MOODY'S ANALYTICS

ANALYSIS
15 JANUARY, 2021

Prepared by

Mark Zandi
Mark.Zandi@moodys.com
Chief Economist

Bernard Yaros Jr.
Bernard.YarosJr@moodys.com
Assistant Director

Contact Us

Email
help@economy.com

U.S./Canada
+1.866.275.3266

EMEA
+44.20.7772.5454 (London)
+420.224.222.929 (Prague)

Asia/Pacific
+852.3551.3077

All Others
+1.610.235.5299

Web
www.economy.com
www.moodysanalytics.com

The Biden Fiscal Rescue Package: Light on the Horizon

INTRODUCTION

President-elect Joe Biden's proposed $1.9 trillion fiscal rescue package, the American Rescue Plan, would provide a large boost to the economy if passed into law. With this additional economic support, real GDP growth would be robust at nearly 8% this year and almost 4% next, bringing the economy back almost to full employment by fall 2022. Given the complicated politics of what Biden is proposing, it would likely have to be passed under budget reconciliation rules requiring only a majority vote in the Senate. Even then, we expect the legislation that ultimately gets through Congress to be no more than half the size proposed, setting the stage for another fiscal policy proposal later this year along the lines of Biden's "Build Back Better" campaign agenda. One way or another, through this step or over several steps, we ultimately expect fiscal support to the economy under the new Biden administration that totals close to what was proposed Thursday. It is thus the impact of this level of support that we assess here.

The Biden Fiscal Rescue Package: Light on the Horizon

BY MARK ZANDI AND BERNARD YAROS

President-elect Joe Biden's proposed $1.9 trillion fiscal rescue package, the American Rescue Plan, would provide a large boost to the economy if passed into law. With this additional economic support, real GDP growth would be robust at nearly 8% this year and almost 4% next, bringing the economy back almost to full employment by fall 2022. Given the complicated politics of what Biden is proposing, it would likely have to be passed under budget reconciliation rules requiring only a majority vote in the Senate. Even then, we expect the legislation that ultimately gets through Congress to be no more than half the size proposed, setting the stage for another fiscal policy proposal later this year along the lines of Biden's "Build Back Better" campaign agenda. One way or another, through this step or over several steps, we ultimately expect fiscal support to the economy under the new Biden administration that totals close to what was proposed Thursday. It is thus the impact of this level of support that we assess here.

Going big

Biden's proposed fiscal rescue package is large. If passed into law in its entirety, it would bring total fiscal support—deficit-financed discretionary fiscal policy—to $5.2 trillion since the pandemic hit. This is equal to an astounding nearly 25% of 2019 GDP—approximately three times that provided during the financial crisis, and substantially more than provided by any other country in the world (see Chart 1). This is a key reason the pandemic has done substantially less harm to the U.S. economy than most others despite the more severe health crisis here due to botched efforts to contain the virus.

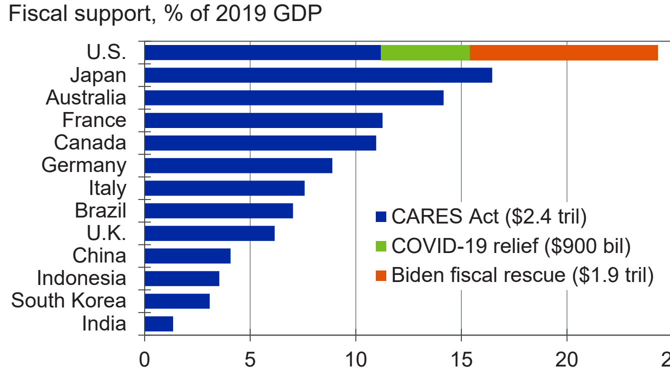
If passed into law by March, which may be pushing things given the arcane budget reconciliation process, this round of federal support would kick in as funds from the $900 billion relief package passed in December are spent down. And more fiscal support will certainly be needed by then. While vaccinations are expected to pick up substantially soon, the pandemic will continue to rage through much of the spring. Infections, hospitalizations and deaths continue to mount, and the full brunt of the new, more contagious strain of the virus has yet to hit fully. Judging by December job losses, particularly in leisure and hospitality, the pandemic continues to do serious economic damage. A double-dip recession is unlikely thanks to what lawmakers have done so far, but the economy will continue to struggle until at least a majority of Americans are vaccinated, which we do not anticipate until midyear.

What's in it

The composition of the proposed $1.9 trillion relief package is familiar, including many of the same measures that have made up previous packages (see Table 1). Financially stressed households will receive more unemployment insurance, food assistance, and aid for back rent, healthcare and paid leave. There is also a substantial increase in the child tax credit. Most costly is a plus-up to $2,000 per person on the $600 Economic Impact Payments, or stimulus checks, recent-

Chart 1: Biden Pumps Up Fiscal Policy

Fiscal support, % of 2019 GDP



Source: Moody's Analytics

Table 1: Biden Fiscal Rescue Package

$ bil

Provisions	2021	2022	2023	Total	Explanation:
Direct COVID Pandemic Response	112.2	43.0	4.9	160.0	Provide the supplies, emergency response, testing, and public health workforce necessary to end the pandemic.
Economic Impact Payments	425.0	0.0	0.0	425.0	Provide an additional $1,400/person (for $2,000 total) and expands eligibility to children
Unemployment Insurance	290.0	0.0	0.0	290.0	Extend current benefits and eligibility, provide $400 supplement until the end of Q3
Rental Assistance	35.0	0.0	0.0	35.0	Provide an additional $35 bil in rental, homelessness and utility assistance
Nutrition	10.9	1.1	0.0	12.0	Extend SNAP benefit
Paid Leave	84.0	0.0	0.0	84.0	14 wks of paid family, medical leave through end of yr
Schools K-12 & Higher Ed	113.9	45.6	10.5	170.0	Additional money to safely reopen and operate schools
Childcare	19.9	14.7	3.8	38.4	Additional funding for hard-hit providers through the Child Care Stabilization Fund
Small Business	50.0	0.0	0.0	50.0	Provide additional grants and fund the Small Business Opportunity Fund
First Responders/Other Public Servants	350.0	0.0	0.0	350.0	Flexible money for state, local and territorial governments
Transportation	16.1	3.0	0.9	20.0	Provide relief for hardest-hit public transit agencies
Tribal Governments	20.0	0.0	0.0	20.0	Provide resources needed to obtain sufficient personal protective equipment
Cybersecurity	1.1	2.8	2.9	6.8	Modernize federal information technology infrastructure
Relief to Families	149.0	0.0	0.0	149.0	Make the child tax credit fully refundable
COBRA and ACA Subsidies	48.5	8.6	0.0	57.0	100% tax credit for COBRA coverage premiums
Mental Health	0.9	2.3	0.6	3.7	$3.5 bil for Substance Abuse and Mental Health Services
Veterans Health	20.0	0.0	0.0	20.0	Funds to make sure that Veterans' health care needs are through this crisis
Total	**1,746.4**	**120.9**	**23.6**	**1,895.5**	

Sources: Biden Transition Team, Moody's Analytics

ly sent to lower- and middle-income households. Though there is considerable political momentum for this, it is not the most effective type of support. Much of the money goes to households that do not need the funds and will save a lot of it, at least initially. The multipliers—the increase in GDP in response to a change in policy—from the stimulus checks are smaller than for other types of government spending (see Table 2). Compared with previous relief packages, the Biden proposal is light on additional help to small businesses but provides substantial funds for testing, tracing and vaccine distribution and aid to state and local governments.

That said, Biden's expansive fiscal policy proposal is good economic policy. The economy is far from full employment, inflation remains well below the Federal Reserve's 2% target, and the Fed has effectively promised to keep short-term rates at the zero lower bound until the economy is at full employment and inflation has been consistently above 2%. Long-term interest rates are also near historic lows. Ten-year Treasury yields rose sharply in the wake of the Georgia Senate races and the shift in investor expectations that the Democratic-controlled federal government will pump up fiscal policy and economic growth, but yields are still only just over 1%.

The pandemic also continues to ravage the finances of lower-income households and minorities. These groups were only beginning to recover from the financial crisis when the pandemic struck. Without substantial targeted government support like that proposed by Biden, their prospects are poor. To be sure, Biden's proposal will add significantly to the nation's fiscal challenges, but those should be addressed through government spending restraint and tax increases only after the economy has returned to full employment.

Economic impact

Assuming that Biden's $1.9 trillion plan is enacted in full by March, the economy would receive a quick boost. Real GDP would jump to more than 7% annualized in the first quarter of this year, despite the intensifying pandemic, and to almost 8% for all of 2021. This is almost double the growth that would be expected without any additional fiscal support. Real GDP should post an additional almost 4% gain in 2022. At this pace of growth, the economy would create 7.5 million jobs in 2021 (December to December) and 2.5 million in 2022 to fully recover the jobs lost since the pre-pandemic peak. By then, the economy will have returned to full employment—an unemployment rate of 4% to 4.5% and a labor force participation rate of more than 62.5%. This is about a year sooner than would be the case if there is no additional fiscal support (see Chart 2).

The Biden proposal is mostly about supporting the demand side of the economy, but it incorporates a handful of policies aimed at increasing the supply of labor. In particular, it would provide funds for childcare, paid leave and health insurance to facilitate the return to the workforce of several million people, mostly women, who have left the workforce during the pandemic to take care of sick family members and friends and children who are unable to go in-person to school.

Table 2: Federal Fiscal Multipliers

$ change in GDP in 2021Q4 for a once-and-for-all $1 change in federal spending or revenue in 2021Q1

Federal Spending	
Supplemental Nutrition Assistance Program (SNAP)	1.61
Supplemental Unemployment Insurance	1.49
Work-Share Unemployment Insurance	1.37
Aid to State and Local Governments	1.34
Low Income Home Energy Assistance Program (LIHEAP)	1.31
Transportation Infrastructure Spending	1.29
Defense Spending	1.24
Childcare (Universal Child Care Act)	1.19
Universal Pre-K (3- and 4-yr-olds)	1.17
Elder Care	1.15
Federal Revenues	
Earned Income Tax Credit	1.27
Child Tax Credit	1.25
Economic Impact Checks	1.09
Payroll Tax Holiday for Employees	1.07
Payroll Tax Holiday for Employers	0.95
Nonrefundable Lump-Sum Tax Rebate	0.93
Personal Income Tax Rate	0.88
Housing Tax Credit	0.80
Student Loan Debt Forgiveness	0.65
Dividend and Capital Gains Tax Rate	0.38
Corporate Tax Rate	0.32
Accelerated Depreciation	0.27
Net Operating Losses	0.24

Source: Moody's Analytics

In response to the stronger economy, the Fed is expected to begin normalizing monetary policy by fall 2023. By then, inflation should be firmly above the Fed's 2% target and inflation expectations even higher. Normalization will proceed slowly, taking approximately to mid-decade for the Fed to increase the federal funds rate target to its 2.5% long-run equilibrium rate (r-star). Long-term rates have already begun to rise, and they will rise more sharply as bond investors begin to anticipate a full-employment economy with higher inflation. Ten-year Treasury yields are projected to be near 1.75% at the end of this year, 2.5% by year-end 2022, and close to 3% when the Fed starts normalizing short-term rates in fall 2023.

Tricky politics

Biden's proposal is just the start of what will be a difficult negotiation, and while the end result will likely be another fiscal relief package, it is also likely to be much smaller than proposed. Because of the proposal's size and inclusion of politically contentious policies such as substantial aid to state and local governments, Democratic lawmakers will almost surely need to use the budget reconciliation process to get the bill across the finish line. Rather than requiring the 60 votes needed to avoid a filibuster, reconciliation allows the Senate to pass legislation with a simple majority vote, which the Democrats can likely muster given the outcome of the recent Georgia Senate races. However, there are meaningful constraints on the reconciliation process, the most important of which is that whatever spending and tax policy is legislated must be budget neutral after the budget horizon—typically 10 years.

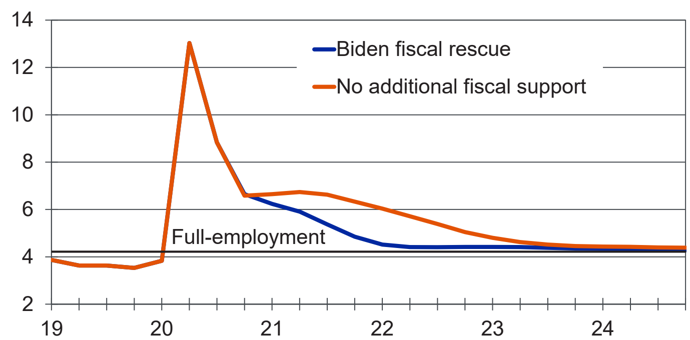
Given the deep political divisions in the country, the complicated politics created by the Democrats' razor-thin majority in the Senate, and the arcane reconciliation budget rules, we expect the package that is ultimately signed into law to be no more than half the size currently proposed. Moreover, the politics of the split Senate, which favor centrist Democrats and Republicans who will hold the critical swing vote to get to a majority, will also impact what parts of the package become law. The increase in the stimulus checks to $2,000 and substantial aid to state and local governments look especially vulnerable, since together they account for about half the total cost of the package and have already received some public pushback from key lawmakers.

With a smaller package, the economy will still need help to get back to full employment in a timely way. Therefore, we expect President Biden will propose more fiscal support later this year with government spending and tax increases in the spirit of the "Build Back Better" policy agenda proposed during his campaign. We expect this support to include a substantive infrastructure plan, increased spending on various social programs, and a potpourri of tax law changes, including tax increases on corporations and well-to-do households. The size and composition of this package is a discussion for another day.

The next few months will be difficult, but the next few years look increasingly bright. The raging pandemic will fade by mid-2021 once a majority of Americans are vaccinated, and the economy will quickly get back on track thanks in significant part to robust fiscal and monetary policy support. President-elect Biden's proposed $1.9 trillion fiscal relief package is a big step in that direction.

Chart 2: Back To Full-Employment By Fall 2022

Unemployment rate, %



Sources: BLS, Moody's Analytics

About the Authors

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody's purchased in 2005.

Dr. Zandi's broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation's daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, *Financial Shock: A 360º Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*, is described by The New York Times as the "clearest guide" to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania. He lives with his wife and three children in the suburbs of Philadelphia.

Bernard Yaros is an assistant director and economist at Moody's Analytics focused primarily on federal fiscal policy. He is responsible for maintaining the Moody's Analytics forecast models for federal government fiscal conditions and the 2020 presidential election, as well as providing real-time economic analysis on fiscal policy developments coming out of Capitol Hill. Besides fiscal policy, Bernard covers the District of Columbia and Puerto Rico and develops forecasts for Switzerland.

Bernard holds an MSc in international trade, finance and development from the Barcelona Graduate School of Economics and a BA in political economy from Williams College.

About Moody's Analytics

Moody's Analytics provides financial intelligence and analytical tools supporting our clients' growth, efficiency and risk management objectives. The combination of our unparalleled expertise in risk, expansive information resources, and innovative application of technology helps today's business leaders confidently navigate an evolving marketplace. We are recognized for our industry-leading solutions, comprising research, data, software and professional services, assembled to deliver a seamless customer experience. Thousands of organizations worldwide have made us their trusted partner because of our uncompromising commitment to quality, client service, and integrity.

Concise and timely economic research by Moody's Analytics supports firms and policymakers in strategic planning, product and sales forecasting, credit risk and sensitivity management, and investment research. Our economic research publications provide in-depth analysis of the global economy, including the U.S. and all of its state and metropolitan areas, all European countries and their subnational areas, Asia, and the Americas. We track and forecast economic growth and cover specialized topics such as labor markets, housing, consumer spending and credit, output and income, mortgage activity, demographics, central bank behavior, and prices. We also provide real-time monitoring of macroeconomic indicators and analysis on timely topics such as monetary policy and sovereign risk. Our clients include multinational corporations, governments at all levels, central banks, financial regulators, retailers, mutual funds, financial institutions, utilities, residential and commercial real estate firms, insurance companies, and professional investors.

Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

Moody's Analytics is a subsidiary of Moody's Corporation (NYSE: MCO). Further information is available at www.moodysanalytics.com.

DISCLAIMER: Moody's Analytics, a unit of Moody's Corporation, provides economic analysis, credit risk data and insight, as well as risk management solutions. Research authored by Moody's Analytics does not reflect the opinions of Moody's Investors Service, the credit rating agency. To avoid confusion, please use the full company name "Moody's Analytics", when citing views from Moody's Analytics.

About Moody's Corporation

Moody's Analytics is a subsidiary of Moody's Corporation (NYSE: MCO). MCO reported revenue of $4.8 billion in 2019, employs more than 11,000 people worldwide and maintains a presence in more than 40 countries. Further information about Moody's Analytics is available at www.moodysanalytics.com.