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THOUGHTS ON THE DEBT CEILING

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Overview:

The U.S. government has bills to pay. These bills come from its responsibility to meet its existing legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and other payments. Unfortunately, the U.S. Government doesn't have enough revenue (mostly generated through taxes) to cover those expenses. Therefore, the government must borrow money, and it does that by issuing bonds (a.k.a. accumulating debt).

The debt limit is a cap on the total amount of money that the United States is authorized to borrow to fund the government and meet the aforementioned financial obligations. The U.S. hit that limit, $31.4 trillion, on January 19, 2023.[1]

Therefore, we are now in a situation where the U.S. Government either raises the debt ceiling or defaults on its debts. Raising the debt ceiling allows the federal government to continue issuing Treasury bonds that bring in revenue and help it pay its bills. But the government can only borrow money if Congress authorizes them to do so *(Note: Congress instituted the limit in 1917 to rein in the Treasury and the Federal Reserve, which were basically spending whatever they wanted and ignoring potential consequences)*.

Has the Debt Ceiling been raised before?

Since 1960, Congress has raised the debt ceiling 78 times, and in the vast majority of cases, Congress extended it without hesitation or drama. Two recent exceptions were the showdowns in 1995-1996 and 2011.

- The government shut down twice between 1995 and 1996. Over a million government workers were furloughed for a week in late November 1995 before the debt limit was raised.[1]

- In 2011, an agreement was made just days before the deadline. As a result, S&P downgraded the U.S. credit rating from AAA to AA+ for the first time. This delay cost the government an estimated $1.3 billion in extra costs that year.[1]

The most important thing to note is that the US Government has NEVER DEFAULTED on its debt.

Why we do not believe the government will default on its debt and the "Crisis" will soon be resolved:

The U.S. dollar is still the king and preferred currency utilized in global markets, and we do not believe it will be replaced anytime soon. The greenback accounts for nearly 60% of all foreign exchange reserves, which is over twice the percentage of total international reserves of the next closest currency.[2] Similarly, as we mentioned, the nation's debt has reached $31.4 trillion. Of that amount, about $24.5 trillion, or 78%, was debt held by the public — representing cash borrowed from domestic and foreign investors.[3] Given the reliance of the global financial system on U.S. Treasury bonds and U.S. dollars, a default could broadly lead to a loss of confidence in the U.S. government and financial markets — an outcome so distasteful to lawmakers that most view it as nearly impossible.

Earlier this month, the Congressional Budget Office (CBO) highlighted the economic severity of a potential, protracted U.S. debt default. The key takeaways from their worst-case scenario forecast are an immediate sharp recession and GDP to fall 6.1% in Q3. In addition, unemployment would increase by 5% with over 8 million jobs lost in Q3 alone.[4] Not to mention that there will be no cash to pay the military, millions of federal pensioners, or beneficiaries of Social Security, Medicare, Medicaid, or other entitlement programs. We think that Congress will not allow this sort of economic turmoil, and therefore believe a resolution on the debt ceiling will ultimately be reached, even in the 11th hour.

Economic Definitions

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

10-year Yield: The 10-year Treasury yield is the yield or interest paid to investors who purchase 10-year Treasury notes. It rises and falls based on myriad factors, including inflation, monetary policy, and investor confidence. The 10-year Treasury yield helps investors track the cost of capital and financial market health.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Congress: Congress is the legislative branch, which makes our laws, and has two parts: the U.S. Senate and the U.S. House of Representatives. Each state has two U.S. Senators and at least one U.S. Representative; the more residents a state has, the more U.S. Representatives it is allowed.

Index Definitions

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Disclosures

1 https://www.visualcapitalist.com/rise-of-americas-debt-ceiling/

2 https://www.imf.org/en/Blogs/Articles/2022/06/01/blog-dollar-dominance-and-the-rise-of-nontraditional-reserve-currencies

3 https://www.pgpf.org/blog/2023/05/the-federal-government-has-borrowed-trillions-but-who-owns-all-that-debt

4 https://www.whitehouse.gov/cea/written-materials/2023/05/03/debt-ceiling-scenarios/