Washington Standoff

Perspectives on the U.S. government shutdown

JANUS

Unable to enact a budget, Congress has allowed the government to shut down for the first time in 17 years. We estimate an economic impact of ~0.1% from gross domestic product (GDP) growth per week that the shutdown continues. The economic impact will be far more severe if the debt ceiling is not raised by October 17, the date on which the government is expected to run out of money. However, President Obama has the authority to raise it by executive order, making a default less likely. The market consensus, which we share, is that resolution will be reached by October 17, clearing the way for continued economic recovery going into 2014.

U.S. Government Shutdown

The U.S. Congress was unable to reach an agreement by midnight September 30, 2013, for funding the government, effectively allowing it to shut down. This is the government's first partial shutdown in 17 years. As a result, the White House ordered nonessential federal agencies to suspend activities, and furloughed 800,000 employees.

The stalemate involves House members' desire to delay either the individual mandate or the medical device tax provisions in the 2010 Patient Protection and Affordable Care Act (ACA) and the Senate's demand for a "clean" temporary spending bill, or continuing resolution, that would fund the government through November 15.

Fundamental Impact

Entitlements continue (e.g., Medicare and Social Security checks), and Fannie Mae and Freddie Mac will work as usual. Nonessential personnel will stay home, however. Federal courts will operate under a special provision. We estimate an economic impact of ~0.1% from gross domestic product (GDP) growth per week that the shutdown continues.

However, things will change if we reach the deadline to raise the debt ceiling – the government is currently expected to run out of cash around October 17 – with no resolution. At that point, the economic impact would become severe and quickly drag on GDP. Recall that in August 2011, the markets dropped ~20% going into the debt ceiling fight because not raising the debt ceiling means the military doesn't get paid and Social Security checks do not go out, a very big deal. It also raises the possibility that the U.S. government could default on its debt, potentially leading to a credit rating downgrade that could raise U.S. borrowing rates.

KEY POINTS

- **Each week the shutdown continues will drain an estimated ~0.1% from GDP growth.**
- **The economic impact will be more severe if the debt ceiling is not raised by October 17.**
- **If necessary, President Obama can raise the debt ceiling.**
- **We believe resolution will be reached by October 17.**

Implications for Investors

The initial impact to markets has been muted so far, as investors have become accustomed to a higher level of uncertainty. Additionally, the health of the world economy has improved since the last debt ceiling showdown. In the event Congress does not come to resolution, President Obama has the authority, though highly controversial, to raise the debt ceiling through executive order, making a default less likely.

The market consensus, which we share, is that resolution will be reached by October 17, clearing the way for continued economic recovery going into 2014. In the event resolution is not reached, Janus fixed income strategies (that is, those that allow the use of U.S. Treasury bonds) hold allocations to the asset class in order to help protect portfolio valuations in times of uncertainty. U.S. Treasury bonds are expected to rally in this scenario until progress is made, and risk assets would be in for a bout of volatility. Active managers, like Janus, who can adjust to macroeconomic developments and the impact that they will have on underlying asset classes should be well positioned for this type of market environment.

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