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Special Coverage:
US government shutdown could raise volatility

Key takeaways

- The US government began its shutdown on 1 October as Congress failed to reach a funding agreement before midnight of 30 September. The last shutdown took place in 2018.
- While essential services like the military, border security, Social Security checks, and air traffic control would keep operating, non-essential services would pause, and many agencies would furlough staff, and key government reports like jobs and inflation data could be delayed. The economy would feel the impact as each week of shutdown could reduce quarterly GDP by about 0.1-0.2%.

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- The politics and uncertainty surrounding a government shutdown has typically created volatility and usually result in equity markets recalibrating. However, this potential short-term weakness is usually overcome by the longer-term fundamentals, which remain positive for the US market. For fixed income investors, uncertainty can cause some short-term volatility but often also adds to the safety appeal of US Treasuries. In addition, the shutdown does not change our view that the Fed will cut rates in October and December, which should support bonds. The US dollar could see some weakness in the short term, but it may easily reverse should the conflicts resolve.

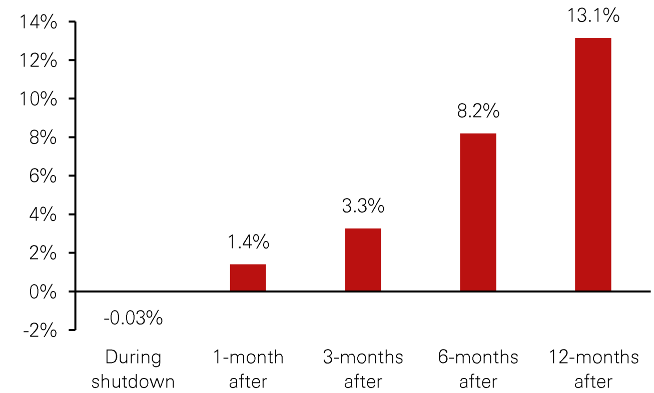
What happened?

- The US government relies on annual appropriations ("funding bills") passed by Congress to operate. The new fiscal year began on 1 October, but the funding was not approved before the current federal funding expired at 11:59pm on 30 September. The Senate’s 60-vote threshold requirement did not pass. As a result, many federal programmes do not have legal authority to spend money.
- The White House budget office (OMB) had already instructed agencies to prepare reduction-in-force (mass firing) plans, which went beyond the usual furlough playbook. The federal judiciary previously said it can only sustain paid operations until 3 October, potentially stretching to 17 October, after which many staff would be furloughed.
- Congress disagreed on healthcare provisions: Democrats wanted Affordable Care Act (ACA) premium subsidies and Medicaid funding extensions included, while Republicans were pushing for a “clean” continuing resolution (CR) without those items.
- During a shutdown, essential or mandatory services will continue to function because they are tied to public safety, national security, or mandatory funding. Active-duty military, border patrol, FBI, and federal prison guards keep working, though sometimes without pay until funding resumes.
- Air traffic controllers and TSA agents stay on their jobs. Delays may happen because training and support staff may be furloughed. For healthcare and emergencies, VA hospitals, Medicare, and Medicaid also keep operating since they are funded outside the annual appropriations. Payments for Social Security & benefits checks will continue, but customer service, such as new applications or helpline support may be slower.

- “Non-essential” federal employees might be placed on unpaid furlough (temporary leave), while “Essential” employees (military, border security, etc) must work without pay until funding resumes. Paychecks would be delayed but back pay is usually guaranteed once a deal is struck.
- Unlike federal employees, many government contractors will not get back pay, so there could be a permanent loss of income and company revenue. Shutdown of national parks, museums, and monuments would hit local hotels, restaurants, and tour operators.
- Government spending is a direct chunk of GDP, so furloughs and paused contracts will be a drag on growth. The Congressional Budget Office (CBO) estimates that the full shutdown will reduce quarterly GDP by about 0.1-0.2% per week. Agencies like the Commerce Department and Bureau of Labour Statistics would suspend economic reports (jobs, inflation, GDP), which could increase short-term market volatility.
- Short shutdown (could last several days to a week): More of a political headache than an economic problems. Medium shutdown (2-3 weeks): Noticeable hit to GDP, rising uncertainty in markets, and stress on workers and contractors. Long shutdown: (1+ month): Cumulative drag on the economy, potential downgrade in US credit outlook, and rising pressure on Congress.

On average, US markets tend to overlook government shutdowns and see strong performance in the months that follow

Average S&P 500 performance: 1976 – Today



Source: Bloomberg, HSBC Private Bank and Premier Wealth as of 26 September 2025. Past performance is not a reliable indicator of future performance.

Investment implications

- On average, in the past shutdowns, the S&P 500 has dipped very slightly, but then tends to recover and strengthen quickly after the shutdown is over.
- For equity investors, the politics and uncertainty surrounding a government shutdown has typically created volatility and usually result in equity markets recalibrating. This potential short-term weakness is usually overcome by the longer-term fundamentals, which remain positive for the US market.
- Treasury yields can swing because of the political uncertainty, especially if a shutdown coincides with debt ceiling fights. Short-term bills maturing around key dates may see higher yields, reflecting risk of payments being delayed. For fixed income investors, this uncertainty could raise risk premia in the short term, but the uncertainty also increases the safe haven appeal of Treasury bonds. Historically, the periods before and after government shutdowns result in a temporary increase in volatility for fixed income markets. But the Fed should remain on its easing path, and we expect the expected rate cuts in October and December to provide support for quality bonds.
- Implications for the US dollar are mixed. In the short term, there could be some USD weakness, but given that the conflicts in Congress are usually resolved, it could easily reverse in short order.

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