Seeking Alpha$^{\alpha}$

The Impact On The Economy And Markets Of The Looming Government Shutdown

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Summary

- Congress is required to pass a budget annually, but has failed to do so on time in 94% of the past 33 years.
- Government shutdowns are rare, typically resolved quickly, and have a modest, temporary economic impact unless prolonged.
- Historically, S&P 500 performance rebounds after shutdowns, with markets largely unfazed by political brinkmanship.
- While headline risks and volatility may rise, the fundamentals of the economy and monetary policy remain more influential for investors.

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The Role Of Congress

The US Congress, otherwise known as the Legislature, is one of three co-equal branches of government, along with the Executive Branch and the Judicial Branch.

Colloquially it is often said that the Legislature makes the laws, the Executive Branch enforces the laws and the Judiciary interprets the laws.

The role of Congress is to introduce and pass bills, which become law when signed by the President. They also control government taxation and spending.

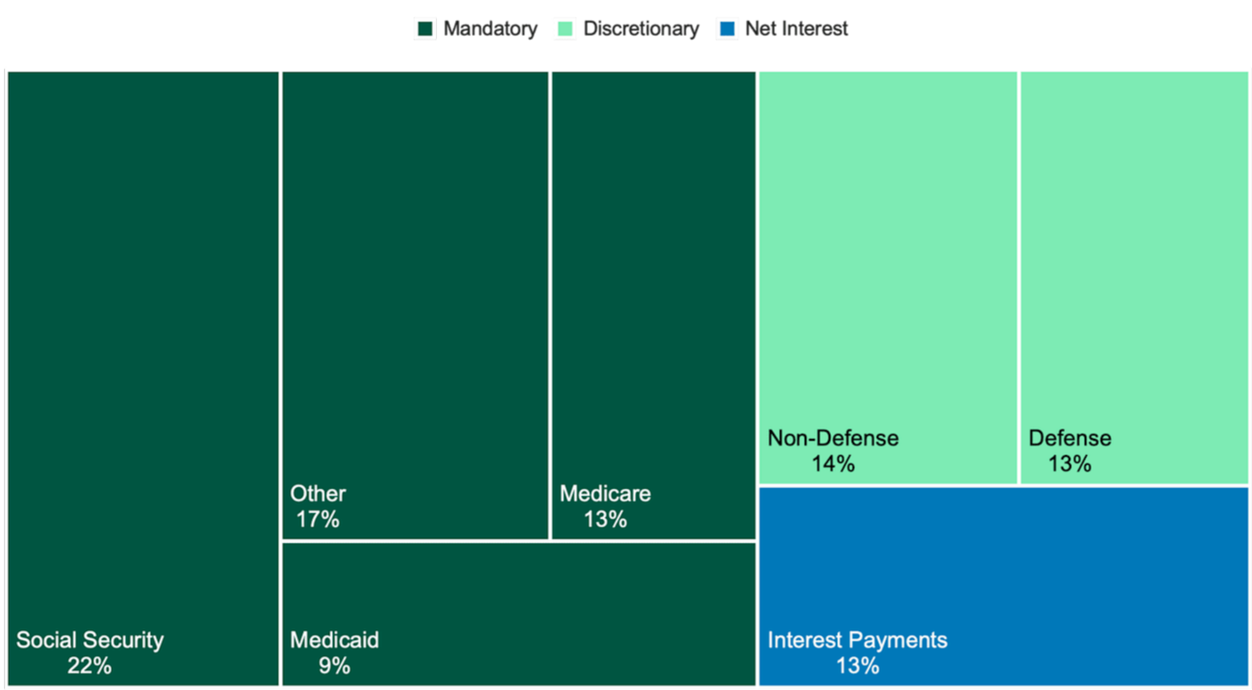
Additionally, Congress provides oversight to ensure laws are implemented correctly, as well as having the power to confirm presidential appointments and declare war.

With all of these duties, Congress only has one legislative responsibility that they are required to fulfill each year, and that is to pass a budget. In actuality, however, it is only necessary for Congress to pass part of the budget, because, as will be described below, much of the government's annual spending is already authorized by pre-existing laws.

The Federal Budget

The Federal Budget is comprised of three components; Mandatory Spending, Discretionary Spending and Interest Expense.

Breakdown of the Federal Government's $6.8 Trillion Budget in Fiscal Year 2024



Congressional Budget Office

Source: Congressional Budget Office

Mandatory programs are the largest segment, representing 61% of the total budget, and include the big three entitlement programs of Social Security, Medicare and Medicaid, which are 22%, 13% and 9% of total spending, respectively.

Discretionary Spending is the next largest component at 27% of spending, and is broken into Non-Defense Spending at 14% and Defense Spending at 13%.

Last comes Interest Payments on the National Debt at 13% of total spending.

Mandatory Spending and Interest Payments do not require annual approval by Congress because they are already authorized by pre-existing laws.

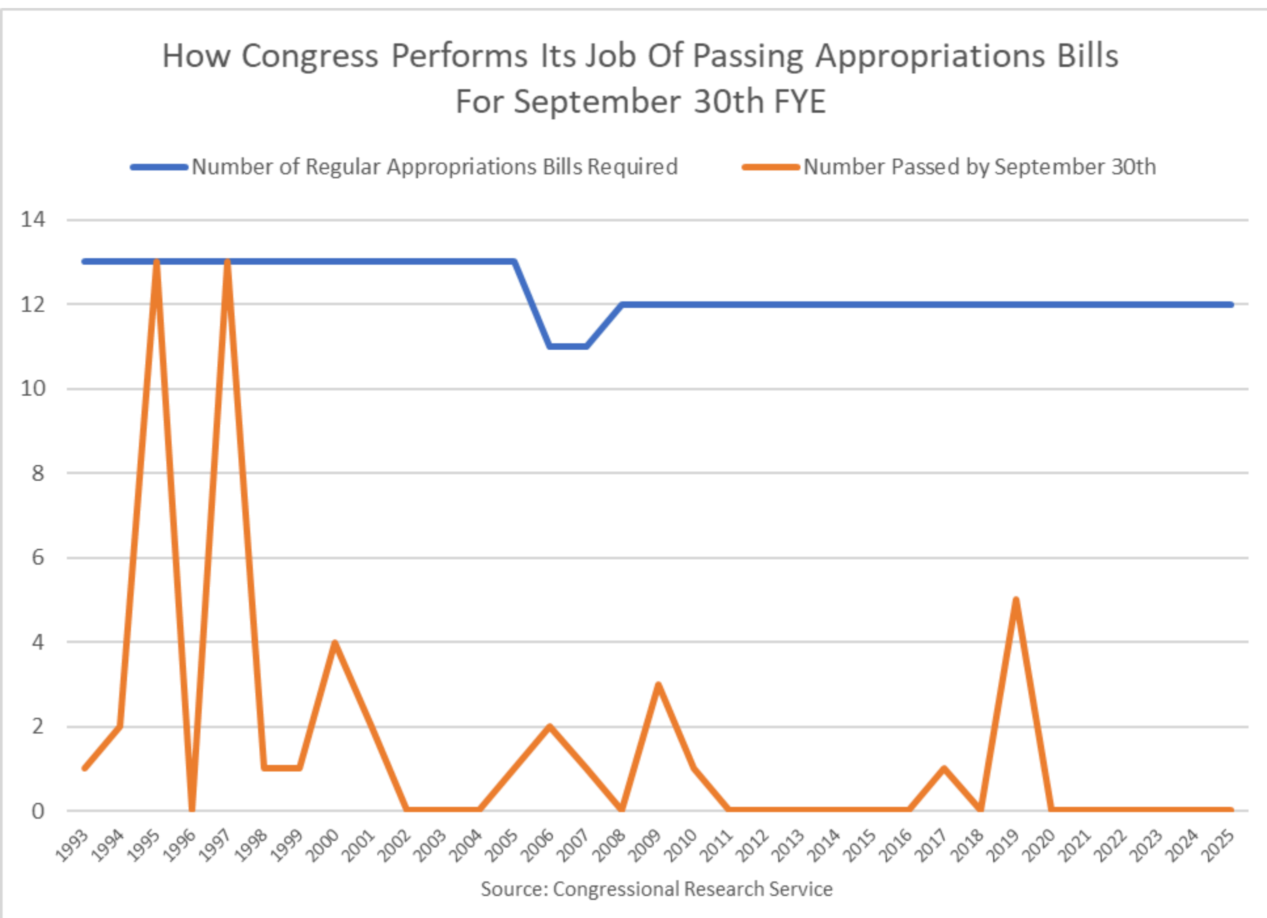
Consequently, the only annual requirement for Congress is to pass legislation which covers the Discretionary Spending portion, which, again, covers 27% of Total Government Spending. This is done through passing 12 Appropriations Bills. These bills must become law by September 30th each year, in order to fund the government for the next fiscal year.

If the Appropriations Bills are not signed into law, then on October 1st a Government Shutdown occurs, because the government can not legally fund the agencies covered by the appropriations.

Given the importance of passing a budget, and it being the sole legally required legislative action of Congress, one would think that this usually gets done.

But one would be wrong.

Over the past thirty-three years, Congress has only passed into law all of the required Appropriations Bills twice, with the most recent being in FY 1997.



Congressional Research Service

That means Congress has failed to complete its legislative duties in 31 of 33 years, or 94% of the time. Thus, Congress deals with the threat of a Government Shutdown almost every year.

Congress does have one out, however, to prevent a shutdown, which is to pass a Continuing Resolution. A Continuing Resolution is a temporary measure that extends funding at existing levels to allow lawmakers more time to reach an agreement. This is the most common practice in the legislature, and is often referred to as "kicking the can down the road." This is how Congress delays making difficult legislative decisions.

As of September 25, 2025, with 5 days to go, Congress has not yet passed into law a single Appropriations Bill for FY2026. Nor have they signed a Continuing Resolution.

The threat of a Government Shutdown is imminent.

History of Government Shutdowns

The reason why a Government Shutdown is often a threat is due to the rules for passing the budget. Under law, Appropriations Bills require a simple majority to pass in the House of Representatives, but must have a Super Majority of 60 votes to pass in the Senate.

Since no party has held a Super Majority in the Senate since the 1960's, bi-partisan support is required. This gives the minority party some leverage in budget negotiations in order to provide their votes to pass the budget legislation.

A discussion of the political posturing between the two parties in order to push their agendas, and how the minority party uses their leverage, is beyond the scope of this analysis. Instead, I intend to focus on what happens if a Government Shutdown occurs.

First, although Congress has only passed all of their Appropriations Bills by the September 30th deadline twice in thirty-three years, a Government Shutdown is still a rare event.

In that time period, there have been 6 Government Shutdowns, although two of them lasted for less than three days, usually over a weekend, and are really only considered technical shutdowns because they were essentially over before any cessation of government activities could begin.

The other 4 lasted an average of 19 days each, and will be discussed below.

The Economic Impact Of A Government Shutdown

While government spending represents roughly one quarter of GDP, the impact of a Government Shutdown would be much less, because only some of the government's programs would be closed.

Mandatory Spending is not affected, so Social Security and Medicare benefits still go out.

The Treasury is still able to pay on its debt obligations.

Only departments that Congress has not funded would be impacted, and they cover 27% of Government Spending. The majority of federal employees, roughly 65% would continue working, since they are considered essential workers.

Importantly, furloughed government workers would receive backpay once the government reopens, thanks to the Government Employee Fair Treatment Act of 2019.

Goldman Sachs has estimated that a government shutdown might reduce growth by 0.15% per week, but it would only be temporary. Growth would rise by a similar amount once operations are reopened.

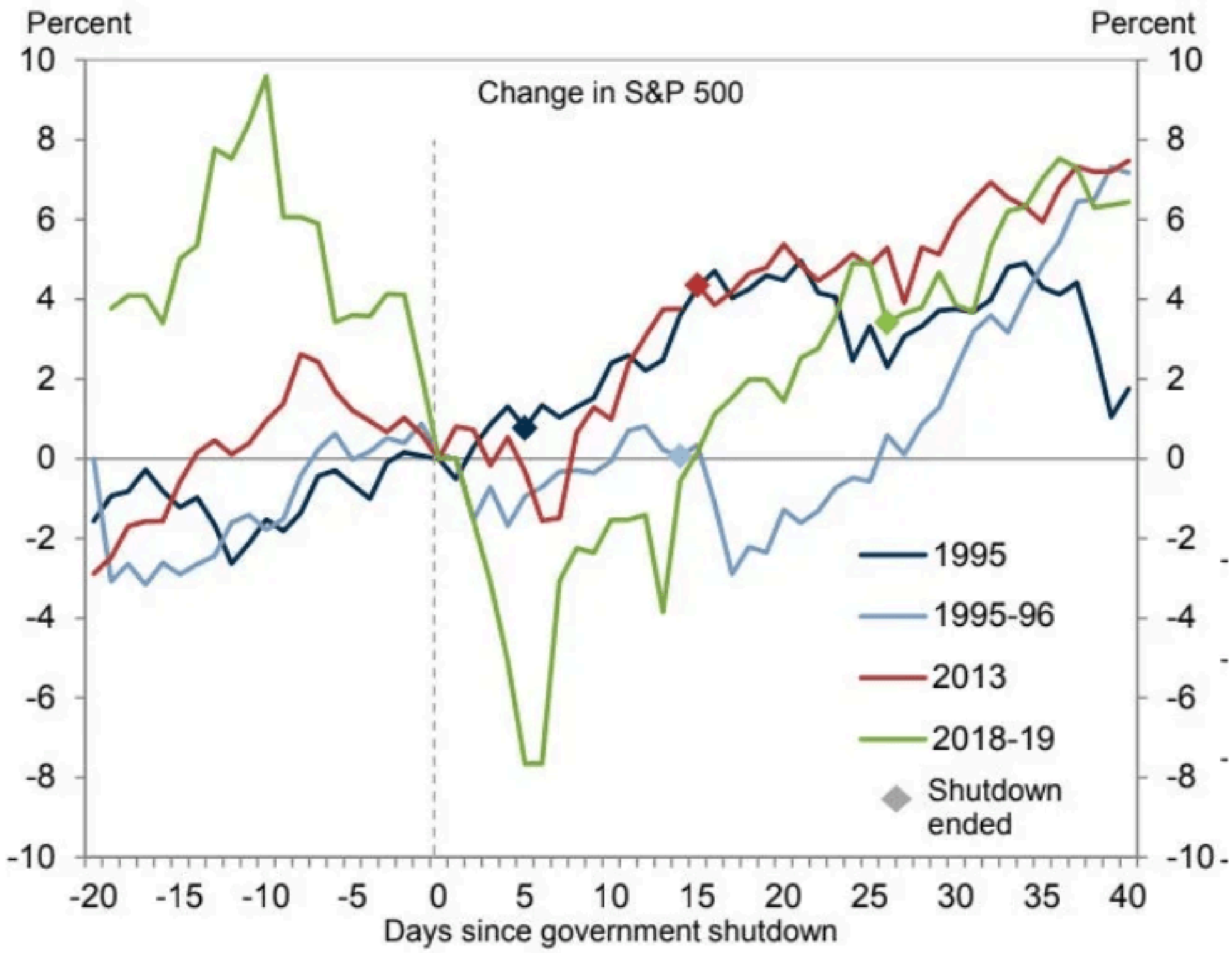
The Congressional Budget Office estimated that the 2018-2019 shutdown, which at 35 days was the longest on record, reduced GDP by $11 billion. However, $9 billion of that was recovered the following quarter.

Overall, the economic impact of a shutdown is modest, unless the shutdown lasts for an extended period of time

The Market Impact Of A Government Shutdown

Historically, Government Shutdowns have not had a negative impact on stocks, as the S&P 500 Index has gained an average of 5.5% over the ensuing 40-day period following the shutdown.

The chart below shows how the stock market initially declines around Government Shutdowns, but quickly rebounds.



Yahoo Finance and Goldman Sachs

Source: Yahoo Finance and Goldman Sachs Global Investment Research

On a longer-term basis, looking at the two most recent shutdowns, the market impact of the closure is but a blip.

Bloomberg

Conclusion

Congress has one responsibility that is required each year, which is to pass a budget to fund the government for the following fiscal year.

History has shown that they aren't very good at doing this, as 94% of the time they reach their September 30th deadline for passing all of their Appropriations Bills without completing the task.

Yet a Government Shutdown, which is threatened almost every year, also rarely occurs. Instead, Congress frequently "kicks the can down the road" by passing a Continuing Resolution, which is a temporary measure to buy them some time to address the tough legislative stumbling blocks.

This year seems to be no different, as Congress will return on September 29th with only 2 days to finish their job.

The political posturing will continue next week, with either the passage of another Continuing Resolution, or a Government Shutdown.

While the rhetoric and political posturing is rising, the financial markets are calm, as the situation has historically always gotten resolved in short order. Concerns about a shutdown may trigger some volatility, and some headline risk about disruptions in government services and furloughed government workers, but the fundamentals of the economy and monetary policy will have a longer lasting impact.

Traditionally, the markets have looked through this political situation.

One thing that is different this year, however, is that the Office of Management and Budget have told federal agencies that will be impacted by funding cutoffs to prepare for the potential permanent reduction in jobs. This might be considered as a negotiating tactic.

Additionally, if a shutdown occurs for an extended period of time, it could delay the release of critical government statistics, which will disrupt the regular flow of information that markets rely on.