

**Box 1.2.1: Spillovers from 2021 US fiscal policy**

**The US economic situation and policy response**

The outbreak of COVID-19 led in the US to an unprecedented output contraction in 2020-Q2, increasing the unemployment rate from 3.5% in February to a peak of 14.8% in April 2020. Nevertheless, the economic effects of the pandemic were less strong in the US than in many other advanced economies. Output fell by just 3.5% y-o-y in 2020 and private employment had recovered about two thirds of its losses by March 2021.

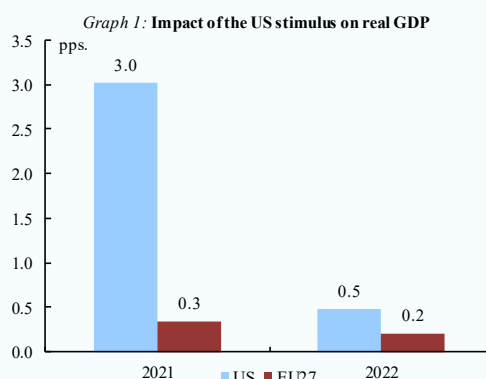
As elsewhere, US fiscal and monetary policy provided ample support to shield households and firms from the consequences of the pandemic. In 2020, fiscal support of well above 10% of GDP for US households and firms stabilised incomes and helped avoid a wave of corporate defaults. In parallel, the Federal Reserve (Fed) cut policy rates to nearly zero and stepped up its asset purchases and liquidity provision.

To support the incipient economic recovery, the US administration has introduced two fiscal support packages since December: a USD 900 billion package, adopted as part of the Consolidated Appropriations Act of 2021, and the USD 1.9 trillion American Rescue Plan (ARP) signed by President Biden in March 2021<sup>(1)</sup>. Both packages focus on support to households, which accounts for almost two thirds of the total. In particular, the ARP extends and tops up the COVID-related unemployment benefits introduced in April 2020, provides one-off payments of USD 1,400 to individuals and expands the Child Tax Credit. A smaller part of the package has been earmarked to backstop loans to small and medium enterprises and to support large companies particularly affected by the pandemic (airlines, railways).

**Quantitative assessment of the packages**

Due to their considerable size and the timing of disbursements, the two packages are expected to have a strong near-term impact on the US economy, while also lifting US demand for foreign exports. The QUEST model with three regions (US, EU27, Rest-of-the-World) has been used to assess the economic impact of the measures in the

US and their spillovers to the EU. The simulation scenario considers a combined fiscal impulse of about 8% of GDP in 2021 and 2% in 2022, as the prevalent share of the funds (especially transfers to households) are to be released in the first half of 2021. The scenario distinguishes between support to liquidity-constrained and unconstrained households and support to firms<sup>(2)</sup>. While the results reported below focus on annual GDP effects, the brunt of the impact is likely to be felt in the second and third quarter of 2021 in the US, while the international impact could be more evenly distributed over the period 2021-2022.



Note: The chart reports the level deviation from the no-stimulus scenario.

It is estimated that the packages could boost US real GDP by around 3% in 2021 (Graph 1). The larger March 2021 ARP package would account for around two thirds of this impact. The moderate size of the output effect, relative to the large size of the packages, reflects the emphasis on transfers to households. While liquidity-constrained households are likely to spend the transfers quickly, other households will raise their consumption only gradually (anticipating a higher tax burden in the future), instead further feeding their savings. Moreover, the simulation also factors in an increase in the bond yields in the US as a result of (temporarily) increased inflation pressures. The rate increase, of 40 basis points, is roughly of the same order of magnitude as the rise observed on the market for inflation-indexed long-term US government bonds since end-2020. The upward rate effect crowds out some interest-sensitive

<sup>(1)</sup> A new structural and investment plan (the American Jobs Plan) of USD 2.3 trn has been announced in April 2021 and may be passed in the second half of the year. The AJP is not pencilled in this forecast, neither is it discussed in this box.

<sup>(2)</sup> The scenario excludes direct transfers to state budgets and some other measures that are assessed to be broadly fiscally neutral. All the measures are largely concentrated in 2021-22.

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Box (continued)

private demand, and triggers an appreciation of the USD, somewhat attenuating the overall positive GDP impact of the measures.

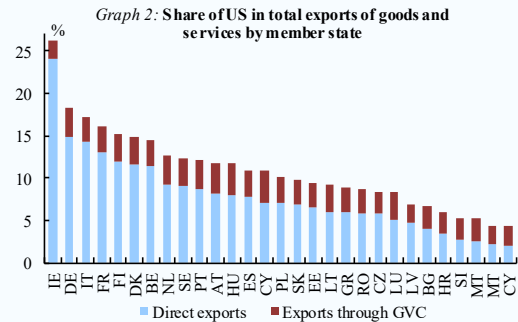
### Spillovers to the EU

The two US fiscal support packages are estimated to increase EU real GDP by about 0.3% in 2021, about a tenth of the US GDP effect in that year (Graph 1). The spillovers in the model derive primarily from international trade linkages, which for the EU are less strong than for some other US trade partners: the share of US imports from the EU in EU GDP has averaged about 4% in recent years. Two separate trade effects can be distinguished. First, stronger US domestic demand implies higher US imports for given relative prices. Second, the appreciation of the US dollar improves the price competitiveness of foreign exporters and further strengthens import demand from the US.

The simulation assumes that US import prices and volumes adjust to higher US demand with a lag, effectively distributing the surge in EU exports and GDP over three years (Graph 1)<sup>(3)</sup>. For the EU, the simulation also assumes that the effective lower bound on nominal interest rates will remain binding in 2021-2022, implying no monetary policy reaction in response to stronger exports. The absence of monetary tightening together with currency depreciation vis-à-vis the dollar adds 0.2 pps. to EU inflation in both 2021 and 2022, triggering a temporary decline in real interest rates. This somewhat reduces real financing costs as well as incentives to save, thus providing additional demand stimulus on top of the direct trade effect.

The strength of spillovers is likely to vary across EU Member States. One way to give a sense of the differences is by looking at the exposure of Member States to US import demand, which determines the first-round export demand effect. Graph 2 presents this exposure, including input-output linkages and thus taking into account indirect trade effects via value chain integration. The Member States that are likely to see their exports rise the most thanks to the extra demand in the US are Ireland, Germany and Italy.

<sup>(3)</sup> These findings are broadly in line with the results reported by other institutions for the American Rescue Plan, in particular the ECB (ECB staff macroeconomic projections for the euro area, 5 March 2021) and the OECD (OECD Economic Outlook, Interim Report March 2021, 9 March 2021).



Source: JRC calculations with Trade-SCAN and the forthcoming Eurostat's FIGARO - EU Inter-country Input-Output Tables, year 2018. More details about the Trade-SCAN model can be found here: Arto, Dietzenbacher and Rueda-Cantuche (2019) and Román et al. (2020).

### Limitations and risks

The simulation uses multipliers for different groups of recipients (e.g. support for liquidity-constrained and unconstrained households, firms etc.) that broadly correspond to the average empirical multipliers for these groups in the pre-COVID period. However, it is possible that the economy may respond differently in current circumstances. Notably, there is considerable uncertainty around crucial structural parameters, such as the importance of financial constraints for households and firms at the current juncture. On the upside, if a larger than assumed share of US households is liquidity-constrained, or a greater share of the transfers reaches these households, the multiplier could be larger, implying larger effects on US GDP and import demand. Conversely, once restrictions on the service sectors are lifted, additional US consumption demand may shift towards services, which have a lower import content. On the EU side, adjustment lags for exporters may be more important at the current juncture, given capacity constraints in international trade.

Spillovers in the model are largely confined to the trade channel. The model accounts for the impact of interest rate differentials on exchange rates but excludes other financial market linkages (and hence risks related to cross-border gross exposures to financial assets). In particular, the simulation does not take into account the risk of turbulences on the US bond market (e.g. as a result of rising inflation expectations), which could trigger abrupt asset price corrections and tightening financial conditions in emerging markets, with associated capital outflows. The realisation of such a risk, as identified in this spring forecast, would slow down the global post-COVID recovery, negatively affecting global demand for EU output.