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## WASHINGTON POLICY STRATEGY

# Potomac Perspective

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**While a government shutdown is not expected to impact financial markets, it could still have ramifications including delaying the release of economic data which could affect the Federal Open Market Committee (FOMC)'s next meeting if the shutdown lasts long enough. We give a brief overview of what activities might (or might not) be impacted. Also, senators reached an agreement on a cannabis banking bill but hurdles remain.**

### POSSIBLE SHUTDOWN IMPLICATIONS

With nine days to go before the end of the federal government's fiscal year, **an agreement to avoid or delay a government shutdown seems unlikely (not impossible, but unlikely). Despite headlines regarding the potential political and economic fallout from a shutdown, we continue to expect that it would have little if any impact on financial markets, but some government functions would temporarily cease.** The Biden administration has not yet released contingency plans, but past shutdowns provide a good idea of what to expect. Here is a brief overview of what investors and company managements can expect.

**Essential services continue.** For example, the military will continue to safeguard the nation, and Treasury auctions will proceed as scheduled. Air traffic controllers will not be paid, but they will continue to work, so commercial flights should continue as normal. During a 34-day shutdown that started in December 2018 and ended in January 2019, air traffic controllers threatened to stop work only in the final days of that shutdown and, according to CNN, only 10 workers failed to show up in the days before the government reopened.

**Non-essential services will be disrupted.** For example, passport and visa applications will not be processed while the government is shut down. Also, economic reports are deemed non-essential, so there will be no employment reports, inflation data, or other economic reports issued until the government reopens. *The lack of economic data could potentially complicate the Federal Reserve's job when the FOMC next meets on November 1.*

In past shutdowns, the Internal Revenue Service has not provided Form 4506-T (proof of a tax return which is needed as part of a mortgage application) which slowed mortgage activity. The Inflation Reduction Act provided the IRS with additional funds, and the head of the IRS has signaled that the agency will use those funds to keep the agency open during the shutdown. **Thus, it seems the IRS will continue to provide tax information related to mortgage applications, so the mortgage sector might not see the same slowdown as in past shutdowns (although the Treasury Department has yet to confirm this).**

As a reminder, during a 34-day shutdown that started in December 2018 and ended in January 2019, the S&P 500 *rose* by approximately 10%. Similarly, the market rose approximately 3% during a 16-day shutdown in October 2013. Other factors will move the financial markets, a government shutdown probably will not.

## **CANNABIS BANKING**

Next week, the Senate Banking Committee is expected to mark-up the “Secure and Fair Enforcement Regulation Banking Act” (SAFER), which would give depository institutions a safe harbor from federal anti-money laundering laws, thereby allowing them to bank the cannabis industry in states that have legalized marijuana. The SAFER bill, an updated version of the Secure and Fair Enforcement Banking (SAFE) Act, has bipartisan support and will likely pass the committee. The full Senate could vote on the bill later this fall, and the bill’s supporters might look to add it to “must pass” legislation such as the National Defense Authorization Act (NDAA). This is similar to past years, but the roles of the House and Senate have changed. In recent years, the House included the SAFE Act in the NDAA, but the Senate stripped the cannabis bill out of the defense bill. Now the roles are reversed.

Cannabis banking legislation is not a priority of House Financial Services Committee Chairman Patrick McHenry (R-North Carolina). Although Chairman McHenry has not explicitly said he would block the bill, his committee has passed legislation, such as cryptocurrency bills, that the Senate has not considered. Chairman McHenry could try to use the SAFER Act as leverage to get the Senate to consider his committee’s legislation, but cryptocurrency is not a priority of Senate Banking Committee Chairman Sherrod Brown (D-Ohio), and he opposes the House’s version of the crypto bills. If the Senate refuses to consider McHenry’s priorities, then Mr. McHenry could refuse to compromise on the SAFER Act. The path to a House-Senate compromise is a difficult one given the disagreements on policy and the differing priorities of two key committee chairmen.

**Chances of passing a cannabis banking bill are better than they have been as a result of the Senate’s work, but given the political dynamics, the chances of passing a cannabis banking bill remain less than 50/50.**

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