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Institute Alert

FIRST ANALYSIS

News or events that may affect your investments **March 4, 2024**

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Government shutdown averted: The road ahead

Key takeaways

- Congress averted a two-part government shutdown by extending two stopgap funding measures to March 8 and 22, and by agreeing to fund 27% of discretionary spending through the end of fiscal 2024 (September 30).
- Signs of progress toward agreement by March 22 on all 12 appropriations bills comprising the fiscal-year 2024 budget is raising hopes that 1% across-the-board cuts in discretionary spending from fiscal 2023 levels can be avoided ahead of an April 30 deadline for a full budget agreement.

What it may mean for investors

- We prefer to see the budget negotiations, with its various 11th-hour deals, as a series of temporary and limited disruptions to the economy, and we reiterate our more defensive portfolio guidance aligning with our outlook for a mild economic slowdown in coming months.

Lawmakers have averted a government shutdown since the October 1 start of the fiscal year by effectively "kicking the can down the road" through a series of continuing resolutions — temporary, stopgap funding measures — to keep the government open. Congress again managed to pull a rabbit out of the hat in the latest round of fiscal 2024 negotiations with an 11th-hour compromise that extends stopgap funding on most discretionary spending and by taking an important step toward more conclusively resolving this year's marathon budget debate.

Breakthroughs emerged this week on several fronts:

- **Extending stop-gap funding of discretionary spending.** Under the latest agreement, stop-gap funding for some of the four appropriations bills expiring at midnight on March 1 would be extended to March 8, while temporary funding measures for much of the rest would be extended to March 22. This legislation dodges a partial government shutdown on March 1 and a full shutdown by March 8.

- **Permanent fiscal 2024 funding.** A longer-term agreement to fund parts of the government through the end of the current fiscal year (September 30) was included in the package. The longer-term agreement includes funding for departments accounting for 27% of federal agency spending.

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- **Avoiding 1% across-the-board spending cuts after April 30.** Although this latest legislation postpones yet again the task of completing a 2024 budget, the bill approves funding for six of the 12 annual appropriations bills.[1] The February 29 compromise cuts down the remaining work to make more plausible a final budget package by March 22. Most importantly, having a budget in place before April 30 allows Congress to avoid an automatic 1% cut to discretionary spending. [2]

Walking a tightrope and juggling priorities

Negotiations were complicated last month by a two-week congressional recess (ending on February 28 for the House) that further compressed an already tight work schedule. Lawmakers also have been distracted by other time-sensitive issues, including pressure to pass foreign-aid assistance for Ukraine and Israel, along with bipartisan tax cut legislation, which includes support for low-income households and small businesses. Furthermore, House Speaker Mike Johnson is facing waning support amid strong divisions between Republicans and Democrats and within his own party. Negotiations over foreign assistance and border security have been difficult enough, taken separately, but have been even tougher to conclude taken together. Adding to gridlock has been a narrowing House GOP majority in the wake of a Democratic win in a special New York election.[3]

What hangs in the balance?

The added wrinkle in the current and coming round of negotiations is the greater, potential impact on economic growth of the 1% sequestration deadline on April 30. The cuts are pursuant to a provision in the June 2023 Fiscal Responsibility Act of 2023, which lifted the debt ceiling. Estimates put the dollar amount of sequestration at about $51 billion, which would shave nearly 0.2% from economic growth.[4] Although a small figure at first glance, our view is that sequestration adds a headwind to an economy that is already gradually slowing.

What it may mean for investors

In our view, a government shutdown now seems less likely but, even if it were to occur, would have only a limited impact on U.S. economic growth this year. We, therefore, prefer to look through any near-term, temporary funding disruptions and stay focused on the longer term.

Importantly for holders of government debt, a shutdown should not affect the Treasury's ability to pay interest and principal on time. In the near term, however, we do expect a further risk of market volatility as the April 30 government funding deadline approaches and, perhaps, collides with the heart of this year's presidential election campaign. In our view, inflation readings over the next few months likely will matter more for the economy than the budget debate in determining the timing and magnitude of Federal Reserve (Fed) interest rate cuts. The good news, for now, is that market expectations for rate cuts are aligning with Fed projections without a sustained pullback in the stock and bond markets.

We favor staying focused on our more defensive strategy toward stocks and bonds, based on our expectation for a slowing economy and still-sticky inflation. This outlook is what drives our guidance to focus on quality and liquidity in portfolios. Volatility tied to disturbances from the threat of a government shutdown or sequestration would not change our focus on the economy's more enduring strengths and weaknesses.

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1. Specifically, the February 29 bill approves funding for the Agriculture Department and Food and Drug Administration; the Commerce and Justice Departments; Science, Energy and Water development; the Interior Department: Military Construction and the Department of Veterans Affairs; and the Transportation Department and Housing and Urban Development.
2. Wells Fargo Investment Institute, "Institute Alert: Round three in the fiscal 2024 budget debate," January 4, 2024.
3. Bloomberg, "Shutdown Countdown Starts Again as Speaker Johnson's Grip Slips," February 26, 2024.
4. Congressional Budget Office (CBO), "Implementing the Statutory Limits on Discretionary Funding for Fiscal Year 2024," January 4, 2024.

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