

Off to the races?

Biden's stimulus plan boosts consumer spending as job growth falls

With a majority in Congress the Democrats will be able to set the political agenda and implement at least part of their priorities. President Biden starts by proposing a massive fiscal stimulus plan which will boost growth far above the economy's potential this year, even if only partially approved by Congress. More initiatives on infrastructure spending and higher taxes, particularly for corporates, are expected to follow.



Source: iStock

President Biden presents a new USD 1.9tn economic rescue plan as consumer spending falters

Last November's election did not result in the massive blue wave that was predicted ahead of time, but in the end, it was still enough to shift the balance of power in favour of the Democratic party. Having won both seats in the Georgia runoff the Democrats now have a slim majority in the Senate thanks to the Vice-President's tie breaking vote.

Source: Committee for a Responsible Federal Budget

Joe Biden, therefore, begins his presidency with Democrats controlling both chambers of Congress, giving him the opportunity to follow up on his campaign promises and aim for the implementation of some the Democrats' most important policy initiatives. Biden's recently presented economic rescue plan takes up a number of proposals that House Democrats introduced at the end of last year but were not included in the USD 900bn fiscal package approved by Congress in December.

President Biden proposes a USD 1.9tn economic rescue plan 200 25 30 120 170 160 350 350 465 Biden economic rescue plan (bn USD) Cash checks Unemployment support State and local aid COVID containment efforts Funding to schools and colleges Expand the child tax credit Rental and small landlord support Support to childcare providers Other

Following last year's CARES act and December's stimulus package, Biden is now proposing another round of fiscal support measures amounting to a total of USD 1.9tn.

With an eye on the recent surge in COVID-19 infections and renewed weakness in the labour market, the plan primarily focuses on supporting households as well as state and local governments. The economy faces substantial headwinds in the first quarter, particularly in the service sector. The proposed stimulus package will bridge the gap until the economy fully reopens and boost consumer spending thereafter.

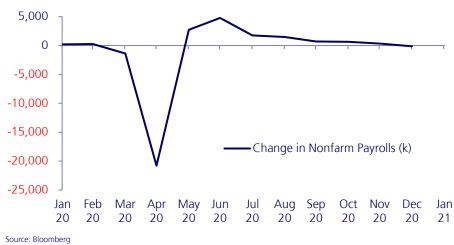
A major boost to household income

The most prominent part of Biden's plan is another direct stimulus payment to individuals of up to USD 1'400 per person. If implemented, that would inject roughly USD 465bn of cash into the private household sector. Another USD 350bn would be provided by an extension of emergency unemployment benefits of 400 USD per week until September. Taken together that amounts to additional support for consumers of almost 4% of GDP. While the final amount that will reach the economy in 2021 is likely to be significantly lower, it would still provide a substantial boost to consumer spending.

The plan will be cut down or split in parts, but additional near-term fiscal stimulus is still likely

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It is unlikely that the full plan will be passed by Congress. Biden signalled that he would prefer a bipartisan approach for his economic plan so he's expected to drop or soften some of the more controversial parts of the plan that will lead to opposition from Senate Republicans. In addition, given the very narrow majority in the Senate, the Democrats will also have to keep an eye on potential opposition from more moderate members within the party.

As headwinds for the economy loom and consumer spending slows one of the less controversial elements of the plan should be increasing direct support for households by topping up December's stimulus checks to USD 2'000. The final amount may be a matter of negotiations but it is still expected to be a substantial increase relative to the funds provided in December.

Similarly, funding a national vaccination program, testing and other COVID containment efforts are also likely to get bipartisan support. The USD 160bn reserved for this in Biden's proposal would help to speed up the path back to a normalisation of the economy.

Other parts of the Biden plan, like the intended aid to state and local governments, are more controversial. If President Biden wants to avoid the budget reconciliation procedure, which would extend the whole approval process, he needs at least 10 Republican votes in the Senate to get the bill through Congress, provided all of the Democrats support it. Given the urgency to support weaker households during the crisis Biden is expected to compromise on some of the issues that face the fiercest resistance.

Consumer spending is expected to get a massive boost later this year

Consumer spending weakened markedly in the final two months of last year. Soaring infection rates led to local shutdown measures and social distancing. The employment situation deteriorated, and the number of payrolls fell in December for the first time since the depths of the crisis in April last year. At the same time, a number of government support measures were about to run out while Democrats and Republicans kept negotiating, increasing uncertainty for many households. The new fiscal package will have a significant impact on consumer spending even if it is only partially implemented. The economy still faces substantial headwinds in the first quarter and most of the additional spending is expected to be backloaded in 2021 when pent-up demand fuelled by massive fiscal stimulus will hit a re-opening economy. Nevertheless, if the plan passes Congress in February it is still expected to have an impact on the first quarter as well.

Data provided by the US Treasury show that 79% of the total estimated amount of cash to support households approved by Congress in December was sent out in the first three days of distributing the second round of stimulus checks. Therefore, cash will quickly reach households once the bill is approved and some of that money will most likely be spent immediately. The job market is expected to deteriorate further in the coming weeks and more households will be cash constrained by the end of the quarter.

A bigger share of consumer cash support is likely to be spent this time

The major part of the cash checks sent out during the first wave of COVID-19 was either saved or used to pay down debt. Accordingly, the consumer saving rate soared to an all-time high. However, consumers on average still sit on a large pile of savings and the outlook is much less uncertain this time given the availability of an effective vaccine and a general view that the situation should start to normalise around the middle of the year. It is therefore reasonable to assume that a larger fraction of the cash stimulus will be spent, supporting consumer spending and employment. Other components of the fiscal package, like the emergency unemployment benefits, will be spread out more broadly over the course of the year.

The economic rescue plan provides nearterm support; longer-term spending plans and tax proposals will follow soon

The presented fiscal stimulus plan is only the first part of Biden's policy measures, meant to provide near-term support to a weakening economy. A second proposal dealing with longer-term issues like infrastructure is expected in a few weeks' time. These longerterm proposals will also address the revenue side of Biden's economic policy, providing more details on the tax policies under consideration by the administration. These proposals will combine the need to raise tax revenues to pay at least a part of the new policy initiatives with the Democrats' longheld objective of reducing income inequality.

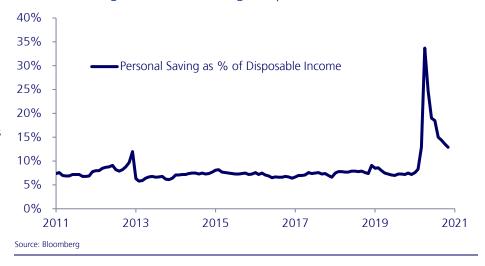
Democrats will strive to increase taxes for high-income earners

High on the Democrats' priority list is an increase of the top marginal income tax rate. This could be combined with lowering the value of income tax deductions for high income taxpayers, which would also raise tax revenue coming from high income earners. In addition, Biden is also likely to strive for an equalization of income and capital gains taxes, a proposal that he made even before becoming a Presidential candidate. Given the slim majority in the Senate the Democrats will have to balance the interest of more moderate party members against those aiming for major changes of the tax system.

Corporate tax rates are expected to increase

Another focus of the Biden administration's tax policy will be corporate taxes. There is widespread support within the Democratic party to lift the corporate tax rate, particularly after the significant reduction implemented by the Trump administration. Joe Biden proposed to raise the tax rate to 28% from 21%.

Personal saving has soared during the pandemic



The new administration wants to benefit from low bond vields 3.5% 3.0% 2.5% 2.0% 1.5% 1.0% 10yr Treasury yield 0.5% 0.0% 2017 2018 2016 2019 2020 2021 Source: Bloomberg

One major issue that could weigh on investor sentiment later this year is the prospect of higher corporate taxes, as mentioned above. In addition, there is the risk that the Fed begins to tighten its monetary policy sooner than expected given that inflation is likely to rebound markedly over the course of the year.

Like tax rates and deductions for individuals, the final number will be a result of negotiations in Congress and is likely to be part of a broader package on tax policy. An overall increase in corporate taxes is likely while more targeted measures, which would particularly impact specific sectors like technology, banks, energy or pharma, are also possible but could be more challenging given the slim majority in the Senate.

With the Biden administration's initial focus on fighting the pandemic and leading the economy out of crisis, the corporate tax hike is not expected to be implemented this year. Nevertheless, the prospect of lower corporate profitability and uncertainty regarding both the level of the future corporate tax rate and when it will be implemented are likely to create some uncertainty among investors once the negotiations gather momentum.

The new administration wants to act big while bond yields are low

Longer-term government bond yields have risen following the Democrats' election victory in Georgia and Joe Biden's announcement of his economic rescue plan with 10yr Treasury yields rising back above 1% for the first time since March last year. While higher than in most other developed economies, this is still an extraordinarily low level historically.

Despite the soaring budget deficit and rise in government debt caused by the fiscal support measures, the actual cost of servicing the debt in the coming years will be lower than before the crisis as yields have plunged during the pandemic. Based on this, Treasury Secretary nominee Janet Yellen asked Congress to grab the opportunity of historically low yields and act big to improve the long-term prospects of the US economy by investing in education, infrastructure and technology.

The Fed keeps the door open for fiscal stimulus by putting a lid on bond yields

Former Fed Chair Yellen is expected to use her close ties with the central bank to deepen cooperation with the Fed. This will be particularly important in fighting future crises as underlined by the successful programs implemented during the COVID-19 pandemic, but it could also help to get the Fed's implicit support for further fiscal measures.

With the move to an average inflation target, the Fed has committed to keeping the target

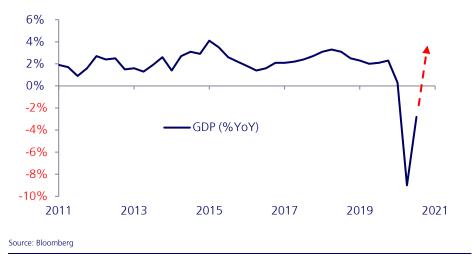
rate at current levels until inflation has risen above 2% and is expected to remain there for a sustainable period of time. Although longerterm inflation expectations rose to the highest level in more than two years at the beginning of the year, they remain low from a historical perspective. Fed Chair Jerome Powell has repeatedly signaled that the FOMC is not even thinking about starting to taper its asset purchases, thus keeping the door wide open for further fiscal stimulus and yields to remain low.

Although challenges will remain, substantial tailwinds for the economy and the markets are on the horizon

We are very constructive regarding the path of the US economy over the course of the coming year. Pent-up demand fueled by a huge amount of fiscal stimulus and loose monetary policy will boost consumption and business activity as the economy begins to normalise. Corporate profits are expected to soar, particularly compared to a dismal 2020. With the Fed keeping a lid on yields and providing abundant liquidity, stock markets should benefit from substantial tailwinds.

A major near-term risk to our optimistic view on the economy are potential mutations of the corona virus that might make a vaccination significantly less effective as well as logistical issues that could severely slow down the distribution of the vaccine.

Growth expected to come back with a vengeance



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