

Perspective on S&P Downgrade of U.S. Debt

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Debt Downgrade

Although the United States was able to avoid default last Tuesday, Aug. 2, by passing legislation that raises the debt ceiling and cuts spending, the legislation does not address many of the long-term fiscal issues we face as a nation. As such, following the close of markets last week, Standard & Poor's (S&P) downgraded the credit rating of the United States to AA+ from AAA.

The action by S&P to downgrade the U.S. credit rating was not surprising as the agency had indicated throughout the debt negotiations that a downgrade was possible and that it was concerned about the direction of U.S. fiscal policy.

Market Implications

The near-term impact of the downgrade should be limited as the market had anticipated the downgrade from S&P, and the other two rating agencies (Moody's and Fitch) have reaffirmed their ratings at the highest levels. We believe that once the dust has settled the markets should take the news in stride.

On a positive note, the Federal Reserve has confirmed that S&P's downgrade will not change the treatment of Treasuries as part of its capital requirements for banks and other financial institutions, and given the importance of this market, it is unlikely that investors will dramatically alter their holdings.

Other Market Concerns

The more pressing concerns for the markets right now are high government debt and sluggish growth in Europe combined with the faltering U.S. recovery. This is the double whammy investors are struggling with and it could be a rocky second half.

We continue expect a gradual recovery in the U.S. economy during the second half of the year although growth will likely remain uneven. We also believe that the actions of the European Central Bank (buying Spanish and Italian debt) and European governments should stabilize the European debt situation for now. However, we believe that the recovery is going to be slow, uneven and prone to flat spots.

Looking ahead

Fundamentally, the U.S. and European governments need to address their fiscal imbalances beyond the actions taken to date. Longer-term, borrowing costs will likely rise unless policy makers can make significant progress in lowering budget deficits and put the U.S. on a more sustainable fiscal path.

Although it is difficult to witness the volatility and uncertainty that has characterized the financial markets in recent weeks, it's important to maintain a long-term perspective.

Lastly, Nationwide is well capitalized and financially sound. The recent review by rating agencies reaffirmed our rating of A+ as well as the financial strength of the company. Obviously, the actions of S&P along with the economic challenges in the U.S. and global markets continue to create uncertainty, Nationwide will continue to monitor and evaluate the situation and will provide additional updates when appropriate.

Paul Ballew currently serves as Nationwide's Senior Vice President and Chief Economist for Nationwide. In this capacity, Mr. Ballew is responsible for the company's macro consumer analytics, economic forecasting and analysis, industry forecasts and strategy support.

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