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RAISING THE ROOF IN THE US

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The debt ceiling is an often-debated topic in the United States. It plays a crucial role in the country's fiscal management and is the only policy of its kind in the western world. Established in 1917, the debt ceiling sets a limit on the amount of debt that the U.S. government can legally accumulate. While its initial purpose was to provide Congress with oversight on borrowing, the debt ceiling has evolved into a contentious political issue, with debates over raising it becoming increasingly sensitive and politically motivated.[i] In recent times, the debt ceiling has sparked market uncertainty and impacted both the stock and fixed income markets. This article delves into the origins of the debt ceiling, its political sensitivities, and the short-term market reactions following the raising of the debt ceiling in 2011 and 2013.

The Birth of the Debt Ceiling:

During World War I, the United States faced the need for increased borrowing to finance the war effort. To maintain control over the government's debt, Congress passed the Second Liberty Bond Act of 1917, which established the debt ceiling. This mechanism allowed lawmakers to limit the accumulation of debt by the federal government. Over time, it became an instrument of fiscal responsibility, ensuring congressional oversight and control over spending.

Politics of Raising the Debt Ceiling:

In recent years, raising the debt ceiling has become an increasingly politically sensitive issue. The debt ceiling represents a point of contention between the executive and legislative branches, as well as between political parties. With each new deadline for raising the ceiling, debates over spending cuts, fiscal responsibility, and the role of government intensify.

The debt ceiling debate often exposes ideological differences, and political posturing can lead to tense negotiations and brinkmanship. Both parties have used the debt ceiling as leverage to push their policy agendas, leading to prolonged and uncertain negotiations. Failure to raise the debt ceiling would risk the possibility of defaulting on U.S. government obligations, potentially causing significant economic and financial repercussions.

2011 Debt Ceiling Crisis:

The debt ceiling crisis of 2011 was one of the most notable and contentious in recent memory. The debate revolved around raising the ceiling from $14.3 trillion to avoid a default on U.S. debt obligations. Political gridlock between the Democratic-controlled Senate and the Republican-controlled House of Representatives heightened concerns about the potential for a default.[ii]

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The stock market experienced significant volatility during the 2011 debt ceiling crisis. As the deadline approached, and with the threat of a potential default looming, investors grew increasingly anxious. The Dow Jones Industrial Average (DJIA) witnessed multiple large swings, sometimes surpassing several hundred points. Initially, stocks declined as uncertainty mounted. However, once the debt ceiling was raised and a potential default was avoided, the market rebounded to some extent. The fixed income market, particularly U.S. Treasuries, reacted differently during the 2011 debt ceiling crisis. The uncertainty prompted investors to seek safe-haven assets, leading to increased demand for U.S. government bonds. As demand surged, yields on Treasury bonds decreased, while bond prices rose. This reaction demonstrated investors' flight to safety in the face of fiscal uncertainty.

2013 Debt Ceiling Standoff:

In 2013, another debt ceiling standoff emerged, resulting in a partial government shutdown. Although the impact on financial markets was relatively subdued compared to 2011, there were notable consequences. The stock market and fixed income securities experienced some volatility during the 2013 debt ceiling debate. As the deadline approached, the markets exhibited brief periods of declines and uncertainty. However, like 2011, once the debt ceiling was raised, stocks and bonds rebounded favorably. [iii]

As I conclude this article, it appears as though a deal to raise the debt ceiling is imminent after considerable work and concessions on both sides of the isle. It's hard to imagine this debate will not re-emerge soon enough to raise uncertainty for investors. However, if history is any guide, uncertainty offers opportunity. At this time investors may benefit from reviewing their portfolios with their advisors to ensure they are set up to capture the trends of any positive rally that occurs while protecting their assets from future volatility down the road.

[i] https://en.wikipedia.org/wiki/2013_United_States_debt-ceiling_crisis#:~:text=It%20began%20in%20January%202013,following%20the%20crisis%20in%202011.

[ii] https://en.wikipedia.org/wiki/2013_United_States_debt-ceiling_crisis#:~:text=It%20began%20in%20January%202013,following%20the%20crisis%20in%202011.
[iii] https://en.wikipedia.org/wiki/2013_United_States_debt-ceiling_crisis#:~:text=It%20began%20in%20January%202013,following%20the%20crisis%20in%202011.