



The Big Casino

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"We're in the end game now."

--Dr. Strange, "Avengers: Endgame"

We wrote a few weeks ago how the discussions around the debt ceiling had moved, to borrow a metaphor from the game of Chess, into the "middle game", an interim but necessary phase of the negotiations. On Monday night, the one-on-one meeting between President Biden and Speaker McCarthy signaled talks are now in the "end game", the most difficult and, naturally, crucial part of discussions. We have several observations to share about the state of play.

Initially, we and many others had thought there was not enough time before a June 1 deadline to forge an agreement and a short-term extension of some sort was in order. That now appears less likely, especially with the speaker pushing for a short timeline and expedited solution. Our assumption is the players at the least tacitly agreed that a drawn-out effort was not going to benefit anyone and might only allow distractions and other variables to come into play. The other, hopefully, big winners in this are the rest of us who had been worried that a prolonged effort would threaten everyone's August congressional recess plans.

However, we currently have a hard time seeing how, considering the current state of play, an agreement is reached, drafted, scored (by both CBO and OMB) and processed through both the House and Senate before June 1. Congress can of course move very quickly when it wants, but if negotiators are going avoid a default something has to give.

While Sec. Yellen's June 1 X Date has served to focus and accelerate negotiations, she has inched back ever so slightly from the firmness of the deadline in recent days. Analysts have come out with a variety of estimates as to when Treasury might actually run out of cash. We do think even if putting the finishing touches on an agreement takes longer than expected that any sort of default or breakdown is unlikely. Some will remember during the 2013 debt ceiling crisis several "deadlines" were missed as negotiators labored to finalize a deal and both sides wordlessly agreed to ignore them and to forge ahead.

It would be unusual for there NOT to be further snags, or even breakdowns, in talks and perhaps a near-death experience before an ultimate resolution is reached. These sorts of high stakes talks rarely move along a straight line. For instance, by public media accounts Monday was a fairly "productive" day but Tuesday was not. The good news is the number of individuals involved in the talks has now been winnowed down to a workable number; the bad news is there are still a lot of moving parts to the complex subject matter at hand.

So far, the equity and debt markets have been relatively subdued in their reactions to the last-minute, up-in-the-air nature of the debt ceiling talks. If history is any guide, this will change soon and could change very, very quickly. Once the markets are spooked, they could turn downward in a stomach-dropping way. This could be a forcing action that provides needed impetus to make the tough policy choices both sides need to embrace to reach a final agreement. Those who lived through watching the freefall in equities markets as the House was in the process of voting down the first version of the TARP bill in 2008 will understand exactly what we mean.

Conventional thinking continues to hold both sides to move beyond their comfort zones on policy changes to reach an agreement the other can live with, and so far we have not seen many trial balloons floated in the media about such changes. The Biden White House is impressively tight in terms of leaks, so we typically ascribe purpose to any comments we see that are likely from that camp. The Administration did make early comments that seemed to put permitting reform and changes to welfare programs on the table, and the House GOP has rejected additions to the drug pricing provisions from the Inflation Reduction Act. Seeing any public hints of more controversial provisions will likely signal a growing intensity to the talks.

As we noted, discussions have entered an end game phase, but to our mind it is only the beginning of what could prove a long, stomach-churning end game. The core challenge still remains — finding an agreement that, at a minimum, keeps the wings of both parties in a neutral position while allowing a “coalition of the willing” to pass a deal.

In the meantime, everyone please remember your veterans this coming weekend.

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