continuing to pay the nation’s bills. These extraordinary measures permit the federal government to continue to honor pre-existing commitments; they do not increase spending or authorize new spending. As of September 30, 2017, and 2016, the federal government had the top two highest possible ratings among the largest credit rating agencies in the US. See Item 7A. – Quantitative and Qualitative Disclosures about Market Risk, Sovereign credit rating for further information.

According to the Treasury, an important item for citizens to understand is the current fiscal policy and the importance and magnitude of policy reforms necessary to make it sustainable. According to the Treasury, a sustainable policy is one where the ratio of debt held by the public to Gross Domestic Product (GDP) (the debt-to-GDP ratio) is stable or declining over the long term. GDP measures the size of the nation’s economy in terms of the total value of all final goods and services that are produced in a year. The debt-to-GDP ratio is a measure commonly used to gauge a nation’s ability to pay its debt, as GDP is one measure of a country’s ability to generate the financial resources needed to service its debt. Total Government debt (federal and state and local) held by the public (excluding intergovernmental debt) was $16,797 billion at September 30, 2017, or 86% of GDP, down from 87% of GDP at September 30, 2016. Total federal debt (including intergovernmental debt) was 75% of GDP, while federal debt held by the public (excluding intergovernmental debt) was 70% of GDP, at September 30, 2017.

The projections in the Financial Report at the end of 2017 indicate that the debt-to-GDP ratio was projected to reach 297% in 2092 and to rise continuously thereafter. The debt-to-GDP ratio rises at an accelerating rate despite primary deficits (the total budget deficit excluding net payments) that flatten out because higher levels of debt lead to higher net interest expenditures, and higher net interest expenditures lead to higher debt. Preventing the debt-to-GDP ratio from rising over the 75 years following 2017 was estimated by the Treasury to require some combination of spending reductions and revenue increases that amount to 2% of GDP over the projection period, no change from their 2016 estimates. While this estimate of the “75-year fiscal gap” is highly uncertain, the Treasury believes it is nevertheless nearly certain that then-current fiscal policies cannot be sustained indefinitely.

State and local

We are not aware of a consolidated state and local government source that analyzes its financial sustainability.

Application of critical accounting policies

Preparing financial statements requires preparers to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by the application of accounting policies. As the combined financial statements in this annual report represent the aggregation of financial data prepared by other entities, and as we do not have complete information about the accounting policies used to prepare the data, we are unable to determine what are the critical accounting policies.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The US is exposed to economic risk from its sovereign credit rating, interest rates, foreign exchange rates, equity prices, and commodity prices. These risks may impact our Government’s combined financial statements as well as the overall US economic health and our Government’s ability to achieve its objectives.

During 2017, the US economy continued its long expansion, unemployment declined to long-term lows, and financial conditions remained broadly stable, notwithstanding short bouts of volatility. US interest rates increased further from the extraordinarily low levels of the post-financial crisis period, as the Federal Reserve continued to tighten monetary policy. Key US asset prices appreciated further, in part reflecting the economy’s strength, with valuations notably elevated in US equities, corporate debt, and some residential and commercial real estate markets. Overall, risks to the US financial stability remain moderate, while financial stability risks outside the US appear to have increased; most notably, the potential for a disorderly United Kingdom (UK) exit from the European Union (EU). As a result of post-crisis regulatory reforms, the US financial system is stronger and better-positioned to withstand a shock or an economic downturn than it was before the financial crisis.
Sovereign credit rating

A sovereign credit rating is the credit rating of a country. Sovereign credit ratings give investors insight into the level of economic and political risk associated with investing in a country. The sovereign credit rating usually influences a country’s access to international funding and interest rates. A poor US credit rating could have significant impact on global financial markets.

The three major credit rating agencies, Standard & Poor’s, Moody’s, and Fitch, left overall ratings of US sovereign debt unchanged at AA+, Aaa, and AAA, respectively, during 2017, and each maintained a stable outlook for US Treasury securities at the end of 2017.51

Interest rate

The federal funds rate is maintained by the Federal Reserve and is generally viewed as the base rate for all other interest rates in the US economy. The higher the federal funds rate, the more expensive it is to borrow money. The US federal funds rate can influence domestic and international monetary and financial conditions. See more about the federal funds rate at Part I, Item I. Purpose and Function of Our Government, Other related entities, The Federal Reserve within this report.

The historically low-yield environment continued to encourage greater risk-taking across the financial system in 2017. In particular, as investors search for higher yields, some may add assets with higher credit or market risks to their portfolios. They may also use more leverage or rely on shorter-term funding. These actions tend to raise the overall level of financial risk in the economy and may put upward pressure on prices in certain markets. If prices in those markets were to fall sharply, owners could face unexpectedly large declines in their overall portfolio value, potentially creating conditions of financial instability. Although both short-term and long-term interest rates have risen since 2016, the consequences of past risk-taking may persist for some time.

The weaknesses of the London Interbank Offered Rate (LIBOR) may undermine market integrity and the uncertainty surrounding its sustainability could threaten US financial institutions and the US financial system more broadly. A new appropriate alternative reference rate has been identified as the Secured Overnight Financing Rate (SOFR) and steps are underway to facilitate a transition away from LIBOR to SOFR.

Foreign currency

The currencies of most developed countries are valued based on the demand and supply of the currency. The value of currency can impact economic factors such as trade balance, GDP, and employment.

Despite depreciating in 2017, the dollar remains stronger, on a trade-weighted basis, than its longer-term historical average. The US dollar in 2017 was 13% stronger than its average level over the last 20 years, measured on a trade-weighted basis. The dollar has been supported by gradual interest rate increases from the Federal Reserve, continued strong growth in the US, and concerns about the growth outlook in some other large economies.

Equity

Generally, rising stock prices for companies from a particular country indicate a healthy, growing market, while a downward trend in stocks may reflect weakening fundamentals in a country’s economy. Rising stock prices usually indicate net investment in the future health and growth of the economy. An equity index represents a portfolio of securities of a certain market or sector. Global equity indices represent the overall health of the equity market.

Developed and emerging market equities saw generally strong performances most of 2017. Equity prices in the United States and other major developed countries rose in 2017 after having fallen over the first part of 2016. The increase in equity prices during 2017 may reflect expectations for expansionary US fiscal policies, along with stronger economic data and earnings growth in both emerging market and advanced economies. The S&P 500 index’s composite trailing Price to
Earnings (P/E) and Price to Book (P/B) ratios remained elevated above their 20-year averages in 2017. The technology sector was the top performer during 2017, supported by strong earnings growth and investor preference for “growth” stocks. The financial and industrial sectors outperformed the broad US equity markets in 2017. Additionally, the financial and industrial sectors outperformed the market in months following the US presidential election of 2016, with financials benefiting from a steeper yield curve, and industrials benefiting from the prospect of new infrastructure spending.

US equity valuations remained elevated in 2017 according to various metrics, particularly the cyclically-adjusted price-to-earnings (CAPE) ratio, which accounts for the long-term earnings of S&P 500 firms.

**Commodity**

Commodities are generally traded goods such as oil, crops, and minerals for inputs towards the production of other goods or services. The prices of most commodities are generally valued based on the demand and supply of the commodity. Volatility in global price can have extensive implications for both commodity importers and exporters.

Commodity prices during the first half of 2017 were generally flat, then rose strongly, in the second half of 2017. The overall S&P GSCI Spot Index increased 11% in 2017, largely reflecting a 12% increase in oil prices (which have a majority weight in the index).

Oil prices began to rise late in the first quarter of 2016, against the backdrop of slowing U.S. domestic production, public comments by officials from the Organization of Petroleum Exporting Countries (OPEC) pointing to possible tightening in supply, and improved oil demand outlook. OPEC and major non-OPEC oil producing nations (NON-OPEC) entered into a production limited agreement in November 2016, which put an implicit floor under global benchmark oil prices. In May 2017, OPEC and NON-OPEC nations agreed to extend production cuts through March 2018, resulting in the West Texas Intermediate (WTI) crude oil prices to generally remain between $42 and $61 per barrel during 2017.

Prices of industrial metals continued to rise in 2017, with the S&P GSCI Industrial Metals Index climbing 31% during 2017. The increase is likely due in part to stronger than expected global growth, but also due to prospective supply cuts in some metals. Anti-dumping restrictions may have led to increases in some metal prices, and copper prices were affected by disruptions to mining. The S&P GSCI Agriculture Index was range-bound in 2017.