The Default Clock Initiative

FOR IMMEDIATE RELEASE
August 16, 2022

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The Debt Default Clock is at four minutes from midnight.

Federal government remains on the path to defaulting on its debt!

Today, the Debt Default Clock Review Committee is releasing its seventh update of the Debt Default Clock. This follows from the Review Committee's meeting of July 21, 2022. The Debt Default Clock estimates how much relative time remains before the federal government's budget leads to a fiscal crisis and eventually causes the Treasury to fail to make a timely interest payment, thereby forcing the federal government into default. Such an event will impose severe financial hardships on the American people. The Review Committee has concluded that the Debt Default Clock now stands at four minutes to midnight, which is one minute further away from midnight compared to where it stood at the time of its prior review in March of 2021.

Clearly, the impact of the covid-19 pandemic and the response to it has had an enormous impact on the fiscal posture of the federal government. During the time between February 2020 and now, federal spending has exploded. The result has been an enormous increase in the deficit and debt for the period that covers the beginning of fiscal year 2020 and the end of fiscal year 2022, which occurs at midnight on September 30, 2022. This has been accompanied, until recently, by enormous increases in the money supply. These applications of both fiscal and monetary stimulus have contributed to a damaged economy in the form of a 40-year high in inflation rates. The economy could be damaged even further if the federal government fails to find an effective way to curtail the fiscal and monetary stimulus. At this point, however, it is key to focus on the fiscal circumstances. This is what the Review Committee focused on at its July 21st meeting.

The Review Committee uses twelve of the most relevant factors making up the federal government's fiscal position to set the Clock's minute hand. In general, the new data collected for this review resulted in changes from the prior review in four of these twelve factors, which caused the minute hand to move an additional minute away from midnight. In short, the improvement stems from Congress enacting a dollar-denominated debt ceiling law in December of 2021 and unexpectedly strong revenue projections put out the Congressional Budget Office in May of 2022. It would be wrong, however, to interpret the minute hand's incremental improvement from where it stood at the time of the prior update in March of 2021 in a way that concludes that the federal government is no longer in a perilous fiscal position. The is because the projections for rising gross interest costs by the federal government are quite disturbing and could rise more quickly in future budget projections. The following highlights the current circumstances regarding the fiscal position of the federal government.

Circumstance #1: There is a dollar-denominated debt ceiling in law now, but this could be taken away in the coming months.

This first circumstance, as stated above, came about by Congress enacting this new law in December 2021. The debt ceiling is now just shy of $31.4 trillion. This subject is covered by Factor #2 under the

Clock. Factor #2 states that if there is no dollar-denominated debt ceiling in place because the debt ceiling law has been suspended or the law has been repealed, no minutes away from midnight may be awarded. Thus, the December 2021 law's enactment caused the Review Committee to award one minute from midnight under Factor #2 at this time, where at the time of the previous update in March of 2021 the debt ceiling law was under suspension and earned no minutes from midnight. It is essential to understand, however, that the federal government will approach this debt ceiling in the months ahead. There is a good chance that Congress will revert to its earlier practice of suspending the debt ceiling, or worse repealing the debt ceiling law altogether. The latter is something the Biden Administration supports.

Circumstance #2: The projected levels of federal revenues calculated by the Congressional Budget Office are moving higher.

Historically, federal revenues have averaged about 17.5 percent of gross domestic product in recent years. Factor #9 of the Clock states that if federal revenues meet or exceed the 17.5 percent level, both now and throughout the ten-year budget period, two minutes away from midnight will be awarded. This is what the Congressional Budget Office reported in May 2022. This caused the Review Committee to exercise its discretion in discounting Factor #9 in this update of the Clock because it is not, at least at this point, a significant contributor to the risk of federal fiscal crisis and eventual default. The rules governing the Clock permit the Review Committee to discount up to two of the twelve factors at any one time.

Circumstance #3: Gross federal interest costs are projected to rise rapidly and could accelerate at an even higher rate.

The Federal Reserve during the two-year period from early 2020 to early 2022, in response to the covid-19 pandemic, moved to keep interest rates very low and adopted a policy of "quantitative easing" by buying Treasury securities among other instruments. These policies served to lessened significantly the projected gross interest costs over the budget period relative to the large increases in the gross debt over the same time. Starting in early 2022, the Federal Reserve has reversed these two policies in order counter the high rates of inflation that have taken hold in the economy. As a result, interest rates for Treasury securities and gross interest costs, as expected, are rising. Two of the twelve factors (Factors #4 and #5) are tied to the projected interest costs. Factor #4 looks at the ratio of gross federal interest costs relative to revenue. In March of 2021, it bought one minute from midnight. The Review Committee left Factor #4 in the position of buying one minute from midnight at recent update but noted that there is a likelihood that this Factor will buy no minutes from midnight at the time of the next update. Factor #5 looks the level of gross interest costs relative to the assumption of net new debt by the federal government. It was discounted by the Review Committee at the time of the March 2021 update because it determined that the Federal Reserve's actions at that time created an anomaly in this Factor. The recent changes in monetary policy described above caused the Committee to lift the discount at this update and directed that Factor #5 buy one minute from midnight. As with Factor #4, the Committee noted this Factor is unlikely to buy this one minute at the time of the next update of the Clock.

Circumstance #4: The current position of the minute hand at four minutes from midnight is fragile and is likely to move closer to midnight at the time of the Review Committee's next update.

Looking ahead, the Review Committee believes that there is a distinct possibility that Congress will revert to its earlier practice of suspending the debt ceiling law in the coming months. If Congress takes this action, the Clock's minute hand will move one minute closer to midnight. Likewise, it is possible that Factors #4 and #5 will lose the one minute from midnight they each are currently buying because gross federal interest cost rise at an even higher rate. Assuming that the current projections for federal revenues as a share of gross domestic product hold, the Review Committee could either continue to discount Factor #9, or direct that it will buy two minutes from midnight. Taken together, these outcomes could mean that the Clock's minute hand would be as far as three minutes from midnight, but alternatively it could be as close as one minute from midnight

Describing the Clock

A full description of the Default Clock instrument, including the most recent data used and graphs depicting the current calculations for the twelve factors, is available at https://debtdefaultclock.us/debt-default-clock/.

Members of the Review Committee are available to discuss this update. Please contact Baker Spring at (703) 812-8178 or baker.spring@compactforamerica.org to arrange for an interview.

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