

US Macroeconomics

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Where Are We on the Debt Ceiling?

There will be a last minute deal to increase and extend the debt ceiling. This is what always happens, and it will happen again. It will not be as bad as 2011 when the US was downgraded. The rating agencies had put the US on negative watch months before the showdown. And there was an unruly 49 seat GOP majority that made it harder for then Speaker Boehner to negotiate with President Obama.

Today, Speaker McCarthy has a much narrower nine-seat majority, which arguably gives him less maneuvering since he can afford to lose at most four members. Remember the GOP holds 18 seats that Joe Biden won. However, the House passed a debt ceiling increase a few weeks ago which gives Speaker McCarthy some negotiating power. In general, both sides may be evenly positioned in the debate. A recent Washington Post/ABC News poll essentially put equal blame on both Democrats (36%) and Republicans (39%) if an agreement is not reached.

There are plenty of areas where both sides can find compromise, but we pinpoint five. One is the **length of the debt ceiling extension**. The Democrats want a two-year extension that extends the debt ceiling increase past the 2024 Presidential Election while the Republicans want a one-year extension. Our best guess is that it will be two years.

Two, Republicans want 1% to 2% **discretionary spending caps** above what has already been appropriated. There is a lot a wiggle room here to negotiate because of how budget accounting works. For example, a “spending cut” occurs when spending grows less than what has been appropriated so a cap may not be painful in any meaningful sense. Republicans may agree to the Administration’s proposed IRS funding in return for these caps.

Three, there is upwards of **\$60 billion of unused pandemic-related funding** that could be clawed back for budgetary purposes. The Administration already said it was amenable to this, so this will be part of any package. Republicans can claim they cut spending, too!

Four, **government regulations** make the permitting process difficult and drawn out. It can take years to build a new plant or facility. It is particularly onerous for the energy sector. The Republicans want a faster approval process. Democrats may acquiesce if “green” technologies are part of the discussion as it can take an inordinate amount of time to build wind farms.

Five, the Republicans want **work requirements** for those families in the Supplemental Nutrition Assistance Program (SNAP). This may be harder to accomplish unless there is worker training and other “perks” involved for those already in SNAP.

In terms of the timing, the X-date is Thursday, June 1 although history tells us there is some room for this to extend into the following week. We doubt that there will be a short-term extension because both sides already have said they do not want one. **A negotiated debt ceiling bill should be completed by Friday, June 9 at the latest.** The negotiation cannot drag out until July because this would damage the Treasury Department’s credibility.

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