Taking Stock: National debt weighs heavily on U.S. bond ratings

by Malcolm_Berko

Dear Mr. Berko: How are U.S. government bonds rated on the world market? My broker says they are not rated "buy," but carry an "implied Triple-A rating" because of our ability to repay the debt. With that debt increasing, are U.S. Treasury bonds still comparable to a Triple-A Moody's or Standard and Poor's rating? If you could point one finger at one person who is responsible for this mess, who would it be? My broker is a very well read and smart professional. He tells me that it is Chris Cox, chairman of the Securities and Exchange Commission, who allowed the brokerage firms and banks to get themselves into this mess. U.S. Sen. John McCain, R-Ariz., said that if he were elected president he would fire Cox for doing such a poor job. â€” W.B.: Harrisburg, Pa.

Dear W.B.: Years ago when Moody's said that a bond was rated AAA, it was really rated AAA. In those days, banks, brokerages, and investors relied on Moody's because Moody's could be trusted. AAA was AAA with no ifs, ands or buts. A Moody's AAA rating was as reliable as the combination of the three constants in our universe: Greenwich mean time, the atomic clock and the speed of light.

Now Moody's has been fudging its rating system and it would be interesting to know how much it's being paid to make the "fudge" and who is buying the candy. Now, I always thought a AAA was always AAA, not almost AAA or nearly AAA. Like being a virgin, she can't be a little bit virgin. Either she is or she "ain't."

But now according to Moody's, the coveted AAA rating is divided into three tranches:

â€” RESISTANT AAA : These are sovereign nations that are not terribly affected by the world economic crisis, such as Australia, Canada, Denmark, Finland, Luxembourg, Netherlands, Sweden, Norway, Singapore and New Zealand.

â€” RESILIENT AAA: These are countries that face shocks to their economic models and large contingent liabilities, but Moody's believe will be able to adjust. These countries are Germany, France, Austria, Spain and Switzerland.

â€” VULNERABLE AAA - These are countries that have a negative outlook based on their ability to rebound back to health. These countries are Spain, the United Kingdom, the United States and Ireland. Some folks would call this AAA junk.

According to Moody's, U.S. interest payments as a percentage of gross domestic product are currently 7.6 percent.

When the 10 percent level is breached, a rating switch is flipped. At the 10 percent level, debt service costs begin to confine a government's ability to function effectively and limit its options to respond.

Italy's indicator is 10.9 percent and Rome has publically admitted that its government can only respond in a very limited way to the crisis because of its huge burden of debt. As the United States continues to grow its national debt, Americans become inexorably closer to that 10 percent level. No matter how you slice the salami, "the old gray mare ain't what it used to be." The U.S. is likely to breach that level. If it does, our debt rating could fall precipitously and Treasury bond rates will bolt up to high single- or low double-digit rates.

I won't blame any single person for this economic mess because "we" got us where we are today. However, the enabler is former Federal Reserve Board Chairman Alan Greenspan, who remarked to questions on the housing market by saying: "There is no housing bubble." It was Greenspan who actively encouraged the use of adjustable rate mortgages; who aggressively encouraged banks to make liberal real estate loans; who encouraged continued easy credit; and who admitted that he misjudged the ability of the financial industry to police itself.

It is common knowledge that Greenspan raised interest rates too soon and kept them too high for too long. Then he lowered interest rates, then dropped them too low and kept them too low for too long. It was under this scenario that Lehman Brothers., Goldman Sachs, Merrill Lynch, Bank of America, Citigroup, AIG, etc., went mad issuing tranches of subprime mortgages and designing computer generated derivatives. All of this happened under Greenspan's watch, and the dumped this mess on poor Ben Bernanke, the current Federal Reserve Board chairman.

In the months before his retirement, Greenspan believed his would be the fifth face on Mount Rushmore. Imagine that!

Chris Cox of the Securities and Exchange Commission is a good choice, too. He was in bed with the brokerage firms and banks and resisted all efforts to have the SEC police their activities. All of this will come out in the Bernard Madoff trial. The new chairman of the SEC is Mary Schapiro, who up until January 2009 was head of FINRA, the disgraced Financial Industry Regulatory Authority. And this will come out in Madoff's trial â€” if he ever goes to trial.

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