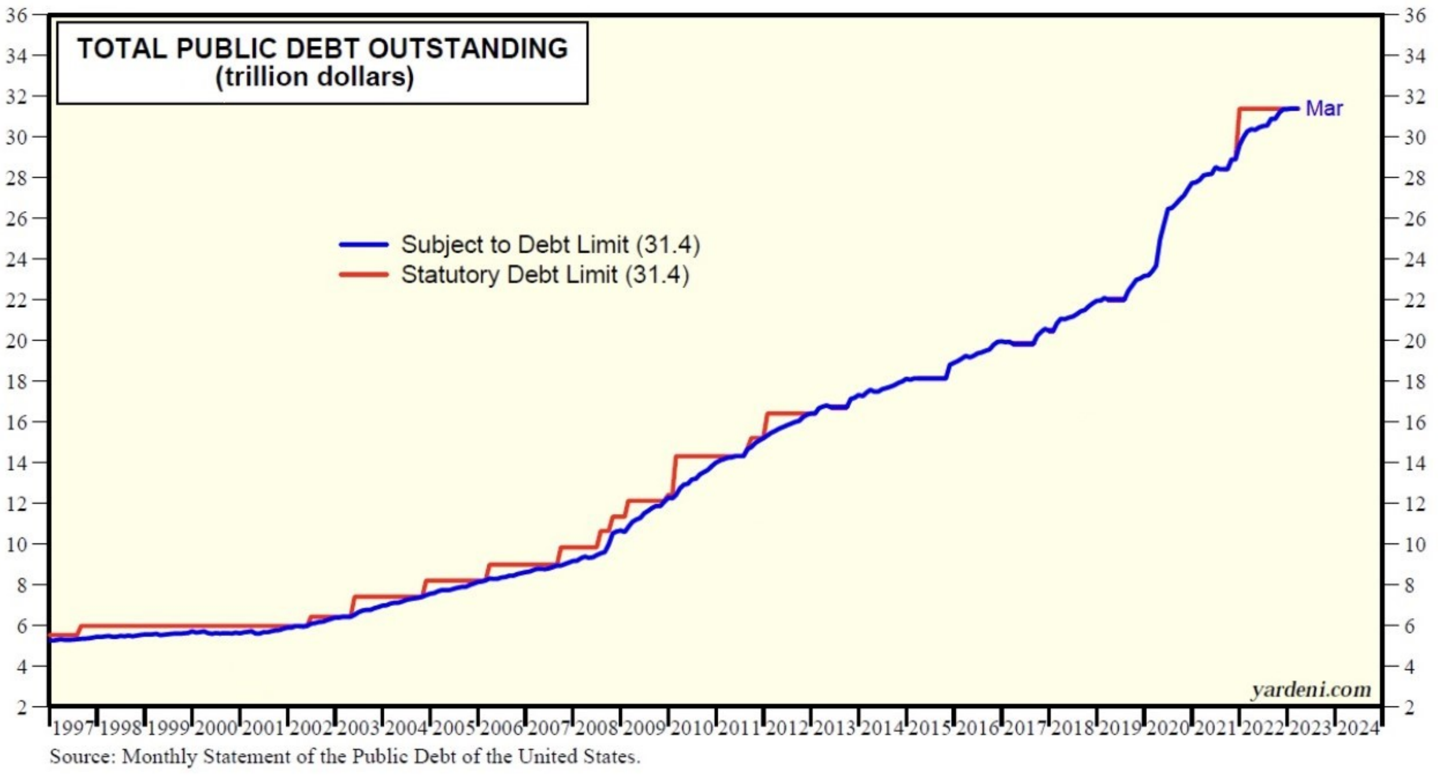
Chart of the Month

April 2023



As shown in the graph above, the U.S. government hit its statutory debt limit of $31.4 trillion in January, prompting the Treasury to implement "extraordinary measures" to pay bills until House Republicans, Senate Democrats, and the White House agree to raise the ceiling, which most likely needs to happen by this summer to avoid defaulting on its obligations. Meanwhile, the Treasury Department has a cash balance of only $265 billion, an amount that is expected to dwindle toward zero until the next quarterly tax receipts arrive in June.

On Wednesday, President Joe Biden reiterated that he will veto the Republicans' debt ceiling bill that passed the House earlier that day. The Biden Administration appears to be firm on refusing to negotiate with House Speaker Kevin McCarthy (R-CA) on anything other than a "clean" debt limit increase. Senate Majority Leader Chuck Schumer (D-NY) has already stated that the GOP's bill (known as the Limit, Save, Grow Act of 2023), which proposes to cap discretionary government spending at fiscal 2022 levels in exchange for raising the debt ceiling by $1.5 trillion until March 31, 2024, will be dead on arrival in the Democrat-controlled Senate despite Sen. Joe Manchin (D-WV) praising the measure.

The debt ceiling crises tend to occur during periods when the parties in power are split with the most difficult struggles happening with a Democrat in the oval office and a Republican-led House of Representatives (as is the case today). The debates typically involve the following talking points: Republicans wanting to reduce wasteful spending and the Democrats claiming that the GOP is going to cut Social Security and Medicare. This showdown is likely to persist until a last-hour deal is reached to either increase the debt ceiling or temporarily suspend it, also known as "kicking the can down the road."

The last time the debt ceiling was breached was in 2011. Standard & Poor's downgraded the U.S. government's credit rating from AAA to AA+ for the first time in history and the S&P 500 fell more than 15% in a matter of weeks (orange line in graph below). The market has followed a similar path thus far this year (see blue line). In 2011, stocks recovered 10% over the balance of the year but failed to get back to their old highs until the following February.

While we are hopeful that an agreement can be achieved, the spreads on U.S. five-year credit default swaps have risen to 54 basis points, their highest level in more than a decade, suggesting Wall Street is growing more concerned about the impasse. Nonetheless, the implied probability of a default is still less than 1%, meaning there is a greater than 99% chance that the federal government will make good on its promises.

S&P 500
2023 vs. 2011

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