CPG Research & Advisory Pty Ltd

US Spending Packages

How much are they spending? What's in them?

The US is not the record COVID spender. While the fiscal response is estimated at 27% of GDP (roughly the GDP of Italy), even this staggering sum is **under half of Japan's claimed 55%**! When Japan's debt is already 300% of GDP, 55% is only a rounding error.

Does it matter?

Japanese 10-year bonds have moved **from 0 to +11bp** during this colossal spending binge.

It is not the actual spending – **markets simply do not believe that Japan can generate inflation** regardless of policy.

By contrast, **US yields have spiked 125bp** as US inflation is already running far in excess of Fed targets.

One of the final major acts of the outgoing Administration was to sign a $900bn relief package in December, after Congress was deadlocked on the details until after the election. It included $600 per person, means tested. Expanded unemployment benefits were included until March. A third of the package was for an extension of the PPP (the US equivalent of JobKeeper employment subsidy).

The package included industry subsidies (particularly aviation), and briefly extended the eviction moratorium. It even included more funding for the border wall.

Where USA is unique is to be doing it all over again in 2021, in the middle of a strong economic recovery.

The first $1.9tr package was criticised for only loose connections to COVID. There were certainly legislative measures that advanced other interests. But the spending measures were generally at least arguably connected.

The new package expands previous measures. The $600 already paid was topped up with another $1400. Enhanced unemployment benefits are extended, as is the foreclosure moratorium and rental assistance and increased food stamps. Household costs such as healthcare and childcare are subsidised.

$350bn goes to schools, to cover COVID19 and staffing costs.

Controversially, it calls for a permanent $15ph minimum wage. Much of the other "pork" that attracted negative attention was numerically a small percentage of the cost – a bridge from New York to Canada, a metro system in Silicon Valley, $480m for Native American languages.

As these two packages are still working through the delivery, details are starting to emerge of the first infrastructure plan.

An initial $2tr is contemplated.

Early details include both economic and social infrastructure. Around $400bn is in social housing, and aged and disability care – although this might take the form of home care, with no infrastructure built.

$100bn is allocated to a broadband rollout, targeting underserved areas.

Lead pipes will be replaced, and clean air initiatives are also included.

On the economic side, renewal of roads, bridges, railways and probably airports will be broad based. During his first press conference, Pres Biden foreshadowed this programme in a lengthy answer dealing with the state of transportation infrastructure. (Of course, he was responding to a question on gun control…)

There is already a "second piece" of the infrastructure plan – **another $2tr planned**. Universal pre-school, community colleges and family leave are included in early released details. Again, the feeling of opponents is that programmes called "infrastructure" will barely resemble the title, while rewarding donors.

After that comes the **first instalment of the "*Green New Deal*,"** inspired by Roosevelt's much-praised Great Depression response. Of course, the US fared vastly worse in the Great Depression than other comparable economies.

While the Green New Deal is estimated by some to cost nearly $100tr (5 times the GDP), around $4tr has been discussed so far. **As candidate, Pres Biden both opposed and supported the Green New Deal – often simultaneously** – so it is unclear whether this is imposed <u>by</u> him or <u>on</u> him.

But how to get these plans through Congress?

While the Democrats hold a 51-50 Senate majority by virtue of the VP's tie-breaking vote, this relies on every moderate holding the line. And on any opposed measures, the ability to filibuster in practice means a 60/40 vote is needed to override.

2021 has already seen its one and only "Budget reconciliation bill" which cannot be blocked by a filibuster. It passed 51-50, and the Parliamentarian's office excluded the $15ph minimum wage as this was not a Budget measure. (This led to some calls for her sacking.)

It may well take the best part of a year to firm up the details of the multiple packages and draft legislation – much of it could be the subject of an early 2022 reconciliation bill ahead of the mid-term elections.

There is serious consideration of the "nuclear option" of eliminating the filibuster forever. Like many things, it has been described as "racist." If it is, the trend is ominous. After Pres Kennedy, only 15 presidential nominees had been filibustered by Bush Sr. This doubled with 15 under Clinton, and more doubled again under Bush Jr (39). Then 175 Obama nominees, and 314 Trump nominees in just 1 term were filibustered.

The Administration is studiously **avoiding talking about using Modern Monetary Theory** to fund this enormous spending, approaching 50% of GDP at a time when USA should be approaching full employment again. MMT holds that there is no penalty for creating money and monetising deficits, as other policy measures can be used to keep inflation under control. Primarily tax increases, and certainly those are on the table.

But repealing corporate and top tax bracket increases will not raise 50% of GDP, or even 5%.

Leading Markets

US markets soared, setting new records. The S&P500, Dow Jones and NASDAQ gained +4.4%, +6.8% and +0.5% respectively; MSCI World ex-AUS gained +4.3% in local terms. Emerging Markets fell -1.5% in $US as Chinese stocks dived, offset by the other BRICs. Frontier Markets added +0.3%.

US 10-year bonds crashed again, closing at 1.74% (+30bp) after 18-month highs. High yield closed at +336bp (-21bp tighter), back to 2018 levels. Distressed credit remained around post-GFC tights. Emerging markets debt underperformed.

Blockage of the Suez Canal could have been a major disaster, but fortunate timing of the high tide saw it reopened.

Other Highlights

COVID-19 deaths passed 2.8m but are slowing in USA (although accelerating elsewhere). Slow vaccine rollouts are stuttering in Europe, with concerns about reported complications extending its lockdowns. USA has fuller coverage but also running into resistance.

Having approved a $2tr stimulus, the US Admin is examining an infrastructure bill and major tax hikes.

US Q4 GDP was upgraded to +4.3% (from +4.1% p.a.). The year's GDP fell -2.4%.

US unemployment eased to 6.2% (-0.1%) in February, with excellent Non-farm Payrolls of +379k and February revised up to +166k. Youth unemployment fell to 10.9% (-0.3%). CPI was +0.4% to be +1.7% YoY although an alarming +2.8% in the 9 months post-COVID. It will peak well over 3%. CPI-linked bonds' breakeven inflation of 2.35% (10-year) is an 8-year high and above the Fed target. Retail sales fell -3% in February after a revised Jan +7.6%.

Eurozone unemployment improved to 8.1% (-0.2%) with participation flat at 56.8%. Prices soared +0.9% to be +1.3% YoY with core inflation at +0.9% YoY. Retail sales dived -5.9% on renewed lockdowns. January's current account surplus of +EUR5.8bn was almost -90% down from December's record.

Domestic

The NSW government joined the Federal government in minority status.

The RBA reassured markets expecting an early unwinding of stimulus, affirming existing policy settings. Negative rate policy was "*extraordinarily unlikely*." Inflation was not expected until a tight labour market drives 3%+ wages growth.

The ASX200 returned +2.44% while Smallcaps added +0.79%.

The 10-year bond weakened from its Feb 27th weekend trading, but improved +13bp to 1.74% on its Australian February close. Listed Property rebounded strongly (+7%) on stabilisation of bonds.

CoreLogic's home price index rose +2.8% in March, the strongest month since 1998 (following February's 18-year high). Smaller cities saw double digit gains YoY. House approvals are +57% YoY, at a record level, but units are down -28.7%.

The population was +220k (+0.9%) YoY.

Q4 GDP surprised to the upside at +3.1% to be -1.1% YoY.

Exports and imports grew +2% in February, leaving the trade surplus estimated at $8.1bn *vs* a revised record $10.1bn in Jan.

Retail sales fell -1.1% in February but are +8.7% YoY.

Unemployment plunged to 5.8% (-0.6%) on +89k jobs in Feb, all fulltime. Underemployment rose +0.4% to 8.5%. Youth unemployment was 12.9% (-1.1%). Payroll jobs now exceed March 2020 levels with over 13M employed. Hours worked remain -0.7% below a year earlier. JobKeeper subsidies ended after a year.

Commodities and Currency

WTI oil was little changed at $US61/bbl (-1.7%). Gold fell to $1708/oz (-1.5%) despite inflation and currency fears.

Iron ore eased to $162 (-6.1%) from multi-year highs.

Base metals Nickel (-13.5%), Tin (-1.2%), Copper (-3.5%), and Zinc (-0.9%) declined while Aluminium gained +0.5%.

The $A closed at US76c (-3%), *vs* a $US stronger against third currencies.

Key Financial Market Data – As At 31st March 2021 (unless specified)

Interest Rate Markets

Index Performance	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
AustBond Bank Bill Index	0.00%	0.00%	0.02%	0.11%	0.67%	1.12%	1.40%

Key Rates	Mar-21	Feb-21	Jan-21
Australian Cash Rate	0.10%	0.10%	0.10%
90 day BBSW	0.04%	0.03%	0.01%
3 Yr Commonwealth Bonds	0.11%	0.12%	0.11%
10 Yr Commonwealth Bonds	1.74%	1.87%	1.09%
CDX North American 5 Yr CDS	51bp	56bp	56bp
iTraxx Europe 5 Yr CDS	50bp	51bp	52bp
iTraxx Australia 5 Yr CDS	63bp	62bp	63bp
US Fed Funds Rate	0-0.25%	0-0.25%	0-0.25%
US 10 Yr Bond Rate	1.74%	1.44%	1.11%

Equity Markets

Domestic	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
S&P/ASX 200 Acc. Index	2.44%	4.26%	18.54%	37.47%	8.46%	9.65%	10.25%
S&P/ASX Small Ord Acc. Index	0.79%	2.09%	16.20%	52.15%	9.62%	8.33%	10.69%
S&P/ASX 200 A-REIT Acc. Index	6.30%	-0.56%	12.61%	45.37%	-0.09%	7.92%	5.96%

International	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
US: S&P 500 ($US)	4.38%	6.17%	19.07%	56.35%	20.60%	16.78%	16.29%
US: NASDAQ ($US)	0.48%	2.95%	19.04%	73.40%	32.14%	24.54%	23.44%
MSCI World Acc. (Local Currency)	4.25%	6.17%	19.26%	51.08%	16.89%	13.32%	13.42%
MSCI World Acc. (AUD)	5.09%	6.33%	12.38%	23.55%	13.59%	13.16%	13.67%
FTSE 100 (£)	3.55%	3.92%	14.45%	18.37%	-3.96%	-1.65%	1.69%
MSCI Emerging Markets ($US)	-1.51%	2.29%	22.43%	58.39%	14.18%	6.48%	12.07%

Fixed Interest Markets

Bonds	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
BarCap Global Agg Acc. (Hgd AUD)	-0.42%	-2.53%	-1.76%	1.14%	3.35%	3.76%	3.26%
AusBond Composite Bond Acc.	0.80%	-3.22%	-3.32%	-1.81%	2.40%	3.98%	3.46%
ICE BoAML High Yield TR ($US)	-0.60%	-0.08%	7.43%	25.66%	7.36%	5.95%	7.63%

Data*	Current Period		Previous Period	
Employment Data				
Employment Growth	February	88,700	January	29,100
Unemployment Rate	February	5.80%	January	6.40%
Participation Rate	February	66.10%	January	66.10%
Lending Finance				
Housing Finance	February	-0.40%	January	10.50%
Personal Finance	February	1.10%	January	0.20%
Business Finance	February	82.30%	January	-32.90%
Other				
Balance on goods and services	February	7,529m	January	9,616m
Retail Sales	February	-0.80%	January	0.50%
Building Approvals	February	21.60%	January	-19.40%

*All data is seasonally-adjusted.

Median Fund Manager Returns (Morningstar)	1 month	3 month	6 month	1 year	2 year p.a.	3 year p.a.	5 year p.a.
Australian Equity Large Cap	2.81%	5.46%	20.63%	40.85%	8.49%	8.14%	8.83%
Australian Equity Small Cap	1.33%	3.52%	17.06%	61.67%	12.60%	9.16%	10.90%
Global Equity Large Cap	4.88%	7.29%	15.45%	26.36%	12.93%	11.40%	12.60%
Global Equity Small Cap	4.66%	8.54%	25.69%	44.81%	15.84%	10.72%	12.63%
Australian Fixed Income	0.75%	-3.27%	-3.03%	-0.63%	2.38%	3.68%	3.15%
Global Fixed Income	-0.40%	-2.90%	-1.53%	2.66%	3.11%	3.26%	2.80%
Australian Listed Property	6.11%	-0.40%	12.47%	44.03%	-0.72%	6.72%	5.03%
Australian Cash	0.00%	0.02%	0.06%	0.23%	0.67%	1.10%	1.38%
Conservative[1]	0.70%	-0.78%	1.39%	4.65%	2.48%	2.67%	2.95%
Moderate[2]	1.24%	0.36%	3.82%	9.32%	3.79%	4.08%	4.08%
Balanced[3]	1.95%	2.18%	8.35%	16.57%	5.71%	5.71%	5.86%
Growth[4]	2.61%	3.34%	11.42%	23.02%	7.17%	6.85%	7.36%
Aggressive[5]	3.22%	5.05%	15.67%	29.56%	8.80%	8.46%	9.42%

[1] Growth Assets 0-20%
[2] Growth Assets 21-40%
[3] Growth Assets 41-60%
[4] Growth Assets 61-80%
[5] Growth Assets 80%+

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