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US GOVERNMENT SHUTDOWN: TIME TO WORRY?

Berenberg Macro View

More volatility ahead? The odds of a federal government shutdown have risen gradually since the start of the month. If Congress fails to pass a resolution by 1 October, the government will suspend non-essential functions. By itself, a short government shutdown would slow economic growth only slightly (one week may shave around 0.1ppt from annualised real GDP growth). However, it could have an important impact by delaying economic data releases. If a shutdown occurs, the White House will likely categorize the Bureau of Labor Statistics and its employees as non-essential, causing them to stop work from next Wednesday onwards. This means the September nonfarm payroll report (due on Friday, 3 October) and the consumer price index inflation data (due 15 October) might not be published on time. At a time when uncertainty about the state of the economy already runs high, concerns about the quality of government data remain and the Fed wants to base its next interest rate decision (due 29 October) largely on these data, publication delays would likely spur volatility in financial markets.

Some background: Each year, Congress must pass 12 appropriations bills that provide funding for certain federal government agencies. The deadline to pass them is 1 October, the start of the fiscal year. So far, none of the bills have passed. If agencies do not receive funding and authorization to spend, they effectively shut down. So-called essential federal spending – including on the military, Medicaid, Medicare and Social Security – remains unaffected. One way to prevent a shutdown involves passing a "continuing resolution", which extends current funding temporarily while Congress decides on the bills. On 19 September, the House passed a continuing resolution to extend funding until 21 November, but the Senate rejected it due to disagreements over spending priorities and amounts. The last federal government shutdown occurred during President Trump's first term, from 21 December 2018 to 25 January 2019. It lasted 35 days and marked the longest shutdown since 1981. Historically, shutdowns have been rare and usually brief – 14 occurred since 1981, averaging around a week each – and the equity market mostly remained unfazed.

Effects on labour market numbers? Neither essential employees who work during a possible government shutdown nor furloughed employees will get paid until the government reopens (both will eventually receive backpay for the shutdown period). A possible government shutdown starting next week would not affect September nonfarm payroll and unemployment rate estimates because the BLS conducted the survey in the second week of September. However, it could impact the estimates for October (due on 7 November) if the shutdown lasts at least until 13 October (assuming data collection happens on schedule). The establishment survey, which produces nonfarm payroll estimates, will count furloughed workers as still employed. In contrast, the household survey, which produces the unemployment rate, will count them as "unemployed on temporary layoff." This could cause a temporary jump in the unemployment rate in the October report. The rate will most likely reverse once the shutdown ends and employees return to work. Such swings in the unemployment rate could increase volatility in financial markets. If markets reacted strongly to the jump in initial jobless claims in the first week of September (from 236k to 264k), which later proved to be a one-off caused by fraudulent claims in Texas, they may also overreact to temporary shutdown effects on economic data. Another factor involves visa processing delays, which could prevent some employees from starting work in October and potentially reduce the nonfarm payroll print. Industries such as healthcare, education, and state/local governments – which rely on federal contract funding and recently carrying much of the nonfarm payroll gains – could freeze hiring temporarily amid shutdown uncertainty. That said, the Fed plausibly understands these possibilities and a potential rollercoaster in the labour market – and therefore should not alter its labour market assessment.

Limited impact on growth unless shutdown lasts long: Delayed payments to federal employees, uncertainty and a freeze in some government spending could hurt economic growth in the short term. However, most of that loss will recover once the situation resolves. Nearly three-fourths of federal spending is mandatory and

continues even if the government shuts down. Only about 25% of federal spending – in other words, 1.5% of GDP – is classified as discretionary and faces disruption. Thus, a shutdown would probably not significantly alter the fourth-quarter GDP reading. However, the ensuing uncertainty and chaos would dent consumer and business sentiment. These indirect effects could potentially harm growth and the labour market (on which the Fed is laser-focused right now).

More than 75% chance of a US government shutdown in 2025



Probability in %, as implied by betting. Source: Polymarket

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