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Fitch Rtgs: US Stimulus Will Boost Growth at a Cost of Higher Deficits, Debt

Fitch Ratings-New York-09 March 2021: The $1.9 trillion American Rescue Plan (ARP) proposed by President Biden and passed by the US House and Senate will deliver a strong economic boost but the scale of the package points to a delayed return to a fiscal stance consistent with stabilization of the government debt ratio, says Fitch Ratings. Consequently, the prospect of debt stabilization is further away than when Fitch placed the US Sovereign Rating of 'AAA' on Negative Outlook in July 2020, despite a stronger economic recovery demonstrated by improving data and supported by the ARP.

The FY 2021 federal deficit is likely to reach 15% of GDP, equaling the FY 2020 deficit as a share of output. Last month, the Congressional Budget Office (CBO) projected a deficit of 10.3% of GDP in FY 2021, including pandemic relief spending of $900 billion passed at the end of December. Fitch had expected and largely factored this in at its July rating review. The CBO expects the Senate's latest bill to add $1.1 trillion to spending in FY 2021 and $458 billion to FY 2022. Direct relief to households in the form of a one-year extension of the child tax credit, extension of unemployment benefits and stimulus checks account for around half of the bill and more than half of the spending in FY 2021 and FY 2022 but other spending will take longer to disburse. Even assuming no other major spending, Fitch projects the federal deficit will approach 7% of GDP in FY 2022.

Federal debt, which recently surpassed 100% of GDP, will approach 109% of GDP in FY 2021, assuming the US Treasury finances part of the upcoming spending from its unusually large cash balance, while general government debt will reach 127% of GDP in 2021, before surpassing 130% by 2023. These projections are comparable to those that we released in July 2020. While stimulus and relief plans have become clearer, the 2020 contraction was shallower than we had expected and macroeconomic forecasts have also improved, given the effects of policy support, adaptation of the economy to restrictions, re-opening and progress on vaccines.

The Biden administration has yet to outline its full spending and tax plans. The administration intends to present another package including infrastructure spending and measures to boost growth potential, and the President's budget may offer further clues in early 2Q21. Fitch assumes that budget outlays under any such package would be spread over a multi-year period and would have a smaller near-term effect on the deficit than the ARP. The administration also plans tax increases, which would go some way to offsetting rising spending. These would include higher Social Security contributions on top earners, for example. President Biden campaigned on a platform that would have raised spending by USD5.4 trillion over 10 years according to the Penn Wharton Budget Model, although estimates vary. The plan would have raised revenues by USD3.4 trillion, leading to a 10-year deficit increase of USD2.0 trillion.

At the time of the review of the US rating in July 2020 we said that we would assess what steps the new administration took toward deficit consolidation in the post-pandemic phase, noting that the rating could be downgraded in the absence of a credible commitment to address medium-term public spending and debt challenges. The future path of mandatory spending including Medicare and social security will remain an important driver of medium-term financing needs.

Our debt dynamics assume that spending reverts to more typical levels as a share of GDP from FY 2023, by which time general government debt is likely to exceed 130% of GDP and be on a gradual upward trajectory under relatively benign economic assumptions. However, without a fiscal anchor and in light of the ambitions of the administration, fiscal policy may be more expansionary, leading debt to rise more rapidly. Fitch also believes that very low interest rates, which have held down debt service costs, will eventually rise despite the Federal Reserve's commitment to an extended period of extremely accommodative monetary policy.

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