Sterling Capital Viewpoint: The Debt Ceiling

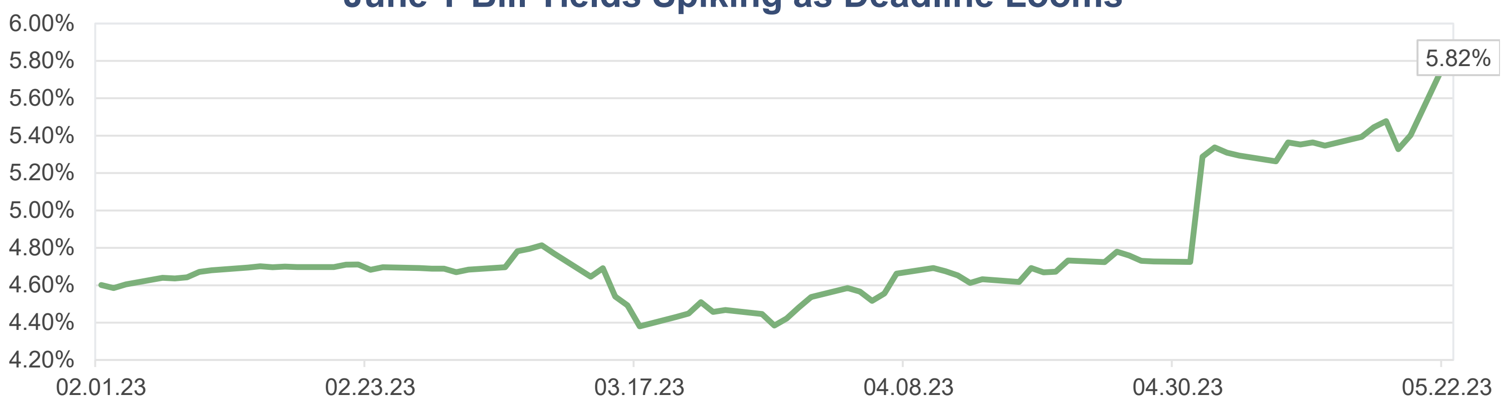
May 22, 2023

The current federal debt limit is approaching $31.4T. Treasury Secretary Janet Yellen has stated that we will hit this limit around June 1 and thus unable to meet all payment obligations. Since January, the Treasury department has used “extraordinary measures” to delay the due date. Such measures include withholding contributions to federal employee retirement funds.

If the U.S. defaults, we believe that Social Security, Medicare, and holders of U.S. Treasury bills and bonds may all be affected. This could damage the reputation of the U.S. and potentially impact the U.S. dollar. The impact would most likely include a run to safe-haven assets including, ironically, longer-term U.S. Treasury notes. The most recent comparable example occurred in 2011, when Standard and Poor’s lowered its rating of U.S. debt to AA+. In that instance, both credit and equities sold off while longer-term U.S. Treasuries rallied.

While this may seem dire, it has happened many times. Since the end of WWII, Congress has approved increasing the debt ceiling over 100 times, most recently in December 2021. The odds that the U.S. will have to miss payments are relatively low, and impacts are typically temporary.

The greatest impact to-date has been on U.S. T-bills due in early June. Yields have spiked up as investors price in the possibility of a delayed payment, as illustrated in the chart below.



Our View

We believe impacts will be minor and mostly temporary, and that after this impasse the market will again turn its focus to inflation and the Federal Reserve, looking ahead to the FOMC meeting on June 13-14 and any subsequent adjustment to the fed funds rate. The situation remains fluid and we anticipate additional volatility.

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Data is as of 05.22.2023. Source: Bloomberg L.P.

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