



U.S. Debt Deal May Mark New Era in Federal Spending



Here's what it could mean for the economy, industry, and policy.

June 2023

First and foremost, the deal to suspend the U.S. debt ceiling, formally known as the Fiscal Responsibility Act (FRA), averted a U.S. sovereign default. However, the compromise may also mark a new era where government spending grows more modestly, in our view. It also could open the door for additional bipartisan legislation in the run-up to the next presidential election.

FRA Likely a Modest Drag on Economy Over Next Two Years

The bulk of the fiscal drag over the next two years would come from caps on non-defense discretionary spending, or the portion of the budget that Congress sets each year. This category includes a wide range of federal programs, from scientific research to education, housing, and law enforcement. Spending on Social Security and Medicare is excluded.

In fiscal year 2024, which begins October 1, 2023, these limits ultimately could translate into a roughly 0.2% drop in government spending after planned adjustments that include diverting funding from the Internal Revenue Service. The FRA limits spending increases in fiscal 2025 to 1%.

Both caps would represent a savings relative to the Congressional Budget Office's previous baseline for the



Michael Pinkerton

Washington Associate Analyst
U.S. Equity Division

assumed annual growth rate in federal spending.

The legislation also expanded work requirements for certain government assistance programs and includes a separate requirement that the federal government restart student loan payments in August, a month earlier than the Biden administration had planned. Repayments on federal student loans have been paused since March 2020 to provide relief during the coronavirus pandemic.

Ultimately, the hit to the economy in 2024 could be moderated by the positive effects of spending from last year's budget, which was about 10% higher than that of fiscal 2022. Private investment in clean energy infrastructure could also accelerate more than expected, fueled by the generous tax subsidies enacted by the Inflation Reduction Act.

“...the compromise may also mark a new era where government spending grows more modestly....”

“
Given concerns about geopolitical tensions, we would not be surprised if Congress were to pass supplemental defense spending.

Bottom Line: The FRA's binding caps on government spending are limited to the next two years and, on their own, should not be a game changer for the U.S. economy over the coming 12 months. The trajectory of inflation and the lagging effects of the Federal Reserve's monetary tightening are likely more important drivers for the domestic economy, in our view.

One risk factor, however, bears watching. The compromise deal automatically imposes a temporary 1% cut if all appropriations are not approved by January 1. Appropriation bills set the funding for discretionary government programs each year. The FRA only sets the topline spending numbers; appropriations lay out the details.

Defense Dodges a Cut, and Energy Receives Permitting Relief

The FRA carves out a 3% increase in defense spending in fiscal 2024. This favorable treatment does not extend to fiscal 2025, when the uptick in military expenditure will be subject to the same 1% cap as the rest of the government's discretionary budget. Given concerns about geopolitical tensions, we would not be surprised if Congress were to pass supplemental defense spending.

Changes to the approval process for energy infrastructure should benefit both fossil fuel and clean energy companies by shortening the duration of environmental reviews and giving

project developers legal recourse if regulators fail to meet these deadlines. We think the limited scope of these reforms should preserve the political momentum behind an overhaul of energy permitting.

Potential losers from the FRA are harder to identify at this juncture. However, the fall should bring greater clarity as the budgeting process reveals which government programs will face the largest cuts.

Potential for Other Compromise Legislation

The debt limit saga and its ultimate resolution demonstrated that Speaker of the House Kevin McCarthy (R-Cal.) can overcome internal differences to wrangle his caucus, suggesting the possibility of additional bipartisan legislation.

We'll be monitoring the progress of initiatives related to permitting for energy projects, a new farm bill that sets agricultural and food policy, and the tax treatment of expenses related to research and development.

A New Era in Fiscal Policy?

The debt deal may mark the start of a new era of fiscal policy where moderate spending growth or modest austerity become the norm.

That's one aspect of the agreement that may get overlooked in the rush to sort out its near-term implications.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T.RowePrice®

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types, advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. **Actual future outcomes may differ materially from any estimates or forward-looking statements made.**

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., distributor, and T. Rowe Price Associates, Inc., investment adviser.

© 2023 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.