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US

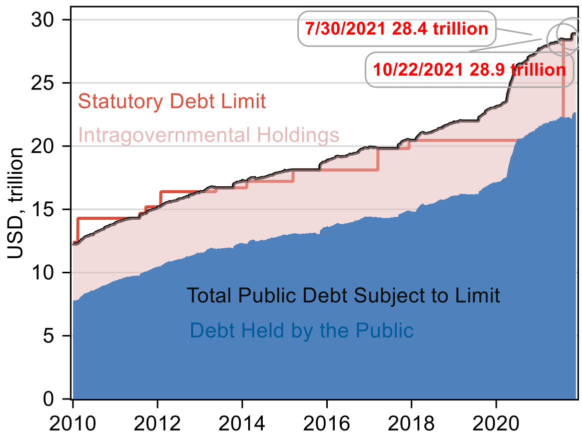
US Debt Ceiling – Approaching the deadline

Both the debt ceiling suspension and the extension of the federal budget for the upcoming fiscal year are facing an official deadline of December 3. However, Treasury Secretary Janet Yellen told lawmakers on Tuesday that she now estimates that the US will reach the 'X Date' on December 15, nearly two weeks later than her initial forecast. These additional 12 days would offer Congress more time to strike a deal on how to lift or suspend the debt ceiling. The market is already starting to price in an increased risk.

The debt limit has already been exceeded

The Treasury Department reached its new USD 28.9tn limit on October 22, and is now, once again, financing the federal government through "extraordinary measures" (legally permissible accounting manoeuvres that temporarily depress debt held in certain trust funds) and cash on hand.

United States: Debt limit, total government debt



Sources: Macrobond and Handelsbanken

In August 2019, policymakers enacted a bipartisan budget deal that raised spending levels and suspended the debt limit for two years. On August 1, 2021, the debt limit was reinstated at approximately USD 28.4tn. The US treasury estimated that the government would run out of money on October 15 2021. On October 14 2021 Biden signed a legislation temporarily raising the government's borrowing limit by USD 480bn to 28.9trn, pushing off the deadline for debt default to December 3. However, Treasury Secretary Janet Yellen told lawmakers on Tuesday that she now estimates that the U.S. Treasury will be able to finance the government later than her initial forecast.

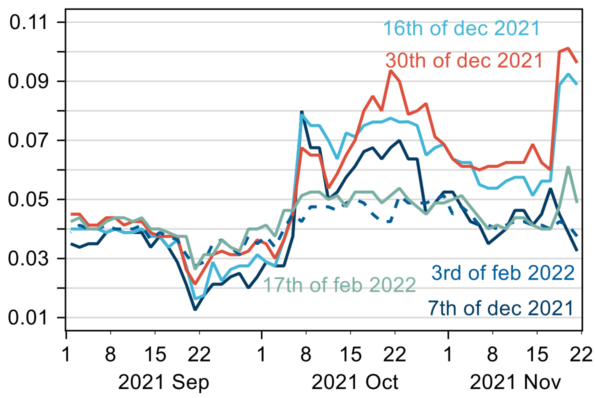
The clock is ticking faster

A day after Biden signed the infrastructure plan on November 16, Yellen wrote in a letter to Pelosi that she now estimates that the U.S. Treasury will reach the X Date on December 15. At the same time government will receive an influx of estimated corporate tax payments, which will probably help them to finance the operations through to December 3.

Estimates from The Bipartisan Policy Centre (BPC) dated October 29 showed that the new X Date may land between mid-December through to mid-February. However, these calculations did not include the transfer of USD 118bn to the Highway Fund to finance the building of railroads and roads as part of Biden's new infrastructure package. The US Treasury now knows that this transfer has to be done within one month after the enactment of the legislation, and completed on December 15th. This means that the clock is ticking faster and, as a result, the market is starting to price in an increased risk for T-bills maturing around the new X-Date.

US Treasury Bills

Maturing between December 21 and February 22



Sources: Macrobond and Bloomberg

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Extraordinary measures

Currently the Treasury needs to run extraordinary measures in order to fulfil their commitments. The three biggest extraordinary measures are: G FUND (Thrift Savings Plan Government Securities Investment Fund), ESF (Exchange Stabilization Fund) and CSRDF (Civil Service Retirement and Disability Fund), with the G Fund being the biggest[1].

DEBT SUBJECT TO LIMIT
EXTRAORDINARY MEASURES
($ billions)

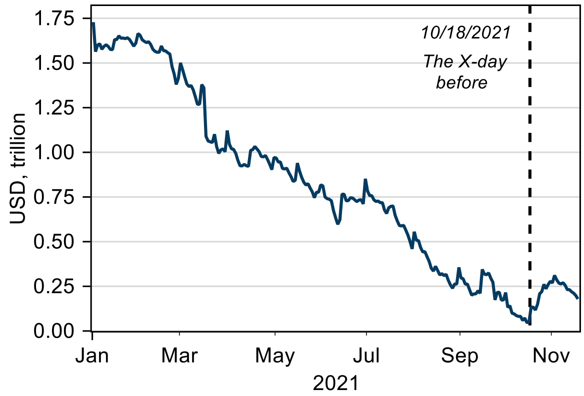
Date	11/10/2021		
Impacted Funds	Measures Authorized	Measures Used	Measures Remaining
CSRDF [1/]	66	(66)	0
G Fund	281	(111)	170
ESF	23	0	23
Totals*	369	(176)	193

**Differences may occur due to rounding.*

Once the Funds are completely disinvested, the measures are no longer useful and Treasury will only have cash on hand plus daily revenue collections to make payments. The next biggest measure, CSRDF, has been totally disinvested since November 15 and US cash on hand is approaching USD 190-170 bn. The cash balance estimates are particularly uncertain due to COVID-19 relief disbursements.

United States Operating Cash Balance

Open position as of Wednesday 17th of November



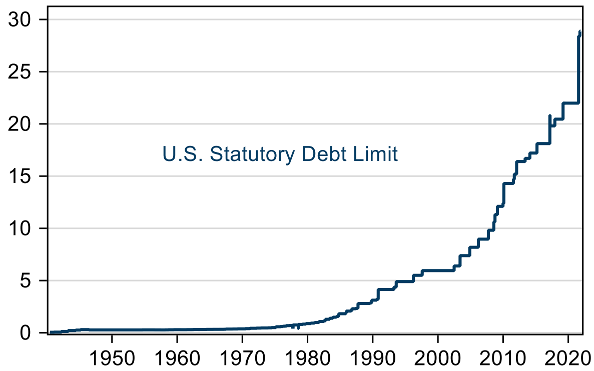
Sources: Macrobond

Why this political schism?

The usual praxis for solving the debt ceiling has been a bipartisan agreement on a reasonable debt limit given the bipartisan nature of the financial obligations that the debt would need to cover. What was once a routine vote has become increasingly partisan and politically weaponised by the Republicans either to demand concessions or force Democrats into unpopular votes to enable more borrowing. This strategy aims to force Democrats to use the reconciliation process to raise the debt ceiling, thus removing the Republicans from the process and from possible political fallout. However, Democrats are unwilling to do that since it would require them to specify a dollar amount to be added to the debt limit, which could then be unpopular with voters.

Debt limit suspension is the kutym since 50´s

Debt limit has been suspended (in some form or other) at least 90 times in the 20th century



Sources: Macrobond, Bloomberg and CRFB

Options before and after the X Date

The base case to raise the debt limit ***before the X Date*** is still that Democrats will propose a reconciliation for the debt ceiling. The difference now is that (unlike October) the Democrats have had time to prepare for this time-consuming procedure. It is possible that they could incorporate it into the Building Back Better reconciliation spending package but they do not need to do that. By using budget reconciliation, Democrats would however only be able to raise the debt limit, not suspend it. The former requires them to come up with a specific dollar amount, while the latter does not demand a specific figure.

The other options on the table are more unlikely. It would look bad for Biden to deliberately invoke the 14th Amendment, especially when it comes to Congress' power of the purse. The government's obligation to pay its debts is literally written into the 14th Amendment of the Constitution and invoking that would literally break the law. Minting a few trillion-dollar platinum coins would create breathing space under the debt ceiling. Treasury could deposit the cash at the Federal Reserve's Treasury account instead of issuing new debt. This would however be

[1] US Treasury´s Daily Debt subject to limit activity from 15th of November 2021

very unconventional and would affect independence of the Fed and Treasury even though well-known economist like Paul Krugman are supporting the idea. For Biden to use this so-called nuclear solution and change Senate rules, the Democrats would need to be strongly in agreement in order to suspend the Republicans from filibustering the vote. This currently seems quite unlikely to happen.

After the X Date, the Federal government will lack the cash to pay all of its obligations. Because the nation runs a deficit, eventually there will not be enough cash on-hand to make all scheduled payments in full and on time. How the Treasury would operate in such an environment is unclear. Prioritization and delayed payments are two possibilities, but substantial uncertainty exists about operationalising them. Otherwise the government needs to default some of its obligations.

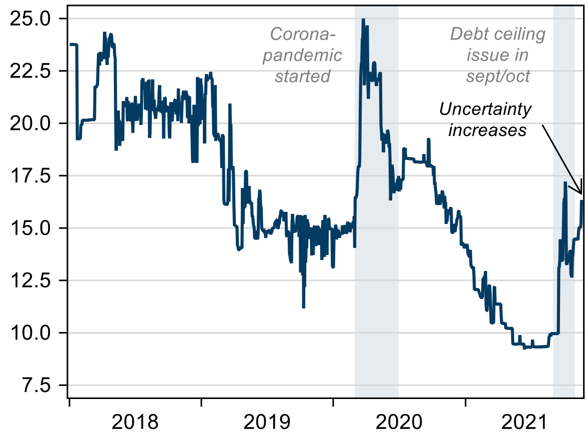
The Treasury Department's Office of Inspector General (OIG) released a report in 2012 on post X Date strategies that Treasury was considering during the summer of 2011. Amongst them was a contingency plan to prioritise principals and interest rate payments before other obligations. The Treasury Department and the New York Fed likely have the technical capability to make principal and interest payments on Treasury securities while delaying other payments. However, choosing to pay certain obligations before other obligations such Medicare, military, defence, childcare and pensions would be of questionable. The other option is to delay all the bills. Treasury might wait until enough revenue is deposited to cover an entire day's payments, and then make all of those payments at once.

Since debt operations (interest and principal payments) are handled by a separate computer system, those payments could likely still be prioritised under this scenario, although legal and operational question marks would remain. In the 2012 OIG report, some senior Treasury officials stated that they believed this to be the most plausible and least harmful course of action.

Political wrangling at the cost of the economy

The inability of either party to compromise is pure politics, with both sides eyeing the midterms and trying to manoeuvre the other side into taking a hit. Much of the uncertainty surrounding the possibility of default assumes that it would come as a result of a miscalculation. But what if a hypothetical situation were to become fact? What would happen if one Party decided to force a default in order to sink the other side, prioritising its own short-term political gains over the country's long-term economic health?

U.S. sovereign credit default swap (CDS)



Sources: Macrobond and Macrobond

This is of course an unthinkable scenario right now and all other debt limit impasses have been resolved. Each time, Republicans and Democrats have been able to reach a deal, and crisis has been averted. However, this has been one of the toughest disparities in congress in the last 100 years and Democrats blame Republicans for breaking with a long-standing tradition of bipartisan cooperation on the debt limit. This is not the first time that the dysfunctionality of US politics has created uncertainty and decreased the country´s creditworthiness. This has been reflected in sovereign CDS spreads, which have clearly been increasing recently.

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