Extraordinary times:
Navigating the current debt ceiling episode

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 limit standoff in a matter of weeks.

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:

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A debt limit impasse has presented itself once again, thrusting a possible funding crisis on the United States, if Congress does not raise or suspend the debt ceiling by June.

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Although the debt limit was reached in January 2023, so-called extraordinary measures are being utilized enabling the U.S. government to continue to borrow to pay its bills. However, the “X-Date” (when the Treasury Department’s ability to finance the operations of the federal government comes to an end) is now expected to occur as early as June 1, 2023 per guidance from Treasury Secretary Janet Yellen in her letter to congress on May 1, 2023.

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.

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

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

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We continue to closely monitor the situation, seek to manage our exposures in a conservative manner and keep our clients informed as the debt ceiling episode unfolds.
**Background: what is the current debt ceiling threat?**

In a recent letter to Congress, Treasury Secretary Janet Yellen stated that the U.S. Treasury “will be unable to continue to satisfy all of the government’s obligations by early June, and potentially as early as June 1.”¹ Secretary Yellen pressed that “it is imperative” Congress act “as soon as possible” on a debt ceiling resolution that “provides longer-term certainty that the government will continue to make its payments.” 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.”

Such aversion had already begun to play out prior to updated guidance about the “X-date” from Secretary Yellen, and has subsequently become more pronounced given the accelerated timeline for a debt limit resolution.

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, net T-bill issuance 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.

Following a similar pattern, while net T-bill issuance is up approximately $300 billion year-to-date through early May, it has contracted on a monthly basis since January and turned substantially negative in April.² That said, we anticipate a significant increase in T-bill supply upon a resolution of the debt ceiling. This additional T-bill supply should, in our view, 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 ratings³. 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 rating³.
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.

Given the guidance we received from Secretary Yellen, where appropriate we have proactively exited all early June 2023 exposure in our portfolios and would consider a similar approach should the guidance around the “X-date” change. We are monitoring developments in Washington and will look to continue to manage potentially susceptible exposures in an appropriate manner.

2.

Like in the past lead up to debt ceiling stalemates, we continue to monitor and manage 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, May 1, 2023
2 Source: TreasuryDirect as of May 2, 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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