UNITED STATES

AS THE EPIDEMIC WANES, THE ECONOMY SOARS

The US economy has taken off. Bolstered by the easing of the Covid-19 pandemic as much as by unprecedented fiscal support, GDP will soar by at least 6% in 2021, surpassing the pre-crisis level of 2019. Inflation will accelerate and temporarily overshoot the Federal Reserve's 2% target. Nonetheless, the central bank will not deviate from its accommodating stance. The Fed's top priority is employment, which continues to bear the scars of the crisis and has a long way to go before making up for all of the lost ground. As a result, monetary conditions will remain accommodating, both for the economy and the markets, even at the risk of encouraging some excessive behaviour.

Even as the United States passes the tragic threshold of 500,000 Covid-19 deaths, hopes are rising, day after day, that the crisis is nearing an end, bolstered by the acceleration of the vaccination campaign (170 million shots have already been given) and the concomitant decline in the rate of new cases, which has fallen practically to the lowest level since the pandemic began. In a televised speech, President Biden used the symbolic date of July 4th – Independence Day – for the possible return to normal. Google mobility indicators are already showing signs of improvement: following the rebound in employment (916,000 jobs were created in March), they confirm that consumer spending has picked up again as a growth engine, after stalling in the last months of 2020.

This growth engine will have no shortage of fuel. The American Rescue Plan, adopted on 11 March 2021, is a gigantic, USD 1.9 trillion stimulus package (9 points of GDP), which the Biden administration is widely targeting at households through stimulus checks, unemployment benefit boosts and tax credits (see box). It is still too early to say whether Americans will have a greater propensity to spend or to save this financial windfall. Either way, the impulse is so strong that the economic growth rate can only be revised upwards.

GROWTH AND INFLATION (%)

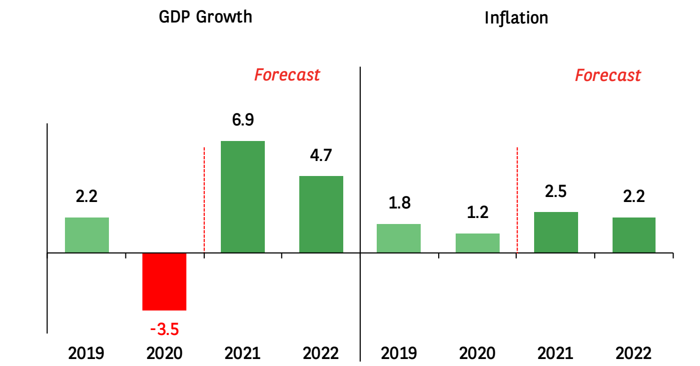

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

THE LATEST COVID-19 WAVE HAS BROKEN

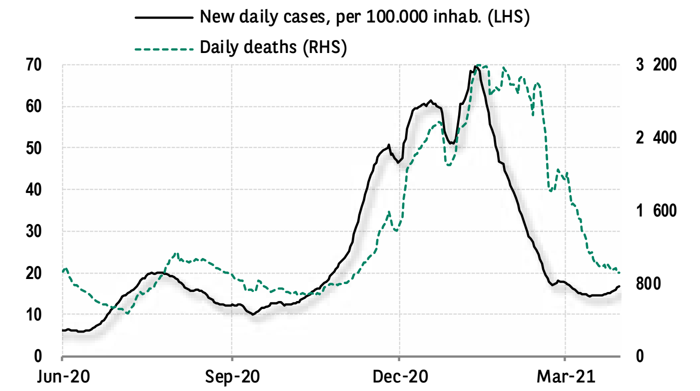

CHART 2 SOURCE: JOHNS HOPKINS UNIVERSITY

GROWTH SURGES TO MORE THAN 6% AND INFLATION REBOUNDS

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, and coupled with the USD 900 bn stimulus extension voted in December 2020, 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 be operating near full capacity approaching fall. At the current pace of vaccinations (2 million shots daily), 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 resumed hiring staffs. The return to full employment should be fairly rapid. For Treasury Secretary Janet Yellen, full employment could be reached as early as 2022.

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, if for no other reason than 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 travels and durable goods (automobiles, household furnishings) is strong, contributing to the rebound in prices. Starting in April and the months thereafter, when statistics are compared with the depressed figures of spring 2020, inflation will rise well above the Fed's 2% target, and could even reach 3%.

Yet the pick-up in inflation could be short-lived. In the United States, as elsewhere, wages and prices remain constrained by global forces, possibly even more so since the Covid crisis has accelerated the digital revolution in the services sector. They are no longer reacting as they

RETAIL INVESTORS MARGIN DEBT FOR EQUITY PURCHASES, % GDP

CHART 3 SOURCE: BIS

did before to labour market slacks, a phenomenon known as the "flattening" of the Phillips curve[1]. Inflation was already remarkably stable at around 2% during the historical decline of unemployment in 2010-2020, and there is little reason to believe it will accelerate over the long term.

RISK OF EXCESS

At the 17 March monetary policy committee meeting, the FOMC decided not to deviate from its accommodating stance: the Fed funds target rate would be maintained near zero and it would continue to make net securities purchases at a rate of USD 120 billion a month, including USD 80 billion in US Treasury securities and USD 40 billion in agency MBS. The Fed intends to continue expanding its balance sheet, which already exceeds the Federal deficit and has swollen to USD 3,500 billion (16.5% of GDP) since the beginning of the pandemic.

Useful for countering depressive shocks, monetary profligacy can also be a source of excess, and is not without drawbacks in the long term. The trillions of dollars created in counterparty to the Fed's asset purchases are being recycled widely, in the emerging markets, real estate, infrastructure, cryptocurrencies, or stock market. Cheap access to liquidity encourages risk taking and leveraging, including in market segments where liquidity cannot always be ensured. Facilitated by the increase in on-line trading platforms, debt financing of stock purchases has hit record highs, both in absolute terms and as a share of GDP (see chart 3).

Even before the Covid-19 crisis occurred, the International Monetary Fund (IMF) was repeatedly stressing the risk to macro-financial stability implied by rising leverage, especially in the corporate or non-bank financial sector (investment trusts and funds, etc.). Now, the stakes is high enough for the US Treasury Secretary to take action. On 31 March, Ms. Yellen decided she would reactivate the Financial Stability Oversight Committee's hedge fund working group.

Completed on 31 March 2021

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1 Proutat J.L. (2018), *The hypothetic return of inflation*, BNP Paribas EcoFlash, September.

THE AMERICAN RESCUE PLAN

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 as a result targets demand. Several measures merit our attention.

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 its "whatever it takes" approach, 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, 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 total disposable household 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 enormous savings: USD 2,850 bn in 2020 (16% of disposable income), more than twice the amount of 2019 savings.

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: ECOFLASH N°21-05, MARCH 2021 BNP PARIBAS