UOB Economic-Treasury Research
Company Reg No. 193500026Z

Jimmy Koh Jimmy.KohCT@UOBgroup.com
Suan Teck Kin, CFA Suan.TeckKin@UOBgroup.com

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Flash Notes

US: Debt Ceiling Debate Still in Deadlock – What's Next?

After live TV speeches on Tuesday morning from both US President Obama and Republican House Speaker John Boehner, it was clear that both sides remained deeply divided in the ongoing debate to raise the US debt ceiling.

To the global financial markets, the heart of the matter is that if the debt ceiling is not raised from the current limit of US$14.3tn, there is a high likelihood that 1) the US government may be unable to make upcoming coupon payments, and 2) as a consequence, the US could lose its AAA credit rating. This would call into question "the full faith and credit of the US government", in the words of US Treasury Sec Geithner in his letter to Congress on 13 May this year to urge an increase in the debt ceiling.

The impact of these adverse developments (i.e. "technical" default and downgrade – however temporary) on the global financial markets is difficult to assess at this point. This is because the US has always been making payments when due and its AAA credit rating is long considered to be a "risk free" benchmark. In addition, a wide-range of credit market products use the Treasury yield as reference rate, and The Economist magazine highlighted recently that that some US$4tn worth of Treasury papers—nearly half of the total—are used as collateral in futures, OTC derivatives and the repo markets, a crucial source of short-term loans for financial firms. It is also unclear whether there is a viable alternative as the "risk-free" benchmark given that the US dollar is a reserve currency and the Treasury a "safe have" asset. Depending on the extent of rating downgrade, it could affect US money-market funds as well, which hold some US$684bn of government and agency securities. All these could result in higher borrowing costs to the US, and possibly weaker growth and higher unemployment.

At this point, it is still possible that both the US government and Congress could come together and raise the debt limit by 2 Aug, the date which the US Treasury is estimated to hit the limit, restricting its ability to make payments.

We have listed below the expected income and outflows of the US Treasury post-2 Aug. For our purpose, the more crucial date to watch out for is 15 Aug, as a US$29bn interest payment is scheduled to be paid. In addition, throughout the month of Aug, there is an estimated US$470.5bn of Treasury debt maturing, which is typically rolled over in normal circumstances. However, if the current debt limit remains in place, the ability to roll over this debt (principal + interest) could be severely curtailed.

If the US Treasury fails to make good on this date, a default ("technical"?) is likely to be declared and US credit rating would be affected. However, even before we reach 15 Aug, all three rating agencies (S&P, Moody's and Fitch) have warned earlier that they could still make a rating cut if the US fails to resolve this debt deadlock.

US Treasury: Estimated Income and Outflows Post 2 Aug (all figures in billions)			
Date	**Income**	**Outflow**	**Major payment items / Remarks**
3-Aug	US$12	US$32	Social security US$23
4-Aug	US$4	US$10	Medicaid and Medicare US$3.1; defense payment US$1.4
			Maturity: US$90.8
5-Aug	US$7	US$12	Federal salaries US$3.4; Medicaid and Medicare US$2.2;
8-Aug	US$11	US$11	Medicaid and Medicare US$2.2; Food, welfare US$1.8; Federal salaries US$1.6
9-Aug	US$4	US$11	Medicaid and Medicare US$2.5; Defense payment US$1.4; Food, welfare US$1.4
10-Aug	US$10	US$19	Social security US$8.5; Medicaid and Medicare US$2.2; Food, welfare US$1.4
11-Aug	US$3	US$11	Medicaid and Medicare US$3.0; Defense payment US$1.4; Federal salaries US$1.0
			Maturity: 93.3
12-Aug	US$10	US$9	Medicaid and Medicare US$2.2; Defense payment US$2.0; Food, welfare US$3.0
15-Aug	US$22	US$41	Interest payment US$29; Medicaid and Medicare US$2.2; Food, welfare US$2.1; Defense payment US$1.4
			Maturity: 26.6
18-Aug			Maturity: 87.0
25-Aug			Maturity: 112.0
31-Aug			Maturity: 60.8
Source: Bipartisan Policy Center http://www.bipartisanpolicy.org/library/staff-paper/debt-limit-analysis; UOB Economic-Treasury Research			