

Stimulus: In defence of American leadership?

Published on: 9 April, 2021 | Author: Investment Team

It was Adam Smith who remarked that, “there is a lot of ruin in a country.” Economies build a great deal of wealth over time and are, perhaps, more resilient than we sometimes think, particularly in the middle of a crisis such as the global pandemic.

This is most evident in the US. At the end of 2020, according to data collected by the US Federal Reserve, the total value of US household wealth: stocks, property, land, and deposits was some \$123 trillion. That is a staggering figure approximating 40 times the total value of the annual output of the UK. A lot of ruin indeed.

If, as Corbusier once noted, houses are “machines for living in,” unquestionably the US is a machine for making money in.

The IMF this week published revisions to its periodic World Economic Update. It makes surprisingly pleasant reading, but most specifically with respect to the United States. The report notes that growth in America is likely to exceed 6% in 2021 and 4.4% in 2022, despite the severity of the pandemic. You may remember that Donald Trump aspired to achieve a growth rate of 4% during his term as president. This rate of growth is so strong that it is greater than the trend growth exhibited by the economy before the pandemic erupted.

At the same time, China is projected to grow by some 8.4% this year but note that the gap between these two hegemonic economies has narrowed considerably.

Until the financial crisis which began in 2007, China typically expanded by 10% per annum whereas the US struggled to find 2%. China is now slowing whilst the US is accelerating relative to it.

?Some commentators suggest that the rise of China, and in particular its technological progress, has given rise to what might be called a “Sputnik” moment. Alarmed by Russian supremacy in the 1960s “space race,” America accelerated its R&D, most visibly with JFK’s pledge to “land a man on the moon and bring him safely back to Earth.”

Then, as now, US commitments were matched with a dramatic expansion of the use of public funds. The new president, Joe Biden, has adopted that playbook, signing into law a stimulus package of \$1.9 trillion (just a little less than the size of the British economy) and currently has a \$3 trillion fiscal package (rather more than the British economy) working its way through Congress.

In the words of his new Treasury Secretary, Janet Yellen (formerly Chair of the Federal Reserve and a widely respected academic economist), it is time to, “go big.” To give these numbers more scale, the total Biden package is equivalent to a quarter of the global response to Covid so far and is a similar proportion of US annual GDP. Unquestionably, big!

The ramifications and implications of this new policy framework are vast and well beyond the scope of this short Thought but there are some bullets worth taking note of since changes of this magnitude will impact financial markets:

1. Savings glut: the world has been suffering from excess savings depressing incomes and growth. Those savings are now being deployed.
2. Competition for savings will rise: interest rates, particularly market interest rates (bond yields), will rise as a result.

3. Growth will accelerate: but a combination of supply-side impairment as a function of Covid and deglobalisation, driven by US/China trade tensions and Brexit, will tend to raise prices. Forty years of price deflation may be coming to an end (that is a big claim but is fundamental to the outlook).

4. Income distribution: current fiscal plans will raise indebtedness still further in highly indebted economies. Janet Yellen has already called for a “global minimum corporation tax rate.” Taxes just about everywhere will rise.

This has been called the “China century” by some, but the US will not cede economic leadership lightly. Moreover, the US still retains the wealth and human capital to defend its role as THE global hegemon and compete with China.

The reordering of the global economy, post-pandemic, has only just begun.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.