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Biggest Economic Threat: Debt Ceiling, Not Shutdown

Businesses and Investors Shrug Off Budget Impasses, but Borrowing Limit Looms Large

By ERIC MORATH and SUDEEP REDDY

U.S. businesses and investors largely looked past the nation's first government shutdown in 17 years, warily monitoring a brewing fight over raising the federal borrowing limit as the leading threat to the economy and markets.

Tuesday's partial shutdown furloughed more than 800,000 federal workers and started disrupting government services across the U.S. The effects are expected to build if the shutdown drags out.

But investors took the standoff in stride, comforted by the quick resolution to budget battles over the past two years. The Dow Jones Industrial Average rose 62 points, or 0.4%, to 15191.70, offsetting half of Monday's dip.

The initial calm raised the prospect that lawmakers might face little immediate pressure from Wall Street to end their standoff over how to fund government operations. "The lack of a severe market reaction probably reduces the urgency for the parties to cut a deal," said Credit Suisse economist Neal Soss.

A shutdown alone is expected to do little economic damage to the overall U.S. economy, based on prior experience. Economists at J.P. Morgan Chase on Tuesday estimated each week of a shutdown would reduce the annualized pace of fourth quarter economic growth by 0.12 percentage point due to reduced pay to government workers. The forecast doesn't account for any private-sector effects or damage to consumer confidence.

The lost pay could be recouped after the shutdown ends if Congress agrees to compensate workers retroactively for their days off, as has happened in the past.

For Derek Volk, president of Volk Packaging Corp. in Biddeford, Maine, the government shutdown is a potential speed bump for a company that has otherwise been growing steadily this year. Volk has nearly doubled its sales force and invested in new box-making equipment this year, but he fears the government pullback could hold back his region's economy.

Heard: Fed Up With the Shutdown
"I do know that it's going to be a beautiful weekend for Maine foliage and the leaf peepers won't be going to Acadia National Park," he said, citing the park's shutdown. "They won't be eating at

local restaurants, staying at hotels and ultimately consuming products that are delivered in a box."

The bigger risk to the economy and markets is the prospect that a protracted fight over the shutdown leads lawmakers into an impasse over how to raise the government's borrowing limit by mid-October. Without an increase in the debt ceiling, the government could run out of cash to pay all its bills—such as Social Security checks, military pay and interest on its debt—which analysts say could cause severe financial turmoil.

The nonpartisan Congressional Budget Office says the U.S. will start missing payments by the end of the October unless Congress raises the borrowing limit.

The government hit its $16.7 trillion debt ceiling in May and since then has been using emergency measures to conserve cash.

Treasury Secretary Jack Lew told lawmakers in a letter Tuesday that the U.S. is now using its final emergency measures. That means Treasury will have about $30 billion in cash on hand by Oct. 17 plus incoming tax revenue to pay its bills, he said.

Gauging the economy's course could be harder in coming weeks. The nation's key economic scorekeepers—statistical agencies within the Labor and Commerce departments—suspended operations Tuesday because of the shutdown.

One of the most eagerly awaited reports—the September employment figures—isn't expected to be released Friday if the shutdown continues. The data will be important to Federal Reserve officials considering how long to continue their bond-buying program, which has buoyed markets for much of the past year. The government still plans to release a weekly report on initial filings for jobless benefits on Thursday; that data is largely produced by state agencies and compiled by the Labor Department.

One of most closely watched private-sector gauges of economic activity, released Tuesday, showed the nation's factories gaining strength in September. The Institute for Supply Management, a private group of purchasing managers, said its manufacturing index rose to 56.2 from 55.7 in August, reaching its highest level since April 2011. Figures above 50 indicate expansion for the sector.

"It feels like we're building momentum," said Bradley Holcomb, chairman of ISM's manufacturing survey. A sustained shutdown, however, "will trickle down to the rest of the economy, probably first to the service sector and then to manufacturing. "

Businesses said the latest troubles in Washington could restrain sales and investment.

"Watching the silliness in Washington is discouraging for the greatest nation in the world," said Drew Greenblatt, president of Marlin Steel Wire Products in Baltimore. "If customers don't really need it, if it isn't crucial, they're not going to pull trigger in this environment."

Gridlock in Washington and troubles abroad are worrying Marlin Steel's customers, who are mainly large manufacturers, Mr. Greenblatt said. Because of the slowdown, the company expects it won't increase annual sales for the first time in eight years. "Everyone is pausing, everyone is holding on to cash—acting in a very restrained manner because they don't know what's going on," he said.

Mr. Volk, the packaging-company executive, said he shared the concerns of House Republicans who were waging the shutdown fight over the Obama administration's signature health-care plan. But he said it's too late. "The horse is out of the barn."

As for what happens next, Mr. Volk said he doesn't know. "I don't think the country has any idea what this is going to do, and I don't either. So many times this has almost happened and at 11th hour they got it together."

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