Active is: Navigating the US government shutdown

How long will the US government stay open?

Mona Mahajan | 05/02/2019

Summary

On the heels of a temporary deal to fund the government until 15 February, a bipartisan committee is working towards a resolution on border security. Elevated uncertainty is likely until a final agreement is reached.

Key takeaways

- The S&P 500 Index returned 10.3% over the 35-day US government shutdown period – the best performance during a shutdown historically – but we will watch for any lingering negative impact on consumer and business confidence
- If the shutdown's impact on the US consumer is constrained, US economic growth remains near 2.5% and earnings growth stays near 4%-6%, we anticipate a positive, albeit modest, return environment in 2019
- Against a tense domestic political backdrop, President Trump may be more inclined to get a "win" in trade, as he can execute this more unilaterally

After a five-week partial shutdown of the US government – the longest in history – President Donald Trump recently agreed on a temporary deal to re-open the government until 15 February.

This three-week reprieve means furloughed employees will receive back pay, and US government agencies should return to full operations. If history is an indicator, US economic growth will likely rebound once the government is opened again, although we will wait to see how the shutdown will affect consumer confidence and small-business optimism.

Economic effect

According to the Congressional Budget Office, the total cost of the shutdown over the 35-day period was USD 11 billion, including lost productivity, delayed spending and private-sector loss of business. However, as the accompanying chart shows, economic growth has typically rebounded after previous shutdowns ended, as employees receive back pay and government spending fully resumes. The estimated permanent loss is therefore lower – at USD 3 billion, or about 0.2 percentage points of GDP.

S&P 500 Index returns during and after historical US government shutdowns

Begin date	End date	Number of days	Return during shutdown	Return 6 months after shutdown	Return 12 months after shutdown	President	Senate	House
21/11/1981	22/11/1981	2	0.0%	-5.6%	10.3%	Reagan (R)	Republican	Democrat
1/10/1982	1/10/1982	1	0.0%	25.4%	36.2%	Reagan (R)	Republican	Democrat
18/12/1982	20/12/1982	3	-0.9%	24.1%	18.9%	Reagan (R)	Republican	Democrat
1/10/1984	2/10/1984	2	-0.6%	10.8%	12.5%	Reagan (R)	Republican	Democrat
4/10/1984	4/10/1984	1	0.0%	9.9%	12.5%	Reagan (R)	Republican	Democrat
17/10/1986	17/10/1986	1	0.0%	20.1%	18.4%	Reagan (R)	Republican	Democrat
19/12/1987	19/12/1987	1	0.0%	8.6%	11.9%	Reagan (R)	Democrat	Democrat
6/10/1990	8/10/1990	3	0.6%	19.7%	21.4%	Bush (R)	Democrat	Democrat
14/11/1995	18/11/1995	5	1.8%	10.9%	22.8%	Clinton (D)	Republican	Republican
16/12/1995	5/1/1996	21	0.1%	8.0%	21.3%	Clinton (D)	Republican	Republican
1/10/2013	16/10/2013	16	1.6%	9.5%	8.2%	Obama (D)	Democrat	Republican
20/1/2018	22/1/2018	3	0.8%	-1.1%	-7.0%	Trump (R)	Republican	Republican
8/2/2018	9/2/2018	1	1.5%	8.9%	0.0%	Trump (R)	Republican	Republican
22/12/2018	25/1/2019	35	10.3%	-	-	Trump (R)	Republican	Rep/Dem (changed control)
Average		**6.79**	**0.4%**	**11.5%**	**14.4%**			

Source: Allianz Global Investors, Congressional Research Service. Data as at 25 January 2019.

We think the downside may ultimately be minimal if the government continues to function beyond 15 February. We could see GDP dip slightly below 2.0% in the first quarter and, depending on the lag effect of this rebound, we could see some positive spillover into the second quarter of this year, with GDP expected to be 2.4%. We will watch closely for any lingering negative impact on consumer and business confidence, which may have economic and market implications.

Beyond the wall

The 2019 political calendar is front-loaded with many key dates and events that will likely be affected in some way from the shutdown:

- *The Fed:* The Federal Reserve held its first 2019 meeting on 30 January. Each meeting will now be accompanied by a press conference with Fed Chair Jerome Powell. Notably, investors will keep listening for any commentary from the Fed on the impact of the shutdown (on both growth and employment).
- *China/US trade negotiations:* On 1 March, the 90-day “truce” in the US-China trade war is set to end. Despite recent comments from Secretary of Commerce Wilbur Ross on a deal being “miles and miles” apart, the pre-work for a final deal seems to be in motion. This includes a delegation from China visiting the US towards the end of January. Notably, President Trump was able to open the government ahead of this visit, which should help reduce political uncertainty in the US – particularly as the US and China continue negotiations on US soil.
- *A newly divided Congress:* If the divisiveness we have seen over the five-week shutdown is any indication, odds seem lower that a divided Congress will compromise on new legislation such as infrastructure or health care.

Political fallout and implications

We remain cautiously optimistic in our base case that the US government will remain open after 15 February, and that the government will not shut down again. We believe that if President Trump is not satisfied with proposals from the Congressional budget committees, he will take unilateral executive action to make amends, including either re-appropriating funding from the defense budget for funding for a wall, or declaring a national emergency to fund the wall.

More broadly, the bitter divide between Democrats and Republicans grew more pronounced during this five-week shutdown period. When the new Congress was sworn in on 3 January, there were increased hopes for potential bipartisan deals around infrastructure and drug pricing, but we think this kind of compromise is now incrementally less likely. Both parties continue to seem reluctant to give the other a "win" as the 2020 presidential elections come to the fore.

Against this domestic political backdrop, we think it's more likely that President Trump will be inclined to get a win in trade, since he can do this more unilaterally. An initial trade deal may be more focused on the US-China trade imbalance, while the more complex structural issues of intellectual property rights and technology-transfer practices may become part of later negotiations.

From an investor perspective, the urgency from the president and his administration to keep the US economy afloat and perhaps get a trade deal done – or at the very least not exacerbate the situation further – may provide a positive backdrop for risk assets. Depending on the ultimate economic effects of the shutdown – hopefully the impact on the US consumer will be constrained, US economic growth will remain near 2.5% and earnings growth will stay near 4%-6% – we anticipate a positive, albeit modest, return environment in 2019.

Further reading

To learn more about the history of US government shutdowns – and their economic impact – read Mona Mahajan's full report: "US government shutdown: deal or no deal in three weeks?"

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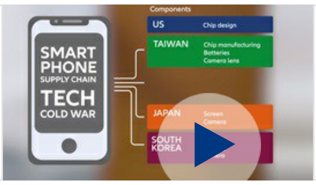

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Ms. Mahajan is the US investment strategist and a director with Allianz Global Investors, which she joined in 2017. As a member of the Global Economics and Strategy team, she is responsible for providing US retail and institutional clients with differentiated investment thought leadership. Ms. Mahajan is also a key spokesperson, communicating – both internally and externally – the firm's high-conviction investment ideas and views from the Global Policy Council. Ms. Mahajan was previously a fixed-income portfolio manager, a structured-finance product specialist and a global market strategist at MetLife. Prior to this, she was an emerging-market strategist at Mirae Asset Global Investments; she also worked at hedge fund companies Para Advisors and Ziff Brothers Investments. Ms. Mahajan has a B.S. in economics from The Wharton School, The University of Pennsylvania; a B.A.Sc. in computer sciences from the University of Pennsylvania; and an M.B.A. from Harvard Business School.

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Active is: Navigating geopolitics

What investors need to know as Brexit nears

07/02/2019

Summary

As the date of the UK's planned exit from the EU approaches, there's an increased probability the Prime Minister will win support for her Brexit deal. But a "no-deal" scenario cannot be ruled out – and it could have a heavy impact on the UK economy. Here's what investors need to know to navigate markets.

Key takeaways

- There's a strong probability that Prime Minister May will get some version of her Brexit deal through Parliament at the next vote, though she will need to make the "backstop" more palatable to her party
- A "no-deal" scenario is still possible, but headlines about the economic disruption from a Brexit crash-out may have further hardened minds against this outcome

- If Mrs May gains a parliamentary majority for her withdrawal agreement, we think sterling would would be positioned to appreciate, gilts would likely sell off and equities would rally after a brief initial drop
- Given that any new agreement would merely set the scene for long negotiations about the future UK-EU relationship, uncertainty will persist; investors must prepare for a wide range of scenarios

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