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Potomac Perspective

The shutdown grinds on, but markets continue to ignore the headlines. The economic impact remains limited and mostly temporary. The lack of urgency or pressure to reopen the government suggests that the stalemate could last at least another week. Expansion of deposit insurance received a public boost this week as the Treasury Secretary urged the Senate to consider the legislation. Lastly, the Senate passed its version of National Defense Authorization Act (NDAA). The bill included an amendment on American investments in China and rejected a provision that could have limited the Federal Reserve's monetary policy tools.

- Shutdown Grinds On – The government shutdown will continue into a third week as the Senate again failed to approve a continuing resolution to fund the government. As expected, markets have mostly ignored the political noise, and we think investors will continue to do so.
    - We should point out that the economic impact of the shutdown will increase as it drags on. The Senate will not return to Washington until Tuesday, which means that all federal workers will have missed their most recent paychecks by then.
    - There are two primary reasons why the shutdown has lasted this long and is likely to continue well into this week. First, there seems to be a lack of urgency among voters. They have yet to feel much pain from the shutdown, so they are not exerting significant pressure on their elected representatives. Second, the bases of both political parties think they are winning the standoff. There is little, if any, panic among partisans. As long as lawmakers think the shutdown is playing well among their supporters, there is little incentive to capitulate and cut a deal with the other side.
    - Threats from the administration to cut off funds for infrastructure projects, or fire government workers, or that government workers might not automatically receive back pay seem to have backfired. The theory was that these threats would influence lawmakers who represent large groups of government employees in states such as Maryland and Virginia, for example. The opposite effect seems to have occurred, stiffening the resistance of Democratic lawmakers who represent these states.
    - All of this may change once government workers and contractors are not paid on schedule, but for now, there seems to be a lack of pressure or urgency to reopen the government.
- National Defense Authorization Act – The Senate passed its version of the NDAA. Two amendments to the legislation, one that passed and the other that failed, are worth noting.
    - **China outbound investments** – The Senate adopted an amendment to the NDAA that could strengthen the review of American investments in China. The Trump administration had previously resisted this legislation as it preferred to act administratively. If negotiations with the House result in this legislation being included in the final version of the NDAA, it could further complicate efforts of American firms to do business in China, especially in high-tech sectors that have national security implications.

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- **Interest on excess reserves** – The Senate rejected, 14-83, an amendment to prohibit the Federal Reserve from paying interest on excess reserves. The Fed and the banking industry had opposed the amendment, and the lopsided vote suggests that even if the issue reemerges in the future, it has only limited support in Congress.

- Deposit Insurance – A proposal to expand deposit insurance coverage got a boost this week when Treasury Secretary Scott Bessent spoke on Thursday at a Federal Reserve conference on community banking. Without endorsing a specific proposal, Secretary Bessent said that he wants to see action on expanding FDIC coverage of noninterest bearing transactional accounts without endorsing a specific approach. The Treasury's public support for this issue does not guarantee success but breathes new life into the issue.
  - Senator Bill Haggerty (R-Tennessee) released an updated proposal to backstop transactional accounts up to $10 million and would be phased in over 10 years. The Treasury's support of this concept increases the chances that the Senate Banking Committee will move forward on the issue later this year or in early 2026.

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