LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

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A HISTORIC GOVERNMENT SHUTDOWN

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KEY TAKEAWAYS

We believe this government shutdown will have limited long-term ramifications for economic growth.

This shutdown is unprecedented, however, and business and consumer confidence are weakening.

Delayed economic data releases could cause a disconnect between the Federal Reserve and financial markets.

The U.S. government is in Day 24 of a partial government shutdown, which is now the longest in U.S. history. The closure reached an inflection point on Friday, when government workers' first payday during this closure passed without a paycheck.

While past shutdowns have largely been a nonevent for the U.S. economy, the current shutdown has lasted for an unprecedented amount of time, and there is still no end in sight. As of now, we believe this shutdown will have limited long-term ramifications for economic growth, but it's important to recognize that we're in uncharted territory.

ANOTHER HEADWIND

Government shutdowns have been rare, especially in recent years. Since 1976, there have been 21 shutdowns (including the current one), and only four have occurred in the past 20 years. Shutdowns have lasted about eight days on average, and there have been only seven government closures that have lasted longer than 10 days (the last being a 17-day shutdown in October 2013).

Past shutdowns have had mixed short-term impacts on the U.S. economy. Business and consumer confidence frequently declined during past shutdowns. Government spending, which has comprised about 10% of gross domestic product (GDP) growth over the past three years, also tended to drop in shutdown periods.

However, even if there were negative short-term repercussions, past shutdowns didn't significantly reduce long-term output. Typically, economic activity lost during shutdowns was largely recouped over the following quarters, especially if government workers received back pay. U.S. stocks also historically fared well after government shutdowns, showing that any economic impact from a shutdown wasn't enough to derail market rallies. The S&P 500 Index climbed during 12 of the past 21 shutdowns, and it rose an average of 13% in the 12 months after the government reopened [Figure 1].

So far, economists are predicting the same outcome for the current shutdown. First quarter GDP forecasts have largely remained consistent since the shutdown began, albeit slightly lower after disappointing manufacturing reports rolled in over the past few weeks. Fourth quarter GDP was likely unaffected since there were only a few business days between December 22 and the end of 2018, and many workers took some vacation during that period.

It's important to remember that there isn't any historical precedent for a shutdown this long, however, and the U.S. economy is especially sensitive to a shift in confidence right now. Consumer and business confidence gauges have declined from cycle highs recently as negative headlines from the U.S.-China trade dispute and geopolitical squabbles have roiled financial markets and soured sentiment. By some measures, economic uncertainty is at its highest point in years, even as data point to solid economic conditions [Figure 2]. Uncertainty about the future of policy and the intangible effects of a prolonged shutdown could dampen sentiment further.

Trade tensions have also softened overall demand, especially among U.S. corporations. Many businesses have gone on the defensive and delayed business investment and expansion plans until a trade resolution occurs, a shift that has unexpectedly weighed on capital expenditures and global manufacturing health. Data show U.S. consumer demand has been largely immune to economic headwinds, but a long shutdown could

1 STOCKS' STRONG GAINS AFTER GOVERNMENT SHUTDOWNS

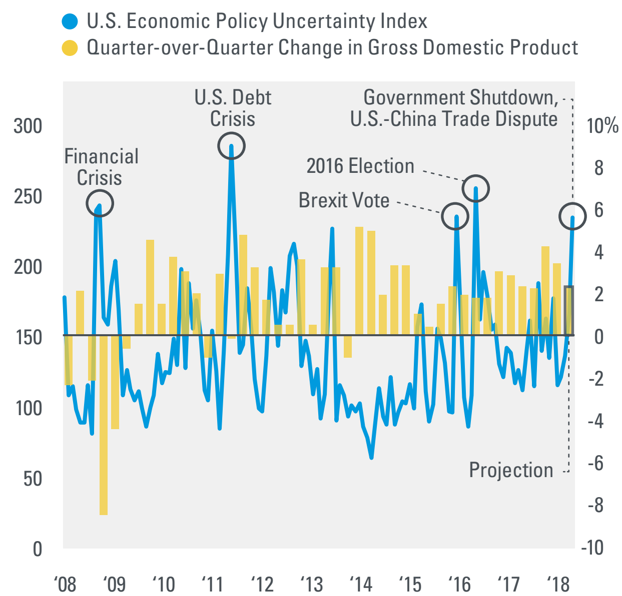
Start	End	Number of Days	S&P 500 Index Return	S&P 500 Index Return 12 Months After End
09/30/76	10/11/76	12	-3.4%	-6.6%
09/30/77	10/13/77	14	-3.2%	12.0%
10/31/77	11/09/77	10	0.7%	1.5%
11/30/77	12/09/77	10	-1.2%	3.2%
09/30/78	10/18/78	19	-2.0%	3.1%
09/30/79	10/12/79	13	-4.4%	24.7%
11/20/81	11/23/81	3	-0.1%	9.3%
09/30/82	10/02/82	3	1.3%	36.2%
12/17/82	12/21/82	5	0.8%	18.0%
11/10/83	11/14/83	4	1.3%	-0.4%
09/30/84	10/03/84	4	-2.2%	13.5%
10/03/84	10/05/84	3	0.1%	12.6%
10/16/86	10/18/86	3	-0.3%	18.4%
12/18/87	12/20/87	3	0.0%	11.9%
10/05/90	10/09/90	5	-2.1%	23.5%
11/13/95	11/19/95	7	1.3%	22.8%
12/15/95	01/06/96	21	0.1%	21.3%
10/01/13	10/17/13	17	2.3%	8.9%
01/20/18	01/22/18	3	0.8%	?
02/09/18	02/09/18	1	1.5%	?
12/21/18	?	?	7.4%*	?
Average (before current shutdown)			-0.4%	13.0%

Source: LPL Research, Bloomberg 01/10/19

*Data as of 01/10/19; the current government shutdown is ongoing.

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

2 U.S. ECONOMIC UNCERTAINTY SPIKES TO HIGHEST SINCE 2016 ELECTION



Source: LPL Research, Bloomberg, Baker Bloom Davis 01/11/19

*The Baker Bloom Davis U.S. Economic Policy Uncertainty Index is a measure of policy-rated uncertainty derived from three underlying components: newspaper coverage of policy-related economic uncertainty, the number of federal tax code provisions set to expire in future years, and disagreement among economic forecasters.

have an outsized impact on consumer health, as government workers pare back spending and other consumers feel the secondary impacts of lower demand and policy uncertainty. Consumer spending accounts for about 70% of GDP growth, so weakening consumer demand could significantly curb output.

DELAYED ECONOMIC DATA

Another consequence of the shutdown has been delayed economic data releases from government agencies. At this point, releases on durable goods, housing, trade, inventories, and the monthly budget statement have been pushed off because of agency closures. So far, none of the missed releases have been major (in our opinion), but fewer data points mean less context for market participants to gauge the health of the economy. If the shutdown persists, the fourth quarter GDP print, which is scheduled to be released January 30, is at risk of being delayed—since the Bureau of Economic Analysis is closed. This data drought comes at a crucial time for market guidance. Investors have scoured recent economic reports to gauge economic health as the economy slows, and while U.S. stocks have rebounded this month, they have largely taken direction from the data-dependent Federal Reserve (Fed). Without the usual slate of economic reports, the Fed has fewer data points to evaluate the U.S. economy, so a disconnect between monetary policy and the economy could emerge. This is a long-term and unlikely scenario, but it is certainly possible if the budget standoff drags on for too long. We think a policy mistake is unlikely, but the probability of this mistake could grow as the shutdown continues.

CONCLUSION

At this point, we see no signs of this shutdown materially affecting economic data, and we maintain our forecast of 2.5–2.75% in GDP growth for this year (as mentioned in our *Outlook 2019*). Still, the length of this shutdown is unprecedented, and confidence, which is still elevated but has been retreating, is especially fragile right now. Headlines we've seen out of Washington, D.C., suggest politicians may reach an agreement soon, though, especially with President Trump threatening to tap emergency funding. While we think there are reasonable prospects the government will reopen soon, we will continue to monitor economic data for any shutdown-related impacts. ■

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