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Economics Group

Special Commentary

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The Race to Recess: A Budget Deal in Reach?

Executive Summary

On Monday, Congressional leadership in both parties and the White House announced a budget deal that would increase the discretionary spending budget caps by a total of $320 billion over FY 2020 and FY 2021. Critically, this increase in spending is relative to *current law* and not *current spending*. As a result, the deal essentially amounts to just a modest increase in inflation-adjusted discretionary spending relative to current spending. A deal of this nature, should it become law, is roughly in-line with what we already have baked into our economic forecast and would probably not lead to significant changes to our outlook for economic growth and federal budget deficits. The agreement would also suspend the debt ceiling until July 31, 2021, preventing a debt ceiling crisis later this fall and pushing off the next debt ceiling event until after the 2020 election.

A deal of this nature, should it become law, is roughly in-line with what we already have baked into our economic forecast.

Budget Deal Largely Baked into our Baseline Forecast

Congressional leadership in both parties and the White House announced a budget deal on July 22 that would increase the discretionary spending budget caps by a total of $320 billion over FY 2020 and FY 2021. Some of the specifics of the deal still remain a bit fuzzy, but the broad contours of the deal seem fairly concrete at this point. In our view, the key fact to understand about the $320 billion number, which is the one that has been most commonly cited in media reporting, is that it is an increase in spending relative to *current law* and not *current spending*. As we have discussed in previous reports, absent a budget deal, discretionary budget authority subject to the sequestration level budget caps was set to decline by about $125 billion in FY 2020 and $100 billion in FY 2021 relative to FY 2019 (Figure 1). Thus, the deal essentially amounts to just a modest increase in inflation-adjusted discretionary spending relative to current spending. It appears the deal will include about $75 billion in offsets, but these savings appear to be concentrated in the last couple years of the 10-year budget window.

The $320 billion number is an increase in spending relative to current law and not current spending.

Figure 1

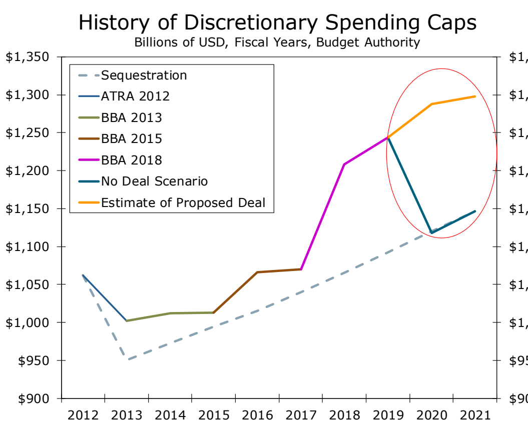
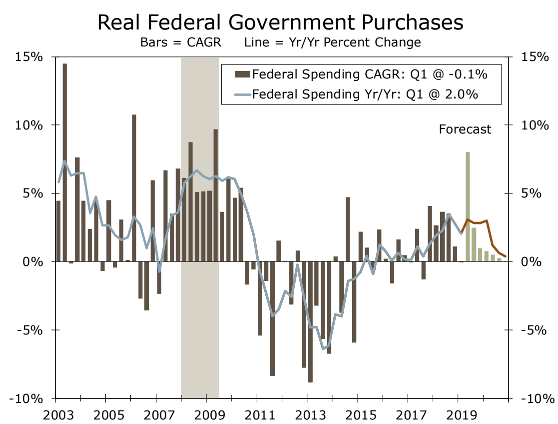


Figure 2



Source: CBO, Congressional Research Service, U.S. Department of Commerce and Wells Fargo Securities

A deal of this nature is roughly in-line with what we already have baked into our baseline economic forecast. Our forecast assumes that the previous FY 2018/FY 2019 boost to growth from more spending would gradually give way to inflation-adjusted federal consumption and investment converging towards zero over time (Figure 2). Put another way, our forecast assumes discretionary spending growth will continue over the next year or two, but at a slower pace than has been the case more recently. Assuming the deal eventually becomes law, we may eventually tweak our deficit and government consumption/investment forecasts once the Congressional Budget Office (CBO) has weighed in with more information on things like spend-out rates and the timing of offsets, but this information is more likely to lead to modest tweaks to our forecast than wholesale changes.

So what is the path forward from here? The deal will need to be turned into a formal bill, scored by the CBO and then passed in the House and Senate, before being signed by the president. Thus far, Congressional leadership in both parties and the president appear to back the bill, which should help ensure its eventual passage, albeit with some defections on both sides. At present, the House is scheduled to leave for August recess on July 26, while the Senate is in town for an extra week through August 2. Both chambers will seek to pass the bill before leaving. If either side's leaders were to get cold feet and revoke their support of the bill, the deal's future would be in serious jeopardy. In this regard, the potentially explosive testimony of former Special Counsel Robert Mueller on July 24 before the House of Representatives stands as a possible risk that could derail the deal.

Bear in mind that this is merely step one of a two-step budget process.

One final point on the budget side: bear in mind that this is merely step one of a two-step process. Now that Congress has set the top-line discretionary spending numbers, policymakers will next need to appropriate money to the various government programs. Until this is complete, the threat of a partial federal government shutdown after September 30 will remain. Indeed, the top-line spending levels were a non-issue earlier this year when a fight over border wall appropriations derailed the budget process and led to an extended government shutdown. More budget drama may still be in store once Congress returns to action in September.

Debt Ceiling Suspended through July 2021

The impetus for reaching a budget deal ahead of the August recess was the pending exhaustion of the debt ceiling related "extraordinary measures" currently being used by the Treasury to keep the federal government solvent. In a letter to Speaker Nancy Pelosi on July 12, Treasury Secretary Mnuchin noted that "based on updated projections, there is a scenario in which we run out of cash in early September." Note that the Treasury Secretary's letter said "a" scenario. The possibility of running out of cash in early September while Congress was still on its August recess presented a risk that, in the end, policymakers seemed unwilling to tolerate. This helped leadership reach a deal before the House leaves for its recess on July 26.

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Should it become law, this week's agreement would suspend the debt ceiling through July 31, 2021, ensuring that another debt ceiling fight will not occur until after the 2020 presidential election. In the near term, the Treasury will actively begin to ramp up Treasury bill issuance, which has been restrained over the past several months by debt ceiling related limitations. We will provide a more detailed outlook for Treasury supply in an upcoming preview piece for next week's quarterly refunding from the Treasury. Qualitatively at least, net T-bill issuance will likely be quite robust between now and next April, as Treasury will need to spend the next few months rebuilding its cash balance and replenishing its extraordinary measures before having to finance the large seasonal deficits that occur annually in February and March.

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