



R&R Weekly Column
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Policy Stimulus in the US: Echoes of The New Deal And Debt Monetisation

Last week the US Congress finally approved the [USD 1.9tn fiscal stimulus package](#) presented by the Biden administration and its Treasury Secretary Janet Yellen. The package consists, among other things, of USD 441bn in direct support to household income (“stimulus cheques”), USD 246bn of unemployment benefit extensions, USD 143bn of tax credit expansion, USD 360bn of aid to state and local governments, USD 227bn for healthcare (including for Covid testing and containment), and USD 176bn for education.

The Biden package is in addition to the 0.9tn fiscal stimulus approved by the US Congress around the time of the US presidential election in November 2020, which was presented by former President Trump. Together, the USD 2.8tn fiscal stimulus is equivalent to 13.3% of the US GDP, which [in current dollars is around USD 21tn](#). Even assuming that only one third of the stimulus will be actually spent, and two thirds will be either saved or else used to pay down debt, this still represents a 4% net stimulus to the economy, which – on the basis of this stimulus – could grow at least 6% in real terms in 2021, and perhaps even 7% in an upside scenario.


The probability of a downside scenario, wherein the US economy grows less than 6%, is quite low at this stage, for the following three reasons: 1) the fiscal stimulus has now been approved by the government and its actual implementation could be quite fast. Sending out cheques, extending unemployment benefits, and increasing tax credits are measures that can be put into action in a fortnight; 2) the risk that the market “undoes” some of the stimulus by demanding higher long-term yields (thus discouraging investment) is kept under control by the Fed’s program of asset purchases; 3) the successful vaccination campaign rolled out by the government, which has already led to around [30% of the US population being vaccinated](#) (versus 10% of the EU, for example), means that new lockdowns and severe restrictions are unlikely to be adopted in the future.


Regarding the successful vaccination campaign one should praise the logistical and organisational abilities of the US system as a whole, especially in situations in which the military gets involved. But other factors should also be considered, including the fact that three of the four internationally approved vaccines are produced by US-based companies (Pfizer, Moderna and J&J), which have favoured their home country in the production and distribution of the vaccine. Also, the low population density of the US may at times have acted as a competitive advantage, for example by providing space to allow Americans to queue inside their cars waiting to be vaccinated, whereas in most countries people have to stand in lines, thus creating possibilities for contagion. In any event, the number of new Covid cases in the US has recently collapsed from around 400K a day to 60K nationwide, as spring begins and larger segments of the country start experiencing warm weather, which has proved to be a more challenging environment for the virus to propagate.


With this rebound in economic activity, [coming after the 4.3% reduction in real GDP in 2020](#), the US in 2021 is already on track to recoup most of the GDP level lost during the pandemic. By comparison, a number of European countries (and most emerging markets) will take years to observe their GDP returning to pre-pandemic levels.


This remarkable comeback is therefore the result of a massive policy response provided by the US government through its various branches. The US federal fiscal deficit is forecast to be 10% of GDP in 2021, after being nearly 15% in 2020, the largest fiscal shortfall since 1945. This echoes the effort made by the US government to fight the Great Depression of the 1930s, and subsequently WW2, through Roosevelt’s New Deal. All this is clearly made possible by the *de-facto* deficit and debt monetisation carried out by the US Federal Reserve, the balance sheet of which has now reached USD 7.5tn, i.e. 35% of nominal GDP. We discussed in our previous columns how central banks, including the Fed, are fighting inflation fears and rising long-term yields. When the FOMC meets this week, it will decide whether or not more decisive actions, such as an enhanced forward guidance, explicit yield curve control, or an extension of the maturity of purchased bonds, are needed at this stage.

Our Recent Publications

 [Preview: Bank Of Japan To Remain Highly Accommodative After Its Strategy Review](#), by Brunello Rosa, Nouriel Roubini and Fawaz Sulaiman Al Mughrabi, 12 March 2021

 [Flash Preview: Bank of England To Stay Put After Budget and New Remit](#), by Brunello Rosa and Karmen Meneses, 12 March 2021

 [Flesh Review: ECB To Significantly Increase PEPP Pace To Maintain “Favourable Financing Conditions”](#), by Brunello Rosa, 11 March 2021

 [GEOPOLITICAL CORNER: The Risk in Europe is Medium Term: Armin Laschet, The Canary in the Coal Mine, and European Populism](#), by John C. Hulsman, 9 March 2021

Looking Ahead

The Week Ahead: EZ's Economic Sentiment To Rise Whilst US, UK, Japan And Norway's Central Banks To Stay Unchanged

In the US, February's retail sales are expected to decline to 5.5% y-o-y (*p*: 7.4%), while IP is expected to expand to 0.9% y-o-y (*p*: -1.8%).

In EZ, March's economic sentiment is expected to rise to 72.4 (*p*: 69.9).

In the US, UK, Japan and Norway, at their monetary policy meetings, the Fed (0.25%), BoE (0.10%), BoJ (-0.10%) and Norges Bank (0.0%) are expected to keep their interest rates unchanged.

The Quarter Ahead: COVID-19 Vaccines Reach 121 Countries; Recovery In The Cards, But Central Banks Maintain Dovish Bias

The US administered a new high of 5m doses of vaccine over the weekend, and - after plateauing the previous week - the daily count of new cases resumed its decline. In addition, the US government announced "a deal to secure another 100m doses of the Johnson & Johnson vaccine".

President Biden stated he "was directing states to make vaccines available to all adults by May 1" – hoping by July 4 small groups could gather and celebrate the Independence Day. At the same time, the president said the fight against COVID-19 is "far from over" and added that restrictions could be re-imposed if there is a surge in cases.

President Biden signed into law the USD 1.9tn 'American Rescue Plan Act', following its passage in Congress. Treasury Secretary Yellen stated that direct USD 1,400 payments to most Americans – a key part of the bill – should "begin showing up in bank accounts".

In the US, Fed Chair Powell suggested that the Fed's position will remain "resolutely supportive for growth". With the reopening of the economy and fiscal stimulus adding momentum to the recovery, financial markets will monitor inflation risks and the likelihood of earlier-than-expected rate hikes.

Several European countries decided to pause the rollout of the of Oxford-AstraZeneca vaccine. However, the World Health Organization (WHO) said there was no reason to stop using AstraZeneca's Covid-19 vaccine as there was "no link between the jab and increased risks of developing blood clots".

Last Week's Review

Real Economy: Global Recovery Contingent On Vaccine Distribution; Inflation Worries Linger

In the US, March's preliminary estimates for 'consumer sentiment' showed an above-consensus improvement (*a*: 83; *c*: 78.5; *p*: 76.8) – reaching a one-year high, as more vaccinations and fiscal relief boosted optimism in the economic outlook.

Still in the US, in February: *i*) CPI inflation rose to 1.7% y-o-y (*c*: 1.7%; *p*: 1.4%) – marking the highest rate since February 2020; while *ii*) core-CPI inflation softened to 1.3% y-o-y (*c*: 1.4%; *p*: 1.4%) - the lowest level since June 2020.

In the EZ, the economy contracted by -4.9% y-o-y in Q4 2020, following a (downwards revised) -4.2% fall in Q3, and an unprecedented -14.6% contraction in Q2 – due to the COVID-19 pandemic. For the year 2020 as a whole, the EZ's GDP shrank by -6.6%, after a 1.3% expansion in 2019.

During its March meeting the ECB left key interest rates at record-low levels, at 0.0%. The bank said it would conduct emergency bond purchases at a significantly higher pace over the next quarter, aiming to: *i*) compress spreads by bringing government bond yields down; and *ii*) support the economic recovery.

Financial Markets: Stocks Returned To Record Territory; Bonds Declined; The USD And Oil Prices Fell; Gold Up

Market drivers: technology shares declined while the blue-chip Dow index and the S&P 500 notched new highs. Yields on USTs rose. Investors sentiment was boosted by: *i*) the upcoming US fiscal stimulus; and *ii*) re-opening prospects.

Global equities closed higher w-o-w (MSCI ACWI, +2.6%, to 674). In the US, the S&P 500 Index hit new records highs (+2.6%, to 3,943), as: *i*) shares in automaker Tesla rebounded after the previous week's sell-off, lifting the consumer discretionary sector; and *ii*) the real estate sector outperformed. In the EZ, shares rose (Eurostoxx 50, +4.5%, to 3,833), as: *i*) the US prepares to inject a massive fiscal stimulus into the economy; *ii*) and the ECB pledged to buy more bonds to counter rising borrowing costs.

Fixed Income: w-o-w global bonds fell (BAML Global, -0.3% to 291.4), and the 10-year UST yields increased to a more than a year high (+8 bps, to 1.64%), as inflation expectations keep rising.

FX: w-o-w, the USD fell against other currencies (DXY, -0.3%, to 91.679; EUR/USD +0.3%, to 1.195).

Commodities: Oil prices fell (Brent, -0.2% to 69.2 USD/b), as global demand weakened. Gold rose (+1.5% to 1,726 USD/Oz), driven by USD strength and higher UST yields.



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year