CETERA® INVESTMENT MANAGEMENT

# COMMENTARY

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## Looming Government Shutdown

- A government shutdown could happen as early as next week.
- Government shutdowns are not new, and this would be the 22nd shutdown since 1976.
- Market volatility could ensue, but shutdowns typically have little lasting impact on economic growth.

As each day passes, it is becoming more likely the U.S. will have a government shutdown next week. Investors are grappling with this possibility, so we wanted to explain what is happening and what this means for markets and your investments. You may be confused because earlier this year Congress debated the debt ceiling and the U.S. risked defaulting on government debt. Now, we have a government shutdown that appears imminent, so let’s break down what is happening before we discuss what this means for your investments and portfolios.

Earlier this spring, we witnessed a divided Congress unable to pass a bill to increase the debt ceiling, which forced the U.S. Treasury to take extraordinary measures to continue to pay its debt, such as U.S. Treasury bonds. Congress had already passed spending bills authorizing spending until 9/30, however, those bills authorized spending that exceeded tax revenues collected, causing a deficit. This required the government to take on more debt and breach the debt ceiling. Thus, the debt ceiling needs to be raised. Ultimately, this debate was not about the debt ceiling and was about spending. The debate forced spending compromises including non-defense discretionary and IRS spending, and claw backs in COVID-19 aid. Additionally, some work requirements for federal aid were tightened and student loan repayments were set to resume.

Now we are approaching the government’s fiscal year end, September 30, and Congress needs to pass 12 annual appropriation bills to fund discretionary spending. If these bills do not pass, it would require a shutdown as some federal government agencies will not be able to pay workers. It should be noted there could be a partial shutdown, where some appropriation bills are passed but not all 12. Currently, none of the appropriation bills have passed, so this could indicate a full government shutdown soon. Non-essential federal workers would be furloughed, and workers deemed essential would continue to work without pay. However, government employees would likely receive back pay once Congress agrees on a bill. Congress could potentially avoid a shutdown, by passing a short-term stop-gap spending bill to keep the government open while they continue to negotiate, but this could also just delay a government shutdown if a deal isn’t met by the end of the stop-gap deadline. It is important to point out that spending on Social Security, Medicare, unemployment benefits, and payments for interest on the debt continue during a shutdown.

What does this mean for your investments? Ultimately, this depends on whether the shutdown is a partial or a full shutdown and how long the shutdown persists. However, the shutdown will likely have little impact on economic growth and much of the impact will be reversed when the government reopens. The good news is that this is happening at a time when economic growth is positive. Though something to watch is that a potential shutdown is occurring when student loan repayments are set to begin, tax bills in California are due, and energy prices have surged. The possible cumulative effect on all of these could impact the consumer. Perhaps the biggest impact could be due to credit agencies putting the U.S. debt on negative credit watch. Fitch already downgraded the U.S. debt in September due largely to the debt ceiling debates. Failing to pass a spending bill on time could cause bond yields to rise further and increase borrowing costs for potential homeowners and businesses. A shutdown would also impact the Federal Reserve (Fed) as government data would be delayed if government agencies were not working. The Fed has said repeatedly that it is data- dependent when it comes to formulating its monetary policy, so a lack of economic data could cause them to pause interest rate moves until it gets a better picture of the data.

In the end, a shutdown would likely cause volatility in markets, but have little lasting impact on economic growth. The Fed may be less reluctant to raise interest rates again, but it was already questionable if they would raise another time this year. This is also a highly political issue and there will be many sensational headlines in the news. It is important not to get distracted by these headlines. Your financial professional can help you stay focused on your own personal financial goals. As always, please contact your financial professional with any questions on tailoring the appropriate portfolio to your personal situation.

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