AUGUST 4, 2023

# U.S. Rating Downgrade by Fitch

## What happened?

On August 1st, Fitch Ratings downgraded the United States of America's long-term issuer rating to AA+ from AAA and updated their outlook from negative to stable.

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## WHY DID FITCH DOWNGRADE THE UNITED STATES?

Fitch downgraded the United States due to a combination of factors. The projected fiscal deterioration over the next three years and a substantial and growing government debt burden were key drivers for the downgrade. In 2022, the government deficit to gross domestic product (GDP) was 3.7%, and Fitch's forecasts indicate an increase to 6.3% in 2023, 6.6% in 2024, and 6.9% in 2025. Beyond the annual deficit to GDP, Fitch projects total debt to GDP to rise over its forecast period, reaching 118% by 2025, an increase from the 2023 projected debt to GDP ratio of 113%. In addition to the fiscal concerns, governance erosion relative to 'AA' and 'AAA'-rated peers over the past two decades has been evident through repeated debt limit standoffs and last-minute resolutions. These factors collectively contributed to the decision to downgrade the United States' rating.

## WHY DID FITCH UPGRADE THEIR OUTLOOK FROM NEGATIVE TO STABLE?

According to Fitch, the stable outlook of the United States is backed by several structural strengths. These strengths encompass its large and well-diversified high-income earning economy. Lastly, one crucial factor supporting their outlook is that the U.S. dollar serves as the world's primary reserve currency, providing the government with exceptional flexibility in financing its activities.

## ANY OTHER IMPLICATIONS?

Due to government-sponsored entities' (GSEs) reliance on implicit government support, rating agencies directly link their ratings on debt issued by GSEs (U.S. Agency bonds) to the U.S. sovereign ratings. GSEs include the Federal Home Loan Mortage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae), and the Farm Credit System (FCS). Because of this linkage, Fitch's downgrade of the United States' long-term issuer rating also led the rating agency to downgrade the GSEs and their U.S. Agency bonds. Given the implicit government support of the GSEs and their financial performance on a standalone basis, our credit opinion has not been altered by the decision of Fitch..

## WHAT DOES THIS MEAN FOR YOUR PORTFOLIO?

In the short and medium term, investors maintain their confidence in the United States Treasury and U.S. Agency market as a global safe haven and the most reliable source of collateral. We view U.S. Treasury and U.S. Agency securities as core portfolio elements. However, the significant level of public debt warrants continued monitoring of the long-term outlook for addressing these fiscal challenges and political governance practices to ensure their effective management.

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1003-MPF-8/4/23-36400