's majority within the Senate has proven fragile, causing his administration to suffer substantive legislative setbacks, such as the shelving of the Build Back Better Act. November 2022 midterm elections appear likely to see Democrats' loss of control of Congress, which could result in political gridlock ahead of 2024 presidential and congressional elections.

Overview of Scope's qualitative assessments for United States' *ESG Risks*

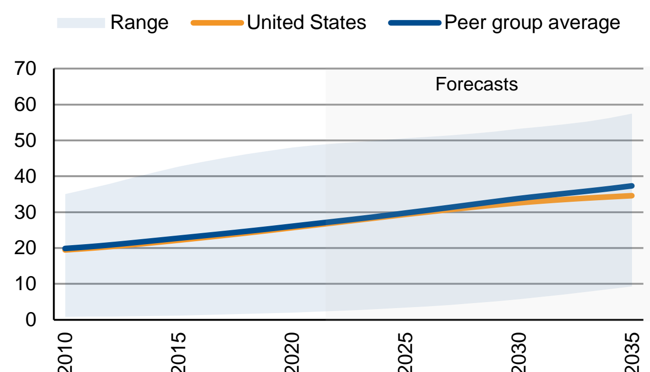
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental risks	Neutral	0	Significant transition risks balanced by current government's ambitious environmental policy initiatives; natural disaster risk exposure
	Social risks	Weak	-1/3	Erosion of socio-economic mobility and rising income and wealth inequality; lessening demographic dividend
	Institutional and political risks	Weak	-1/3	Resilient democratic institutions despite erosion of institutional strengths under Trump presidency; polarisation prevents bipartisan problem-solving; risk of gridlock after 2022 elections and institutional risk after 2024 elections

CO_2 emissions per GDP, $mtCO_2e$



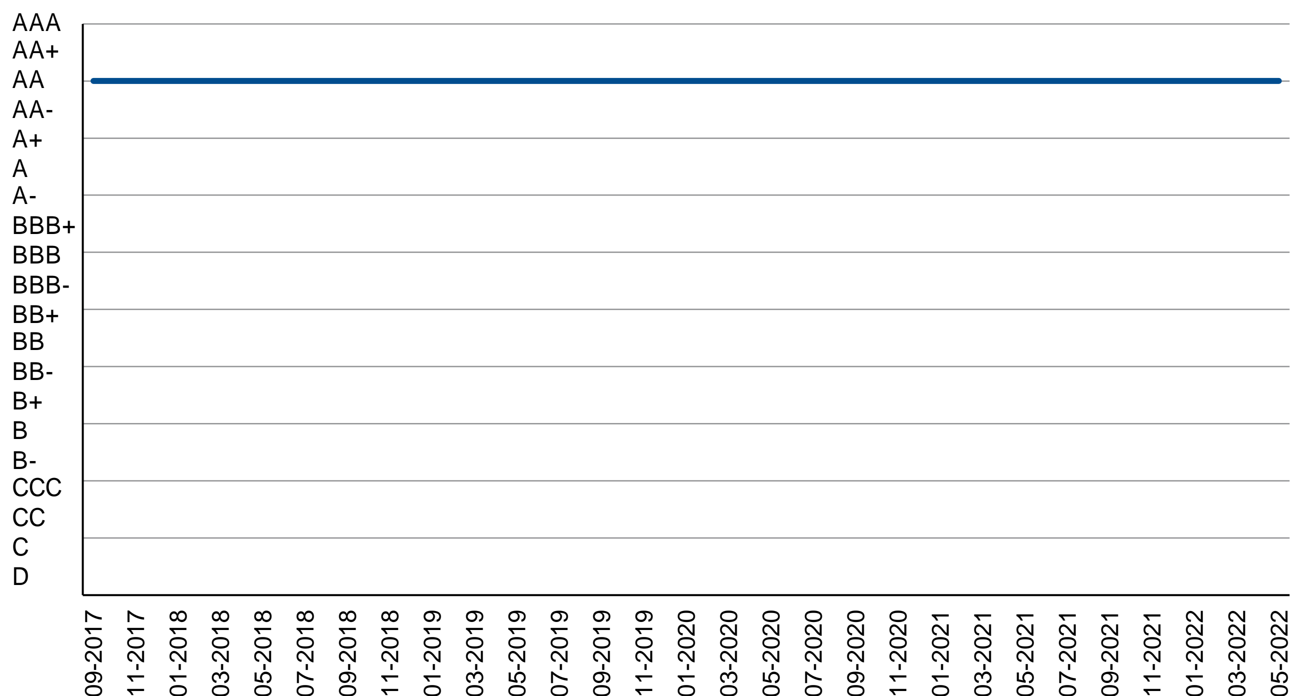
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Belgium
Czech Republic
Estonia
France
Italy
Japan
Lithuania
Malta
Slovenia
United Kingdom

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	57.8	59.9	62.8	65.1	63.1	69.2	76.0	79.7
Nominal GDP, USD bn	18,695.1	19,479.6	20,527.2	21,372.6	20,893.8	22,997.5	25,346.8	26,695.2
Real growth, %[1]	1.7	2.3	2.9	2.3	-3.4	5.7	2.3	2.5
CPI inflation, %	1.3	2.1	2.4	1.8	1.2	4.7	7.7	2.9
Unemployment rate, %[1]	4.9	4.4	3.9	3.7	8.1	5.4	3.7	3.5
Public Finance Risk								
Public debt, % of GDP[1]	107.2	106.2	107.5	108.8	134.2	132.6	127.8	125.4
Interest payment, % of government revenue	6.4	6.5	7.3	7.5	6.9	5.2	4.3	5.4
Primary balance, % of GDP[1]	-2.3	-2.6	-3.2	-3.5	-12.4	-8.5	-3.6	-2.3
External Economic Risk								
Current account balance, % of GDP	-2.1	-1.9	-2.1	-2.2	-2.9	-3.5	-3.5	-3.2
Total reserves, months of imports	1.4	1.5	1.4	1.6	2.1	-	-	-
NIIP, % of GDP	-43.5	-39.4	-47.2	-52.6	-67.1	-78.7	-	-
Financial Stability Risk								
NPL ratio, % of total loans	1.3	1.1	0.9	0.9	1.1	-	-	-
Tier 1 ratio, % of risk-weighted assets	13.2	13.5	13.8	13.7	14.5	14.9	-	-
Credit to private sector, % of GDP	182.3	190.7	179.5	190.8	215.9	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	265.8	256.1	256.3	244.9	228.5	-	-	-
Income quintile share ratio (S80/S20), x	9.0	9.0	9.0	9.2	-	-	-	-
Labour-force participation rate, %	71.9	72.4	72.6	73.1	-	-	-	-
Old-age dependency ratio, %	22.8	23.5	24.2	24.9	25.7	26.4	27.1	27.9
Composite governance indicator[2]	1.2	1.3	1.2	1.1	1.0	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 19 May 2022	17.6

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