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House Republicans might try to pass a debt ceiling bill as soon as next week but the plan (if it passes the House) is unlikely to pass the Senate. For now, debt ceiling talks are nowhere. There could be a last-minute agreement to avoid a crisis, but the path to a deal seems unusually difficult. In 2013, Federal Reserve (Fed) officials discussed contingency plans in the event that Congress fails to raise the debt ceiling. The existence of contingency plans, plus previous market reactions to past standoffs (especially in 2011), suggest a risk-off trade once investors start pricing in no deal before the X-date.

Also, the Federal Deposit Insurance Corporation (FDIC) suggested that it might propose a special assessment next month on large banks to pay for having guaranteed uninsured deposits at Silicon Valley Bank (SVIB) and Signature Bank (SBNY).

DEBT CEILING

Negotiators Not Close

Debt ceiling negotiations are essentially nowhere as the X-date (the date when Treasury exhausts its extraordinary measures to manage the debt ceiling) approaches. According to Axios, tax receipts might be running below expectations which could pull the X-date into early or mid-June instead of previous forecasts that predicted sometime between July and September. If the X-date is sooner rather than later, investors should expect market volatility to accelerate in the coming weeks. **A confluence of events could lead to increased volatility and a risk-off trade as soon as early May.**

Recently, investors have focused on the situation in the banking industry, first quarter earnings season, and the Fed. By early May, the Federal Open Market Committee (FOMC) would have held its next meeting (May 2-3), earnings season would be well underway, and it appears the banking situation has stabilized. This coincides with efforts by House Republicans to pass a debt ceiling bill in the next week or two.

House Speaker Kevin McCarthy (R-California) has been working to write a debt ceiling bill that would raise the debt ceiling until May 2024 in return for spending cuts. Proposals that could be included in Speaker McCarthy's plan include:

- Clawback of unused COVID-19 relief funds;
- Prohibition of student debt cancellation;
- 10-year spending caps at fiscal year 2022 levels;
- Food stamp work requirements; and
- Repeal of the Inflation Reduction Act (IRA).

House Republicans could struggle to agree among themselves regarding 10-year spending caps, as some conservatives have signaled that they would only support caps based on fiscal year 2019 levels but many Republicans, especially moderates, would oppose using fiscal year 2019 levels. Given a slim five-seat House majority, it is far from certain that House Republicans can pass their own debt ceiling plan. Even if McCarthy can unite House Republicans and pass a bill, the Senate is unlikely to pass whatever bill the House passes.

A bipartisan group of House members is working on its own debt ceiling bill, but it has yet to agree on the details and whatever this group proposes would likely be opposed by most conservatives in the House, which would put McCarthy is a precarious situation. Passing a bill with Democratic votes that alienates conservatives could put McCarthy's speakership at risk. Although a deal could come together at the last minute, given the GOP's narrow majority and the Speaker's tenuous political position, **the pathway to an agreement is more uncertain than usual.**

What If

If Congress and the White House fail to raise the debt limit, Treasury and the Fed would be forced to take actions in order to make sure that bondholders are paid on time. Fed officials discussed contingency plans when faced with a similar situation in 2013. According to a transcript of an October 16, 2013, FOMC conference call, **Treasury would prioritize bondholders. Principal and interest payments would be "funded by Treasury auctions that roll over the maturing securities into new issues, so the new issues would fund the redemption of the maturing securities." However, Fed officials noted that in order make coupon payments, Treasury might need to delay other government payments.** This could lead to delays in payments of government benefits (i.e. Social Security), government payrolls, or government contractors and vendors. Any delayed or missed payment could pressure Congress into a quick agreement. Paying Wall Street or Chinese bondholders ahead of Social Security recipients or members of the U.S. armed forces will likely generate a dramatic political backlash.

1. The transcript shows that in 2013 the Fed also considered actions in order to address any disruptions in the financial markets. Among the actions considered (and which would presumably be on the table now), the Fed might consider:
2. "Outright purchases, securities lending, rollovers, repos to keep the federal funds rate in its target range, and discount window lending."
3. options to address strains in money market funds including reverse repo operations and repurchase operations; and
4. Actions if the FOMC decides it needs to increase its support of market functioning by removing securities with delayed payments (or those seen as likely to have delayed payments) from the market. This would increase the Fed's balance sheet.

The fact that the Fed would consider such actions (which it presumably would announce immediately before the X-date), gives more credence to the view that as the X-date approaches without an agreement to raise the debt ceiling, a risk-off trade is likely.

FDIC to Propose a Special Assessment in May

On Tuesday, the FDIC provided a semi-annual update to its Deposit Insurance Fund (DIF) Restoration Plan. The key takeaways from the meeting were that losses at SIVB and SBNY to cover insured deposits (~$3 billion) will not impact the DIF and **staff did not recommend making any changes to the current deposit insurance assessment schedule. However, losses to cover the uninsured deposits at SIVB and SBNY (~$19 billion) will require a special assessment.**

FDIC Chairman Martin Gruenberg said the FDIC will probably propose a special assessment next month. Staff did not signal what the special assessment would look like, but FDIC Board Member (and Consumer Financial Protection Bureau Director) Rohit Chopra reiterated that the special assessment should be targeted at the biggest banks. Interestingly, Acting Comptroller Michael Hsu, who regulates most of the largest banks, did not comment or ask questions.

Bottom-line: The FDIC updated the timing for a special assessment but gave no new details about which banks would be subject to a special assessment to cover losses incurred by the FDIC from guaranteeing uninsured deposits at SIVB and SBNY, how large it might be, or how long the payment schedule might be. **The FDIC is likely to propose a special assessment in May and would likely follow with a report to Congress on deposit insurance. This report could also provide policy options to Congress including the expansion of deposit insurance coverage. Given that the situation in the banking industry seems to have stabilized, currently there seems to be little political will to expand deposit insurance coverage.**

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