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Potomac Perspective

The mood surrounding the debt ceiling talks has turned slightly more optimistic although any agreement could still be weeks away and is still not assured. We look at the possible timelines.

Congressional committees will hold hearings into the recent bank failures which could give updated clues about the future of changes in bank regulation.

Debt Ceiling – **The mood surrounding the debt ceiling debate seems more optimistic than it has in months, which could boost the financial markets. However, no deal has been struck yet, and until that happens a technical default remains a possibility. We continue to believe that the chance of a default on U.S. Treasuries remains remote, as the Treasury Department should be able to prioritize bond payments.**

The timing of when Washington needs to raise the debt ceiling remains fluid, and Treasury Secretary Janet Yellen could provide an update this week. Recently, Treasury wrote that the X-date could be as soon as June 1. The nonpartisan Congressional Budget Office (CBO) concurred with this projection when it forecast that the X-date could be as soon as early June. The lack of a definite date is due to the uncertainty of tax receipts for the Treasury. The X-date will drive negotiations as Congress is unlikely to reach a deal with the Biden administration until the last moment.

Regarding the timing of here are two possible scenarios:

1. **X-date during first week of June.** Even if the X-date is during the first week of June, the practical deadline might be as early as May 26. Even after a deal is reached, it needs to be put into legislative language and members of the House and Senate will need a few days to review the bill before voting on it. With Congress scheduled to be out of session the week after Memorial Day, an agreement probably needs to be in place before the holiday weekend. If needed, Congress could pass a short-term suspension of the debt ceiling in order to allow for time to vote on the bill, but this probably needs to happen before the Memorial Day weekend.
2. **X-date in mid-June.** Under this scenario, the government would have enough cash to make all payments through June 15. At that point, quarterly tax receipts could push the X-date July since June 15 tax payments could provide enough revenue to fund the government for several more weeks. Under this scenario, a temporary suspension may not be necessary since the White House and McCarthy's team would have time to reach a deal.

Beyond the question of timing, there remains the issue of what acceptable terms are. The White House seems to be open to rescinding unspent COVID funds and energy permitting reform. Repealing the Inflation Reduction Act is unacceptable to Biden and Democrats, and Republicans will probably relent on this issue. The biggest sticking point will be on overall spending caps; that is, how high would the cap be set and how long would it remain in place. If this is the biggest sticking point, then it is probably a good sign that a deal is achievable since the level and the term of a cap are both negotiable items.

It bears repeating that the Trump factor (T-factor) is one of the biggest unknowns in negotiations and could upend a debt ceiling agreement even after Speaker Kevin McCarthy signs off. The possibility that former President Donald Trump could insert himself into the debate, criticize any agreement as a bad deal, and scare away congressional Republicans cannot be dismissed.

As we look at the various possible outcomes, we continue to view the odds of each as follows:

- **Default on U.S. Treasuries** – remote.
- **Technical default** (delayed payments to federal employees, delayed Social Security payments, delayed payments to government contractors and vendors, etc.) – relatively high but lower than in previous weeks due to increased optimism regarding the state of talks.
- **Credit rating downgrade** – relatively high. In 2010, S&P downgraded its credit rating of U.S. government debt after President Barack Obama and House Speaker John Boehner reached an agreement and the despite the fact that no government payments were missed. In this event, Moody's might be expected to lower its rating from Aaa to Aaa- or Aa+, while S&P could drop its from AA+ to AA.

Bank Hearings This Week – The Senate Banking Committee and the House Financial Services Committee will each hold hearings regarding the recent bank failures. One set of hearings will include management from Silicon Valley Bank (SIVB) and Signature Bank (SBNY), while the other set of hearings will include the regulators. **The hearings with the regulators are likely to be the more important hearings, as they could provide updated clues about possible changes to bank regulation, including the timing of such changes**.

- **Hearings with the regulators:**
  - Tuesday, 10 a.m. – House Financial Services Committee
    - Federal Reserve (Fed) Vice Chairman for Supervision Michael Barr, Federal Deposit Insurance Corporation Chairman (FDIC) Martin Gruenberg, Comptroller of the Currency Michael Hsu, and National Credit Union Administration Chairman Todd Harper
  - Thursday, 9:30 a.m. – Senate Banking Committee
    - Fed Vice Chairman Barr, FDIC Chairman Gruenberg, Comptroller Hsu, New York Department of Financial Services Superintendent Adrienne Harris, and California Department of Financial Protection and Innovation Commissioner Chothilde Hewlett.
- **Hearings with management:**
  - Tuesday, 10 a.m. – Senate Banking Committee
    - Gregory Becker (SIVB), Scott Shay (SBNY), and Eric Howell (SBNY).
  - Wednesday, 10 a.m. – House Financial Services Committee
    - Gregory Becker (SIVB) and Scott Shay (SBNY).

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