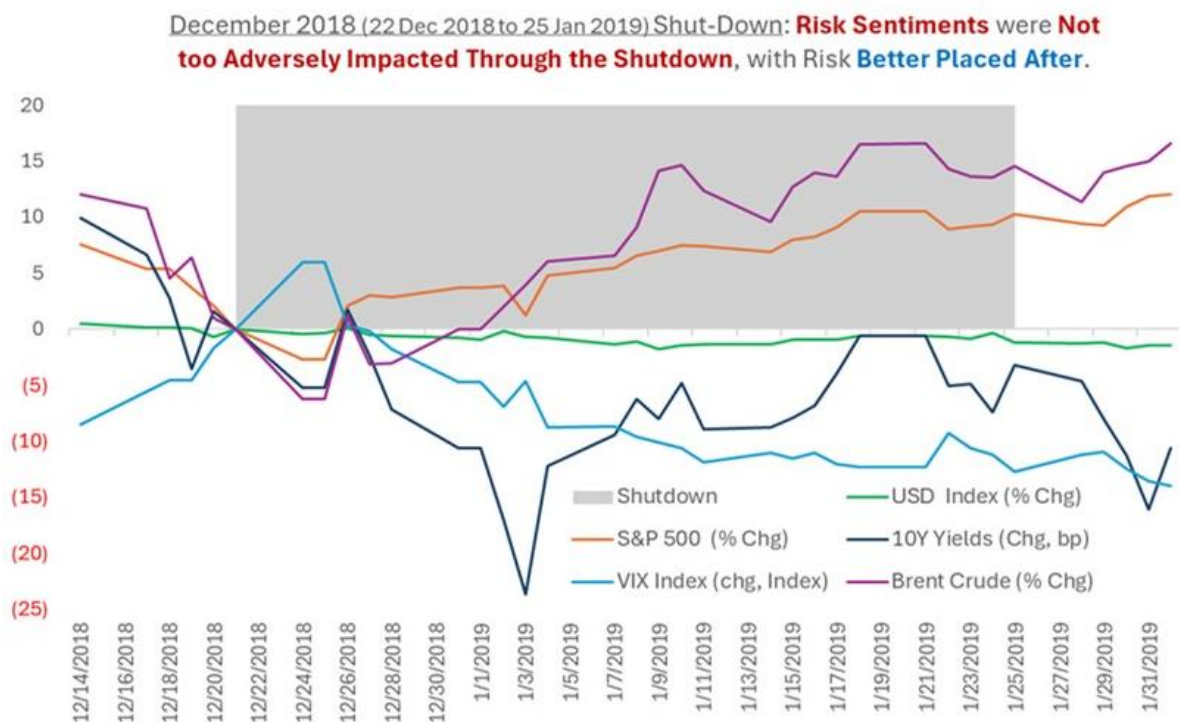


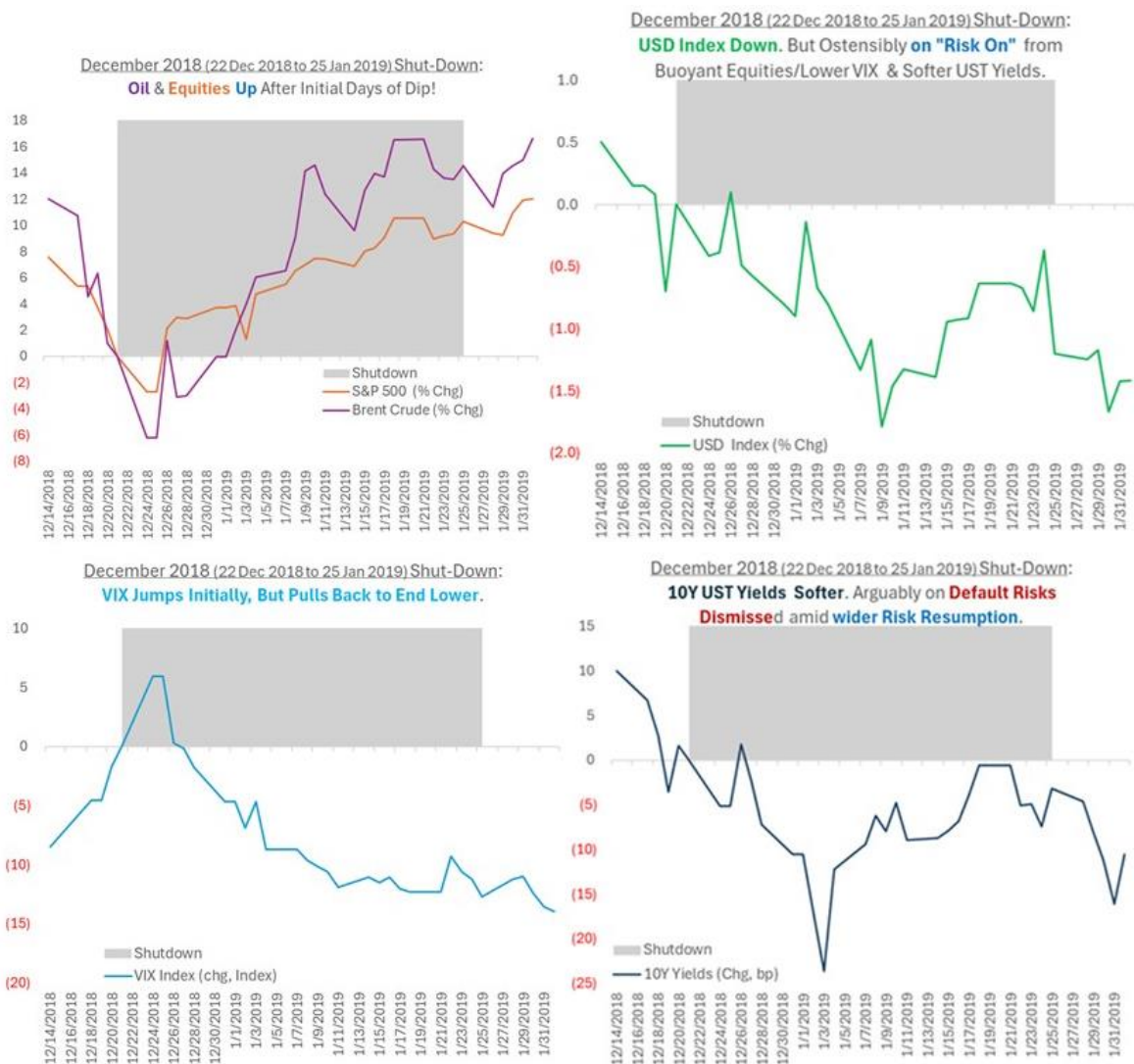
US Shutdown: Risk that Blows Over, Not Up?

- 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)





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