Update on the Debt Ceiling

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On January 19, 2023, Treasury Secretary Janet Yellen informed Congress that the outstanding debt of the United States had reached its statutory limit and that the Treasury Department began implementing certain "extraordinary measures" to prevent the nation from defaulting on its obligations. Secretary Yellen also indicated that the period of time those measures may be deployed was subject to considerable uncertainty, but it was unlikely that cash and extraordinary measures would be exhausted before early June. Private forecasters put the so called "X-date" (the term used to reference the expected date that the U.S. Treasury would no longer be able to meet all its financial obligations) sometime in the third quarter. At that time, PFM Asset Management (PFMAM) provided our thoughts on the debt ceiling issue[1].

In a more recent letter[2] to Congressional leaders on May 1, Secretary Yellen provided updated information noting, "our best estimate is that we will be unable to continue to satisfy all of the government's obligations by early June, and potentially as early as June 1, if Congress does not raise or suspend the debt limit before that time." That pulled forward the potential X-date to a date much earlier than previously anticipated.

Secretary Yellen commented in her recent letter that "waiting until the last minute to suspend or increase the debt limit can cause serious harm to business and consumer confidence, raise short-term borrowing costs for taxpayers, and negatively impact the credit rating of the United States" and that failing to act "would cause severe hardship to American families, harm our global leadership position, and raise questions about our ability to defend our national security interests." Other economists have noted that even talking about a possible default is something that great economic powers just don't do.

The timing of when the Treasury could run out of money is a critical factor in understanding the urgency of political negotiations, the Treasury maturities most at risk to a potential default, even if only for a short period of time, and potential market volatility leading up to that date.

1 *PFM Asset Management LLC. (2023, February 9). Our Thoughts on the Debt Ceiling. PFM Asset Management LLC. https://www.pfmam.com/docs/default-source/default-document-library/special-report---our-thoughts-on-the-debt-ceiling.pdf?sfvrsn=470e2f6_0*

2 *Yellen, J. L. (2023, May 1). Secretary of the Treasury Janet L. Yellen Letter to Congressional Leadership on the Debt Limit. https://home.treasury.gov/system/files/136/Debt_Limit_Letter_Congress_Members_05012023.pdf*

The X-date estimate remains uncertain because of the significant daily flows into and out of the Treasury General Account (TGA). While the Federal government typically runs a surplus in April due to individual income tax receipts, the U.S. has run a deficit in May for 55 straight years. June is mixed bag but has been at a surplus 70% of the time, while July and August are uniformly at deficits. However, funding capacity must be met on a day-by-day basis[3].

In addition to higher short-term yields, there are uncertain implications from a Treasury default, or even risk of cutting it too close.

Moody's recently noted[4] that April tax receipts were running 35% below last year's pace, which is meaningfully weaker than anticipated, in part because of weaker capital gains revenue because of last year's stock market declines. When Secretary Yellen wrote the original letter in January, the TGA balance was $455 billion; it dropped to a low of $86 billion just prior to the April 15 tax date; and was $188 billion as of May 3[5]. In addition to other ongoing expenditures, there are large upcoming Social Security benefits or supplemental security income payments[6] on May 10, 17 and 24, and June 1 and 14[7]. The Treasury would expect large inflows from corporate and individual tax payments on June 15. If the Treasury can cover funding needs to June 15, inflows at that time would likely take them to late July.

Because previous expectations were that the Treasury would not hit the X-date until late July or early August, the market reacted to Yellen's updated information by initially pushing up the yield on Treasury bills maturing in early to mid-June. For example, on May 4, the Treasury sold $50 billion of 4-week Treasury bills maturing June 6, 2023, at a rate of 5.84%[8] — the highest yield for any Treasury bill auction since 2000. Yields on Treasuries with maturities in the June–August timeframe remain elevated. In contrast, yield on Treasury bills maturing in May yield 100 basis points (1.00%) less than those maturing in June[9].

3 *Department of Treasury, Bureau of the Fiscal Service. (2023, April 30). https://fiscal.treasury.gov/files/reports-statements/mts/mts0423.pdf*

4 *Zandi, M. Yaros, B. (2023, April). The Debt Limit Drama Heats Up. Moody's. https://www.moodysanalytics.com/-/media/article/2023/debt-limit-drama.pdf*

5 *Bureau of the Fiscal Service. (2023). Issues: Current and Archive. https://fsapps.fiscal.treasury.gov/dts/issues/2023/2?sortOrder=desc#FY2023Q2*

6 *Social Security Administration. (2022, January). Schedule of Social Security Benefit Payments 2023. Social Security Administration. https://www.ssa.gov/pubs/EN-05-10031-2023.pdf*

7 *Fiscal Data. (2023, May 10). https://fiscaldata.treasury.gov/datasets/daily-treasury-statement/operating-cash-balance*

8 *Department of the Treasury, Bureau of the Fiscal Service. (2023, May 4). Treasury Auction Results. https://www.treasurydirect.gov/instit/annceresult/press/preanre/2023/R_20230504_1.pdf*

9 *Treasury Direct. (2023, May). Announcements and Results by Auction Year. https://treasurydirect.gov/auctions/announcements-data-results/announcement-results-press-releases/previous-announcements-and-results/*

In addition to higher short-term yields, there are uncertain implications from a Treasury default, or even risk of cutting it too close. Economic risks and market volatility would likely spike well before the Treasury's account balance is exhausted. In a recent press conference[10], Fed Chair Jerome Powell stated: "It's essential that the debt ceiling be raised in a timely way so that the U.S. government can pay all of its bills when they're due. A failure to do that would be unprecedented. We'd be in uncharted territory, and the consequences to the U.S. economy would be highly uncertain and could be quite averse."

President Biden and House Speaker McCarthy met at the White House on May 9 to attempt to resolve the potential crisis. Initial reports suggest that the parties remain at an impasse. Congressional Republicans want to tie any debt ceiling increase to significant spending cuts, while the Biden administration wants a clean debt ceiling increase with any spending cuts to take place through normal budget negotiations ahead of the October 1 start to the next U.S. government fiscal year. A temporary option used in the past has been a short-term extension of the debt ceiling[11]. This could be used to get through the near-term June 1 – 15 critical period and provide more time for further discussion and negotiations.

Implications for State and Local Government Series (SLGS) Securities

Yellen's May 1 letter also announced the suspension of the State and Local Government Series (SLGS) Treasury securities program. SLGS are commonly used in PFMAM's Structured Products business and are used in refunding escrow portfolios. Without access to SLGS, escrow portfolios must use cash or open market securities, as permitted by bond documents and tax regulations.

PFMAM continues to closely monitor this developing situation and its market impact. Should you have any questions, please reach out to your PFMAM client service professional.

10 *Powell, J. H. (2023, May 3). Transcript of Chair Powell's Press Conference. https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20230503.pdf*

11 *Gangitano, A. (2023, May 4). OMB director says short-term debt ceiling extension possible. The Hill. https://thehill.com/homenews/administration/3988519-omb-director-says-short-term-debt-ceiling-extension-possible/*

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