Goldman Sachs | Economics Research

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US Economics Analyst

The Debt Limit Looks Riskier Than Usual (Phillips)

- We estimate Congress will need to raise the debt limit by mid-October, though it is possible the Treasury might be able to operate under the current limit until late October. It is possible, though not likely, that the Treasury might be able to continue to make all scheduled payments until sometime in early November if the deficit is smaller than expected.
- There are two procedural routes congressional Democratic leaders can take to raise the debt limit, but neither is easy. Democrats would not need Republican support if they use the reconciliation process, but they would face a number of other procedural and political disadvantages. Attaching a debt limit suspension to upcoming spending legislation looks more likely, but this might not succeed and could lead to a government shutdown.
- A failure to raise the debt limit would have serious negative consequences. While it seems likely that the Treasury would continue to redeem maturing Treasury securities and make coupon payments, if Congress does not raise the debt limit by the deadline the Treasury would need to halt more than 40% of expected payments, including some payments to households.
- Beyond the direct impact, the debt limit could also affect the medium-term outlook for fiscal policy. We already expect the Democratic fiscal package to be scaled back from the proposed $3.5 trillion/10 years in new spending to $2.5 trillion, offset by around $1.5 trillion in new tax revenue. While there is not necessarily a direct linkage between the debt limit and the fiscal package, the more these issues become entangled the more pressure there may be from centrist Democrats to scale back the size of the fiscal package.

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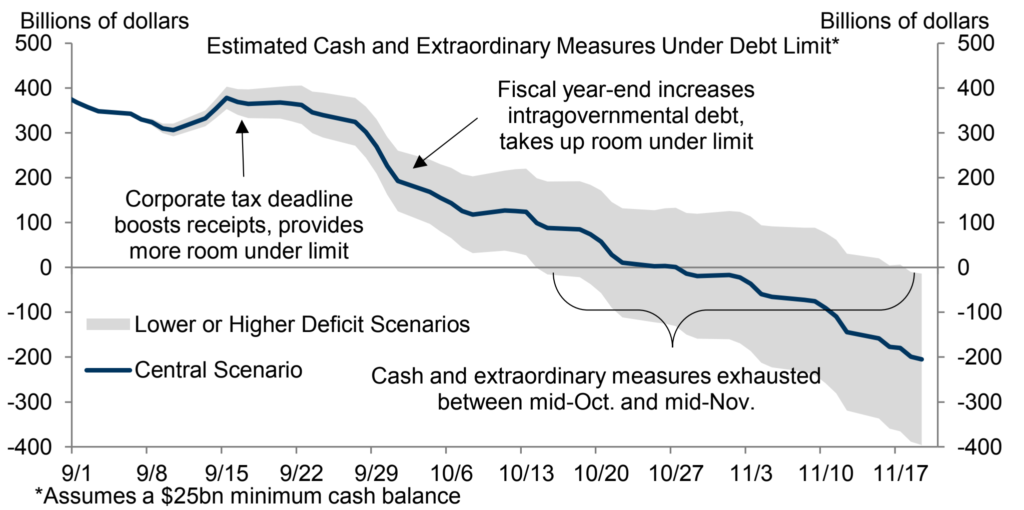
The Debt Limit Looks Riskier Than Usual

An October Debt Limit Deadline

We estimate Congress will need to raise the debt limit by mid-October, though it is possible the Treasury might be able to operate under the current limit until the end of the October (Exhibit 1). If revenues surprise to the upside—the September 15 corporate tax deadline should provide new information—or outlays surprise to the downside, it is possible, though not likely, that the Treasury might be able to continue to make all scheduled payments until sometime in early November.

Exhibit 1: The Debt Limit Will Bind in October



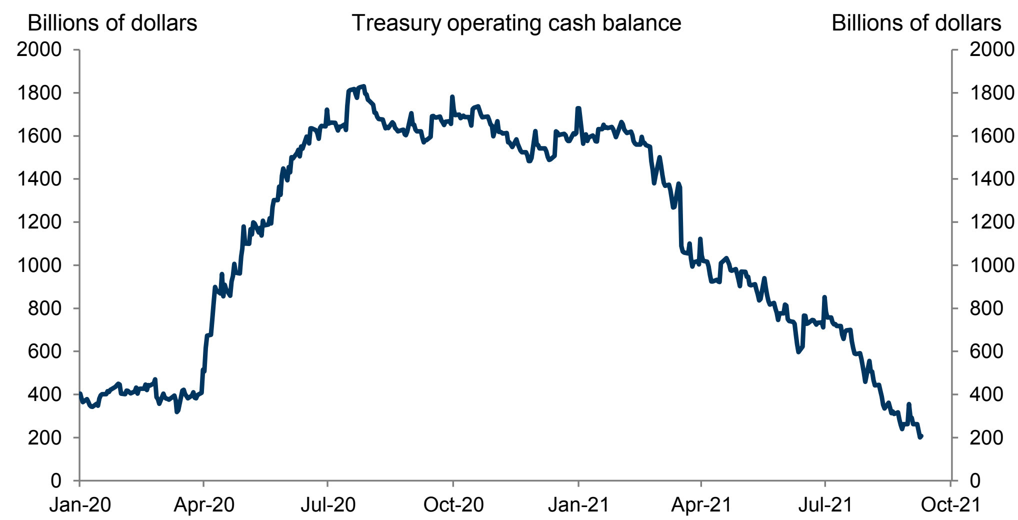
Source: Goldman Sachs Global Investment Research

Projecting the amount of room remaining under the debt limit is more difficult than usual, for two reasons. First, cash flows are somewhat less predictable. This was particularly true earlier in the year, after Congress approved large amounts of COVID-relief funding. While day-to-day swings in cash flows have been closer to the normal range recently, the potential need to fund various COVID-relief programs still exists and creates additional uncertainty regarding the deadline.

Second, the Treasury's higher-than-usual cash balance creates ambiguity. In the past, the Treasury's projection of the date by which Congress needs to raise the debt limit has assumed a minimum level that the cash balance must not drop below (e.g. $25bn). Since the cash balance is usually much smaller than it has been over the last year, the main determinant of the deadline was the size of the deficit relative to the "extraordinary measures" that Treasury can employ to make room for additional borrowing under the limit.

This time around, the Treasury started with a cash balance of $459bn when the debt limit was reinstated Aug. 2, much larger than ahead of prior debt limit deadlines. This has declined to around $200bn since then (Exhibit 2). In light of greater uncertainty regarding cash flows, setting a higher minimum cash balance than usual would be prudent. That said, a projection that the debt limit must be raised at the same time that the Treasury has a large cash balance would likely reduce the credibility of the projection and the urgency Congress feels at that point to raise it. The deadline is likely to fall in October regardless, we believe, but a more conservative (higher) assumption regarding the cash balance could put the deadline earlier in the month, while a lower assumption would put the deadline closer to the end of the month.

Exhibit 2: The Treasury's Cash Balance is Likely to Fall Further



Source: US Department of the Treasury

There Is No Easy Way Out

There are two procedural routes congressional Democratic leaders can take to raise the debt limit, but neither is easy. The first would be to pass the increase via the reconciliation process, which they are also attempting to use to pass a broad fiscal package. The only advantage this would provide is that reconciliation legislation requires only 51 votes to pass the Senate, rather than the 60 usually needed. In theory, it could pass with only Democratic votes.

However, using the reconciliation process has several disadvantages. First, it would require Democrats to pass a new budget resolution. The resolution the House and Senate passed in August House and Senate passed last month to provide procedural protections to their $3.5 trillion fiscal legislation omitted a debt limit increase. Revising the resolution would take time and there is some question as to whether it would be procedurally possible[1]. Since the resolution also sets the parameters for the upcoming fiscal package that has already started to move through committees, reopening the budget resolution could create problems for that bill as some centrist Democrats might be loath to vote again to allow such a large package, particularly if a debt limit increase is attached.

Second, while Senate rules clearly allow the debt limit to be raised, there is a good

[1] Although the Budget Act of 1974 clearly allows revisions to the resolution, the Senate Parliamentarian has imposed some restrictions on the circumstances under which revisions can be made.

chance that suspending the debt limit would be prohibited. Over the last decade, debt limit suspensions have become common instead of increases, as suspensions allow lawmakers to avoid voting on a large dollar figure. An increase lasting past the 2022 midterm elections would be in the trillions, which congressional Democrats are apt to want to avoid, particularly at the same time they are debating a large fiscal package.

Third, using the reconciliation process would likely mean that Democrats alone would bear the political burden of raising the limit, since Republicans would be unlikely to vote for an increase (or suspension) unless absolutely necessary.

In light of these disadvantages, we would not expect Democrats to pursue a reconciliation strategy for the debt limit before the end of September. Instead, it appears more likely to us that a debt limit suspension will be added to other legislation Congress will vote on in the next few weeks.

The most likely scenario would be for Democratic leaders to combine the debt limit suspension with a stopgap spending bill (a "continuing resolution") that would extend spending authority past the end of the fiscal year (e.g. from Oct. 1 to mid-December) as well as provide funding for disaster relief and resettling Afghan refugees. At the moment, the vote on that bill looks likely the week of Sep. 20, though this could slip.

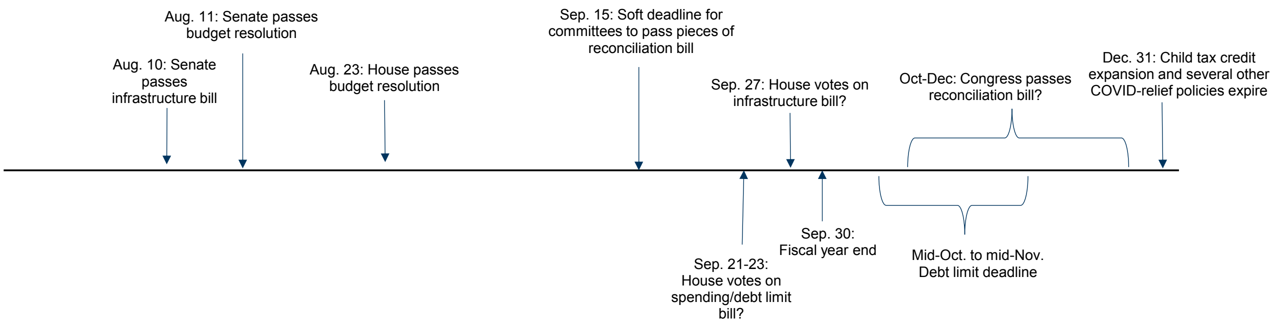
A Government Shutdown Is a Very Real Possibility

If Democratic leaders move forward with plans to combine the debt limit with the spending bill, we can envision three outcomes:

1. **The bill passes, resolving both issues.** The simplest outcome would be for Republicans to allow the continuing resolution/debt limit bill to pass. This could technically happen without Republican support, if they voted against the bill but did not filibuster it—in that case, it could pass with 51 votes. The debt limit increase might also be structured to allow the President to raise or suspend the debt limit, subject to a resolution of disapproval that would block it. Congress could pass such a resolution, but the President could veto it, leaving the debt limit increase intact. Congress used a version of this in 2011 to end the debt limit standoff that year. While such a scenario is possible again this year, it does not look like the most likely outcome, in our view.
2. **Republicans oppose the package, and Democratic leaders extend spending authority without the debt limit.** As noted above, the exact date on which the Treasury will no longer be able to satisfy all its obligations is unclear, but it is probably not October 1. If Republicans are willing to support an extension of spending authority but not a debt limit increase, Democratic leaders could have a difficult time keeping the two issues joined if the debt limit is not seen as immediately pressing. Instead, a short-term extension of spending authority could push the issue until later in the month.
3. **Republicans oppose the package but Democrats keep them tied together.** In this scenario, a shutdown would become likely. This would be more likely if the debt limit deadline turns out to be earlier in October than expected.

At this point, we think that the combined probability of the first two options, in which the government stays open, is greater than a shutdown starting October 1. However, there is a good chance that the solution at the end of this month is a temporary one, and that uncertainty persists into October. Exhibit 3 summarizes the key events on the calendar through year-end.

Exhibit 3: A Crowded Schedule



Source: Goldman Sachs Global Investment Research

The Riskiest Debt Limit Deadline in a Decade

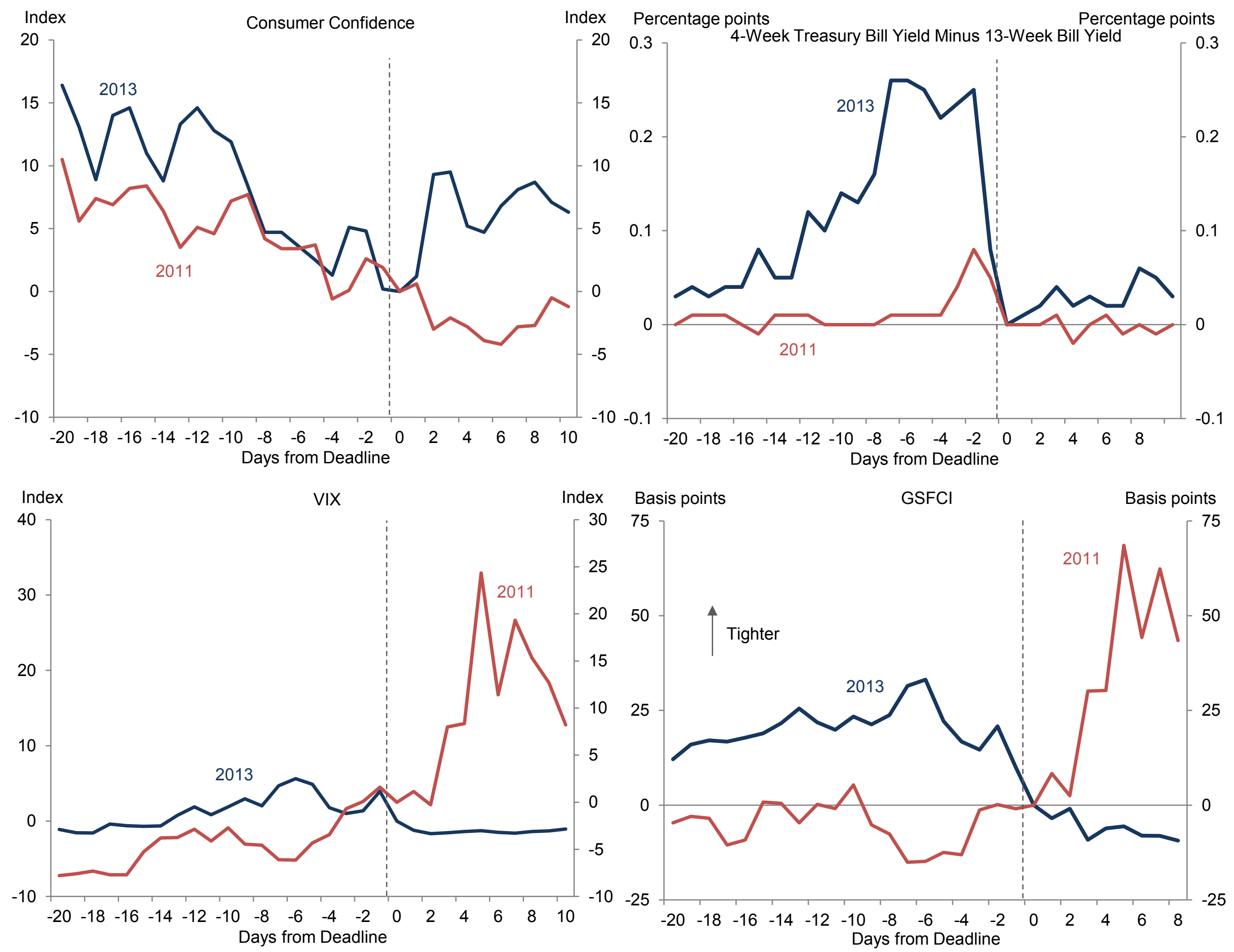
The upcoming debt limit deadline is beginning to look as risky as the 2011 debt limit showdown that led to Standard & Poor's downgrade of the US sovereign rating and eventually to budget sequestration, or the 2013 deadline that overlapped with a government shutdown. Like in 2011, sizeable budget deficits have motivated Republicans to use the debt limit to win policy concessions. Like in 2013, the deadline falls soon after the end of the fiscal year, raising the prospect of a government shutdown on top of debt limit uncertainty.

The main difference is that Congress is not under divided control as it was in those instances. In theory, this could have made an increase easier, since Democrats could pass it via reconciliation. Even without that process, Democrats set the agenda on the House and Senate floors and can force repeated votes on the issue, which should make it somewhat easier to pass a debt limit increase than in a divided Congress.

However, unified Democratic control has made it harder in other ways. Prior debt limit increases have usually been bipartisan because there was no other choice. This time, Democrats could theoretically increase the debt limit without Republican support, and Republicans might believe they eventually will. Republicans might eventually support an increase if there is truly no other option, so Democrats might try to eliminate any other options.

The 2011 and 2013 debt limit experiences had clear effects on financial markets and public sentiment. Exhibit 4 shows selected indicators by proximity to the deadline in those years. In 2011, the S&P downgrade and, more importantly, the economic deterioration in Europe had an impact even after the debt limit was raised. In 2013, the effects were strongest in farther ahead of the deadline, as the government shutdown preceded the deadline by more than 2 weeks.

Exhibit 4: The Debt Limit Could Hit Public and Market Sentiment



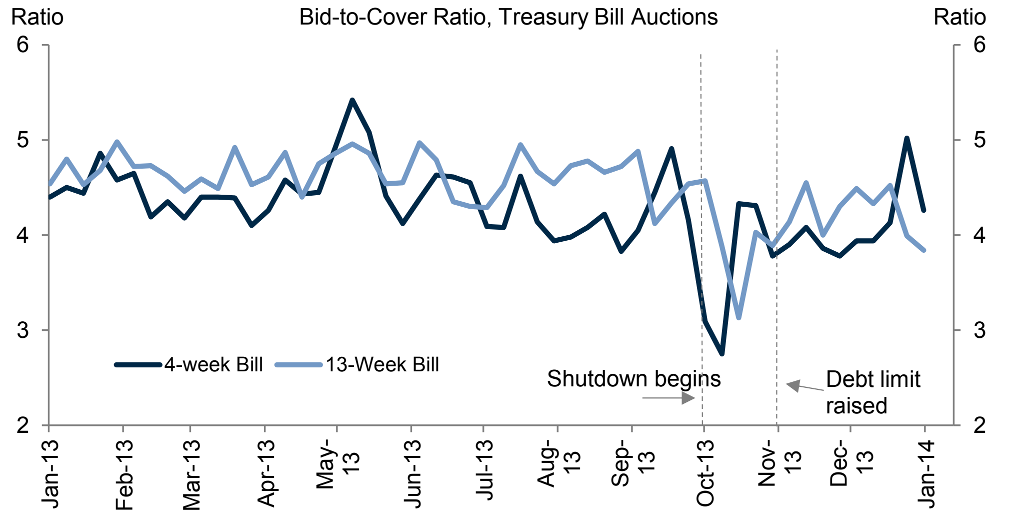
Source: Bloomberg, US Department of the Treasury, Rasmussen, Goldman Sachs Global Investment Research

Missing the Deadline

If neither party blinks, it is conceivable that the Treasury could exhaust its cash balance and extraordinary measures before Congress addresses the debt limit. If this occurs, it seems reasonably clear that the Treasury could continue to make payments of principal and interest on Treasury securities, at least as a technical matter.

Redeeming maturing securities should not be constrained by the debt limit, since new issues would replace maturing securities without increasing the overall amount of debt subject to limit. The only obvious scenario in which redeeming maturing securities could become a problem would be if debt limit issues reduced demand for Treasuries to the extent there was insufficient demand at auctions, but this seems quite unlikely. In the period ahead of the 2013 debt limit deadline, which coincided with a government shutdown, Treasury bill auctions saw a notable decline in demand for securities compared with surrounding auctions, and a higher resulting yield, but the volume of bids was nevertheless multiples of the amount the Treasury was offering (Exhibit 5).

Exhibit 5: Debt Limit Uncertainty Could Affect Treasury Auctions



Source: US Department of the Treasury, Goldman Sachs Global Investment Research

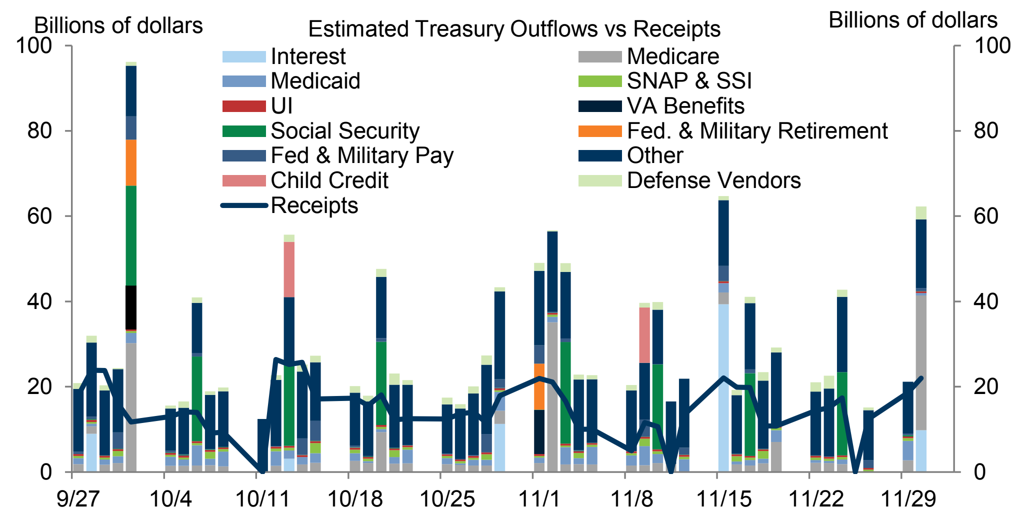
Covering interest payments without a debt limit increase would depend on the Treasury's ability and willingness to prioritize certain payments over others. The historical record suggests this is what would indeed occur:

- In 1957, prioritization appears to have occurred following expiration of a temporary increase in the debt limit. As the federal government began to run a budget deficit following expiration, the Treasury was forced to delay payments to federal contractors.
- In 1985, ahead of the debt limit increase that year, the General Accounting Office (GAO, now known as the Government Accountability Office) advised the Senate Finance Committee that the Treasury had the authority to choose the order in which to pay obligations.
- In early 1996, the Treasury indicated that failure to raise the debt limit would result in failure to make Social Security payments, though Congress provided relief before any delay occurred.
- In July 2011, the Treasury and Fed developed procedures to prioritize government payments in the event the debt limit was not increased in time. According to an FOMC transcript from that time, principal and interest on Treasury securities would continue to be made on time and other payments could have been delayed. Principal would have been paid by rolling maturing issues into new securities. To ensure the timely payment of interest, the Treasury would have held back other payments in order to accumulate sufficient cash balances to ensure sufficient cash on hand.
- In 2013, FOMC transcripts described a similar procedure to prioritize payments on Treasury securities.

Exhibit 6 shows estimated daily levels of federal receipts and payments, excluding public debt transactions. The Treasury makes coupon payments infrequently and generally takes in more cash than the amount of the payment on the days they are due. If the debt limit has not been raised by the time that payment approaches, the Treasury would likely need to delay other payments, even if there is sufficient cash to make them, in order to build cash to make the coupon payment.

Even if the Treasury could make its scheduled coupon payments, the consequences of a failure to raise the debt limit would be severe. As shown in Exhibit 6, Federal outlays are likely to exceed receipts by around $500bn (2.2% of annual GDP) in total over October and November. If Congress fails to raise the limit, the Treasury would need to reduce outlays by that amount, a reduction of more than 40%.

Exhibit 6: Without a Debt Limit Increase, the Treasury Might Need to Choose Which Bills to Pay



Source: Goldman Sachs Global Investment Research

FOMC transcripts from around the time of the 2011 and 2013 debt limit debates include a discussion of the measures the Fed might take in the event that Congress failed to raise the debt limit. While many of the actions are already part of the Fed's toolkit, including repo and reverse repo operations, the distinguishing feature is that the Fed would maintain eligibility for Treasuries with delayed payments as collateral. Also discussed in those transcripts are CUSIP swaps, in which the Fed would swap unaffected Treasury securities on its balance sheet with delayed-payment securities. However, this was seen as a more controversial step that Chairman Powell, then a Fed governor, described as "loathsome" though one that he would not rule out "in extremis".

The Impact of Fiscal Policy Beyond the Near-Term

Beyond the near-term effects of a failure to raise the debt limit, a prolonged standoff could have more important effects on fiscal policy over the medium-term. As noted above, the debt limit needs to be raised around the same time that Congress is likely to consider major fiscal legislation to implement large parts of President Biden's agenda. To win the necessary support, we expect that congressional Democratic leaders will scale down their proposed $3.5 trillion/10 years reconciliation bill to something more like $2.5 trillion in new spending financed by around $1.5 trillion in new tax revenue. Some centrist Democrats are calling for lower figures. While there is not necessarily a direct linkage between the debt limit and the fiscal package, the more these issues become entangled the more pressure there may be from centrist Democrats to scale back the size of the fiscal package.

Alec Phillips

The US Economic and Financial Outlook

THE US ECONOMIC AND FINANCIAL OUTLOOK
(% change on previous period, annualized, except where noted)

	2019	2020	2021	2022	2023	2024	2021				2022			
			(f)	(f)	(f)	(f)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
OUTPUT AND SPENDING														
Real GDP	2.3	-3.4	5.7	4.6	2.0	2.0	6.3	6.6	3.5	5.5	5.0	5.0	3.5	1.5
Real GDP (annual=Q4/Q4, quarterly=yoy)	2.6	-2.3	5.5	3.7	1.7	2.1	0.5	12.2	5.2	5.5	5.1	4.7	4.7	3.7
Consumer Expenditures	2.2	-3.8	7.6	3.5	2.0	2.1	11.4	11.9	-0.5	3.5	4.5	3.5	2.5	2.0
Residential Fixed Investment	-0.9	6.8	11.0	3.0	2.6	2.0	13.3	-11.5	3.1	6.0	4.0	4.0	3.0	3.0
Business Fixed Investment	4.3	-5.3	8.1	5.9	4.1	3.9	12.9	9.3	5.4	6.4	6.1	5.6	5.1	4.2
Structures	2.1	-12.5	-7.3	2.7	4.9	3.4	5.4	-5.4	0.5	2.0	2.0	4.0	8.0	6.0
Equipment	3.3	-8.3	14.1	6.4	3.0	2.8	14.1	11.6	3.4	7.0	8.0	7.0	4.0	2.5
Intellectual Property Products	7.2	2.8	10.5	7.0	5.0	5.2	15.6	14.6	10.0	8.0	6.0	5.0	5.0	5.0
Federal Government	3.8	5.0	0.9	-1.2	0.0	0.0	11.3	-5.2	-4.0	-2.0	0.0	0.0	0.0	0.0
State & Local Government	1.3	0.9	0.9	3.3	0.6	0.5	-0.1	0.3	5.2	5.0	5.0	2.0	0.5	0.5
Net Exports ($bn, '12)	-905	-943	-1,240	-1,277	-1,259	-1,233	-1226	-1247	-1236	-1251	-1269	-1276	-1281	-1283
Inventory Investment ($bn, '12)	75	-42	-63	150	96	60	-88	-169	-45	50	75	150	200	175
Industrial Production, Mfg.	-2.0	-6.6	6.1	4.8	1.9	1.7	2.7	5.0	3.0	5.0	5.4	6.1	4.5	1.9
HOUSING MARKET														
Housing Starts (units, thous)	1,292	1,397	1,623	1,676	--	--	1,599	1,586	1,662	1,645	1,653	1,682	1,686	1,685
New Home Sales (units, thous)	683	828	860	918	977	978	896	739	876	928	913	901	908	951
Existing Home Sales (units, thous)	5,327	5,658	5,972	5,964	6,086	6,210	6,303	5,833	5,862	5,891	5,920	5,949	5,979	6,009
Case-Shiller Home Prices (%yoy)*	3.4	9.9	9.4	7.6	6.2	--	11.7	15.2	11.7	9.4	8.1	6.1	7.8	7.6
INFLATION (% ch, yr/yr)														
Consumer Price Index (CPI)**	2.3	1.3	5.0	2.2	2.4	2.4	1.9	4.8	5.2	5.0	4.6	3.2	2.2	2.2
Core CPI **	2.2	1.6	4.4	2.5	2.5	2.5	1.4	3.7	4.1	4.2	4.5	3.1	2.4	2.5
Core PCE** †	1.6	1.5	3.80	2.00	2.15	2.20	1.7	3.4	3.5	3.8	3.6	2.6	2.1	2.0
LABOR MARKET														
Unemployment Rate (%)^	3.6	6.7	4.2	3.5	3.3	3.2	6.0	5.9	5.0	4.2	3.8	3.7	3.6	3.5
U6 Underemployment Rate (%)^	6.8	11.7	7.6	6.8	6.4	6.2	10.7	9.7	8.7	7.6	7.2	7.0	6.8	6.8
Payrolls (thous, monthly rate)	168	-785	620	215	123	100	518	615	679	667	317	213	179	150
Employment-Population Ratio (%)^	61.0	57.4	59.6	60.2	60.2	60.2	57.8	58.1	59.0	59.8	59.8	60.0	60.1	60.2
Labor Force Participation Rate (%)^	63.3	61.5	62.2	62.4	62.3	62.2	61.5	61.6	61.9	62.2	62.2	62.3	62.4	62.4
GOVERNMENT FINANCE														
Federal Budget (FY, $bn)	-984	-3,132	-3,000	-1,300	-1,100	-1,200	--	--	--	--	--	--	--	--
FINANCIAL INDICATORS														
FF Target Range (Bottom-Top, %)^	1.5-1.75	0-0.25	0-0.25	0-0.25	0.25-0.5	0.75-1	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
10-Year Treasury Note^	1.92	0.93	1.60	1.80	2.30	2.45	1.74	1.45	1.40	1.60	1.60	1.60	1.60	1.80
Euro (€/$)^	1.12	1.22	1.20	1.25	1.30	1.30	1.17	1.18	1.18	1.20	1.23	1.24	1.25	1.25
Yen ($/¥)^	109	103	110	105	102	100	111	111	110	110	108	107	106	105

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.
** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.
† PCE = Personal consumption expenditures. ^ Denotes end of period.
Note: Published figures in bold.
Source: Goldman Sachs Global Investment Research.

Economic Releases

Date		Time (ET)	Indicator	Estimate GS	Consensus	Last Report
Tue	**Sep 14**	6:00	NFIB Small Business Optimism (August)	n.a.	99.0	99.7
		8:30	**Consumer Price Index (August)**	**+0.37%**	**+0.4%**	**+0.5%**
			Ex Food and Energy	**+0.19%**	**+0.3%**	**+0.3%**
Wed	**Sep 15**	8:30	Empire Manufacturing Index (September)	n.a.	18.0	18.3
		8:30	Import Price Index (August)	n.a.	+0.3%	+0.3%
		9:15	**Industrial Production (August)**	**+0.9%**	**+0.4%**	**+0.9%**
			Capacity Utilization	**76.9%**	**76.4%**	**76.1%**
			Manufacturing Production	**+0.7%**	**+0.4%**	**+1.4%**
Thu	**Sep 16**	**8:30**	**Retail Sales (August)**	**-0.4%**	**-0.8%**	**-1.1%**
			Ex Autos	**+0.3%**	**-0.1%**	**-0.4%**
			Ex Autos & Gas	**+0.2%**	**-0.1%**	**-0.7%**
			Ex Autos, Bldg Materials & Gas	**+0.5%**	**-0.1%**	**-1.0%**
		8:30	**Initial Jobless Claims**	**330k**	**320k**	**310k**
			Continuing Claims	n.a.	2,740k	2,783k
		8:30	**Philadelphia Fed Manufacturing Index (September)**	**18.0**	**19.0**	**19.4**
		10:00	Business Inventories (July)	n.a.	+0.5%	+0.8%
Fri	**Sep 17**	**8:30**	**Umich Consumer Sentiment (September preliminary)**	**73.0**	**72.0**	**70.3**

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Joseph Briggs and Ronnie Walker, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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