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What could a government shutdown mean for markets?

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A shutdown could potentially reduce confidence and cause global investors to continue reallocating away from the U.S.

The U.S. government is facing a funding deadline on September 30, risking a potential shutdown. The Senate recently rejected the House's funding bill, with many Senate Democrats opposing its exclusion of certain provisions, such as extensions for Affordable Care Act subsidies, which are set to expire at the end of 2025.

A government shutdown occurs when the federal government reduces its operations because Congress has not passed the necessary funding bills. Importantly, a shutdown is not the same as a default, and only some federal employees who are deemed non-essential are furloughed or work without pay until funding is restored. Although shutdowns are disruptive, they are usually short and have limited economic impacts. Since 1950, there have been 21 shutdowns, most lasting only a few days.

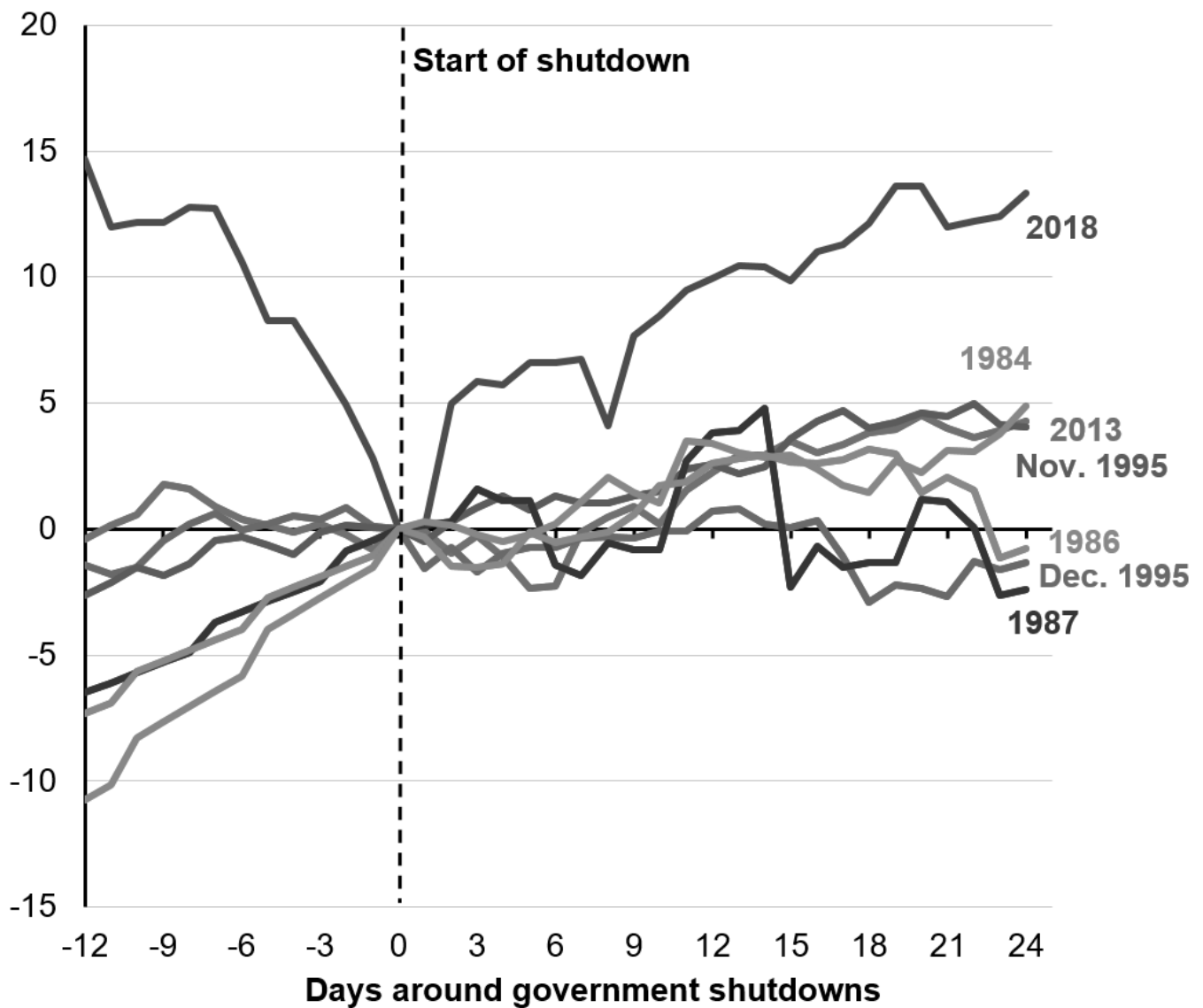
Markets tend to overlook brief shutdowns, as they rarely affect corporate earnings. However, longer or repeated shutdowns can reduce confidence and cause investors to flock toward safe-haven assets. For example, during the longest government shutdown ever, which lasted 35 days from December 2018 to January 2019, the S&P 500 corrected by 13% and 10Y yields fell 13bps in the 12 preceding days. Other factors also contributed to the sell-off. From an economic perspective, the CBO estimated it permanently shaved around \$3 billion from GDP.

The pending shutdown could have a greater impact on equity markets than usual due to deep political divisions, an economy vulnerable to external shocks and recent policy changes that have already unsettled markets this year. Treasury yields could increase due to political uncertainty and rising deficits, but historical precedent points to lower yields. However, with the debt ceiling already raised, any movements will likely be moderate. As of publication, Congress has not passed any of the 12 required annual appropriation bills, increasing the risk of a full shutdown. However, the Senate could still approve a continuing resolution to provide short-term funding, as the House has already done. For context, during the 2018–2019 shutdown, five of the 12 bills had been passed, resulting in only a partial shutdown.

A shutdown could potentially reduce confidence and cause global investors to continue reallocating away from the U.S. **As we've discussed previously**, international investors are allocating less to the U.S. than they have in previous years. It would also disrupt the federal agencies that collect data for key indicators like CPI, which could affect the TIPS market and the Fed's policy decisions. For now, investors should stay the course but remain focused on diversification and allocating to quality companies and alternative assets.

S&P 500 returns around past government shutdowns

%, price return indexed to zero at start of shutdown



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

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