The Daily Dish

Timely Thoughts on the Unthinkable

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Gordon Gray's extremely timely Thinking the Unthinkable: The Risks of a U.S. Treasury Default begins: "The United States is not yet the closest it has ever been to default, but that may soon change." I don't know if that makes him the most optimistic pessimist or the most pessimistic optimist doing fiscal policy in town. Regardless, the paper is chock-full of insights into the dangers with which the president and Congress are flirting.

One danger is higher interest rates on Treasuries: "Historical episodes such as those in 1979 and 2011 are just illustrations of how transient disruptions can increase federal borrowing costs, and ultimately increase spending. Simple debt management disruptions have seen borrowing costs increase by 4–48 bp, and an accidental default saw a premium of 60 bp." Moody's estimated there would be a permanent rise in Treasury borrowing costs of 27 basis points. The shocking implication is that taxpayers would be on the hook for $850 billion in higher debt due to increased interest costs over the next decade. Yikes.

This would occur even as families faced strains on their own finances. Looking at the average home price, if mortgage rates jumped 1.47 percentage points, "over the life of the loan, the homeowners would pay nearly $150,000 more in interest, and their monthly payment would increase by 13 percent – essentially a $400 monthly tax courtesy of Washington, D.C." Similarly, higher interest rates would add $2,030 in additional interest payments over the life of a car loan.

In the spirit of the moment, that is all the good news. It may be that some lose their jobs entirely. An internal 2013 Federal Reserve study estimated that within three years of the default, "unemployment would increase 1.7 percentage points above baseline estimates. At present, a 1.7-percentage-point increase would equal over 2.8 million more unemployed Americans. This scenario is just one, possibly conservative, estimate. Moody's more recently estimated that a prolonged default scenario would pare real GDP by 4.6 percent and put 7.8 million Americans out of work, while simultaneously wiping out $10 trillion in household wealth."

But let's end on an optimistic note. After all, the United States is soon to be the closest it has ever been to default – but I bet it won't.