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Shutdowns and Markets: Historically, Business as Usual

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With the US Senate unable to pass a continuing resolution to fund government operations before the end of the fiscal year, a shutdown began at midnight on October 1. In the resolution, the GOP majority sought a simple extension of fiscal year 2025 funding levels through November 21, whereas the minority Democrats also wanted to address the extension of expiring health care subsidies and other health-care-related matters. Republicans preferred to negotiate extending health care provisions later in the fall.

Historically, government shutdowns are not particularly rare, with 20 occurring since 1976. The average funding crisis has lasted a week, with the longest stretching 35 days. A Morgan Stanley analysis found Treasuries have provided a safe-haven during closures, with yields dropping by an average of 0.59% during the 20 shutdowns. Additionally, according to S&P Global, the average price return for the S&P 500 Index during these shutdowns has been virtually flat.

Analysts at Wolfe Research have found, going back decades, that in past episodes both stocks and bonds have tended to slump in advance of closures but rally once they begin, as sentiment improves in anticipation of an eventual resolution. However, if a shutdown drags on for weeks, as it did in 2018-19, we could see noticeable effects on GDP and unemployment; however, these should be temporary and followed by a bounce back.

Economists estimate that each week that the government is shut down shaves about 0.2% from GDP, but virtually all of that lost growth comes back once the funding crisis has been resolved. It should be noted that while temporary shutdowns affect discretionary government spending, they do not impact mandatory outlays such as Social Security or Medicare payments.

One impact of a funding crunch that could spark market anxiety is the suspension of government economic data collection, which will keep both investors and policymakers at the US Federal Reserve temporarily in the dark.

From an investment perspective, while shutdowns rarely have lasting effects at the index level, they can impact individual companies, particularly those who derive a significant portion of revenues from government funding, such as defense and aerospace companies, as well as information technology providers. We believe that shutdowns can create opportunities for active managers who have carefully analyzed the business models of these organizations to take advantage of the short-term price dislocations that may occur if and when investors overreact to the headlines of the day.

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