

TRENDMACRO LIVE!

On the Pending Government Shutdown

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It'll be America's 18th shutdown. They've all been resolved. This one will be, too.

As of this writing it seems there will be a US federal government shutdown, at least for a brief period. We're surprised it's gotten this far -- indeed, some of the principals in the drama [still say](#) it won't happen. But if it does, as with all things investors must consider, the real issue is: so what?

- We caution against the conditioned reflex that this will be a systemic event leading to cascading financial contagion (see ["A Little Distant Gunfire"](#) August 29, 2013).
- Admittedly, in our minds that reflex is especially strongly stimulated by a rather amazing coincidence. As we detailed last week, our analysis of the 2011 debt limit crisis has it inextricably intertwined with a political crisis in Italy, triggered by Silvio Berlusconi and ultimately threatening the euro currency (see ["Once More unto the Debt Crisis, Dear Friends"](#) September 25, 2013). Now, it seems, here we go again -- the resignation this weekend of five Berlusconi cabinet ministers may bring down the Italian government (see ["Red Letta Day"](#) September 30, 2013).
- But 2013 is not 2011. The global economy is not so fragile now, so susceptible to contagion. Indeed, we've already had one political crisis in Italy this year, and it didn't make any difference at all (see ["Elezione!"](#) February 14, 2013).
- And this won't be our first government shutdown. It will, in fact, be [our eighteenth](#). And it won't even be the first one to be tied up with a debt limit crisis and the threat of default (again, see ["Once More unto the Debt Crisis, Dear Friends"](#)).
- *Remember, nothing actually happens just because the government shuts down, and nothing breaks that stays broken.* It's not a cliff you fall off. It's not a trap-door you fall down through but then can't get back up through. A government shutdown is not like cutting the engines of an airplane in mid-air. It is more like a car running out of gas driving down the highway.

Our sense of the chatter over the weekend, though, is that there is a great deal of alarm. No doubt that comes from the sheer incoherence of the process of negotiation and resolution between the House, the Senate and the president, and the inability to clearly visualize how this could ever end. And some of that alarm is manufactured deliberately by the politicians involved, to draw attention to themselves, to demonize their opponents,

Update to strategic view

US MACRO, US STOCKS, US BONDS: A shutdown is highly likely, but we think the prevailing sense of alarm about it -- inflamed by the very politicians who've caused this mess -- is overdone. The US has already experienced 17 shutdowns, the most recent one associated with a debt limit crisis. All were resolved with no significant damage, and this one likely will be, too. The process is disturbingly opaque and indeterminate. But a possible compromise has already been identified -- repealing the Obamacare tax on medical devices, made by companies mostly located in blue states. Or the GOP could find "peace with honor" by dropping all demands except for one small one especially embarrassing to Democrats -- prohibiting the subsidy of Obamacare costs for congress itself. We'll have to judge by the news flow when the time comes, but we expect any volatility spikes here are likely to be buyable for stocks and sellable for bonds.

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increase pressure on their negotiating counterparties -- and the [raise money for their campaigns](#).

- But these things do end. There is always some kind of compromise when the pressure is on, just as there was after we'd fallen off the fiscal cliff for one day right after year-end (see "[Tax Hikes Have Consequences](#)" January 2, 2013).
- There have *already* been compromises.
- Democrats and Republicans in the House [voted unanimously](#) Friday night for a bill funding payment of military personnel through a shutdown.
- In the [House version of the continuing resolution](#) sent to the Senate Friday night, the defunding of Obamacare was demoted to a delay of the personal mandate for one year, with [two Democrats voting aye](#).
- [17 Democrats voted aye](#) on an amendment to repeal the tax on medical devices imposed in the Affordable Care Act.
- *We can build on that. Democrats love the medical device companies, which are mostly located in blue states. Republicans love tax cuts.*
- *Or we could repeat a version of the "peace with honor" that allowed the debt ceiling to be suspended in February -- with the GOP basically caving, but extracting a concession too small for Democrats to dare to fight, but nevertheless politically embarrassing to them. In the February deal, it was committing the Democratic Senate to pass its first budget in four years.*
- *Today, when the House gets a bill from the Senate stripped of its Obamacare parts, it could return a version amended to add only the proviso that congress can't subsidize the costs of Obamacare for its own members and staff. Would Senate Majority Leader Harry Reid (D-NV) risk being blamed for a shutdown over that?*

Bottom line

A shutdown is highly likely, but we think the prevailing sense of alarm about it -- inflamed by the very politicians who've caused this mess -- is overdone. The US has already experienced 17 shutdowns, the most recent one associated with a debt limit crisis. All were resolved with no significant damage, and this one likely will be, too. The process is disturbingly opaque and indeterminate. But a possible compromise has already been identified -- repealing the Obamacare tax on medical devices, made by companies mostly located in blue states. Or the GOP could find "peace with honor" by dropping all demands except for one small one especially embarrassing to Democrats -- prohibiting the subsidy of Obamacare costs for congress itself. We'll have to judge by the news flow when the time comes, but we expect any volatility spikes here are likely to be buyable for stocks and sellable for bonds. ▶

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[Late Appropriations and Government Shutdowns: Frequency, Causes and Remedies](#)

Roy T. Meyer
Public Budgeting and Finance
Fall 1997

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