
DEBT CEILING: WAITING FOR A DONE DEAL

Kevin Flanagan — Head of Fixed Income Strategy

05/31/2023

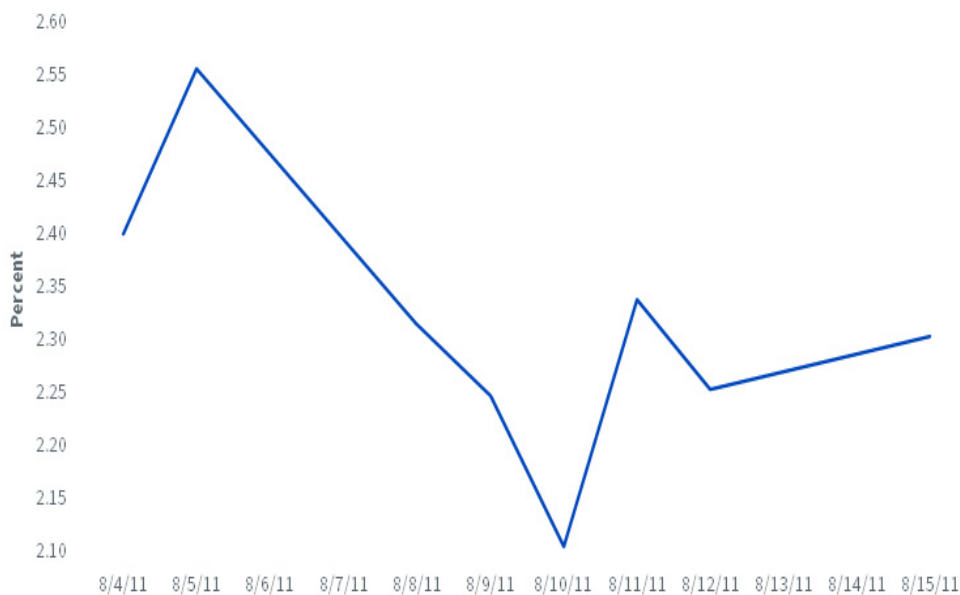
As I write this blog post, the [debt ceiling](#) saga is unfortunately still ongoing, but definitive progress has been made. According to reports, the Biden Administration and Congressional Republican negotiators have agreed to a debt ceiling/budget deal, with the expectation that a vote in the House of Representatives would come by mid-week. The Senate would then take up the legislation for a vote. Late last week, Treasury pushed back the debt ceiling 'X' date to June 5th. While a somewhat welcome development on the surface, the shot clock is still ticking.

On that note, the credit ratings agencies have now been injected into the conversation. In my prior debt ceiling-related blog post earlier this month, I mentioned how as recently as March of this year, S&P Global Ratings affirmed the U.S. [AA+ rating](#) with a stable outlook. That was more than two months ago, and now we have Fitch Ratings weighing in on the subject last week. While the actual [AAA rating](#) for the U.S. remained unchanged, Fitch did downgrade the outlook to "negative watch" due to the dysfunction occurring in the debt ceiling process.

The more widely followed Moody's Investors Service also weighed in on the matter. The Aaa rating and "stable" outlook are still being maintained, but if the upcoming June 15 interest payment were missed, the rating agency would downgrade the US rating one notch to Aa1. Interestingly, both Fitch and Moody's expect a debt ceiling deal, but the two ratings agencies have taken somewhat different approaches. For Moody's, it appears as if the more important criterion is an actual default of debt service, whether it be principal or interest, while Fitch appears to be focusing more "on the process".

That takes us back to the 2011 episode, one which has some intriguing similarities to the current debt ceiling chapter. Ultimately, the Democrats and Republicans came together and produced the Budget Control Act (BCA) of 2011, which ended up increasing the debt limit. However, the BCA was too little, too late, as S&P still decided to downgrade the U.S. credit rating a notch to AA+ on August 5, 2011, only days after the legislation was signed into law. The move reflected S&P's opinion that "political brinksmanship" was making "America's governance and policymaking becoming less stable, less effective and less predictable."

U.S. Treasury 10 Year yield



Source: Bloomberg, as of 5/25/23.

So, how did [Treasuries \(UST\)](#) respond to the 2011 downgrade? Conventional wisdom (including yours truly) thought yields, such as that for the [UST 10 Year note](#), would go up. Intuitively, one would think that a credit downgrade would not be a positive development. However, a visible risk-off reaction ensued following the downgrade with the S&P 500 falling nearly 7% in the immediate aftermath. Meanwhile, despite the negative credit rating action, Treasuries were still viewed as the global safe-haven investment, and the UST 10 Year yield actually plunged 45 [basis points](#) in the days that followed (see graph).

Conclusion

Certainly, past is not necessarily prologue, but as we've seen in the past, the rating agencies can still act even if there's a debt ceiling agreement, especially if the focus is more on the "partisan/dysfunctional process". Given the uncertainties surrounding the debt ceiling saga, sometimes looking at current headlines juxtaposed with historical events can provide some useful context.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Blogs

- + ["Floating" Up to the Ceiling...Revisited](#)
- + [Some Perspective on Banking Woes: Two Months Later](#)
- + [The New Fed Debate: Skip vs. Pause or Pause vs. Cut?](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Debt ceiling : The maximum amount of money that the United States can borrow cumulatively by issuing bonds.

AA+ Credit Rating : The AA+ rating is issued by S&P and is similar to the Aa1 rating issued by Moody's. This rating is of high quality and falls below the AAA ranking. It comes with very low credit risk, even though long-term risks may affect these investments. The AA+ rating is considered one of the rankings for investment-grade debt.

AAA credit rating : This is the highest issuer credit rating assigned by Standard & Poor's, signaling strong confidence that the issuer will be able to maintain its payment obligations.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Basis point : 1/100th of 1 percent.