J.P. Morgan finds economic damage from debt ceiling delay

By Erik Wasson - 04/21/11 05:17 PM ET

J.P. Morgan analysts in an internal April 19 research **note** have concluded that if Congress waits too long to raise the debt ceiling, doing so could have dire consequences to the economy.

The analysis is being circulated to members of Congress and the media by Rep. Peter Welch (D-Vt.).

In recent days Rep. Michelle Bachmann (R-Minn.) and Cato scholar Jagadeesh Gokhale have argued that allowing the debt ceiling to be breached is a good thing.

The bankers at J.P. Morgan take a different view and says that even a technical default where Treasury delays a payment temporarily, could shrink the economy.

“Our analysis suggests that any delay in making a coupon or principal payment by Treasury would almost certainly have large systemic effects with long-term adverse consequences for Treasury finances and the US economy,” they state.

They also state that delaying a raising of the debt ceiling “is likely to negatively impact markets” because investors will undertake risk management actions to prepare for a possible Treasury default.

Treasury Secretary Timothy Geithner has called on Congress to raise the nation’s $14.3 trillion debt ceiling before May 16, but has also said Treasury can take evasive action to delay a default before July 8.

J.P. Morgan estimates that a technical default would cause foreign holders of U.S. bonds to dump 20 percent of their holdings. This would drive up yields on treasuries by 50 basis points, the analysts estimate.

Such a rise would cause a 0.4 percent decline in gross domestic product, they estimate. Further more, stock markets are likely to plunge on the news of the default, the report states.