

ANALYSIS
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Playing a Dangerous Game With the Debt Limit

INTRODUCTION

The Biden administration and Congress have much to resolve in the coming weeks. There are the massive legislative efforts to increase spending on infrastructure and fiscal support for a range of social programs and climate change. But even more pressing, Congress has a September 30 deadline to renew expiring government spending authority for the 2022 fiscal year that begins October 1. Failure to do so would result in a government shutdown. Then there is the Treasury debt limit, which was reinstated on August 1 of this year. Unable to borrow more, Treasury has been using its available cash to pay its bills, but by mid- to late October those funds will be exhausted. Someone would not get paid in a timely way. The U.S. government will default.

Shutting the government down would not be an immediate hit to the economy, but a default would be a catastrophic blow to the nascent economic recovery from the COVID-19 pandemic. Global financial markets and the economy would be upended, and even if resolved quickly, Americans would pay for this default for generations, as global investors would rightly believe that the federal government's finances have been politicized and that a time may come when they would not be paid what they are owed when owed it. To compensate for this risk, they will demand higher interest rates on the Treasury bonds they purchase. That will exacerbate our daunting long-term fiscal challenges and be a lasting corrosive on the economy, significantly diminishing it.

Playing a Dangerous Game With the Debt Limit

MARK ZANDI AND BERNARD YAROS

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Debt limit countdown

The Treasury debt limit is the maximum amount of debt that the Treasury can issue to the public or to other federal agencies. The amount is set by law and has been increased over the years to allow the Treasury to finance the government's operations.

The original intent of the debt limit was to be a forcing mechanism on lawmakers to remain fiscally disciplined. It has failed at this. Instead, it has become highly disruptive to the fiscal process. Until about a decade ago, lawmakers would increase the limit to remain in compliance with it. Since then, they

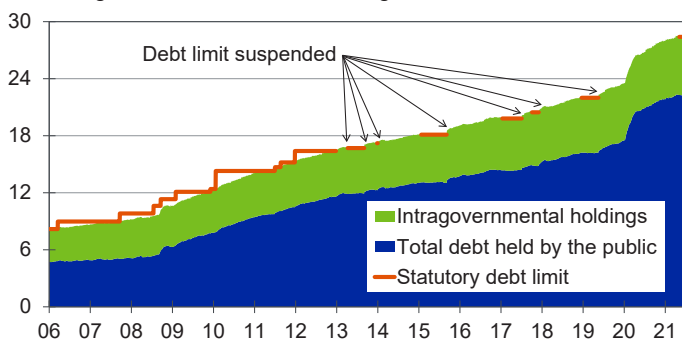
have simply suspended the limit for varying periods of time (see Chart 1).

The most recent debt limit suspension was provided in the Bipartisan Budget Act of 2019, which suspended the limit through August 1 of this year. The Treasury has since been using extraordinary measures and drawing down what cash it has available to pay its bills. But time is running out. In a September 8 letter to House Speaker Nancy Pelosi, Treasury Secretary Janet Yellen confirmed that the Treasury would no longer be able to pay all its bills in a timely way beginning sometime in October. Given the uncertainty in the timing of Treasury's payments and receipts, it is not possible to know precisely when the Treasury will default. Our best estimate is October 20 (see Chart 2). On that day, the Treasury has a more than \$20 billion payment due to Social Security recipients.

There has been debate over whether the Treasury could pay global investors in Treasury securities first and thus avoid defaulting on its debt obligation. This view is misplaced. While Treasury has the technical ability to pay bond investors before others, as those payments are handled by a different computer system than other government obligations, it is unclear whether the Treasury is legally

Chart 1: Debt Limit Suspension Is the Norm

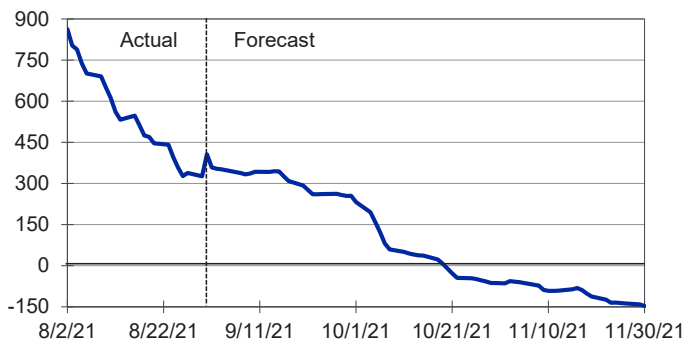
Federal government debt outstanding, \$ tril



Sources: U.S. Treasury, Moody's Analytics

Chart 2: Default Likely on October 20

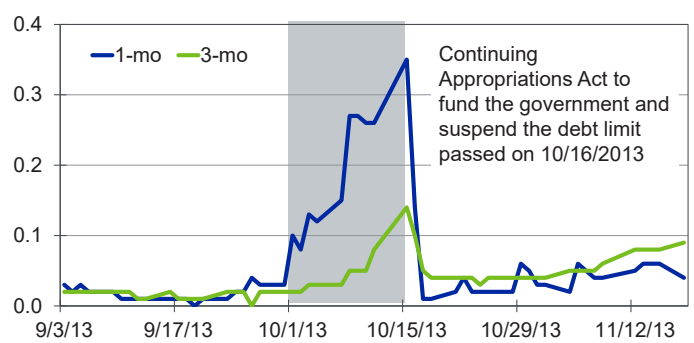
Borrowing capacity under reinstated debt limit, \$ bil



Sources: U.S. Treasury, Moody's Analytics

Chart 3: Rates Jump in Debt Limit Standoff

Yield on U.S. Treasury bills, %



Sources: U.S. Treasury, Moody's Analytics

able to do so. Moreover, politically it seems unimaginable that bond investors would get their checks before everyone else.

Even if the Treasury decided to prioritize bond investors and pay them first, this would not stop investors from demanding a much higher interest rate for the legal uncertainty and the possibility that they may not get paid on time in the future. Bond investors, especially [foreign investors](#), would reasonably ask how long Congress would actually allow them to be paid ahead of American seniors, the military, or even the federal government's electric bill. Deciding which other bills receive priority would be all but impossible. The Treasury could not sort through the blizzard of payments due each day. More likely, as outlined in a [report by Treasury's inspector general](#), the Treasury would delay all payments until it received enough cash to pay a specific day's bills.

Financial markets have yet to significantly react to the developing standoff over the debt limit. Credit default swaps on Treasury securities—the cost of insuring against a default by the Treasury—are currently close to a low 4 basis points for one-year Treasuries, and less than 30 basis points for five-year securities. For context, in summer 2011, when brinkmanship around raising the debt limit was especially heated and Treasury debt lost its AAA rating from credit rating agency Standard & Poor's, CDS spreads spiked to as high as 80 basis points on one-year Treasuries and 65 basis points on five-year Treasuries.

Financial markets are still calm, likely because it has become standard practice for Congress to run down the clock but in the end figure out a way to raise the debt ceiling

when absolutely necessary. It is thus widely expected that Congress will do so again. These expectations may be stronger now than in times past, as Democrats control both the executive and legislative branches of government. Investors appear to believe this deadline will not be as disruptive as those in 2011 and 2013, during the so-called [budget wars](#) in the wake of the financial crisis. Ironically, because investors seem so sanguine about how this drama will play out, policymakers may believe they have nothing to worry about and fail to resolve the debt limit in time. This would be an egregious error.

Economic fallout

As the deadline gets closer, global investors will rightly begin to worry that lawmakers will misstep and fail to act in time. Interest rates will push higher, slowly at first, but then more quickly. And if policymakers actually do fail to raise or suspend the limit before the Treasury runs out of cash and defaults on its obligations, interest rates will spike, with enormous costs to taxpayers, consumers and the economy.

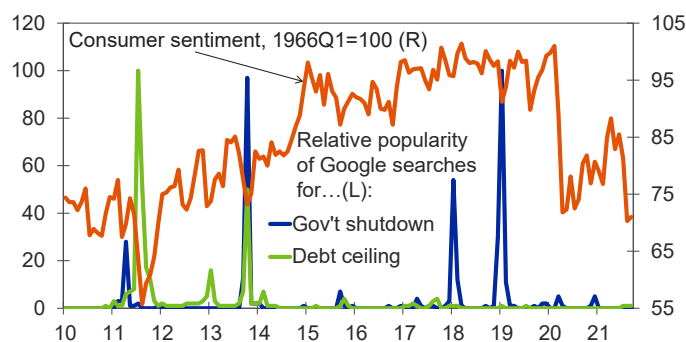
Just how costly this can be is evident in a 1979 episode when Treasury inadvertently missed payments on Treasury bills maturing that spring. The mishap was caused in part by fallout from a delay in raising the debt limit, but also by problems with word processing equipment the Treasury used at the time to pay investors. Even though investors received their payments with only a small delay, T-bill yields initially jumped by 60 basis points and remained elevated for several months thereafter. [The cost to taxpayers](#) was ultimately in the tens of billions of dollars.

The costs are also evident from the reaction of investors in Treasury securities during the last round of debt limit brinkmanship in late 2013. A Moody's Analytics analysis of the period shows that investor concerns over a U.S. government default pushed 10-year Treasury yields up an estimated 6 to 12 basis points at the height of their angst. Short-term interest rates also jumped (see Chart 3). Even though the Treasury ultimately did not default and interest rates quickly declined, the episode cost taxpayers an estimated nearly half-billion dollars in added interest costs, not including the costs to households and businesses that also paid higher interest rates on the funds they borrowed. While these costs were modest, they were unnecessarily incurred, and they surely would have been many multiple times greater if the Treasury actually had defaulted on its debt.

Darker sentiment, heightened uncertainty

Political brinkmanship over the operations of the federal government is unnerving for Americans to watch. In both the 2011 and 2013 debt limit episodes, households were closely attuned to the political hardball being played in DC, at least judging from Google searches, and consumer sentiment suffered (see Chart 4). Google searches for "debt ceiling" are on the rise again, and given that consumer psyches are already on edge over the pandemic and the recent surge of the Delta variant of the virus—the long-running [University of Michigan survey of consumer sentiment](#) fell to a pandemic low in August—the

Chart 4: Sentiment Is Fragile and Vulnerable



Sources: Google Trends, Univ. of Michigan, Moody's Analytics

Chart 5: Heightened Political Uncertainty

Political uncertainty index, pre-pandemic avg=100



Source: Moody's Analytics

political battle currently shaping up over the debt limit could be especially enervating and cause consumers to turn more cautious in their spending, weakening the economic recovery.

The political uncertainty created by the brinkmanship is also disturbing for businesses and financial institutions. Uncertainty is already extraordinarily high, according to the Moody's Analytics political uncertainty index, due to the bitter partisan politics in DC (see Chart 5). Historically, on average, our political uncertainty index is close to 100. The index is three times that today and more than twice that at its previous peak during the 2013 debt limit battle. This is sure to increase in coming days, making businesses more reluctant to invest and hire, entrepreneurs less likely to start companies, and financial institutions more circumspect about extending credit.

The economic damage caused by heightened political uncertainty is evident from the period immediately following the financial crisis, when the Obama administration was engaged in a series of bruising budget battles with the Republicans in control of Congress, including over increasing the debt limit in 2011 and again in 2013. We found that the heightened uncertainty at the time reduced business investment and hiring and weighed heavily on GDP growth. If not for this uncertainty, by mid-2015, real GDP would have been \$180 billion, or more than 1%, higher; there would have been 1.2 million more jobs; and the unemployment rate would have been 0.7 percentage point lower. That is, if not for the political logjams in Washington over the debt limit after the financial crisis, [the](#)

[post-crisis economic recovery would have been meaningfully stronger.](#)

It is difficult to distinguish between political uncertainty and policy uncertainty. Political uncertainty is created by political brinkmanship and dysfunction in government. Policy uncertainty is created by potential changes in government spending, taxes and regulation. The 2011 showdown over the Treasury debt limit was especially hard on the economy, as it created a great deal of political uncertainty but also involved large changes to spending and tax policy. The current government funding and debt limit debates are similar, as they conflate with a high degree of policy uncertainty related to the large legislative packages currently making their way through Congress.

Default scenario

If lawmakers are unable to resolve the debt limit in time and the Treasury actually begins paying its bills late and defaults, financial markets would surely be roiled. Sometime in mid-October, there would likely be a [TARP moment](#), harkening back to that dark day in autumn 2008 when Congress initially failed to pass the Troubled Asset Relief Program, and the stock market and other financial markets cratered. A similar crisis, characterized by spiking interest rates and plunging equity prices, would be ignited. Short-term funding markets, which are essential to the flow of credit that helps finance the economy's day-to-day activities, likely would shut down as well. The economic recovery would quickly be in jeopardy.

It is unimaginable that lawmakers would allow things to get to this point, but as the

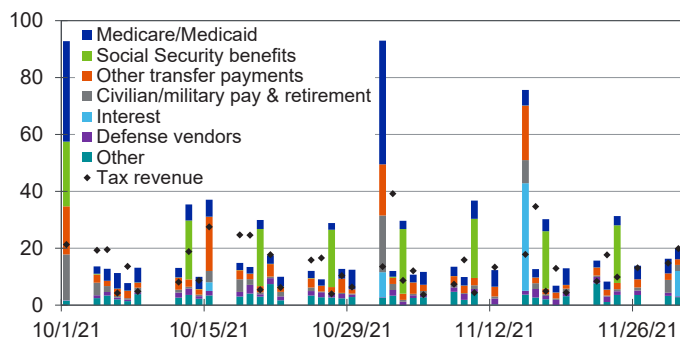
TARP experience highlights, they have done the unimaginable before. Yet, if that experience is a guide, lawmakers would quickly reverse course and resolve the debt limit impasse to allow the Treasury to raise funds and pay its bills. Much damage will have already been done, but markets and the economy would right themselves.

However, if lawmakers do not reverse course and the impasse drags on, the federal government would have to significantly cut back spending. Based on the expected timing of outlays and tax receipts, this would probably mean delaying about \$80 billion in payments due November 1 to Social Security recipients, veterans, and active-duty military for as long as two weeks (see Chart 6). The hit to consumer, business and investor confidence would be severe. If the impasse over the debt limit lasts through all of November, the Treasury will have no choice but to eliminate a cash deficit of approximately \$200 billion by slashing government spending. Annualized, this is equal to more than 10% of GDP. The economic blow would be devastating.

It is difficult to envisage what steps policymakers would take to mitigate the economic fallout of this scenario. With short-term interest rates already pinned to the zero lower bound and a bloated balance sheet, it is unclear how much the Federal Reserve could do to support the reeling economy. The Fed would surely ramp up its quantitative easing—purchases of Treasury bonds—but any benefit would likely be overwhelmed as global investors sold or stopped buying U.S. securities. Moreover, with lawmakers at loggerheads over the debt limit, it is unlikely they would agree on anything else, including

Chart 6: Tracking Outlays and Receipts

Projected Treasury payments and tax receipts, \$ bil



Sources: U.S. Treasury, Moody's Analytics

a response to the crisis created by the breach of the debt limit.

This economic scenario is cataclysmic. Based on simulations of the Moody's Analytics model of the U.S. economy, the downturn would be comparable to that suffered during the financial crisis. That means real GDP would decline almost 4% peak to trough, nearly 6 million jobs would be lost, and the unemployment rate would surge back to close to 9% (see Table). Stock prices would be cut almost in one-third at the worst of the selloff, wiping out \$15 trillion in household wealth. Treasury yields, mortgage rates, and other consumer and corporate borrowing rates spike, at least until the debt limit is resolved and Treasury payments resume. Even then, rates never fall back to where they were previously. Since U.S. Treasury securities no longer would be risk free, future generations of Americans would pay a steep economic price.

What's next

It is unclear how lawmakers will resolve the impasse. Optimistically, lawmakers could include an agreement to suspend the debt limit in a short-term spending bill necessary to fund the government in the new fiscal year. This would be consistent with a long history of bipartisan agreements on the debt limit, and seems reasonable given the bipar-

tisan nature of the financial obligations the debt would need to cover. The \$3 trillion in fiscal support lawmakers provided in 2020 to help the economy through the pandemic, beginning with the [CARES Act](#), had strong bipartisan support. And both parties have played a role in passing recent expensive packages along party lines:

the Democrats with the \$1.9 trillion dollar [American Rescue Plan](#), and Republicans with the [\\$1.8 trillion tax cuts of 2018](#). This path forward could occur even without [Republican votes](#) if Republican lawmakers decided not to filibuster the legislation, allowing the Democrats to pass the legislation with their 50 votes in the Senate. Democrats have suggested they might include provisions in the legislation to reduce the odds of a filibuster.

However, given the increasingly partisan nature of the debt limit debate, the Democrats may have to go it alone, adding it to the [\\$3.5 trillion reconciliation spending package](#) they are currently debating. This path is fraught with risk. There is a meaningful chance that the Senate parliamentarian decides that it cannot be included in any package to be passed in reconciliation, potentially forcing Vice President Kamala Harris to take the unusual step of overruling the parliamentarian. Even then, it is not at all clear that the Democrats will be able to pass the package in time given the complexity of the process and the myriad other legislative efforts underway in Congress. There is also the difficulty of reaching agreement on most anything, including among just Democrats.

Even if Democratic lawmakers pull this off in time and the Treasury avoids a default,

there is sure to be long-term repercussions. The debt limit will likely be forever so politicized that the political party in power will need to increase or suspend the limit without support from the other party. The future brinkmanship around resolving the debt limit, and thus the resulting uncertainty and economic damage, will be permanently greater.

With the significant challenges faced in both of these paths out of the impasse, there is a consequential risk that lawmakers misstep, and the U.S. government fails to pay its bills on time. The nation will suffer its first default in history.

Conclusions

A bedrock of the U.S. economy and global financial system is that the U.S. government pays what it owes in a timely way. Alexander Hamilton, the nation's first Treasury secretary, established this principal at the founding of the nation when he agreed to [pay Revolutionary War bond investors](#) 100 cents on the dollar. This despite that the bonds were trading at pennies on the dollar because few believed the new American government would make good on its debts. When the government did make good, it established the sound credit of the U.S. and paved the way for the U.S. dollar to ultimately become the global economy's reserve currency. The economic benefits of this over the generations are incalculable.

The mounting political brinkmanship over the debt limit is thus painful to watch. If lawmakers are unable to increase or suspend the debt limit before the Treasury fails to make a payment, the resulting chaos in global financial markets will be difficult to bear. The U.S. and global economies, which still have a long way to go to recover from the recession caused by the pandemic, will descend back into recession. In times past, lawmakers have taken strident warnings like these to heart, and acted. Let us hope they do so again. Soon.

Table: Macroeconomic Impact of U.S. Treasury Default

	Real GDP, 2012\$ bil		Nonfarm employment, mil		Unemployment rate, %		S&P 500 Index		Treasury yield, %				
	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario			
2020Q1	18,952	18,952	0.00	151.9	0.00	3.8	3.8	0.0	3,069	3,069	1.37	1.37	0.00
2020Q2	17,258	17,258	0.00	133.7	0.00	13.1	13.1	0.0	2,929	2,929	0.69	0.69	0.00
2020Q3	18,561	18,561	0.00	140.9	0.00	8.8	8.8	0.0	3,322	3,322	0.65	0.65	0.00
2020Q4	18,768	18,768	0.00	142.6	0.00	6.8	6.8	0.0	3,554	3,554	0.86	0.86	0.00
2021Q1	19,056	19,056	0.00	143.4	0.00	6.2	6.2	0.0	3,863	3,863	1.34	1.34	0.00
2021Q2	19,361	19,361	0.00	145.1	0.00	5.9	5.9	0.0	4,183	4,183	1.59	1.59	0.00
2021Q3	19,596	19,596	0.00	147.3	0.00	5.2	5.2	-0.0	4,387	4,387	1.35	1.35	0.00
2021Q4	19,952	19,045	-4.55	149.1	143.8	-5.30	4.5	7.5	4,296	3,133	-27.07	1.70	1.46
2022Q1	20,177	18,847	-6.59	150.7	142.2	-8.45	3.9	8.5	4,199	2,822	-32.79	1.99	2.69
2022Q2	20,315	19,095	-6.01	151.8	143.7	-8.16	3.5	7.7	4,080	2,942	-27.89	2.22	2.55
2022Q3	20,383	19,431	-4.67	152.5	146.0	-6.54	3.4	6.6	3,963	3,455	-12.81	2.32	2.55
2022Q4	20,456	19,807	-3.17	153.1	148.5	-4.57	3.4	5.3	3,929	3,657	-6.91	2.37	2.70
2023Q1	20,582	20,220	-1.76	153.7	151.0	-2.68	3.4	4.3	3,905	3,742	-4.19	2.46	2.80
2023Q2	20,722	20,563	-0.77	154.2	152.8	-1.34	3.5	3.6	3,900	3,775	-3.21	2.68	2.98
2023Q3	20,868	20,813	-0.26	154.6	153.9	-0.66	3.5	3.4	3,919	3,790	-3.28	2.91	3.18
2023Q4	21,018	20,943	-0.36	155.0	154.2	-0.74	3.5	3.6	3,928	3,798	-3.30	3.05	3.32
2024Q1	21,170	21,032	-0.65	155.2	154.2	-1.07	3.6	4.0	3,936	3,806	-3.30	3.20	3.47
2024Q2	21,306	21,122	-0.86	155.4	154.2	-1.27	3.7	4.2	3,949	3,819	-3.29	3.32	3.59
2024Q3	21,436	21,241	-0.91	155.6	154.4	-1.24	3.8	4.3	4,007	3,876	-3.27	3.42	3.69
2024Q4	21,575	21,387	-0.87	155.8	154.7	-1.09	3.9	4.2	4,079	3,946	-3.26	3.52	3.79
2025Q1	21,707	21,537	-0.78	155.9	155.0	-0.89	4.0	4.2	4,149	4,014	-3.26	3.62	3.89
2025Q2	21,835	21,683	-0.70	156.0	155.3	-0.71	4.0	4.2	4,206	4,068	-3.27	3.70	3.97
2025Q3	21,958	21,813	-0.66	156.2	155.5	-0.63	4.1	4.2	4,258	4,117	-3.30	3.77	4.04
2025Q4	22,088	21,938	-0.68	156.3	155.7	-0.63	4.1	4.2	4,307	4,163	-3.33	3.83	4.11
2026Q1	22,211	22,051	-0.72	156.5	155.8	-0.66	4.2	4.3	4,355	4,209	-3.36	3.91	4.18
2026Q2	22,321	22,154	-0.75	156.6	155.9	-0.69	4.2	4.3	4,405	4,256	-3.39	3.97	4.25
2026Q3	22,431	22,265	-0.74	156.8	156.1	-0.67	4.2	4.3	4,458	4,306	-3.42	4.00	4.28
2026Q4	22,539	22,379	-0.71	157.0	156.4	-0.63	4.2	4.3	4,513	4,358	-3.44	4.03	4.30
2027Q1	22,647	22,494	-0.68	157.2	156.6	-0.58	4.3	4.3	4,577	4,419	-3.46	4.04	4.32
2027Q2	22,757	22,610	-0.65	157.3	156.8	-0.55	4.3	4.3	4,643	4,481	-3.47	4.04	4.32
2027Q3	22,871	22,727	-0.63	157.5	157.0	-0.54	4.3	4.3	4,705	4,541	-3.49	4.04	4.31
2027Q4	22,987	22,842	-0.63	157.7	157.2	-0.54	4.3	4.3	4,763	4,597	-3.49	4.03	4.30
2028Q1	23,103	22,957	-0.63	157.9	157.3	-0.58	4.2	4.4	4,821	4,653	-3.50	4.03	4.30
2028Q2	23,220	23,072	-0.64	158.1	157.5	-0.64	4.2	4.4	4,877	4,706	-3.50	4.03	4.31
2028Q3	23,338	23,189	-0.64	158.3	157.6	-0.70	4.2	4.4	4,929	4,756	-3.51	4.02	4.29
2028Q4	23,456	23,305	-0.64	158.5	157.7	-0.75	4.2	4.4	4,977	4,803	-3.51	4.01	4.29
2029Q1	23,573	23,422	-0.64	158.7	157.9	-0.80	4.2	4.4	5,031	4,854	-3.51	4.00	4.28
2029Q2	23,691	23,540	-0.64	158.9	158.0	-0.83	4.2	4.5	5,082	4,903	-3.52	3.99	4.27
2029Q3	23,807	23,655	-0.64	159.1	158.2	-0.85	4.2	4.5	5,137	4,956	-3.52	3.98	4.26
2029Q4	23,926	23,773	-0.64	159.3	158.4	-0.87	4.2	4.5	5,186	5,003	-3.52	3.97	4.25
2030Q1	24,047	23,893	-0.64	159.4	158.6	-0.88	4.2	4.5	5,234	5,050	-3.52	3.96	4.23
2030Q2	24,170	24,015	-0.64	159.6	158.7	-0.89	4.2	4.5	5,286	5,109	-3.52	3.95	4.22
2030Q3	24,293	24,137	-0.64	159.8	158.9	-0.91	4.2	4.5	5,354	5,165	-3.53	3.93	4.21
2030Q4	24,417	24,260	-0.65	160.0	159.1	-0.92	4.3	4.5	5,405	5,214	-3.53	3.93	4.20
2031Q1	24,543	24,383	-0.65	160.2	159.2	-0.93	4.3	4.5	5,467	5,274	-3.53	3.91	4.19
2031Q2	24,673	24,511	-0.66	160.3	159.4	-0.95	4.3	4.5	5,529	5,334	-3.54	3.90	4.17
2031Q3	24,803	24,638	-0.67	160.5	159.5	-0.97	4.3	4.5	5,578	5,381	-3.54	3.90	4.18
2031Q4	24,934	24,766	-0.67	160.6	159.6	-0.98	4.3	4.5	5,632	5,433	-3.54	3.89	4.17

Table: Macroeconomic Impact of U.S. Treasury Default (Cont.)

	Real GDP, 2012\$ bil		Nonfarm employment, mil		Unemployment rate, %		S&P 500 Index		Treasury yield, %	
	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario	Baseline	Default scenario
2020	18,385	18,385	142.3	142.3	8.1	8.1	3,219	3,219	0.9	0.9
2021	19,491	19,264	146.2	144.9	5.5	6.2	4,182	3,891	1.5	1.9
2022	20,333	19,295	152.0	145.1	3.6	7.0	4,043	3,219	2.2	2.6
2023	20,797	20,635	154.3	153.0	3.5	3.7	3,913	3,776	2.8	3.1
2024	21,372	21,195	155.5	154.4	3.7	4.2	3,993	3,862	3.4	3.6
2025	21,897	21,743	156.1	155.4	4.1	4.2	4,230	4,090	3.7	4.0
2026	22,375	22,212	156.7	156.1	4.2	4.3	4,433	4,282	4.0	4.3
2027	22,816	22,668	157.4	156.9	4.3	4.3	4,672	4,509	4.0	4.3
2028	23,279	23,131	158.2	157.5	4.2	4.4	4,901	4,729	4.0	4.3
2029	23,749	23,597	159.0	158.1	4.2	4.5	5,109	4,929	4.0	4.3
2030	24,232	24,076	159.7	158.8	4.2	4.5	5,322	5,135	3.9	4.2
2031	24,738	24,575	160.4	159.4	4.3	4.5	5,552	5,355	3.9	4.2

Note: Based on the Moody's Analytics Sep 2021 baseline scenario.

Default scenario assumptions:

Treasury defaults on Oct 20 and resumes full payments on Dec 1.

Federal Reserve responds by increasing its quantitative easing, which is determined endogenously in the macro model.

There is no discretionary fiscal policy response.

S&P 500 volatility increases consistent with 2011 debt limit experience.

Sources: BEA, Census Bureau, BLS, U.S. Treasury, Federal Reserve, Moody's Analytics

Endnotes

- 1 The Treasury debt limit is also popularly known as the debt ceiling.
- 2 These are similar to [estimates](#) done by the Congressional Budget Office, the nonpartisan government agency that is responsible for assessing the federal government's fiscal situation and budgetary impact of legislation that impacts government spending.
- 3 Treasury bond payments are made through a separate [Fedwire system](#).
- 4 There have been [legislative attempts](#) to prioritize Treasury's payments in the case of breach of the default limit. Social Security payments, payments to the military, and interest and principal payments to Treasury bond investors receive priority. But the legislation has never become law and would likely not mitigate a serious reaction by overseas investors, who would appropriately conclude that this prioritization would be politically untenable and not stand for long.
- 5 Yields on short-term Treasury securities did increase by a few basis points for a few days after Secretary Yellen's September 8 letter to Congress warning that the debt limit would be breached sometime in October.
- 6 On August 5, 2011, S&P announced the company's decision to give its first-ever downgrade to U.S. sovereign debt, lowering the rating one notch to "AA+", with a negative outlook.
- 7 The referenced Moody's Analytics study is available upon request.
- 8 The Moody's Analytics political uncertainty index uses six equally weighted components that capture both fiscal and monetary policy uncertainty: 1. Percent of respondents to the Moody's Analytics weekly business survey that say regulation and legal issues are their biggest problem. 2. Five-year U.S. CDS-implied EDF. 3. The value of expiring tax provisions. 4. 10-year CPI dispersion from the Federal Reserve Bank of Philadelphia survey of professional forecasters. 5. Unemployment rate (one-year-ahead) forecast dispersion from the same Philadelphia Fed survey. 6. LIBOR-OIS spread. The fiscal and monetary policy subcomponents are equally weighted. The index begins in 2004.
- 9 These results are based on a structural vector autoregressive model of the U.S. economy. The model is used to estimate the extent to which surprise changes in political uncertainty produce changes in GDP, unemployment, the hiring rate, investment, jobs, and several other economic variables. A description of the model is available upon request.
- 10 The [Moody's Analytics macroeconomic model](#) of the U.S. and global economies is similar in theory and empirics to those used by the Federal Reserve Board and Congressional Budget Office for forecasting, budgeting and policy analysis. The model has been used to evaluate the plethora of fiscal and monetary policies implemented during the COVID-19 pandemic.
- 11 Economists at the Federal Reserve have conducted similar simulations with similar results. See "[Possible Macroeconomic Effects of a Temporary Federal Debt Default](#)," Engen et al., October 2013.
- 12 The broad trade-weighted value of the U.S. dollar declines only modestly in this scenario, at least in the near term, as global investors are unsure of alternative global safe havens to the dollar. The Swiss franc, euro and British pound are the most significant beneficiaries. However, the value of the U.S. dollar steadily weakens in the longer run, since its status as the global reserve currency is diminished.
- 13 The parliamentarian has historically had the final say on what can be included under budget reconciliation. However, in actuality, the vice president, who presides over the Senate, has the prevailing authority over what is allowable under reconciliation. Vice President Kamala Harris could therefore overrule the parliamentarian to get a debt limit increase through reconciliation. This would be the first time a vice president has overruled a parliamentarian since Nelson Rockefeller did so in 1975.
- 14 Moderate Senate Democrats already have a difficult political vote to make on the large legislative package and adding in an increase in the debt limit makes the vote that much more difficult. A suspension, as opposed to an increase, of the debt limit may be politically more palatable, but suspending the debt limit is likely to be permissible under budget reconciliation.

About the Authors

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody's purchased in 2005.

Dr. Zandi's broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation's daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, *Financial Shock: A 360° Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*, is described by The New York Times as the "clearest guide" to the financial crisis.

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