S&P Issues a Negative Outlook for the U.S. I Say, "So What?"

Presented by Michelle Mabry

On Monday, April 18, Standard & Poor's issued a negative outlook for the U.S. government. While this was the headline of the day, I don't believe it should have been.

Let's be clear about what actually happened. S&P did not downgrade U.S. credit, just its long-term outlook for that credit. The U.S. credit rating today is still solid—it remains at AAA—but S&P believes the trends are moving in the wrong direction. With deficits at current levels, and the federal debt increasing, S&P says that the U.S. financial position could get worse in the future. While I agree with every word, it's not really news. High and rising deficits and debt have been on the front page for months, and they are currently one of the focal points of political debate. It seems a bit anticlimactic for S&P to express its concerns now.

And the markets seemed to agree. Bonds sold off on Monday morning, but they rallied and recovered most of their losses by the end of the day. The credit default swap market has continued to put the risk of a U.S. default on par with that of Germany, which is low.

While there is uncertainty going forward—the next hurdle is for Congress to increase the federal debt limit—S&P's announcement seems to be a nonevent, conveying no new or useful information. Moreover, issuing it at a time when Congress is actually starting to meaningfully discuss the debt issue seems unusual. If S&P's statement helps focus the debate in Washington, it ultimately could prove helpful. Indeed, the value of the statement lies in the fact that markets are starting to focus on the debt issue, which should help propel its resolution.

One way to approach the current situation is by looking to the past. In 2009, S&P put a negative outlook on the UK government. The UK never lost its AAA rating, and the negative outlook was removed last October. The last time the U.S. was put on negative watch, by Moody's, was in 1996; the watch was removed two months later after the federal debt ceiling was raised. So, based on history, one would not necessarily expect any further actions to occur. At the same time, we can't state with certainty what will happen next.

In summary, S&P has reminded us that the government needs to get its financial house in order or bad things could happen. A good analogy might be that of a driver at the start of a twisty mountain road. If he tries to follow a straight line, he will probably crash. That driver has a negative outlook. Similarly, if the U.S. debt situation continues on its current path, it will probably crash, too. But didn't we already know that? S&P hasn't given us anything new to consider, and, therefore, its announcement doesn't deserve a reaction at this time.

Disclosure: *Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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