Moody's Downgrade of U.S. Credit Rating

May 2025

Moody's downgraded the U.S. government's credit rating from Aaa to Aa1, citing concerns over rising fiscal deficits, increasing debt burden, and the mounting interest burden. This action follows similar downgrades by S&P and Fitch. While the outlook remains stable given the strong U.S. economy and U.S. dollar dominance, the market reaction was muted, as these concerns were largely priced in. Analysts view the downgrade as a lagging indicator rather than a market-alerting event. Moving forward, Federal Reserve policy and economic fundamentals will play greater roles in shaping U.S. Treasury yield movements.

By Cathay SITE

On May 16, 2025, Moody's Ratings downgraded the U.S. government's credit rating from Aaa to Aa1. This followed similar downgrades by S&P's in August 2011 and Fitch in August 2023. With Moody's action, the U.S. has now lost its AAA rating from all three major credit rating agencies.

Key reasons for the downgrade

Moody's cited several reasons for the downgrade, including: persistent and rising fiscal deficits, averaging nearly US$2 trillion annually and projected to grow from 6.4% of GDP in 2024 to nearly 9% by 2035 without significant fiscal reforms; a rising debt burden, with U.S. federal debt expected to increase from 98% of GDP in 2024 to 134% by 2035; mounting interest burden with federal government interest payments projected to rise from 18% of fiscal revenue to 30% over the same period.

Additionally, Moody's emphasized the lack of political will to implement meaningful fiscal reforms, highlighting growing concerns over policy consistency and the independence of the Federal Reserve, especially after the return of President Trump and his influence over monetary and trade policy.

Outlook remains stable

Despite the downgrade, Moody's revised the U.S. credit outlook from "negative" to "stable," based on the strength of the U.S. economy, the role of the U.S. dollar as global reserve currency, and effective monetary policy led by an independent Federal Reserve. Notably, Moody's affirmed the U.S.' long-term local- and foreign-currency country ceilings at Aaa, which mitigates the risk of downgrades to corporate debt ratings.

Analysts believe that the market had already largely priced in U.S. debt concerns, with U.S. credit default swaps (CDS) showing a similar increase to that following the Fitch downgrade in 2023. Historical precedents show varied outcomes: the S&P downgrade in 2011 led to a decline in yields due to flight-to-quality behavior, while the Fitch downgrade in 2023 had a muted market impact. This suggests that rating actions, while symbolic, are not always materially disruptive to U.S. Treasuries.

Symbolic shift, limited market impact

The Moody's downgrade was more of a confirmation of existing concerns rather than a new catalyst for a major market downturn. The U.S. dollar's status as the world's primary reserve currency, with nearly 58% of global foreign exchange reserves held in dollar assets (mainly U.S. Treasuries), remains a significant factor supporting demand for U.S. debt. Bloomberg's prediction of U.S. government default probability over the next year was at 0.05% on May 16th. Forced selling of U.S. Treasuries appears unlikely.

Looking ahead, factors such as the Federal Reserve's monetary policy and the trajectory of the U.S. economy will be more crucial in determining the direction of U.S. Treasury yields. Long-term investors are advised to stay focused on fundamentals and consider short-term market volatility as an opportunity for strategic allocation.