WEEKLY COMMENTARY

Will US Political Partisanship Push the Economy over the Debt Ceiling Cliff?

By Francis Généreux, Principal Economist

America's debt ceiling standoff continues to be a concern for the US and global economies. As we discussed in a previous Weekly Commentary, the US hit the legal debt limit on January 19. It was last raised in December 2021. Since the debt ceiling was reached, the US Treasury has been taking extraordinary measures to keep the federal government running without incurring additional debt.

Until fairly recently, most estimates suggested that the Treasury Department could keep this up until summer. But tax receipts came in lower than expected on Tax Day on April 18. On May 1, US Treasury Secretary Janet Yellen warned Congressional leaders that "After reviewing recent federal tax receipts, our best estimate is that we will be unable to continue to satisfy all of the government's obligations by early June, and potentially as early as June 1, if Congress does not raise or suspend the debt limit before that time." The Congressional Budget Office (CBO), a nonpartisan federal agency that provides budget analysis to Congress, came to the same conclusion: "Because tax receipts through April have been less than the Congressional Budget Office anticipated in February, we now estimate that there is a significantly greater risk that the Treasury will run out of funds in early June."

So while it seemed that Congress and the White House would have months to come up with a solution, now they only have a few weeks. To make matters worse, President Biden will be travelling abroad, and Congress will be on recess for a week around Memorial Day.

So far, talks to raise the debt limit haven't really gone anywhere. The Democrats want a clean debt limit increase with no strings attached, while Republicans are calling for deep budget cuts. On April 26, the Republican-controlled House passed the Limit, Save, Grow Act of 2023, which would slash federal spending. It would raise the debt ceiling by US$1.5 trillion or until March 31, 2024, in exchange for cutting federal discretionary spending to FY2022 levels, limiting growth in discretionary spending to 1% thereafter, imposing new work requirements for adult recipients of federal social programs, and scrapping Biden agenda items such as climate tax breaks, student debt forgiveness and increased IRS funding. According to the CBO, the bill would reduce the projected deficit for fiscal 2023 by US$415.4 billion and shave a total of US$4.8 trillion off the deficit by 2033. It would undo much of the fiscal policy proposed or enacted by the Biden administration. But the Republican bill is probably dead on arrival in the Democratic-controlled Senate, and the president has vowed to veto it if it makes it to his desk.

President Biden met with Congressional leaders of both parties on Tuesday. While there were no major breakthroughs, the two sides do seem to be softening their stances despite remaining miles apart. They may be able to find common ground on unspent pandemic funding and fast-tracking of new energy projects. The president said he also told Congressional leaders he's prepared to begin a separate discussion about his budget.

Other debt ceiling solutions could be on the table as well. The 14th Amendment to the Constitution says the validity of the public debt cannot be questioned. So there's growing talk that the president may invoke this clause to challenge the legality of the debt limit or override it. House Democrats could also use an arcane parliamentary procedure to pass a bill without the consent of the House speaker if they can get five Republicans to help them reach a 218-vote majority. But that's very unlikely.

Congress could also extend the deadline by suspending the debt ceiling for a few months to provide more time to iron out a more substantial agreement. The president and Congressional

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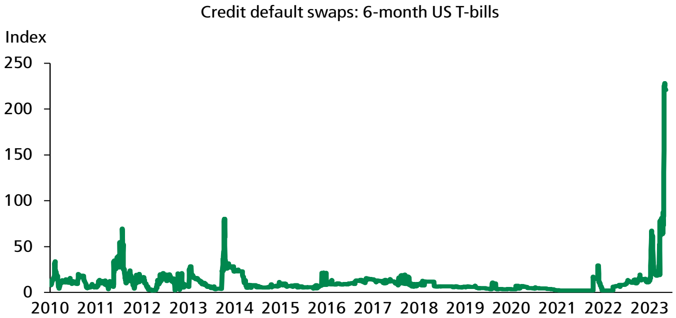
Republicans aren't entertaining this option yet. But as the deadline approaches, they could change their tune, especially if financial markets and economic confidence continue to be rattled.

It's clear that debt ceiling uncertainty and the upcoming June deadline are weighing on investors. We're seeing some distortions in the US government bond market. Very short-term T-bills—which could be affected by a default—are reacting strongly to news about debt ceiling talks. Credit default swap spreads are also up sharply, a sign that the cost of insuring against a potential default is going up. Such insurance now costs more than it did during previous debt ceiling standoffs (graph). Today's stalemate is reminiscent of Congressional wrangling over the bank bailout in the fall of 2008. When the first bill failed, the stock market fell so precipitously that Congress relented and gave the Bush administration what it wanted.

GRAPH
Concerns Are Growing over the Soaring Cost of Insuring against a US Government Default



Sources: Datastream and Desjardins Economic Studies

Simply being on the brink seems to have both a financial and economic cost. In early May, the White House Council of Economic Advisers released analysis showing how different debt ceiling scenarios could affect economic activity. The uncertainty from simply approaching a default would cut Q3 annualized real GDP growth by 0.3% and wipe out 200,000 jobs. A short-lived default would do twice the damage. The worst-case scenario—a protracted default—could trigger a full-blown economic and financial crisis, with over 8 million jobs lost and a 6.1% drop in real GDP. This would have significant economic repercussions in Canada and elsewhere.

Hopefully it doesn't come to that. The odds of a default are low, but not zero. Fortunately, both sides continue to talk. They might work out an agreement or extend the deadline. Or the Treasury could find other solutions or prioritize the payment of some bills over others to avoid a financial default.

Either way, US political partisanship has brought the world to the economic and financial brink. Only time will tell if it takes us over the cliff.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, Francis Généreux, Principal Economist, Marc-Antoine Dumont, Economist and Maëlle Boulais-Préseault, Economist

UNITED STATES

TUESDAY, May 16 - 8:30

April	m/m
Consensus	0.7%
Desjardins	2.0%
March	**-1.0%**

Retail sales (April) – Retail sales fell in both February (-0.7%) and March (-0.6%) after spiking 2.8% in January. Sales probably jumped in April. New vehicle sales surged 7.2% last month, while higher gasoline prices likely boosted gasoline station receipts. Excluding motor vehicles and gasoline, preliminary card transaction data is positive, particularly for furniture, apparel and food services. All in all, we expect a 2.0% increase in total retail sales and a 1.6% gain in sales excluding motor vehicles and gasoline.

TUESDAY, May 16 - 9:15

April	m/m
Consensus	0.3%
Desjardins	-0.2%
March	**0.4%**

Industrial production (April) – After three straight negative months last fall, industrial production rose three months in a row from January to March 2023. However, we're forecasting a slight drop in April. After March's 8.4% surge, energy production likely fell. The mining sector probably contracted in April, while the situation in the manufacturing sector is murkier. Hours worked in the automotive industry point to a spike in production in April, but the rest of the manufacturing sector doesn't seem to have the same momentum. We still think manufacturing will rise 0.2%. Overall, we anticipate a 0.2% decline in industrial production.

WEDNESDAY, MAY 17 - 8:30

April	ann. rate
Consensus	1,400,000
Desjardins	1,380,000
March	**1,420,000**

Housing starts (April) – Housing starts declined 0.8% in March after seeing their biggest monthly increase since March 2021 in February. Housing starts likely fell further in April based on March's 7.7% drop in building permits. Residential building construction has lost 5,900 jobs in the last three months. That said, the recent positive trend in new single-family home sales suggests some support for housing starts. We think April's print will come in under 1,400,000 units.

THURSDAY, MAY 18 - 10:00

April	m/m
Consensus	-0.5%
Desjardins	-0.7%
March	**-1.2%**

Leading indicator (April) – The leading indicator fell for the thirteenth straight month in March. Excluding the early days of the pandemic, March's 1.2% decline was the worst print since March 2009. We expect another negative month in April. Consumer confidence, the ISM index and interest rate spreads will be the major headwinds, partly offset by the stock market, which rose overall last month. We think the leading indicator will fall by 0.7%.

THURSDAY, MAY 18 - 10:00

April	ann. rate
Consensus	4,300,000
Desjardins	4,200,000
March	**4,440,000**

Existing home sales (April) – After surging 13.8% in February, existing home sales fell 2.4% in March. Based on the 5.2% drop in pending home sales—the worst print since last September—we expect another decline in April. Looking at the preliminary regional data for existing home sales, a highly negative year-over-year change suggests there's been another decrease over the month. We project existing home sales will come in at 4,200,000 units.

CANADA

MONDAY, May 15 - 8:15

April	ann. rate
Consensus	n/a
Desjardins	200,000
March	**213,900**

Housing starts (April) – Housing starts are expected to have slowed to around 200K in April, as the impact of the prior slowing in existing home sales continues to weigh on presales and new building construction. Higher construction costs and interest rates are also keeping projects on hold. Residential building permits have continued to trend lower as well, albeit with some variability.

MONDAY, May 15 - 9:00	
April	**m/m**
Consensus	n/a
Desjardins	10.9%
March	**1.4%**

Existing home sales (April) – "Housing correction? What housing correction?" Canadians would be right to wonder just that given the home sales data released in April. Starting with Toronto, the Toronto Regional Real Estate Board said that existing home sales advanced by 27% m/m in April on a seasonally adjusted basis. Similar numbers could be posted in major centres like Mississauga and Vancouver, with still-healthy gains in other smaller cities. All told, we expect existing home sales to post a double-digit advance for April—the fifth advance in seven months.

TUESDAY, May 16 - 8:30	
April	**m/m**
Consensus	n/a
Desjardins	0.3%
March	**0.5%**

Consumer Price Index (April) – Headline inflation likely receded for a seventh consecutive month in April, falling to 4.0% on an annual basis. That would mark the slowest reported pace since mid-2021 but would be due in part to a large monthly print falling out of the twelve-month calculation. During the month of April, the end of Alberta's electricity subsidy and an increase in carbon taxes likely put some extra upward pressure on energy prices. Excluding food and energy, inflation probably continued to run above 4%, although a boost to alcohol taxes likely pushed price growth higher than it would have otherwise been. As a result, the Bank of Canada's two core measures of inflation will remain in focus, with 3-month annualized rates lingering stubbornly around 3.5%. With that said, there does seem to be a high bar for these measures to accelerate. Any progress in these measures towards the 2% target will help reassure Canadian central bankers of their current policy stance.

TUESDAY, May 16 - 8:30	
March	**m/m**
Consensus	n/a
Desjardins	0.3%
February	**-3.6%**

Manufacturing sales (March) – Following the decline in February, manufacturing sales are expected to have increased 0.3% in Canada in March. This March gain looks to have been led by volumes, as prices remained fairly stable in March. The increase in sales volumes was likely driven by the transportation industry. Exports of aircraft and other transportation equipment and parts rose in March, pointing to higher manufacturing sales in this sector. Still, our projected increase in factory sales of 0.3% is less than the 0.7% flash estimate from Statistics Canada.

FRIDAY, MAY 19 - 8:30	
March	**m/m**
Consensus	n/a
Desjardins	-0.9%
February	**-0.2%**

Retail sales (March) – Retail sales likely declined for a second month in a row in March. While our forecast for a 0.9% drop is somewhat stronger than Statistics Canada's flash estimate which showed a decrease of 1.4%, it would be another weak print for retail sales which haven't seen consistent growth since early 2022. Lower auto sales likely drove this pullback. Excluding motor vehicles, retail sales are expected to have remained steady in March, and core retail sales are anticipated to have increased during that same month. So we think the data will show that weakness in headline retail sales was concentrated in the auto industry in March.

OVERSEAS

MONDAY, May 15 - 22:00

China: Industrial production and retail sales (April) – Year-over-year changes in industrial production and retail sales in early 2023 gave us a good idea of the scale of the post-pandemic economic rebound. Both indexes likely surged in April, but such gains would largely be a reflection of very favourable base effects compared with spring 2022, when many cities were locked down.

TUESDAY, May 16 - 19:50	
Q1 2023	**t/t**
Consensus	0.2%
Q4 2022	**0.0%**

Japan: Real GDP (first quarter) – Japan hasn't seen two consecutive quarters of real GDP growth since the end of 2020. After falling 0.3% on a non-annualized basis in the summer of 2022, Japan's economy was flat (0.0%) at the end of last year. The consensus forecast is for a slight increase in the first quarter of 2023.

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Economic Indicators

Week of May 15 to 19, 2023

UNITED STATES

Day	Time	Indicator	Period	Consensus		Previous reading
MONDAY 15	8:30	Empire State Manufacturing Index	May	-1.5	-10.0	10.8
	9:15	Speech by Federal Reserve Bank of Minneapolis President N. Kashkari				
TUESDAY 16	8:15	Speech by Federal Reserve Bank of Cleveland President L. Mester				
	8:30	Retail sales				
		Total (m/m)	April	0.7%	2,0%	-1.0%
		Excluding automobiles (m/m)	April	0.3%	1.6%	-0.8%
	9:15	Industrial production (m/m)	April	0.0%	-0.2%	0.4%
	9:15	Production capacity utilization rate	April	79.7%	79.6%	79.8%
	10:00	Business inventories (m/m)	March	0.0%	0.0%	0.2%
	10:00	Testimony of Federal Reserve Vice Chair M. Barr before a House committee				
	12:15	Speech by Federal Reserve Bank of New York President J. Williams				
	19:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic and by Federal Reserve Bank of Chicago President A. Goolsbee				
WEDNESDAY 17	8:30	Housing starts (ann. rate)	April	1,400,000	1,380,000	1,420,000
	8:30	Building permits (ann. rate)	April	1,440,000	1,400,000	1,413,000
THURSDAY 18	8:30	Initial unemployment claims	May 8–12	n/a	259,000	264,000
	8:30	Philadelphia Fed index	May	-18.0	-15.0	-31.3
	9:05	Speech by Federal Reserve Governor P. Jefferson				
	9:30	Testimony of Federal Reserve Vice Chair M. Barr before a Senate committee				
	10:00	Leading indicator (m/m)	April	-0.5%	-0.7%	-1.2%
	10:00	Existing home sales (ann. rate)	March	4,300,000	4,200,000	4,440,000
FRIDAY 19	8:45	Speech by Federal Reserve Bank of New York President J. Williams				
	11:00	Speech by Federal Reserve Chair J. Powell				

CANADA

Day	Time	Indicator	Period	Consensus		Previous reading
MONDAY 15	8:15	Housing starts (ann. rate)	April	n/a	200,000	213,900
	8:30	Wholesale sales (m/m)	March	n/a	-0.4%	-1.7%
	9:00	Existing home sales (m/m)	April	n/a	10.9%	1.4%
TUESDAY 16	8:30	Consumer price index				
		Total (m/m)	April	n/a	0.3%	0.5%
		Total (y/y)	April	n/a	4.0%	4.3%
	8:30	Manufacturing sales (m/m)	March	n/a	0.3%	-3.6%
WEDNESDAY 17	---	---				
THURSDAY 18	10:00	Release of the Bank of Canada's Financial System Review				
	11:00	Speech by Bank of Canada Governor T. Macklem and by Senior Deputy Governor C. Rogers				
FRIDAY 19	8:30	Retail sales				
		Total (m/m)	March	n/a	-0.9%	-0.2%
		Excluding automobiles (m/m)	March	n/a	0.0%	-0.7%

NOTE: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are daylight saving time (GMT - 4 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of May 15 to 19, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
SUNDAY 14							
Japan	19:50	Producer price index	April	0.0%	5.6%	0.0%	7.2%
MONDAY 15							
Eurozone	5:00	Industrial production	March	-2.6%	0.2%	1.5%	2.0%
China	22:00	Industrial production	April		10.8%		3.9%
China	22:00	Retail sales	April		22.0%		10.6%
TUESDAY 16							
United Kingdom	2:00	ILO unemployment rate	March	3.8%		3.8%	
Eurozone	5:00	Real GDP – preliminary	Q1	0.1%	1.3%	0.1%	1.3%
Eurozone	5:00	Trade balance (€B)	March	n/a		-0.1	
Eurozone	5:00	Net change in employment – preliminary	Q1	n/a	n/a	0.3%	1.5%
Japan	19:50	Real GDP – preliminary	Q1	0.2%		0.0%	
WEDNESDAY 17							
Japan	00:30	Industrial production – final	March	n/a	n/a	0.8%	-0.7%
Italy	4:00	Trade balance (€M)	March	n/a		-2,108	
Eurozone	5:00	Consumer price index – final	April	0.7%	7.0%	0.7%	6.9%
Germany	5:00	ZEW Current Conditions Survey	May	-37.0		-32.5	
Germany	5:00	ZEW Expectations Survey	May	-5.0		4.1	
Japan	19:50	Trade balance (¥B)	April	-1,078.6		-1,209.9	
THURSDAY 18							
Mexico	15:00	Bank of Mexico meeting	May	11.25%		11.25%	
Japan	19:30	Consumer price index	April		3.5%		3.2%
FRIDAY 19							
Japan	00:30	Tertiary Industry Activity Index	March	0.3%		0.7%	
Germany	2:00	Producer price index	April	-0.5%	4.3%	-2.6%	7.5%

NOTE: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are daylight saving time (GMT - 4 hours).