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Why the debt ceiling matters for your money

Congress needs to soon reach a debt ceiling agreement to ward off higher borrowing costs, stock market volatility, delayed Social Security payments, and more.

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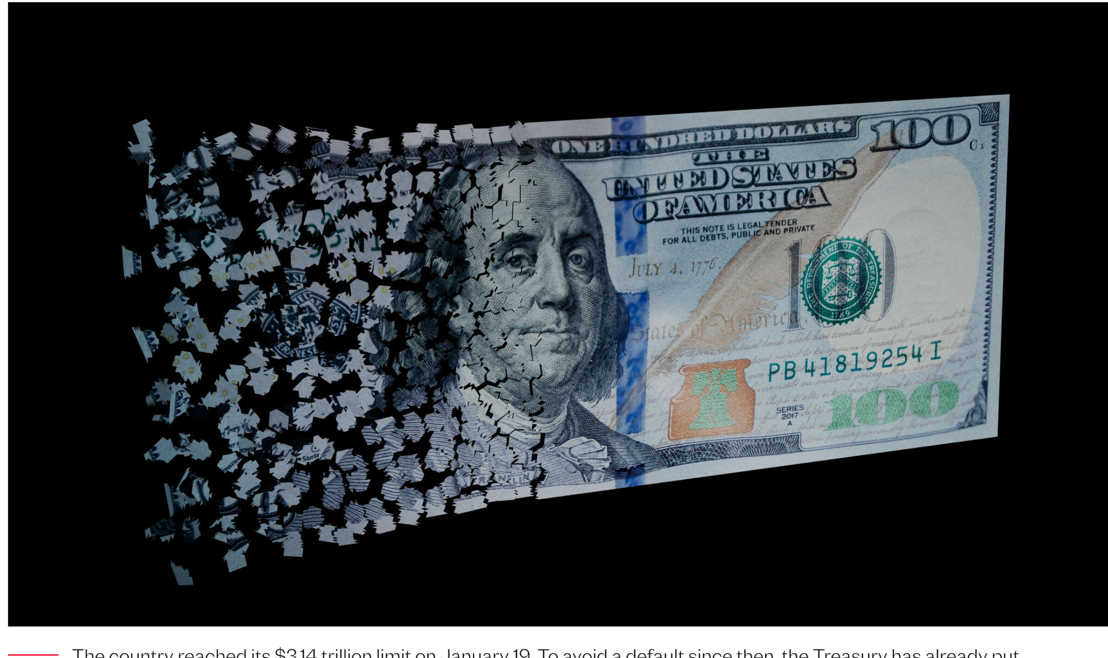

The country reached its $3.14 trillion limit on January 19. To avoid a default since then, the Treasury has already put "extraordinary measures" in place, which means that it's reordering some payments and putting off others to stretch the country's cash as far as possible.
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Even if you don't follow politics closely, you've likely heard of the latest stalemate in Washington, where there's a showdown between President Biden and Republicans in Congress about whether to raise the current debt ceiling.

If they fail to reach an agreement in the next few weeks, the United States could default on its debt, potentially pushing the country into an economic crisis and a recession. Here's what you need to know about the debt limit and how it affects your money:

What is the debt ceiling?

The debt ceiling is the legal limit on the amount of money that the United States Treasury is allowed to borrow to fulfill its existing financial obligations. Since the country runs a deficit, meaning it spends more money than it brings in, it needs to regularly borrow additional funds.

"The debt ceiling in and of itself is not authorizing new spending, it's just making sure the government can pay the bill that it has already committed to," says Ted Rossman, a senior industry analyst at Bankrate.

Historically, the U.S. Congress has always extended the debt ceiling as needed, although in recent years political battles around the process have sometimes led to brinksmanship similar to what we're seeing now. In 2011, the country came to the verge of default in a standoff that led to a dip in stock prices and a lowering of the U.S. credit rating.

Congressional Republicans want Biden to agree to spending cuts before they vote in favor of raising the debt ceiling, while Biden and the Democrats would prefer to negotiate the debt ceiling separately from spending cuts, which was how Congress raised the debt ceiling in the last administration.

What happens if the U.S. defaults?

The country reached its $3.14 trillion limit on January 19. To avoid a default since then, the Treasury has already put "extraordinary measures" in place, which means that it's reordering some payments and putting off others to stretch the country's cash as far as possible. However, Treasury Secretary Janey Yellen has said that even with those measures, the United States could run out of money as early as June 1, which would lead to the country defaulting on its debt. So the debt ceiling deadline is just a few weeks away.

A default could have a wide-ranging economic impact, including pushing up interest rates, creating stock market volatility, and potentially pushing the country into a recession. There could also be a long-term impact on the creditworthiness of the United States.

"Confidence in the United States would be undermined," Rossman says. "Treasuries are viewed as the safest security on earth, not just in the United States, but in the global financial system. A default would be a really big deal."

Keith Hall, a distinguished visiting fellow at the Mercatus Center at George Mason University, points to Greece's government debt crisis of 2009 as an example of how it could play out.

"Their financial crisis meant a real spike in interest rates," Hall says. "It slowed down the economy because people stopped borrowing money, and they went into a recession. They've had a long time recovering from that jump in rates."

How a default could impact your personal finances

Since the United States has never defaulted on its debt in this way before, it's hard to predict exactly how it would impact the finances of individuals. It's likely you could see the value of your investments go down and the cost of borrowing to go up. In addition, if you receive any payments from the federal government, such as Social Security or military benefits, those payments could be cut or delayed until Congress raises the debt ceiling.

"The other part would be that small or even medium sized businesses might need to start cutting back and laying off workers as a cost-savings measure to preserve earnings," says Jason Steeno, president of CoreCap Investments and CoreCap Advisors in Southfield, Michigan.

How to prepare for a debt default

With a projected default date of June 1, there's not much time to prepare your finances. To the extent possible, however, it may make sense to shore up your emergency savings now. If you have less than three months' worth of expenses saved in a rainy-day fund, you might consider putting off discretionary purchases to direct extra money to savings. You can take advantage of higher interest rates now (and in the future) by moving your savings into a high-yield savings account.

You might also consider making additional payments on any debts with variable rate interest (such as credit card debt or a home equity line of credit) that you hold, since that could get more expensive if interest rates shoot even higher. A potential recession also presents an opportunity to take a closer look at your budget to see if there are any areas where you could make additional spending cuts.

As for your investments, while they may experience volatility in the short-term, if you don't need the cash right away, avoid making knee jerk changes. Over the long haul, stock investments tend to outperform other types of securities, even if they have significant ups and downs along the way.

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Beth Braverman is a freelance writer, covering mostly about personal finance, parenting, and careers. Throughout her 20-year career as a journalist, she's loved helping people see how making smart money decisions can improve their lives. Beth began her career as a daily newspaper reporter, before moving into the world of magazines and personal finance. A former Money magazine writer, Beth has been a full-time freelancer for seven years. Her work has appeared in dozens of publications, including magazines like Real Simple, Consumer Reports, and AARP, and online at sites like CNNBusiness.com, CNBC.com, and USNews.com. She has received multiple awards for her work, including recognition from the American Society of Business Publication Editors, the Society of American Business Editors and Writers, and the New York Financial Writers Association. Beth received her undergraduate degree in newspaper journalism from the S.I. Newhouse School of Public Communications at Syracuse University. She also holds a master's degree in business reporting from the Columbia University Graduate School of Journalism.

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