U.S. Debt Ceiling

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U.S. Debt Ceiling: a brief overview

The Debt Ceiling is a legislative limit set by the United States Congress on the maximum amount of debt the federal government can borrow to fund its operations. The system was created during World War 1 to simplify borrowing. Before then, any new spending measure required approval from Congress. The current debt limit is $31.381 trillion and was reached in late January. Since then, the U.S. treasury has invoked “extraordinary measures” so that the U.S. can pay its bills and avoid default; however, these funds could run out as early as June 1st.

Historically, when the U.S. reached its maximum allotted debt, Congress would raise the debt ceiling, which enables the U.S. government to borrow more money to pay its obligations. This occurs quite regularly, as Congress has raised the debt ceiling 78 times since 1960. If the U.S. were to default, there would be a pause on tens of billions of dollars of payments, including social security, Medicare, and interest on past debt. This would likely lead to downgrades of the country’s credit rating, increased borrowing costs, and broader economic instability.

What is currently happening?

The Republicans, who have a majority in the United States House of Representatives, want to cut government spending and refuse to raise the debt ceiling until they can arrange a deal with The Biden Administration. There have been ongoing negotiations amongst the two parties, with both parties stating that the U.S. government will not default and that they are making progress towards an agreement on the budget. In terms of the deal, cuts to Medicare and Social Security have already been ruled out and a reduction in Covid-19 relief funds is largely agreed upon amongst both parties. Sources say they are $70 billion apart in a deal that will be worth well over $1 trillion.

Outlook

Both parties are eager to come up with resolution to this issue. Although the situation is quite fluid, it looks like progress is being made. This will only have a short-term impact, if any, on our portfolios caused by market uncertainty. If equities decline in the coming days due to reasons related to the debt ceiling, they will recover once a deal is reached and the ceiling is raised. Hence, we will take advantage of the potential price weakness if the situation drags on by adding to the quality companies that we already own in the portfolios.

Sources: CI Global Asset Management as of May 29, 2023.

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