

U.S. Economic Comment

- Debt ceiling: progress toward resolution?
- The long-term budget outlook: bleak

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The Looming “X-Date”

The debt limit of the United States, which places a statutory constraint on the amount of money that the Treasury Department can borrow and is currently set at \$31.4 trillion, was reached on January 19, 2023. At the time, the Treasury Department announced a “debt issuance suspension period,” which enabled it to use various “extraordinary measures” that allowed for continued borrowing without breaching the debt ceiling. As in past episodes, the Treasury’s actions were meant to buy time for Congress and the White House to come together and bridge differences on budgetary priorities so to pass an increase in borrowing authority. However, compromise in the current episode has proven particularly challenging, with the Biden Administration and Senate Democrats holding the line for a “clean” increase in borrowing authority (i.e. one with no concessions made for future budget restraint), while Republicans, who control the House, are demanding meaningful reductions in future spending. The issue came to the forefront in recent days, as sluggish tax collections and the timing of various payments by Treasury have potentially pulled forward the so-called “X-date,” when Treasury will breach the debt ceiling.

Prior to recent developments, consensus estimates for the X-date varied, centered around a period in late July or early August. Given the potentially large window of time, Republicans in the House narrowly passed the *Limit, Save, Grow Act of 2023* on April 26th with the aim of clearly defining goals in any debt ceiling negotiation, while simultaneously shifting the onus to the Biden Administration to come up with a viable alternative. Democrats declared the House plan a non-starter and reemphasized the need to raise the debt ceiling without preconditions. The tone of the debate shifted as final tax settlements for 2022 (filed in April) lagged estimates and budget tabulations indicated that total federal revenues were down 10.0 percent from the same period in FY2022 (October-to-April). Moreover, recent readings indicate that Treasury cash-on-hand has fallen perilously low relative to projected upcoming obligations (chart, left). It appears that the Treasury could encounter debt ceiling difficulties much earlier than anticipated -- potentially mid-June -- and if it manages to muddle through, mid-to-late July appears to be the next funding choke point.

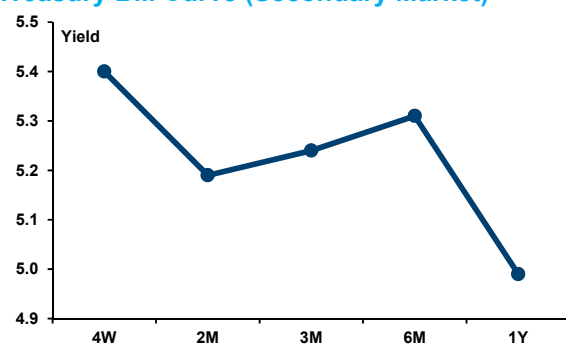
In light of budgetary developments and warnings from figures including the Fed Chair, Treasury Secretary, and private-sector business leaders, this week the Biden Administration and House Speaker McCarthy expressed willingness to hammer out a compromise to avoid default. President Biden announced that he will return to Washington early following the G-7 summit in Japan to continue negotiations, and House Speaker McCarthy and Senate Majority Leader Schumer suggested that they could bring votes on a compromise package to the floors of both Chambers of Congress by early June. Hope for an expedient resolution dimmed somewhat today, when lead

Treasury General Account



Source: H.4.1 Report, Federal Reserve Board via Haver Analytics

Treasury Bill Curve (Secondary Market)



Source: Bloomberg

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Republican negotiator, Rep. Garret Graves of Louisiana, broke off talks with no immediate plans to resume them in upcoming days. Negotiations should restart soon, but evidence thus far suggests that a quick resolution absent market turmoil forcing a resolution is not a given.

Even with potential catastrophic consequences of a default looming, evidence of market fallout thus far has been muted. The S&P 500 is up slightly month-to-date (less than 0.5 percentage point). The Treasury market has shown hints of stress, specifically in the short end of the curve. On May 4, 2023, Treasury auctioned \$50 billion 4-week bills scheduled to mature on June 6 at a 5.84 percent yield, demonstrating the aversion of investors to hold debt close to the mid-June risk point. In the secondary market, the 4-week bill is yielding well above other short-term issues (i.e. those not overlapping with the potential June X-date; chart, prior page). Pressure could well intensify in the equity and Treasury markets, but outcomes will depend heavily on the actions of Congressional negotiators in the coming two weeks.

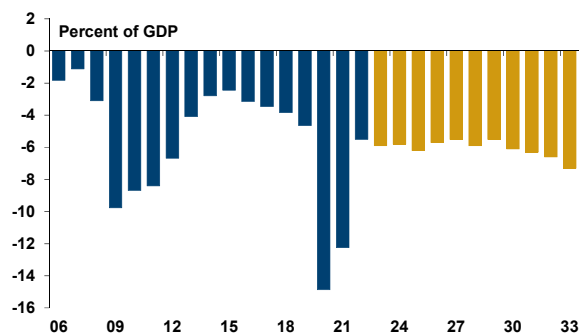
The Longer-Term Budget Picture

Even if negotiations on the debt ceiling culminate in a satisfactory resolution in the coming days, a recent report by the Congressional Budget Office highlights the challenging situation that faces the nation over the next decade (and beyond), underscoring the difficult decisions that will have to be made with regard to tax and spending priorities (*An Update to the Budget Outlook: 2023 to 2033* (May 2023): <https://www.cbo.gov/publication/59096>). The budget deficit in FY2022 narrowed to \$1.38 trillion from \$2.78 trillion in FY2021 and \$3.13 trillion in the preceding year as pandemic-related measures faded, but the budget situation again appears to be deteriorating (deficit of \$1.5 trillion expected by the CBO for FY2023) with projections for the deficit as a share of GDP remaining significant over the next decade (chart, below left). For reference, from 1973 to 2022, annual deficits averaged 3.6 percent of GDP (versus 7.3 percent projected in FY2033).

Revenues as a share of GDP are projected to hold at approximately 18 percent over the forecast horizon, and outlays in the mid-20-percent area. Mandatory outlays, which encompass federal health care costs and old age benefits among other programs, are expected to come under pressure with spending on Medicare and Social Security rising from 8.2 percent of GDP in 2023 to 10.1 percent in 2033. Combined with rising interest expense from an increasingly large pool of outstanding debt, these obligations increasingly will crowd out other areas (defense, education, road maintenance, etc.). Declining fiscal space also will hinder the government's ability to enact counter-cyclical policies (fiscal stimulus) during recessions.

The cumulative burden of these projected deficits is best illustrated in the mounting ratio of outstanding debt to GDP (chart, below right). That debt burden will generate additional interest costs, with net interest outlays projected to expand from \$663 billion in 2023 to \$1.4 trillion in 2033 (or 2.5 percent of GDP to 3.7 percent in 2033 versus a prior 50-year average of 1.6 percentage points). Moreover, if nothing is done to increase mounting debt, prior CBO projections from February suggest publicly held debt approaching 200 percent of GDP by 2050. If politicians cannot right the fiscal ship in the medium term, painful choices await on the horizon.

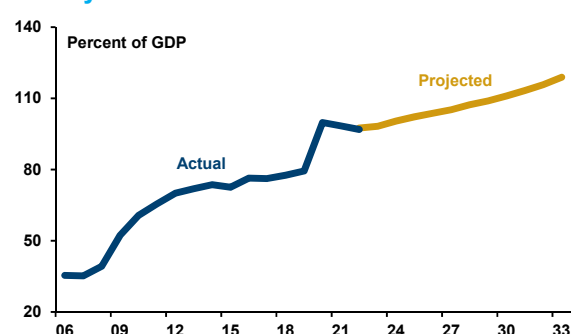
Federal Deficit as a Share of GDP*



* Fiscal year basis. Readings from 2023 to 2033 are projections from the Congressional Budget Office.

Sources: U.S. Department of the Treasury via Haver Analytics; Congressional Budget Office, "An Update to the Budget Outlook: 2023 to 2033" (May 2023). <https://www.cbo.gov/publication/59096>

Publicly Held Debt as a Share of GDP*



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Note to readers: The next U.S. Economic Comment will be dated June 2, 2023.

The Week Ahead

New Home Sales (April) (Tuesday)

Forecast: 0.670 Million (-1.9%)

Sales of new homes have moved irregularly higher since the recent low of 0.543 million in July 2022, signaling that activity may have bottomed out and is mounting a modest recovery. While activity is picking up, recent prospective buyer traffic has remained light and mortgage rates have drifted back toward seven percent. This suggests the jump of 9.6 percent in sales in March may have overstated the degree of underlying strength in the market for new homes.

Revised GDP (Q1) (Thursday)

Forecast: 1.1%, Annual Rate (Unrevised)

Data released since the late April publication of the initial estimate of Q1 GDP suggests that the revised reading (second estimate) is likely to be close to the preliminary tally. Consumers were active in Q1, with personal consumption expenditures driving GDP growth (+3.7 percent, annual rate). Business fixed investment rose modestly (+0.7 percent), as investment in structures (+11.2 percent) offset weakness in equipment spending (-7.3 percent). Cautious inventory management by businesses was a key drag on growth, with inventory investment subtracting 2.3 percentage points. A jump of 4.0 percent in the GDP price index suggested that prices rose briskly in the first quarter.

Personal Income, Consumption, Prices (April) (Friday)

Forecast: 0.5% Income, 0.6% Consumption, 0.3%

Core PCE Price Index

A jump in average hourly earnings points to a firm increase in the wages and salaries component of personal income in April. Other components of income also could perform well, as rental income is likely to remain on its recent upward path and elevated interest rates could boost interest income. On the spending side, a jump in sales of motor vehicles suggests a brisk increase in outlays for durable goods, and a pickup in outlays in key retail categories raises the prospect of an increase in spending for nondurable items. Service spending has been well maintained. Results for the CPI suggest a brisk increase in the core price index for personal consumption expenditures.

International Trade in Goods (April) (Friday)

Forecast: -\$86.5 Billion (\$0.9 Billion Wider Deficit)

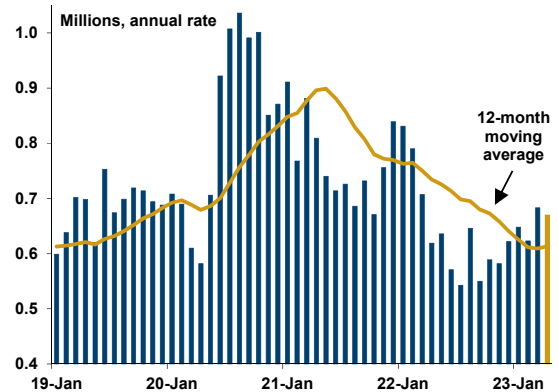
The trade deficit in goods could widen in April after a narrowing of \$6.4 billion in March that reflected a jump of \$5.0 billion in exports (+3.0 percent) and easing of \$1.4 billion in imports (-0.5 percent). Imports could continue their downward trend, which would be a favorable development for the U.S., but exports also could cool in April after high-side readings in several categories in March, offsetting the anticipated softening in imports.

Durable Goods Orders (April) (Friday)

Forecast: -1.5% Headline, -0.2% Ex. Transportation

A slowing in new aircraft orders reported by Boeing suggests easing in the volatile civilian aircraft component in April after a burst in the prior month. With economic conditions softening, and the factory sector contracting, bookings excluding transportation are likely to be soft.

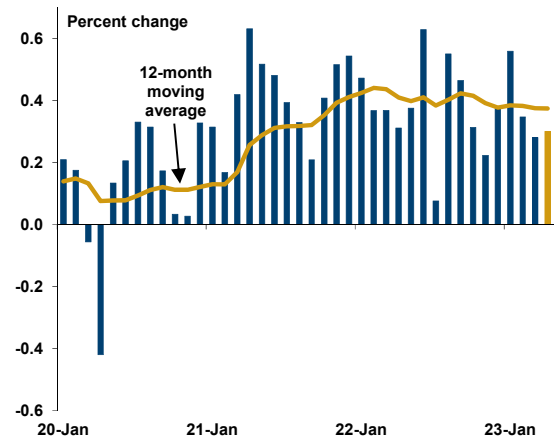
New Home Sales*



* The gold bar is a forecast for April 2023.

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Core PCE Price Index*



* PCE = personal consumption expenditures. The gold bar is a forecast for April 2023.

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Economic Indicators

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Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP)

Treasury Financing

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AUCTION: \$111 billion 13-,26-week bills	AUCTION: \$42 billion 2-year notes \$35 billion 21-day CMBs ANNOUNCE: \$35 billion* 4-week bills for auction on May 25 \$35 billion* 8-week bills for auction on May 25 \$39 billion* 17-week bills for auction on May 24 SETTLE: \$35 billion 4-week bills \$35 billion 8-week bills \$39 billion 17-week bills \$45 billion 156-day CMBs	AUCTION: \$39 billion* 17-week bills \$43 billion 5-year notes \$22 billion 2-year FRNs	AUCTION: \$35 billion* 4-week bills \$35 billion* 8-week bills \$35 billion 7-year notes ANNOUNCE: \$111 billion* 13-,26-week bills for auction on May 30 SETTLE: \$111 billion 13-,26-week bills \$35 billion 21-day CMBs	SETTLE: \$22 billion 2-year FRNs																																										
29	30	31	1	2																																										
MEMORIAL DAY	AUCTION: \$111 billion* 13-,26-week bills ANNOUNCE: \$35 billion* 4-week bills for auction on June 1 \$35 billion* 8-week bills for auction on June 1 \$39 billion* 17-week bills for auction on May 31 SETTLE: \$35 billion* 4-week bills \$35 billion* 8-week bills \$39 billion* 17-week bills	AUCTION: \$39 billion* 17-week bills SETTLE: \$15 billion 20-year bonds \$15 billion 10-year TIPS \$42 billion 2-year notes \$43 billion 5-year notes \$35 billion 7-year notes	AUCTION: \$35 billion* 4-week bills \$35 billion* 8-week bills ANNOUNCE: \$111 billion* 13-,26-week bills for auction on June 5 SETTLE: \$111 billion* 13-,26-week bills																																											
5	6	7	8	9																																										
AUCTION: \$111 billion 13-,26-week bills	ANNOUNCE: \$35 billion* 4-week bills for auction on June 8 \$35 billion* 8-week bills for auction on June 8 \$39 billion* 17-week bills for auction on June 7 SETTLE: \$35 billion* 4-week bills \$35 billion* 8-week bills \$39 billion* 17-week bills	AUCTION: \$39 billion* 17-week bills	AUCTION: \$35 billion* 4-week bills \$35 billion* 8-week bills ANNOUNCE: \$111 billion* 13-,26-week bills for auction on June 12 \$36 billion* 52-week bills for auction on June 13 \$40 billion* 3-year notes for auction on June 12 \$32 billion* 10-year notes for auction on June 12 \$18 billion* 30-year bonds for auction on June 13 SETTLE: \$111 billion* 13-,26-week bills																																											

*Estimate