

WHEN WILL THE DEBT CEILING AFFECT STOCKS?

Will the markets feel stress as the deadline to raise the debt limit approaches?

Presented by Benedict A. Mitchell Jr.

August 2 looms. That is the absolute deadline for raising the federal debt ceiling, according to Treasury Secretary Timothy Geithner. The U.S. actually "hit" the \$14.3 trillion ceiling on May 16 but took "extraordinary measures", in Geithner's words, to avoid default. (Those measures included suspension of Treasury payments to the Civil Service Retirement and Disability Fund and the Federal Employees' Retirement System Thrift Savings Plan.) While Congress will surely vote to raise the debt cap by August 2, our politicians are mostly transmitting contention.^{1,2}

Will other nations start to lose confidence in us? Our markets are pretty confident that Congress will resolve the issue. Still, the mere prospect of a default could end up doing some damage on Wall Street (and Main Street). The longer Congress dallies, the more the world questions how serious our politicians are about reaching an accord. Remember the headlines about the debt crises in Greece, Spain, Ireland and Portugal? Remember how that instability weighed on Wall Street? Well, we could give global investors a sense of déjà vu.

Bond yields could rise. We last hit the federal debt limit in 1995. Before Congress hiked it, Treasury yields rose in the preceding months. Some analysts think that if they head north just a quarter-percent as a result of this current impasse, taxpayers could collectively be on the hook for up to \$500 million per month.³

If Treasury yields rise, businesses big and small will feel the pain. They want and need loans; they need to repay existing debts. They don't need pressure on interest rates.

The world isn't walking away from us yet. Our debt remains very attractive to foreign investors. Foreign ownership of U.S. Treasuries climbed from 37% in 1997 to 57% in 2010, and foreign governments were responsible for most of the increase.³

The dollar is still the world's reserve currency. That fact alone will insulate us a bit in the short term. (What other currency could serve as a benchmark? The euro? Look what's going on with that.)

When S&P downgraded the U.S. credit outlook this year, did global markets correct? No. Other economies hold a great deal of faith in ours. If our legislators get their act together, we can avoid anything reminiscent of what occurred recently in Europe.

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Citations.

- 1 - guardian.co.uk/business/2011/may/16/us-government-hits-debt-ceiling [5/16/11]
- 2 - npr.org/blogs/thetwo-way/2011/05/16/136356437/debt-limit-reached-treasury-to-stop-investing-in-pension-plans [5/16/11]
- 3 - curiouscapitalist.blogs.time.com/2011/05/16/14292/ [5/16/11]