BRIEF UPDATE – US DEBT CEILING

May 23, 2023

Market participants, and the US Federal Reserve, are increasingly focused on the showdown over the US budget and statutory limit on issuing new debt, also called the debt ceiling. As of this writing, White House and Congressional leaders are conducting negotiations to raise the debt limit from its current $31.4 trillion. Treasury Secretary Janet Yellen has indicated that the extraordinary measures used to meet the federal government's obligations under the current debt ceiling may be exhausted as soon as early June. At that point, if Congress does not raise or suspend the debt ceiling, the federal government will be forced to prioritize payment of its obligations. This could lead to suspending payments for government programs or even a default on Treasury interest and/or principal payments.

Any form of default would severely disrupt global financial markets and compromise the US government's future capacity to borrow. However, we believe this outcome is unlikely. Congress has raised the debt ceiling 78 times since 1960; 49 of these under a Republican president and 29 under a Democratic president.[1] And there have been several past debt ceiling conflicts with split leadership in Washington (see the Appendix) that were typically resolved after exhausting nearly all the time available for negotiation. Unfortunately, in recent decades the US debt limit has become a point of contention in debates over fiscal policy, resulting in two partial government shutdowns (in 2013 and again in 2018-2019).[2] We do not believe that either party in Congress views default as a viable option, but the highly partisan environment is making it harder to reach an agreement to extend the debt limit than has been the case in the past. While prior debt ceiling conflicts have ultimately been resolved, there is a level of political brinksmanship that makes markets understandably nervous.[3] Short-term Treasuries with maturities near the expected debt ceiling crisis point this summer have experienced increases in both yields and volatility, reflecting investor nervousness.

Our tactical portfolio positioning maintains a defensive tilt with an underweight position in public equities (and US large cap stocks in particular) versus long-term strategic allocation target weights. We have also added to investment grade fixed income positions, including short-term Treasuries and corporate bonds, given attractive yields. And if rates were to spike higher on fears of a protracted crisis, then we would likely recommend leaning further towards short duration bonds (assuming there is not an imminent need to utilize the cash for liability funding purposes).

If we get closer to the deadline without an agreement and see substantial market reactions, we will reach out to provide additional information and perspective. As always, please do not hesitate to get in touch with any questions you may have.

Appendix: Summary of Recent Debt Ceiling Outcomes

Limit Hit	President	House	Senate	Result	Debt Ceiling Before	Debt Ceiling After
Nov 1995	Clinton	R	R	Raised	$4.9 trillion	$5.5 trillion
May 2002	Bush	R	D	Raised	$6.0 trillion	$6.4 trillion
Feb 2003	Bush	R	R	Raised	$6.4 trillion	$7.4 trillion
Oct 2004	Bush	R	R	Raised	$7.4 trillion	$8.2 trillion
Feb 2006	Bush	R	R	Raised	$8.2 trillion	$9.0 trillion
May 2011	Obama	R	D	Raised	$14.3 trillion	$14.7 trillion
Dec 2012	Obama	R	D	Suspended	$16.4 trillion	
May 2013	Obama	R	D	Suspended	$16.7 trillion	
Mar 2015	Obama	R	R	Suspended	$18.1 trillion	
Oct 2015	Obama	R	R	Suspended	$18.1 trillion	
Aug 2017	Trump	R	R	Suspended	$19.8 trillion	
Dec 2017	Trump	R	R	Suspended	$20.5 trillion	
Mar 2019	Trump	D	R	Suspended	$22.0 trillion	
Sept 2021	Biden	D	R	Raised	$28.4 trillion	$31.4 trillion
Jan 2023	Biden	R	R	TBD	$31.4 trillion	

Source: Ned Davis Research

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[1] *Robert O. Abad, Western Asset Management Company, "The US Debt Limit Saga," May 9, 2023.*
[2] *Jeffrey O. Herzog and Timothy Paulson, Lord Abbett & Co., "Investment Brief: The US Debt Ceiling Debate," May 18, 2023.*
[3] *Ibid.*