



Box C:

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Spillovers to Ireland from the America Rescue Plan

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On 27 February 2021, the US House of Representatives passed President Biden's America Rescue Plan. The associated fiscal package is very large, amounting to \$1.9 trillion (8.5 per cent of 2020 GDP). This Box provides an assessment of the possible economic implications of the Biden package for the US economy as well as spillovers to the rest of the world and Ireland. Our estimates suggest that the Biden stimulus would add just under 1 per cent to economic output in Ireland by 2022. The results show that the US stimulus measures are likely to contribute to a favourable external demand environment for the Irish economy in the coming years, complementing the projected recovery in domestic demand. The benefits to the Irish economy would be reduced if US monetary policy was tightened in response to a sustained increase in inflation.

Background and Context

The aim of the America Rescue Plan is to provide direct relief to Americans in response to the adverse economic effects of the COVID-19 pandemic. In 2020, US GDP fell by 3.5 per cent and employment by just under 6 per cent. The plan includes a broad range of relief measures including \$1,400 per-person cheques to households, increases in tax credits such as the Child Tax Credit and Earned-Income Tax Credit, an extension of unemployment benefits, and support to small businesses through emergency grants.¹ Although the plan includes fiscal changes over a 10-year horizon, the direct fiscal stimulus is front loaded and concentrated over the next three years (2021-2023). For example, the Congressional Budget Office (CBO) has estimated that \$1.1 trillion (60 per cent of the total) is expected to take place

¹ See: <https://www.whitehouse.gov/american-rescue-plan/>.



in 2021 while a further \$0.5 trillion (26 per cent of the total) is allocated in 2022 and \$0.1 trillion (6 per cent of the total) is allocated to 2023.²

In this Box, we focus on estimating the impact of the US fiscal stimulus on economic activity over the projection horizon.³ These estimates are incorporated into the forecasts for the economy presented in this Bulletin.

Modelling the America Rescue Plan

To assess the America Rescue Plan, we estimate not only its potential impact on the US economy but also its spillover effects to the global and Irish economies using both the NiGEM and COSMO macroeconomic models.⁴ In line with ECB (2021, Box 4), we assume that the \$1.9 trillion plan is comprised of temporary shocks to (i) transfers to targeted households, (ii) general transfers to households, and (iii) government consumption.⁵ Transfers account for the majority of the stimulus (see Figure 1). It is assumed that households save a proportion of the transfers they receive. However, for the targeted transfers, we assume that these go to income constrained households and thus the full amount is consumed.⁶

In terms of monetary policy, we assume that the Federal Reserve fully accommodates the fiscal expansion by holding interest rates unchanged for the duration of the shocks.⁷ Some commentators have raised concerns about the potential for the US stimulus package to overheat the US economy and cause more persistent and problematic inflationary pressures.⁸ If this materialised, the Fed may need to raise interest rates, which would ameliorate some of the inflationary pressures and reduce the impact of the stimulus on output. NIESR (2021) shows that pursuit of an active monetary policy reaction would modestly reduce the positive effect on US GDP of the extremely large fiscal package.

² See: https://www.cbo.gov/system/files/2021-03/Estimated_Budgetary_Effects_of_HR_1319_as_passed_0.pdf

³ The results are presented in the Box as deviations from a model baseline that excludes the impact of the US fiscal stimulus in the America Rescue Plan.

⁴ NiGEM is a model of the global economy maintained by the National Institute for Economic and Social Research (NIESR) in the UK. We use NiGEM in combination with the Central Bank's model of the Irish economy (COSMO) to estimate the effect of external economic developments on Ireland.

⁵ ECB (2021, Box 4) "Risks to the US and euro area outlook related to the American Rescue Plan. Available at: https://www.ecb.europa.eu/pub/projections/html/ecb.projections202103_ecbstaff~3f6efd7e8f.en.html#toc9

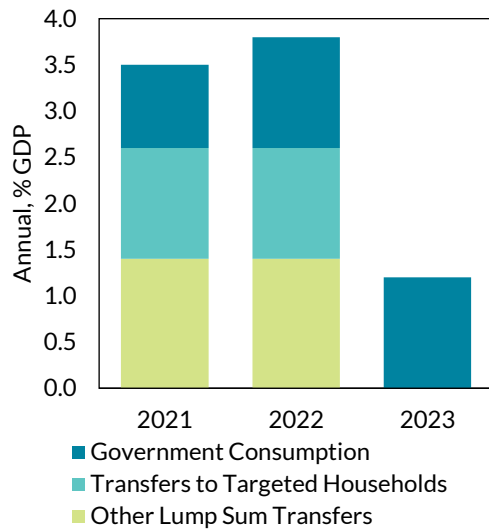
⁶ If a smaller amount of targeted transfers were assumed to flow into consumption then the magnitude of stimulus and spillovers to Ireland would be somewhat lower.

⁷ If interest rates increase in response to more persistent inflationary pressures then the benefits to Ireland would be reduced.

⁸ See Financial Times (12 April 2021) "Larry Summers: 'I'm concerned that what is being done is substantially excessive'". Available at: <https://www.ft.com/content/380ea811-e927-4fe1-aa5b-d213816e9073>

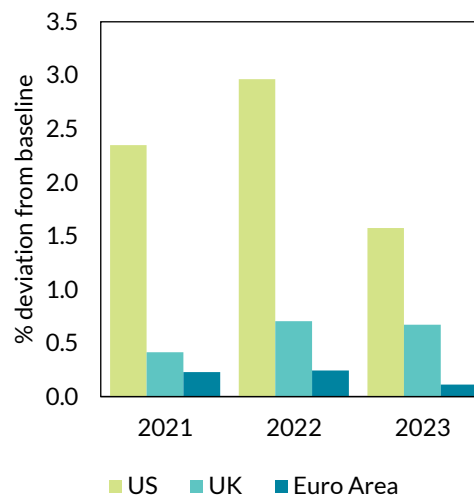


Figure 1: Fiscal stimulus assumptions



Source: author's calculations.

Figure 2: Impact of US Stimulus on GDP in US, UK, and EA



Source: author's calculations, NiGEM.

Impact on US Economy and Key Trading Partners

The impact of the stimulus on the US economy and Ireland's other key trading partners is shown in Figure 2. The plan is estimated to boost US GDP by 2.3 and 3 per cent in 2021 and 2022, respectively. Due to the temporary nature of the stimulus, the effect carries through to 2023 and beyond at a diminished rate. The US stimulus provides positive spillovers to the rest of the world mainly through the trade channel (i.e. US import demand increases). The size of the spillovers to each individual country depends on the country's share of trade with the US as well as the degree of openness of each economy. Overall, the effects of the stimulus are estimated to increase UK and euro area GDP by 0.7 and just over 0.2 per cent, respectively, by 2022. These estimates are consistent with those reported by ECB (2021) and NIESR (2021).

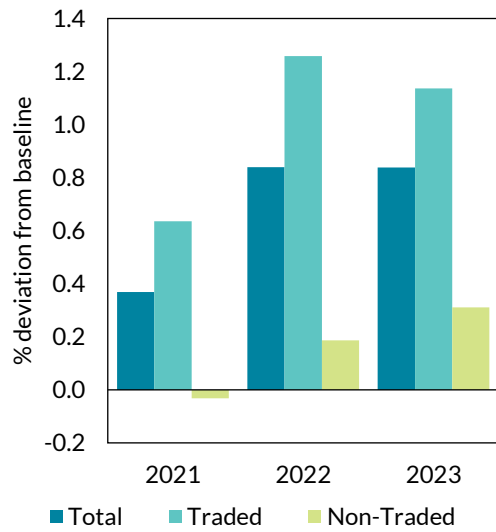
Impact on Ireland

The stimulus to the US economy and subsequent spillovers to Ireland's other main trading partners has a positive impact on the Irish economy. The transmission of the shock to the economy occurs largely through the increase in foreign demand. This directly boosts output and employment in the traded sector, reducing the unemployment rate. In the model, the increase in employment and incomes stimulates consumption and non-traded sector output. Figure 3 shows that Irish output is estimated to be 0.8 per cent higher by 2022 than in the absence of the US stimulus. The increase in overall output is driven by the traded sector where output rises by 1.2 per cent. Improvements to the



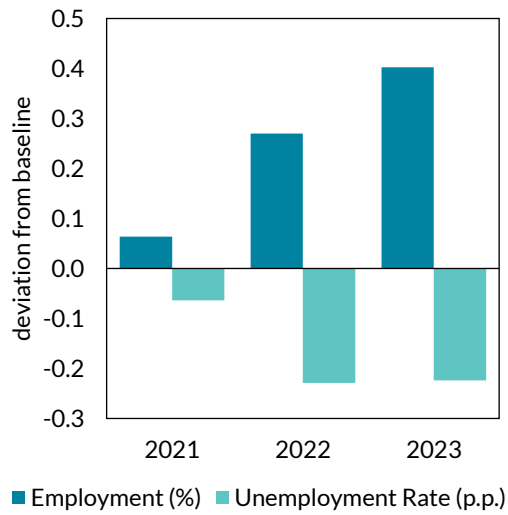
labour market would result in an estimated 0.4 per cent increase in employment and about a 0.2 percentage point reduction in the unemployment rate (see Figure 4).

Figure 3: Impact of plan on Irish output by sector



Source: authors' calculations, COSMO.

Figure 4: Impact of plan on Irish labour market



Source: authors' calculations, COSMO.