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Investment Brief

Insights on U.S. Government Shutdowns

A concise guide to what may happen if U.S. government services are halted due to a lack of legislative funding —and the implications for investors.

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KEY POINTS

- The U.S. government is poised to "shut down" at the end of September 2023, which would represent the ninth such occurrence in the past four decades.
- While this shutdown will certainly prove inconvenient for many, it is likely to have only minimal impact on the U.S. economy.
- Longer term market impacts are also likely to be minimal, although it may create some short-term uncertainty.

For the ninth time since 1982, the U.S. government appears headed for a shutdown at the end of September, under which funding for all but the most essential operations is halted. The complicated U.S. budgeting process typically requires passage of a temporary extension (a continuing resolution, or CR) to allow government operations to continue before the various spending bills are passed. With a divided Congress and only a thin level of control for Republicans in the House of Representatives, the passage of budget legislation is particularly vulnerable to the demands of various interest groups—in this case, a handful of Republican House members who are demanding deep spending cuts.

We have some history of shutdowns to go by, although the length and potential impact of these shutdowns have increased in recent years. In general, the economic impact has ultimately been small, although the disruption to government services can be quite inconvenient.

What happens during a shutdown?

All nonessential services are halted, and those employees are furloughed. Essential services such as law enforcement, air traffic control, and parts of the military will continue to be provided. We don't know for sure how many workers would be furloughed should the 2023 edition of the shutdown come to pass, and the amount has fluctuated in prior instances, based on which agencies have already received funding, and what services are deemed essential. However, reasonable estimates range from 2-3 million workers who will not receive paychecks during that time (they have historically received back pay upon their return to work); some functions such as passport or other permitting agencies may see delays, while tourist services (such as national parks) may shut down completely. All told, roughly 1.3% of the total U.S. workforce would be affected, based on data from the Congressional Budget Office and Bureau of Labor Statistics as of August 2023.

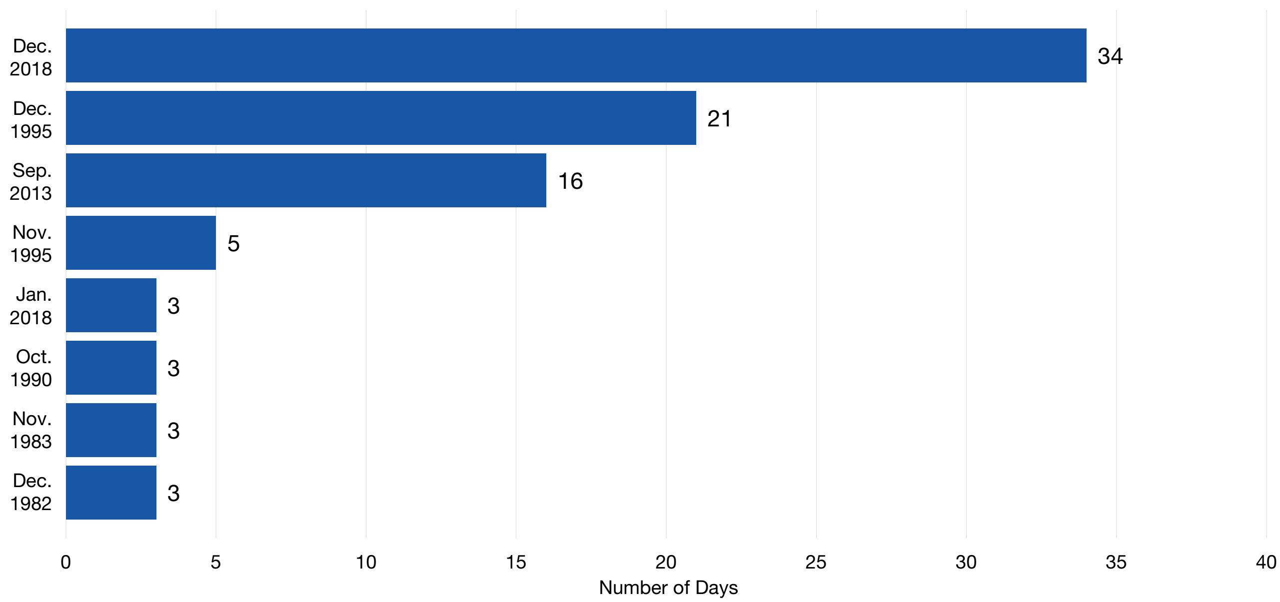
What is the potential economic impact?

Perhaps the largest variable for the U.S. economy is the length of a shutdown. The longer it runs, the greater the economic impact, and the larger the disruption. For example, the hiring and training of employees in areas with key worker shortages (such as air traffic control or passport agencies) will be put on hold, potentially leading to more structural delays. Also, while most economic activity is merely delayed, some may be permanently cancelled during an overly long shutdown. According to a J.P. Morgan report, estimates of the aggregate impact to economic activity generally range from 0.1% to 0.2% of GDP for every week of a shutdown, with most of that activity quickly recouped when the shutdown ends.

However, given the large disparity in positions among rival factions in Congress and the lack of broad support for the Speaker of the House, Kevin McCarthy, there are reasons to believe a shutdown may last longer than the eight-day average of the past 40 years. Note that two of the longest shutdowns have occurred in the past decade, and it's possible this trend will continue.

Figure 1. The Two Most Recent U.S. Government Shutdowns Have Been Among the Longest

The longest U.S. government shutdowns since 1976



Source: The Washington Post. For illustrative purposes only.

There are several ways in which a shutdown may contribute to short-term uncertainty. First, because we cannot know for certain what the true economic impact may be, markets may struggle to interpret economic data during, or soon after, a shutdown. Also, the calculation of some economic data may fall under "nonessential" government functions, and so the release of some key economic indicators, such as the U.S. consumer price index (CPI), may be delayed. (In that case, the official mark will simply carry forward the average of the prior 12 months.)

Finally, a shutdown in the context of the recent downgrade to the U.S. debt rating by Fitch, hardly inspires confidence in the U.S. government, and represents yet another example of political brinksmanship—just one more reason for investors to worry about the potential for disruption due to political dysfunction.

How have shutdowns affected the market?

Because most of the economic impact of a shutdown is typically recouped after the event is over, primarily via the provision of back pay to the millions of furloughed employees, we do not anticipate any meaningful long-term impact from a prospective shutdown. Figure 2 shows that the equity market generally looks through shutdown episodes, with a slight selloff prior to the event, and no discernable trend during the shutdown. Markets are generally higher after the uncertainty of the shutdown eases, as shown by 12-month forward returns.

Figure 2. How Has the Market Responded to Prior U.S. Government Shutdowns?

Data for S&P 500® Index around the indicated U.S. government shutdowns

Close	Reopen	Week Before (% Change)	Day of (% Change)	Total Change (%)	12 Month Total Return (%)
9/30/1976	10/11/1976	-1.4	-0.1	-3.5	-1.7
9/30/1977	10/13/1977	0.9	0.7	-2.5	12.1
10/31/1977	11/9/1977	1.1	-0.3	0.4	12.0
11/30/1977	12/9/1977	-2	0.3	-1	6.4
9/30/1978	10/18/1978	0.7	0.4	-2	12.6
9/30/1979	10/12/1979	-0.2	-1.5	-5.2	17.7
11/20/1981	11/23/1981	-0.8	0.8	0.7	16.3
9/30/1982	10/2/1982	-1.8	0.3	-0.1	44.2
12/17/1982	12/21/1982	-3.1	1.6	2.4	25.6
11/10/1983	11/14/1983	0.3	0.3	1.6	6.4
9/30/1984	10/3/1984	0.3	-0.9	-2.2	18.2
10/3/1984	10/5/1984	-1.6	-0.7	-0.6	14.5
10/16/1986	10/18/1986	1.3	0.3	-1.2	43.4
12/18/1987	12/20/1987	3.3	2.5	2.7	24.7
10/5/1990	10/9/1990	2.2	-0.4	-2.4	26.1
11/13/1995	11/19/1995	0.7	-0.1	0.7	25.9
12/15/1995	1/6/1996	-0.1	-0.1	0.2	20.8
10/1/2013	10/16/2013	-0.9	0.8	2.4	19.7
1/19/2018	1/22/2018	0.4	0.4	1.2	-2.7
12/22/2018	1/26/2019	-7.1	-2.7	9.4	36.0
Averages		**-0.4**	**0.1**	**0.1**	**18.9**

Source: CFRA Research and Bloomberg. Data as of September 28, 2023. For illustrative purposes only.

Past performance is not a guarantee of future results.

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A Final Word

Though the historical impact of government shutdowns on the economy and markets has been small, the uncertainty around such events can engender market volatility in the short term. As we noted in an earlier comment about the Fitch downgrade, that sort of volatility can be a welcome development for active managers, and we will be monitoring future developments closely.

Glossary & Index Definitions

The **S&P 500® Index** is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

Indexes are unmanaged, do not reflect deduction of fees and expenses and are not available for direct investment.

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