ZANETTI FINANCIAL, LLC

Zanetti Monday Missive 2023.08.07

US Credit Rating Downgrade

“If you don’t take good care of your credit, then your credit won’t take good care of you.”
~ Tyler Gregory (Rap Musician)

Happy Monday Everyone!

Last Tuesday Fitch Ratings downgraded the credit rating of the US Government.


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U.S. NEWS

Fitch Downgrades U.S.’s Credit Rating

Firm warns of debt burden, dysfunction;

The downgrade appears to have shocked the White House.

Press secretary Karine Jean-Pierre grimaced that the Fitch decision “defies reality to downgrade the United States at a moment when President Biden has delivered the strongest recovery of any major economy in the world.”

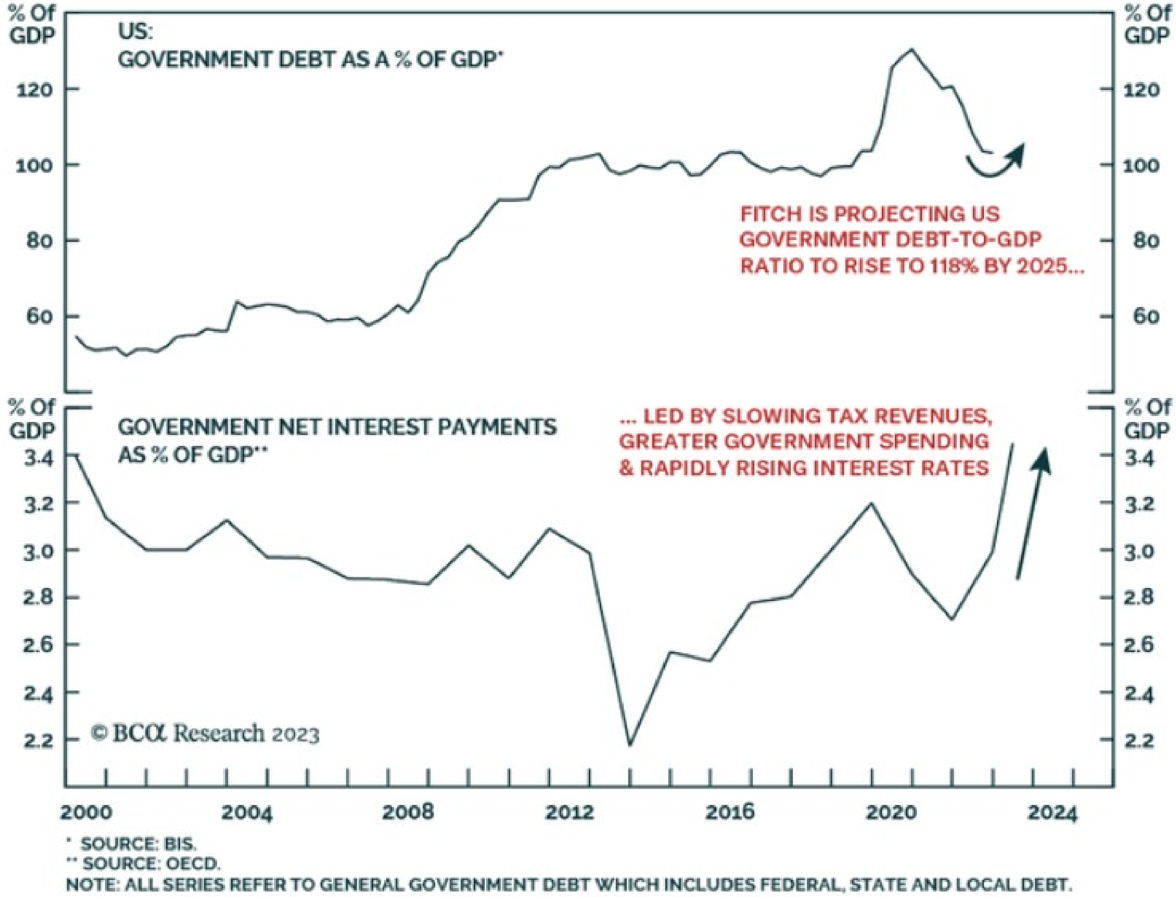
Janet Yellen stated the decision was “arbitrary and based on outdated data.”

Fitch defended its decision by warning of the growing debt burden, the political dysfunction in Washington and reflecting on the gridlock that was created between Congress and the President as they came to the brink of a historic default.

Fitch said the downgrade reflects an “erosion of governance” in the US, relative to other top-tier economies over the last two decades. They expect “fiscal deterioration” over the next three years. These factors have “eroded confidence in fiscal management.”

Fitch expects the government deficit to grow from 3.7% up to 6.3% (that’s for the annual budget). This deficit growth is due to weaker federal revenues, increased spending initiatives, and now higher interest burdens. The firm also expects the US economy to slip into a recession later this year.

I think the following chart sums up Fitch’s concerns quite nicely:



What this chart is saying is that debt is expected to grow as a percentage of GDP, but worse yet, the interest payments are growing at a much faster clip – both in dollar amounts as well as a percentage of GDP.

Those interest payments will add to the debt level, which will be handled by printing more money – which will add to inflation and the deterioration of the dollar, which will require the Fed to raise interest rates further.

It’s a vicious cycle.

Has Fitch been reading our Monday Missives? 😉

The last time a credit agency downgraded our credit rating was in 2011 by Standard & Poor, as we were coming out of the Great Financial Crisis. The last remaining credit agency to not yet downgrade our credit rating is Moody's.

Personally, I think this is another canary in the coal mine.

I also think that most folks who read the newspapers can agree that whether it be a government, a business, or an individual, you can't continue to spend more money than you make – and at a greater rate every year – while facing zero financial consequences.

This credit downgrade is similar to when an individual gets a lower credit score. The credit agencies look at how much money one makes in comparison to how much debt they take on. A reasonable amount of debt can actually improve your credit score, because it shows that you have no problem paying your debt. That's the whole point of why credit scores exist – trying to predict how well you will reliably pay your debt in the future.

When you rack up too much debt compared to your income, the credit agencies will lower your score – even if you've never missed a payment – just because the likelihood of falling behind and missing a payment is greater the more debt you have.

Fitch made their decision based on the same basic principles.

Is this the nail in the coffin for the US economy? No.

It's just another data point. It's another agency (an agency that can be politically manipulated, but appears to be rising above right now) that is saying – "Hey, Washington DC, wake up! Quite being financially irresponsible!"

Can Washington wake up? Sure then can! But will they? That's the real question. My guess is no. Not until the economic consequences become much more dire.

This rating downgrade is like coming home from school with a B when you're used to bringing home A's.

I think Washington will shrug it off – or blame it on other people (or Presidents, or political parties, or a virus, or a war, or…).

But that's the point of the canary in the coal mine. It's a warning! Miner's used to bring canaries down to the depth's of the mine they worked in and if the canary dropped dead in the cage, the miner's would high-tail it out of there, knowing there were poisonous gases lurking about. Unfortunately, this dead canary will be shrugged off.

Meanwhile, big picture, I think this is just another hole in the dam. If you're not diligent, the water will win.

Although it doesn't feel good to watch our currency degrade, doesn't it feel good to watch as your investment strategy is validated by a credit agency?

Your I-Used-To-Believe-In-UFOs-But-Now-That-The-Government-Says-They-Exist-I'm-Not-So-Sure Financial Advisor,

Walt

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Our mailing address is:

5130 San Francisco Rd NE
Suite A

Albuquerque, NM 87109

505-858-3303