Capital Markets Strategy

Essential inCights for the C-Suite

MUFG

US Government Shutdown

Implications for the Economy, Policy & Markets

SEP 2023

Global Corporate & Investment Banking Capital Markets Strategy Team

Tom Joyce

Managing Director
Capital Markets Strategist
New York, NY

Tom.Joyce@mufgsecurities.com
(212) 405-7472

Hailey Orr

Managing Director
Capital Markets Strategist
New York, NY

Hailey.Orr@mufgsecurities.com
(212) 405-7429

Stephanie Kendal

Vice President
Capital Markets Strategist
New York, NY

Stephanie.Kendal@mufgsecurities.com
(212) 405-7443

Angela Sun

Analyst
Capital Markets Strategist
New York, NY

Angela.Sun@mufgsecurities.com
(212) 405 -6952

AUTHORS

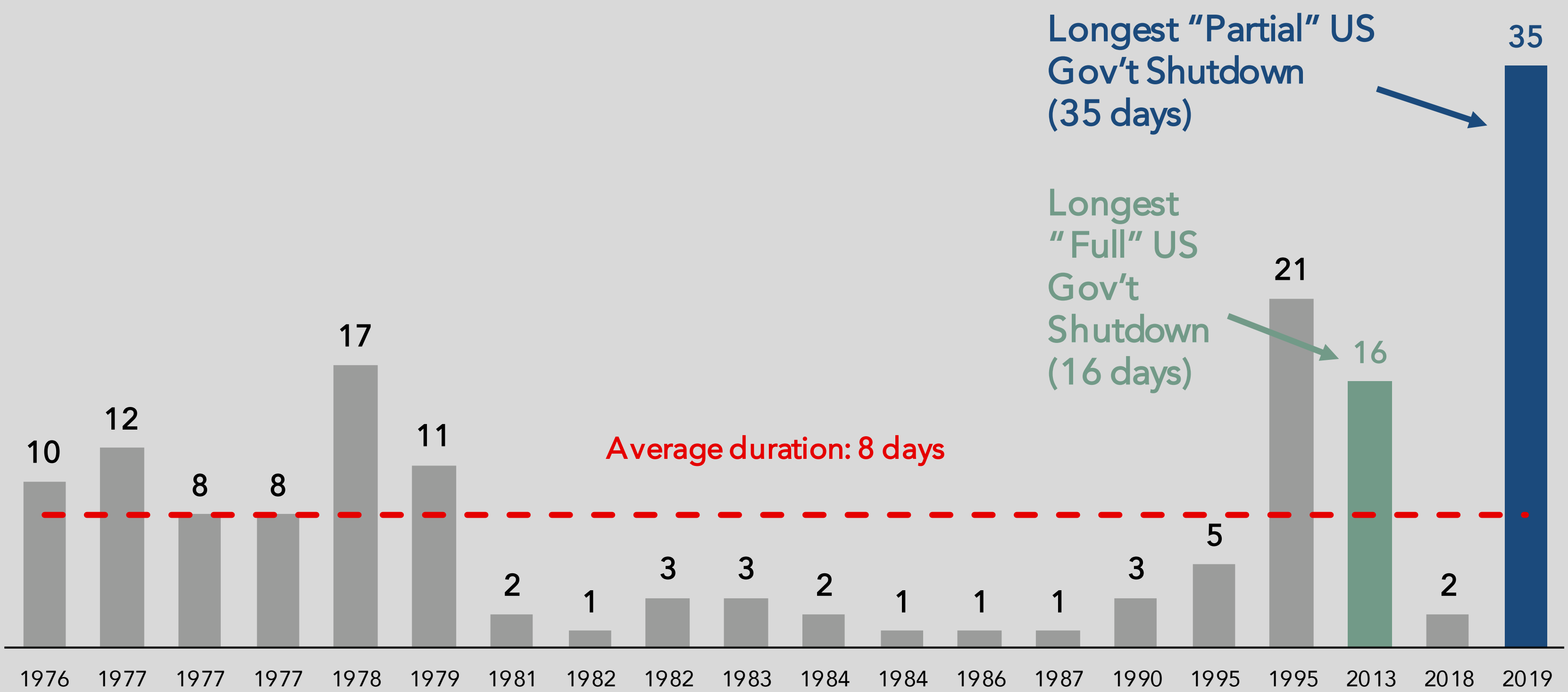
“We want to be respected but no longer think we need to be respectable. We are in a crisis of political comportment… This has been happening for a while but gets worse as the country coarsens.”

Peggy Noonan, Award-winning WSJ columnist and
former President Ronald Reagan speechwriter (1984-86)

Duration of US Gov't Shutdowns

There have been three US Government shutdowns over the prior decade. Lasting 16 days, 2013 was the longest "full shutdown" on record. 2018-19, with 5 of 12 appropriations bills passed (75% of Gov spending), was the longest "partial shutdown" on record at 35 days. Given the level of discord in Washington, the current impasse is more likely to be a "full" shutdown.

Duration of US Gov't shutdowns (days)



Source: (1) LPL Research. Data as of September 22, 2023.

Timing Considerations

The US Senate has already passed all 12 appropriations (spending) bills with strong bipartisan support, while the US House of Representatives is well behind schedule with insufficient time to pass all 12 by the weekend. With House Republicans increasingly divided, the probability of a US Government shutdown has likely risen above 75%.

Key dates ahead of a potential US Government shutdown

Monday, Sep 25	House Rules Committee reviewing appropriations (no time to pass all 12 by weekend). Most proposals dead-on-arrival (DOA) in Senate.
Tuesday, Sep 26	House Speaker McCarthy to meet with his caucus. Earliest potential "procedural" votes on specific legislation, if any (more likely later in the week).
Wednesday, Sep 27	2nd Republican Presidential debate
Wed-Thurs, Sep 27-28	House & Senate working to pass individual stand-alone appropriations bills or a short-term Continued Resolution (CR), respectively.
Thursday, Sep 28	Final version of a Senator McConnell & Schumer short-term CR expected
Friday, Sep 29	May be first "real" chance to see a bill pass both Senate & House (even if unlikely).
Saturday, Sep 30	Last day of US Gov't 2023 fiscal year. Federal funding will lapse at midnight. Late night "last minute" negotiations.
Sunday, Oct 1	First day of US Gov't 2024 fiscal year. First day of potential Gov't shutdown.
Monday, Oct 2	With most Gov't offices closed on weekend, this may be viewed as the "real" deadline for Congress to pass a short-term CR.

Source: (1) Veda Partners (Henrietta Treyz). Oxford Economics. WSJ. FT. Bloomberg Gov. Politico. The Hill.

What "Stops" in a Gov't Shutdown?

Unlike the partial shutdown of 2018, the current impasse would more likely be a "Whole of Gov't" shutdown with more significant impact to Government employees and services. Numerous gov't agencies can also issue stop-work orders on a broad range of non-essential contracts.

Areas of expected stoppage or disruption in a shutdown

Economic data releases (unemployment, inflation) delayed until reopen

" Federal Mediation and Conciliation Services" cut back (role in UAW and other labor strikes)

FTC would cease vast amount of competition and consumer protection investigations

SEC would not review / approve registrations

Federal **"emergency relief"** services become complicated (higher risk, funds depleted)

National parks, museums & monuments would close

Interior Department energy project permitting would be limited

What “Stops” in a Gov’t Shutdown?

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Areas of expected stoppage or disruption in a shutdown, cont’d

- Most **EPA inspections** of hazardous waste sites & facilities would stop
- **Nuclear Regulatory Commission** would stop licensing and permitting
- Most civilian **Defense Department** employees on furlough
- **NIH** clinical trials (i.e., cancer) possibly postponed
- **Food stamps** (for low income, disabled) possibly delayed
- **HUD’s** fair housing services & subsidies would cease or delay
- **SBA** loan reviews & issuance would cease

Delayed Data Releases in Event of Shutdown

In the event of an October shutdown, the following data releases would be delayed by a number of days or weeks, depending on the length of the shutdown

Data releases that would be delayed by an early October government shutdown

OCT 2	August **construction spending**
OCT 3	August **JOLTS** Report
OCT 5	**Jobless claims**, week ended September 30
OCT 6	September **employment report**
OCT 11	September **Producer Price Index**
OCT 12	September **Consumer Price Index**
	Jobless claims, week ended October 7
OCT 13	September **import prices**
OCT 17	September **retail sales**
OCT 18	September **housing starts**
OCT 25	September **new home sales**
OCT 26	Q3 **GDP** report
OCT 27	September **PCE inflation**, spending

Source: (1) Bloomberg, "US Economic Data on Jobs, Inflation Would Be Delayed in Shutdown." Data as of September 15, 2023.

What "Stays Open" in a Shutdown?

Numerous "essential" government services, or independently funded entities (i.e., the Federal Reserve), will continue to function during a Government shutdown. However, as happened in the record partial shutdown of 2018, attendance among "essential" employees (i.e., TSA) became more problematic as the shutdown progressed.

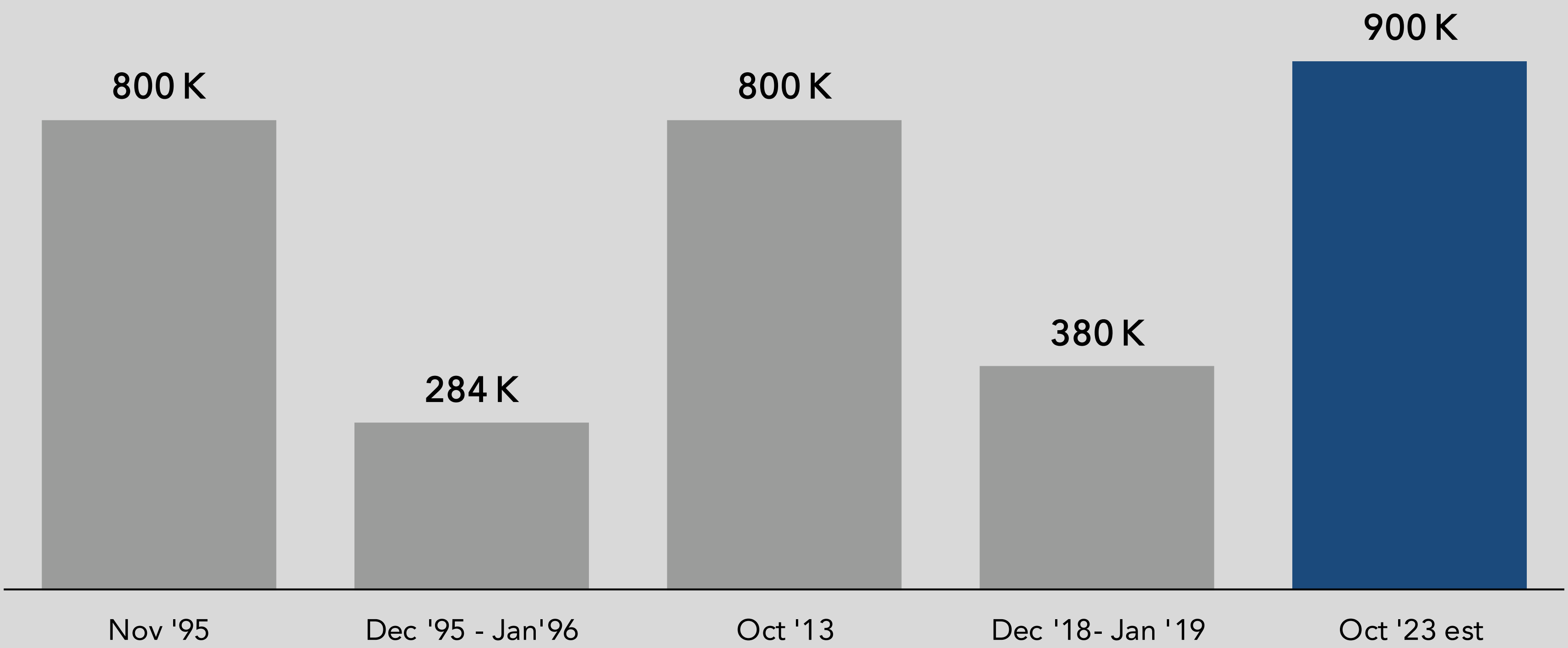
Essential services remaining open in a shutdown

- **Federal Reserve** not impacted (independently funded; will meet again on Nov 1)
- **Social Security** & **Medicare** payments continue
- **Congress** receives full pay; staffers pay delayed until "reopen"
- **Military operations**, **border security** & **nuclear security** would continue
- **US Postal services** continue (independently funded)
- **Airports** (i.e., air traffic, TSA) & Amtrak remain open
- **Federal courts** would operate normally (for roughly 2 weeks)
- **Energy Information Administration** publications on US oil statistics would continue on schedule
- **US Passports & Visas** would still be issued at consulates globally (unless funds depleted)
- **COVID-19** response & research continues
- **HUD's** work for **FHA** & **Ginnie Mae mortgages** uninterrupted

Impact on Federal Employment

In the event of a full shutdown, approximately 900k of 2.3 mm government employees would be furloughed (i.e., stay home without pay). The remaining 1.4 million employees deemed essential to public health and safety would continue to work, receiving “back pay” when the Government subsequently re-opens. During the “partial” shutdown of 2018-19, attendance among “essential” employees (i.e., TSA) became a problem as the shutdown progressed.

US workers furloughed during government shutdowns, thousands



Source: (1) Oxford Economics, “A government shutdown will not sink the economy” (September 21, 2023).

Impact on US Economy

The economic impact of a shutdown will depend on length of time, "partial" or "full" shutdown, and other variables occurring concurrently (markets, confidence, etc.). Further, more than 50% of economic losses typically reverse in subsequent quarters.

CBO estimates of 2018-2019 shutdown impact (35 days)

Congressional Budget Office

$18 bn of delays in Federal spending on compensation and purchases

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$11 bn reduction to GDP

- $3 bn or 0.1% of GDP in Q4 2018; and
- $8 bn or 0.2% of GDP in Q1 2019

More than 50% of economic loss was reversed in subsequent quarters

Economists estimate that each week of a US Government shutdown reduces economic output by 0.1% to 0.2% of GDP. *Since essential employees receive back pay on the "reopen", and since lawmakers frequently reimburse furloughed workers for missed pay, most of the economic loss is reversed in subsequent quarters.*

Source: Oxford Economics. Bloomberg Economics. Congressional Budget Office.

Implications for US Sovereign Rating

On September 25, Moody's released a report on the potential implications of a government shutdown. While the report acknowledges the limited long-run economic impact, it highlights the weakness of US institutional and governance strength vs. AAA rated peers.

FAQ: Potential credit implications of a government shutdown
Sept 25, 2023

What impact could it have on the US sovereign credit profile?

A shutdown would be credit negative for the US sovereign. While government debt service payments would not be impacted and a short-lived shutdown would be unlikely to disrupt the economy, it would underscore the weakness of US institutional and governance strength relative to other Aaa-rated sovereigns that we have highlighted in recent years. In particular, it would demonstrate the significant constraints that intensifying political polarization put on fiscal policymaking at a time of declining fiscal strength, driven by widening fiscal deficits and deteriorating debt affordability.

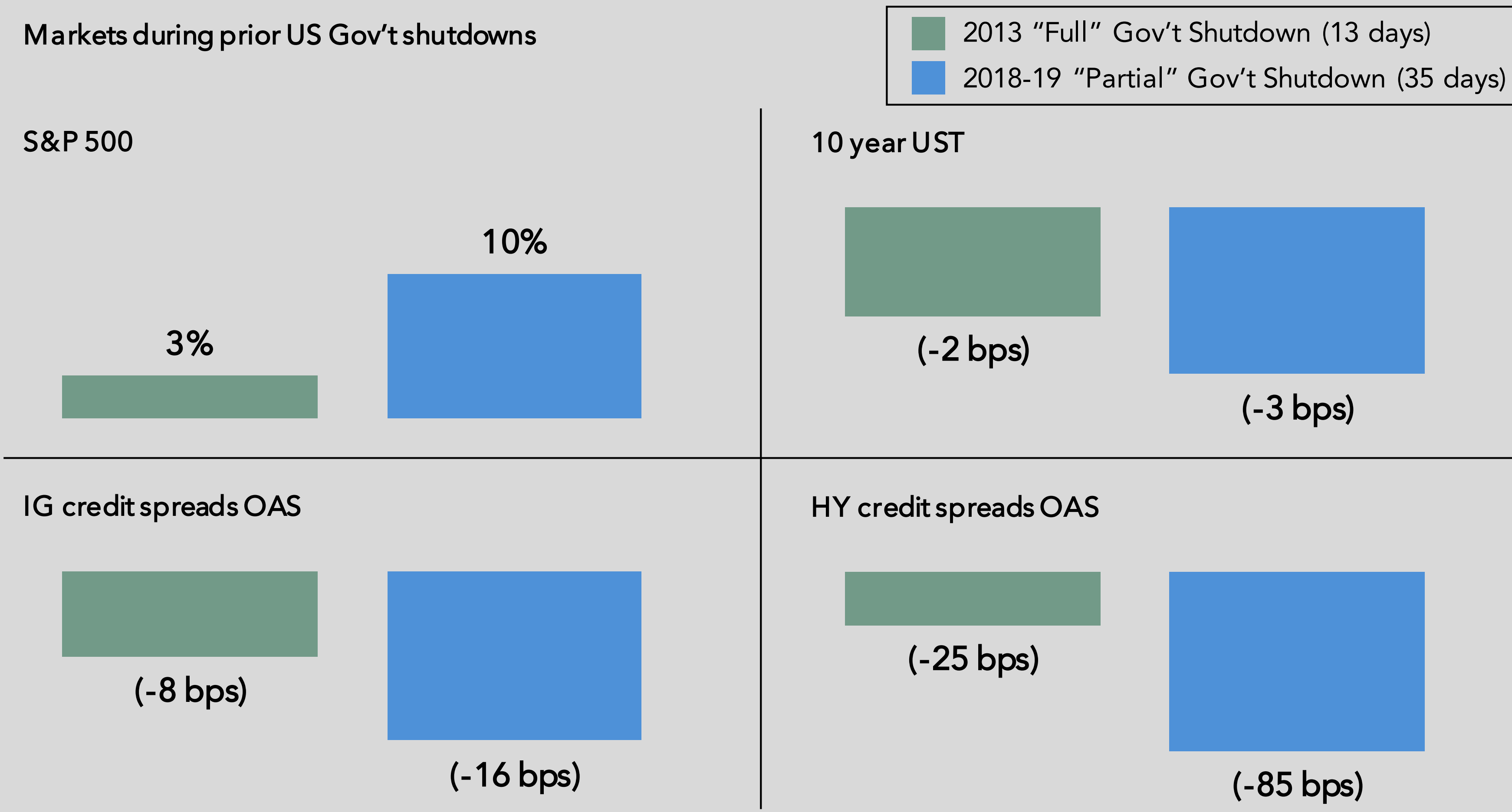
Moody's

Source: (1) Moody's: FAQ: Potential credit implications of a government shutdown.

Markets Can Perform During Shutdowns

In the last two decades, only the 2013 and 2018 shutdowns were long enough to provide a meaningful snapshot of how markets performed during that period. In both cases, however, extenuating circumstances unrelated to the shutdown proved to be more important market drivers, with both equity and credit markets rallying during the shutdown period.

Markets during prior US Gov't shutdowns

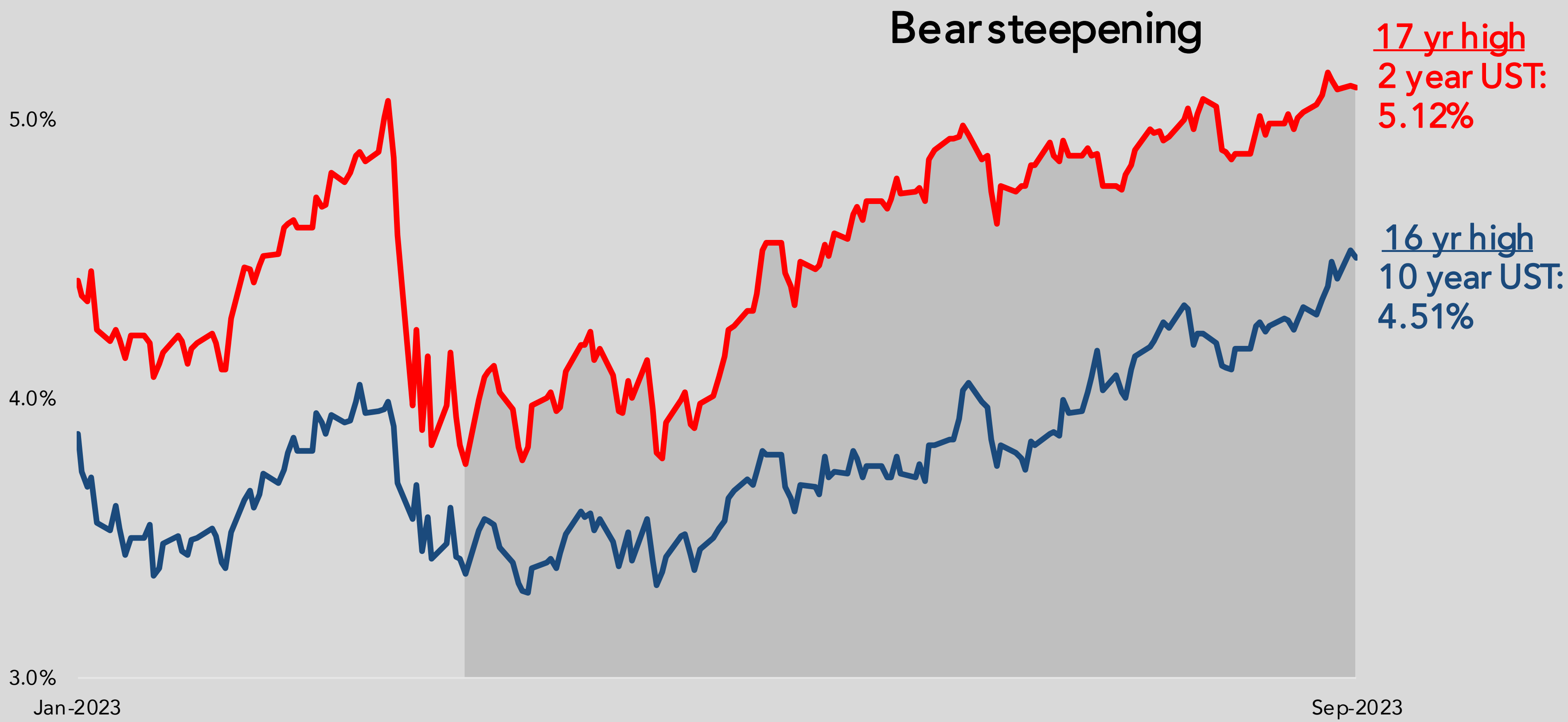


Source: (1-4) Bloomberg. Data as of September 26, 2023.

US Rates at 17 Year Highs

The bear market steepening in US rates since July, which is quite atypical this late in a Fed tightening cycle, has been reinvigorated as massive curve inversion positions unwind on the challenging combination of: (1) resilient US labor market data; (2) the Fed's hawkish pause; (3) ongoing Fed QT; and (4) resurgent UST supply.

2 year and 10 year UST yields YTD



Source: (1) Bloomberg. Data as of September 26, 2023. MUFG Rate Strategy (George Goncalves).

About the Authors

Tom Joyce

Managing Director
Capital Markets Strategist
New York, NY

Tom.Joyce@mufgsecurities.com
(212) 405-7472

Role

Tom Joyce is a Managing Director and Capital Markets Strategist within MUFG's global capital markets and investment banking business. Based in New York, Tom heads a team that creates customized analytical content for multi-national S&P 500 companies. His team provides in depth analysis on the impact of economic, political, public policy and regulatory dynamics on the US credit, foreign exchange, rates and commodities markets.

Experience

Tom has over 25 years of Investment Banking experience in New York, London, Hong Kong, and San Francisco. Over the last 15 years, Tom created and built the Capital Markets Strategy role, advising corporate C-Suite executives (Boards, CEOs, CFOs, and Treasurers) on the pervasive macro forces driving markets. Tom also presents at dozens of corporate events each year including Board meetings, CEO ExCo sessions, CFO and Treasury off-sites, corporate leadership events and conferences.

Education

Tom's educational background includes a year of study at Oxford University from 1991 - 1992, a Bachelor of Arts in Political Science from Holy Cross College in 1993, and a MBA from Kellogg Business School, Northwestern University in 2000.

Personal

Tom resides in New Canaan, CT with his wife and four sons, where he serves on the Board of Trustees of the New Canaan Library as well as the Holy Cross College President's Council.

About the Authors

Hailey Orr

Managing Director
Capital Markets Strategist
New York, NY

Hailey.Orr@mufgsecurities.com
(212) 405-7429

Role

Hailey Orr is a Managing Director in MUFG's Capital Markets Strategy group within the global capital markets and investment banking business. The team provides market based content for corporate clients to assist in strategic decision making. Focus areas include the impact of economic, political, public policy and regulatory dynamics on the US credit, foreign exchange, rates and commodities markets.

Experience

Hailey has a decade of Wall Street experience, including three years as a Consumer Sector Specialist in Equity Sales and seven years as a Capital Markets Strategist. Hailey is also a member of MUFG's Inclusion & Diversity Council and has devoted years to participating in and developing Wall Street recruiting programs.

Education

Hailey graduated with honors from the University of Michigan's Ross School of Business with a BBA and a minor in International Studies.

Personal

In March 2020, Crain's New York Business Magazine named Hailey one of the "Rising Stars in Banking and Finance".

Stephanie Kendal

Vice President
Capital Markets Strategist
New York, NY

Stephanie.Kendal@mufgsecurities.com
(212) 405-7443

Role

Stephanie Kendal is a Vice President in MUFG's Capital Markets Strategy group within the global capital markets and investment banking business. The team provides market based content for corporate clients to assist in strategic decision making. Focus areas include the impact of economic, political, public policy and regulatory dynamics on the US credit, foreign exchange, rates and commodities markets.

Experience

Stephanie has spent over five years as a Capital Markets Strategist. She is an active member of the University of Michigan recruiting team and is focused on the diversity recruiting effort at MUFG. Stephanie is also a part of MUFG's DEI, Culture & Philanthropy (DCP) Council.

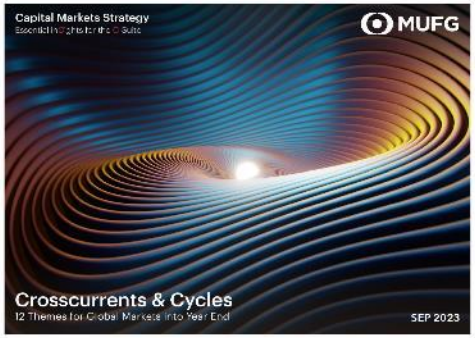
Education

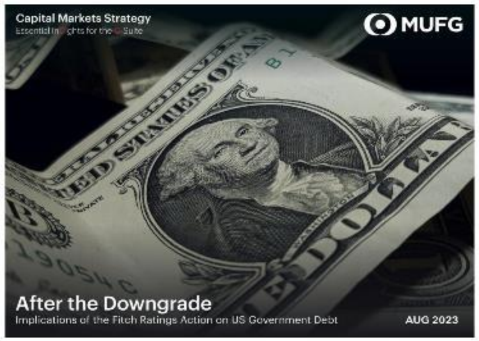
Stephanie graduated with honors from the University of Michigan's Ross School of Business with a BBA .

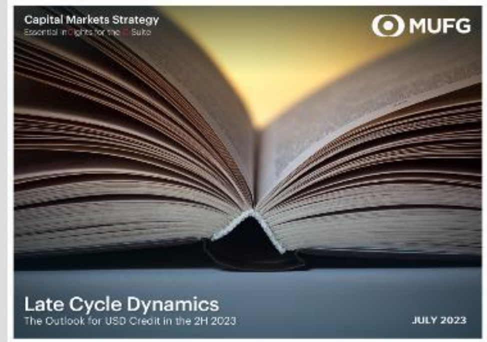
Personal

Stephanie is actively involved in NYC's iMentor program, mentoring high school students with their journey to college graduation.

MUFG's Capital Markets Strategy Team







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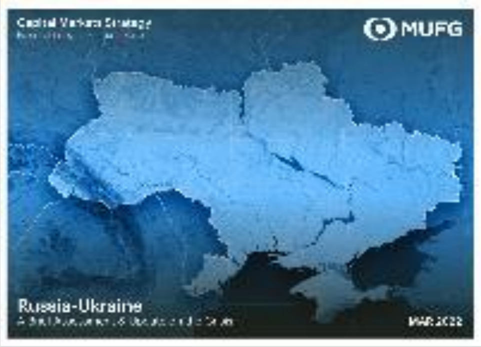

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