Another federal government shutdown is looming in the U.S. This is because Congress has still not passed a regular budget, and the temporary law that authorized the government to continue spending expires on Friday. Until then, Congress must overcome the considerable differences of opinion and pass a new short-term spending bill to avoid a government shutdown.

The clock is ticking

Because Congress was unable to agree on a budget for the new fiscal year, which began on October 1, and instead only adopted a short-term spending authorization (“continuing resolution”), US politics is once again under considerable pressure after just a few weeks. This is because the spending authorization for the US federal government expires at midnight on Friday. By then, Congress must have passed a new continuing resolution and President Biden must have signed it into law in order to avoid a government shutdown.

The bottleneck is once again in the House of Representatives. There, Speaker Johnson – a Republican who was recently appointed after much wrangling – can only rely on a narrow majority of 221:212 seats. In order to avoid another revolt of Republican representatives, he must present a bill that receives the necessary majority in the House by Republican votes alone. Johnson’s predecessor McCarthy was voted out of office after he pushed the current continuing resolution through parliament with the help of the Democrats. Johnson can therefore only allow himself a few dissenters.

In order to pass the US budget, 12 separate appropriation bills for the various areas of government must be approved by Congress. Johnson wants to extend some of them until January 19 and the rest until the beginning of February. Such short-term bridge financing is the rule rather than the exception in the US budget process; there have been 131 continuing resolutions in the last 25 years.

A lever for spending cuts?

Johnson is apparently aiming for a stop-gap measure on the basis of unchanged spending levels. The time thus gained should then be used for negotiations on longer-term issues. And here the Republicans will try to push through spending cuts, which is understandable given massive deficits of 6-7% of GDP.

The problem with these cuts, however, is that most of the spending is off-limits for political reasons. Congress will not tackle mandatory spending, i.e. primarily social security payments and spending on Medicare/Medicaid, in the run-up to the elections in November 2024. These make up around 60% of the budget (Chart 1). Interest (for
which the President’s draft budget currently estimates 11.5% of expenditure) is also excluded. This leaves the so-called discretionary expenditures, which is also the subject of the 12 budget laws. However, almost half of this is accounted for by defense spending, which the Republicans also do not want to cut. This leaves only 15% of the budget where cuts might be implemented. However, this expenditure block has already been slashed in recent years. Further significant cuts here are unlikely to be acceptable to the Democrats. Even if it is possible to gain more time for negotiations through a continuig resolution, it is not certain whether a budget can be passed at the beginning of 2024.

Chart 1 - Structure of US federal government outlays
Spending categories in $bn, President’s budget for fiscal 2024

Consequences of a shutdown
A failure of the negotiations this week would force the closure of government agencies. This would not affect the payment of social security pensions, for example, but no new applications could be processed. The continuation of essential government functions would also be guaranteed. Nevertheless, numerous government employees would be furloughed; the US federal government has around 3 million civilian employees. However, they would receive their pay in arrears after the end of the shutdown, which would limit the impact on the economy. The longest shutdown to date at the end of 2018/beginning of 2019 lasted 34 days (Chart 2).

The shutdown should not be confused with a default which is the issue when it comes to the debt ceiling. If the debt ceiling is reached, the government cannot meet all its obligations because it is not allowed to increase its debt, in which case all government spending would be affected.
Chart 2 - Half a century of shutdowns
Duration of shutdowns which lasted a minimum of one full day in days. Month denotes month with the first day of the respective shutdown episode.

Source: US House of Representatives, Commerzbank Research

Rating
A shutdown – as has already occurred 21 times since 1976 – would be negative for the economy in the short term, but probably not dramatic if it is short. The Congressional Research Service cites a study according to which a general shutdown dampens GDP growth by 0.2 percentage points per week in the affected quarter and increases it accordingly in the following quarter after the reopening.

From an economic perspective, it is perhaps more significant that a shutdown would once again demonstrate the dysfunctionality of US politics. In its most recent downgrade of the outlook for the US credit rating, the rating agency Moody’s pointed to the political polarization in Congress, which increases the risk that policymakers will not comprehensively address the declining long-term debt sustainability. Moody’s is thus threatening to withdraw the USA’s highest credit rating of Aaa. S&P and Fitch have already downgraded the USA.
In accordance with ESMA MAR requirements this report was completed 13/11/2023 11:31 CET and disseminated 13/11/2023 11:31 CET.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank’s non-US branch offices mentioned in the document.

Please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal view about the subject securities and issuers; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day’s closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together “Commerzbank”) and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: https://commerzbank.bluematrix.com/sellside/Disclosures.action

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.
Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document. Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addresses only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

**Germany:** Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

**United Kingdom:** This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

**United States:** To the extent this report is distributed to U.S. investors, it is restricted from being sent to U.S. retail investors. Commerz Markets LLC (“CMLLC”) is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. For securities purposes, Commerzbank AG provides this report as a third-party report, therefore the involved research analysts may not be registered with FINRA and the reports are not subject to the full provisions of FINRA Rule 2242. Any securities transactions by US investors resulting from this report must be effected with CMLLC. CMLLC is a member of FINRA and SIPC. Banking and swap services in the U.S. will be provided by Commerzbank AG in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. Commerzbank AG is not a member of SIPC and is a provisionally registered swap dealer with the CFTC.

**Canada:** The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

**European Economic Area:** Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

**Switzerland:** Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

**Singapore:** This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”) pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a “financial advisory service” within the meaning of the Financial Advisers Act, Chapter 110 of Singapore (“FAA”) and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

**Japan:** This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to “professional investors” as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

**Australia:** Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313.