After a period of calm that set in following the arrival of the partial fiscal cliff at the beginning of the year, and the implementation of automatic spending cuts, a new budget crisis is looming in the United States. This time, there are two obstacles. The first will occur on October 1 if Congress and the White House fail to adopt a series of resolutions aimed at funding the government’s day-to-day operations. The second should occur around October 17 when measures to prevent the federal debt from reaching its legal ceiling are exhausted.

The consequences of shutting down government operations are not as dire as they appear. Not all government activities and federal programs will be affected—only those that require annual funding and those deemed non-essential for public security, order and health. Social programs usually enjoy ongoing funding while some services, such as new registration applications and claims, may be delayed.

More importantly, a shutdown of operations means that thousands of federal government employees will be on unpaid furloughs. The last time this type of episode occurred, in 1995 and 1996, when President Clinton and the Republicans failed to reach a budget agreement, about 800,000 civil servants were affected.

The impacts on the rest of the economy are also worth noting. During two previous shutdowns in fiscal year 1996, consumer confidence indexes plummeted. The real GDP did not suffer too badly in Q4 1995 overall, with growth of 2.9% (annualized), despite the negative contribution of 0.9 percentage point from the federal government. The market’s reaction was quite scattered, at worst an uptrend was slowed to a crawl. Overall, for the two shutdown episodes that occurred in late 1995, the yield of 10-year Treasuries fell by about 30 basis points.

Implications: If the political juggernaut continues until September 30, we will see the first government shutdown in almost 18 years. However, these types of conflicts between President Obama and the Republicans always end with agreements struck in the 11th hour. The condition issued by the Republicans—to defund President Obama’s health care reform—is inadmissible for Democrats. If a happy solution cannot be found, it would be surprising if this conflict were to last long. Confidence may dip temporarily, but growth should remain on track.

The issue with the debt ceiling is more worrisome. President Obama has stated clearly that he no longer wanted to negotiate this issue and that it is up to Congress to adjust the ceiling to the level required in view of revenues and already approved expenses, while the Republicans are seeking new budget cuts. The federal government’s inability to contract more loans could tarnish its credibility and payment defaults (interest and other expenses) could deal a blow to the financial and economic situation.