

TRENDMACRO LIVE!

On the Debt Ceiling Deadlock, Volume 2

Thursday, July 28, 2011

Donald Luskin

Two nearly identical plans on table -- now everyone just needs to agree to say "done."

It's a new act in the Washington drama over the debt ceiling, as our story moves from the White House to Congress.

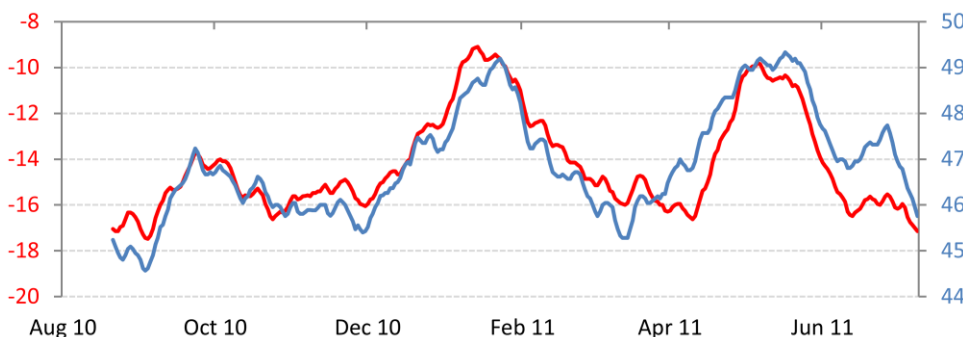
- [Obama's speech Monday night](#) was his valedictory -- extracting himself from a no-win political quagmire of his own making, amidst falling voter approval (see the charts below, and ["On the Debt Ceiling Deadlock"](#) July 25, 2011). His rhetorical emphasis on the need to raise taxes is his way of making himself deliberately irrelevant -- [Senate Majority Leader Harry Reid's plan](#), which had been revealed earlier in the day, and which Obama had [instantly endorsed](#), includes no tax hikes.

Update to strategic view

US MACRO: There are now two substantively identical plans on the table to resolve the debt ceiling crisis -- with the crucial sticking point being the duration (and by implication, also the size) of the ceiling hike. Even if Boehner's plan passes the House, it is dead. It's up to the Senate to craft a compromise with a longer-term and larger hike, and more spending cuts, which we would expect in a matter of days.

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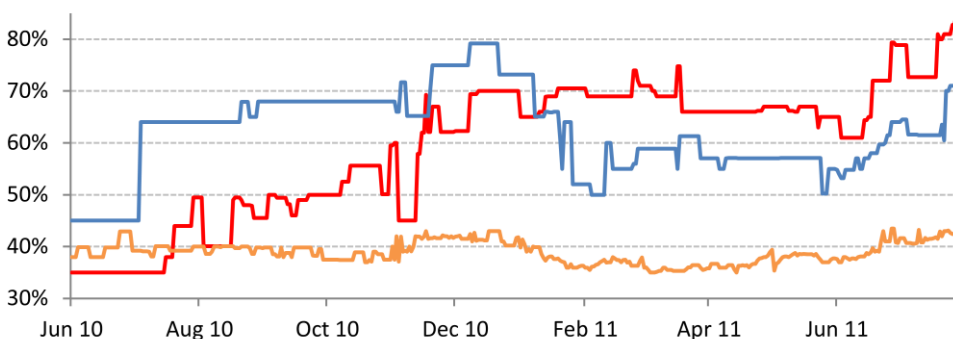
— Obama approval index — Obama approval rating
 Daily, 21- day moving averages Source: Rasmussen, TrendMacro calculations



Futures-implied probability, GOP control 2012:

— House — Senate — Presidency

Source Intrade



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- Obama now has one actual requirement for the outcome -- that a hike in the debt ceiling be large enough to carry across the 2012 election. He doesn't want to face this issue again before then -- it is evidently a loser for him, and a winner for the GOP.
- This requirement is the substantive difference between Reid's proposal and that of [House Speaker John Boehner](#). Once the war-spending gimmick is stripped from Reid's proposal, the spending economics of the two are [substantively identical](#).
- ***So this is what it boils down to now -- whether the hike in the debt ceiling will be short-term or long-term.***
- The next step is to get Boehner's proposal passed in the House this evening. But this is really an irrelevancy since Reid has [made it clear](#) that it will be rejected by the Senate instantly. If the stock market drops following the failure of the Boehner proposal, given that it is irrelevant anyway, this would present an interesting very short term speculative opportunity.
- So, whether the Boehner proposal passes or fails, the next *relevant* step is the Senate's to take. Reid and minority leader Mitch McConnell will have to craft an altered version of the Reid proposal that has some chance of being agreed by the House. They are no doubt already working on it collegially -- in between hurling insults at each other in public -- and we would expect the Senate to be in session over the weekend so it can get passed, and then thrown to the House next Monday or Tuesday.
- The Reid/McConnell exercise will consist of McConnell trading away Boehner's short-term debt ceiling hike in exchange for Reid giving more spending cuts. Note that each party has something to give that the other party urgently wants -- as bad as things may seem, this is the *sine qua non* of any successful negotiation.
- So early next week we are likely to have the House looking at a version of the Reid proposal with a single large hike in the debt ceiling, and more spending cuts -- which may or may not be greater than the hike in the debt ceiling.
- Could such a bill pass the House? We think it could, because it would not require GOP unanimity. Some Democrats would vote for it because it achieves a large longer-term hike in the debt ceiling, and many Republicans could vote for it because it achieves substantial spending cuts -- indeed, more than the Boehner proposal. Obama can sign it because he'll want to take credit for brokering such a terrific compromise (though in fact he will have done just the opposite).

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trendmacro.com

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Donald Luskin
Menlo Park CA
650 429 2112
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Sixmilebridge Ireland
212 537 9067
lorcan@trendmacro.com

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Bottom line

There are now two substantively identical plans on the table to resolve the debt ceiling crisis -- with the crucial sticking point being the duration (and by implication, also the size) of the ceiling hike. Even if Boehner's plan passes the House, it is dead. It's up to the Senate to craft a compromise with a longer-term and larger hike, and more spending cuts, which we would expect in a matter of days. ▶