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S&P Slashes Outlook on U.S. to 'Negative' Amid Soaring Debt

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Sounding the alarm about the country's deep fiscal problems, Standard & Poor's on Monday downgraded its outlook on the U.S. credit rating to "negative," raising the likelihood the U.S. will lose its coveted 'AAA' rating as Washington struggles to fix its beleaguered balance sheet.

The move signals the seriousness of the debt crisis in the U.S., which at most times is considered the safest investment in the world. It is likely to increase pressure on lawmakers and the White House to bridge their wide gaps and could mark the first step to the U.S. losing the perfect credit rating that allows it to tap the capital markets at very low rates.

S&P said the negative outlook means there is a one in three chance of the U.S. losing its 'AAA' rating.

Wall Street was spooked by the S&P call, which marks the first time a credit ratings company has lowered its outlook on the U.S. during the current crisis. The Dow Jones Industrial Average plummeted more than 200 points Monday morning, the U.S. dollar slumped against the yen and gold flirted with $1,500 a troy ounce for the first time ever. European markets, already jittery about their own debt crises in Greece and elsewhere, also tumbled.

S&P explained its rationale for cutting its outlook on the U.S. to "negative" from "stable" by citing the nation's "very large budget deficits and rising government indebtedness."

"We believe there is a material risk that U.S. policymakers might not reach an agreement on how to address medium- and long-term budgetary challenges by 2013; if an agreement is not reached and meaningful implementation is not begun by then, this would in our view render the U.S. fiscal profile meaningfully weaker than that of peer 'AAA' sovereigns," S&P said in the statement.

At the same time, S&P has affirmed its 'AAA' rating on the U.S. and said the economy is "flexible and highly diversified."

In response to the S&P move, the Treasury Department issued a statement that noted recent efforts to fix the country's balance sheet.

"We believe S&P's negative outlook underestimates the ability of America's leaders to come together to address the difficult fiscal challenges facing the nation," said Mary Miller, the assistant secretary for financial markets at the Treasury Department.

Fiscal Wake-Up Call

The downgrade by S&P comes as Washington struggles to reach a consensus on how to fix the country's deep fiscal problems. While Republicans, led by Rep. Paul Ryan, have called for heavy cuts in government spending on entitlement programs, Democrats and President Barack Obama would prefer to tax wealth Americans due to worries about the impact of fiscal reform on Medicare.

"Standard and Poor's is saying, 'Wake up. You have no time to kick this down the road, this has to be addressed now,'" said Peter Kenny, managing director at Knight Capital Group. "Tough decisions need to be made at every level of government to get our house in order."

Historically, America's credit rating had been seen as untouchable and among the safest in the world. "It is backed by a strong track record of prudent and credible monetary policy, evidenced to us by its ability to support growth while containing inflationary pressures," S&P said.

However, spending has increased dramatically in recent years and, critically, tax revenues have failed to keep up the pace.

S&P said the U.S.'s total government deficit fluctuated between 2% and 5% of gross domestic product, or GDP, from 2003 to 2008. Yet it has "ballooned" to more than 11% in 2009 and has yet to recover, S&P said.

“More than two years after the beginning of the recent crisis, U.S. policymakers have still not agreed on how to reverse recent fiscal deterioration or address longer-term fiscal pressures,” S&P credit analyst Nikola Swann said in a statement.

David Beers, global head of sovereign and international public finance ratings, said the downgrade was not related to the debate in Congress over whether or not to raise the debt ceiling, allowing the U.S. to continue to borrow more money, Dow Jones Newswires reported.

Even if U.S. lawmakers bridge wide gaps and reach a deal on a way to fix the budget, S&P notes the work will not be done. Recent experiences -- especially in Europe -- highlight that implementation could take time, cost serious political capital and ultimately be reversed by future lawmakers.

By S&P’s baseline estimate for GDP growth near 3% annually, total government debt may reach 84% of GDP by 2013. In its rosier scenario for 4% GDP growth, total debt would still rise to nearly 80% of GDP by 2013. On the other hand, if the U.S. slips into a mild, one-year double-dip recession in 2012, net debt would surpass 90% of GDP by 2013.

"S&P's change is warranted given the U.S. fiscal disarray. Even with the Ryan proposal, which is unlikely to pass, we have to wait 29 years to balance the budget," said Cam Harvey, a finance professor at Duke, alluding to the Congressional Budget Office's prediction that the budget won't be balanced until 2040 under the Ryan plan.

Ratings Companies Running Out of Patience?

The Treasury Department did receive a heads up over the weekend from S&P about the impending bombshell, a senior Treasury official told FOX Business’s Peter Barnes.

Still, the timing of the comments from S&P have raised some eyebrows, with some saying politics may have a role.

“I think it’s politically-timed,” said Charles Geisst, a finance professor at Manhattan College. “I think that’s the motivation. I'm not quite sure that’s their business to do that -- to make politically-timed statements.”

It would be nothing new though. Moody’s put some U.S. Treasuries on review for possible downgrade in 1996 during a similar budget impasse after Republicans refused to vote to increase the debt ceiling, notes Win Thin, global head of emerging markets strategy at Brown Brothers Harriman.

“With no one expecting any serious progress on deficit reduction until after the 2012 election, S&P seems to be simply firing a shot across the bow to U.S. policymakers,” Thin said. “The S&P statement means that the agencies do not have unlimited patience with regards to U.S. fiscal policy and the rising debt load.”

S&P, Moody’s and Fitch have been criticized for their role in the financial crisis as they kept safe ratings on mortgage bonds that turned out to be very toxic.

“It’s certainly useful to hear this, but I just go back to Standard & Poor’s missing the boat entirely on the subprime crisis,” said Geisst. “I personally would take them seriously, but I’m not too sure everyone will because of that. They can’t spot a subprime crisis in Arizona but they sure as hell spot a budget crisis.”

The U.S. is hardly alone as ratings companies have lowered their outlooks and eventually their ratings on a slew of European countries in recent months and years, highlighted by Greece and Ireland.

In 2009 S&P downgraded the U.K.’s debt outlook to “negative” from “stable,” a move that set off a yearlong effort to slash that country’s spending.

"America's dangerous deficits have come home to roost," said Rep. Kevin Brady, vice chairman of the House’s Joint Economic Committee. "Standard & Poor's is comparing our nation's deficits and debts to our AAA peers and finding reason for concern."