Economic Research

Economic Briefing

Another US shutdown is looming

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If Congress does not reach an agreement, the US government will run out of money tomorrow. Many agencies that do not perform essential functions would then have to close. This would put some strain on the US economy as a whole, but is not likely to jeopardize the expansion.

Donald Trump blocks compromise…

A bipartisan compromise had actually already been found to extend the US federal government's funding, which was due to expire on Saturday, until March 2025. However, president elect Donald Trump, rejected the compromise, thereby expressing the widespread dissatisfaction of numerous Republican representatives with the agreement. In the end, the package also included some costly additional measures, for example in the area of health care, and comprised 1547 pages, which the members of Congress were supposed to approve at short notice. The rebellion against the compromise was further fueled by Elon Musk.

The Republican speaker of the House of Representatives, Johnson, then made a second attempt at an agreement. However, this slimmed-down version also included Trump's demand to suspend the debt ceiling for two years. But in doing so, he angered a number of fiscally conservative Republicans. Accordingly, this Plan B also failed, with 38 Republicans voting against it together with the Democrats. Currently, the Republicans have only a narrow majority of 219:211 in the House of Representatives; this will shrink further to 219:215 in January after the newly elected Congress convenes.

…because he wants the debt ceiling out of the way

In June 2023, the legislature suspended the debt limit for the federal government. It will come into force again on January 1, 2025, with the debt level reached at that time being the new ceiling. An increase in public debt will then only be possible if the debt limit is suspended again or increased by a certain amount. Currently, only about 70% of government spending is covered by tax revenues, with the rest being financed by bond issuance. Donald Trump's plans, in particular the promised tax cuts and the extension of the 2016 income tax cut, would further increase the deficit. The debt ceiling is therefore threatening to hinder his plans, which explains his call for a longer-term suspension of it.

Even if the debt ceiling is not suspended or raised by January 1, this would not immediately affect the US federal government, however. The deficits could be covered

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for a few more months by drawing on account balances and some creative accounting instead of incurring additional debt.

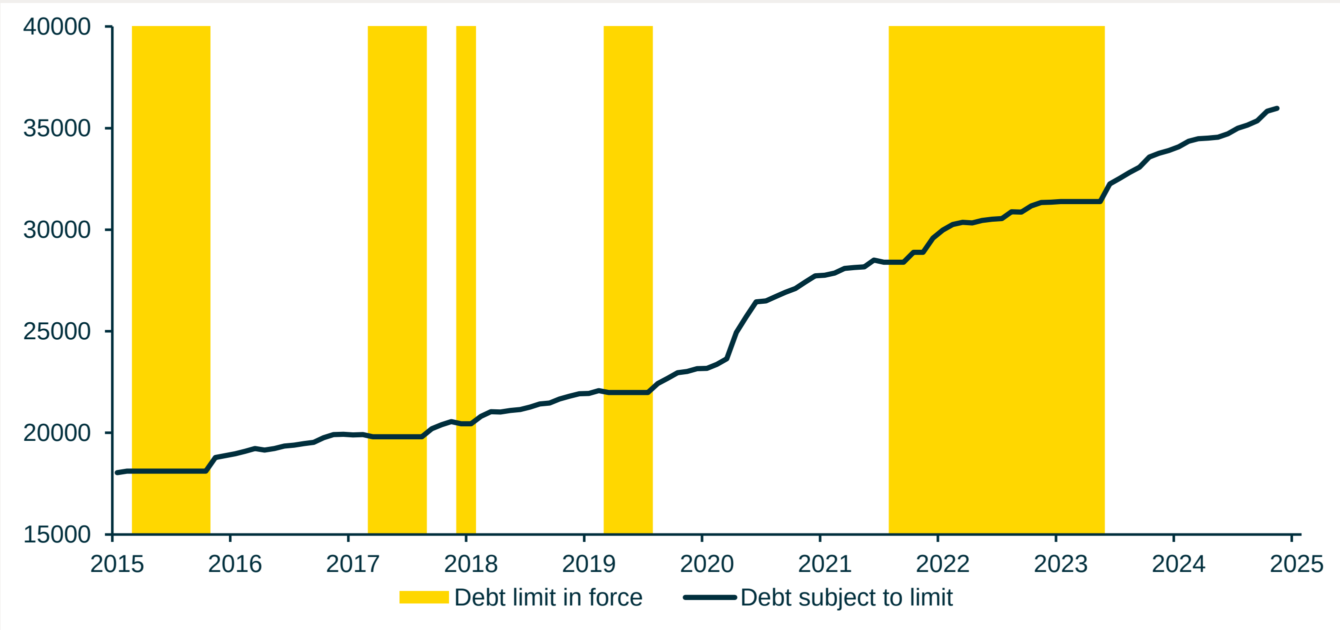
Box: the US debt limit

Congress sets a limit on the amount of debt that the US federal government can incur. This limit has had to be repeatedly increased over time because spending usually exceeds revenues.

Over the last ten years, the national debt has doubled, with the debt ceiling being suspended for about half of that time, particularly to allow the debt to rise sharply during and after the coronavirus pandemic (Chart 1).

At the end of November, the US federal government was in debt to the tune of almost $36 trillion, which corresponds to around 120% of GDP. One fifth of this debt is intra-governmental debt (mainly the Treasury's debt to Social Security). The US government owes $28.8 trillion (almost 98% of GDP) to the public – and the Fed is part of the public when it comes to debt statistics.

Chart 1 - US debt ceiling has been in force only half of the time
US federal government debt in billion dollars, monthly data



Source: US Treasury, Commerzbank Research

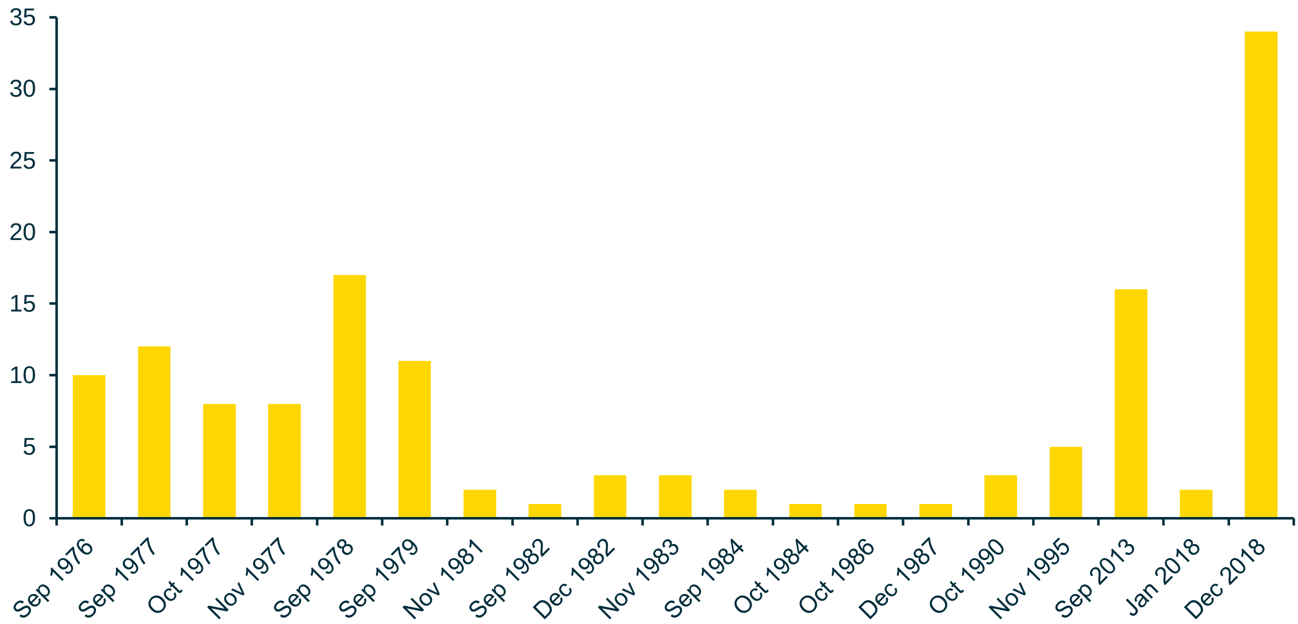
… and another shutdown is looming

The US fiscal year began on October 1 without Congress having agreed on a budget for fiscal 2025. However, delays in passing the budget are the norm rather than the exception. Since 1976, a regular budget has only been passed in time for the start of the fiscal year on four occasions, the last of which was for the 1997 fiscal year. Congress usually passes a short-term spending authorization for a limited period of time (a so-called “continuing resolution”). If no budget has been passed during this time, a new stopgap measure must then be passed. Congress is currently in this situation, because the Continuing Resolution passed at the end of September expires tonight. If Congress has not agreed on a new bridging finance by midnight today (and an agreement must be approved by the Senate, where the Democrats still have a narrow majority until the newly elected senators meet at the beginning of 2025), government agencies could be shut down.

There have been 21 such shutdowns since 1976. The last one – and so far the longest – lasted 34 days in January 2019 (Chart 1).

Chart 2 - 50 years of shutdowns

Shutdown of federal government agencies, length in days



Source: House of Representatives, Commerzbank Research

What happens during a shutdown?

Without legal authorization of expenditure, "non-essential" government operations are suspended and government employees are sent on unpaid forced leave. However, the personnel necessary for critical government tasks such as defense, police duties or other vital functions remain in post without pay. In addition to these "essential" tasks, expenditure required by law continues, such as social security payments.

Possible consequences of a shutdown are:

- Because ultimately only a small part of the administration and spending is affected, the direct impact on growth is likely to be small. For example, the Congressional Budget Office (CBO) **estimates** that the last shutdown at the turn of the year 2018/19 caused gross domestic product to fall by 0.2 percentage points in the first quarter of 2019. Most of this was made up for later, so the overall effect is negligible. At that time, around 800,000 of the 2.1 million federal employees were sent on forced leave. The impact is also so slight because the employees' salaries have always been paid subsequently.

- From the perspective of the financial markets, it is important that debt service would not be affected by a shutdown. Interest and principal payments would be honored on US Treasuries. This is an important distinction from not raising the debt ceiling, which would impose much greater strains on the economy and could lead to a formal default if government debt such as Treasuries were not serviced in a timely manner.

- Statistics agencies such as the Census Bureau (responsible for data such as new orders or housing starts) and the Bureau of Labor Statistics (labor market and price data) are affected by a shutdown. In the event of a prolonged shutdown, the timely publication of the December employment report due on January 10 could be delayed. The Fed, which publishes data on industrial production, is not directly affected by a shutdown, but it relies in part on data from other sources for its statistics. "Private" data such as the ISM purchasing managers' index are not affected.

- A shutdown would certainly not be good for consumer and business sentiment. However, experience shows that the main effect of a shutdown is political, not economic. And here it depends on who the Americans blame most for the closure of government agencies. However, if the shutdown continues, neither party is likely to emerge unscathed.

What happens next?

Next year, Republicans will hold a majority in both chambers of Congress. It is therefore up to them to raise the debt ceiling. In recent years, this has always been a political tightrope act, which the Republicans in particular had used to accuse the Democrats of unsound budgetary policy. The Republicans are now likely to turn the tables, which explains why Trump wants to see the issue resolved before he takes office. It is therefore unlikely that the Democrats will agree to a longer-term suspension of the debt ceiling.

It should be easier to reach an agreement on a continuing resolution for one or two weeks that is not tied to other political proposals. However, it is not clear whether this will be possible without a shutdown, at least for a short period.

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