First Trust Portfolios Canada®
Monday Morning OUTLOOK

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The Shutdown Showdown

Economic data are all over the place. GDP keeps growing in spite of signs of weakness in the labor market. Tariff policy is volatile, immigration has slowed, monetary policy tightened in 2023-24, with the M2 measure of money declining and "real" short-term interest rates consistently higher than at any time since 2010.

Yes, M2 grew 4.8% in the past year, but this is slower than the pre-COVID trend of about 6.0%. And by virtually any valuation metric (price to earnings, price to sales, and our capitalized profits model) the stock market is expensive. Yet, it keeps moving higher, with investors showing no sign of worrying about anything.

Interestingly, even with a government shutdown looming, markets don't seem to be worried at all in spite of talking heads and analysts warning this could cause a recession.

But there is no evidence of a link between shutdowns and recessions. In the past thirty years the government has been shut for a grand total of 80 days. Do you know how much of those 80 days we were in recession? Zero. Zilcho. Nada.

In other words, the US economy has been less likely to be in recession when the government has been shut than when it's open. In fact, the closest a recession followed these shutdowns was fourteen months after the 2018-19 shutdown, and that recession was due to COVID.

None of this is to say that a recession couldn't possibly follow on the heels of a government shutdown; it could happen. But if we get a recession, it's going to be due to other factors like tighter money and volatile tariffs, not the shutdown.

Nor is a shutdown going to lead to some sort of emergency. The Treasury Department would still receive revenue and entitlement payments would still go out for Social Security, Medicare, and Medicaid. Treasury bondholders would get paid in full, both principal and interest. The military, border control, weather service, FAA, and the Post Office, among other operations, would still continue.

What would make this shutdown different is the posture of the Trump Administration. Normally, "essential" federal employees continue to work and "non-essential" employees stay home. When the shutdown ends, everyone gets back pay.

But this time the president is playing hardball. The Administration is telling agencies and departments to make lists of non-essential workers who can be *permanently* let go, which means that after the shutdown, many of these workers would have no job to go back to. Democrats are being forced to make a choice between a reduction in government workers and using the budget battles and potential shutdown to boost spending.

In other words, we may be approaching a watershed moment for the direction of federal spending, or at least the portion of spending subject to annual appropriations.

Government jobs have already declined, the Supreme Court just backed cuts to foreign aid and the looming shutdown battle seems poised to continue this process. The US government has been way too big for way too long, reducing freedom and stifling long term economic growth.

We see reason for optimism here. Shrinking the government boosts our long-term growth potential. That's exceedingly good…but it also seems clear that markets have priced in lots of good news. Stocks are priced for perfection and while we always hope things turn out perfectly, they would have to turn out better than perfect to keep the market moving.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-30 / 8:45 am	Chicago PMI – Sep	43.5	**44.1**		41.5
10-1 / 9:00 am	ISM Index – Sep	49.0	**48.9**		48.7
9:00 am	Construction Spending – Aug	-0.1%	**-0.5%**		-0.1%
afternoon	Total Car/Truck Sales – Sep	16.2 Mil	**16.2 Mil**		16.1 Mil
afternoon	Domestic Car/Truck Sales – Sep	12.6 Mil	**12.7 Mil**		12.6 Mil
10-2 / 7:30 am	Initial Claims – Sep 27	225K	**236K**		218K
9:00 am	Factory Orders – Aug	+1.4%	**+1.2%**		-1.3%
10-3 / 7:30 am	Non-Farm Payrolls – Sep	50K	**90K**		22K
7:30 am	Private Payrolls – Sep	62K	**100K**		38K
7:30 am	Manufacturing Payrolls – Sep	-8K	**-7K**		-12K
7:30 am	Unemployment Rate – Sep	4.3%	**4.3%**		4.3%
7:30 am	Average Hourly Earnings – Sep	+0.3%	**+0.3%**		+0.3%
7:30 am	Average Weekly Hours – Sep	34.2	**34.2**		34.2
9:00 am	ISM Non Mfg Index – Sep	51.8	**51.9**		52.0