

The Washington brief

from the Investment Advisory Group

Fall Preview: Funding concerns take center stage (again)

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Executive summary

- As Congress returns from its August recess, government funding concerns remain paramount. Congress has limited legislative days left before the September 30th fiscal year end to pass the 12 appropriations bills required to avoid a government shutdown.
- Due to the difficulty of passing all 12 appropriations bills by September 30th, Congress could utilize a Continuing Resolution (CR) to fund government operations through late November or early December allowing more time to hash out permanent funding.
- Given the current contentious political environment, passing a CR through the House and Senate in September could prove to be difficult, therefore we expect a short government shutdown in early October.
- Additionally, we believe the odds are high that widespread disagreement between House Republicans and the Senate Democrats/Biden Administration over funding will prevent Congress from passing all 12 appropriations bills by calendar year-end.
- Failure to pass all these appropriations bills would trigger automatic across-the-board spending cuts for FY'24. This was outlined in the Fiscal Responsibility Act, passed earlier this year. This act is used to address the debt ceiling.

Our take

The inevitabilities of fall are upon us – kids are back in school, football games have started, and a fight in Washington over funding the government is about to start. **When it returns from the August recess, Congress must pass the appropriations bills required to keep the government in operation before the fiscal year ends on September 30th.** Very little progress has made so far: the House has passed just 1 of 12 bills, while the Senate has passed none. There are a total of 11 legislative days in September for Congress to complete this task.

In addition to the abbreviated timeline, the usually politically charged environment in Washington has become utterly chaotic. Former President Trump is under multiple indictments and President Biden's son is under investigation, meaning added scrutiny and the looming potential that the President himself will become the target of impeachment proceedings. Furthermore, the GOP Presidential nomination process is in full swing, the Ukraine war is still raging, the national credit rating has been put on watch, with narrow majorities in Congress.

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With these difficult circumstances, Congressional leaders of both parties have indicated they need more time. House Speaker McCarthy (Republican) and Senate Majority Leader Schumer (Democrat) desire passing a continuing resolution. This would likely fund the government at current levels through late November or early December. Complicating matters, leaders of the Republican House Freedom Caucus have stated they will not support a clean CR without addressing three distinct issues. These items are border security, reforms at the Department of Justice (DOJ), and the elimination of “woke” policies at the Department of Defense. **That sets up a two-step funding fight that could last the rest of this calendar year with the first step involving clearing the CR and the second to get the final funding bills passed.**

The first fight has already begun even though Congress is not in session. Despite Speaker McCarthy’s desire to move a CR, he will likely first attempt to use only Republican votes, which would require satisfying the Freedom Caucus items. It remains to be seen whether there is a package of reforms that do enough for the Freedom Caucus that could also pass the Senate. For instance, it’s highly unlikely these DOJ and Department of Defense reforms would have enough votes in the Senate without scaling them back considerably from the original House proposal, thus losing the Freedom Caucus votes in the House. **Therefore, it is very likely that the back and forth of getting a CR through the House and Senate will take more than the available time. With discussions potentially extending past the September 30th deadline, we expect a short government shutdown in early October.** At some point thereafter, we anticipate the passage of a continuing resolution, funding the government through early December.

Then the real fight – which may not have a solution – will begin. Even with more time, the distance between House Republicans and Senate Democrats/Biden Administration on spending levels and policy priorities may not be bridged. For example, not only are there differences over border security funding levels, there is also complete disagreement on how these funds should be spent. The current distance seems to be so great that it could take elections rather than negotiations to ultimately address what policy choices are made. Ultimately, if legislation is not approved by the end of the calendar year, the recently passed debt ceiling agreement effectively steps in and overrides the stalemate. **Recall the previously passed *Fiscal Responsibility Act* includes a provision that extends funding into next year but automatically imposes spending cuts across all government programs for fiscal year ’24, which begins on October 1st.**

Bottom line

The government funding fight is setting up for a very bumpy ride for the next few months. Headlines around a government shutdown tend to add to short-term market volatility. However, the historical evidence suggests a minimal impact on long-term economic growth or the direction of the market.

We believe the most likely scenario is a hard-fought process for a CR, with a brief government shutdown in early October. In turn, we believe this means a larger year-end fight and an inability to pass all 12 spending bills by the calendar year-end deadline. Such a scenario would lead to automatic across-the-board cuts for fiscal year ’24. Disagreement remains on whether the automatic spending cuts will incentivize moderate lawmakers to strike a bipartisan deal, or whether such cuts are “red meat” for Freedom Caucus Republicans who want to reduce spending.

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