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US debt ceiling in focus

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Pressure is mounting on Congress to suspend or increase the government's debt limit as the so-called "X-date", or date when the Treasury runs out of money and extraordinary measures to raise funds, draws closer. Market concerns of a technical default in the Treasury market are growing, as Congress remains at an impasse over the debt ceiling issue.

As noted in our February debt ceiling update, the USD31.4 trillion federal borrowing limit was reached on January 19, meaning the debt ceiling issue must be resolved soon or the US government risks running out of funds to pay its obligations. The debt ceiling does not authorize new spending but prescribes how much the government can borrow to cover its existing obligations. Since January, the Treasury has utilized extraordinary measures to meet its obligations until the debt ceiling can be raised.

Invesco Fixed Income believes that Congress will ultimately raise or suspend the debt ceiling, allowing the US government to resume its normal debt issuance and financing activities. But negotiations have been tenuous between the White House, which insists on a "clean" debt ceiling bill with no conditions, and some members of Congress, who have refused to consider an increase in the debt limit without spending cuts, making the timeframe for a quick resolution seem unlikely, in our view.

Overview

- On May 1, Treasury Secretary Janet Yellen notified Congress that the Treasury may run out of funds as early as June 1 if Congress doesn't raise or suspend the country's debt limit, or "ceiling". Congressional negotiations to raise the debt ceiling currently remain at a stalemate.
- We are optimistic that Congress will pass legislation to raise the debt ceiling, or temporarily suspend it, though the decision will likely be contentious and go down to the wire.
- Yields on US Treasury bills (T-bills) that mature in early-June through late-August have risen sharply and remain elevated, as these bills are the most impacted by uncertainty over the timing of the so-called "X-date", the date when the Treasury runs out of funds.

What is the likely X-date?

On May 1, Treasury Secretary Janet Yellen notified Congress that, unless the debt limit is increased or suspended, the Treasury may be unable to meet its obligations as soon as June 1.[1] Historically, the Treasury has been conservative in its estimates, given the tendency of Congress to wait until the last minute to resolve this issue.

The Congressional Budget Office has lent credence to Yellen's timeframe, recently highlighting that, "Because tax receipts through April have been less than the Congressional Budget Office anticipated in February, we now estimate that there is a significantly greater risk that the Treasury will run out of funds in early June".[2]

Prior to these updates, market analysts had expected the Treasury to exhaust its cash and extraordinary measures by late-July/early-August. But as more data have become available on federal tax receipts received on April 18, the probability has risen of an early June X-date.

Why is the X-date difficult to predict?

Predicting when the Treasury will be unable to meet its obligations has become increasingly challenging due to the variability of federal tax receipts versus outlays. Secretary Yellen has noted that "the actual date that the Treasury could exhaust extraordinary measures could be several weeks later versus their current estimates".[1] Thus, how long the Treasury can fund the government's operations will likely remain uncertain over the next few weeks.

1. Debt_Limit_Letter_Congress_Members_05012023.pdf (treasury.gov)
2. CBO Sees Greater Risk That the Treasury Will Run Out of Funds in Early June | Congressional Budget Office

Because the annual deadline for filing individual taxes is in April, federal tax collections are usually at their highest in that month, making them critical for determining the X-date. Complicating matters, the Internal Revenue Service has extended the filing date to October 16 for California residents affected by storms earlier this year.[3]

If tax receipts provide the Treasury with sufficient funding through June 15, quarterly corporate tax payments due that day could fund the Treasury through June 30. At that time, a one-time extraordinary measure is set to become available, which could provide an additional USD143billion[4] to the Treasury, and could push the X-date to late July or early August.

Given that the X-date will likely occur between early June and August, yields on T-bills that mature during this window have risen significantly in recent weeks. We believe the X-date will occur in early August, recognizing that a shortfall in tax receipts could pull this timing to early June.

What would happen in the event of a technical default?

The transcript of a joint conference call between members of the Federal Open Market Committee and the Federal Reserve System highlights a contingency plan forged in 2011 during a similar debt ceiling showdown. It could provide guidance on how the current situation might be handled if Congress does not resolve the debt ceiling issue by the X-date.[5]

The 2011 plan discussed procedures based on three principles:

1. Payment of principal and interest on Treasury securities would be made on time.
2. Other payments might be delayed.
3. Settlement of any payments would be made as usual.

If the debt ceiling debate is not resolved, the Treasury could avoid default by continuing to pay interest on Treasury securities as they become due by delaying other payments. As securities mature, the Treasury would likely pay principal by auctioning new securities for the same amount, avoiding an increase in the overall stock of government debt. The Treasury would likely delay payments on all other obligations, including to US government departments and agencies, contractors, Social Security beneficiaries, and Medicare providers until it had at least enough cash to pay a full day's obligations. This would avoid attempting to pick and choose which payments to make on a given day.

Federal workers would likely still be expected to work and national parks and other government agencies would likely be expected to remain open, but federal employees' paychecks would likely be delayed.

There is a risk that, if the government prioritizes payments and indefinitely postpones them to certain programs, lawsuits and litigation could ensue, which would likely add further complexity to an already difficult situation.

Secretary Yellen has averted questions about proceeding down a path that would invite legal challenges, citing that it is imperative that Congress fulfill its job, given the ramifications for the economy and the financial system. Yellen has also noted that options, such as invoking the fourteenth amendment, which requires the president to meet obligations to holders of federal debt, would create a "constitutional crisis".

Conclusion

Looking ahead, the X-date will likely remain very uncertain over the next few weeks and markets will likely be focused on the weekly releases of the Treasury's balances, in addition to formal updates from the Treasury that could provide clarity on the exact timing of the X-date. We are optimistic that Congress will pass legislation to raise the debt ceiling, or temporarily suspend it, though the decision will likely be contentious and go down to the wire.

3. IRS: California storm victims qualify for tax relief; April 18 deadline, other dates extended to May 15 | Internal Revenue Service
4. Description_Extraordinary_ Measures-2023_01_19.pdf (treasury.gov)
5. FOMC Conference Call Transcript, August 1, 2011 (federalreserve.gov)

Learn more

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References and useful resources:

- US Department of the Treasury @ https://home.treasury.gov/
- US Department of the Treasury, Debt Limit https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit
- SIMFA @ https://www.sifma.org/
- Committee for a Responsible Federal Budget (CRFB) @ https://www.crfb.org/
- CRFB Q&A: Everything You Should Know About the Debt Ceiling https://www.crfb.org/papers/qa-everything-you-should-know-about-debt-ceiling

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