Shutdown standoff 2023: Is more fiscal trouble brewing?

September 19, 2023

Historically, shutdowns have had no meaningful impact on the broader economy. Given the current political environment, could this time be different?

So far this year, we've had a showdown over the debt ceiling, a downgrade of the U.S. credit rating and now — if Congress is unable to pass its annual spending bills by the start of the fiscal year (October 1) — the possibility of a government shutdown. On the heels of one fiscal standoff, is the U.S. economy prepared for another one this fall?

No two standoffs are the same

In terms of market and broader economic implications, a government shutdown is very different from the debt ceiling conflict. When the government doesn't pass its annual spending bills, resulting in a shutdown, the impact is limited to the functioning of some federal agencies and mainly impacts federal employees and services. Importantly, benefits such as Social Security and Medicare continue to flow, and the Treasury can continue to pay timely interest payments on U.S. debt. In contrast, a debt ceiling standoff — which we saw earlier this year and relates to the ability of the federal government to meet its financial commitments — could lead to a default, which could have serious consequences on the markets and the economy.

The numbers speak for themselves. The U.S. government has shut down 21 times since 1976. The shortest shutdown was for a day; the longest shutdown was for 35 days in 2019.[1] The 2019 shutdown delayed $18 billion in federal spending and suspended some federal services. When the government reopened, we saw a lift in GDP the following quarter. The total impact of the event was very marginal — 0.02% of GDP.[2] Similarly, the market impact of government shutdowns has also been limited. While they may introduce some volatility, they haven't meaningfully impacted long-term equity returns. Looking at historical data, the S&P 500 was, on average, positive in the month after a government closure. Firms with government contracts may see some disruption, however.

Drama in the House

There is a risk the government will shut down, as there are a lot of moving parts and a tight timeline. Given the compromises it took to raise the debt ceiling in June, congressional leaders may not be in favor of another showdown. Nevertheless, we are likely to see at least some drama play out, especially in the House, as the September 30 deadline approaches.

House Speaker Kevin McCarthy has already signaled that he is focused on a short-term continuing resolution (temporary spending bill) to ensure government funding is not interrupted at the end of September. However, getting the continuing resolution through the House may be easier said than done. While many Republicans already agreed to and voted for the Fiscal Responsibility Act, which established the spending targets for FY 2024, a handful of lawmakers continue to voice opposition, which adds some uncertainty. Further complicating the speaker's efforts is the fact that it may be difficult to secure the physical presence of key Republican members in D.C. in time for an already tight vote.

The odds of a shutdown have increased recently, although a continuing resolution could be passed to keep the federal government open and running — for now. But kicking the can down the road will only get Congress so far. Congress will need to work overtime in the fall to pass spending bills that have the support of President Biden. If Congress fails to pass the spending bills by January 1, 2024, automatic across-the-board 1% cuts in spending — including defense — will be triggered.

The bottom line is that while an additional round of fiscal wrangling may add noise and introduce limited volatility to markets, a shutdown — unlike the debt ceiling dilemma — is unlikely to lead to far-reaching economic implications, especially if it's short.

[1]Congressional Research Service

[2]Congressional Budget Office: The Effects of the Partial Shutdown Ending in January 2019

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