10 March 2021

Research US

Overshooting the old GDP trend path in Q3 21

Key takeaways

- We argue that many elements of President Joe Biden's relief package should be considered as "insurance" (or automatic stabilisers) and not discretionary fiscal spending. A lot will fall out naturally next year. That said, some elements are clearly very stimulating.
- We argue that the US GDP will overshoot its pre-corona trend path in Q3 21 and stay above suggesting there are no long-lasting damages to the economy from COVID-19 (on the contrary the support may undo some of the damages created by the last crisis).
- We now forecast GDP growth of 7.5% this year and 5.3% next year (up from 3.3% and 3.8%, respectively). We expect the unemployment rate to decline below 4% in H2 21, when activity in the employment-heavy sectors returns to normal.
- We argue that inflation is set to move higher but it will take some time before it gets long-lasting. We expect PCE core inflation to reach 2% by end-2022.

Biden's plan: Discretionary in nature but mostly insurance in practice

President Joe Biden's relief package of close to USD1,900bn (or 8.1% of nominal counterfactual 2021 GDP assuming nominal GDP would have grown in line with the 2017-2019 trend in 2020-21 without COVID-19) will soon be approved, on top of the ~USD900bn package agreed upon in December (3.9% of nominal counterfactual 2021 GDP).

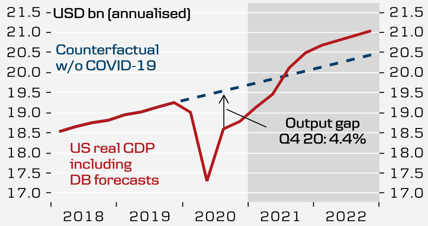
Biden's relief package – estimated outlays per year (approximately)

	2021	2022	2023	2024	Sum 2021-2031
Estimated outlays (USD bn)	1,457	127	117	66	1,886
% of total package	77	7	6	3	100
% of counterfactual nominal 2021 GDP	6.2	0.5	0.5	0.3	8.1

Sources: Danske Bank calculations based on CBO cost estimates of the House package

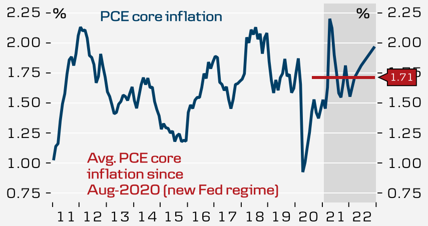
Looking at CBO's cost estimates for the different elements reveals that approximately 77% of the UDS 1,900bn are spent this year, 7% next year and 6% in 2023 based on some calculations of the distribution of outlays (the US fiscal year, which CBO refers to, is running October-September, which one needs to adjust for). 77% corresponds to USD1,457bn or 6.2% of nominal counterfactual 2021 GDP). The outlays this year are mainly for unemployment benefits, a third stimulus payment, child tax credit and state and local aid. The federal minimum wage hike has been ruled out of scope for budget reconciliation, which reduces the total size of the package by nearly USD75bn.

New US macro forecasts



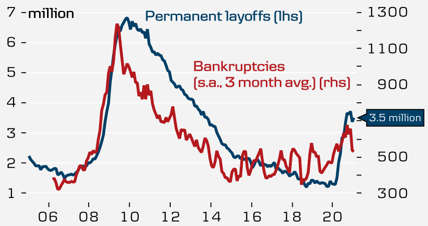
Sources: BEA, Macrobond Financial, Danske Bank Calculations

PCE core inflation to move higher towards 2% by end 2022



Sources: BEA, Macrobond Financial, Danske Bank forecasts

Ambition: avoid long-lasting damages to the economy



Sources: American Bankruptcy Institute, BLS, Macrobond Financial

Senior Analyst
Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.dk

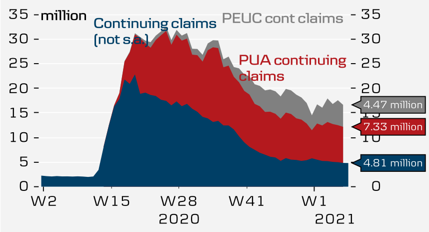
We would like to highlight two things. Firstly, we argue that elements of Biden's plan should considered insurance or automatic stabilisers to avoid significant income/earnings losses amid the pandemic. That said, a big unknown is whether some elements will become permanent down the road, which we cannot say much about right now. **Secondly, the plan is a ceiling of how much money can be spent, not how much will actually be spent**. For example, at the time of writing, USD3,100bn of the allocated USD4,100bn from previous packages are spent, so it is not a given that all of the allocated money are spent eventually.

What do we mean when we say elements of Biden's plan are insurance? One of the major elements in President Joe Biden's relief package is the extension and expansion of unemployment benefits. **In December, unemployment benefits were extended to March and a sudden end would lead to a monthly income loss of approximately USD22bn per month** (equivalent to 1.1% of estimated monthly average nominal counterfactual 2021 GDP), as nearly 17 million people are still claiming benefits at the time of writing. The costs would likely be higher when negative spirals ("animal spirits effects") kick in. **Biden's plan avoids this income loss by extending an existing policy. Given we expect a strong recovery especially from Q2 and onwards, we do not think all money will be spent, as people find employment instead**. The same goes for the allocated money for additional business support, which is also preventing more long-term damages to the economy by keeping businesses running. **Avoiding significant income losses and bankruptcies are necessary for a strong recovery**, otherwise risk is that the current supply crisis develops into a pro-longed demand crisis. **The same goes for the money for COVID-19 vaccinations, testing and treatment**. **Most of these things will automatically fall out next year.**

The most debateable parts of Biden's plan are the third stimulus payment (1.8% of nominal counterfactual 2021 GDP) and USD350bn for state and local aid (1.5% of nominal counterfactual 2021 GDP). **One of the big unknowns is how much of the third stimulus payment will be used for spending.** A *study by Coibion, Gorodnichenko and Weber (2020)* shows that 15% of the previous round of stimulus payments was spent, 33% was saved and 52% was used to pay off debt. Looking at the monthly PCE data for January, Americans seem to have spent a slightly larger share of the second check, approximately 17.5%. As the third round is also going to be paid out before the pandemic is completely over, we believe a lot of the money will be saved although to a lesser extent as we have seen some easing of restrictions and changed behaviour due to lower new cases. **We guesstimate a 25-50% spending ratio immediately adding 0.4%-0.9% to GDP when not taking any positive spirals/fiscal multipliers into account. A guesstimate of the marginal propensity of spending at 25-50% corresponds to a fiscal multiplier in the 1.3-2.0 range.**

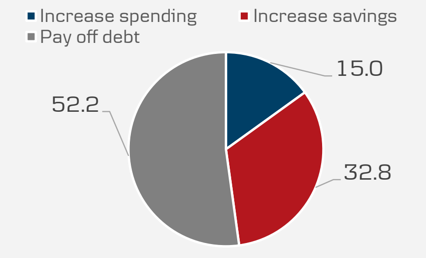
Another of the big unknowns is how much of the forced savings will be spent when the economy reopens. One very important feature of this crisis is the sharp rise in nominal personal income due to two household stimulus payments and higher unemployment benefits, which for some exceeded wage compensation. The combination of higher income and lower spending due to restrictions and changed behaviour, **we estimate savings have risen by approximately USD1,450bn cumulative over the pandemic (equivalent to 6.2 % of nominal counterfactual 2021 GDP)**. Assuming our guesstimate that 30-50% of the third payment will be spent, plus/minus USD100bn are saved as "free savings" (the rest for debt reduction) taking the total amount of free savings to USD620bn (or 2.7% of nominal counterfactual 2021 GDP). **We are, however, sceptical that all of the free savings are spent when the pandemic is over**. The latest *Federal Reserve Update on the Economic*

Nearly 17 million people are still claiming benefits – income loss of 1.1% of monthly GDP if not extended



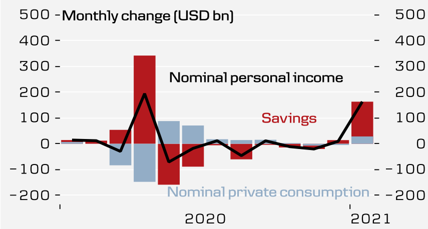
Sources: US Labor Department, Macrobond Financial

Most of the first stimulus payment was used for paying off debt



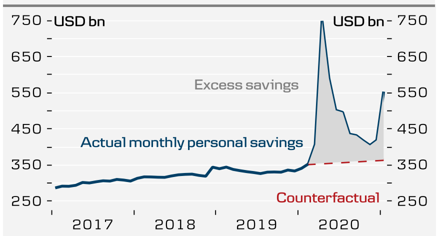
Sources: Coibion, Gorodnichenko and Weber (2020)

Most of the second stimulus payment was also saved



Sources: BEA, Macrobond Financial

Household savings have increased a lot but we think many will save them for a rainy day



Sources: BEA, Macrobond Financial, Danske Bank calculations

Well-Being of US Households showed that still many Americans are not able to pay an emergency expense that costs 400 dollars so we should probably not expect Americans will spend all of their savings, as **they are likely to save the money for a rainy day. Guesstimating that 25-50% will be released for consumption, it would add 0.7-1.3% to GDP in 2021 (again the fiscal multiplier would be in the 1.3-2.0 range).**

The combination of the third stimulus check and released savings may add between 1.1-2.2% to GDP this year alone without taking positive externalities (the fiscal multiplier into account). It may, including the fiscal multiplier, be in the 1.4-4.4% of GDP range over a couple of years.

How stimulative is the third stimulus payment and excess savings? Depend on how much consumers decide to spend eventually

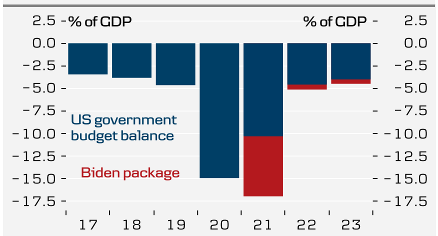
		Third stimulus payment	"Free savings" out of excess savings	Sum
Amount (USD bn)		414	620	1034
For spending (USD bn) assuming 25% or 50% spending ratio	25%	103	155	258
	50%	207	310	517
% of nominal counterfactual 2021 GDP	25%	0.4%	0.7%	1.1%
	50%	0.9%	1.3%	2.2%
Fiscal multiplier in the range 1.3-2.0	1.3	0.6%	0.9%	1.4%
	2.0	1.8%	2.7%	4.4%

Sources: Danske Bank calculations based on estimated fiscal multiplier, CBO costs estimates

With respect to direct transfers to state and local governments (which are experiencing a deterioration of their budgets due to the unemployment crisis), we know the fiscal multiplier is around 1 or slightly higher than 1, see *Wilson (2020)*. That said, at least some of the help for state and local governments mean that they do not have to reduce spending a lot (e.g. fire people) and in that sense it should also be seen at least partially as insurance. That said, the USD350bn is likely more than needed and hence stimulative.

The fact that most of the money are allocated this year also means that a lot of the support falls out in coming years, where fiscal policy becomes contractionary (depending on how big Biden's infrastructure package will be. For more on that see below).

US fiscal policy would have been contractionary without Biden's package – a lot of support to be discontinued next year (Biden's infrastructure package a joker)



Sources: Danske Bank calculations based on CBO economic/budget outlook February 2021, Macrobond Financial

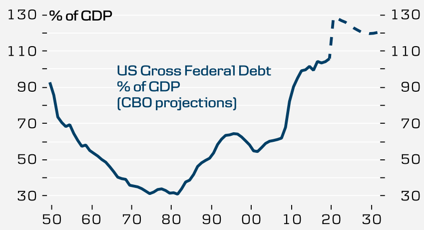
Relief package may limit the room for manoeuvre later

Obviously, the US cannot spend the same money twice. President Biden has proposed significant changes to economic policy down the road including more money for infrastructure, green energy transition and research and development (especially within technology). During the election campaign, *The Committee for a Responsible Federal Budget* identified spending proposals for a total of USD10,350bn over 10 years (equivalent to 4.8% of GDP per year. The spending proposals were only partly financed by higher taxes (USD4,300bn) and cost savings on national security and immigration (USD750bn) (2.4% of GDP per year over 10 years).

The personal tax hikes (accounting for around 50% of the tax increases) are mainly targeted at high-income earnings and hence should not have a big impact on growth in the short term. We know fiscal multipliers for high earnings are low, as they generally have a low marginal propensity to consume. Higher corporate taxes are, all else equal, negative for investment growth. However, as we argued in connection with Trump's tax cuts, we think other factors are more important for investment decisions (in particular, future growth expectations), at least in the short run. Business investments did not increase much on the back of Trump's tax cuts, as investments were subdued despite easy and cheap credit. This also means a reversal should not necessarily have a big impact the other way around.

The total net deficit is USD5,300bn (2.5% of GDP per year) if everything is approved and hence very expansionary (over 10 years). This would come on top of both the December-package and Biden's relief package. US gross federal debt has also risen to above 100% of GDP and was expected to remain high in coming years even before Biden's package. **There are already discussions on whether US public finance is sustainable in the long-run and the discussions are likely to continue in coming years. At the moment, however, we are not overly concerned**.

US government debt is high even without taking Biden's new package and an infrastructure package into account



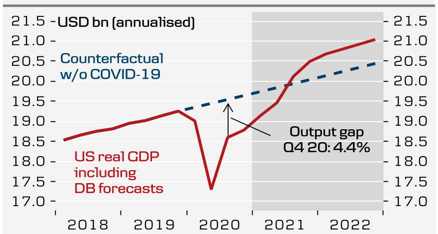
Sources: CBO projections, Macrobond Financial

We note that policy proposals usually get watered down during negotiations due to different priorities and hence the proposals should most likely not be taken for face value. This means that both spending and tax revenues are unlikely to be as large as suggested. **Still, if the economy is running closer to full capacity here in 2021, the timing of more expansionary fiscal policy may be inappropriate.** In that sense, Larry Summers are right when he says that elements of the relief package may decrease the degrees of freedom later. It is too early to get very concrete on what is on the table but it is something that will become a market theme later in the year. **At the time of writing we will not be surprised if the spending proposals will cost around USD7,500bn over 10 years and taxes will be increased equivalent to around USD3,000bn over 10 years but we are awaiting further details**.

Growth outlook: We expect a significant rebound

We estimate the output gap in Q4 20 was around 4.4% compared to a counterfactual path with GDP growth of 0.5% q/q through 2020. We estimate the total GDP loss in 2020 was USD1,073bn, or 5.5% lower than what real GDP would have been without COVID-19.

We expect US GDP to overshoot and stay above the old trend path

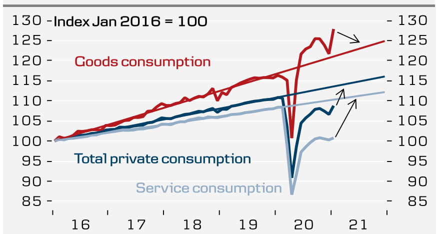


Sources: BEA, Macrobond Financial, Danske Bank forecasts

We are revising our US growth forecasts higher supported by the big relief package (bigger than we anticipated) and because we were simply too pessimistic in our latest update. Supporting our bright growth outlook is also a much better and faster vaccine rollout in the US after a slow start. **The US now aims at concluding vaccinations by the end of May** and with spring on its way, we expect much higher activity, as restrictions will be eased gradually from now on before being completely removed. **Like in other countries, we have seen a shift towards goods consumption (away from services) but we expect to see a reversal, when things normalise. This would definitely lead to a boost in employment, as employment-heavy service industries have been hit the hardest**.

We also expect residential investments to continue at a high level short-term driven by a warm housing market although higher interest rates (and substitution back to service consumption) may start to dampen investments later in the year.

The great reversal of consumer patterns

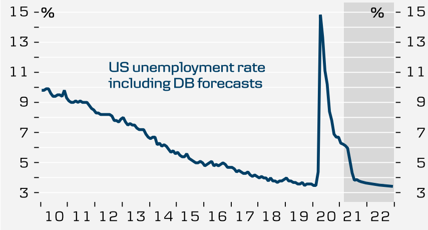


Sources: BEA, Macrobond Financial, 2016-2019 trend lines

We now expect GDP growth of 7.5% this year and 5.3% next year (up from 3.3% and 3.8%, respectively). We expect US GDP to reach the level in Q4 2019 in Q2 21 and we expect US GDP to overshoot the old trend path in Q3 21 and stay above it implying that we do not expect any permanent damages to the economy a year or so from now. On the contrary, we think the support may undo some of the damages caused by the financial crisis. We expect quarterly GDP growth to return back to more normal levels in 2022, so the high growth rate also in 2022 is partly due to overhang (3.5pp). **Consensus is lower forecasting 5.5% this year and 3.8% next year but it seems like many analysts are yet to take more fiscal stimulus and the updated vaccination end date into account**.

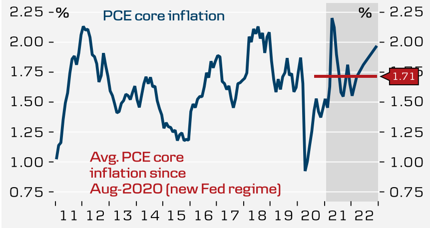
The question is whether this will lead to an overheating of the economy or not? We think not. It is good to remember that nothing suggested the economy was overheating before the pandemic. **That said, we will definitely be closer to full capacity meaning that we also expect higher actual inflation, also because the Fed will allow inflation to move higher without offsetting by tightening monetary policy prematurely**. We are seeing high price pressure within manufacturing but we expect it will moderate, as goods consumption moves back to more normal levels. PCE core inflation will move significantly higher in coming months but that is mainly transitory due to base effects stemming from the pandemic last year. **We forecast PCE core inflation will move close to 2% by year-end 2022.**

Unemployment to drop sharply when the recovery takes off



Sources: BLS, Macrobond Financial, Danske Bank forecasts

PCE core inflation to move higher towards 2% by end 2022



Sources: BEA, Macrobond Financial, Danske Bank forecasts

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 10 March 2021, 15:25 CET.

Report first disseminated: 10 March 2021, 15:40 CET.