The US in 2021: The Biden bounce

The US economy faces major near-term challenges, but longer-term we think the market is too cautious on its prospects. A vaccine, a major fiscal stimulus, ongoing Federal Reserve support and a more internationalist approach with allies and trade partners can lay the foundations for a vigorous recovery from 2Q21

James Knightley: The US in 2021

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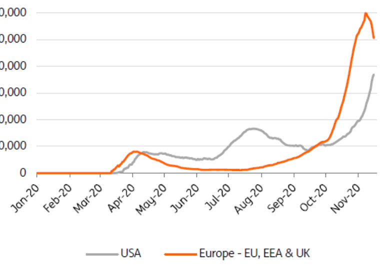
Back in the red

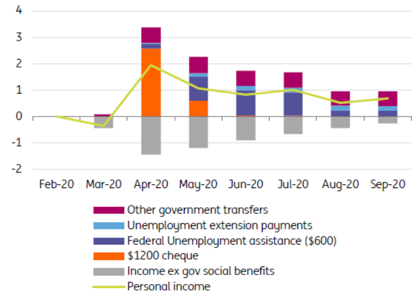
Recent newsflow on the efficacy of Covid vaccines has undoubtedly come as welcome news, but we know that an inoculation programme remains several months away. With the number of cases rising rapidly and healthcare systems facing increasing challenges there is the very real prospect of more individual states having to reintroduce containment measures.

As in Europe, we suspect that manufacturing, construction and most retail will remain open, but restrictions on other sectors will still come at a huge economic cost with millions of jobs potentially at risk. Adding to the problems, this comes at a time when millions of households are already experiencing cuts to their incomes as state unemployment benefits expire and Federal government support becomes more limited. The key question is how will politicians respond?

Given Donald Trump's legal challenges to the election and claims of fraud, we sense that political animosity could delay or limit a government response, potentially deepening an economic crisis. The Federal Reserve may feel the need to respond, with more stimulus to try and shore up confidence. Either way, we fear the December-January period will be tough on both a human and an economic level with a probable negative GDP print for the first quarter.

US Covid cases following Europe's surge while incomes are being squeezed





Source: Macrobond, ING

But the turn is coming

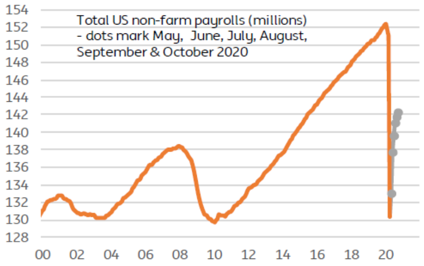
However, as a vaccine programme starts to be rolled out – we assume it starts fairly early in the year following regulatory approval – this can give a huge lift to both consumer and business sentiment. The prospect of a return to normality, with people willing and able to get a flight, go to the cinema and meet with friends in a bar, could propel growth massively. As we have repeatedly noted, it is higher income households that have been holding back the recovery in consumer spending since they spend so much more of their income on experiences - something they haven't been able to do due to Covid restrictions.

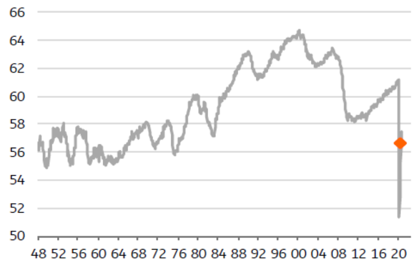
Assuming a smooth transition to a Joe Biden presidency, the rebound could be further fuelled by a substantial fiscal stimulus. The 5 January runoff for the two Senate seats in Georgia will determine how ambitious he can be. The Democrats would need to defeat both incumbent Republican Senators to regain control and this looks challenging. Even if they don't pull it off, we still assume a package of around $1 trillion is possible, equivalent to just under 5% of GDP.

This would be focused initially on low income households and hard-pressed state and local governments, but is also likely to leave a large chunk of money for investment projects. The $2 trillion proposed for Green Energy projects is on the table, but that runs the risk of being curtailed or delayed because of the challenges of getting it through the Senate. Tax hikes are also on the agenda, but we suspect they will be delayed until 2022/23 as next year is all about growth and recouping the 10 million jobs that are still to be regained.

With the Federal Reserve set to leave monetary policy ultra-loose for the next couple of years and Biden likely reverting to a more predictable, multilateral approach to international relations this can give businesses the confidence to put money to work through investment and hiring workers.

Jobs market remains much weaker than February





Source: Macrobond, ING

Could it be too good

One increasingly plausible scenario is that inflation expectations start to rise and the yield curve steepens more sharply as market pricing for Federal Reserve interest rate increases are brought forward.

After all, the pandemic has caused major structural changes to parts of the economy and there is the possibility that robust demand, coupled with supply constraints, leads to rising inflation numbers. For example many entertainment venues, bars and restaurants have gone out of businesses while airlines, car hire firms and hotel chains have cut back dramatically on capacity. A global recovery may put upward pressure on fuel prices, adding to the sense that inflation will move higher.

Of course, we continue to argue that the US is largely a service sector economy and weak wage growth in an environment of high unemployment will act as an offset. Nonetheless, we wouldn't be surprised to hear the Fed gradually shift its language to indicate that it may not be as late as 2024 before they consider raising interest rates.

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