

US government shutdown & its implications

Democrats blocked Republican's stopgap funding package; face-off over healthcare spending

Impact on GDP dependent on length of shut down; expect less than 0.5ppts cut to GDP

Flight to safety should support short-term demand for USTs & gold; USD could take a hit

Background

This piece is a revisit to the potential impact and implications of a US government shutdown, originally published on 8th January 2024. It has since been updated to reflect ongoing developments.

At the point of writing, the US government has officially shut down after the Democrats rejected the stopgap funding package. A shutdown wouldn't be unprecedented but the economic impact might be milder than it first appears with many essential government functions exempted for by the shutdown and the law guaranteeing backpay for government employees once the government reopens. The effects of a shutdown will nonetheless depend on the extent and duration of the shutdown.

According to the United States of House of Representatives, there were at least 20 funding gaps from 1977, with the longest government shutdown running for 34 days. This occurred from 22 December 2018 to 25 January 2019, and was due to President Donald Trump demanding that any spending bills to include funding for a border wall leading to failure of an agreement.

Impact

The impact of a shutdown on monetary policy and financial markets is mostly centred on the dampening effect it has on economic activity and will largely depend on the length of a shutdown. In our opinion and using history as a guide:

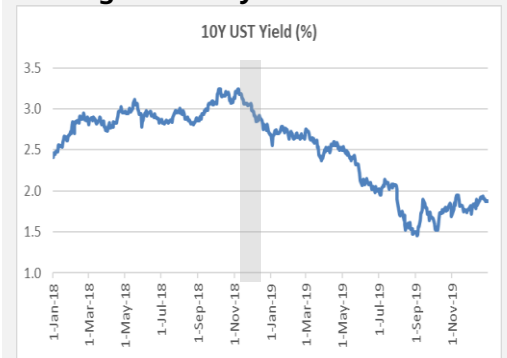
- 1) **Impact on the economy will be two-fold.** Dent in consumer and business sentiment could delay spending. First, it increases uncertainty which makes companies less willing to invest in new plants, equipment and hiring. Secondly, consumers, especially federal workers may postpone spending until they get more clarity about what's going to happen. Thirdly, other disruptions to permitting, licensing, and verifications could lead to delays in lending and trade activity.
- 2) **Effects on overall economic activity:** As mentioned, the effects of a government shutdown on the economy would depend on its extent and duration. *The Congressional Budget Office (CBO) estimated that although most of the real GDP was lost during the 4Q of 2018 and the 1Q of 2019 eventually would be recovered, about \$3bn (-0.02% of annual GDP in 2019) would never be.* In contrast, the Bureau of

Figure 1: Equities fell as fear over government shutdown dampened market risk appetite



Source: Bloomberg

Figure 2: Risk-off sentiments spurred flight to safety in UST leading to lower yields



Source: Bloomberg

Economic Analysis (BEA) estimated the shutdown shaved 0.1ppts of GDP in 4Q of 2018 and 0.3ppts in 1Q of 2019.

As mentioned, the timing of a shutdown matters for its effect on output. In the absence of any policy changes, the shutdown itself simply delays, as opposed to cancelling, government spending. If a shutdown is brief, then the subsequent catch-up in government spending could occur in the same quarter that spending was delayed.

- 3) ***Roughly 750k employees of the federal agencies could be furloughed each day and the total daily cost of their compensation would be roughly \$400m***, a waste of federal funds. Most of the cost was a result of Congress granting back pay to federal employees who did not work during the closure, but some of it came from the financial toll of winding down operations and ramping them up again, as well as extra costs from paying workers to develop contingency plans.

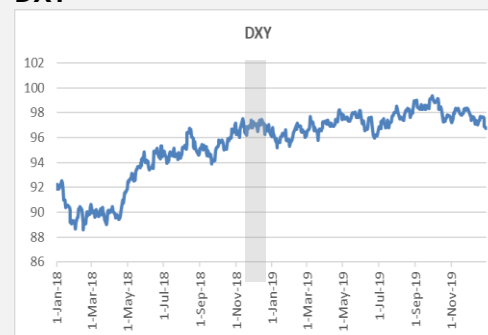
Knee jerk reactions on financial markets

In the financial markets, threats of a government shutdown would unnerve markets and push investors to seek safety in haven assets. Key losers will likely be oil and equities. During the 2018-2019 shutdown, the S&P 500 slid 2.7% d/d on 24th December after losing an average of more than 1.0% d/d the week prior to that. Key winners, on the other hand, includes US Treasuries and gold. The yield on benchmark 10Y UST yield fell 5bps on 24th December 2018, while DXY also fell 0.4% d/d. Gold prices shot up 1.1% d/d on 24th December and were generally on an uptrend subsequent to that. Given the knee-jerk and likely shortlived market impact, we are leaving our house views on rates and FX unchanged.

	1995/96	2013	2018/19
Days of shutdown	21	16	34
S&P 500 (% change)			
D-Day/Day after	-0.2	-0.6	-2.7
1 week after	0.9	-0.9	2.9
10Y UST yields (Change in bps)			
D-Day/Day after	-4	-1	-5
1 week after	-17	Increase less than 1	-7
DXY (% change)			
D-Day/Day after (% change)	-0.1	-0.1	-0.4
1 week after	Fell less than 0.1	-0.4	-0.2
Gold			
D-Day/Day after	-0.1	-0.9	1.1
1 week after	0.1	-1	2.3

<https://history.house.gov/Institution/Shutdown/Government-Shutdowns/>, BEA, Bloomberg, HLBB Global Markets Research

Figure 3: Temporary blip for the DXY



Source: Bloomberg

Figure 4: Gold prices rallied on haven bids



Source: Bloomberg

House View and Forecasts

FX	This Week	4Q-25	1Q-26	2Q-26	3Q-26
DXY	97.00-99.75	96.45	95.57	94.24	92.99
EUR/USD	1.16-1.20	1.19	1.20	1.22	1.24
GBP/USD	1.32-1.35	1.36	1.37	1.38	1.39
USD/CHF	0.78-0.82	0.78	0.78	0.77	0.76
USD/JPY	147-152	146	145	142	140
AUD/USD	0.64-0.67	0.67	0.67	0.68	0.68
NZD/USD	0.56-0.60	0.59	0.60	0.60	0.60
USD/CNY	7.11-7.15	7.08	7.06	6.99	6.94
USD/MYR	4.18-4.24	4.20	4.15	4.10	4.10
USD/SGD	1.28-1.31	1.28	1.26	1.24	1.23
USD/THB	31.50-33.00	32.25	32.30	32.20	32.00

Rates, %	Current	4Q25	1Q26	2Q26	3Q26
Fed	4.00-4.25	3.50-3.75	3.25.-3.50	3.00.-3.25	3.00.-3.25
ECB	2.00	2.00	2.00	2.00	2.00
BOE	4.00	3.75	3.50	3.50	3.50
SNB	0.00	0.00	0.00	0.00	0.00
BOJ	0.50	0.50	0.75	0.75	0.75
RBA	3.60	3.35	3.10	3.10	3.10
RBNZ	3.00	2.75	2.75	2.75	2.75
BNM	2.75	2.75	2.75	2.75	2.75

Source: HLBB Global Markets Research

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