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Macro Market Insights

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Showdown to Shutdown

What is going on in Washington is more of a political charade than real budget negotiations; albeit, it is a distraction from the real structural problems created from a two decade period of debt-fuelled surges in consumption. That being said, with financial markets taking a very immediate focus on the outlook of the US economy, investors are looking past this political uncertainty and for a deal to arise because they know, that inevitably, this will be resolved. That is why, despite equities only falling off marginally, the financial markets have underreacted to the developments of a government shutdown.

A lot of fear and focus is going into what will happen if the US were to actually default on its debt, but investors are seeing past this commentary because as of this point it is far too premature. The Obama Administration, through Jack Lew and the US Treasury, has done a good job fear mongering investors of the devastating effects of US default. It is also fair to say that the financial media has played a role in perpetrating this message. This, however, is only a bargaining chip at the Obama Administration's disposal to lead voters to associate blame for this whole debacle on the Republicans and their members in Congress. And while they very well might be able to play this game of politics with the general public, it is evident over the last week that investors are yet to react.

Equities markets slipped at the beginning of the week, which was prompted by the government shutdown. This reflects some 800,000 government employees that were furloughed or temporarily laid off because their respective government agencies are not in operations. IHS Global Insight, a consulting firm, estimates the cost to be 300 million dollars a week in lost productivity to the US economy. Other analysts calculate it to shaving a tenth of a percentage point off Q4 GDP growth for every week that the government is shutdown. Obviously, in the near term, that number is of little significance, but it could very well have an impact depending on how long this shutdown is sustained.

What this means, though, is that US economy will suffer in the fourth quarter because of the brutality of their government, and that is **the single greatest consequence** of this government shutdown. Any market reaction to a US default will be short lived, because at this point their Treasury will not default. The US Treasury sees annual revenues between 16 and 20 percent of GDP, and interest payments on their debt amount to about 2.5 percent of their GDP annually. In the extreme scenarios where Congress fails to implement measures to raise the debt ceiling, the Treasury, for a short period of time, would still be able to make interest payments to their creditors.

The problem with this debate goes beyond the logistics of whether or not the US will satisfy debt payments; moreover, it should be focused on how the biggest impediment to the US economic recovery has been the US Government. It is inevitable we are entering a transition of deleveraging as a result of how much debt has been incurred by the world's economic superpowers. And with that deleveraging means moderation and repression both individually and from the provisions of government. What it should not mean is halt to economic activity when governments lack the ability to show leadership and implement constructive policy.