Extraordinary times:

Navigating the current debt ceiling episode

January 2023

Debates over federal fiscal policy and rising debt levels, along with continued differences in views of government spending priorities, have led to a series of contentious debt limit episodes in recent years. Last raised in December 2021, the U.S. debt ceiling stands at $31.4 trillion.[1]

While the details for each debt ceiling episode are unique, we are once again facing the prospect of a debt ceiling stalemate later in the year.

We provide herein some context, our perspective on the current situation and insights into how our portfolios are positioned in light of the latest data.

Key client considerations:

A potential debt ceiling episode has presented itself once again, thrusting a possible funding crisis on Congress as early as June. The current stalemate is distinguished from other episodes by divisions within the U.S. House of Representatives, most recently on exhibit during the contentious election of the new House Speaker.

Although the debt limit has been reached, the so-called "X-Date" (when the use of expected extraordinary measures and borrowing authority are tapped out) is not expected to occur before June 2023 per guidance from Treasury Secretary Janet Yellen.

While uncertainty around the debt ceiling can be unnerving for investors, we take comfort in the fact that the full faith and credit of the U.S. Treasury has always been honored, and BlackRock remains confident that a default on Treasury debt obligations is a very low probability outcome.

Nevertheless, we take the view that legislative and execution risks around debt ceiling episodes should be respected and factored into portfolio strategies.

BlackRock has convened a firm-wide task force to analyze market conditions and historical precedents to consider steps that could best situate our clients in light of our thinking.

We continue to closely monitor the situation, seek to manage our exposures in a conservative manner and keep you informed as the debt ceiling episode unfolds.

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Background: what is the current debt ceiling threat?

Treasury Secretary Janet Yellen recently confirmed that the United States was projected to reach the statutory debt limit beginning on January 19. She also noted the Treasury began using so-called "extraordinary measures", which give the Treasury room to operate without hitting the statutory borrowing authority limit. While these measures will provide temporary relief, they are not long-term solutions. Secretary Yellen noted that such measures could provide relief until early June, also known as the "X-date", but the timeframe is "subject to considerable uncertainty." In the event the debt limit is not eventually raised or suspended, the U.S. Treasury would likely face a funding crisis that could impact a range of federal commitments and strain financial markets. Despite the potential once again for political turmoil over the debt ceiling, Congress has always acted in timely manner and protected the full faith and credit of the United States.

What are markets telling us?

Prior debt ceiling episodes have historically had the largest impact on the U.S. Treasury Bill (T-bill) market, typically exhibited as an aversion to maturities deemed by the markets as most vulnerable to potential delayed payment risks from a "technical default."

So far and given that an X-date remains fairly distant.

In our opinion, conditions are still developing and further risk aversion on the part of market participants is possible in the event given a resolution remains subject to heightened political risks.

In our view, a more substantial government money market fund footprint and a more restrictive balance sheet environment for banks and broker/dealers could also contribute to an increase in aversion to obligations deemed vulnerable to potential delayed payment risks.

What's the impact on U.S. Treasury issuance?

In previous cycles, T-bill outstandings declined in the run-up to debt ceiling dates in order for the U.S. Treasury to both comply with statutory borrowing limits and also provide headroom for Treasury coupon settlements. Amid the extraordinary measures, net T-bill issuance has risen over $185 billon this year through the first few weeks of January and is anticipated to continue to move higher over the balance of the first quarter[2] before declining in the lead up to a resolution of the debt ceiling. We would anticipate a subsequent increase in T-bill supply later in the year upon such a resolution. This additional T-bill supply should continue to provide some relief to current front-end Treasury and repurchase agreement rates.

Are there additional risks associated with ratings downgrades?

Major ratings agencies have published reports on the potential for delayed payment on U.S. debt as a result of the debt ceiling. According to Moody's, any missed debt payment would be considered a default, triggering a downgrade of the U.S. sovereign and all Treasury security ratings[3]. Fitch Ratings has stated that reaching an X-date without having raised the debt ceiling could likely have negative implications for the U.S. sovereign rating[4].

How is BlackRock Cash Management responding?

In spite of these challenges, BlackRock Cash Management's view remains that the debt ceiling will be resolved in a timely manner, but the aforementioned legislative and execution risks should be taken into consideration in portfolio strategies.

To that end, BlackRock re-convened a task force to centrally coordinate firm-wide management and contingency planning around debt ceiling impasses.

Specifically, BlackRock's Money Market Fund platform has taken the following steps:

1.

We are taking a cautious approach toward the Cash Management platform's exposure from June through October 2023 maturities of Treasury obligations that we believe could be vulnerable to a technical default or underperformance relative to surrounding maturities. We are monitoring developments in Washington and will look to manage potentially susceptible exposures in a conservative fashion, as warranted.

2.

Like in the past lead up to debt ceiling stalemates, we anticipate aggressively monitoring and managing Treasury collateral exposure within our repurchase agreement transactions that we deem at risk to potential delayed principal payment in the event an X-date is crossed.

3.

We have augmented liquidity without sacrificing yield by significantly increasing our exposure to the Fed's Overnight Reverse Repo Facility in funds which are eligible to participate on the platform.

While these planning initiatives are consistent with our approach to liquidity, **BlackRock remains confident that a default on Treasury debt is a very low probability outcome**. We will continue to closely monitor the situation for updates and seek to manage our exposures in a conservative manner.

As always, we are here to help. Please contact your relationship manager or visit blackrock.com/cash for more information.

Want to know more?

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[1] Source: Treasury Secretary Yellen Debt Limit Letter to Congress, January 13, 2023
[2] Source: TreasuryDirect as of January 24, 2023
[3] Source: Government of United States: FAQ on the Sovereign Credit Implications of U.S. Government Debt Limit Brinkmanship, Moody's, October 5, 2021
[4] Source: US Governance, Policy Risks in Focus as Divided Government Looms, Fitch Ratings, November 8, 2022

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