

# What are the implications of a US govt shutdown?

## Research Report

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## What is a shutdown?

US government shutdowns happen when the US Congress fail to pass a spending bill or where the US Congress refuses to raise the US debt limit. This creates a funding gap because the Congressional spending authorization is not in place.

On this occasion the fight has been over two issues:-

- US President Donald Trump's insistence on US Congress spending for more border security / wall between the US/ Mexico border
- Democrats are supporting a solution for "Dreamers", the DACA program.

Surveys show 80% of Americans support the principle of allowing the 700k children of undocumented migrants, "Dreamers" the right to remain in the USA. The Trump Administration announced the end to the DACA program on the 5<sup>th</sup> September 2017 saying that a "wind down would occur for current applicants". There is a March 5<sup>th</sup> 2018 deadline to resolve the DACA issue.

*What are the statistics? There have been 18 "shutdowns" of the US federal government in the last 40 years. They have lasted on average 7 days, with a range of 1 day to 21 days.*

The practical impact of a shutdown is US government staff are told to stay at home. There is a shutdown in a literal sense in that the office does not open. Only essential services like law enforcement function during a shutdown.

A shutdown damages confidence and hurts lower income more than median and higher income families. In a country where so many people increasingly live "paycheck to paycheck" it is negative for the personal consumption/ consumer side of the US economy which is 68% GDP of US GDP.

## How important are shutdowns?

An informative report by *Standard & Poor* last December identified a shutdown as costing the US economy about US\$6.5bn per week or c. 0.2% of US GDP.

During a period of healthy GDP growth, (Q3 2017 3.2% up 0.1% the US economy should keep its speed assuming the shutdown does not last too long. A shutdown would have a quarterly not annual impact.

Political events / shock events have a poor track record of achieving a lasting impact on US financial markets. This experience goes back a long way. The assassination of JFK bought a 2.8% drop, which was recouped over the next 2 days. Richard Nixon's resignation, the S&P fell 1.3%, collapse of Long Term Capital Management, the S&P fell 2.2%. The worst shock, September 11<sup>th</sup> 2001 the S&P fell 11.6% in the week following the re-opening of the US capital markets. Some distinguish the Sept 11<sup>th</sup> response on the grounds that it happened whilst the US economy was slowing and was more vulnerable.

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When we look at “bad events” from a US perspective, it is worth noting the US economy achieved substantial GDP growth during World War II and emerged financially in a league of its own. The US was for years, the world’s largest creditor helping to fund the rebuilding of other countries’ infrastructure. Longer term, WW2 conveniently for America, relocated the world’s financial capital to New York and ensured the US dollar became the global reserve currency.

### **Conclusion – “not particularly bothered”**

US indices had a strong run in 2017, up c. 25%. The mood so far in 2018 remains positive as profit growth is forecast from lower US corporate taxes and accelerating GDP growth in the US, EU, China and most of SE Asia. S&P 500 earnings are forecast to grow 20.19% in 2018 to \$107 – hence the index is on a forward multiple of 26.2x P/E. This is certainly an expensive rating.

My main concern for 2018 is the impact of higher US interest rates on a tired US bull market now in its ninth year.

*Common sense suggests a US shutdown is a low magnitude political “Washington” event. It is not on the scale of assassinations / resignations/ major bankruptcies/ major global events. An adverse movement of 1% could be an excessive response to the shutdown.*

*In our view the US economic impact from the shutdown will be negligible hence the same holds for its financial market impact.*

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