GENERALI INVESTMENTS

GIAM Macro & Market Research- Market Commentary

US: Fiscal stimulus to boost GDP growth to 5.5% in 2021.

- **The thin majority in the Senate will allow the incoming administration to deliver quickly a sizeable fiscal stimulus. We expect a package worth around US$ 800bn (on top of the US$ 900bn already agreed on in December), centred on the strengthening of direct income support to households, extended unemployment benefit and aid to local governments. The lack of a strong majority will likely delay measures on infrastructure and health insurance into 2022.**
- **Rising disposable income and the lifting of restrictions will lead consumption (especially in services) to soar from Q2 on, with a beneficial spill-over to capex. Therefore, we revise up our 2021 growth forecast to 5.5%. GDP will be back to the Q4 2019 level by the summer**
- **Stronger growth will speed up the healing of the labour market, and we see the unemployment rate down closer to around 5% by year-end. Despite temporary spikes and base effects, we expect only a mild increase in inflation. This will allow Fed accommodation to continue but talks of a QE tapering are likely to start during the summer.**

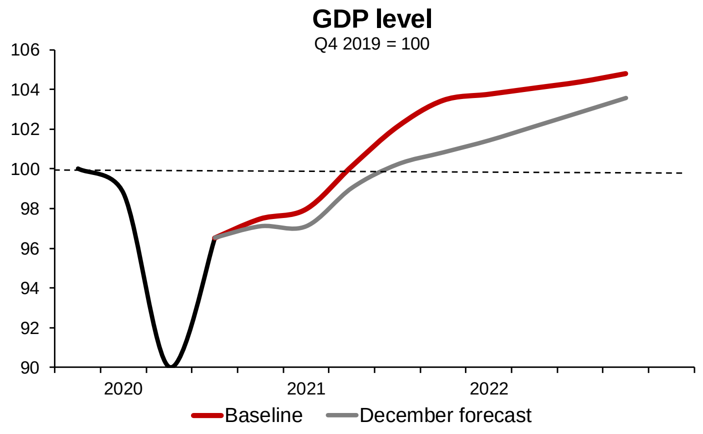
Winning the two runoff Senate elections in Georgia by a razor-thin margin the incoming Biden administration secured the full control of the Congress with the smallest possible majority: 50-50, with Vice President Harris breaking the tie. This will allow for a much stronger implementation of the policies Democrats pledged during the electoral campaign.

In terms of economic policies, the Congress will be able to pass another round of fiscal stimulus, topping up the US$ 900 bn already legislated in December. We expect a package of around US$ 800bn, geared on direct income support to households, an extension of enhanced unemployment benefit into the summer and aid to state and local governments.

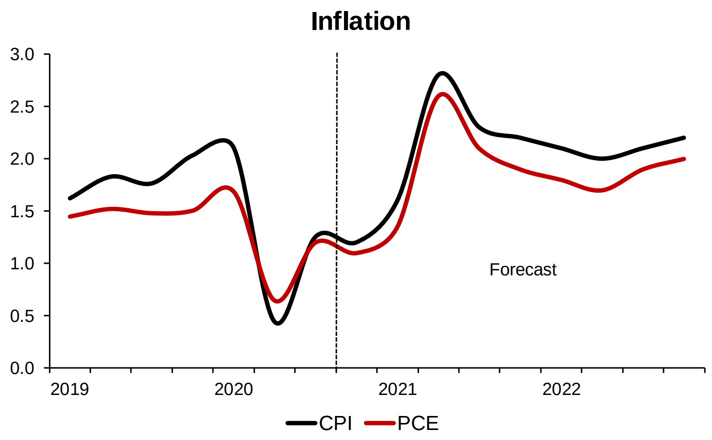
The total amount of stimulus (US$ 1.7tn) falls short of the US$ 2tn announced by Sen. Biden during the campaign, as a result of the residual constraints the Democrats face. First, a full implementation of fiscal policy would require the backing of 60 senators, which is impossible to attain. The very tiny majority gives a very strong power to centrist, fiscally conservative Democratic Senators who have in the past voiced their opposition to some of the measures proposed by the party (and especially its more radical wing).

Second, fiscal support must be delivered quickly, as the resurgence of pandemics is having a strong impact on the economy (as witnessed by the 140k drop in payrolls in December reported today) and the priority is to minimize its long-term consequences. Therefore, the new administration will proceed using the so-called reconciliation process, which allows to legislate on fiscal matters with a simple majority but can be used only once in a year. This also means that other significative measures, like investment on infrastructure and higher taxation on corporations and wealthy household will likely be postponed to 2022.

Nevertheless, the boost to disposable income will be very significant and will coincide with the beneficial effects from expected beginning of lifting of Covid-related restrictions. This and pent-up demand will lift consumption starting from Q2, after a relatively weak Q1 due to the still strong influence of the pandemics. In the second half of the year there will be also second-round effects on capex, and increased confidence will add to historically low borrowing costs. Therefore we revise up our 2021 growth forecast to 5.5%. This implies that pre-crisis (Q4 2019) levels of activity will be reached during the summer. Risks are overall balanced: a bigger fiscal package could be agreed on, but a resurgence in the pandemics would delay the recovery.



The rebound in services consumption will bring about the much-needed job recovery in sectors like travel and leisure which have been crippled by the pandemics. We expect the unemployment rate to slide from the current 6.7% closer to 5% by the end of the year. However, in line with what seen in the recovery from the Great Financial Crisis, inflation will pick up only moderately, if one looks through the strong base effect expected for the second quarter of the year and to the possibility of occasional outbursts related to temporary supply constraints when the economy picks up. CPI inflation will average 2.2% this year and core PCE inflation will end the year at around 1.8%.



Fiscal activism relieves the Fred from a heavy burden but will not alter the accommodative stance in the short term given that full employment will not be reached before 2022 and inflation risks are low. We bring forward to a still distant H1 2024 the date for the rate lift-off, but the issue of asset purchases tapering will become more pressing. We expected a discussion on to start in the summer.