MAY 2025

INSTANT INSIGHT
US RATING DOWNGRADE

- **Moody's cut its credit rating for the US on Friday from Aaa to Aa1 (stable outlook).** Moody's placed the US rating on watch in November 2023, so the news was not unexpected. Moody's cited the federal government's budget deficit and debt as key concerns.
- **Moody's is the last of the three major ratings agencies to cut the US rating from the best possible rating.** S&P downgraded the US from AAA to AA+ in August 2011, and Fitch did so in August 2023.
- **US 10-year Treasury yields rose 5bp on Friday overall,** closing at 4.48%, a level similar to that reached around a week after 'Liberation Day' on 2 April.
- **We do not expect any forced selling of US Treasuries as a result.** However, the ratings downgrade reflects ongoing uncertainty regarding US policy.

There has been a steady decline in ratings for US Treasuries since the early nineties (see Tables 1 and 2). The US debt-to-GDP ratio and budget deficit have been on a worsening trend, and had led agencies to downgrade the rating over time. Credit downgrades of the US government have lost political significance after S&P downgraded the US in 2011, and there were limited, if any, repercussions. Ultimately, we do not expect there to be forced selling of US Treasuries.

Table 1: S&P rating for the US[1]

Rating	Watch	Effective
AA+u		5 August 2011
AAAu	Negative	14 July 2011
AAAu		24 February 2011
AAA		27 July 1992

Table 2: Moody's rating for the US[1]

Rating	Watch	Effective
Aa1		16 May 2025
Aaa		2 August 2011
Aaa	Negative	13 July 2011
Aaa		6 February 1996
Aaa	Negative	24 January 1996
Aaa		6 May 1993

The news reflects ongoing uncertainty in several areas of US policy, including around the shape of the US budget, which is starting to worry markets. Early in his presidency, President Trump was discussing government spending cuts, deregulation to accelerate growth, and revenue raised from tariffs, which would balance off the extension of the 2018 tax cuts and any other expansionary policies. It appears this will not be the case. Republicans' "One, Big, Beautiful Bill", which includes significant tax cuts, has passed the House Budget Committee after initially failing to do so; the next step is the Rules Committee, before going to the full House for a vote.

Other news items impacting US markets include speculation that there will be a change in US banking regulations, loosening the Supplementary Leverage Ratio (SLR), which would make it less punitive for US banks to own US Treasuries. This could be helpful, leading to more entities who can buy more Treasuries and help absorb the high levels of issuance. The SLR constrains balance-sheet capacity and reduces banks' ability to lend. You can see evidence that banks have been reined in, potentially too much, by looking at the growth of the private credit markets. These changes are likely to only impact the largest globally systematically important banks.

INSIGHT'S INVESTMENT VIEW: US TREASURIES

- We expect a US economic slowdown to lead to Fed rate cuts, but we believe uncertainty over tariffs and their potentially inflationary effects will stay the Fed's hand. However, we think the Fed will act rapidly once it decides to cut.
- Curve steepening is a consensus trade, but we expect this in the near term due to the market repricing the front end of the curve given a higher likelihood of Fed cuts (rather than higher expectations for growth leading the longer end of the curve to rise).
- That said, given heightened inflation risks, limited fiscal discipline and potential eroding confidence in the US fiscal situation, we expect the term premium to rise somewhat over the horizon.

[1] Source: Bloomberg, as at 19 May 2025.

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