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1820 Hall Avenue
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1111 Tenth Street
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115 S. Lakeshore Blvd
Suite D
Marquette, MI 49855
906-273-1501

Last-Minute Agreement Ends Government Shutdown, Suspends Debt Ceiling

After a 16-day federal government shutdown and gridlock over whether to raise the nation's debt ceiling, a last-minute agreement brought a temporary end to the impasse. The measure, formally known as the "Continuing Appropriations Act, 2014," was passed by both houses of Congress and signed by President Obama shortly after midnight on October 17--the day on which the Treasury had said it would begin running out of cash to pay the nation's bills.

What does the agreement do?

The legislation suspends the debt ceiling until February 7 and provides sufficient funding to reopen the government for the next three months (through January 15). It applies retroactively through October 1, the day on which the federal government was forced to begin furloughing roughly 800,000 employees.

To try to address longer-term issues, the agreement also establishes a congressional budget conference that would issue a report no later than December 13. That will be run by Sen. Patty Murray (D-Washington) and Rep. Paul Ryan (R-Wisconsin), who head their respective chambers' budget committees. The across-the-board budget cuts known as the sequester, which were adopted as part of the agreement that ended the 2011 debt ceiling and were implemented earlier this year, remain in effect. The new agreement also requires income verification for people receiving subsidies under the Affordable Care Act, and if the debt ceiling is reached again in February, the Treasury will not be prohibited from using measures like those it has been using since May to cope with the current debt ceiling.

What exactly is the debt ceiling?

The debt ceiling represents a limit on the amount the Treasury is allowed to borrow to manage the national debt (the total amount currently owed by the U.S. government). An increase in the debt limit does not authorize additional government spending, which only Congress can approve; it enables the Treasury to help manage its cash flow and pay bills that have already been incurred.

Technically, hitting the debt ceiling is not the same as defaulting on payments. In fact, the Treasury actually hit the debt ceiling in May, and has been using various accounting measures since then to temporarily extend its ability to borrow. That created greater uncertainty about whether hitting the debt ceiling on October 17 would have prevented the country from meeting its financial obligations. That was a special concern not only for recipients of Social Security and Medicare benefits but also for investors. Because Treasuries have traditionally been seen as the safest sovereign debt in the world, overseas investors hold a substantial amount of it. The uncertainty helped underscore fears not only of a default, but that some countries might increase calls for alternatives to the U.S. dollar as the global reserve currency.

How will the agreement affect financial markets?

Investors' immediate reaction to the news was extremely positive. Word on Thursday that a deal had been reached sent the S&P 500 up 1.4% and added 206 points to the Dow Jones Industrial Average in a single day. Even if that enthusiasm fades as equities once again start to respond to other influences, it was a far cry from the reaction to the 2011 extension of the debt ceiling, which was followed by a 10.6% decline in the S&P over the week following the August 2 signing. But investors now must turn their attention once again to corporate earnings season and the question of whether the shutdown's economic impact will affect when the Federal Reserve starts to taper its economic support.

The new agreement also helps protect the nation's credit rating from a threatened downgrade that would

have affected borrowing costs. Yields on 1-month Treasury bills, which had soared in October when several institutional investors began unloading them as the debt ceiling deadline neared, were cut in half overnight after the announcement.*

When will government agencies return to fully functional status?

The roughly 800,000 federal employees furloughed during the shutdown were instructed by the Office of Management and Budget to be ready to return to work the day after the agreement was signed. However, individual agencies may vary depending on the method each uses to notify employees, who will be entitled to receive back pay for the shutdown period.

What was the economic impact of the shutdown?

Standard & Poor's estimated that as of the day before the agreement, the shutdown had cost the U.S. economy $24 billion, cutting roughly 0.6% from inflation-adjusted Q4 gross domestic product.** (S&P also estimated that had there been a default, the result would have put the economy into recession.)

***Source:** U.S. Treasury Resource Center (www.treasury.gov) Daily Treasury Yield Curve Rates as of 10/17/2013.

****Source:** Standard & Poor's press release, October 16, 2013.