Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: September 29, 2023

Although there's been some talk of what a government shut-down does to the SEC, there's lots, lots more to worry about. Risks are out there, risks that should be taken very, very seriously by the Members of Congress who seem to think that more chaos stokes their political fortunes. Perhaps it does, but it could well do a lot of damage to their finances, not to mention those of all the voters who might well bear a reasonable grudge.

Where's the systemic scary place? Or, better said, places? Some are right in front of us; others lurk in the closet waiting to pounce.

What worries me the most in the immediate future is the ability of bad actors to exploit what could be lightly- or even unguarded portals into critical financial market infrastructure. There are of course many, many bad actors out there with the sophistication and/or state sponsorship quickly to test and then attack critical points in the payment, settlement, and clearing systems and/or the grids on which they rely.

As I discussed on Tuesday, not all providers of critical financial market infrastructure are under the hopefully-eagle eyes of the federal banking agencies which, funded outside federal appropriations, will remain open. Some fall under the SEC or CFTC, agencies that will be hobbled, and some critical providers are wholly outside the regulatory perimeter. Even if their nodes of market access seem small, disruption has a bad habit of migrating at lightning speed. Even if power outages are short, systemic damage could well be done.

You'll notice the absence of specific problem portals here and that's for cause. Although one likes to think that no one but the nicest people read one's prose, that's not always the case. Why give anyone any ideas they don't already have? Here's hoping – indeed expecting – that critical financial watchdogs have defined "essential" personnel staying on the job well and widely enough to fortify the barricades.

Another shut-down systemic risk is more structural, or at least I hope it is because then it could be slower and easier to stop. The risk lies in Treasury-market fragility about which much has been said but almost nothing dispositively done beyond the Fed's standby-repo facility and ongoing expectations that the central bank will somehow save us.

So it will, but it shouldn't have to make moral hazard still more endemic thanks only to a Congress that can't agree on the direction the sun rises each morning. How many more crises can Congress cause before it all on its own threatens Treasury-market liquidity and the sanctity of the dollar on which it and so much else rely?

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And, one more thing: economic inequality will get still worse following even a short shutdown should we be so lucky and only have a short one. Sixty percent of American households now live pay-check to pay-check. In the 2018 shut-down, 62 percent of government workers struggled to pay rent, meet mortgage obligations, or make even minimum credit-card payments even though federal worker average wages then were $85,556.

Even a small slow-down due to the shut-down will affect all households with little to spare for the proverbial rainy day – consumer delinquencies are already beginning to climb. Something bad, thanks to the shut-down will only make this worse.

The Members of Congress playing with a shut-down are like children playing with matches. Something could easily go up in flames. Let's hope it's just their own political futures, but that sadly remains to be seen.