

What is the debt ceiling?

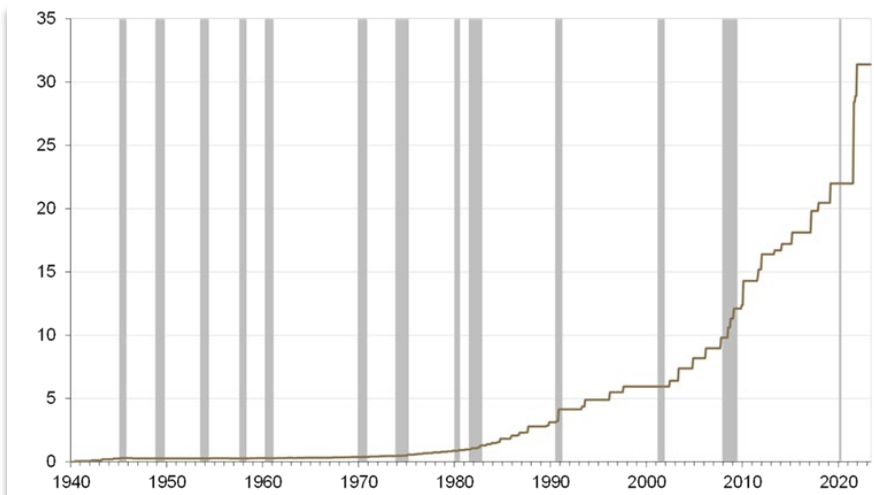
Once again, a last-minute deal to raise the US debt limit and avoid a default has been reached. While this game of political “chicken” seems to occur with regular frequency, what exactly is the debt ceiling, and why does it matter?

The US debt ceiling is a statutory limit on the amount of money the US Treasury is permitted to borrow to fund existing government obligations. The limit does not explicitly influence spending legislated by Congress; rather it is a tool meant to help impose fiscal discipline.

Once that limit is hit, the government can no longer fund previously budgeted spending or other obligations, such as interest and principal payments on existing debt via the use of debt.

US statutory debt limit

(Trillions of US dollars)

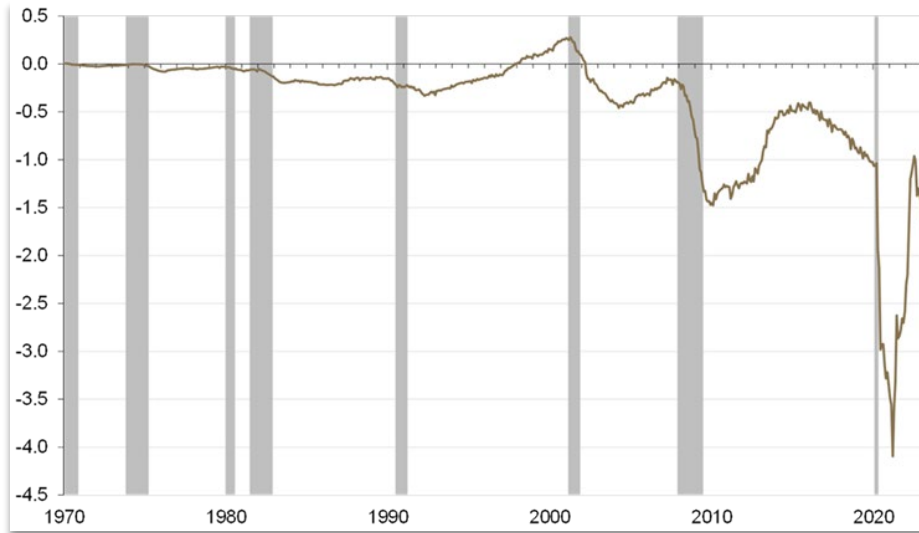


Source: Guardian Capital based on data from the US Treasury and Bloomberg to May 11, 2023

The need to raise the debt limit comes thanks to the increased tendency for the US federal government to run deficits (i.e., spending is higher than revenues). Aside from just over four years around the turn of the millennium, the US government has been in deficit for almost the entirety of the last five decades, with the magnitude of those fiscal shortfalls rising drastically in the aftermath of the Financial Crisis and further exacerbated by the pandemic.

US federal government deficit

(Trillions of US dollars; 12-month moving total)



Source: Guardian Capital based on data from the US Treasury and Bloomberg to April 2023

The failure of Congress to reach an agreement can lead to government shutdowns, such as in 1995 and 2013, and the potential for default on government debt. The former has a material impact on the domestic US economy, given that the US federal government employs 2.9 million American civilians¹, while the latter has substantial implications for global financial markets. US Treasuries are not just an investment asset; they are integral in the plumbing of the global financial system. Any actual default would have significant and far-reaching implications. As a result, it is not surprising that an agreement to raise the debt limit has once again been reached at the 11th hour.

This latest episode of the debt saga underscores that while it's important to be aware of political risks, investors should not make wholesale changes to long-term investment plans because of them.

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¹ U.S. Bureau of Labor Statistics, All Employees, Federal [CES9091000001], FRED, Federal Reserve Bank of St. Louis, Updated May 5, 2023. <https://fred.stlouisfed.org/series/CES9091000001>

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