2025 US Debt Ceiling Showdown

The Cost of Congressional Indecision: Stress, Disruption, and Inflation

As Congress works to forge a compromise on the US debt ceiling, the US Treasury will engage in a series of actions to forestall default, potentially until September. This report examines how a lengthy debt ceiling impasse will likely stress Treasury market auctions and general functioning, alter Fed balance sheet policy actions, and potentially raise borrowing costs for businesses.

Key Insights

- The red sweep (i.e., GOP control over both houses of Congress and the White House) does not guarantee smooth sailing for key pieces of legislation in 2025, including for the debt limit.
- The US Treasury will do what it legally can to forestall default through a series of actions, including extraordinary measures, drawing down its account held at the Federal Reserve (Fed), reducing sizes of Treasury bill auctions, and issuing one-off cash management bills to raise cash.
- If Congress and the president do not agree on a path for the debt ceiling before the US Treasury runs out of cash to operate the federal government, then the US will experience a sovereign debt default.
- A deal is highly likely as default would be disastrous, but the wait still comes at a cost. Avoiding default might still weigh on the US economy if a lengthy debt ceiling debate stokes ratings downgrades for US debt and higher borrowing costs.

US Debt Ceiling Crisis Redux

Figure 1

What might the 2025 US debt ceiling episode look like?

Timing & Options

- January 2025
  - ✓ Jan 1 – 2023 suspension ends
  - ✓ Jan 2 – New limit set at Jan 1 amount
  - ✓ Jan 14-23 – Extraordinary Measures begin
- X-date timing
  - ✓ Very Early – April or May 2025
  - ✓ Early – June 2025
  - ✓ Late – September 2025
- Debt ceiling options
  - ✓ Repeal (unlikely outcome)
  - ✓ Raise
  - ✓ Suspend (done repeatedly)
  - ✓ Default (never occurred, deserves moderate risk assessment)

Scenarios

- Suspension or raise the limit
  - ✓ 11th hour, no budgetary changes, no impact on the economy
  - ✓ 11th hour, no budgetary changes, sovereign debt downgrade, minor impact on the economy
  - ✓ 11th hour, yes budgetary changes, spending cuts, weighs on the economy
  - ✓ 11th hour, yes budgetary changes, spending cuts, sovereign debt downgrade, deepens weight on the economy
- No suspension or raising of the limit
  - ✓ Sovereign debt default
  - ✓ Instant global financial crisis
  - ✓ Instant US recession
  - ✓ Instant global recession

Source: The Conference Board, January 2025

The 2025 debt ceiling issue starts now

The Fiscal Responsibility Act of 2023 suspended the debt limit until January 1, 2025, and January 2 marked the establishment of the new debt limit at the amount of outstanding debt subject to the statutory limit the previous day, or US$36 trillion.

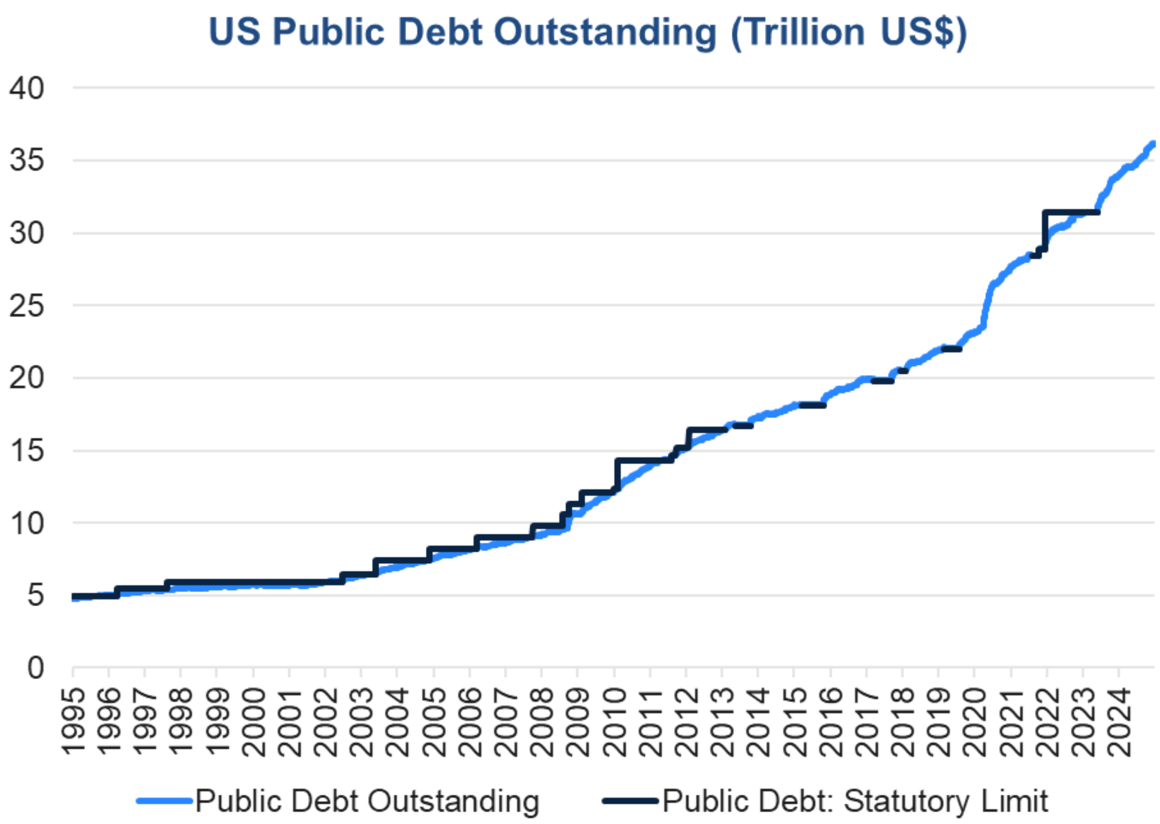
This ceiling is known as the debt limit, the point at which the US Treasury Department loses its legal authority to issue US federal government debt to raise cash. This cash is used to pay for ongoing obligations associated with running the government on a daily basis and financing existing obligations that have accrued in the form of sovereign debt.

Debt limits are unique to the US and Denmark, as no other economies have a cash limit on borrowing. However, Denmark's limit was set at 2 trillion Danish krone (US$284 billion) in 2010, or five times its recent sovereign debt levels. Hence Denmark's debt ceiling is never used as a tool to negotiate other fiscal priorities, as is the case in the US. Most other economies with caps on sovereign debt accumulation use debt as a share of GDP (e.g., 60% in the European Union) as a target, which helps avoid crisis deadlines.

The US Treasury stated in a letter that the limit was not reached on January 2 because of a scheduled payment that will reduce public debt for a few weeks. The outstanding debt subject to the limit is projected to decrease by approximately US$54 billion at the start of the year, mostly due to a scheduled redemption of nonmarketable securities held by a federal trust fund associated with Medicare payments. Nonetheless, the Treasury estimated that unless Congress acts, the debt limit will be reached sometime between January 14 and 23, 2025.

Figure 2

US public debt will reach the statutory limit in January 2025



Source: US Treasury and The Conference Board, 2025

The Treasury can stave off sovereign debt default for months

Once the debt ceiling is reached this month, a breach can be forestalled by the US Treasury in the absence of congressional action for as many as six to nine months. The delay of a potential breach depends upon the extent to which the Treasury uses what are known as "extraordinary measures" to create "headroom" under the debt limit and the timing of federal government outlays, tax receipts and other revenues, and tax refunds to individuals and businesses.

Extraordinary measures include suspension of debt issuance for several government funds. Those funds include the Civil Service Retirement and Disability Fund (CSRDF), Postal Service Retiree Health Benefits Fund (PSRHBF), Government Securities Investment Fund (G Fund) of the Federal Employees Retirement System's Thrift Savings Plan (TSP), Exchange Stabilization Fund (ESF), and State and Local Government Series securities (SLGS). While stopping investments in the CSRDF, PSRHBF, G Fund, and ESF would create headroom, suspension of SLGS issuance conserves headroom (i.e., it eliminates increases in debt that would count against the debt limit if issued).

Figure 3

What are Treasury's options to delay default once debt limit is reached?

Extraordinary Measures and Actions (Billion US$)			
Type	**Average issuance in 2024**	**Last issuance**	**Effect on Headroom**
State and Local Government Series Securities (SLGS)	13.2	7.3	Conserves
Civil Service Retirement and Disability Fund (CSRDF) redemptions and stop reinvestments	9.0	8.9	Creates/Conserves
Postal Service Retiree Health Benefits Fund (PSRHBF) redemptions and stop reinvestments	-	-	Creates/Conserves
Government Securities Investment Fund (G Fund) of the Federal Employees' Retirement System (TSP) stop reinvestments			Creates
Type	**Average Balance in 2024**	**Last value**	
Treasury General Account (TGA)	786.0	720.4	
Federal Financing Bank (FFB)	5.0	4.5	Creates
Exchange Stabilization Fund (ESF)		15.0	Creates

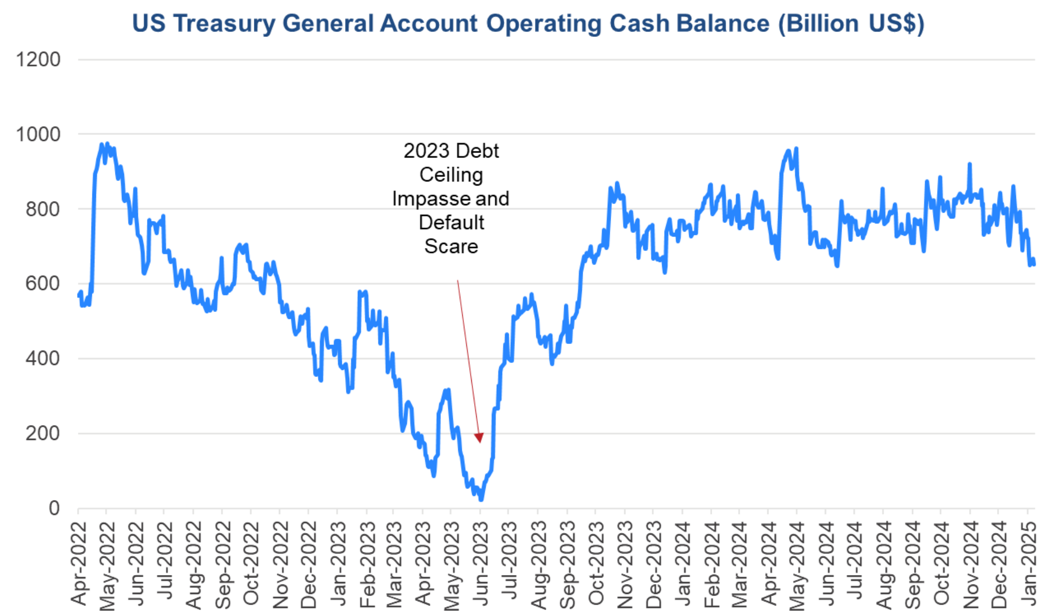
Source: US Treasury and The Conference Board, 2025

An extraordinary measure included in the Treasury's May 2023 set of contingencies was exchanging US Treasury securities for obligations issued by the Federal Financing Bank (FFB). Treasury can enter a multistep exchange transaction with the FFB and the CSRDF under which newly issued FFB obligations that do not count against the debt limit are swapped for an equal amount of outstanding Treasury securities held by the CSRDF that do count against the debt limit. Under such a debt swap, the FFB uses the Treasury securities that it receives from the CSRDF to pay down an equal amount of its outstanding borrowings from Treasury, and Treasury in turn can extinguish the Treasury securities it receives from the FFB to create headroom under the debt limit. The FFB currently has about US$4.5 trillion in outstanding marketable Treasury securities.

Additional actions to avoid default include the Treasury drawing down cash from the account it holds at the Fed, called the Treasury General Account (TGA). The TGA appears as a liability on the Fed's balance sheet and routinely has a daily balance of US$750 billion to US$850 billion that can be tapped to forestall breaching the debt limit.

Figure 4

Treasury will draw down its TGA at the Fed

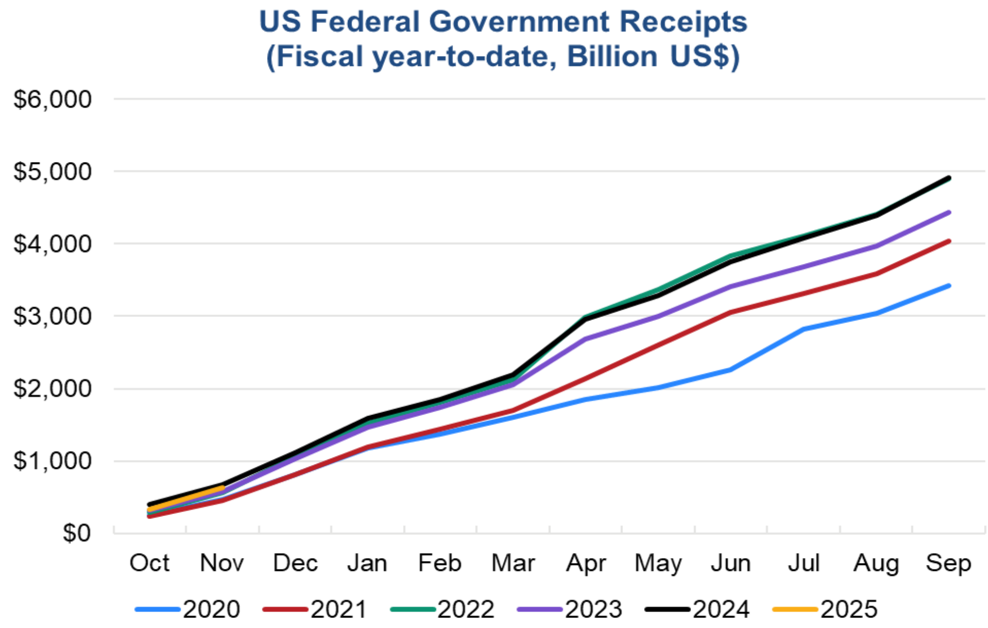


Source: US Treasury and The Conference Board, 2025

Once extraordinary measures are exhausted—the point that is known as the X-date—the Treasury has no choice but to cease debt issuance and funding of government operations and payments. Estimates for the X-date span from sometime in June 2025 to mid-September 2025. There is also a risk that the X-date occurs before June 2025 if daily tax receipts run below prior-year norms and/or April calendar year 2024 tax refunds are outsized. So far, FY2025 tax receipts and refunds are accumulating at the same rate as in FY2024.

Figure 5

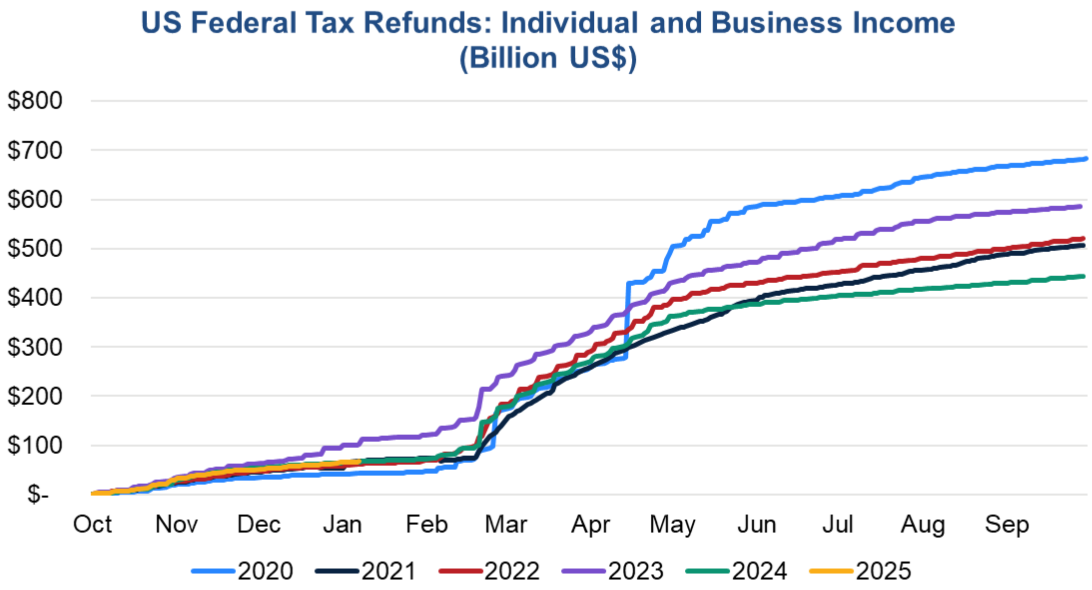
Lower federal government revenues could accelerate X-date



Source: US Treasury and The Conference Board, 2025

Figure 6

Higher federal tax refunds could accelerate X-date



Source: US Treasury and The Conference Board, 2025

Treasury default prevention may alter Fed's monetary policy agenda

The Fed may alter its reverse repo operations to accommodate Treasury's actions to forestall default. This is because the Treasury will temporarily shrink the TGA during the debt ceiling impasse and then rapidly replenish it once a debt limit deal is reached. This is relevant for monetary policy because the TGA is recognized as a liability on the Fed's balance sheet.

When the Fed engages in quantitative tightening (QT) (i.e., allowing Treasury notes and bonds and mortgage-backed securities to roll off of the asset side of the balance sheet at maturity), it simultaneously reduces the balance sheet. So far, the Fed has engaged in reverse repo operations to reduce liabilities at the same time that QT reduces assets.

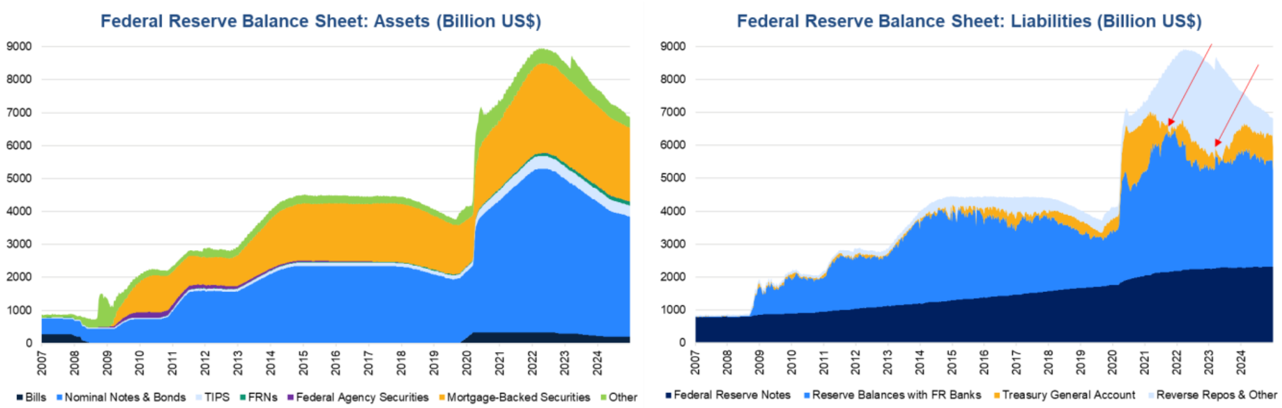
During the 2023 debt ceiling impasse, Treasury drained the TGA by US$524 billion (or to US$49 billion on May 24, 2023, from US$573 billion on January 25, 2023). However, the actions did not affect QT or the Fed's reverse repo operations because the TGA's share of liabilities on the balance sheet was smaller than the share of reverse repos. Reverse repos did fall by US$23 billion during the 2023 impasse, but the level of reverse repos (i.e., US$2.82 trillion on January 25 and US$2.61 trillion on May 24, 2023) consistently dwarfed TGA levels.

However, the results of 2025 TGA drawdown may have a different effect on Fed balance sheet policy. If the Fed is still engaged in QT over the next few months, then the Treasury's cash drawdown will reduce liabilities on the Fed's balance sheet. This means that TGA shrinkage can accommodate QT and the Fed can potentially stop reverse repo operations.

A survey of primary dealers anticipates that QT will end around May 2025, with a range of March to July. If Treasury staves off the debt ceiling X-date until June or even as late as September, then the Fed likely need not worry about the impact on the balance sheet once Treasury starts replenishing the TGA following a debt ceiling resolution.

Figure 7

Treasury's TGA drawdown may slow or halt QT



Note: Red arrows denote ends of 2021 and 2023 debt ceiling impasses.
Source: Federal Reserve Board and The Conference Board, 2025

Impasse will disrupt bond market

The impasse will distort and stress the US bond market leading up to the X-date and for a month or two after. Such distortions run counter to the Treasury Department's primary goal in debt management policy, which is to finance the government at the lowest cost over time by issuing debt in a regular and predictable manner, providing transparency in decision-making, and seeking continuous improvements to the auction process. Treasury also desires orderly US sovereign debt auctions and never wants an auction to fail.

Once extraordinary measures begin, the Treasury will reduce the size (i.e., dollar amount) of four- and eight-week bill issuance. As the debt ceiling X-date nears, Treasury may issue cash management bills that last only a few days to raise cash, which may or may not be announced at quarterly refunding rounds. One-month sovereign credit default swap spreads also tend to spike as US default risks rise.

During the impasse, investor interest in Treasury auctions may flag, causing primary dealers to pick up the slack so that auctions do not fail, and investors operating in secondary Treasury markets will demand outsized premiums for purchasing debt that expires close to the X-date.

Once the debt ceiling is resolved, Treasury will need to quickly ramp up the size of auctions to return bill issuance to preferred values and replenish the cash drawn down from the TGA.

In addition to these explicit costs, the Treasury Borrowing Advisory Committee notes that market participants must undertake significant preparations, requiring operation, liquidity, and solvency plans to reduce exposure in case of a possible default. The costs of the standoff extend well beyond what is seen in markets, as default preparations.

What Does Congressional Indecision Mean for Businesses?

Congressional inaction induces material additional economic costs

Even without a default, lower sovereign debt ratings raise borrowing costs for the US government, businesses, and consumers. The US Government Accountability Office (GAO) estimated that the 2011 and 2023 US sovereign debt downgrades raised US Treasury borrowing costs by billions of dollars.

At least two debt ceiling episodes were accompanied by US sovereign debt downgrades as ratings agencies viewed the proceedings as signs of considerable fiscal risks.

1. Amid the 2011 debt ceiling impasse and political brinkmanship, Standard and Poor's downgraded the US' credit rating to AAA from AAA+ in August 2011. S&P Global stated that the downgrade reflected its opinion that the fiscal consolidation plan that Congress and the administration had recently agreed to fell short of what would be necessary to stabilize the government's medium-term debt dynamics. Moreover, S&P Global doubted the "effectiveness, stability, and predictability of American policymaking." The GAO estimated

that the 2011 debt limit crisis raised Treasury borrowing costs by US$1.3 billion in FY2011, not accounting for higher costs for borrowing for Treasury securities that remained outstanding after FY2011.

2 After the 2023 debt ceiling debacle, which ended in June of that year, in August of the same year, Fitch Ratings downgraded the US' credit rating to AA+ from AAA. The agency cited "expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to 'AA' and 'AAA' rated peers over the last two decades that has manifested in repeated debt limit standoffs and last-minute resolutions."

About the Author

Dana M. Peterson, Chief Economist, The Conference Board

THE CONFERENCE BOARD is the Member-driven think tank that delivers ***Trusted Insights for What's Ahead***®. Founded in 1916, we are a nonpartisan, not-for-profit entity holding 501(c)(3) tax-exempt status in the United States.