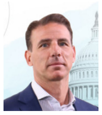
Traffic Jam on Pennsylvania Avenue

As debt ceiling measures approach their deadline, both parties grapple with how to pass their initiatives.



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Key Points

- Congress is off to its slowest start in decades with major legislation stalled until late spring/early summer.
- Decisions on the budget and debt ceiling have been elusive, and time is running short.
- Banking, defense, and energy-related issues enjoy a modicum of bipartisan agreement, but passing anything will have varying degrees of success.

Congress is off to one of its slowest starts in recent memory. House Republicans have passed only one of their marquee bills, and Senate Democrats continue their slog to confirm nominees—both judicial and agency wide.

While House Republicans passed a series of messaging bills that are essentially dead-on-arrival in the Democrat-controlled Senate, they're struggling to garner support within their conference for their top priorities, including immigration reform and big-tech regulation.

As we look ahead to the spring and early summer, both ends of Pennsylvania Avenue will be focused on a handful of issues that could shape up or shake up the landscape for the remainder of 2023.

Debt Danger

Congress only has a few weeks to go until the Treasury Department reaches the beginning of the x-date period—when extraordinary measures to make payments on the debt will be exhausted. While President Joe Biden and House Speaker Kevin McCarthy (R-CA) haven't met since February 1, Congress and the White House remain at loggerheads on the debt-ceiling debate. McCarthy has repeatedly tried to force Biden's hand, most recently penning a letter to the president outlining House Republican demands.

But Biden and his Democratic allies on the Hill maintain that they won't budge until McCarthy and House Republicans move forward with their own budget proposal and corresponding spending cuts, and insist the debt-ceiling vote should be clean. While there's still time to solve this episodic dilemma (and we do think default will be averted), the biggest danger surrounds the June-July x-date run-up, as evidenced by the same exercise back in 2011 resulting in a downgrade of US credit.

McCarthy plans to deal with the debt limit by introducing legislation combining an extension of the debt limit with some of the provisions mentioned in the aforementioned letter to Biden:

1. Recapture unspent COVID-19 funding;
2. Cut non-defense discretionary spending;
3. Strengthen work requirements for federal social programs;
4. Overhaul energy policy to encourage increased domestic production; and
5. Draft border legislation aimed at stemming the stream of fentanyl.

It's likely that Biden will continue to stand firm and won't cede ground on the policy front, declaring that paying the nation's debt is non-negotiable. We're then back to square one.

Budget Standoff

Washington's annual budget exercise has become an exercise in gamesmanship. Deadlines are blown, budget submissions regardless of party control are always declared aspirational or political, and rarely do the House and Senate agree on the same terms. The process can, however, act as a blueprint for tax and spending priorities in the fiscal year ahead. This year is panning out to be no different but with a lot more at stake than past cycles.

With budget, spending proposals, and the debt ceiling currently linked by Republicans, Washington is playing a game of chicken waiting to see what cards the other side is holding. While Biden's initial budget was predictably met with scorn, McCarthy and House Republicans will struggle to pass a budget with significant spending cuts acceptable to all factions of their majority. Nonetheless, Republicans will ultimately need to put forward a budget in order for the annual appropriations process to begin—or we may be looking at static government funding for the next cycle.

Defense in the Driver's Seat

High-ranking Pentagon brass spent the first few months of the year canvassing Capitol Hill seeking support of the Biden administration's $842 billion request for spending on defense. While defense spending currently garners bipartisan support for an increase over 2023 topline numbers, defense hawks in both parties are balking at the submission and seeking to boost defense spending above the Pentagon's request.

The ultra-conservative wing of the House, once again, remains the wildcard in this scenario. Since defense spending is part of the discretionary spending side of the ledger, it could be subject to their demands to cut spending.

Banking on Compensation

In the aftermath of the Silicon Valley Bank failure, Republicans and Democrats alike are receptive and agree that penalties for executives at failed banks should be strengthened and/or compensation reclaimed. At the end of March, four bills were already making their way through Senate committees as well as the powerful Senate Banking Committee, targeting executive accountability and authorizing regulators to recover bank-CEO compensation.

Biden and senators on both sides of the political spectrum are in agreement that standards should be tougher. Despite this, the move has been met with strong resistance from the banking industry and some House Republicans. They argue that new legislation could invite unnecessary government intrusion into the banking industry with the potential to expand into other industries.

We don't see banking-related legislation moving forward unless there is a continuation of bank failures in the coming months. We do, however, see the potential for regulatory activity based on pressure from legislators and the president.

Fossil Fuels vs. Climate Change: One and Done?

Before adjourning for the two-week April recess, House Republicans managed to pass one of their top priorities with Democratic support. The Lower Energy Costs Act (LECA) repeals a number of climate, healthcare, and tax programs that were enacted in 2022's Inflation Reduction Act. This includes the $4.5 billion energy-efficient home rebate program; the Environmental Protection Agency program aimed at ramping up national green banking and emission reduction; and emission fees targeted at fossil-energy companies.

LECA also directs the Interior Department to complete a quarterly lease sale of oil and gas, lifts a moratorium on coal leasing on federal land, and prohibits the president from declaring a national ban on fracking.

Lastly, there's a provision aimed at easing permitting restrictions that tend to delay energy projects. Permitting reform was championed in 2022 by Sen. Joe Manchin (D-WV) but not included in the final Inflation Reduction Act. This could be the only area of bipartisan agreement in LECA and could serve as a starting point for Senate negotiations. The rest of LECA's components would be hard-won in the Senate, and, even if it were to survive a vote, the Biden administration has made clear its intentions to veto the bill.

After the spring recess, Congress and the White House will face major decisions with limited time on the clock. While there are still narrow areas of potential agreement between Republicans and Democrats, the gulf between them on critical issues could widen further and the ripple effects of delays or a roadblock on these issues could have far-reaching ramifications for the economy.

Talk to your financial professional to help make sure your portfolio is prepared for whatever happens in Washington D.C.

About the Author:

James R. (JT) Taylor serves as Senior Policy Analyst at Hedgeye Potomac Research. JT has extensive experience in both government and business in Washington, D.C., with a career spanning the legislative and executive branches as well as the financial-services industry. Prior to joining Potomac Research Group, he ran Pelorus Research, the US public-markets division of the Holdingham Group based in the United Kingdom. He previously led a policy research team as Managing Director at DeMatteo Monness. From 2002-2009, he was Managing Partner of Kemp Partners, a Washington, D.C.-based strategic consulting, business development, and marketing firm he founded with former Housing and Urban Development Secretary Jack Kemp in 2002. At Kemp Partners, he oversaw day-to-day operations and business development while managing client relationships in both the corporate arena and financial-service industries.