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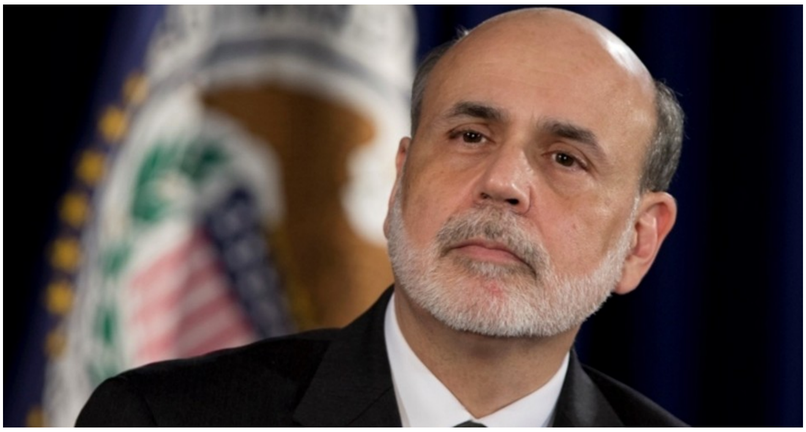
Written by Raven Clabough on September 17, 2012

U.S. Credit Rating Downgraded



The Federal Reserve has announced that it would begin yet another round of quantitative easing, a maneuver that has caused the independent and nationally recognized statistical rating organization Egan-Jones to lower the United States government to "AA-" from "AA." Egan-Jones specifically cited the third round of quantitative easing from the Federal Reserve, indicating it would hurt the U.S. economy and the nation's credit quality.

In the explanation for the downgrade, Egan-Jones stated, "From 2006 to present, the US's debt to GDP rose from 66% to 104% and will probably rise to 110% a year from today under current circumstances; the annual budget deficit is 8%. In comparison, Spain has a debt to GDP of 68.5% and an annual budget deficit of 8.5%."

"We are therefore downgrading the US country rating from "AA" to "AA-," the company announced.

Egan-Jones continued by addressing the impact that the company believes the next round of quantitative easing will have on the economy:

> The Fed's QE3 will stoke the stock market and commodity prices, but in our opinion, will hurt the US economy and, by extension, credit quality. Issuing additional currency and depressing interest rates via the purchasing of MBS does little to raise the real GDP of the US, but does reduce the value of the dollar (because of the increase in money supply), and in turn increase the cost of commodities (see the recent rise in the prices of energy, gold, and other commodities).
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> The increased cost of commodities will pressure profitability of businesses, and increase the costs of consumers thereby reducing consumer purchasing power.
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> In our opinion, QE3 will be detrimental to credit quality for the U.S.

On September 13, the Federal Reserve announced that it will begin a third round of quantitative easing, which entails the printing of more money which is then given to banks to hold or invest in order to increase stock prices.

The Federal Reserve stated September 13 that it is "concerned that, without further policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions."

Fed Chairman Ben Bernanke did his best to sell the notion of QE3, stating on September 13 that quantitative easing is not "comparable to government spending."

Bernanke said the Fed will eventually "normalize its balance sheet by selling" recently-acquired financial assets back into the market.

"The odds are strong that the Fed's asset purchase programs, both through their net interest earnings and by strengthening the overall economy, will help reduce rather than increase the federal deficit and debt," Bernanke said.

This latest round of quantitative easing will involve the purchase of $40 billion in mortgage-backed securities by the Federal Reserve, paid for by printing money. The touted intent is to keep mortgage prices low, thereby encouraging people to purchase homes, and increase money circulation in the economy.

The Federal Reserve's decision to pursue another round of quantitative easing is driven by the same Keynesian logic that has already proven to be detrimental to the economy. And as noted by *The New American's* Charles Scaliger, the maneuver seems to indicate that the Federal Reserve is out of touch with the average American. Scaliger explains that most Americans are "too busy struggling to find or keep employment, pay down debts, and avoid foreclosures" to even consider purchasing a home. In the meantime, banks are not inclined to lend out the newly printed money for home purchases or "invest the new money productively."

Egan-Jones contends that QE3 will not achieve what it is intended to do — raise the real GDP — but will instead reduce the value of the dollar.

Additionally, any efforts by the Fed to push interest rates down to zero "accentuates the negative consequences of this steady erosion in the dollar's buying power by imposing a negative return on short-term bonds and bank deposits. In effect, the Fed has announced a course of action that will steal — there is no better word for it — nearly 10 percent of the value of Americans' hard earned savings over the next 4 years," *Forbes* reported.

The Fed's third round of quantitative easing has already provoked an increase in stock prices.

Many recognize that quantitative easing will prove to be harmful to the economy by increasing inflation and exacerbating all the existing problems that are currently plaguing the economy. Scaliger explains:

> What is likely to result from QE3 is rising prices coupled with stubbornly stagnant unemployment figures. With gasoline again at record highs and grocery costs soaring, inflation is starting take a serious bite at the checkout counter.

A number of experts are in agreement with Egan-Jones' assessment of QE3. In fact, according to an August survey by CNN Money, 93 percent of investment strategists were opposed to another round of quantitative easing, with 77 percent of economists also in agreement.

This is the second time this year that Egan-Jones has downgraded the credit rating. In April, Egan-Jones downgraded the U.S. credit rating to "AA" from "AA+" with a negative watch. That negative watch meant there was a 50 percent chance that the credit rating would be downgraded within the next three months. In fact, they were the firm that downgraded the U.S. last July even before Standard & Poor's did.

"Regardless of who does the downgrade, you have to pay attention — maybe they're not as well known, but Egan-Jones has been ahead of the pack for a while," Joe Saluzzi, co-manager of trading at Themis Trading told CNBC.

The Egan-Jones downgrade came just days after Moody's warned that it would downgrade the United States' credit rating if Congress is unable to reach an agreement on the fiscal cliff. According to the Congressional Budget Office, a failure to reach an agreement and permit the spending cuts and tax increases to take effect would send the economy into a recession.

Currently, both Moody's Investors Service and Fitch give the United States an "AAA" rating, and Standard & Poor's has rated the United States "AA+." However, all of those ratings have a negative outlook.

Photo: Federal Reserve Chairman Ben Bernanke speaks during a news conference in Washington, Sept. 13, 2012: AP Images