Rosa & Roubini
ASSOCIATES

MAKING SENSE OF *THIS* WORLD — *31 May 2021*

R&R Weekly Column
By Brunello Rosa

Biden's Budget Highlights His Ambition To Revive The US Economy

US President Joe Biden gave a speech in Cleveland last week, in which he provided his vision for the future of the US economy. He highlighted the importance of putting the middle class back at the centre of his project to rebuild the economy after the pandemic, partly at the expense of the wealthiest 1% of US citizens and large US corporations. Following the speech, he revealed his first, ambitious, USD 6tn annual budget, which Congress needs to pass by the end of September. The budget is large (as was the last budget of the Trump administration, at USD 4.8tn), and it come in addition to both the USD 1.9tn Covid stimulus bill approved earlier this year and the USD 2.2tn infrastructure plan (which has now been reduced to USD 1.7tn).

This potentially transformative bill will allocate more than USD 800bn to fight climate change, including investments in environmentally-friendly energy, USD 200bn to provide free pre-school places for all 3-year-old and 4-year-old kids, USD 109bn for two years of free community college for all US students, USD 225bn for a national paid family and medical leave programme, USD 115bn for road and bridge repairs and USD 160bn for public transit and railways, and USD 100bn to improve access to broadband internet for every US household. It also includes USD 1.5tn for operating expenditures for the Pentagon and other government departments. To pay for this increased expenditure, the US administration proposes to increase the taxes on corporations from 21% to 28%, increase capital gains and the top income tax bracket to the tune of USD 3tn, and run a fiscal deficit of over USD 1.3tn over the next decade. The combined effects are expected to push the US debt-to-GDP ratio to 117%, a level not seen since WWII.

This budget will reinforce the fears, discussed in our previous columns (on May 3 and May 17) that the US economy will overheat over the next few years, thus leading to a rise in inflation, which eventually the Federal Reserve will have to stave off with a rise in interest rates, thus potentially leading to a recession. In effect, inflation has been rising in the last few months, with even the closely watched (by the Fed) headline personal consumption expenditures (PCE) gauge reaching 3.6% y/y in April, with core PCE having reached 3.1% y/y in April (a level not seen since 1992), up from the 1.9% recorded in March. For reference, the standard consumer price index (CPI) was up by 4.2% in April. We expect inflation prints to remain high in the next few months.

In spite of some investor worries, the Federal Reserve remains relatively relaxed about these increases in inflation, which are still considered to be transient. Even recently, Fed Vice Chair Richard Clarida reassured the market that the Fed will look through temporary spikes in inflation due to base and supply-bottleneck effects. Even if the minutes of the April FOMC meeting showed that several FOMC participants were willing to begin a discussion on tapering asset purchases in the next few months, the probability of a rate increase in the near term is very low. We do not expect a rate increase to occur before 2023 at the very earliest.

The market is jittery, but ultimately seems willing to follow the lead of the central bank. The USD remains weak versus the EUR, CAD, AUD, and NZD, among others. The 2y Treasury yield, at 0.14%, is still very close to the middle of the 0-0.25% range for the Fed funds target, and the 10y Treasury yield still remains at 1.58%, a level that is indicative of the fact that inflation expectations are not running out of control.

Our Recent Publications

- Market Review And Outlook: Vaccine Rollouts And Abundant Liquidity To Support Market Performance, *by Alessandro Magnoli Bocchi and Fawaz Sulaiman Al Mughrabi, 21 May 2021*
- **GEOPOLITICAL CORNER:** Looking Beyond its Covid Tragedy, India Remains the World's Most Significant Rising Power, *by John C. Hulsman, 18 May 2021*

Looking Ahead

The Week Ahead: US Unemployment To Fall While EZ Inflation Rate Is Expected To Rise

In the US, in May, non-farm payrolls are expected to increase to 650k (*p*: 266k), while the unemployment rate is expected to fall slightly to 5.9% (*p*: 6.0%).

In the EZ, April's retail sales are expected to climb to 26% y-o-y (*p*: 12.0%), and the inflation rate is expected to rise to 1.9% y-o-y (*p*: 1.6%), with core-inflation rising to 0.9% y-o-y (*p*: 0.7%).

The Quarter Ahead: Global Vaccine Distribution To Face Delays; US Budget Increase; CBs To Maintain Their Easing Bias

The surge of the COVID-19 in India and lower-than-expected vaccine supplies in Q2-2021 are likely to have a negative impact on global recovery prospects. Concretely, by the end of June COVAX will face a shortfall of 190m doses; however, its original objective – delivery of 2bn doses of vaccines worldwide in 2021, and 1.8bn doses to 92 lower income economies by early 2022 – are still well within reach.

Amid rising COVID-19 cases globally, US president Joe Biden ordered his intelligence agencies to *"review the evidence for the lab-leak hypothesis"*, and to report the findings back to him within 90 days. China continues to deny the possibility of lab leak.

US Senate Republicans have blocked the creation of a bipartisan panel to study the January 6 attack on the Capitol, in a show of party loyalty to former president Donald Trump. The vote was 54 to 35 – short of the 60 votes needed to take up a House-passed bill.

The Biden administration released its budget for fiscal year 2022, calling for increases in spending on: *i)* education; *ii)* healthcare; and *iii)* renewable energy. President Biden proposed a USD 6tn budget for the year beginning October 1, including USD 1.5tn in discretionary spending for the military and domestic programs.

In the US, the Fed seems willing to start reducing the pace of asset purchases; yet, any real action is likely months away. Fed officials have reiterated that price pressures including: *i)* fiscal stimulus; *ii)* supply constraints; and *iii)* rising commodity prices are transitory.

Last Week's Review

Real Economy: DM Economic Recovery Still Fragile As Vaccine Delays Hinder Growth Outlook

In the US, April's orders for 'non-defense capital goods excluding aircraft' – a closely watched proxy for business spending plans – jumped by 2.3% (*c:* 0.8%; *p:* 1.6%). April's 'durable goods orders' fell to -1.3% (*c:* 0.7%; *p:* 1.3%), showing the first decline in almost a year, as supply shortages continued to impact production.

Still in the US, in April: *i)* the PCE price index rose faster-than-expected to 3.6% y-o-y (*c:* 2.2%; *p:* 2.4%), as price pressures built in the rapidly expanding US economy; and *ii)* core-PCE price index – the Fed preferred inflation gauge – rose to 3.1% y-o-y (*c:* 2.9%; *p:* 1.9%), marking the highest rate since the 1990s, and bringing it well above the Fed's 2% average target.

In the EZ, May's consumer confidence indicator rose in line with consensus to -5.1 (*c:* -5.1; *p:* -8.1), up for the fourth month in a row to the highest level since October 2018, supported by: *i)* the gradual reopening of the economy; and *ii)* an acceleration in the COVID vaccination pace.

In New Zealand, during its May meeting, the RBNZ held its Official Cash Rate (OCR) unchanged at 0.25%, but projected a 25bps rate hike to 0.50% by September 2022 - reaching 1.50% by the end of 2023.

Financial Markets: Global Equities And Bonds Rise; USD Flat; Oil Prices Near 70 USD/B

Market drivers: optimism about the reopening of the US economy and prospects of robust economic recovery fueled by: *i)* massive government spending; and *ii)* ultra-loose monetary policy supported risk-on sentiment.

Global equities rose w-o-w (MSCI ACWI, +1.4%, to 711). In the *US*, growth shares outperformed their value counterparts; Facebook and Google parent Alphabet helped communication services stocks outperform within the S&P 500, and a rebound in Tesla boosted consumer discretionary shares (+1.2%, to 4,204). In the *EZ*, European stocks advanced on continued affirmations of ultra-easy monetary policy and reports of a massive US fiscal spending plan (Eurostoxx 50, +1.1%, to 4,071).

Fixed Income: w-o-w global bonds rose (BAML Global, +0.3% to 292.7) and UST yields fell (-4bps, to 1.59%), as a reading on inflation came in higher than expected.

FX: w-o-w, the USD was flat (DXY, 0%, to 90.031; EUR/USD +0.1%, to 1.219).

Commodities: Oil prices rose (Brent, 4.8% to 69.6 USD/b), as signs of a brighter global demand outlook more than offset concerns over potentially more Iranian supply. Gold prices climbed (+1.2% to 1,903 USD/Oz) as UST yields retreated and the USD eased off of its more than two-week highs.

Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*