Investments - Flash

M. Alain Freymond - Associé & CIO

U.S. CDS SURGE TO EXCEED EVEN CHINA'S

International investors lose confidence in U.S. debt

Four months of chaotic policies on a number of fronts and increasingly problematic financing of US debt have been enough to significantly alter international investors' perception of the quality of the US government's credit rating. As Moody's downgraded the U.S. rating from “Aaa” to “Aa1”, thus withdrawing the last top rating the country held among the three main agencies, the U.S. Treasury CDS reached an extreme level of 57. In one hundred and twenty days, the US Treasury CDS has more than doubled and now exceeds that of the Chinese government (52). It far exceeds all European government CDS levels, notably Germany's (13). The crisis of confidence engendered by Trump's policies on international relations and customs policies comes at the worst possible time for the US Treasury, which is facing a massive need to refinance its global debt (37T). By 2025, $7 trillion in Treasury bonds must be refinanced, along with an estimated budget deficit of nearly $2 trillion. At a time when the United States most needs to reassure international investors, its policies are creating one of the most severe crises of confidence in decades. Long-term yields have thus logically evolved in line with this crisis, and are now at high levels, incorporating excessive expectations of rising inflation over the year (University of Michigan survey +7.3%). We believe that, in this context, the Federal Reserve will soon have to end its QT and buy back Treasury bonds to avoid further tensions on the yield curves. The downturn in activity expected in Q2 should accompany a probable rate cut and contribute to an improvement in sentiment and confidence, underpinning a better outlook for bonds.