The Economist

Joe Biden’s stimulus is a high-stakes gamble for America and the world

It is part of a three-pronged economic experiment

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When the pandemic struck it was natural to fear that the world economy would stay in the doldrums for years. America is defying such pessimism. Having outrun gloomy growth forecasts from last summer, it is adding fiscal rocket fuel to an already fiery economic-policy mix. President Joe Biden’s $1.9trn stimulus bill, which he was poised to sign into law after *The Economist* went to press, takes to nearly $3trn (14% of pre-crisis gdp) the amount of pandemic-related spending passed since December, and to about $6trn the total paid out since the start of the crisis. On current plans the Federal Reserve and Treasury will also pour some $2.5trn into the banking system this year, and interest rates will stay near zero. For a decade after the global financial crisis of 2007-09 America’s economic policymakers were too timid. Today they are letting rip.

The probable result is a bounce-back that was unthinkable in the spring of 2020. In January America’s retail sales were already 7.4% higher than a year earlier, as most Americans received $600 cheques from the government, part of the previous round of stimulus. Stuck at home and unable to spend as much as they normally would in restaurants, bars and cinemas, consumers have accumulated $1.6trn in excess savings during the past year. Mr Biden’s stimulus gives most Americans another $1,400 each. Unusually for a rich country, a big chunk of the cash pile is held by poor households that are likely to spend it once the economy fully reopens. If vaccines continue to reach arms and America avoids a nasty encounter with new variants, the unemployment rate should fall comfortably below 5% by the end of the year.

The good news is not confined to America. Manufacturing surveys are healthy even in the euro zone, which is behind on vaccinations and battling new variants, and is applying less stimulus. Mr Biden’s spending will further boost global demand for goods. America’s trade deficit is already more than 50% greater than before the pandemic, as the economy sucks in imports. But the rest of the world will not match Uncle Sam’s breakneck pace. On March 9th the oecd, a club of rich countries, forecast that America’s economy will, uniquely among big economies, be larger at the end of 2022 than it had been predicting before the pandemic. From April to September America is likely to outgrow even China, which is tightening monetary policy and has suffered a 9% fall in its stockmarket since mid-February.

Surging out of a crisis that had at its worst moment cut the number of people in work by 15% will be a triumph for America, and will stand in contrast to the puny recovery after the financial crisis. Mr Biden’s spending will provide welcome relief to those whose lives have been upended—today America is still missing 9.5m jobs. Thanks to extra cash for most parents, the country's persistent and widespread child poverty will fall dramatically.

Yet, though today's policymakers have a guaranteed place in economic history, they may not come to be seen as heroes. That is because America is running an unpredictable three-pronged economic experiment that features historic levels of fiscal stimulus, a more tolerant attitude at the Fed towards temporary overshoots in inflation, and huge pent-up savings which no one knows if consumers will hoard or spend. This experiment has no parallel since the second world war. The danger for America and the world is that the economy overheats.

It is a risk that investors have been weighing up. America's ten-year bond yields, which move inversely against prices, have risen by about one percentage point since last summer, on expectations of higher inflation and higher interest rates. Because of America's pivotal role in the global financial system, its outlook for monetary policy spills across borders. In recent weeks Australia's central bank has had to increase its bond purchases to prevent yields from rising too much. The European Central Bank was deciding whether to make a similar intervention as we went to press. Emerging markets with big deficits, like Brazil, or with large dollar-denominated debts, like Argentina, have reason to fear the tightening in global financial conditions following a turn in American monetary policy.

The Fed is adamant that it will keep interest rates low and continue to buy assets until the economy is much healthier. Inflation will inevitably rise as a collapse in commodities prices early in the pandemic falls out of comparisons with a year earlier, but the Fed will ignore this. Under its new "average inflation targeting" regime, adopted last year, it is seeking to bring about inflation over its 2% target in order to make up for past shortfalls. That is particularly desirable because, for much of the past decade, the world economy's problem has been too little inflation, not too much. Even if the economy eventually overheats, Jerome Powell, the Fed's chairman, has argued that this, too, will be temporary. Longer-term inflation dynamics, he argues, "don't change on a dime".

Might they, however, turn on trillions of dollars? We have no reason to doubt the Fed's near-terms plans, but neither it nor the markets can predict the eventual outcome of America's experiment. The Fed might have to pour cold water on the economy, raising interest rates to get inflation down. That would be awkward, given how much it has recently emphasised its obligation to seek "broad based and inclusive" strength in the jobs market. Higher rates would puncture asset markets and might also precipitate conflict with an increasingly indebted government.

All the chips on red

Mr Biden's stimulus is a big gamble. If it pays off, America will avoid the miserable

low-inflation, low-rate trap in which Japan and Europe look stuck. Other central banks may copy the Fed's new target. Massive fiscal stimulus may become the normal response to recessions. The risk, however, is that America is left with rising debts, an inflation problem and a central bank facing a test of its credibility.

This newspaper would have preferred a smaller stimulus. Alas, America's troubled politics do not permit fine-tuned policymaking and Democrats wanted all they could get. Mr Biden's gamble is better than inaction. But nobody should doubt the size of his bet.■

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