U.S. TREASURIES: CAUTION, LOW CEILINGS

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With most of the focus in Washington, D.C., being centered on the repeal and replacement of the Affordable Care Act, a topic that had garnered a great deal of attention in the past seems to be flying under the radar: the debt ceiling. This disparity in media coverage will more than likely continue, but in the weeks ahead, the debt ceiling debate definitely will be heating up.

What Is It?

The debt ceiling, also known as the debt limit, is the total amount of money the U.S. government is allowed to borrow to meet its legal obligations. According to the Treasury Department, since 1960, Congress has acted 78 times to permanently raise, temporarily extend or revise the definition of the debt limit. For the record, adjustments have been made 49 times and 29 times under Republican and Democratic presidents, respectively.

Recent Episodes

Two of the more noteworthy episodes in the recurring debt ceiling saga occurred relatively recently. The first, and perhaps the most infamous, occurred in 2011. As you may recall, politics was in full play as President Obama and the House Republicans each vied to hold sway, but unfortunately, a budget impasse ensued, with raising the debt ceiling being held hostage in the process. Ultimately, the two aisles came together and produced the Budget Control Act (BCA) of 2011, which not only dealt with budgetary issues but also ended up increasing the debt limit in three steps by a total of $2.1 trillion, to $16.4 trillion.

However, the BCA was too little, too late, as Standard & Poor's still decided to downgrade the U.S. credit rating a notch to AA+ on August 5, 2011, only days after the legislation was signed into law. The move reflected S&P's opinion that the BCA "falls short of what…would be necessary to stabilize the government's medium-term debt dynamics." In addition, the S&P also cited "political brinksmanship" making "America's governance and policymaking becoming less stable, less effective and less predictable."

The BCA increase in the debt ceiling lasted until the fall of 2013, creating the second newsworthy episode. This time around, the debt ceiling debate was coupled with the October 2013 government shutdown, which lasted approximately 16 days. It is important to note that while linked, these two events are not the same thing and often get confused. That being said, a resolution was once again found, as the debt limit was suspended until February 2014 and laid the groundwork for our present-day scenario.

Fast Forward to Now

After a variety of suspensions and resets, the current debt ceiling of $19.8 trillion was put in place on March 15 this year. Since then, "extraordinary measures" have been used to create room for Treasury borrowing to continue to occur. This approach has been utilized many times in the past, but at some point, these measures become exhausted, and action needs to take place. Without Congressional action, this is the position in which Treasury soon will find itself. Consensus analysis tends to place the drop-dead date in early October, but there is a risk it could be pushed up to early September, depending upon budget cash flows.

What if the Unthinkable Happens?

Interestingly, during the 2011 episode, the Treasury and the Federal Reserve (Fed) produced a plan of sorts in case the debt ceiling was not raised in time. With respect to the financial markets, the most important part of this plan stated that principal and interest on Treasuries would be made on time. For maturing principal, Treasury would have "auctions that would roll over those maturing securities into new issues" and for timely interest payments, it would be "holding back other government payments" and use accumulated "sufficient cash balances in its Fed account." Needless to say, prioritization is a politically charged concept, as it means the risk of payment delays and/or partial payments for other government obligations.

This topic can't fit into just one blog post, so I'll follow up with another debt ceiling-related post soon. Stay tuned…

Unless otherwise noted, data source is the Federal Reserve, as of July 20, 2017.

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Federal Reserve : The Federal Reserve System is the central banking system of the United States.