Biden's growth gambit

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Highlights

- President Joe Biden's US $1.9 trillion stimulus proposal is an 'all-in' push to bridge the pandemic crisis and put the economy in the fast lane to full employment.
- Biden's plan could increase the US deficit by about 8% of GDP in 2021, after measures last year totalling 11.5% of GDP, although we don't expect the full proposal to reach the finish line.
- Stimulus could lead the economy to run hot in the short term while other components could become long-term drags on the labour market, economic growth and corporate earnings.

Joe Biden was sworn in as President at a critical point in the US recovery, with many economic indicators recently turning negative. Initial unemployment claims ticked up and retail sales slumped in January as new cases of the virus and deaths surged. President Biden's economic policy response is to provide emergency income relief for households, states and the healthcare system (Table 1). In this way, the plan should bridge short-term economic weaknesses until vaccinations can be rolled out, setting the stage for a more durable recovery. But more than just a temporary bridge of emergency relief, Democrats' fiscal ambitions may lead the US economy to run hot, helping to reduce unemployment more quickly.

Table 1 | Overall fiscal cost of President Biden's proposed "American Rescue Plan"

Provision	Fiscal cost
$1,400 stimulus cheques	$465 billion
Increase aid to state and local governments	$350 billion
Increase UI supplement from $300/week to $400/week and extend to September	$350 billion
Fund vaccination and testing efforts	$170 billion
Raise the minimum wage to $15/hour	-
Other spending	$565 billion
Total	**$1.9 trillion**

Source: Committee for a Responsible Federal Budget.

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Investments

The American Rescue Plan (ARP), Biden's recent Covid stimulus proposal, could increase the US federal deficit by 7.5% of GDP in 2021 by our calculations. But with Democrats having the slimmest of majorities in the Senate, the proposal will likely not get implemented in its entirety. However, even a scaled down package would come on top of about $900 billion USD of economic stimulus approved in December.

The ARP does not change our view that medium-term inflation expectations will remain anchored to the Fed's 2% target. But it does push up expected inflation in the short term. We estimate that even a partial adoption of the Plan could temporarily bring aggregate demand above supply, closing the US output gap in 2021 (Figure 1). As a testament to the impact of Joe Biden's fiscal ambitions on short-term inflation expectations, one-year US breakeven rates broke above 3% in the days following the announcement. But the measures most likely to be adopted in 2021 – direct stimulus cheques, extension of unemployment insurance supplements and vaccination funding – are temporary in nature. As long as those outlays don't become a structural part of US fiscal spending and the Fed stands ready to mop up excess liquidity after the recovery, the risks to medium-term inflation remain contained.

Figure 1 | Our projection of the 2021 output gap turns positive with Biden's Covid rescue plan
(negative output gap signifies under-employment)

Source: Calculations by the Mackenzie Multi-Asset Strategies Team, underlying data via Bloomberg.

While the ARP will focus mainly on short-term stimulus, other key components of the Democrats' fiscal program are expected to have longer term macro impacts. We expect a push for more infrastructure spending as well as a plan to raise taxes on corporations and high-income earners, a central tenet of Biden's platform. Infrastructure spending is deeply needed and should garner broad bipartisan support. Infrastructure investments can boost long-term productivity growth, and a tilt to green energy may help the US tackle long-term climate risks.

Raising taxes on US corporations and high-income individuals earning above $400k would provide revenue offsets to higher spending but weigh on growth. Reducing the structural deficit is important for macro stability to sustain long-term economic growth. But higher corporate taxes are themselves a drag on long-term growth, as they lower the return to investment and discourage capital accumulation. Higher corporate taxes also have a direct impact on equity earnings, a potential headwind for investors.

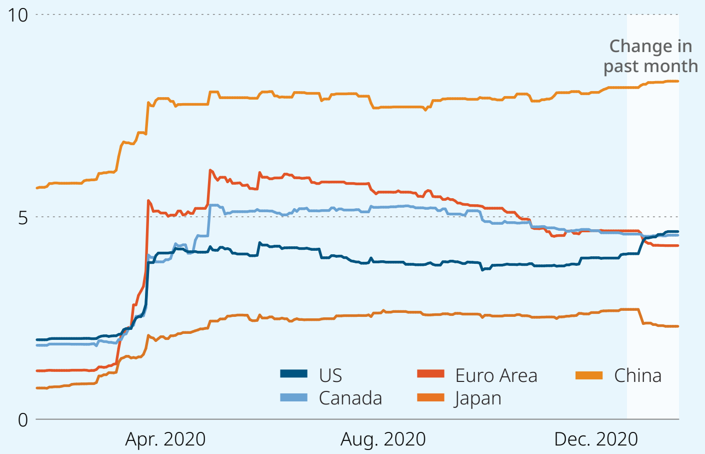
Similarly, the inclusion of a $15 federal minimum wage in the ARP poses a risk to the labour market recovery and overall growth. While minimum wage increases are not always economically harmful, a large hike irrespective of local labour market conditions in the middle of a recession could cause job losses and erode the US economy's stabilizers when the next crisis comes. Biden's "Buy American" plan could also result in greater protectionism, which discourages innovation, productivity and long-term growth.

If President Biden succeeds in fast-tracking the US economy to full employment, it might all be worth it in the short term, but their plan is not a free lunch in the long term.

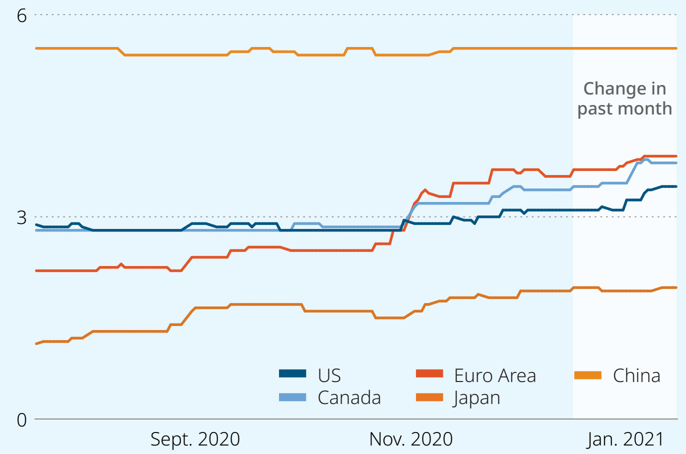
Global macro update

- Democrats' win in the Senate runoffs and President Biden's ambitious fiscal stimulus plan pushed growth and inflation expectations higher in the **United States**. We expect positive spillover effects for **Canada**'s economy as well, with Canadian exports heavily dependant on US demand.
- In the **Euro Area**, a slow start to vaccination efforts may delay the economic recovery.
- **Japan**'s declaration of a "state of emergency" lockdown on January 7 was a hit to both growth and inflation expectations in the first quarter of 2021. The Bank of Japan's decision to stand pat at its January 21 meeting solidified the anticipation of negative inflation in 2021.

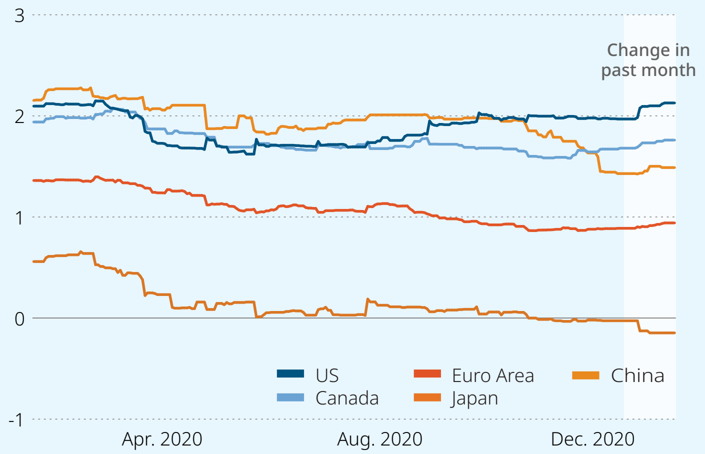
2021 real GDP growth forecast (%, consensus)



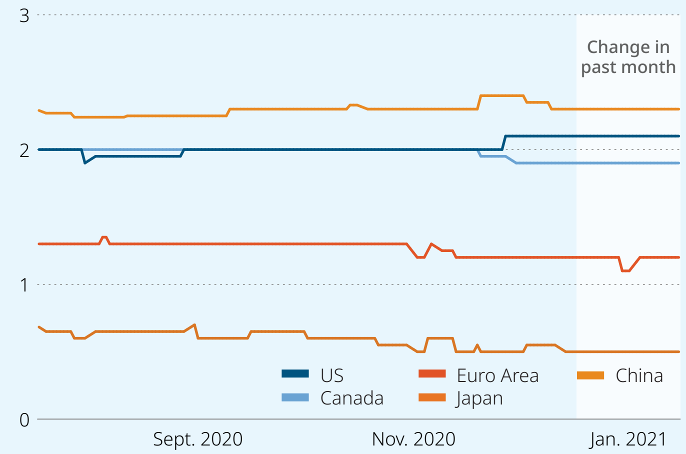
2022 real GDP growth forecast (%, consensus)



2021 inflation forecast (%, consensus)



2022 inflation forecast (%, consensus)

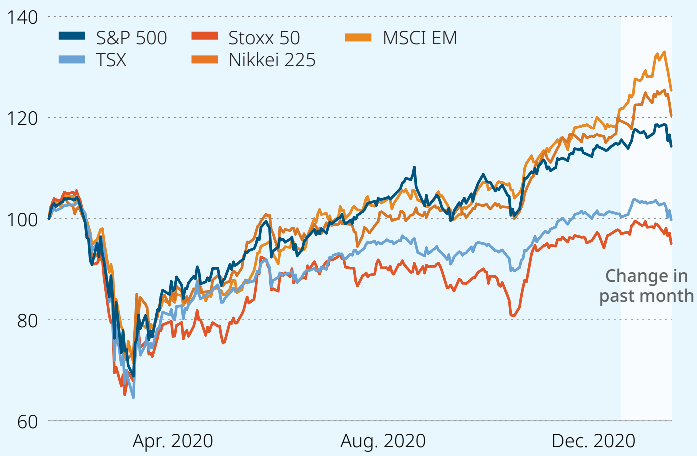


Source: 2021 forecast survey from Consensus Economics, 2022 forecast survey from Bloomberg, as of January 31, 2021.

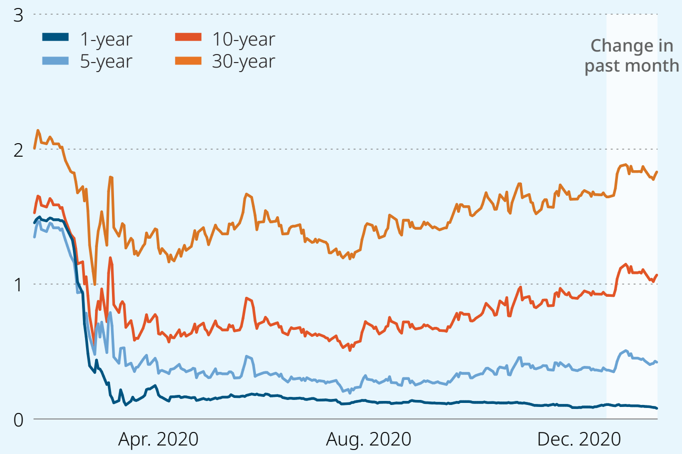
Capital markets update

- **Equity markets** generally climbed in the first three weeks of 2021, before reversing their gains in the final days of January as volatility surged.
- The **US yield curve** steepened significantly after Democrats' win in the Senate runoffs, with markets expecting higher government spending and inflation.
- Reflecting weakness in their domestic economies, the **euro and yen** depreciated in January.
- **Oil prices** followed the reflationary impulse from the Democratic win, having now mostly recuperated to their pre-crisis levels.

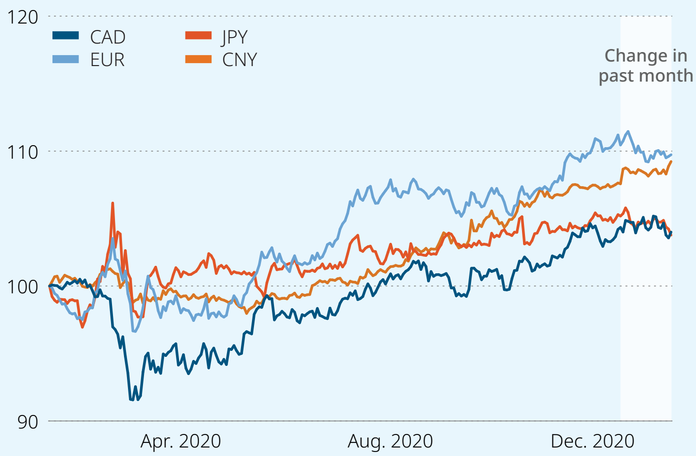
Equity indices (one year ago=100)



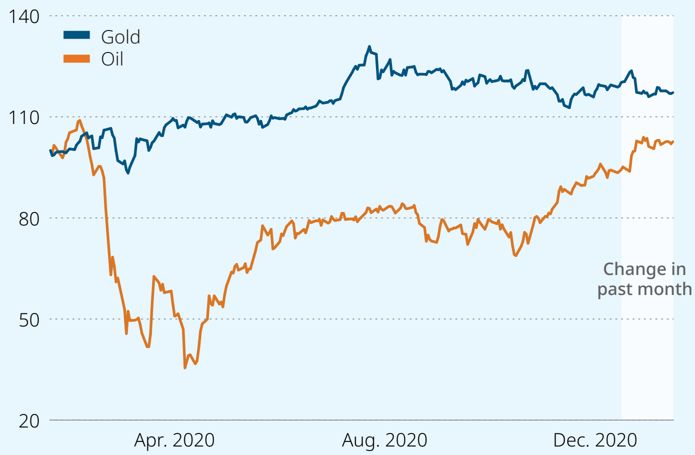
US Treasury yields (%)



Currencies (relative to USD, one year ago=100)



Commodity prices (in USD, one year ago=100)



Source: Via Bloomberg as of January 31, 2021.

What we'll be watching in February

Feb 2: Euro Area 2020 Q4 GDP release

- After a stronger-than-expected GDP rebound in 2020 Q3 (+12.5% quarterly), we anticipate a drop in Euro Area output in Q4, with Covid restrictions severely delaying the recovery.
- The goods sector has shown improving resiliency to lockdowns in the second global infection wave, so we expect the pain to be heavily concentrated in service-sector firms.

Feb. 5: US jobs report

- The last US payroll report was a negative surprise, with a net loss of 140,000 jobs in December (+50,000 expected). This time, economists expect a net gain of about 100,000 for January.[1]
- A surprise to the downside, especially the news of a net employment loss, could boost support for the Biden administration's fiscal stimulus proposal.

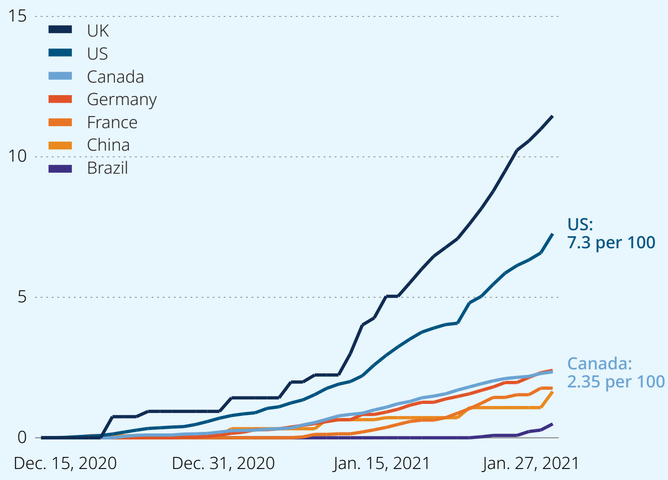
Feb. 12: Lunar New Year

- China wants to complete immunization of at-risk groups before the Lunar New Year. The government is planning to have vaccinated 50 million people in advance of the travel-heavy holiday.

Emerging theme

- Trends in vaccination pace have emerged in recent weeks, with clear heterogeneity across countries. Speedier countries will reach **herd immunity** faster, reopening their economy sooner.
- The **UK** is clearly outpacing other large countries. UK vaccination efforts have benefitted from a larger vaccine stock, the UK being one of the only countries having approved the convenient Oxford/Astra Zeneca vaccine, and faster distribution of that stock, notably by being one of the first countries to adopt the First Doses First strategy.
- **Canada** is trailing the US in its vaccination efforts. Delays in deliveries to Canada in coming weeks will likely increase the gap.
- **Emerging markets** will be left behind, many of them having barely started vaccinating their populations. Reinforcing the theme of a "K-shaped" recovery, rich countries will reopen their economies faster and have a head start towards getting back to full employment.

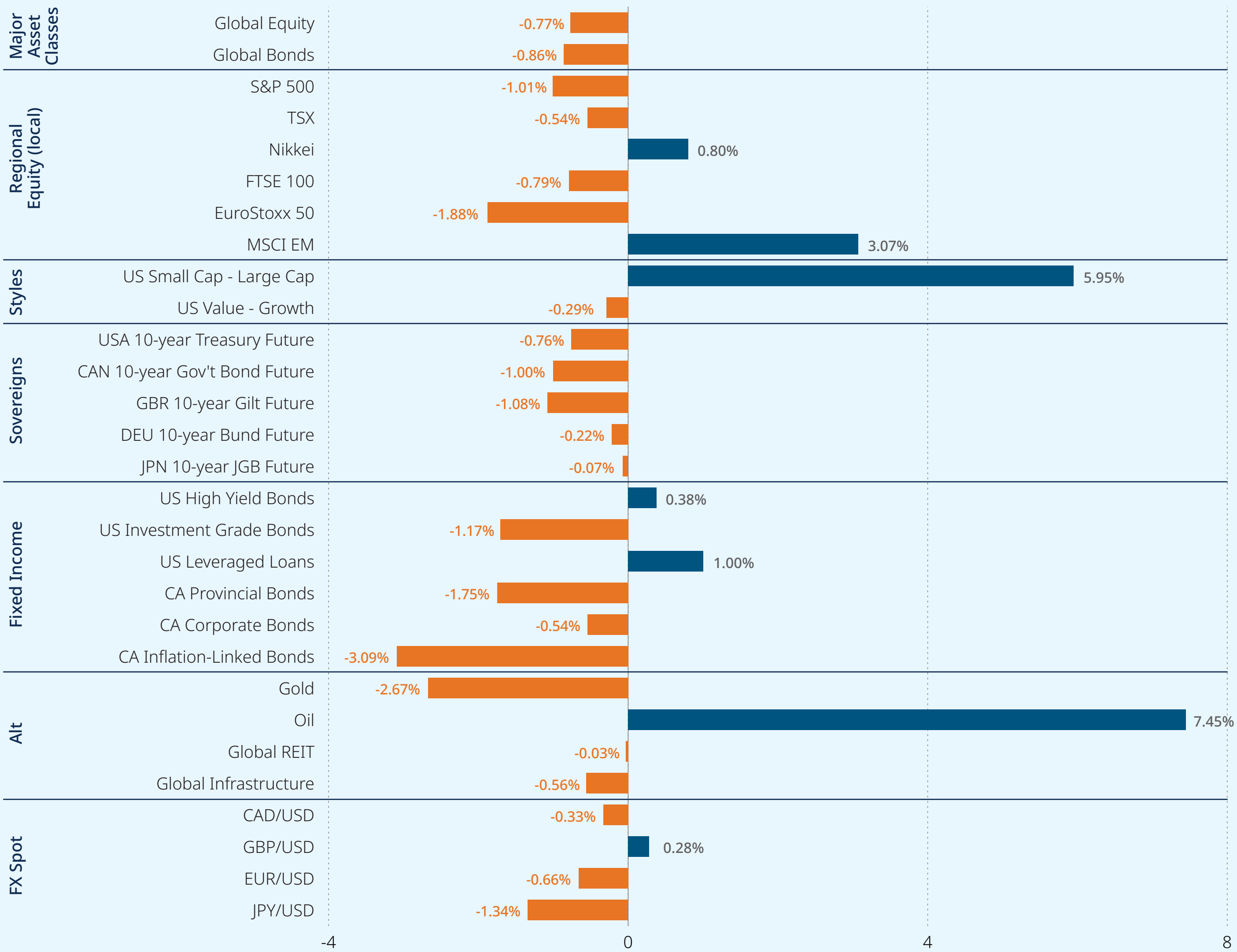
Vaccine doses administered per 100 people



Source: Vaccine data via Our World in Data, country population via Bloomberg as of January 28, 2021.

1 Bloomberg's survey of economic forecasters as of January 26, 2021.

Appendix: Capital market returns in January



Source: Market data from Bloomberg as of January 31, 2021. Index returns are for the period: 2020-12-31 to 2021-01-31. In order, the indices are: MSCI World (lcl), BBG Barclays Multiverse, S&P 500 (USD), TSX Composite (CAD), Nikkei 225 (JPY), FTSE 100 (GBP), EuroStoxx 50 (EUR), MSCI EM (lcl), Russell 2000 - Russell 1000, Russell 1000 Value - Russell 1000 Growth, USA 10-year Treasury Future, CAN 10-year Gov't Bond Future, GBR 10-year Gilt Future, DEU 10-year Bund Future, JPN 10-year JGB Future, BAML HY Master II, iBoxx US Liquid IG, Leveraged Loans BBG (USD), Provincial Bonds (FTSE/TMX Universe), BAML Canada Corp, BAML Canada IL, BBG Gold, BBG WTI, REIT (MSCI Local), Infrastructure (MSCI Local), BBG CADUSD, BBG GBPUSD, BBG EURUSD, BBG JPYUSD.

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