

UNITED STATES: DOES THE AMERICAN RESCUE PLAN GO TOO FAR?

Jean-Luc Proutat

Totalling USD 1.9 trillion or 9 percent of GDP, the American Rescue Plan ranks among the largest stimulus packages ever launched in the United States.

The plan aims to overcome the Covid-19 pandemic, but does not stop there. The new supportive measures, combined with those approved in December 2020, could rapidly bring the US economy under pressure.

Inflation is not the biggest threat, even though it is expected to rise above 2%. The surge in prices is likely to be short lived since global competition and the accelerating digital revolution are bound to have a moderating effect.

Among the possible harmful effects is the risk of fuelling speculative behaviours in certain market segments (tech stocks, high-yield bonds...).

To the tune of “whatever it takes”, the United States is merrily leading the dance. According to IMF estimates, the US is by far the country whose government is doing the most to counter the depressive impact of the Covid-19 pandemic: nearly USD 3.7 trillion or 17 points of GDP injected in 2020 (excluding equity, loans, and guarantees) twice the size of the European Union’s budget efforts. At a time when vaccination campaign paves the way for a spectacular recovery, a new round of budgetary stimulus is engaged. The new Democratic administration is preparing to inject an additional USD 1.9 trillion, a figure that could be much higher if its infrastructure modernisation plan also comes to light. Public debt and the deficit, which were already given little consideration under Donald Trump, will continue to see major overruns. Without taking into account the Biden’s administration spending programmes, the Congressional Budget Office (CBO) estimates that the Federal deficit will hold above 10% of GDP in 2021, after hitting an all-time high of 14.9% of GDP in 2020. The public debt ratio also seems to have risen above 100% of GDP for the long term. Given the gravity of the health crisis, however, few seem to be alarmed so far. The coin finally dropped when Lawrence Summers, former Treasury Secretary under Bill Clinton, wrote an editorial in the Washington Post sounding the alarm. At a time when the worst of the crisis seems to be over in the US, isn’t President Biden’s vast stimulus plan oversized? Doesn’t it risk triggering price instability in the goods, services or capital markets?

Twice as big as the output gap

Although not as big as the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, the American Rescue Plan is still double the size of the American Recovery and Reinvestment Act of 2009 and ranks among the largest stimulus packages ever approved by Congress. Totalling USD 1.9 trillion, half of the plan is geared towards households and targets demand (see also box 1).

To help the unemployed, whose ranks have swelled by more than 4 million during the Covid crisis, jobless benefits will be extended through 6 September 2021 with a Federal contribution of USD 300 a week. In a small concession to the moderate part of the Senate, the government scaled back the Federal bonus from an initial sum of USD 400 a week. Stimulus checks of a maximum of USD 1400 per person will be sent to American households for a total budget of about USD 400 billion. The child tax credit will be raised from USD 2000 to USD 3600 per dependent child under the age of 6, and to USD 3000 for each dependent child between the ages of 6 and 17. Although the Senate imposed some stricter income-based conditions and made the stimulus a little less generous¹, the measures cover a wide range of areas that largely exceed the economic victims of the pandemic. According to estimates by the Institute on Taxation and Economic Policy, roughly 286 million men, women and children, or 86% of the US population, will receive a stimulus check from the Treasury in the weeks ahead. This is bound to fuel debate on the proper calibration of government subsidies. It is worth keeping in mind that household disposable income did not diminish during the crisis, but to the contrary increased exceptionally thanks to transfers as part of the CARES Act. With spending curtailed over the past year, Americans have built up vast savings: USD 2,850 bn in 2020 (16% of disposable income), more than twice the amount of 2019 savings.

¹ Income conditions: up to USD 80,000 annually (degressive above USD75,000 annually) for a single adult, USD 160,000 annually for a married couple (degressive above USD 150,000 annually).

ECONOMIC RESEARCH



BNP PARIBAS

**The bank
for a changing
world**

Another subject of debate that was a serious sticking point for the Republican minority in Congress is state and local government subsidies, which will near USD 350 bn. These funds are not targeted – a specific budget line covers the rollout of testing and vaccination campaigns – and they are being injected into state and local coffers that have already benefited from major Federal subsidies. Like household income, state and local revenues rose at a record-high pace in 2020.

Is there reason to fear that the economic swimming pool will not only be filled but will overflow? According to CBO estimates, the output gap – the production shortfall that must be closed before the US economy returns to its potential – is USD 960 bn. Twice as big, the American Rescue Plan would quickly close the gap, even with a low multiplier. Assuming a multiplier of 0.5 and that most of the stimulus plan's USD 1.9 trillion will be rapidly deployed, the economy would grow by at least 6% in 2021. Under these circumstances, the US economy would more than close the output gap, and by next fall, it would be operating near full potential. At the current pace of vaccinations (2 million shots daily, or a total of 120 million altogether), it is reasonable to assume that by this same horizon, the sectors currently paralysed by the pandemic (hotel and restaurant services, entertainment industry) will have returned to normal operations and will have begun hiring again. The labour market would fully recover or so. For Treasury Secretary Janet Yellen, full employment could be reached as early as 2022.

Inflation and asset prices: moderate to strong risks

Along with the upturn in commodity prices (oil prices have risen roughly 150% over the past year, and metals are up by 60%), growing tensions across the US economy are fuelling inflation expectations, notably in the markets, where 10-year indexed swap rates have risen to nearly 2.5%. Consumer prices are, de facto, picking up, mainly as a result of heavier energy and food bills. They also signal a catching-up effect. With fewer Covid-19 cases and the easing of lockdown restrictions, consumers are now able to make certain purchases that they had been putting off. Household demand for durable goods (automobiles, household furnishings) is strong, contributing to the rebound in prices. Starting in April and the months thereafter, when statistics will be compared with the depressed figures of spring 2020, inflation will be well above the Fed's 2% target, and could even reach 3%.

Yet the surge in inflation will be short lived. Unless the post-Covid world will mark a 40-year leap backwards in time, there is little risk of "having to get the toothpaste back into the tube"². In the United States, as elsewhere, wages and prices are still subject to global pressures, possibly even more so since the Covid crisis has accelerated the digital revolution in the services sector. They are no longer reacting as they did before to labour market slacks, a phenomenon known as the "flattening" of the Phillips curve. Inflation was already remarkably stable at around 2% during the historical decline of unemployment in 2010-2020, and there is no reason for it to accelerate over the long term.

The monetarist explanation, which claims that inflation will finally react to the central bank's quantitative easing, is not much convincing. The trillions of dollars created in counterparty of Fed's asset purchases could have a thousand different destinations other than the US market for goods and services: excess reserves can be recycled far and wide, in the emerging markets, real estate, infrastructures, cryptocurrencies, as well as the stock market.

Especially the stock market. In the United States, the surge in equity prices did not begin with the discovery of Covid-19 vaccines, but dates back precisely to 23 March 2020, when the Fed fired its monetary bazooka (unlimited quantitative easing, exceptional refinancing programmes). At a time when valuations are becoming hard to explain in certain segments of the markets (tech stocks, high-yield bonds), there is a risk that the billions in stimulus funds will fuel irrational exuberance along with the economy.

Jean-Luc Proutat

jean-luc.proutat@bnpparibas.com

THE AMERICAN RESCUE PLAN (USD BILLION)	
HOUSEHOLDS	910
Direct stimulus checks	400
Tax credits (children, individuals)	160
Jobless benefits boost	270
Health insurance (extension of Obamacare...)	80
PUBLIC SERVICES AND INSTITUTIONS	763
Transfers to state and local governments	350
Transfers to schools and universities	170
Funding for testing and vaccination campaigns	123
Other (social welfare actions...)	120
COMPANIES	226
Transfers to ailing sectors	140
Transfers to pension systems	86
TOTAL	1900

SOURCE: COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET, US TAX FOUNDATION, BNP PARIBAS

² To use the expressive image of former Bundesbank chairman Karl Otto Pöhl, who in the early 1980s compared inflation to toothpaste: "once it's out of the tube, you can hardly get it back in"



William De Vijlder
Chief Economist

+33 1 55 77 47 31

william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

Jean-Luc Proutat

US, UK - Head of economic projections, relationship with French network

+33 1 58 16 73 32

jeanluc.proutat@bnpparibas.com

Hélène Baudchon

France - Labour markets

+33 1 58 16 03 63

helene.baudchon@bnpparibas.com

Louis Boisset

Japan - European Central Bank watch, Euro area global view

+33 1 57 43 02 91

louis.boisset@bnpparibas.com

Frédérique Cerisier

Euro area (European governance and public finances), Nordic countries

+33 1 43 16 95 52

frederique.cerisier@bnpparibas.com

Guillaume Derrien

Italy, Spain, Portugal - International trade

+33 1 55 77 71 89

guillaume.a.derrien@bnpparibas.com

Raymond Van Der Putten

Germany, Netherlands, Austria, Switzerland - Energy, climate

+33 1 42 98 53 99

raymond.vanderputten@bnpparibas.com

Tarik Rharrab

Statistics

+33 1 43 16 95 56

tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon
Head

+33 1 42 98 56 54

laurent.quignon@bnpparibas.com

Laure Baquero

+33 1 43 16 95 50

laure.baquero@bnpparibas.com

Céline Choulet

+33 1 43 16 95 54

celine.choulet@bnpparibas.com

Thomas Humblot

+33 1 40 14 30 77

thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure

Head - Argentina

+33 1 42 98 79 82

francois.faure@bnpparibas.com

Christine Peltier

Deputy Head - Greater China, Vietnam, South Africa

+33 1 42 98 56 27

christine.peltier@bnpparibas.com

Stéphane Alby

Africa (French-speaking countries)

+33 1 42 98 02 04

stephane.alby@bnpparibas.com

Stéphane Colliac

Turkey, Ukraine, Central European countries

+33 1 42 98 43 86

stephane.colliac@bnpparibas.com

Perrine Guerin, Sara Confalonieri

Africa (Portuguese & English-speaking countries)

+33 1 42 98 43 86

perrine.guerin@bnpparibas.com

Pascal Devaux

Middle East, Balkan countries

+33 1 43 16 95 51

pascal.devaux@bnpparibas.com

Hélène Drouot

Korea, Thailand, Philippines, Mexico, Andean countries

+33 1 42 98 33 00

helene.drouot@bnpparibas.com

Salim Hammad

Latin America

+33 1 42 98 74 26

salim.hammad@bnpparibas.com

Johanna Melka

India, South Asia, Russia, CIS

+33 1 58 16 05 84

johanna.melka@bnpparibas.com

CONTACT MEDIA

Michel Bernardini

+33 1 42 98 05 71

michel.bernardini@bnpparibas.com





CONJONCTURE

Structural or in news flow, two issues analysed in depth



EMERGING

Analyses and forecasts for a selection of emerging economies



PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed



ECOFASH

Data releases, major economic events. Our detailed views...



ECOWEEK

Weekly economic news and much more...



ECOTV

In this monthly web TV, our economists make sense of economic news



ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy



MACROWAVES

The economic podcasts

RECEIVE OUR PUBLICATIONS

SUBSCRIBE ON OUR WEBSITE
[see the Economic Research's website](#)

ET

FOLLOW US ON LINKEDIN
[see the Economic Research's linkedin page](#)

The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. This report does not constitute an offer or solicitation to buy or sell any securities or other investment. It does not constitute investment advice, nor financial research or analysis. Information and opinions contained in the report are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient; they are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein. Any reference to past performance should not be taken as an indication of future performance. To the fullest extent permitted by law, no BNP Paribas group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report. BNP Paribas SA and its affiliates (collectively "BNP Paribas") may make a market in, or may, as principal or agent, buy or sell securities of any issuer or person mentioned in this report or derivatives thereon. BNP Paribas may have a financial interest in any issuer or person mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon. Prices, yields and other similar information included in this report are included for information purposes. Numerous factors will affect market pricing and there is no certainty that transactions could be executed at these prices. BNP Paribas, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any person mentioned in this report. BNP Paribas may, from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as adviser, manager, underwriter or lender) within the last 12 months for any person referred to in this report. BNP Paribas may be a party to an agreement with any person relating to the production of this report. BNP Paribas, may to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication. BNP Paribas may receive or intend to seek compensation for investment banking services in the next three months from or in relation to any person mentioned in this report. Any person mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

BNP Paribas is incorporated in France with limited liability. Registered Office 16 Boulevard des Italiens, 75009 Paris. This report was produced by a BNP Paribas group company. This report is for the use of intended recipients and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of BNP Paribas. By accepting this document you agree to be bound by the foregoing limitations.

Certain countries within the European Economic Area:

This report has been approved for publication in the United Kingdom by BNP Paribas London Branch. BNP Paribas London Branch is authorised and supervised by the Autorité de Contrôle Prudentiel and authorised and subject to limited regulation by the Financial Services Authority. Details of the extent of our authorisation and regulation by the Financial Services Authority are available from us on request.

This report has been approved for publication in France by BNP Paribas SA. BNP Paribas SA is incorporated in France with Limited Liability and is authorised by the Autorité de Contrôle Prudentiel (ACP) and regulated by the Autorité des Marchés Financiers (AMF). Its head office is 16, boulevard des Italiens 75009 Paris, France.

This report is being distributed in Germany either by BNP Paribas London Branch or by BNP Paribas Niederlassung Frankfurt am Main, a branch of BNP Paribas S.A. whose head office is in Paris, France. BNP Paribas S.A. - Niederlassung Frankfurt am Main, Europa Allee 12, 60327 Frankfurt is authorised and supervised by the Autorité de Contrôle Prudentiel and it is authorised and subject to limited regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

United States: This report is being distributed to US persons by BNP Paribas Securities Corp., or by a subsidiary or affiliate of BNP Paribas that is not registered as a US broker-dealer. BNP Paribas Securities Corp., a subsidiary of BNP Paribas, is a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority and other principal exchanges. BNP Paribas Securities Corp. accepts responsibility for the content of a report prepared by another non-U.S. affiliate only when distributed to U.S. persons by BNP Paribas Securities Corp.

Japan: This report is being distributed in Japan by BNP Paribas Securities (Japan) Limited or by a subsidiary or affiliate of BNP Paribas not registered as a financial instruments firm in Japan, to certain financial institutions defined by article 17-3, item 1 of the Financial Instruments and Exchange Law Enforcement Order. BNP Paribas Securities (Japan) Limited is a financial instruments firm registered according to the Financial Instruments and Exchange Law of Japan and a member of the Japan Securities Dealers Association and the Financial Futures Association of Japan. BNP Paribas Securities (Japan) Limited accepts responsibility for the content of a report prepared by another non-Japan affiliate only when distributed to Japanese based firms by BNP Paribas Securities (Japan) Limited. Some of the foreign securities stated on this report are not disclosed according to the Financial Instruments and Exchange Law of Japan.

Hong Kong: This report is being distributed in Hong Kong by BNP Paribas Hong Kong Branch, a branch of BNP Paribas whose head office is in Paris, France. BNP Paribas Hong Kong Branch is registered as a Licensed Bank under the Banking Ordinance and regulated by the Hong Kong Monetary Authority. BNP Paribas Hong Kong Branch is also a Registered Institution regulated by the Securities and Futures Commission for the conduct of Regulated Activity Types 1, 4 and 6 under the Securities and Futures Ordinance.

Some or all the information reported in this document may already have been published on <https://globalmarkets.bnpparibas.com>

© BNP Paribas (2015). All rights reserved.

Edited by the Economic Research - BNP PARIBAS

Head office: 16 boulevard des Italiens - 75009 PARIS / Tél : +33 (0) 1.42.98.12.34
www.economic-research.bnpparibas.com
 Head of publication : Jean Lemierre / Chief editor: William De Vijlder



BNP PARIBAS

The bank
for a changing
world