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Impact Of The Debt Ceiling Debate On The U.S. Economy--Getting Worse By The Day

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NEW YORK (Standard & Poor's) Oct. 16, 2013--The U.S. government has been shut down for more than two weeks. Earlier today, Senate leadership crafted an agreement to end the shutdown and avert a debt default. However, the deal needs to be voted on by both chambers of Congress.

We believe that to date, the shutdown has shaved at least 0.6% off of annualized fourth-quarter 2013 GDP growth, or taken $24 billion out of the economy. However, the closer we get to breaching the debt ceiling, the higher we expect the economic impact to be.

In the summer of 2011, as we approached the last debt ceiling standoff, consumer confidence plummeted and hit a 31-year low in August when the debt ceiling issue came to a head. Given that this round of debt-ceiling negotiations is occurring after two-plus weeks of a government shutdown, the total impact on the economy will likely be even more severe.

While we believe the Senate deal will be passed and the debt ceiling will be raised, the impact of a default by the U.S. government on its debts would be devastating for markets and the economy and worse than the collapse of Lehman Brothers in 2008.

Should a default occur, the resulting sudden, unplanned contraction of current spending could see government spending cut by about 4% of annualized GDP. That would put the economy in a recession and wipeout much of the economic progress made by the recovery from the Great Recession.

As we've said, we expect the Senate deal to be approved. However, the current chatter coming out of Washington suggests that any continuing resolution will be a temporary one, with an early 2014 timeframe for the next set of Washington deadlines. The short turnaround for politicians to negotiate some sort of lasting deal will likely weigh on consumer confidence, especially among government workers that were furloughed. If people are afraid that the government policy brinkmanship will resurface again, and with it the risk of another shutdown or worse, they'll remain afraid to open up their checkbooks. That points to another Humbug holiday season.

The bottom line is the government shutdown has hurt the U.S. economy. In September, we expected 3% annualized growth in the fourth quarter because we thought politicians would have learned from 2011 and taken steps to avoid things like a government shutdown and the possibility of a sovereign default. Since our forecast didn't hold, we now have to lower our fourth-quarter growth estimate to closer to 2%.