

THEMATIC

A post-Covid structural change in developed markets: the strong political will to invest in the US



Valentine AINOZ,
Deputy Head of Developed
Markets Strategy Research



Mickael BELLAICHE,
Fixed Income and Credit
Research Strategist



Delphine GEORGES,
Senior Fixed Income Research
Strategist

*"Doing nothing is not
an option"*
(Joe Biden)

What matters to fixed income investors is the macro-financial environment that will prevail after the strong rebound in growth and inflation expected in H2. In a context where investors must question whether the change in consumer prices is transitory or a regime shift, it is important to focus on the sustainability of economic growth on the basis of capex trends. Indeed, US long-term economic growth could be boosted by a strong policy of investment (public and private). This would represent a strong contrast with Europe. What are the implications for fixed-income investors?

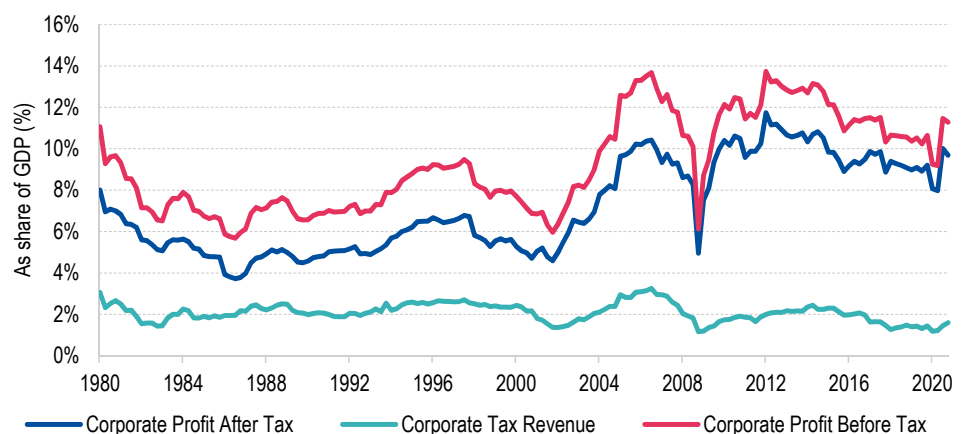
Biden's message is clear: investment is a top priority. The president argued that the United States' position as a preeminent global power was under threat from China if investments were not made. "Doing nothing is not an option". Biden said it would be unacceptable not to move forward: "America is no longer the leader in the world because we're not investing". China is "counting on American democracy to be too slow, too limited and too divided to keep pace" and "we can't afford to prove them right."

• **The US administration has proposed a two-part plan called Build Back Better of more than \$4 trn over 10 years, after years of underinvestment in infrastructure and education.** These are the basic ingredients of long-term growth. It could have significant implications on long-term growth trends and productivity. The first part, the American Jobs Plan (AJP) amounts to more than \$2tn in spending and tax incentives organised around four areas: 1) traditional infrastructure investments (roads, bridges, ports and digital infrastructure); 2) environmental infrastructure (water and energy); 3) manufacturing, supply chain and R&D initiatives (electrical vehicles and semiconductors); and 4) social welfare (investment in housing, childcare facilities, and upgrades of schools and community colleges). The second part

is the American Families Plan of \$1.8 trn over 10 years in new benefit spending and tax credits focused on child care and education. The new spending would raise total infrastructure investment to around 4.5% of GDP, the highest level since the 1970s. Infrastructure policies are the fiscal policies which have among the highest multipliers.

• **The tax reform proposed by the new administration aims also to improve economic efficiency via a better allocation of capital.** President Biden is in favour of raising corporate taxes to fund his infrastructure plan. However, we don't think it will penalise private investment. First, revenues from corporate taxation are beginning to look very low. The share of federal revenue raised by the corporate tax has fallen steadily for decades and is now under 10%. In contrast, the share of revenue raised by taxing labour has been growing and now exceeds 80%. Secondly, we think that aggregate demand matters more to the investment outlook than tax rate changes. Thirdly, there is no evidence that the 2017 tax law made substantial progress in long-term economic growth. The increase in corporate cash balances were mainly directed toward financing buybacks and dividend payouts for shareholders. Indeed, the recent jump in share buybacks has come almost entirely from companies with lowered tax rates.

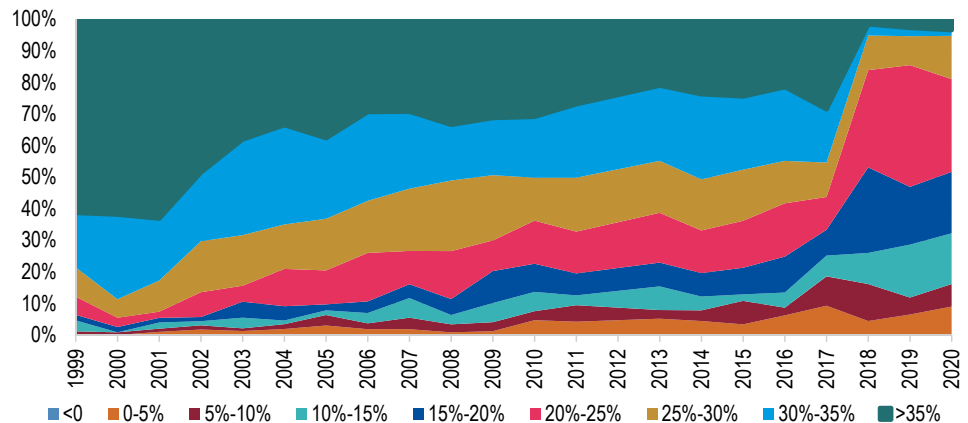
1/ Corporate profit and taxes as a share of GDP



Source: Datastream, Amundi Research - Data as of 31 December 2020

THEMATIC

2/ Distribution of effective tax rates among US IG



Source: Bloomberg, Amundi Research - Data as of 31 December 2021

The Fed is willing to let the economy run hot

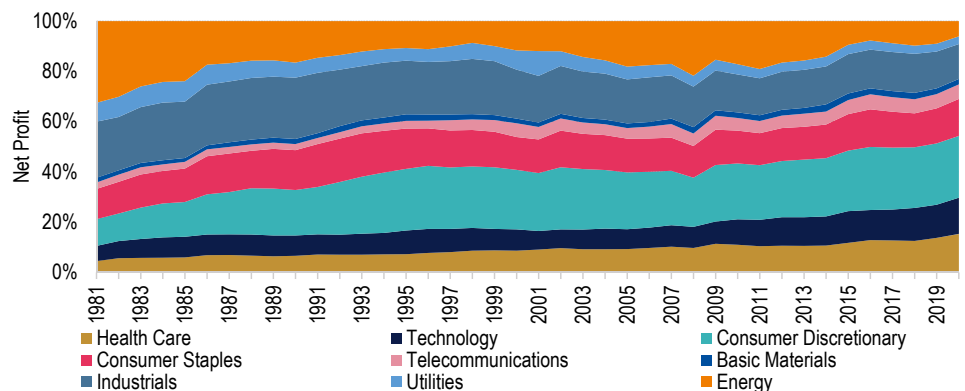
In addition, we see a pick-up in private investment in the technology and consumer non-cyclical sectors. The change in the Fed's policy framework is providing strong support to the US economy. Indeed, we have observed a strong rebound in investment by American companies sustained by the very low interest rate environment.

• **Companies are benefiting from historically attractive financing conditions.** In 2008, the recession was triggered by an endogenous financial shock, which led to a prolonged period of tight financing conditions and private sector deleveraging. This time is different from 2008: the Fed's monetary policy has pushed the cost of debt to historically low levels, and activity on the corporate debt primary market remains very solid. On the one hand, the record low cost of funding has led to reduced interest payments on debt and improved corporate creditworthiness. The weakest companies (with the lowest ratings, affected by the Covid crisis) are taking advantage of low rates to refinance their debt and lower their average cost of debt. On the other hand, solid and well-capitalised companies

are using the very low cost of debt to accelerate their development.

- **Cash on the balance sheets of S&P 500 companies is at an all-time high of \$2.7 trillion.** Cash holdings along with improving cash flow could spark more capital spending, dividends and buybacks but also investment. The cash is concentrated in the technology, health care and consumer sectors.
- **M&A activity remains on track in the United States and Asia despite the crisis.** M&A activity accelerated sharply during the second half of 2020; during this period volumes were the highest of all 2H periods since 2015. This rebound in M&A activity was driven by technology, consumer non-cyclical and communication sectors. These companies have outperformed in recent years and were the big winners of the crisis. Most of them are well-rated and well-capitalised. They have an offensive strategy and pursue external growth to gain in scale and diversity (by product, region, and customer). By contrast, M&A activity remains modest in Europe.
- **US capex was one of the surprising areas of resilience in the last quarter of 2020.** While capex is growing in most

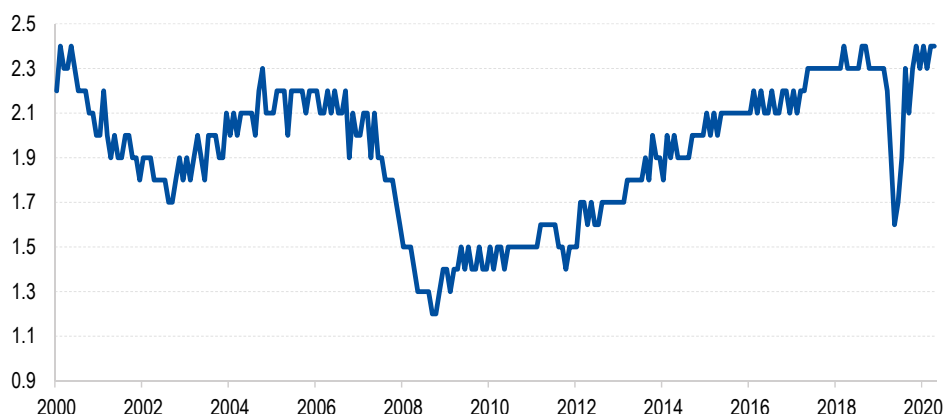
3/ S&P500: U.S. net profit by sector (% total)



Source: Datastream, Amundi Research - Universe: S&P500 ex. Financials and Real Estate
Data as of 31 December 2020

THEMATIC

4/ Rate of job quitting (in %, SA)



Source: Datastream, Amundi Research - Data as of 31 March 2021

areas of the economy, two areas stand out: technology and renewable energy.

Overall, the technology, health care and consumer discretionary sectors continue to show strong development.

These sectors, which had already been driving the US economy over the past decade, are the big winners of the crisis. Interestingly, the situation on the labour market is completely different from that of 2008. Despite the high unemployment rate, we are already seeing tensions in the labour market. In the April NFIB Small Business Optimism Index report, a record 44% of surveyed businesses noted they had one or more jobs that could not be filled. People who have voluntarily quit their jobs have already returned to the pre-Covid level.

In the short term, strong growth and buoyant inflation will drive sovereign core bond yields higher. The coordinated response of monetary and fiscal policies to the Covid shock has been of unprecedented magnitude in peacetime, particularly in the United States. With the economic recovery accelerating, the case for shorter duration remain (in particular in the US).

Over the long run:

- **In the US, the current expansionary fiscal policy (BBB) and investment**

growth have the potential to raise the equilibrium real interest rate.

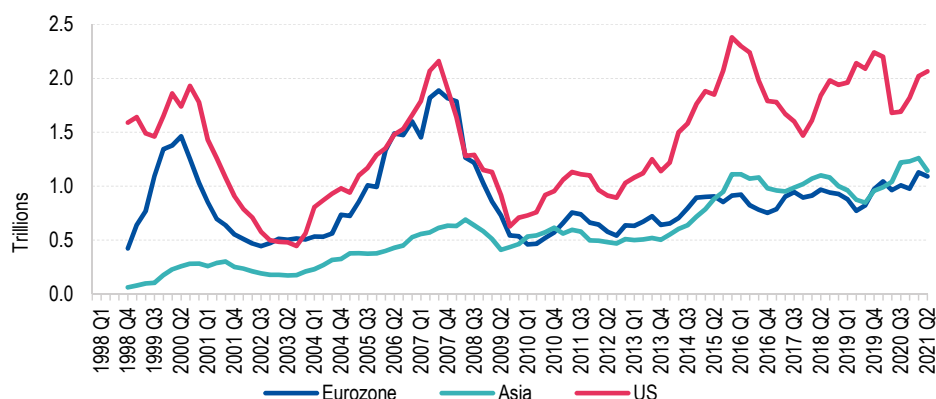
After decades of decline, the US real equilibrium interest rate is now estimated at around 0% to 0.5%. It could rise in the next few years as greater tolerance for budget deficits, unconventional monetary policy and structural measures to promote investment should lead to a new macroeconomic regime and a receding of the risk of secular stagnation.

- **The upside in euro core rates will be limited by the economic fragmentation between Eurozone countries.**

The EU recovery fund (€750bn) and expansionary fiscal policy has allowed countries like Italy and Spain to have strong investment plans. However, public stimulus measures are not as ambitious as those planned in the US, and private investment has so far remained muted. The size of the EU recovery fund is not sufficient to compensate for years of underinvestment. Indeed, the last decade has been marked by a strong divergence in R&D expenditure among developed countries. The overall R&D-to-GDP ratio in Europe has been around 2%, i.e., significantly lower than in the United States, Japan, South Korea and

Over the long run, the US current expansionary fiscal policy has the potential to raise the equilibrium real interest rate

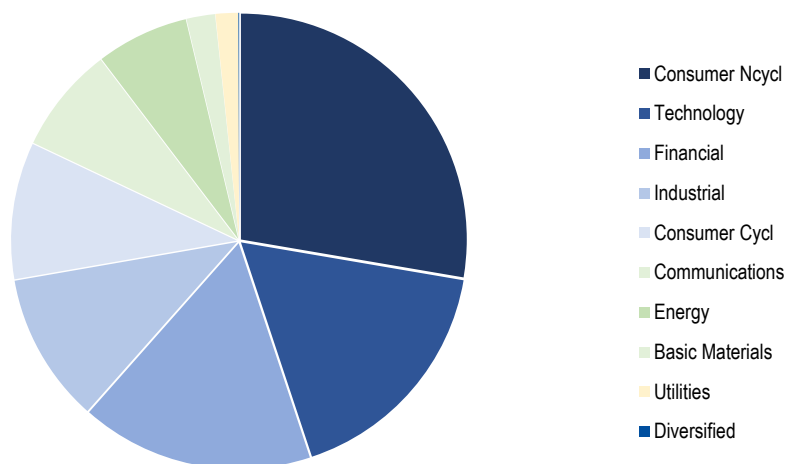
5/ M&A volumes (trailing 4 quarters in USD)



Source: Bloomberg, Amundi Research - Data as of 30 April 2021

THEMATIC

6/ M&A activity in North America (last 12 months)



Source: Bloomberg, Amundi Research - Data as of 30 April 2021

Singapore. R&D spending has been particularly low in peripheral countries. Barring a significant rise in growth expectations, the ECB stands alone in trying to avoid financial fragmentation. The ECB's ability to stabilise the markets is thus essential. Fiscal policy can only be effective if sovereign yields remain low

and stable even in the face of growing deficits. Otherwise, divergences on the ECB board are likely to increase as the economic recovery starts, as the debate on the assessment of "favourable financing conditions" is still open within the ECB.

Finalised on 20 May 2021

Amundi Research Center



Find out more about
Amundi publications
research-center.amundi.com

Emerging Private Equity
Money Markets Find Monetary
Foreign Top-down Policies
Exchange Corporate Equities
Sovereign Bonds Forecasts
ESG Fixed Income Yield Real Estate
Quant Investment Asset
Strategies Allocation

DISCLAIMER

The MSCI information may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.mscibarra.com).

In the European Union, this document is only for the attention of "Professional" investors as defined in Directive 2004/39/EC dated 21 April 2004 on markets in financial instruments ("MIFID"), to investment services providers and any other professional of the financial industry, and as the case may be in each local regulations and, as far as the offering in Switzerland is concerned, a "Qualified Investor" within the meaning of the provisions of the Swiss Collective Investment Schemes Act of 23 June 2006 (CISA), the Swiss Collective Investment Schemes Ordinance of 22 November 2006 (CISO) and the FINMA's Circular 08/8 on Public Advertising under the Collective Investment Schemes legislation of 20 November 2008. In no event may this material be distributed in the European Union to non "Professional" investors as defined in the MIFID or in each local regulation, or in Switzerland to investors who do not comply with the definition of "qualified investors" as defined in the applicable legislation and regulation. This document is not intended for citizens or residents of the United States of America or to any "U.S. Person", as this term is defined in SEC Regulation S under the U.S. Securities Act of 1933. This document neither constitutes an offer to buy nor a solicitation to sell a product, and shall not be considered as an unlawful solicitation or an investment advice. Amundi accepts no liability whatsoever, whether direct or indirect, that may arise from the use of information contained in this material. Amundi can in no way be held responsible for any decision or investment made on the basis of information contained in this material. The information contained in this document is disclosed to you on a confidential basis and shall not be copied, reproduced, modified, translated or distributed without the prior written approval of Amundi, to any third person or entity in any country or jurisdiction which would subject Amundi or any of "the Funds", to any registration requirements within these jurisdictions or where it might be considered as unlawful. Accordingly, this material is for distribution solely in jurisdictions where permitted and to persons who may receive it without breaching applicable legal or regulatory requirements. The information contained in this document is deemed accurate as at the date of publication set out on the first page of this document. Data, opinions and estimates may be changed without notice.

You have the right to receive information about the personal information we hold on you. You can obtain a copy of the information we hold on you by sending an email to info@amundi.com. If you are concerned that any of the information we hold on you is incorrect, please contact us at info@amundi.com.

Document issued by Amundi Asset Management, "société par actions simplifiée" - SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 - Head office: 90 boulevard Pasteur - 75015 Paris - France - 437 574 452 RCS Paris - www.amundi.com
Photo credit: ©MDelporte - iStock/Getty Images Plus - PM Images

Chief editor

BLANQUÉ Pascal, *Group Chief Investment Officer*

Editor

DEFEND Monica, *Global Head of Research*

With Global Research contributors

AINOUZ Valentine, *Deputy Head of Developed Markets Strategy Research, CFA*
BELLACHE Mickael, *Fixed Income and Credit Research Strategist*
BERARDI Alessia, *Head of Emerging Macro and Strategy Research*
BERTONCINI Sergio, *Senior Fixed Income Research Strategist*
BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*
CESARINI Federico, *Cross Asset Research Strategist*
DELBO' Debora, *EM Macro Strategist*
DI SILVIO Silvia, *Macro Strategist*
DROZDZIK Patryk, *EM Macro Strategist*

With the Amundi Insights Unit contribution

BERTINO Claudia, *Head of Amundi Investment Insights Unit*
CARULLA POL, *Amundi Investment Insights Unit*

Conception & production

BERGER Pia, *Research*
PONCET Benoit, *Research*

Deputy-Editors

BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*

GEORGES Delphine, *Senior Fixed Income Research Strategist*
HERVÉ Karine, *EM Macro Strategist*
HUANG Claire, *EM Macro Strategist*
LEONARDI Michele, *Cross Asset Research Junior Analyst*
MIJOT Éric, *Head of Developed Markets Strategy Research*
PERRIER Tristan, *Global Views*
PORTELLI Lorenzo, *Head of Cross Asset Research*
STRENTA Aurelien, *Emerging Market Analyst (V.I.E)*
USARDI Annalisa, *Senior Economist Cross Asset Research*
VARTANESYAN Sosi, *Sovereign Analyst, Emerging Macro & Strategy Research*

FIOROT Laura, *Deputy Head of Amundi Investment Insights Unit*
DHINGRA Ujjwal, *Amundi Investment Insights Unit*
PANELLI Francesca, *Amundi Investment Insights Unit*