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R&R Weekly Column
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Biden's Spending Spree Aims To Undercut Populist Backlash

Last week, US President Joe Biden gave his first speech to a joint session of Congress, flanked by the House Speaker Nancy Pelosi and the President of the Senate, US Vice-President Kamala Harris. Joe Biden outlined to Congress the massive three-pronged fiscal stimulus package that has been rolled out in the last few weeks: the USD 1.9tn American Rescue Plan, the USD 2.3tn infrastructure spending bill (dubbed a "blueprint for blue-collar America"), and the USD 1.8tn expansion of the dwindling US social safety net. This spending spree, equivalent to 30% of the country's USD 20tn GDP, will be financed in part by the enormous amount of debt that has been issued since the pandemic crisis started, which has brought the US debt to GDP ratio to 133%. But it will also be financed by higher corporate taxes and by higher taxes on the richest segment of the population.

The economic impact of this composite fiscal stimulus plan will be immediate, with real GDP growth expected to be between 6 and 7% in 2021. Yet it impact will also be protracted over time, with infrastructure projects likely to last many years.

Its impact on inflation has caused concern among market participants and analysts. Even if only 1/3 of the American Rescue Plan ends up being effectively spent (with the rest either saved or used to pay down debt accumulated during the pandemic), there is the risk that this enormous amount of money injected into an already recovering economy may generate some inflationary pressures when the output gap eventually closes, especially as fiscal expansion has been monetised by the central bank. As we discussed in our in-depth report on this issue, US inflation has been on the rise for months now; CPI inflation has reached 2.6%. During his latest press conference, Fed Chair Powell recently said that the Fed expects base effects to add at least 1% to headline inflation (and 0.7% to core inflation), with bottlenecks in the supply chain of commodities or essential parts (such as semi-conductors), adding additional upward inflationary pressures. Even a fellow Democrat such as Larry Summers expressed some doubts, his concern being that the stimulus package might have been excessive.

In our view, the risk that inflation will spin out of control is limited, and in any case after many years of inflation undershooting, a brief period of even 3-4% inflation cannot hurt too much, and would actually help in making the debt burden more sustainable in real terms. Whatever the economic impact, it seems to us that this discussion misses the real motivations behind Biden's stimulus package, which we believe are twofold. *First*, the Biden administration wants to use the occasion offered by the pandemic to make once-in-a-generation investments, in order for the US to catch up on the many fronts that it has been falling behind many other countries. For example, in the quality of its infrastructure, its public education and childcare, public transportation, digital and ecological transformation, to cite only some of the most prominent areas the US may need to address. This is really the implementation of the old Churchillian adage "never waste a good crisis."

Second, Biden has only two years (really, only a year and half now) to eradicate populism from the country's political trajectory. Populism could easily resurface in the 2022 mid-term election, leading even to a comeback of Donald Trump, the US champion of populism. Economic malaise would be the obvious culprit for such a resurgence, and so Joe Biden wants to make sure that, by November 2022, the pandemic will be just a horrible memory, and that as many Americans as possible will have returned to work, and are not open to the sirens of the populist narrative. This is to make sure that, if Kamala Harris has to succeed him three years from now, or if he decides to run for a second term himself, the race won't be lost from the get-go, but the Democrats will instead actually have good chance of success.

Our Recent Publications

- Flash Preview: BOE on Hold While Reflecting Successful Vaccination Campaign in Growth Forecasts, *by Brunello Rosa and Karmen Meneses, 30 April 2021*
- Flash Review: Federal Reserve No Time Yet To Think About Tapering, *by Brunello Rosa, 28 April 2021*
- Flash Review: Bank of Japan Stands Pat in April And Confirms Its Easing Bias, *by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 27 April 2021*
- Flash Preview: US Federal Reserve - Strong Economic Expansion Ahead, But No Tapering Talk Yet, *by Nouriel Roubini and Alessandro Magnoli Bocchi, 26 April 2021*

Looking Ahead

The Week Ahead: US Non-Farm Payrolls Are Expected To Increase

In the US, April's non-farm payrolls are expected to increase by 925k (*p:* 916k) and unemployment is expected to decline to 5.8% (*p:* 6.0%).

In the EZ, retails sales for March are expected to soften to 1.8% m-o-m (*p:* 3.0%).

The Quarter Ahead: COVID-19 Restrictions Ease In US; EU-Russia Relations Deteriorate; Central Banks On Hold

Over the next quarters, DMs are likely to recover towards their pre-pandemic potential, because: *i)* DM economies are now more resilient to lockdowns; *ii)* monetary and fiscal stimuli will boost near-term aggregate demand – especially in the US.

In the US, fully vaccinated individuals can now remove their masks when walking, jogging, biking or in small outdoor gatherings; indoor activities still require masks.

US Fed Chair Powell stated that "*temporary price jumps will force the Fed to pull back on the stimulus it has pumped into the economy during the pandemic*". Powell highlighted the Fed's commitment to: *i)* keep the benchmark lending rate near zero, where it has been since the start of the crisis; and *ii)* continue its massive bond buying program "*until employment recovers and inflation exceeds the 2% threshold for some time*".

President Biden called for an expansion of federal programs to: *1)* drive the economy past the pandemic; and *2)* expand the social safety net – funded by a series of tax increases on the wealthy that would "*raise about USD 1.5tn over a decade*". So far, in a deeply divided Congress, Republican lawmakers opposed Biden's plans.

The EU has accused Russia of "seeking confrontation", after Moscow, in a retaliatory move, sanctioned senior EU officials and the EP President. EU leaders stated *that "this action is unacceptable […], as it targets the EU directly, not only the individuals concerned"*.

In the UK, the 'Medicines and Healthcare products Regulatory Agency' (MHRA) released the first breakdown by age of the Oxford/AstraZeneca vaccine adverse side-effects. The MHRA said rare blood clotting affects particularly younger adults (209 individuals to date, including 41 deaths).

Last Week's Review

Real Economy: Global Economic Recovery Remains Uneven, While Downside Risks Elevate

In the US, Q1 GDP growth rose above-consensus to 6.4% q-o-q (*c:* 6.1%; *p:* 4.3%), as activity and demand consolidated their recovery from last year's steep contraction, helped by: *i)* reopening efforts amid an acceleration in the pace of COVID-19 vaccinations; and *ii)* continued government stimuli, in response to the pandemic.

Still in the US, March's PCE price index rose above-consensus to 2.3% y-o-y (*c:* 1.6%; *p:* 1.5%) – the most since 2018; core-PCE price index rose in-line with expectations to 1.8% y-o-y (*c:* 1.8%; *p:* 1.4%).

In the EZ, Q1 GDP growth declined to -0.6% q-o-q (*c:* -0.8%; *p:* -0.7%), entering a double-dip recession in Q1-2021, as COVID-19 lockdowns continued to hamper the services industry. Year-on-year, EZ's GDP dropped by -1.8%, easing from a slump in Q4-2020 (*c:* -2.0%; *p:* -4.9%).

Still in the EZ, March's inflation rate increased to 1.6% y-o-y (*c:* 1.6%; *p:* 1.3%), marking the highest level since April 2019.

In the US and Japan, both CBs kept their interest rates unchanged in their April monetary policy meetings (Fed: 0.25%; BoJ: -0.1%).

Financial Markets: Stocks Fall, As COVID-19 Cases Spike; Bond Yields Rise; USD And Oil Up

Market drivers: with much of the good news on corporate earnings and economic recovery already priced into the market, investor sentiment was hampered by worries about: *i)* rising COVID-19 cases; *ii)* the EZ double-dip recession; and *iii)* rising UST yields.

Global equities fell w-o-w (MSCI ACWI, -0.3%, to 702). In the *US*, the S&P 500 Index finished virtually flat (0.0%, to 4,181), retreating from records set mid-week amid a broader market sell-off led by the energy sector. In the *EZ*, shares fell (Eurostoxx 50, -1.0%, to 3,975) after an increase in EZ bond yields prompted investors to take profits from stocks at near-record valuation levels.

Fixed Income: w-o-w global bonds fell (BAML Global, -0.3% to 292.2), as UST yields rose (+6 bps, to 1.63%), driven by solid economic data; however, the Fed's dovish tone helped moderate the increase.

FX: w-o-w, the USD strengthened (DXY, +0.5%, to 91.280; EUR/USD -0.7%, to 1.202), as a shift in risk appetite favored safe-haven flows.

Commodities: Oil prices rose (Brent, +1.7% to 67.3 USD/b), as investors focused on H2-2021 prospects of robust demand recovery - despite rising COVID-19 cases in India, Japan and Brazil. Gold fell (-0.5% to 1,769 USD/Oz) as higher bond yields dented its appeal.

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*