



Markets in a Minute: Debt Ceiling

9/30/2021

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As many of us know, regularly spending more than you earn is an easy way to jeopardize your financial health by amassing too much debt. So, it can be hard to watch the national debt grow at a rate that those who spend prudently might consider irresponsible. That said, the U.S. government is not an individual and, for better or worse, sometimes lives by different rules.

Congress, like many households, has been known to squabble over finances, just with higher stakes. It's worth recalling that the current showdown over raising the national debt limit is well-trodden territory:

- Since 1960, Congress has acted **78 times** to modify the debt limit — **14 of those** since 2001.
- The debt ceiling has increased consistently over the past six decades regardless of which party controlled **Congress** or the White House. As noted by the Department of Treasury, it has been revised 49 times under Republican presidents and 29 times under Democratic presidents since 1960.

A quick refresher on the debt ceiling:

- Rather, it allows the Treasury to raise money (by issuing debt) to cover expenses Congress and the president have already approved. (More on this below)
- The debt ceiling, **currently \$28.4 billion**, doesn't authorize new spending commitments. Rather, it allows the Treasury to raise money (by issuing debt) to cover expenses Congress and the president have already approved.
- The debt ceiling was **first enacted in 1917** as part of legislation that gave the federal government greater financial flexibility to fight World War I. The measure also placed a specific limit on borrowing and required Congressional approval for any increase.

Congressional skirmishes over raising the debt ceiling often center on the size of the national debt. So, how high is U.S. public debt? And how does it stack up to that of other developed markets?

- The national debt now stands at about **136% of GDP** — in other words, the U.S. government owes substantially more than the total value of what the country produces each year. Investors, lenders, and economists use debt-to-GDP to gauge a country's ability to service its debt.

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- While the national debt as a percentage of GDP has climbed significantly over time, the cost of servicing that debt has **fallen since 2000** because of the decline in interest rates — and those costs are forecast to drop further. As Treasury secretary Janet Yellen noted in a recent **op-ed**, the U.S. can borrow more cheaply than almost any other country.
- On a relative basis, the U.S. is in better shape than some of its peers and worse off than others. Japan's debt-to-GDP is **a whopping 266%**, while Germany's is **just 70%**.

How did markets perform during the 2011 and 2013 debt-ceiling crises?

- Rather, it allows the Treasury to raise money (by issuing debt) to cover expenses Congress and the president have already approved.
 - In 2011, U.S. equities declined by -2.0% and international equities fell -1.6%
 - In 2013, U.S. equities gained 0.8% and international equities rose 3.0%
- Perhaps counterintuitively, Treasury (particularly longer-dated government bonds) had positive returns during each crisis as a result of the flight to safety among investors worried about the potential economic consequences and other risks, including the European sovereign-debt crisis that was underway in 2011.

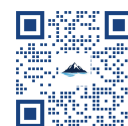
Despite equity and debt markets' ability to largely brush off these skirmishes, there are indeed potentially dire consequences for not raising the debt ceiling. What happens if Congress doesn't raise the debt ceiling — or delays further?

- There are a number of **extraordinary measures** that the Treasury can use to manage debt near the ceiling, such as suspending investments in federal employee pension plans. By some accounts, it has already exhausted many of these measures.
- If the government runs out of money to pay its bills — which at the current pace could happen as soon as October or November — it may be forced to withhold or delay payments on such existing obligations as Social Security and Medicare benefits, military salaries, interest on the national debt, and tax refunds.
- Delays in raising the debt ceiling may diminish the standing of the U.S. government as a borrower and thus force it to pay higher rates on Treasuries because of the perceived higher risk. That would make it more expensive for the government to raise money and higher debt-service costs could crowd out discretionary spending.
- The U.S. Government Accountability Office (GAO) **estimates** that delays in raising the debt ceiling in 2011 increased the Treasury's borrowing costs about \$1.3 billion in that fiscal year. That year, Standard & Poor's took the unprecedented step of lowering its long-term sovereign credit rating on the U.S. from **AAA to A+**, where it remains today.

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Many economists have warned that failing to raise the debt ceiling would have dire economic consequences. As ominous as that sounds, we should remember that we've been down this road before. As Yellen pointed out in her op-ed, "the U.S. has always paid its bills on time." While debt-ceiling showdowns can contribute to market volatility, history has also shown that markets tend to look past these skirmishes.

Sources: *Kestra Investment Management*

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