Dagong Downgrades the Sovereign Credit Ratings of the United States of America

Description

Dagong Global Credit Rating Co., Ltd.

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Editor's Note: In 2010, China's main credit rating agency Dagong argued for the first time that the U.S. economy was actually much closer to $5 trillion rather than $15 trillion:

"In the components of the U.S. GDP in 2009, the financial services sector accounted for 21.4% while the real economy sector accounted for 65%. The total output value of the U.S. financial services industry is composed of two major parts: one is the transferred production value, most of which comes from value distribution of participating in international production. Another part is the inflated value originated from credit innovation, which belongs to bubble value. In addition, due to the high economic financialization, more than half of the profits in the real economy come from the returns of financial activities. If we exclude the factor of virtual economy, the U.S. actual GDP is about 5 trillion U.S. dollars in 2009, per capita GDP about $ 15,000. Meanwhile, the total domestic consumption was 10.0 trillion U.S. dollars and government expenditure was 4.5 trillion U.S. dollars. The production capacity of real value in the national economy is the material base to arrange social distribution and consumption. As the U.S. government arranges its budget according to the GDP including the virtual value, its revenue must fall short of its expenditure, so the socialization and normalization of debts will exacerbate the

> environment of economic development. It is predicted that the average real GDP per year of the United States will not reach 6 trillion U.S. dollar and per capita GDP will be less than 20,000 in the coming 3-5 years."

Dagong Global Credit Rating Co., Ltd. (Dagong) has decided to downgrade both the local and foreign currency sovereign credit ratings of the United States from A- to BBB +, and each with a negative outlook. The perennial negative impact of the superstructure on the economic base has continued to deteriorate the debt repayment sources of the federal government, and this trend will be further exacerbated by the government's massive tax cuts. The increasing reliance on the debt-driven mode of economic development will continue to erode the solvency of the federal government.

The main reasons for downgrading the sovereign credit ratings of the United States are as follows:

1. **Deficiencies in the current US political environment** make the efficient administration of the federal government difficult, so the nation's economic development is on the wrong track. In a political environment built on factional rivalries, factional interests are prioritized, and it is hard for the government to focus on managing the national economy and social development. Thus, the economy is highly debt-driven. Nevertheless, the government seems not to have learned from the financial crises that it is this debt-driven model that has hindered the country in balancing the budget. Instead, contrary to all logic, it continues to seek credit expansion through direct issuance of US dollars, and is thus on the wrong track from the start.

2. **The distorted credit environment** that violates the law of value leads to the abnormal solvency of the federal government. Capital always seeks profit; this makes the financial sectors of the United States strive for more profits through continuous expansion of the chain of credit transactions by designing capital products and trading structures, and the virtual value-added model of capital self-circulation that runs out of the real economy provides living space for the ever-burgeoning debt bubble of the federal government. The government has invented a virtual form of solvency by increasing new debt in the name of the United States by abusing the right to manipulate the money supply, that is, by abusing the right to issue dollars as the international reserve currency. Therefore, the distorted credit environment has made the federal government's so-called solvency its latest derivative product.

3. **Massive tax cuts** directly reduce the federal government's resources that would enable it to pay off debt. The tax cuts act implemented from 2018 did not attack the root cause of the unsustainable debt-driven US economy, so it is projected that the US economy will grow only 2.3% in 2018, and will grow even more slowly in subsequent years. Besides, the fiscal revenue of the federal government will keep declining due to the tax cuts, so it is projected that the ratio of tax revenue to GDP will fall to 14.0% in 2022, that is 3.3 percentage points down from that of 2017. The increasing demand for national defense, infrastructure and nondiscretionary spending will made it hard for the government to reduce fiscal expenditure effectively; thus it is estimated that the federal fiscal deficit in 2018 and 2019 will rise to 3.9% and 4.1% respectively.

4. **Using increasing debt** to make up for the fiscal gap brought about by the tax cuts will inevitably increase the credit risk of the federal government. The financial gap and the pressure to repay maturing debt increase the government's needs for financing. It is estimated that the government's ratio of fiscal revenue-to-debt will be 14.9% and 14.2% in 2018 and 2019 respectively, and the ratio will deteriorate to 12.1% in 2022. Then the government will have to keep on raising the debt ceiling. In addition, the government's monetizable assets-to-debt ratio [was] merely 7.3% in 2017. That is to say, the government cannot stay solvent by relying solely on its monetizable assets and it has to resort to

debt monetization to maintain the balance between repayment sources and debt. However, interest rate increases and the Federal Reserve's balance sheet reduction will only raise the cost of finance through debt roll-over. That means that rolling over debts is unsustainable.

5. **The virtual insolvency** of the federal government will likely become the detonator of the next financial crisis. The serious imbalance between the sources of debt repayment and liabilities makes the federal government the weakest link in the US debt chain. Taking advantage of its right to print money, the US strives to maintain its solvency by purchasing treasuries with newly-printed dollars, which, in itself, is a debt crisis. The market's reversing recognition of the value of US treasury bonds and US dollar will be a powerful force in destroying the fragile debt chain of the federal government.

The debt-economy model determined by the US political system, strategy and economic base will not change; tax cuts have increasingly adverse effects on the government's repayment sources; the continuous reduction of fiscal revenue and the growth of debt show that the government's ability to pay back creditors is weakening. Hence, Dagong holds a negative outlook for both the local and foreign currency sovereign credit.

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