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CIO Viewpoint

Biden's first 100 days - pushing US renewal

Investment Solutions

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Joe Biden's first 100 days in office have surprised both critics and supporters with ambitious spending plans to rebuild the US economy. A combination of Covid's economic shock, cheap debt and failed past austerity policies have catalysed the biggest investment in US infrastructure and social welfare in generations.

Limited stimulus and economic austerity followed the 2008/09 Great Financial Crisis, leading to a weak recovery and exacerbating inequalities. President Biden, and much of his current team who served in the Obama White House, clearly wish to avoid repeating the same mistake. Now, the President appears to prefer running the risks of too much, rather than too little stimulus to re-boot the US economy.

A precondition for economic recovery is overcoming the pandemic. The new administration has surpassed its first campaign pledge to deliver 200 million jabs by 29 April, within its first 100 days. In a widespread rollout programme, the US has made vaccines available to everyone over the age of 16 and has fully vaccinated 30.9% of the population as we publish. That has outpaced the UK, European Union and all other developed economies in delivering two jabs.

The stage is set for a strong recovery. Congress has approved the first part of the Biden administration's fiscal programme, the USD 1.9 trillion 'American Rescue Act' designed to secure a rapid revival through income-support policies.

The administration's ambition goes beyond pandemic relief. President Biden has added two more fiscal packages that promise to reshape the US economy, in what he describes as a "once-in-a-generation investment in America." The second part of his programme, a USD 2.3 trillion 'American Jobs Act' published at the end of March, aims to upgrade the US's infrastructure, reversing decades of underinvestment.

Go big or go home

Thirdly, last week the administration unveiled a USD 1.8 trillion package labelled the 'American Families Plan,' including USD 800 billion in tax credits. This will fund jobs and incomes, education and Medicare, in turn supporting stronger economic demand and productivity. Included are plans for the almost four-fifths of American private-sector workers who currently lack paid leave.

Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

Key takeaways

- The US economy is poised to experience a strong rebound this year
- The Biden administration has met its initial ambitions in Covid vaccinations and unveiling three spending packages to reshape and support the economy
- Biden's latest proposals would raise capital gains and corporate taxes to invest in infrastructure and human capital
- The improving outlook is seen in rising yields, and the dollar may weaken on strengthening global growth and trade. We see the S&P 500 at 4,500 by year-end.

To pay for this, and in line with campaign pledges, the top income tax rate for those earning more than USD 1 million would rise from 37% to 39.6%.

In addition, capital gains tax would also rise from 20% to 39.6%, plus an already existing 3.8% Medicare surcharge. If the capital gains tax passes later this year, it would be the first time in American history that capital is taxed at the same rate as earnings.

However, we expect the capital gains tax proposal to be pared back in Congress to a rate of around 30%, effective in January 2022. This would be in line with estimates that maximise tax receipts to the government, as a higher rate may discourage investment activity and reduce the tax base.

The scale of the challenge in re-booting the US economy is difficult to overstate. By multiple measures, including life expectancy, obesity, murder rates, infant mortality and education, the US trails every other developed nation (see chart).

That has a disproportionate impact on the country's effective use of its human capital. It is also economically wasteful since a country's stability hinges on the welfare of the poorest 20% of the population. The Biden stimulus aims to provide a 20% boost to after-tax income for the poorest fifth of the population, while the greater burden of paying for it falls on the highest income earners.

The political opposition to Biden's spending is relatively muted to date. His approval ratings have remained consistently between 54% and 57%, as his policies have not shifted the US's polarised political opinions one way or another.

President Biden came to office pledging to govern in a bipartisan manner. Still, with a majority in the House of Representatives and his vice president's casting vote in the Senate, legislation has passed through Congress without the support of Republicans.

Geo-strategic challenges

Biden's first 100 days kicked-off with the US re-joining the Paris accord and on 22 April reinforced the country's commitments to tackle climate change. But at a strategic level, the struggle to retain the US's global leadership continues.

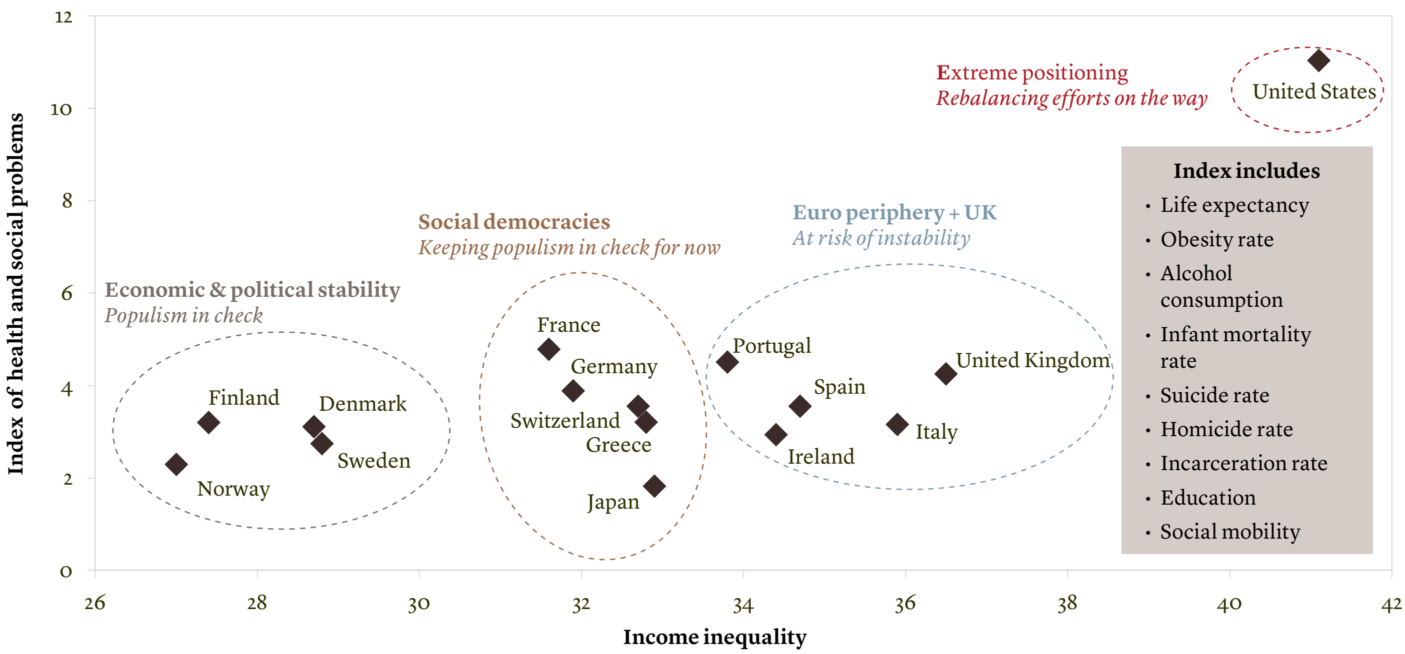
The administration is working to rebuild its multilateral approach to geopolitics. The President met with Japan's Prime Minister Yoshihide Suga in mid-April, to discuss how to jointly counter China's strategic and security challenges.

Relations with China have changed in tone, but not yet in substance. China's economic ambitions put it on a collision course with the US as its share of global gross domestic product increased from 13% to 17% since 2009.

After speaking with President Xi Jinping, Mr Biden last week told Congress that "China and other countries are closing in fast," posing a strategic challenge to the US. "Autocrats

Inequalities waste human capital, destabilise political life and weaken economies

Index of health and social problems



Source: Lombard Odier

think that democracy can't compete in the 21st century with autocracies," he said. Antony Blinken, US Secretary of State, said on 2 May that China's increasing military assertiveness and domestic repression threaten the international "rules-based order."

On 16 April, the US imposed further financial sanctions on Russian entities and officials in retaliation for cyber attacks and other interference, following measures in March over the country's treatment of political opposition leader Alexei Navalny. The US, Japan and South Korea will discuss cooperation over North Korea this week at a G7 foreign ministers' meeting. Last month, the US and Iran agreed to talks about resuming negotiations on nuclear enrichment and sanctions. The Biden administration is also beginning to withdraw troops from Afghanistan.

Improving outlook

The success of the US's vaccine programme and unprecedented levels of planned fiscal spending have altered expectations for the US economy, driving an increase in GDP forecasts. In early 2021, the consensus among economists was for growth of around 4% for the full year, and a similar expansion for the European Union. Now, analysts' consensus is for an expansion of 6.25% in the US, while the EU's prospects, they say, remain unchanged. We expect the US economy to expand by 6.0% this year, compared with 4.3% in the EU, and 9% in China.

The improving US outlook is reflected in rising US yields, which almost doubled in the first quarter of the year. Short-term inflation will keep government bonds under pressure, and we have increased our year-end target for US 10-year treasuries to 2%.

For the dollar, interest rates in the rest of the world will be more important than domestic yields. In particular, improving global growth and trade will contribute to a rise in yields elsewhere, weakening the dollar to a certain extent.

In equity markets, the focus is shifting from fiscal stimulus to more regulation and taxes. A corporate tax rise may trim 2022's earnings per share, which otherwise are forecast to grow 14%, compared with this year. We expect information technology, healthcare and consumer stocks to be the most affected. Overall, we remain modestly overweight US equities and see the S&P 500 at 4'500 by year-end, with small capitalisations and stocks of companies transitioning to a net-zero economy benefitting the most from the administration's pro-growth policies.

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