

# Monitoring Market Implications: U.S. Government Shutdown

How are Allspring's investment experts thinking about the U.S. government shutdown and market implications?

Authors Date Topic

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# Key takeaways

- Allspring's Investment Teams consistently monitor risks that could potentially influence investment portfolios.
- Over the past several weeks, our investment teams have been closely monitoring the potential for a U.S. government shutdown and possible market impacts.
- Research consistently points to the fact that both equity and fixed income markets tend to look through shutdowns, focusing on the long-term fundamentals and not on the short-term disruptions to services and income.

# **Investment Analytics Team**

Our Investment Analytics team has been monitoring the potential for a U.S. government shutdown for several weeks now. Given the infrequent and sporadic nature of shutdowns, traditional equity and fixed income risk models are ineffective at modeling these types of events. However, our team has access to alternative data sources, including research from trading partners. That research consistently points to the fact that both equity and fixed income markets tend to look through shutdowns—focusing on long-term fundamentals, not on short-term disruptions to services and income.

We've also investigated how government shutdowns tend to end. As reported by the media, many government employees are deemed "essential" and required to stay on the job. Those same employees, however, typically have their paychecks deferred until the government is back up and running. Essential workers have a limit, typically 3 to 4 weeks, before daily living expenses start to overwhelm their short-term savings. When a critical number of workers refuse to report to work—shutting down a major U.S. airport, for instance—politicians typically come back to the negotiating table and agree on a short-term fix.

#### Global Fixed Income Research Team

The government shutdown is not a shock as we've been following it for weeks. Further, shutdowns have happened numerous times in the past—the most recent one, in December 2018, lasted for 35 days. Typically, there has been some short-term volatility with limited negative effects on markets. Some of the previous shutdowns had related debt ceiling concerns, but on a positive note, that isn't the case with the current one. Nonetheless, we're focused on the following:

- **Duration of the shutdown:** The longer the government shutdown lasts, the greater the impacts on governmental employees, labor statistics, and growth.
- Government statistics: Many government statistics, such as labor, inflation, and gross domestic product data used by market participants, may be affected and/or not available during the shutdown. While the lack of data could create some volatility, many market participants use alternative data sources, so those sources will likely be leaned on during the closure.
- Government spending: Federal expenditures tend to decline during shutdown periods, which can provide savings, but the situation has a negative effect on government employees and suppliers. Those who stop getting paid are likely to spend less, which in turn can strain local economies.
- Long-term structural changes: Some are of the opinion that this shutdown could lead to permanent closure of government departments and/or further reduction in the number of employees.

In sum, we will be watching developments closely, but our expectation is that any modest slowing in the economy will be paid back on a reopening unless there are structural shifts.

### Plus Fixed Income Team

The new U.S. fiscal year begins with a government shutdown—the first since the 35-day closure in 2018–2019. While that episode remains fresh in investors' minds, most shutdowns have historically been brief and had minimal impact on interest rates, curve shape, or broader economic conditions. However, the current situation carries elevated uncertainty, especially amid reports that the Trump administration is considering permanent layoffs for furloughed workers. This raises the potential risk of a more pronounced market reaction if sentiment deteriorates. The shutdown also threatens to delay and distort key economic data releases from agencies like the Bureau of Labor Statistics and the Bureau of Economic Analysis. The longer federal workers remain furloughed, the more stale and potentially misleading the data becomes. This could complicate the Federal Reserve's (Fed's) decision-making process, particularly if concerns about employment persist. In that case, the Fed may find it difficult to justify not delivering the 0.25% federal funds rate cut expected in October.

# **Growth Equity Team**

Government shutdowns may dominate headlines, but for equity markets, they've historically been little more than noise. In fact, the <u>S&P 500 Index</u> has tended to look through these episodes entirely, with post-shutdown dips often proving to be attractive entry points. Following the four most recent multi-day shutdowns, the index posted strong forward returns—averaging double-digit gains over the subsequent 6- and 12-month periods. The 2018–2019 shutdown, the longest on record, was followed by a 26% rally over the next year. While short-term volatility can spike, history suggests that shutdowns are more political theater than market threat.

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