2 Mar 2021

# Research Briefing | US

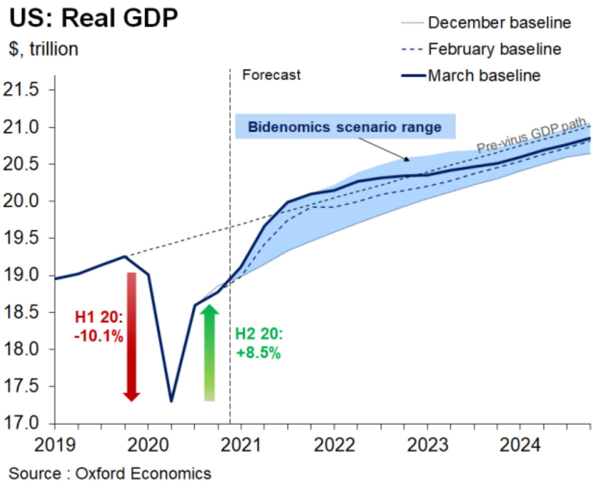
## Economy to experience strongest growth since 1984


**Economist**

Gregory Daco
Chief US Economist
+1 917 880 2637


- **A year ago, the US economy plunged into the deepest and fastest economic contraction since WWII. This year, improving health conditions, expanding vaccine distribution, and generous fiscal stimulus will form a powerful cocktail that lifts real GDP growth to its fastest rate since the early 1980s.**
- **We expect the full $1.9tn American Rescue Plan will be signed by President Joe Biden in the coming weeks, which should boost real GDP growth by 3.3ppts by Q4 2021 and see the economy growing 7% in 2021.**
- **US households will drive the recovery. Lower-income families will benefit from generous fiscal transfers totaling nearly $1tn, including checks, unemployment benefits, and tax credits. Higher-income families will be able to spend their steady income streams and some of the accumulated $1.8tn excess savings.**
- **While the savings rate (flow measure) is expected to fall back to pre-Covid levels by early 2022, the excess savings (stock measure) isn't expected to be run down rapidly. Instead, it will continue to flow into financial assets and be turned gradually into wealth, from which the propensity to consume will be minimal, gradual, and partial.**
- **The cumulative amount of fiscal stimulus is expected to rise from 18% of GDP in 2020 to 25% in 2021. Our baseline assumption is that the average fiscal multiplier on the ARP will be around 35 cents/$ in 2021, and transfers to households will have a cumulative multiplier close to 1 over the next two years.**
- **We anticipate the economy will add seven million jobs in 2021, bringing the unemployment rate down below 5% by year end. Inflation will reach levels rarely experienced over the past decade, at close to 3%, but uncontrolled overheating isn't likely.**

**Figure 1: 2021 will be a banner year for the US economy**




The US economy is expected to grow 7% in 2021, with employment rising by nearly seven million. Inflation will surpass 2%, but not spiral out of control.


**Contact:** Gregory Daco | gregorydaco@oxfordeconomics.com

# Economy to experience strongest growth since 1984

## Strong start to the year

US consumers went on a shopping spree at the start of 2021. A second round of stimulus checks to low-income families, extended and expanded unemployment benefits, and an improving coronavirus situation fueled a burst in spending. The impressive 5.3% rebound in retail sales in January ended a three-month streak of declines. Real consumer spending rose 2% in January and is now within 1.8% of the pre-coronavirus level of outlays (**Figure 2**).

While high-frequency data and severe weather point to a fallback in spending in early February, the strong start to the year should be sufficient to lift real consumer spending growth to 5.1% in Q1, and real GDP growth to around 6%.

## Savings buffer or savings coffer

Using aggregate personal saving data and high-frequency data on consumer spending and employment by income from [Opportunity Insight](), we estimate that US households have accumulated $1.8tn in *excess* savings over the past 11 months – worth around 9% of total personal income in 2021.

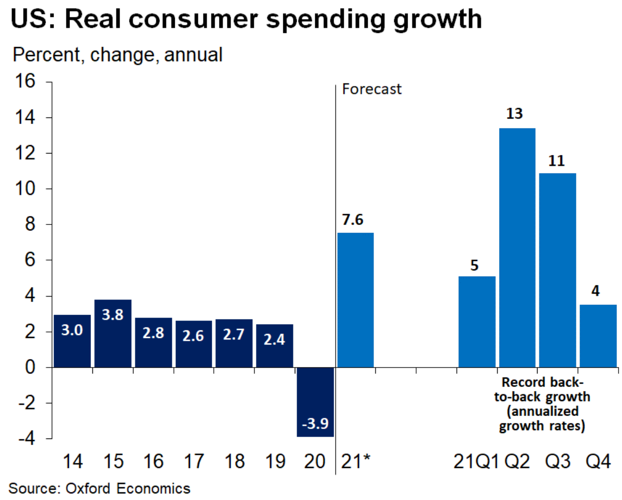
At the onset of the Global Coronavirus Recession (GCR), the personal saving rate spiked from 12.7% to 33% – far surpassing its prior 1975 all-time high. Initially, this reflected households putting aside transfers from the CARES Act, such as checks to families and expanded jobless benefits. However, the saving rate had fallen back to 13% by the end of 2020, and the excess savings entirely reflected higher-income families' lack of opportunity to spend on services while their finances remained steady (**Figure 3**).

The personal saving rate rose to 20.5% in January, reflecting the $600 checks and extended unemployment benefits from the $900bn [Consolidated Appropriations Act, 2021](). We expect it to have fallen back again in February, but then to rise strongly in the spring when the ARP provides additional checks worth $1,400 and extended unemployment benefits.

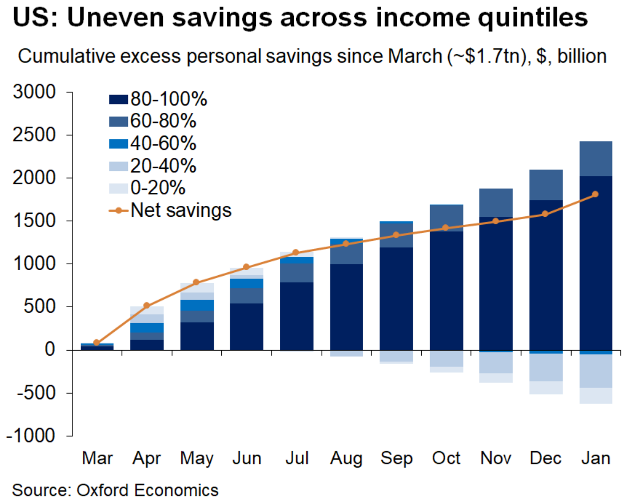
Thereafter, we see the saving rate falling back to 7.5% by year-end (**Figure 4**) as improving health conditions, warmer weather, rebounding employment, and rising mobility support a mini-boom in consumer spending this summer.

Importantly, while the savings rate (flow measure) is expected to fall back to pre-coronavirus levels, the *excess* savings (stock measure) isn't expected to be run down rapidly. Instead, we believe the stock will continue to flow into financial assets and increasingly represent wealth, for which the propensity to consume will be minimal, gradual, and partial.

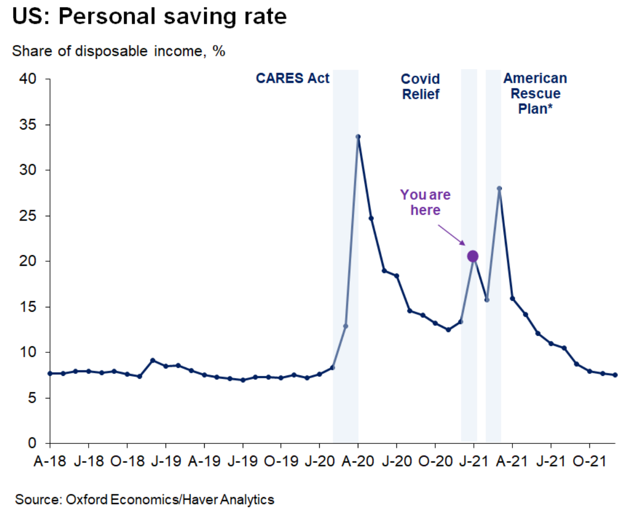
### Figure 2: Consumer splurge




### Figure 3: Most of the excess savings are held by higher-income families




### Figure 4: Personal savings rate expected to fall back to pre-coronavirus level by early 2022






OXFORD ECONOMICS

## Details of the American Rescue Plan

Biden's $1.9tn ARP can be decomposed into three distinct categories of outlays. First, $920bn would be spent on direct assistance to households. Second, $720bn of spending would be geared toward state and local governments ($350bn) and miscellaneous health and education measures. The third block represents $120bn in aid to businesses.

The first block of aid to households has three major components:

- Individual checks of $1,400, bringing the total tax rebate to $2,000, including December's $600 checks.
- Extended and expanded unemployment benefits through August. The ARP would feature a $400/week federal top-up and it would extend the Pandemic Unemployment Assistance Program and Pandemic Emergency Unemployment Compensation programs.
- A fully refundable Child Tax Credit and an increase in the credit to $3,000 per child. The plan would expand eligibility to millions of very poor families while increasing the Earned Income Tax Credit.

## Fiscal multipliers matter

While we previously assumed a $1.3tn fiscal stimulus package would emerge from the announced $1.9tn ARP (in our February baseline), we now believe the full package will eventually be signed by President Biden in early March.

We estimate the lift to real GDP growth will total 3.3ppts by Q4 2021, with the economy expected to grow 7.1% y/y in Q4 – the strongest performance since 1984. Importantly, the GDP effect of the spending of fiscal transfers, aid to businesses, and savings will vary greatly.

The fiscal multiplier on direct transfers to low-income families or unemployed individuals will approach 5 cents/dollar in 2021 and could approach 1 in total (**Figure 7**). However, other stimulus measures will likely have a much lower multiplier. Our baseline assumption is that the average multiplier on the ARP will be closer to 35 cents/$ in 2021 (**Figure 6**).

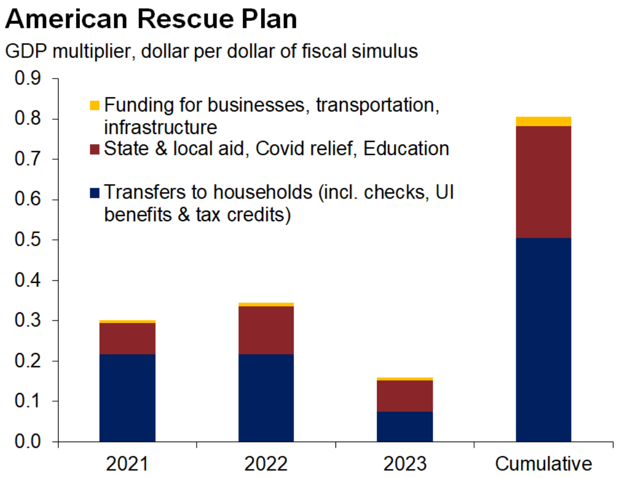
Our forecast fiscal multipliers are aligned with the range of multipliers estimated by Congressional Budget Office (CBO) when the output gap is large and the federal funds rate is at the effective lower bound. They also align with CBO's recent examination estimate of multipliers for the CARES Act.

### Figure 5: The American Rescue Plan

| The American Rescue Plan | | |
|---|---|---|
| Provisions | 2021 ($, bn) | 10-years ($, bn) |
| Additional stimulus checks of $1400 | $422 | $422 |
| Increase unemployment top-up to $400; extend UI programs through August | $243 | $243 |
| Child tax credit, EITC, other tax breaks for households | $129 | $142 |
| Support for renters, small landlords; other housing assistance | $25 | $40 |
| Other saftey net, support for workers, households | $53 | $75 |
| Subtotal, direct assistance to households | $872 | $922 |
| Direct assistance to state and local governments | $350* | $350 |
| Funding to reopen schools; other education | $25 | $170 |
| Expanded covid testing, vaccines; other health care | $80 | $205 |
| Funding for businesses, industry-specific assistance; transporation & infrastructure | $93 | $113 |
| Miscellaneous other | $118 | $160 |
| Total | $1,538 | $1,920 |

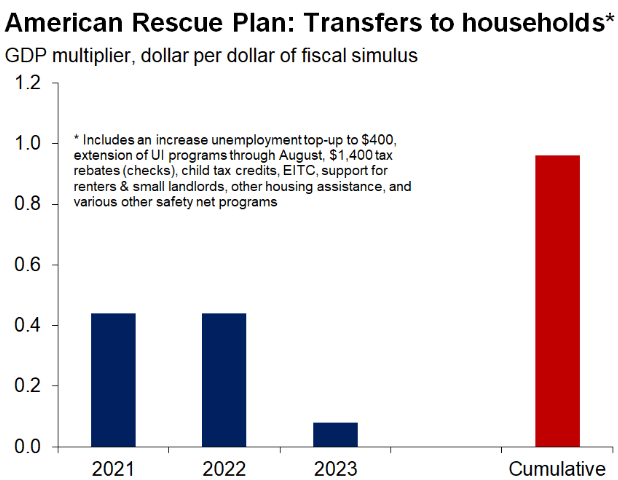
*Represents federal outlays. Spending by state and local governments will occur more gradually.
Source: Oxford Economics

### Figure 6: Fiscal multipliers for the ARP




Source : Oxford Economics

### Figure 7: Fiscal multipliers for the household transfers contained in the ARP




Source : Oxford Economics

## Seven million jobs and inflation above 2%

The benefits of a stronger economy in 2021 will lead to greater employment growth. We anticipate the unemployment rate will fall toward 4.7% in Q4, with the economy adding around 7 million jobs in 2021 (**Figure 8**). Importantly, we also expect the labor force participation rate to rise from 61.4% today to 62.4% by Q4 2021, and to 62.6% in Q4 2022 (still below its pre-pandemic peak due mainly to early retirements).

Favorable year-on-year price comparisons, higher oil prices, and stronger economic activity will lead to higher inflation in 2021. We see headline PCE inflation firming from 1.4% y/y in Q4 2020 to 2.7% in Q2 2021, while core inflation rises from 1.2% y/y to 2.2% y/y. At year-end, we foresee headline inflation at 2.7% and core inflation 2.3% (**Figure 9**).

While "warm" inflation may feel "hot" following a decade of sub-2% inflation in the wake of the financial crisis, broad-based overheating isn't likely. We expect the Fed will look through transitory inflationary pressures and focus on achieving a "broad and inclusive" labor market recovery before removing accommodation.

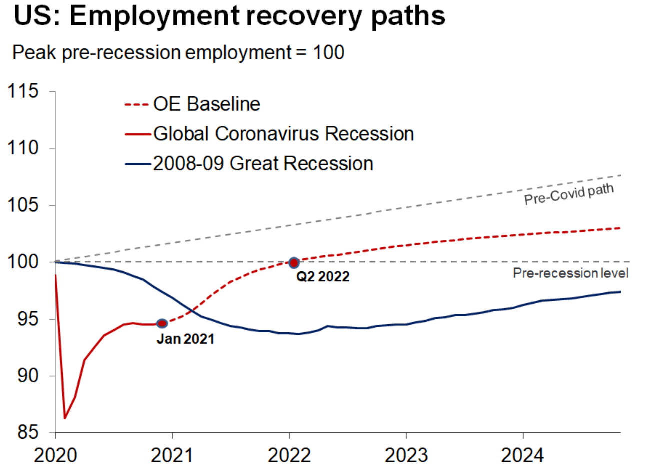
Increased government outlays will push the budget deficit toward 15.3% of GDP in FY2021, after reaching 14.9% of GDP in FY2020. While federal debt held by the public will rise to 108% of GDP in 2021, the inflation-adjusted interest cost of debt will remain very low (**Figure 10**).

## More stimulus?

Looking ahead, we continue to believe policy risks are tilted to the upside. Once Congress passes the ARP, policymakers' attention will shift to Biden's proposed Build Back Better plan. Indeed, Democrats can use the budget reconciliation process, which requires only 50 votes in the Senate, twice this year for fiscal 2021 and 2022.

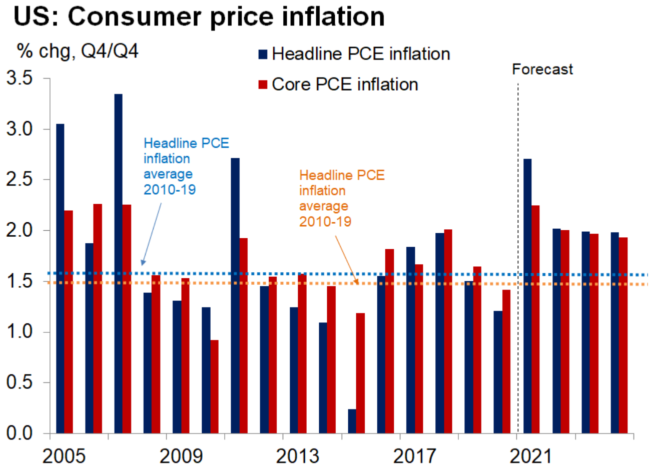
Early discussions point to a mix of infrastructure spending, research and development outlays, and climate change initiatives that would be paid for with an increase in individual income taxes on high-income families and a partial reversal of the corporate tax rate cut from the Tax Cuts and Jobs Act. As previously noted, we believe such a plan would significantly lift the economy's potential over multiple years, meaning that fiscal space concerns appear misguided. "Political space" won't be a concern unless Democrats decide to sabotage their once-in-a-generation opportunity to address a long-standing policy priority: infrastructure.

### Figure 8: Nearly seven million new jobs in 2021



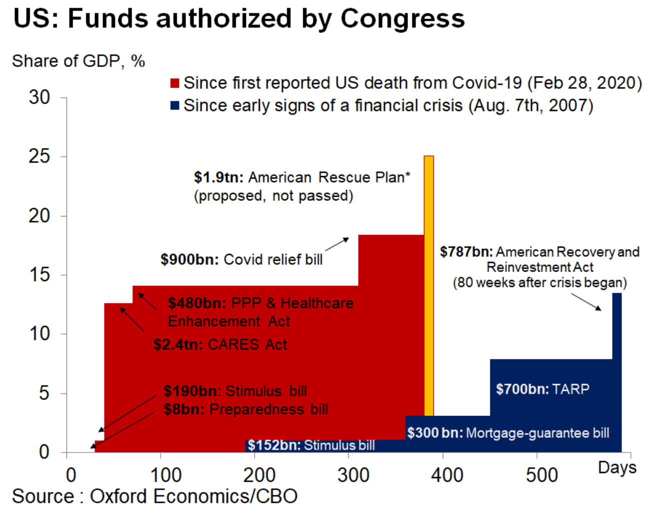

Source: BLS/Oxford Economics/Haver Analytics

### Figure 9: Inflation may feel hot, but overheating is unlikely




Source : Oxford Economics/Haver Analytics

### Figure 10: Unprecendeted fiscal stimulus should support a strong recovery in 2021




Source : Oxford Economics/CBO



OXFORD ECONOMICS