

“Floating” Up to the Ceiling...Revisited

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How concerned should investors be about the pending debt ceiling debate? History has shown us that a resolution always seems to be found, but past debt ceiling sagas, as well as the current episode, underscore the point that this has become a very contentious, politically charged issue that takes investors down to the wire.

What Is It?

The debt ceiling, also known as the debt limit, is the total amount of money the U.S. government is allowed to borrow to meet its legal obligations. According to the Treasury Department, since 1960, Congress has acted 78 times to either permanently raise, temporarily extend or revise the definition of the debt limit. For the record, adjustments have been made 49 times and 29 times under Republican and Democratic presidents, respectively. The present debt limit stands at \$31.4 trillion, and according to the most recent update from Treasury Secretary Yellen, it looks like the “extraordinary measures” put in place to push out the “day of reckoning” will run out in early June.

Recent Episodes

Unfortunately, debt ceiling sagas have seemingly become more commonplace in recent years, with perhaps the most noteworthy episode occurring in 2011. As the reader will recall, partisan politics was on full display back then as well, as President Obama and the House Republicans were each vying to hold sway, but a budget impasse ensued, with failure to raise the debt ceiling being held hostage in the process. Ultimately, the two aisles 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.” Interestingly, as recently as March of this year, S&P Global Ratings affirmed the U.S. AA+ rating with a stable outlook.

What Should Investors Focus On

It looks like the “2023 version” will be “messy” as well. What exactly do we mean by “messy”? The answer is essentially twofold. Obviously, the political process comes to mind, but we are also going to take a look at the ramifications for the U.S. Treasury (UST) market, more specifically, t-bills. T-bills are the focus because these are the instruments that market participants feel have a higher possibility of being negatively

impacted if the debt limit is not raised on a timely basis due to the weekly maturity feature of these securities. In other words, the t-bill maturity dates would potentially be occurring right around, or right after, the debt ceiling needed to be raised, and the overarching concern is that failure to raise the debt ceiling on a timely basis could lead to a delayed payment. Interestingly, there seems to be a broad consensus that t-bill holders would eventually get paid, so it's more of a "delayed payment" anxiety.

That Was Then

Prior debt ceiling episodes provide a good snapshot of what investors could potentially expect to see if there is no agreement as the deadline date looms ahead. Obviously, past experiences don't necessarily mean a similar result for present occurrences, but they do offer some useful insights, nonetheless. The Federal Reserve Board has published a study in the past showing how t-bill yields performed during the 2011 and 2013 episodes. They noted that in each instance, t-bills maturing around the projected deadline date did experience an uptick in yield, with the bills slated to be the second to come due after this date revealing the largest gains. For the 2011 chapter, the peak increase was 19 basis points (bps), while in 2013, the increase was more than twice as big at 46 bps.

This Is Now

Post-[May FOMC meeting](#), some t-bills that will mature in early June of this year are trading with higher yields due to the debt ceiling effect. Remember, June has seemingly become the consensus estimate for the deadline date this time around. In fact, last week's 1-Month t-bill auction registered a record yield of 5.84%. However, it should be noted that the yield has come back down to the 5.35%–5.40% vicinity as of this writing.

What If the Unthinkable Happens?

Interestingly, during the 2011 episode, Treasury and the Fed produced a "plan" of sorts in case the debt ceiling was not raised in time. With respect to the financial markets, the most important part of this plan stated that principal and interest on Treasuries would be made on time. For maturing principal, Treasury would have "auctions that would roll over those maturing securities into new issues," and for timely interest payments, it would be "holding back other government payments" and use accumulated "sufficient cash balances in its Fed account." Needless to say, "prioritization" is a politically charged concept, as it means the risk of payment delays and/or partial payments for other government obligations.

Reducing the Potential Uncertainty Quotient

While there are probably some who feel that this time around, there may not be a solution on a timely basis, the lion's share of participants seems to be operating under the assumption that the U.S. government will ultimately meet their obligations. However, even the slightest prospect of a temporary technical default can create investor anxieties, a sentiment one does not usually think about with "safer" investments. As I've detailed, the UST market, specifically t-bills, has the potential to see increased volatility in the days/weeks ahead. For those investors who wish to avoid the potential debt ceiling scenario that could be forthcoming,

the [WisdomTree Floating Rate Treasury Fund \(USFR\)](#) offers an alternative that focuses on floating rate Treasuries with stated maturities of essentially 1–2 years.

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