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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 generous[1], 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).

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 gouvernance 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

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Head office: 16 boulevard des Italiens – 75009 PARIS / Tél : +33 (0) 1.42.98.12.34
w.economic-research.bnpparibas.com
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