Special Commentary — September 21, 2021

Government Funding, Debt Ceiling Take Center Stage

Economist(s)

Michael Pugliese
Economist | Wells Fargo Securities, LLC
Michael.D.Pugliese@wellsfargo.com | 212-214-5058

Summary

- About a month ago, we published a report highlighting the possibility of a federal government shutdown and debt ceiling dispute when Congress returned from its summer recess in mid-September.
- That time is now upon us, and fiscal policymakers in Washington D.C. have not yet resolved these two issues.
- As a refresher, there are two key deadlines on the horizon for government funding and the debt ceiling. Government funding runs out on September 30, and Congress needs to pass a continuing resolution (CR) by that date to avoid a federal government shutdown.
- In addition, the U.S. Treasury has been utilizing "extraordinary measures" and cash on hand to remain compliant with the debt ceiling since August 1. Slowly but surely, these measures are running out, and in the near future Treasury will no longer have enough cash to fully meet the obligations of the federal government.
- For several months now our forecast of the debt ceiling "X date", or the date on which the federal government would not have enough cash to fully meet its obligations, has fallen sometime in late October/early November.
- Our projection for the "X date" has not changed much since our previous publication. The final week of October starts on October 25, and that week through the first few days of November continues to strike us as the most likely period during which the Treasury's coffers will run dry if the debt ceiling is not increased or suspended by then.
- As we see it, there are two possible ways in which these issues get resolved. In scenario one, at least 10 Republican Senators join the Democrats to end a potential filibuster and permit a floor vote on a combined CR/debt ceiling suspension.
- In scenario two, a CR passes Congress without an attached debt ceiling increase, and then Democrats amend their previously-passed budget resolution to increase the debt ceiling without Republican support.
- In some previously contested debt ceiling disputes, the drama has been associated with lower equity prices, wider corporate bond spreads, higher short-term interest rates, lower consumer and business confidence and even a federal government credit rating downgrade.
- Furthermore, even if the debt ceiling does not cause any major disruptions, a shutdown could still weigh on the economy. The 2018-2019 federal government shutdown lasted about one month and directly subtracted 0.1 percentage point from Q4-2018 real GDP growth and 0.3 percentage point from Q1-2019 real GDP growth.
- This potential source of economic policy uncertainty also could be challenging for the Federal Reserve as its tapering discussions reach a climax in the next couple of months. If the economic recovery is threatened and/or markets are in turmoil over a government shutdown and debt ceiling dispute, the central bank may be wary of initiating a taper at such an inopportune time.
- A shutdown could also wreak havoc on the collection of critical economic data the Fed uses to guide its monetary policy decisions.

An Update on Recent Government Funding and Debt Ceiling Developments

The final week of October starts on October 25, and that week through the first few days of November continues to strike us as the most likely period during which the Treasury's coffers will run dry if the debt ceiling is not increased or suspended by then.

About a month ago, we published a report highlighting the possibility of a federal government shutdown and debt ceiling dispute when Congress returned from its summer recess in mid-September. That time is now upon us, and fiscal policymakers in Washington D.C. have not yet resolved these two issues.

As a refresher, there are two key deadlines on the horizon for government funding and the debt ceiling. Government funding runs out on September 30, and Congress needs to pass a continuing resolution (CR) by that date to avoid a federal government shutdown starting on October 1. In addition, the U.S. Treasury has been utilizing "extraordinary measures" and cash on hand to remain compliant with the debt ceiling since August 1. Slowly but surely, these measures are running out, and in the near future Treasury will no longer have enough cash to fully meet the obligations of the federal government.

For several months now our forecast of the debt ceiling "X date", or the date on which the federal government would not have enough cash to fully meet its obligations, has fallen sometime in late October/early November. Quarterly corporate tax payments were made in mid-September, and the robust pace of collections was mostly in-line with our expectations. Subsequently, our projection for the "X date" has not changed much since our previous publication. The final week of October starts on October 25, and that week through the first few days of November continues to strike us as the most likely period during which the Treasury's coffers will run dry if the debt ceiling is not increased or suspended by then. That said, there is still considerable uncertainty around this estimate as highlighted by Treasury Secretary Yellen's comments in a recent *Wall Street Journal* piece: "Sometime in October—it is impossible to predict precisely when—the Treasury Department’s cash balance will fall to an insufficient level, and the federal government will be unable to pay its bills."

Congress needs to pass a CR by the end of September to avoid a government shutdown.

To recap, Congress needs to pass a CR by the end of September to avoid a government shutdown, and it needs to increase or suspend the debt ceiling by roughly the end of October to avoid a potential federal government default. With Congress back in session this week, what is the plan moving forward?

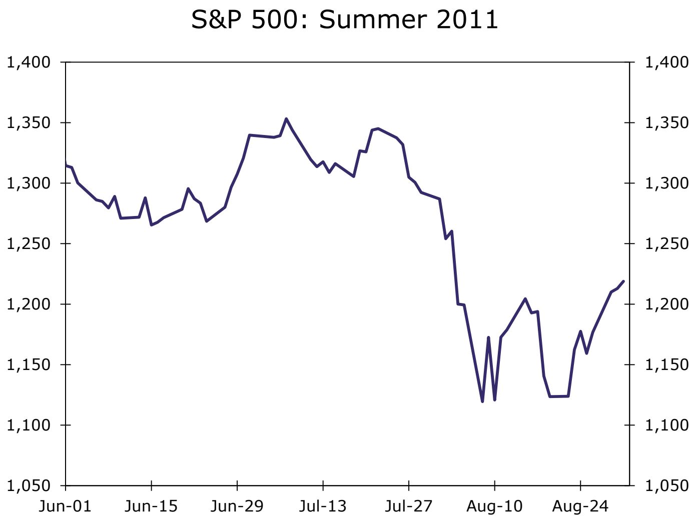
Democrats appear poised to introduce a CR with a debt ceiling suspension attached to it. The CR would fund the government through December 3, 2021, giving policymakers more time to work on and pass the 12 appropriation bills for FY 2022, while the debt ceiling would be suspended through December 16, 2022. This combined bill can be filibustered in the Senate, however, and it appears likely Senate Republicans will do just that if it passes the House of Representatives. On August 10, 46 Republican Senators released a letter stating that they would not vote to increase the debt ceiling "whether that increase comes through a stand-alone bill, a continuing resolution, or any other vehicle." So far as we can tell, their position on this has not changed since that letter was published.

If this CR/debt ceiling bill fails, what happens next is really anyone's guess. A CR without a debt ceiling suspension attached might be able to pass, and this would avert a government shutdown starting on October 1. But, with the "X date" so close on the horizon, Congress would still need to find a solution to the debt ceiling shortly thereafter.

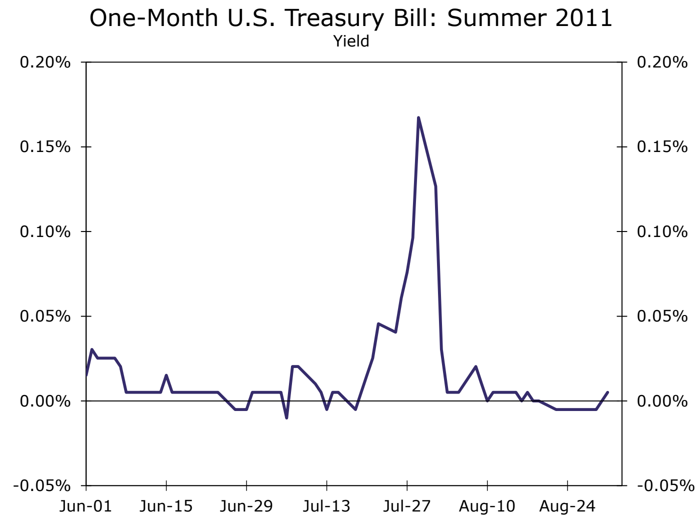
How Will This Get Resolved, and What Are the Economic Implications?

As we see it, there are two possible ways in which these issues get resolved. In scenario one, at least 10 Republican Senators join the Democrats to end a potential filibuster and permit a floor vote on a combined CR/debt ceiling suspension. In scenario two, a CR passes Congress without an attached debt ceiling increase, and then Democrats amend their previously-passed budget resolution to increase the debt ceiling without Republican support. Under this scenario, our understanding is that the debt ceiling increase could not be filibustered in the Senate, but it would need to be a debt ceiling *increase* to a specific dollar amount rather than a debt ceiling *suspension* until some specific future date.

Our previous reports have covered how debt ceiling disputes that go down to the wire can cause economic harm, but we will reiterate a few key points. In some previously contested debt ceiling disputes, the drama has been associated with lower equity prices, wider corporate bond spreads, higher short-term interest rates, lower consumer and business confidence and even a federal government credit rating downgrade (Figures 1 and 2). Furthermore, even if the debt ceiling does not cause any major disruptions, a shutdown could still weigh on the economy. The 2018-2019 federal government shutdown lasted about one month and directly subtracted 0.1 percentage point from Q4-2018 real GDP growth and 0.3 percentage point from Q1-2019 real GDP growth.



Source: Bloomberg LP and Wells Fargo Securities



Source: Bloomberg LP and Wells Fargo Securities

This potential source of economic policy uncertainty also could be challenging for the Federal Reserve as its tapering discussions reach a climax in the next couple of months. If the economic recovery is threatened and/or markets are in turmoil over a government shutdown and debt ceiling dispute, the central bank may be wary of initiating a taper at such an inopportune time. A shutdown could also wreak havoc on the collection of critical economic data the Fed uses to guide its monetary policy decisions. Some Federal Reserve officials have stressed that they would like to see the fall economic data before making a decision on tapering, and a government shutdown could impede this.

This potential source of economic policy uncertainty also could be challenging for the Federal Reserve as its tapering discussions reach a climax in the next couple of months.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Charlie Dougherty	Economist	704-410-6542	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	704-410-1681	Shannon.Seery@wellsfargo.com
Hop Mathews	Economic Analyst	704-383-5312	Hop.Mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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