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Opinion: The view from the cheap tweets

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The most recent U.S. government shutdown ended, with funding extended to February 8. How did we get here, and what are the potential effects?

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The expression “the view from the cheap seats” originally denoted someone’s view of an event that’s obstructed or from a long way away. But it’s become a metaphor for a person’s point of view when they’re not directly involved or well-informed about a situation but feels the need to comment anyway.

This may describe myself as the author of this article; it certainly describes the senior political figures involved in yet another government shutdown. Too many are involved in political point scoring and the blame game via Twitter rather than resolving issues. I can just imagine how self-satisfied the authors of these acerbic tweets are based on their self-assessment of how clever their comments were. “We may not have solved anything, but we scored high on social media reviews!”

Shutdowns have happened before

This week’s government shutdown lasted only a few days, and funding was extended to February 8. Since 1976, there have been 19 occasions when Congress and the president have failed to pass appropriations legislation to fund government operations. In 16 cases, the Antideficiency Act required the federal government to begin a shutdown of activities, including the furlough of non-essential personnel and the curtailment of services. This act prohibits federal employees from “making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation.” Essential services in the military and justice system can continue, although employees may not get paid until the budget is resolved.

Shutdowns have occurred under Republican and Democrat presidencies including Presidents Reagan, Clinton, H.W. Bush and Obama. Shutdowns occur less frequently than in the 1970s and 1980s, but they are lasting longer. During the Obama administration in 2013, the shutdown lasted 16 days while Republicans attempted to tie the funding of the Affordable Care Act (ACA) to the agreement of a continuing resolution. In this week's shutdown the Democrats attempted to tie a resolution to issues such as Deferred Action for Childhood Arrivals (DACA), a policy President Obama introduced in 2012 calling for deferred action for undocumented people who came to the U.S. as children. Republicans would prefer to address additional immigration reform and border security.

While issues such as ACA and DACA are very important, tying multiple issues together unnecessarily makes it more complicated to reach an agreement. The principle reason each party mixes multiple issues is to gain negotiating leverage over the other. The continuing resolution requires 60 votes out of the 100 available in the Senate. Neither party tends to have a majority of this magnitude; as a result, the continuing resolution provides the minority party with leverage to further their issues.

Effect on the economy and financial markets

There are economic consequences of a shutdown in that government payments (federal spending, lost wages, delayed tax refunds, etc.) decline during the shutdown, which reduces economic activity, but it's mostly temporary. In 2013, approximately 800,000 government employees were furloughed and not paid, so their wages were not being spent. But when the issues are resolved the back wages are paid, and economic activity catches up. Given the use of credit cards (effectively deferring payments by consumers for 30 days) and the relatively short duration of previous shutdowns, there is typically very little practical economic impact.

Government shutdowns tend not to affect monetary policy. The Federal Reserve has looked through uncertainty around shutdowns and other minor shocks to growth (like natural disasters) where the economy is expected to make up the temporary growth shortfall in subsequent quarters. The most recent shutdown is no exception, and I expect the Fed to continue raising policy rates with two to three increases this year.

Historically, equity markets have been most vulnerable, with a median decline of 0.9% on the first day of a shutdown but little impact over a few weeks.[1] I think the probability of this week's government shutdown, and subsequent agreement to extend funding to February 8, causing a sizeable market correction remains low and here's why: shutdowns are typically short lived, and markets were aware of the rising odds of a shutdown, so it didn't come as a complete surprise. Implied equity volatility, proxied by the Chicago Board Options Exchange Volatility Index (VIX), rose from a low of 9 to 12 over the past two weeks (although it remains close to a standard deviation below its five-year average).[2] More broadly, Washington has been a source of significant economic policy uncertainty throughout the last year, and risk assets have largely priced in this environment.

Today's economy can withstand political uncertainty

Current economic conditions — an acceleration of U.S. and global growth, a boost to earnings from a weak dollar and corporate tax cuts, and record high business and consumer sentiment — are materially better than the backdrop of the shutdown in 2013: unemployment was over 7%, GDP growth was lower at 1.7% and 10-year rates rose from 1.7% to 3% between May and December (referred to as a taper tantrum).[3]

In what scenario could a shutdown have a bigger impact? It could compound risks associated with other major upcoming policy decisions, such as extending the debt ceiling and renegotiating the North American Free Trade Agreement (NAFTA), or coincide with unanticipated domestic or global shocks.

Bottom line

Government shutdowns typically have limited long-term impact to investors. The most likely consequence of a shutdown is further damage to the reputation of the U.S. and its political system. Think about how embarrassing it would be for a company to tell its customers it was not going to provide their goods or services because of an internal budget dispute; the reputation of that company would be ruined. That's the longer term consequence of a shutdown: further decline in the trust of individuals elected to serve the country who appear to gain satisfaction from hurling abuse at each other from the cheap tweets.

Chicago Board Options Exchange Volatility Index (VIX) reflects a market estimate of future volatility based on the weighted average of the implied volatilities of S&P 500 Index options.

[1] Source: Columbia Threadneedle Investments and Goldman Sachs Global Investment Research as of 01/19/18

[2] Source: Columbia Threadneedle Investments and Bloomberg as of 01/19/18

[3] Source: Columbia Threadneedle Investments

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