Weekly Market Update

Markets are cautious but not chaotic despite government gridlock

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ARTICLE HIGHLIGHTS

- The budget and debt ceiling stalemate overshadows other market developments.
- U.S. equity and fixed-income markets appear optimistic that a worst-case scenario will be averted.
- The government shutdown delays release of the September jobs report and other key data.
- Overall, the U.S. economy remains fundamentally sound but with little forward momentum.
- We have lowered our GDP growth forecast from roughly 3% to 2% for the next two quarters.

October 4, 2013

U.S. equity markets trended lower during the week but held up better than might be expected given the partial government shutdown and looming deadline to raise the federal debt ceiling. Investors appear to be basing their relative optimism on historical experience, as previous government shutdowns ultimately proved less calamitous for the economy and markets than originally feared. For the week through October 3, the S&P 500 Index was down roughly 0.7% and was moving slightly higher on the morning of October 4. Trading volumes were thin.

Fixed-income markets were also calm. Returns for the broad-based Barclays U.S. Aggregate Bond Index and many of its components were essentially flat, and the yield on the bellwether 10-year Treasury security stayed in a narrow range around 2.6%. Issuance of new bonds slowed dramatically during the week. Net flows into fixed-income mutual funds remained supportive of high-yield bonds and loans, but emerging-market debt funds continued to bleed assets.

For more perspective from TIAA-CREF on the government shutdown, the debt ceiling debate, and other political issues that could affect markets and the economy, visit our Washington Watch page. Current market updates are available here.

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Outlook

The economy will suffer during the government shutdown, because, as occurred during last fall's "fiscal cliff" debate, hiring and spending on capital goods and consumer goods will slow. Overall, however, the negative impact on GDP growth is likely to be incremental. That said, the longer the shutdown drags on, the more likely it is that the Federal Reserve will delay tapering its bond purchases into early 2014. This could be bullish for higher-yielding fixed-income sectors such as commercial mortgage-backed securities, high-yield bonds, and emerging-market debt, which stand to benefit the most from continued Fed support.

Beyond the shutdown, the worst-case scenario would be a failure to raise the debt ceiling, an outcome that few observers—including the markets—believe will actually be allowed to happen. The debate is expected to go down to the wire, however, and financial markets could become increasingly volatile along the way. On the other hand, a quick agreement on both the debt ceiling and the shutdown could nudge the economy and the markets back onto their pre-crisis growth path.

The government shutdown prevented some key economic data, including the September employment report, from being issued during the past week. In general, although the economy appears to remain fundamentally sound, there is little overall momentum, and our outlook calls for a continued slow recovery. Activity in September picked up from a weak July and slightly better August, but not by much. As a result, we have lowered our GDP growth forecast from about 3% to 2% for the next two quarters—with the caveat that the fourth-quarter growth rate is highly dependent on how long the shutdown lasts and whether the debt ceiling debate heads toward the brink.

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The information provided herein is as of October 4, 2013.

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