2011 US ratings downgrade — $2-tr error and the Jharkhand connection

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Fitch Ratings' downgrade of US sovereign rating wasn't well received by the markets for obvious reasons.

However, the reaction this time is significantly better compared with the panic and fear that swept global equity and bond markets in August 2011, when S&P Global Ratings downgraded the US to AA+, a notch below the top rating of AAA.

ANALYSIS.

As it was a historic event then, given it was the first time the US had been downgraded, everyone from Barack Obama to Warren Buffet tried to quell fears, noting there was no chance the US would ever default.

FLASH BACK

Strangely, bond investors also thought so, as amid the panic, investors flocked to buy US government bonds, the very instrument whose credit worthiness had been questioned by S&P. The reason? Investors were, as it is, licking their wounds from the carnage caused by the global financial crisis of 2008 and fears of the Eurozone debt crisis were escalating.

In this context, the ratings downgrade spooked investor sentiment and aggravated panic among them, pushing them to take refuge in US government bonds.

BEARING THE BRUNT

Globally, equity markets bore the brunt of the downgrade. For example, S&P 500 lost 8 per cent in just 2 days and the Nifty 50 4 per cent when the downgrade happened.

But the last US downgrade was not just about the mayhem it caused, it was also notable for a glaring $2-trillion error.

After S&P had submitted the documents to the US Treasury in the morning of August 5, 2011, to alert them of the impending US ratings downgrade, the Treasury had quickly pointed out a massive $-2 trillion error in S&P's calculation of estimates for US federal debt levels.

S&P had quickly gone back to the drawing board, reworked its assumptions, but stuck to its downgrade decision, which it announced at the end of the day.

US' fall from grace

	Foreign currency long term ratings		
	Moody's	S&P	Fitch
United States	Aaa	AA+	AA+
Countries with the highest ratings			
Denmark	Aaa	AAA	AAA
Australia	Aaa	AAA	AAA
Switzerland	Aaa	AAA	AAA
Germany	Aaa	AAA	AAA
Netherlands	Aaau	AAA	AAA
Singapore	Aaa	AAA	AAA
Sweden	Aaa	AAA	AAA
Norway	Aaa	AAA	AAA
Countries with AA ratings			
Emirate of Abu Dhabi	Aa2	AA	AA
Ireland	Aa3	AA	AA-
Hong Kong	Aa3	AA+	AA-
South Korea	Aa2	AA	AA-
Czech Republic	Aa3	AA-	AA-
Qatar	Aa3	AA	AA-
New Zealand	Aaa	AA+	AA+
Finland	Aa1	AA+	AA+
Taiwan	Aa3	AA+	AA
France	Aa2	AA	AA-
United Kingdom	Aa3	AA	AA-
Belgium	Aa3	AA	AA-
Emerging economies			
India	Baa3	BBB-	BBB-
China	A1	A+	A+
Saudi Arabia	A1	A	A+
South Korea	Aa2	AA	AA-
Brazil	Ba2	BB-	BB
South Africa	Ba2	BB-	BB-
Indonesia	Baa2	BBB	BBB
Philippines	Baa2	BBB+	BBB
Mexico	Baa2	BBB	BBB-
Malaysia	A3	A-	BBB+

Source: Bloomberg

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S&P FLAYED

This resulted in much bad blood spilling into the public, with the US Treasury going all out to criticise S&P for the downgrade despite the error.

"A judgement flawed by a $2-trillion error speaks for itself" was the comment from a US Treasury department spokesperson.

According to source-based media reports then, S&P shifted the rationale for downgrade from economic to political after the identification of the error.

In its downgrade, it noted how the political divide had reduced confidence in government's ability for the much-needed fiscal reforms. S&P's response was that the error did not have any impact on the ratings decision, given the political rationale.

JHARKHAND ANGLE

However, it was not just the markets that faced the casualty of the downgrade. There were self-inflicted wounds, as well. Jharkhand-born Indian American Deven Sharma, who had risen through the ranks of corporate America to become President of S&P and head of its ratings division, and hence considered the man who pressed the downgrade button, had to quit S&P a month later.