US Daily: Q&A on the Likely Federal Shutdown (Phillips)

- A government shutdown this year has looked likely for several months, and we now think the odds have risen to 90%. The most likely scenario is a shutdown starting Oct. 1. While there is still a chance that Congress can reach a last-minute deal to extend funding past Sep. 30, there has been little progress made and there is little time left. In the seemingly unlikely event Congress passes a short-term extension, we would still expect a shutdown sometime later in Q4.
- We continue to think a shutdown would last 2-3 weeks. If the government shuts down on Oct. 1, a quick reopening looks unlikely as political positions become more deeply entrenched. Instead, political pressure to reopen the government is likely to gradually build. In particular, pay dates for active-duty military (Oct. 13 and Nov. 1) could be potential pressure points, as well as possible deterioration in "essential" operations like airport screening and border patrol as workers go unpaid.
- We have estimated a shutdown would subtract 0.2pp from Q4 GDP growth for each week it lasts (adding the same to 1Q2024, assuming it has ended by then). Regardless of duration, federal employee furloughs should subtract 0.15pp for each week of shutdown. We have estimated the indirect private sector hit at 0.05pp per week, but this is likely to be smaller in a short shutdown, and larger in protracted shutdown lasting many weeks.
- We expect all data releases from federal agencies to be postponed until after the government reopens, except for releases from the Federal Reserve, which does not rely on congressional funding.
- Although we would expect the shutdown to end after 2-3 weeks, more than one shutdown is possible. The two parties are far apart on spending proposals, and any agreement to reopen the government after the likely shutdown is likely to expire before year-end, potentially risking another funding lapse.

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Q&A on the Likely Federal Shutdown (Phillips)

What are the odds the government shuts down?

A shutdown this year has looked likely for several months, and we now think the odds have risen to 90%. The most likely scenario in our view is that funding will lapse after Sep. 30, leading to a shutdown starting Oct. 1. That said, a short-term extension cannot be entirely ruled out. In the event that Congress avoids a shutdown starting Oct. 1, we would still expect a shutdown at some point later in Q4.

While there is likely sufficient support in both chambers of Congress to pass a short-term extension of funding—this is known as a "continuing resolution" (CR)—that is "clean" with no other provisions attached, the majority of that support would come from Democrats. The Senate is considering a CR that includes aid for disaster relief and Ukraine. House Republican leaders are under political pressure to pass a CR that includes Republican policy priorities that can pass with mainly or exclusively Republican support. At the moment, neither chamber looks likely to pass the other chamber's CR.

The outlook seemed bleak ahead of the debt limit deadline earlier this year, but Congress resolved it in time; why shouldn't we expect a last-minute deal once again?

The smaller economic hit from a shutdown puts less pressure on Republican leaders to override the objections of some in their party to reach a deal. Ahead of the debt limit deadline earlier this year, Republican leaders reached a deal over the objections of some in their party because the potential hit to the economy from an impasse would have been unpredictable and severe, and even lawmakers most strongly opposed to a compromise agreed that the debt limit must be raised. By contrast, the economic hit from a shutdown would be smaller and more predictable, as there have already been two protracted shutdowns over the last decade. While most lawmakers on both sides of the aisle would prefer to avoid a shutdown, both sides appear more willing to take the chance it occurs.

When will the outlook for a shutdown become clearer?

The Senate is considering a CR that includes funds for Ukraine and disaster aid. It is still possible those items will be removed before final passage, but for now they are likely to reduce support among Republicans and delay passage (to waive procedural obstacles, unanimous consent is required, which will be harder with these additions). Senate passage looks unlikely before the end of the week (around Sep. 29).

The House has yet to vote on a CR, but is also likely to do so later this week. House Republican leaders continue to look likely to include border security funding and potentially a spending cut in the House CR, which would likely mean little to no Democratic support and little chance of passing in the Senate. An Oct. 1 shutdown will continue to look likely unless one of the chambers changes course over the next few days.

How long will the shutdown last?

We think 2-3 weeks is a reasonable central scenario. If a shutdown occurs, it is likely to last more than a few days, as neither side seems likely to make immediate concessions. While some funding lapses have ended very quickly, the political environment going into the deadline is more reminiscent of the situation preceding longer shutdowns in the past. However, we are also skeptical of arguments that a government-wide shutdown would last for more than a few weeks (i.e., for a few months), as we would expect political pressure to build until it forces a political resolution.

The last shutdown took 5 weeks to end; why wouldn't this shutdown last at least as long?

The long shutdowns in the past affected only some agencies and, in particular, did not affect the Department of Defense. The 21-day shutdown that started in late 1995 affected agencies representing only around 1/4 of discretionary funding, while the 35-day shutdown that started in late 2018 affected around 1/3 of funding. In both cases, Congress had already approved defense funding and some non-defense spending bills. In 2013, the Department of Defense reopened after a few days, cutting the impact of the remaining period of shutdown in half (defense represents around half of discretionary funding). The upshot is that a full-government shutdown has never lasted longer than a week.

Shutdowns affecting the entire government are typically short because of the political ramifications of certain aspects of a shutdown. For example, while all active-duty military and some civilian employees of the Defense Department would continue to work, none would be paid for work during the lapse until the government reopens (the first pay date at risk is October 13, when roughly 1.3 million active-duty servicemembers should receive around $4bn in pay). A failure to pay the military could have negative political consequences for whichever political party voters hold more responsible.

Similarly, customs and border patrol agents, airport screeners, and other critical workers would go unpaid but still be required to work. During the 2018-2019 shutdown, a failure to pay airport screeners led to a rise in absences and resignations, which in turn led to delays and airport terminal closures. The tight labor market could exacerbate these kinds of effects if the government shuts down in October.

If political pressure is insufficient to force a reopening, there is also a procedural backstop against a prolonged shutdown. In general, the Speaker of the House controls the agenda on the House floor, including which bills come up for a vote. However, a majority of the House can sign onto a "discharge petition" to circumvent the Speaker and bring a piece of legislation up for a vote. This would not prevent a shutdown, as most if not all Republican lawmakers would resist siding with Democrats against the leader of their own party. The process also involves multiple steps that would likely take at least two weeks, far longer than the time remaining before funding expires. However, once a shutdown occurs, and particularly once political pressure builds, a discharge petition might come into play as a means of ending the shutdown.

How might the economic effect of the shutdown change if it grows longer?

We have estimated a shutdown would reduce Q4 GDP growth by 0.2pp for each week it lasts, but the per-week effect would depend on the duration of the shutdown. The main effect of the shutdown is the hit to GDP from the missed work that furloughed workers do not perform. We estimate the direct effect to be -0.15pp per week, assuming the funding lapse affects all agencies, and this per-week effect should not change regardless of how long the shutdown lasts.

There are likely some indirect effects on private sector activity as well, and we assume another -0.05pp hit to Q4 GDP growth for each week of shutdown due to indirect effects on the private sector. However, this indirect effect would depend on the timing and length of the shutdown. A one-week shutdown would have a minimal impact on private sector activity, as it would not last long enough to affect federal pay, procurement, permitting, or other activities that intersect with the private sector (an exception would be services that depend on federal facilities being open, like janitorial or food services). If it occurred at the start of the quarter, there would be ample time to make up lost activity before the end of the quarter. By contrast, a two-month shutdown could affect growth in private-sector activity by more than the -0.05pp per week of shutdown we estimate. In a longer shutdown, new federal contracts for goods and services would slow if not stop, existing contracts could be affected by the absence of federal officials to provide guidance, and federal inputs for private activity—IRS tax transcripts used in mortgage underwriting, environmental reviews for construction projects, and the like—would not be available.

What would a shutdown mean for economic data releases?

If the government shuts down, agencies that rely on congressional funding will not publish periodic economic data. As of now, Congress has not yet passed the appropriations bills that fund the Dept. of Labor or the Dept. of Commerce, so a failure to enact a CR by Sep. 30 would affect releases from both agencies. Commodity-related reports from the Dept. of Agriculture and Dept. of Energy would also be postponed. (The Federal Reserve does not rely on congressional funding and will continue to release data on schedule.) This stands in contrast to the 2018-2019 shutdown, when some agencies (e.g., the Dept. of Labor) continued to release data on schedule, because Congress had already passed the spending bills that fund them.

Although federal statistical agencies should already have September survey data in hand, those data will not be released while the government is closed and would likely be released with a delay following reopening to allow time for processing. In general, releases are likely to come out roughly the same number of days after reopening as they were originally scheduled to come out after the start of the month (e.g., the employment report scheduled for Oct. 6 would come out around 6 days following reopening). A shutdown lasting 2-3 weeks could also complicate the gathering of data for October (the reference week for the employment situation report will be Oct. 9-13), likely leading to delays in publication of reports due in November. While it would depend on how long the shutdown lasted, there is a clear possibility that there will be little or no additional data available at the next FOMC meeting on November 1 beyond what had been published ahead of the last meeting.

What would a shutdown mean for overall spending and Treasury issuance?

A shutdown lasting a few weeks should have little overall effect on the Treasury's financing needs but would delay some payments until after the government reopens. The main short-term impact would be to delay payments to federal employees and military personnel by around $20bn per month. Beyond this, there would likely be a slight reduction in miscellaneous payments, but most payments would continue, either because they are not funded through appropriations—this is generally the case for benefit programs—or because they relate to activity that occurred before funding expired. Overall, the shutdown is unlikely to meaningfully change the roughly $200bn in funds the Treasury is likely to raise in October.

Once the government reopens, could it shut down again?

Multiple shutdowns are a distinct possibility, and there is historical precedent: In 1995, funding for all agencies lapsed for 5 days, restarted, and then lapsed a month later for a subset of agencies, lasting 21 days. In 2018, funding for all agencies lapsed briefly at the start of 2018, and then for 35 days for a subset of agencies at the end of that year. This year, Congress has made little progress on the 12 annual appropriations bills it needs to pass, so it looks likely that at least one—and probably more than one—CR will be necessary while work on the full-year bills continues. Whether Congress enacts that CR before or after current funding expires on Oct. 1, the end-date of the next CR Congress passes is likely to pose a new shutdown risk. The upshot is that uncertainty regarding federal operations will likely persist for the next few months, regardless of how the next week plays out.

Alec Phillips

Disclosure Appendix

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