U.S. rating downgraded for first time

TREASURY OBJECTIONS REBUFFED

S&P cites “political brinkmanship,” debt concerns

by Zachary A. Goldfarb

Standard & Poor’s announced Friday night that it had downgraded the U.S. credit rating for the first time, dealing a symbolic blow to the world’s economic superpower in what was a sharply worded critique of the American political system.

Lowering the nation’s rating to one notch below AAA, the credit rating company said “political brinkmanship” in the debate over the debt had made the U.S. government’s ability to manage its finances “less stable, less effective and less predictable.” It said the bipartisan agreement reached this week to find at least $2.1 trillion in budget savings “fell short” of what was necessary to tame the nation’s debt over time and predicted that leaders would not be likely to achieve more savings in the future.

“Not only is the rating itself at risk, but the process of decision making,” said David Beers, head of S&P’s government debt rating unit.

The decision came after a day of furious back-and-forth debate between the Obama administration and S&P. Treasury Department officials fought back hard, arguing that the firm’s political analysis was flawed and that it had made a numerical error in a draft of its downgrade report that overstated the deficit over 10 years by $2 trillion. Officials had reviewed the draft earlier in the day.

A judgment flawed by a $2 trillion error speaks for itself,” a Treasury spokesman said Friday.

But S&P, recognizing that the world’s superpower is facing a deepening debt crisis, cut the U.S.’s rating to AA+ from AAA, the second-highest rating grade.

The downgrade to AA+ will push the global financial markets into uncharted territory after a volatile week fueled by concerns over a worsening debt crisis in Europe and a faltering economy in the United States.

DOWNGRADE CONTINUED ON A9
The AAA rating has made the U.S. Treasury bond one of the world’s safest investments — and has helped the nation borrow at extraordinarily cheap rates to finance its government operations, including two wars and an expensive social safety net for retirees.

Treasury bonds have also been a stalwart of stability amid the economic upheaval of the past few years. The nation has had a AAA rating for 70 years.

Analysts say that, over time, the downgrade could push up borrowing costs for the U.S. government, costing taxpayers tens of billions of dollars a year. It could also drive up interest rates for consumers and companies seeking mortgages, credit cards and business loans.

A downgrade could also have a cascading series of effects on states and localities, including nearly all of those in the Washington metro area. These governments could lose their AAA credit ratings as well, potentially raising the cost of borrowing for schools, roads and parks.

But the exact effects of the downgrade won’t be known until at least Sunday night, when Asian markets open, and perhaps not fully grasped for months. Analysts say the initial effect on the markets could be modest because they have been anticipating an S&P downgrade for weeks.

Federal officials are also examining the impact of a downgrade in large but costlier financial markets where U.S. government bonds serve an extremely important function. They were generally confident that markets would hold up but were closely monitoring the situation. Regulators said that the downgrade would not affect how banking rules treat Treasury bonds — as risk-free assets.

The ratings action immediately fueled partisan wrangling Friday night. Allies to President Obama said he underscored his call for a “grand bargain” that would trim $4 trillion from the federal budget involving a mix of tax revenue and spending cuts.

Republicans criticized Obama’s handling of the economy.

“Standard & Poor’s rating downgrade is a deeply troubling indicator of our country’s decline under President Obama,” Republican presidential candidate Mitt Romney said.

S&P has angered government officials with aggressive warnings during the past few months of a potential downgrade. &P corrected its draft report Friday after Treasury raised concerns about the math.

Over the past few months, the multiple warnings from S&P have not worried government bond markets. What’s more, the two other major credit rating companies, Moody’s Investors Service and Fitch Ratings, have said they would preserve the nation’s AAA rating for now.

S&P’s downgrade was as much a political critique as a financial conclusion. It is based on a view that U.S. political leaders would be unable to come up with at least $4 trillion in savings, which is needed to bring the nation’s debt to a manageable level over the next decade.

The debt deal swung earlier this year proposed spending cuts in two phases. Democrats and Republicans agreed to the first round, worth nearly $1 trillion. But a congressional committee must decide on the remaining $1.2 trillion to $1.5 trillion — and S&P questioned whether that would ever happen.

S&P added that it expects that the upper income Bush-era tax cuts will continue, despite vows from Obama to end the breaks next year.

“The majority of Republicans in Congress continue to resist any measure that would raise revenues,” the firm said.

S&P’s downgrade served as an indictment of the gridlock that sent the nation to the edge of defaulting on its debt obligations. It is also striking in part because it reflects the tremendous power of a small group of financial analysts employed by a New York company — part of McGraw-Hill. Credit-rating companies’ reputations were sullied during the financial crisis.

In Europe, political leaders have taken aim at credit rating companies when they cut the ratings of governments struggling with heavy debt burdens.

S&P said the nation could suffer additional downgrades later on if the nation’s debt burden grows worse. “A new political consensus might (or might not) emerge after the 2012 election, but we believe that by then the government debt burden will likely be higher,” the firm said.

The company said the United States’s financial position was diverging from that of other AAA countries, including Canada, France, Germany and Britain.

Countries with a AA+ rating include New Zealand and Belgium. Among those countries with a AA rating, one notch lower, are Bermuda, Spain and Qatar.

Staff writers Neil Irwin and Cecary Podkul contributed to this report.
Political parties trade blame for U.S. rating downgrade

Partisan battles, in addition to major debt burden, led to S&P’s decision

BY ZACHARY A. GOLDFARE

Standard & Poor’s historic downgrade of the U.S. credit rating caused Washington to erupt on Saturday in the exact partisan clashes that S&P had said led to its decision in the first place.

Both major political parties accused each other of causing the downgrade and used the credit rating agency’s report to make their cases. Democrats criticized Republicans for refusing to consider increasing tax revenue to help tame the nation’s debt. Republicans blamed Democrats for not taking seri-

ous action to reform entitlements and failure of the House for allowing the downgrade to happen on his watch. It was hardly a banner day for the nation’s capital, where Congress and the president, already suffering low poll numbers for their inability to work together, endured reprimands and lec-

tures from nations worldwide.

China, a major holder of U.S. debt, derided the United States in an editorial in a state-run newspaper for “its addiction to debt.” In Germany, a news magazine called the downgrade “a public humiliation.”

S&P said Friday night that it had downgraded the U.S. credit rating one notch — from AAA to Aa3 — because “political brinkmanship” had made the government’s ability to manage its fi-

nances “less stable, less effective and less predictable.”

The agency’s decision was a reflection of the nation’s massive debt burden and its inability to function politically. Al-

though the fallout largely triggered political recriminations, analysts wor-

ried that the consequences of the downgrade, while not fully known, could lead to higher borrowing costs for the govern-

ment and consumers over time.

S&P officials said it is unlikely that the country will regain its top credit rating anytime soon. And if one of the two other ratings agencies — Moody’s In-

vestor Service and Fitch Ratings — followed suit, analysts say, financial markets could erupt in widespread turmoil as investors lose faith in the nation’s ability to meet its financial obligations.

For now, those two agencies say they plan to preserve the AAA rating, although they warned that they could change their view if there is a significant deterioration in the economy or if leaders are unable to find more budget savings.

Still, given S&P’s move, gov-

ernment officials and investors worldwide were bracing for signs of distress that may occur when financial markets open Monday.

The S&P downgrade was an-

nounced after a flurry of contacts between the Treasury Department and the company. S&P had warned for months that it might downgrade the United States if leaders did not come up with a plan to cut the deficit by $4 trillion over 10 years.

S&P noted that the budget deal reached last week — which calls for $2.2 trillion in savings and was considered a crisis-

averting breakthrough in Wash-

ington — “fell short.”

On Friday, before Obama left for a weekend at Camp David, Treasury Secretary Timothy F. Geithner and National Economic Council Director Gene B. Sper-

ling briefed Obama on the poten-

tial downgrade.

On Saturday, the administra-

tion quickly moved to cast doubt on S&P’s conclusions, saying it had neglected to recognize that

leaders in Washington had made progress despite the political wrangling. Officials also said that S&P’s methodology was “flawed” and that the company had to correct large math errors in an early draft of its report.

But officials also said the downgrade supported Obama’s call for a “grand bargain” to cut the nation’s debt through a com-

bination of tax increases and an overhaul of entitlement pro-

grams such as Social Security and Medicare.

“The bipartisan compromise on deficit reduction was an im-

portant step in the right direc-

tion. Yet the path to getting there took too long and was at times too divisive,” White House press secretary Jay Carney said. “We must do better to make clear our nation’s will, capacity and com-

mitment to work together to tackle our major fiscal and eco-

nomic challenges.”

Another administration offi-

cial said: “The S&P decision was shockingly flawed” but added that “the truth is that it takes two parties to solve a problem, es-

pecially one as serious as bringing down our deficit.”

Others in Washington used the downgrade as a political weapon, which bodes ill for a congressional “supercommittee” that is supposed to agree on at least $1.2 trillion in budget sav-

ings by Thanksgiving to supple-
ment the nearly $1 trillion in cuts lawmakers already agreed to. In its report, S&P expressed doubt that the panel would succeed

Sad House Speaker John A. Boehner (R-Ohio): “Democrats who run Washington remain un-

willing to make the tough choic-

es required to put America on solid ground.” He quoted the S&P report as saying that reforming entitlement programs is neces-

sary, but he did not mention its discussion of the potential need for new tax revenue.

The downgrade and fall in the stock market “provide further evidence that President Obama’s agenda has been a disaster for our economy,” said Sen. Ronald H. Johnson (R-Wis.).

Democrats were just as critical of Republicans.

Timothy M. Kaine of Virginia, a former chairman of the Demo-

cratic National Committee who is running for the Senate, said that “the continuing resistance of congressional Republicans to entertain the need for new rev-

enue as part of a reasonable solution is a critical part of the down-

grade decision.” He did not mention S&P’s statement about entitlements.

Added Sen. Christopher A. Coons (D-Del.): “By refusing to negotiate in good faith, Republic-

ans turned the debt-ceiling de-

bate into a hostage crisis and last night we saw its first casualty.”

Republican presidential can-

didates went for the jugular, issuing statements that tried to pin S&P’s action on Obama. For-

mer Minnesota governor Tim Pawlenty called the president “inert,” while Rep. Michele Bach-

mann (Minn.) said he is “destroy-

ing the foundations of the U.S. economy one beam at a time.”

Obama aides said they hoped the political fallout will be mini-

mal for the president as he seeks re-election, so long as the down-

grade has a limited effect on the economy. The aides noted that voters will decide next fall based on their personal financial situa-

tions, rather than a broad event that deals with a national rating.

“The Republican candidates would have put our economy at great risk by allowing the nation to default on its obligations,” said Ben LaBolt, a spokesman for the Obama campaign.

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Staff writers Rosalind Helderman, Felicia Sonmez and Yuan Q. Mui contributed to this report.
Debate preceded the downgrade

BY ZACHARY A. GOLDFARB

The Obama administration had just finished a fight with House and Senate Republicans when it entered a battle with a small group of credit-rating analysts based in New York, London, and Toronto.

Standard & Poor’s had warned for months that it might downgrade the U.S. credit rating if leaders couldn’t find a way to reduce the growing national debt by $4 trillion over 10 years.

When the deal reached Tuesday fell short of those expectations, the Treasury Department and S&P engaged in a furious set of exchanges that ultimately led to a downgrade Friday night. Since then, the Obama administration and S&P have been engaged in a war of words over the circumstances of the downgrade.

Gene R. Sperling, director of the National Economic Council, said Saturday that S&P’s conduct was “breathtaking,” adding that it “smacked of an institution starting with a conclusion and shaping any arguments to fit it.”

David Beers, the head of S&P’s sovereign rating unit, had a different view. “This agreement will not produce a stabilization of the government’s debt burden on its own, and we don’t have a lot of confidence that another agreement is going to follow this one,” he said.

Friday’s hectic events began at 11:55 p.m. when an S&P analyst called Treasury to say its analysts had decided to cut the nation’s credit rating, widely expected to keep the country’s debt burden out of the headlines.

The analyst sent a draft copy of the downgrade report.

The initial report said the debt in 2011 would reach a worrisome $23.2 trillion, equal to 93 percent of the size of the economy.

Treasury officials reviewed the report and after about 30 minutes found what John Bellows, the acting assistant secretary for economic policy, on Saturday called a “basic math error of significant consequence.”

Treasury argued that S&P calculated spending over the next 10 years in a way that overstated the debt by $2 trillion. Treasury said S&P used the wrong budget metrics to project spending levels.

About 3:15 p.m., Treasury officials called S&P to tell analysts that they had overstated the debt. They heard “stunned silence,” according to some sources familiar with the call. Other sources disputed the characterization.

Two hours later, S&P called Treasury to acknowledge that Treasury’s analysis was correct but told officials that the downgrade would still occur. According to the new calculations, the debt is projected to reach $29.1 trillion, or 95 percent of the size of the economy.

Treasury asked S&P to take more time and wait until Monday to make a final decision.

The officials also argued that S&P analysts did not recognize that Washington was taking steps to tame the national debt despite the political theater of recent months.

But S&P analysts took the opposite view — that all the partisan wrangling made it far less likely that leaders would be able to do what’s necessary to achieve budget savings and that the altered calculation did not change that picture.

Beers reconvened a committee of analysts who vote on ratings decisions to decide whether to proceed with the downgrade. They voted to do so.

At 7:15, S&P called to say it would downgrade and soon provided a copy of the report to Treasury.

The revised downgrade report more greatly emphasized political analysis compared with the original report, according to a version of the first report reviewed by The Washington Post.

It announced the unprecedented decision at 8:30 p.m.

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Read five ways the credit rating could affect you at washingtonpost.com/business.
U.S., European officials work to calm anxiety

EMERGENCY FINANCIAL ACTIONS PLEDGED

Downgrade, debt crisis could feed on each other

BY ZACHARY A. GOLDFARB
AND ANTHONY FAIOLA

Top economic officials from around the world scrambled Sunday to contain the fallout from an unprecedented downgrade of the U.S. credit rating and a serious worsening of Europe’s economy. Treasury Secretary Timothy F. Geithner and Federal Reserve Chairman Ben S. Bernanke joined counterparts from six of the world’s largest economies in an emergency conference call Sunday evening to discuss how world markets would respond to the Standard & Poor’s downgrade and the escalating European debt crisis. Afterward the officials released a statement pledging to support financial stability.

At the same time, the European Central Bank, after a hastily arranged meeting, signaled that it would invest in European bond markets in a bid to prop up hard-hit Italy and Spain, Europe’s fourth- and fifth-largest economies, which are in the midst of a worsening financial crisis.

U.S. and European officials are trying to calm anxiety about the global economy as the U.S. downgrade and European debt problems threaten to feed on each other, weighing on markets and a limp economy on both sides of the Atlantic.

The emergency actions evoked memories of the response to the financial crisis in 2008 and portended intense volatility in global financial markets this week. The economy continued on A4
MARKET TURMOIL

ECONOMY FROM A1

dollar fell over the weekend while gold soared. Stock markets in the Middle East plunged, and U.S. stock futures appeared negative. Asian markets dropped at the opening.

After the emergency conference call involving Geithner and Bernanke, the top seven economies expressed support for actions taken by both the United States and Eu-

rope and committed “to taking coordinated action where needed, to ensuring liquidity, and to supporting financial market functioning, financial stability and economic growth.” They said they would partic-

ularly take action to curb volatil-

ty in currency trading.

Amid this uncertainty, the Obama administration an-

nounced Sunday that Geithner, the president’s longest-serving economic adviser, would remain in his post through fall 2012. Geithner had told President Obama that he was ready to step down after leaders reached an agreement to raise the debt ceiling last week, but the president asked him to stay.

Geithner told Obama on Friday morning that he would agree to remain in the administration only to inform the president later in the afternoon that the country would face a downgrade.

S&P cited the U.S. debt burden and political paralysis in its deci-

sion to remove the nation’s ster-

ling AAA rating. The Obama ad-

ministration blasted the decision, saying it was based on faulty logic and math, while acknowledging that Washington must do more to tame its debt.

“I think S&P showed really ter-

rible judgment,” Geithner said Sunday on NBC’s “Nightly News.” “Our country is much stronger than Washington.”

The political parties continued to point fingers at each other Sun-

day for the downgrade. On NBC’s “Meet the Press,” Sen. John F. Ker-

ry (D-Mass.) called S&P’s action the “party downgrade,” referring to conservative Republicans who refused to vote for an increase in the federal debt limit.

On CBS’s “Face the Nation,” Sen. Lindsey O. Graham (R-S.C.) blamed Obama, saying that “if he was in the Southeastern Confer-

ence, he’d be fired as a coach.”

Most analysts say the markets have been prepared for a down-

grade by S&P, which has been i-

ssuing threats about a downgrade for months. And although the di-

rect impact might be limited, the downgrade adds to broader con-

cern about the state of the U.S. and European economies.

On Monday, S&P will issue more detailed guidance about the impact of the downgrade on the many entities whose own ratings rely on the U.S. government’s AAA rating. These include money mar-

ket funds, government-owned corporations such as Fannie Mae and Freddie Mac, banks, insur-

ance firms, and states and locali-

ties, including those in the Wash-

ington area.

The ratings on numerous mu-

icipalities are likely to be down-

graded after the S&P action, ac-

cording to a report issued Satur-

day by J.P. Morgan Chase.

Meanwhile, on Tuesday, the Fed is set to meet amid increasing evidence that the U.S. economic recovery is faltering.

The central bank is expected to downgrade its assessment of the U.S. economy and is considering taking new, modest steps to bol-

ster economic growth, such as pledging to continue its ongoing efforts to support the economy for a longer period. Fed officials are unlikely to take a significant step toward stimulating the economy at this meeting.

By intervening in bond mar-

kets, the European Central Bank could at least temporarily take some of the pressure off Italy and Spain. Investors have been dump-

ing Spanish and Italian bonds, driving their borrowing costs to record levels in recent days.

The events have sparked fears that the world’s seventh- and 12th-

largest economies could be en-

gulfed by the same kind of crisis that forced smaller Greece, Ire-

land and Portugal to request emergency bailouts.

The ECB, as is customary, did not explicitly say it would buy Italian and Spanish bonds. But it strongly suggested that it would. The bank’s governing council agreed after an eleventh-hour emergency telecon-

ference to take more drastic steps to ensure (bond) price stability in the euro area.

Raj Badiani, economist with IHS Global Insight in London, said the ECB’s action represents “a vote of confidence in the respec-

tive governments and an attempt to provide a sharp jolt to the nega-

tive sentiment engulfing Spain and Italy.”

German Chancellor Angela Merkel and French President Ni-

colas Sarkozy issued a separate statement Sunday saying that they support efforts announced last week by Spain and Italy to shore up their finances and that they support an expanded European rescue fund.

But analysts say the actions may be only a short-term solution. If Italy or Spain fail to quell mar-

ket panic, analysts say, Europeans might be forced to move toward the advent of a new euro-bond, putting the economic weight of Germany and France behind their profligate neighbors. Germany and other strong European econo-

mies are opposed to such a deal or other measures that would make them carry the burden of their struggling neighbors any longer.

Concern over Italy, in particu-

lar, is growing in large part be-

cause Europe’s economies are slowing at the same time that the countries need strong economic growth to tame their debt loads.

Although a snapshot of the Ital-

ian economy released by authori-

ties Friday indicated that the country’s economic growth is bet-

ter than that of some other nations in the region, investors are fixat-

ing on its $2.3 trillion debt and the question of who would aid Italy if it cannot pay its bills.

Last week, the ECB began to scoo-

p up the debt of Portugal and Ireland for the first time since March. But even that measure was opposed by Germany and other fiscally conservative nations, and analysts expect greater concern about the vast sums that would be spent to bolster Italy and Spain.

In a worst-case scenario, Italy would need a bailout of about $1.4 trillion—or more than dou-

ble the size of an established Euro-

pean rescue fund.


Faiola wrote from London. Staff Writers Cozy R. Podkul and Neil Irwin contributed to this report.
Geithner to remain Treasury secretary

by Zachary A. Goldfarb

Treasury Secretary Timothy F. Geithner has told President Obama he plans to remain in his job through the fall of 2012, keeping in place Obama’s longest-serving economic adviser after the first-ever U.S. credit downgrade and renewed fears of a second recession.

Geithner, who has been battling financial crises since 2007 as a top Federal Reserve official and then Treasury secretary, considered leaving the administration after Congress raised the federal debt ceiling and reached an agreement with Obama to tame the national debt.

But several developments have made his departure more difficult. The debt ceiling was raised with only hours to spare. The deal to tame the debt fell short of what Geithner and Obama wanted. The economy has suddenly taken a turn for the worse. And on Friday, Standard & Poor's downgraded the U.S. credit rating for the first time. And the White House, worried that it would be hard to find a suitable replacement, pressured him to stay.

Geithner told the president Friday morning that he would remain in his post. Hours later, he had to go to the White House to meet with Obama again and tell him the nation would likely lose its AAA credit rating.

On Sunday afternoon, Geithner joined an emergency conference call involving the seven major economic powers to discuss the impact of the downgrade.

“Secretary Geithner has let the president know that he plans to stay on in his position at Treasury,” Treasury spokeswoman Jenni LeConte said in a statement. “He looks forward to the important work ahead on the challenges facing our great country.”

White House press secretary Jay Carney said, “The president asked Secretary Geithner to stay on at Treasury and welcomes his decision.”

Exhausted from the multiple crises of recent years, Geithner and his family had decided to move back to New York, where they lived when he was head of the Federal Reserve Bank of New York. His son will finish his senior year of high school there.

Geithner planned to commute from New York to Washington during the week. He did so during the beginning of the term and didn’t like it, so he considered stepping down to tend to his family needs and get a break from government service.

His departure would have marked the loss of Obama’s longest-serving economic adviser at a time when the recovery has slowed and the unemployment rate remains stubbornly high.

Geithner is the last remaining member of the president’s original economic team. Austan Goolsbee, chairman of Council of Economic Advisers, left Friday. Other key members of the team include National Economic Council director Gene Sperling, a former Treasury counselor who is rejoining a role he held in the Clinton administration, and Jacob Lew, the budget director who is likewise rejoining a Clinton-era role.

During his tenure, Geithner has continually won over Obama in contentious policy debates. He shaped the president’s response to the financial crisis, successfully arguing that the government should not seize struggling banks.

More recently, he urged Obama to propose cutting the annual deficit by $8 trillion over 10 years, despite other top advisers advocating that the president focus squarely on the nation’s high unemployment.

Geithner turns 50 later this month. He was one of the architects of the Wall Street bailout in the fall of 2008 and faced sharp criticism in his first year as Treasury secretary, including calls for his resignation. He has been accused of protecting the bonuses of Wall Street traders while paying insufficient attention to the nation’s foreclosure epidemic.

In the past, analysts have discussed Roger Altman, an investment banker and deputy Treasury secretary in the Clinton administration, and Erskine Bowles, a former Clinton chief of staff who co-chaired Obama’s deficit reduction commission, as possible candidates for the top Treasury post.

But administration officials have feared what a confirmation battle would look like in a time of intense partisan conflict.