Mizuho Brief: US

Economics & Strategy | Asia ex-Japan

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US Shutdown: Risk that Blows Over, Not Up?

- Markets Sanguine: At least markets appear to believe so, given the sanguine reactions - **USD** and **UST yields mostly steady** while **equities** have **maintained traction**.
- With Good Reasons: And to be fair, there are good reasons why concerns about the shutdown are not overblown.

1. Fleeting & Shallow: For one, **most episodes** in the past have **faded quickly** - *mostly within days,* even though in December 2018 it lasted over a month (35 days) - and **with little lasting damage** from the temporary disruptions.
2. Reinstatement & Restitution: What's more, **jobs temporarily furloughed** due to suspension of non-essential government services have typically been **reinstated** and with **full restitution of wages** forgone.
3. Spending Interrupted, Not Funding Impacted: Crucially, the shutdown is a **procedural interruption to government spending** due to spending bills blocked and **not a cashflow crisis** from going broke (subject to a debt ceiling cliff* or worse a loss of confidence). In other words, it is a **temporary spending constraint, not a tumultuous funding crisis**.

- Unfussed, Underwritten & Unimpaired: It appears then that **US assets are by and large spared**.

- Especially as markets are (1) *not fussed about a prolonged shutdown.*
- Furthermore, (2) *demand appears to be underwritten* by implied guarantees of job restoration/age restitution, that safeguard cashflow/wage expectations from negative shocks.
- And ***critically**,* (3) *risk* (credit, macro and market) *sentiments are unimpaired,* **averting adverse risk re-pricing**, (involving default or degradation).

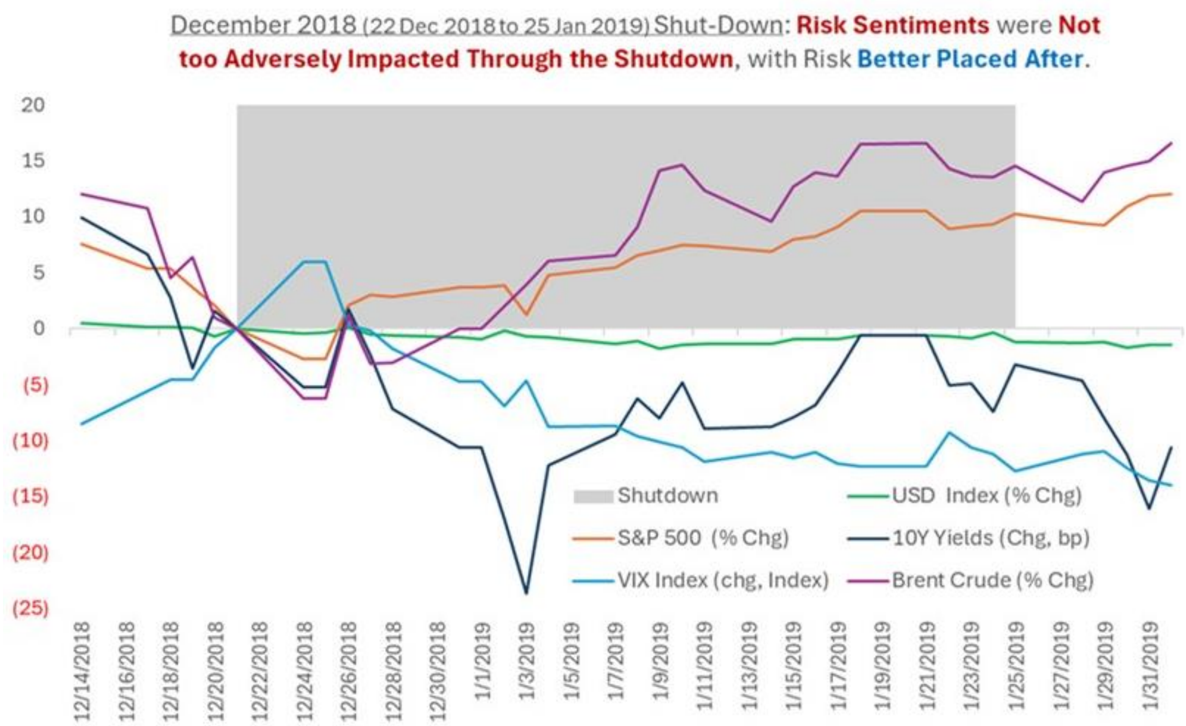
- Dec 2018 – US Assets Backstopped, if not Buoyed: In fact, in the most recent shutdown in December 2018 (the longest at 35 days), risk appeared supported after initial wobbles [See Charts];

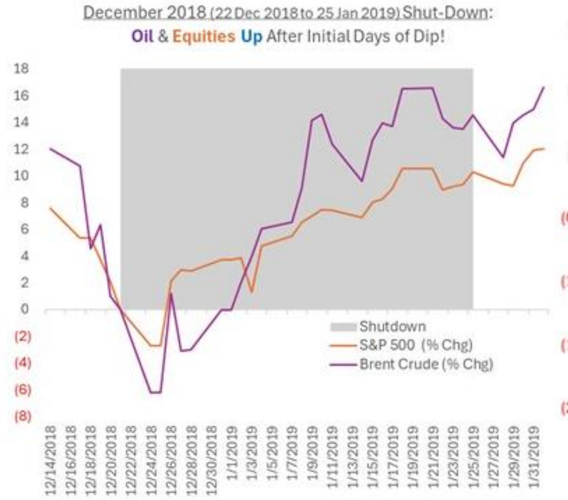
- Equities (S&P500) rose alongside softening VIX *affirming unimpaired risk appetite;*
- Oil picked up in a sustained manner (ostensibly reflecting *demand fears quelled*) and;
- 10Y UST yields softened. Arguably more due to *default/credit risks dismissed* rather than haven demand per se.

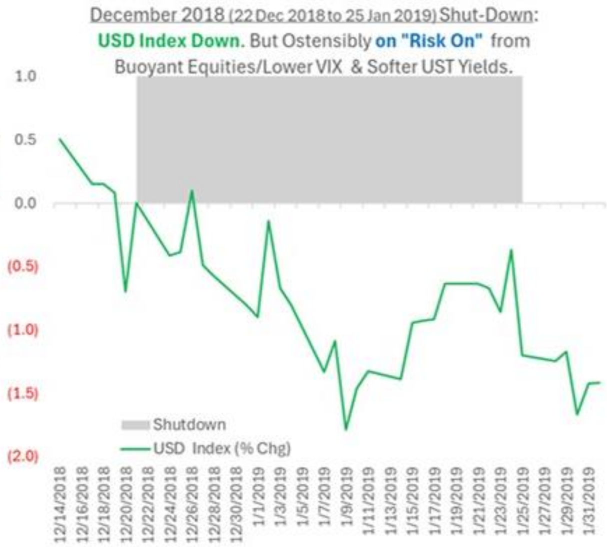
- Dec 2018 – Softer USD From "Risk On" Not "Sell America": Admittedly, back then, USD pulled back by 1-2%. But from "risk on" dynamics, not credit-/default-related "Sell America" fears.

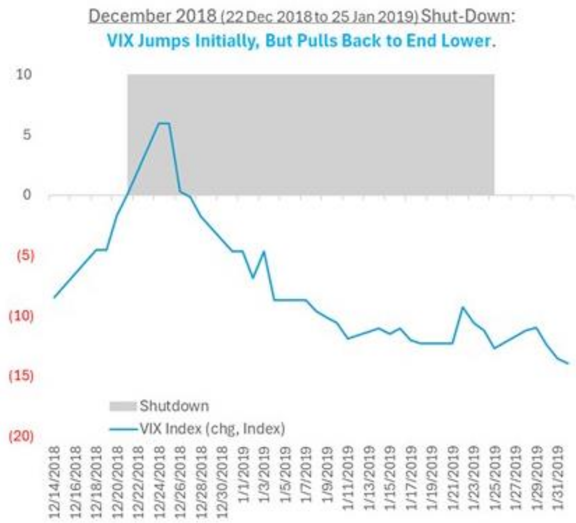
- (Rear-View) Consolation: But **consolation from past episodes** is no reason for complacency given more acute risks involved.
- … Not Conviction: Especially with political antagonism exacerbated by "Doge 2.0" risks, **conviction about a sanguine episode may be compromised**.
- Standoff & Brinksmanship: With **political stakes raised by blame-shifting**, the envelope may be pushed on brinksmanship, *prolonging pain.*
- Furlough vs. Layoff Risks: More worryingly, *if* whispers about Trump using the **shutdown as an excuse to cut federal jobs** (permanently) prove to be true, **adverse demand impact may follow**.
- Fed View Obscured: For now, the **Fed's assessment of underlying economic balance of risks is obscured** by data suspensions and unseasonal disruptions (from the shutdown).
- Dovish Bias: Our sense is that the **case for insurance** (or in Powell's language, **"risk management"**) **easing grows**. And this could correspond to more downside in yields.
- Mixed USD(?): But corresponding USD pullback may be offset by wobbles on wider political risks/uncertainty.

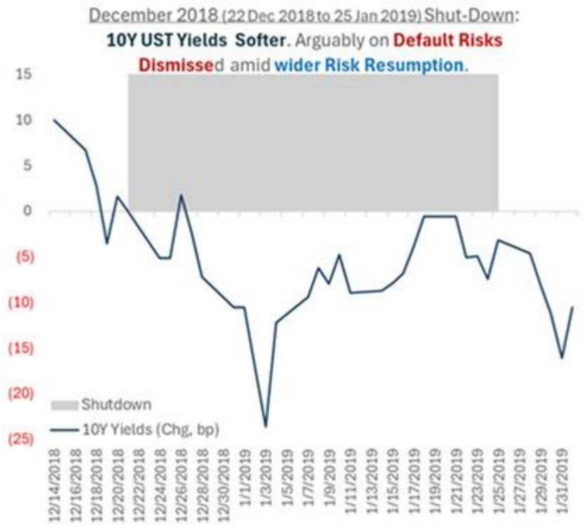
* Arguably, markets have grown de-sensitized to debt ceiling cliffs as these have been routinely averted (with the debt ceiling raised)




December 2018 (22 Dec 2018 to 25 Jan 2019) Shut-Down:
Oil & Equities Up After Initial Days of Dip!
Shutdown
S&P 500 (% Chg)
Brent Crude (% Chg)


December 2018 (22 Dec 2018 to 25 Jan 2019) Shut-Down:
USD Index Down. But Ostensibly on "Risk On" from
Buoyant Equities/Lower VIX & Softer UST Yields.
Shutdown
USD Index (% Chg)


December 2018 (22 Dec 2018 to 25 Jan 2019) Shut-Down:
VIX Jumps Initially, But Pulls Back to End Lower.
Shutdown
VIX Index (chg, Index)


December 2018 (22 Dec 2018 to 25 Jan 2019) Shut-Down:
10Y UST Yields Softer. Arguably on Default Risks
Dismissed amid wider Risk Resumption.
Shutdown
10Y Yields (Chg, bp)

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