



## To the point!

Cross-Asset- and Strategy-Research

# Fitch downgrades the U.S. – so what?

## The downgrade is not a harbinger of things to come for Germany

In early August, the international credit rating agency Fitch – the smallest of the "Big 3" – gave the United States federal government the thumbs down. Instead of the top rating of 'AAA', the U.S. are now only awarded an 'AA+'. It's kind of like when a student brings home "only" an A instead of an A+. No big deal. Historically, there have been virtually no sovereign defaults for either rating category. (Let's keep a veil of silence over the lamentable performance of some 'AAA'-rated subprime bonds during the financial crisis).

Following the Fitch move, the reaction of the financial markets was correspondingly restrained. The excitement was all the less because the U.S. had already lost its immaculate rating record in 2011 when S&P Global, the world's largest rating agency, had lowered it by a notch. (In the interest of full disclosure: At the time, I was part of the S&P rating team that made this move. It wasn't a walk in the park back then!).

### The Fitch decision has no relevance for Germany

As expected, it did not take long for some German politicians to speak out, saying that the U.S. downgrade was proof of the importance of the German so-called "debt brake", which severely limits the government's ability to borrow. Without the debt brake, so the fiscal doomsters go, Germany would also be threatened to be relegated in the ratings league table. Interest rates on the national debt would rise as a direct consequence. It might then no longer be possible to finance important investments.

At first glance, this sounds plausible. But fortunately, this thesis is entirely incorrect. Both previous U.S. downgrades were based on the dysfunctional political processes, most recently on display



**Moritz Kraemer** -- Chief Economist

LBBWResearch@LBBW.de

August 18, 2023

---

The U.S. downgrade: a storm in a teacup

---

in May during the unseemly wrangling over the U.S. debt ceiling. Fortunately, an absurd legal budget framework, exacerbated by extreme political polarization, is not (yet) a problem in Germany. Thus, the U.S. case is fundamentally different.

Moreover, neither of the two U.S. downgrades to date had any noticeably impact on the refinancing costs of the U.S. federal government.

More generally speaking: There is no empirical evidence that a sovereign downgrade in the AAA/AA categories entails significant interest rate effects. This is not surprising, because the historically observed default rates are, as mentioned above, close to zero for both categories. Investors generally understand this. Some politicians do not.

### Rating Agencies: Growth is Germany's Achilles' heel

More specifically, it is not correct that the rating agencies consider the debt brake as a key anchor for Germany's top-notch rating. They simply don't. If there is a threat to Germany's AAA, it would most likely come from weak growth. This in turn would be a result of declining demographics, burgeoning bureaucracy, and insufficient investment in education, infrastructure, and digitization. All three major agencies make this crystal clear in their credit reports. Germany's public investment backlog is partly due to the rigid debt brake enshrined in the constitution.

It follows that dogmatic insistence on the debt brake at a time of massive investment needs may make a German downgrade more likely, not less. If Germany won't make progress with productivity-enhancing investments, the already weak growth potential (see [To-the-Point! last week](#)) could fade even further.

For the fans of the debt brake it seems that if the only tool available is a hammer, then every problem somehow looks like a nail.

---

#### Disclaimer:

This publication is addressed exclusively at recipients in the EU, Switzerland, Liechtenstein and the United Kingdom.

This report is not being distributed by LBBW to any person in the United States and LBBW does not intend to solicit any person in the United States.

LBBW is under the supervision of the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany).

This publication is based on generally available sources which we are not able to verify but which we believe to be reliable. Nevertheless, we assume no liability for the accuracy and completeness of this publication. It conveys our non-binding opinion of the market and the products at the time of the editorial deadline, irrespective of any own holdings in these products. This publication does not replace individual advice. It serves only for informational purposes and should not be seen as an offer or request for a purchase or sale. For additional, more timely information on concrete investment options and for individual investment advice, please contact your investment advisor.

**We retain the right to change the opinions expressed herein at any time and without prior notice. Moreover, we retain the right not to update this information or to stop such updates entirely without prior notice.**

Past performance, simulations and forecasts shown or described in this publication do not constitute a reliable indicator of future performance.

The acceptance of provided research services by a securities services company can qualify as a benefit in supervisory law terms. In these cases LBBW assumes that the benefit is intended to improve the quality of the relevant service for the customer of the benefit recipient.

**Additional Disclaimer for recipients in the United Kingdom:** Authorised and regulated by the European Central Bank (ECB), Sonnemannstraße 22, 60314 Frankfurt/Main (Germany) and the German Federal Financial Supervisory Authority (BaFin), Graurheindorfer Str. 108, 53117 Bonn (Germany) / Marie-Curie-Str. 24-28, 60439 Frankfurt/Main (Germany). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

---

Downgrade had  
no effect on the  
interest burden

---

---

Germany's  
credit rating:  
Growth more  
important than  
the debt brake

---