Understanding the Debt Ceiling and Why Not to be Afraid

**What is the U.S. Debt Ceiling?**

Simply put, the debt ceiling was implemented to allow a freer flowing and capitalistic monetary system in the United States and effectively the world. Prior to its development, the borrowing of any money by the U.S. government had to be approved by Congress – a taxing, slow, and inconvenient process that hindered fast economic growth.

**How does it work?**

Essentially, the debt ceiling allows Congress to pre-approve a certain limit or amount of money the federal government can borrow. This pre-approval is for larger increments than before and is intended to make the federal government more fiscally responsible within the debt perimeters.

**What happens if the debt ceiling isn’t raised?**

If for some reason the debt ceiling isn’t raised, then the federal government has effectively gone bankrupt and cannot pay its interest payments or its debt obligations. With an already uncertain economic future – rising interest rates, market volatility, and a looming recession – defaulting would only add rocket fuel to that already volatile mix.

This would stop the government from making its social security payments and from paying its federal employees, national defense, public health systems, and public-school systems.

**What might the financial industry’s reaction be if the debt ceiling isn’t raised?**

As Janet Yellen, the U.S. Secretary of Treasury, has said, “Failure to meet the government’s obligations would cause irreparable harm to the U.S. economy, the livelihoods of Americans, and the global financial system.”

Essentially, the financial markets will react and overreact to the negotiation process and to the outcomes. A longer-term structured debt deal will help stabilize the stock and bonds markets for the globe, but a short term “deal” that doesn’t resolve this issue, will signal to the markets the continued uncertainty – causing volatility and a downward trajectory across financial markets.

**What should you do?**

As citizens saving for retirement or in retirement you can’t plan for the world to end - that’s an effort not worth taking on.  But we do know that volatility happens all the time. ***The best thing you can do is develop a financial strategy with a trusted advisor.***  Make sure that plan is diversified, goal-based, and fits your risk tolerance.

**How do I assess my risk tolerance?**

Your risk tolerance is easy to fit and assess when times are good and the stock market is going up, but in times like these - where uncertainty reigns, your advisor becomes paramount.  They are the ones that should be able to truly assess your risk tolerance and your capacity for risk while still meeting your financial goals.

**Why is a trusted financial advisor so important?**

The plan you develop with your advisor needs to create stability while still maintaining flexibility to allow tweaking in times of turbulence.  When times get choppy, your financial advisor is there to reevaluate your plan, your goals, and your risk assessment to make sure you can weather the storm and maintain your lifestyle.  Planning, documentation, and communication are everything - connect with your advisor and make sure your financial plan fits what you need – helping you to find peace of mind during these seemingly chaotic times.

**How do I understand the recent “debt deal?”**

As we’ve stated earlier in this discussion, the debt ceiling process and corresponding debate is not a new phenomenon - having started 105 years ago. This most recent iteration has followed a similar pattern to the others, ultimately leading to pressure packed negotiations that send the resolution to the final available seconds.

The “debt deal” that has just been struck is 99 pages long. Ultimately, this novel states the suspension of the debt ceiling until Q1 2025, putting some caps on spending and other entitlements until that time arrives. The suspension of the overall debt ceiling is basically a game of kick-the-can where we haven’t really solved anything and this ever increasing game of political brinkmanship will be repeated after the 2024 election cycle.

Catastrophe has definitely been punted and the financial markets have reacted positively to the news which is great for everyone involved.

**When January 1, 2025 gets here, quicker than we expect, don’t let the impending politics stress out your financial plan. Talk your financial advisor about how to prepare for the volatility ahead of time.**