In the Markets Now

Government shutdowns

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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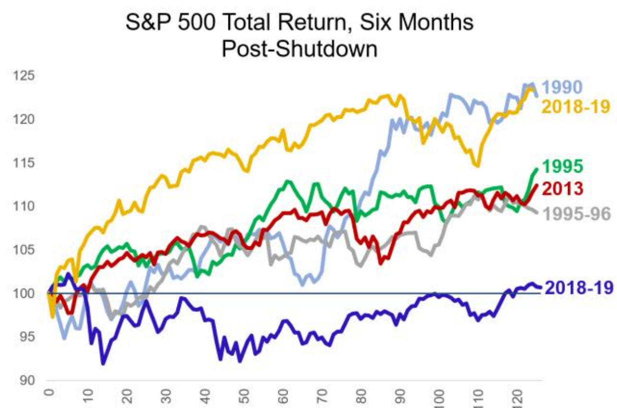
EXAMINING THE MARKET AND ECONOMIC IMPACT OF A GOVERNMENT SHUTDOWN

Though the stock market has held up fairly well in the face of weak Fall seasonality and other headwinds, it looks increasingly likely that a government shutdown will be added to the wall of worry in the coming weeks. As our partners at Strategas wrote earlier this month: "Though a deal to avoid breaching the debt ceiling this year was ultimately agreed upon, it did little to alleviate broader fiscal concerns in the US… we are setting up for a budget fight when Congress returns from recess in September **and there is an increasing likelihood that we will see a government shutdown on October 1."**

Levels of government spending relative to the size of the national debt are at the heart of the issue, just as they were for the debt ceiling debate earlier this year (though items like Ukraine aid and border control spending are adding to tensions). The economic impact of a shutdown is likely to be far less severe, however (one reason shutdowns are used more frequently as political tools). Goldman Sachs writes that while a failure to raise the debt limit would have left the government with authority to spend but insufficient funds to do so (forcing the Treasury to eliminate the budget deficit and almost surely cause a recession), "under a shutdown, the government would have the funds but no authority to spend them. Since the rules for spending under a shutdown are clear, the economic hit is more predictable."

More predictable, and also more limited in scope. Strategas notes that while shutdowns are uncomfortable for policymakers and cause a large inconvenience to federal workers, "shutdowns are timing differences and have little impact on GDP. **In fact, each of the last six shutdowns occurred in quarters with positive GDP.** At most, we could see a 0.2% of GDP change in Oct., which is mostly recouped in Nov. and Dec. as retroactive pay is implemented." And while the most recent shutdown was historically long, the average duration of a shutdown/funding gap going back to 1977 is just 8 days – not enough time to do too much damage. Similarly, shutdowns are non-events for the stock market. For all six major shutdowns since 1990, the S&P 500 was higher six months from the onset every single time, averaging a ~14% return over the period.



Shutdowns may not be particularly important to economic growth or stock performance, but timing could be an interesting wrinkle as it relates to interest rates and monetary policy. The Federal Reserve depends on economic data collected by government agencies to make monetary policy decisions. **If the government is shuttered, that data won't be collected or reported at a critical policymaking juncture for the (vocally data-driven) Fed.** This is where the length of the shutdown will matter. Shut down for a few days, and nothing really changes. Shut down for 3-4 weeks, and some critical data could go uncollected. Ultimately, we believe this would increase the odds that rates wouldn't be raised in November – despite the Fed explicitly signaling that they want to hike one final time in 2023. The stakes would simply be too high to fly blind.

While a shutdown is not guaranteed (we've only had 6 in the last 33 years, with several avoided at the last minute), elements for one are all present – fiscal spending disagreements compounded by a testy debt ceiling debate, a desperately thin House majority, and additional hot-button issues like border spending. **Luckily, shutdowns have not been drivers of economic slowdown or stock market weakness in the past, and therefore should not be a factor in long-term financial planning.**

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