IM&R What Will Happen with the Debt Ceiling?

Jerry Burhop, CFA®, CIPM®, Vice President and Portfolio Manager

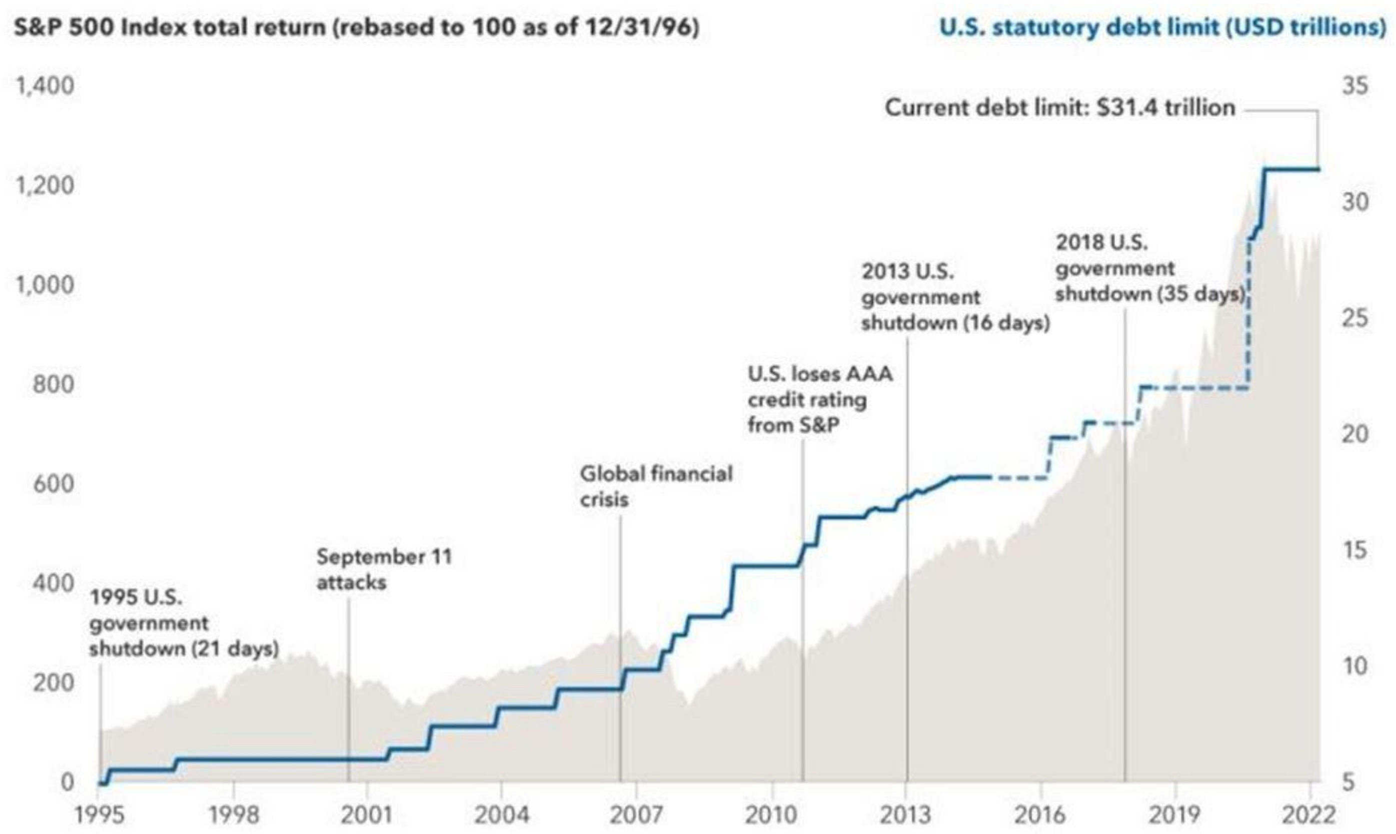
The President and Congress are currently playing brinksmanship with the debt ceiling. President Biden is insisting on a raise of the debt ceiling with no conditions, while House Republicans have passed a bill to raise the limit that requires reductions in future spending.

This is not the first time the U.S. has approached the debt ceiling; in fact, it has been adjusted 102 times since World War II. A battle over the limit in 2011 resulted in S&P lowering the U.S. credit rating to AA+ and has remained there since. Moody's, Fitch and DBRS do have the U.S. rated at AAA. Any additional lowering of the credit rating could cause borrowing costs to rise.

In the run up to the deadline in 2011, the Treasury department prepared a plan to prioritize payments and meet the interest obligations on U.S. bonds, managing the auctioning of maturity replacements to stay within the limit and control the cash on hand. This time it may seem a little different since the politics feel more acrimonious, but the U.S. has never failed to pay its bills. Many people think this could be the worst standoff yet or at least as bad as 2011.

You should expect increased market volatility as the deadline approaches. In IM&R, we do expect a compromise to be reached. That compromise would come in the 11th hour, but still early enough to not threaten another downgrade by the rating agencies. Markets have historically powered through every debt ceiling debate thus far and we expect this one to have similar results. In fact, not long after the 2011 credit rating action, U.S. stocks embarked on one of the longest bull markets in history — a virtually uninterrupted run from 2011 until the start of the COVID-19 pandemic.

A debt ceiling standoff could get ugly, but markets have historically powered through.



Sources: Capital Group, Refinitiv DataStream, Standard & Poor's, U.S. Department of the Treasury, U.S. Office of Management and Budget. Periods in which the statutory limit has been suspended are reflected by the dotted lines. These periods include February 4, 2013, through May 18, 2013; October 17, 2014, through March 31, 2017; September 30, 2017, through March 1, 2019; and August 2, 2019, through July 31, 2021. Data as of March 31, 2023. Past results are not predictive of results in future periods. The S&P 500 is an index of 500 of the largest exchange-traded stocks in the U.S. from a broad range of industries whose collective performance mirrors the overall stock market. You cannot invest directly in any index.

There is always some conversation around the legality of the debt ceiling as the payment of debt is explicitly included in the Constitution's Fourteenth Amendment, making the debt ceiling seem unenforceable.

Fourteenth Amendment, Section 4:
The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned.

Please reach out to your financial professional if you have any questions or concerns.

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