

Federal Funding Outlook Ahead of the January 30th Deadline | RECAP

We hosted Dominik Lett, Budget Policy Analyst at Cato Institute, to break down budget dynamics, key friction points, and the likely path. **KTs:** **1)** A short partial shutdown beginning Jan 31 is most likely. **2)** About \$1.2tn, or 75% of FY26 discretionary funding, could be affected. **3)** Defense and DHS can better withstand a lapse. **4)** Data releases and tax refunds may face delays, though overall economic and market impacts should remain limited. PPTs attached.

1) A short partial shutdown beginning Jan 31 remains the base case. The Senate does not appear positioned to pass the six-bill minibus as written, and Democrats want DHS removed from the package. Any Senate change would have to return to the House for another vote, but the House is not back until Feb 3. Even if Senate leaders move procedural steps this week, the calendar leaves little room to clear debate, process amendments, and finish the package. Travel slowdowns in Washington have added more delay.

2) The policy dispute turns on DHS funding. Democrats want DHS removed from the minibus and have proposed changes that include added protections for schools and places of worship, tighter rules for enforcement personnel, and limits on inland CBP activity. Republicans say the House bill already included meaningful concessions, such as more funding for body cameras, and they oppose reopening the agreement. Any Senate change would require House approval, which effectively guarantees a lapse until next week. Once the House returns, Congress can opt to pass the five non-DHS bills first, negotiate DHS separately, or revisit a single amended package if both sides align on revisions.

3) The shutdown may impact \$1.2tn or 75% of FY26 discretionary funding. This includes major departments such as Defense, Homeland Security, State, Treasury, Health and Human Services, Labor, Housing and Urban Development, Transportation, and Education. The broader context is that FY26 was tracking about \$24bn above FY25 levels, with Republican priorities gaining more funding. These priorities include larger increases for Veterans Affairs, Commerce, and Financial Services, along with expanded resources for defense modernization and immigration enforcement programs that were strengthened through the OBBB.

4) Defense and DHS are better positioned to manage a lapse. The One Big Beautiful Bill created roughly \$350bn in multi-year funding that can be used during a shutdown. \$150bn supports defense modernization and \$170bn supports immigration enforcement, and a large share becomes available in FY26–FY27. This allows DoD and DHS to maintain operations even if annual appropriations stall. Other departments—Labor, HHS, Education, Treasury, State—do not have this buffer. They would rely on standard shutdown procedures, including furloughs for non-essential staff, slower grantmaking and contracting, and prioritization of critical functions.

5) Key data releases and tax refund processes could be affected. BLS paused several reports in the last shutdown, and the JOLTS release scheduled for Feb 3 is at risk if the lapse runs into next week. IRS activity would also slow in a longer shutdown, raising the risk of delayed processing and refunds. Defense operations would continue for excepted personnel, but civilian and contractor work may face schedule disruptions.

Investment implications: A short, partial shutdown is unlikely to derail equities. Defense and border-security spending continuity should limit downside for related contractors, while agencies

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without OBBB cushions face more disruption risk. If refunds are delayed, lower-income consumer activity could soften at the margin, but the effect should fade quickly if funding resumes next week.

FY2026 Appropriations: Shutdown Risk & Outlook

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Executive Summary

- A partial government shutdown is increasingly likely by January 30th
- Minneapolis ICE shootings have galvanized Democratic opposition to DHS funding
- Six of 12 appropriations bills already signed; six remain (representing ~\$1.2T / 75% of discretionary)
- House is on recess until Feb 2nd, with no plans to return
- Defense and immigration agencies have OBBBA funding buffers; impact may be muted

Tight Timeline

- January 19: House leadership releases bipartisan minibus funding deal
- January 22: House passed final FY26 bills (341-88 for minibus; 220-207 for DHS)
- January 23: President signed CJS, Energy & Water, Interior bills into law
- January 24: Border Patrol shoots Alex Pretti in Minneapolis - Democrats immediately vow opposition
- January 26/27: Senate delayed by winter storm; negotiations ongoing
- January 30 (midnight): CR expires - partial shutdown begins if no deal
- February 2: House scheduled to return from recess

FY2026 Appropriations Status by Category

SIGNED INTO LAW (6 bills)

- Agriculture / FDA
- Military Construction / VA
- Legislative Branch
- Commerce, Justice, Science
- Energy & Water
- Interior & Environment

AWAITING PASSAGE (6 bills)

- Defense
- Homeland Security
- Labor, Health and Human Services, Education
- Transportation and Housing & Urban Development
- State & Foreign Operations
- Financial Services & General Government

FY2026 Appropriations Status by Major Agency

Agencies with Full Year Funding

- Department of Agriculture
- Veterans Affairs
- Department of Commerce
- Department of Justice
- Department of Energy
- Department of the Interior

Agencies without Full Year Funding

- Department of Defense
- Department of Homeland Security
- Department of Health and Human Services
- Department of Education
- Department of Labor
- Department of the Treasury
- Department of State
- Department of Transportation

FY25 vs FY26 Comparison

- FY26 budget increases spending by \$24 billion year-over-year
- Transportation, Commerce, Financial Services, and the VA receive the largest increases.
- Department of State and Health and Human Services receive the largest cuts.
- Budget also includes some \$30 billion in extra spending for health care
- \$50 billion above budget targets

Annual budget authority, millions of dollars

Appropriations Subcommittee	FY 2025	FY 2026	Change
Agriculture, Rural Development, FDA	26,643	26,650	+7
Commerce, Justice, Science	69,702	78,011	+8,309
Defense	838,117	838,653	+536
Energy and Water Development	58,068	58,039	-29
Financial Services and General Government	16,248	26,548	+10,300
Homeland Security	87,540	90,767	+3,227
Interior, Environment	43,624	41,450	-2,174
Labor, Health and Human Services, Education	200,681	198,008	-2,673
Legislative Branch	6,742	7,229	+487
Military Construction, Veterans Affairs	146,553	153,278	+6,725
National Security, Department of State	59,347	50,014	-9,333
Transportation, Housing and Urban Development	94,370	102,883	+8,513
Total	1,647,635	1,671,530	+23,895

One Big Beautiful Bill Act (OB3) Context

- Signed July 4, 2025 - provided +\$350B in extra appropriations
- Defense: +\$150B for military modernization, missile defense, and shipbuilding
- DHS: +\$170B for ICE enforcement, detention, border operations
- This funding can continue during a shutdown
- ICE operations can likely to continue even without DHS funding bill
- Other agencies (HHS, Labor, etc.) lack similar buffers

Shutdown Risk Assessment

Most Likely: Partial Shutdown

- Senate fails to pass full package
- House not in session until Feb 2
- Shutdown begins 12:01 AM Saturday
- Affects: DoD, DHS, State, Treasury, HHS, Labor, HUD, Transportation, Education
- Duration: At least until Feb 2-3
- Could extend if DHS impasse continues

Alternative: Last-Minute Deal

- Republicans agree to split DHS
- Pass 5 non-DHS bills separately
- Requires unanimous consent in Senate
- House returns early (unclear)
- DHS operates under CR or OBBBA funds
- Very tight timeline - low probability

Key Departments Affected by Partial Shutdown

Department	Key Functions at Risk	OBBBA Buffer?
Defense	Military pay, operations (but has workarounds)	Yes - \$150B
DHS	ICE, TSA, FEMA, Coast Guard - essential workers unpaid	Yes - \$170B
Treasury/IRS	Taxpayer services, refund processing	Functionally no
HHS	Head Start, other discretionary health programs	No
Transportation	Air traffic control (essential but unpaid), FAA	No
Labor/BLS	Economic data releases could be delayed	No
State	Diplomatic operations, passport services	No
Education	Title I, student aid processing	No

Lessons from October 2025 Shutdown

- 43 days - longest in US history (Oct 1 - Nov 12, 2025)
- Central issue then: ACA premium subsidies (expired Dec 31)
- SNAP benefits disrupted
- FAA staffing shortages caused flight cancellations/delays
- IRS furloughed ~50% of workforce; processing backlogs
- 8 moderate Democrats ultimately voted to end shutdown
- Republicans took more blame initially, then narrowed
- **Key lesson:** Public pain eventually forces resolution

Summary Impact of Shutdown

\$1.2T

Federal spending
at stake

75%

Of discretionary
budget affected

6

Appropriations
bills unpassed

43 Days

Last shutdown's
record duration

Questions?

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