THE WEEKLY **EZ** ECONOMIC MONITOR
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CLAUS VISTESEN, CHIEF EUROZONE ECONOMIST

The coronavirus will lead to a sustained change in the way the EZ conducts economic policy.

The squabble over Eurobonds is a distraction; such an instruments won't help much at this point.

An overview of the stimulus measures so far indicates easing measures at nearly 25% of EZ GDP.

Covid-19 is Driving a Lasting Economic Policy Shift in the EZ

The coronavirus outbreak, by definition, will fade eventually, but we suspect the measures to combat it will be more long-lasting. In terms of sheer scale, EZ governments and the ECB are throwing the kitchen sink at the virus, but that's only half the story. A closer look at shifts in the underlying policy structures suggests that the euro area has crossed the Rubicon in a number of key areas. *It has taken the virus less than two weeks to vanquish the otherwise sacred code of fiscal discipline.* On March 16, EZ finance ministers formally agreed that fiscal stimulus aimed at cushioning the fall-out will be excluded from the calculations used to determine compliance with the Stability and Growth Pact. This step followed an earlier exemption for Italy, granted by the Commission, as the country moved quickly to lock down in response to the outbreak.

The counterpoint is that the fiscal rules will be re-tightened once the outbreak is over, but we doubt it. Before the outbreak, the defenders of fiscal discipline were already being marginalised, in the context of a slowing economy, and a central bank facing diminishing returns with respect to further easing with conventional policy tools. In this context, Covid-19 was merely the straw that broke the camel's back.

In addition, economic policy is inertial, especially on the fiscal side. It's difficult to imagine that EZ governments will be able to draw back quickly the myriad of initiatives currently put into place. The hit to economic growth in the first half of the year will be vicious, and even with a quick and decisive policy response, the aftershock will linger long after the virus is gone.

Meanwhile in Frankfurt, the ECB stuttered in the early stages of the crisis, but it has since made a strong comeback; see here. It is now set to expand its balance sheet by over a trillion between now and the end of the year, and it also has put into place a new set of TLTROs. This latter effectively offers banks unlimited liquidity, at negative rates, aimed at supporting the private sector during the efforts to contain the virus.

Crucially, the ECB now is also bending the self-imposed rules that have been threatening to stymie the effectiveness of its asset purchases. The central bank stepped in earlier this month to drive Italian bond yields lower. In doing so, it put action behind the committment that it actually *does* care about spreads, in contrast to Ms. Lagarde's now infamous mistaken comment to the contrary. More importantly, the governing council has announced that the issuer limits—capping purchases to 33% of a single debt instrument—will *not* apply to the €750B Pandemic Emergency Purchase Programme or PEEP. Combined with the fact that PEEP purchases will be concentrated on the short end of the curve, to "reduce roll-over risk", the ECB is sending a clear message to markets. *It will not allow markets to disrupt the transmission mechanism of monetary policy.*

So far so good, but this is Europe after all, and old differences were laid bare last week. In a conference call with EZ finance ministers on Tuesday, Ms. Lagarde aired the idea of a joint debt issuance by EZ members—a so-called coronabond—and also suggested that the ESM bailout fund could be activated. The politicians agreed that an ESM program could be useful, but the suggestion of mutualised debt predictably split finance ministers between north and south. This, in turn, re-ignited the inextinguishable debate about solidarity in Europe, and whether this will prove the crisis that breaks it apart.

Never bet against Europeans arguing over trivialities, but on this occasion we think the debate about eurobonds is a distraction. Mutualised debt issuance at this point won't achieve anything that national governments can't do more efficiently. *They have already pledged enormous amounts of stimulus, and the ECB has committed near-unlimited firepower to support those efforts*. As we have explained in recent *Monitors*, the key challenge now is to get the transmission mechanism right. A centrally organised debt issuance and stimulus program in Brussels wouldn't add much here. Finally, the EU has litte influence over member states' health policies, making a joint-European response even more ill-equipped to combat this particular crisis. We can't dismiss the possibility that EU politicians will continue to squabble over this, but we hope not.

What are governments doing?

The final part of this *Monitor* responds to a number of requests from readers to provide an overview of the fiscal measures taken to date. It's a long list, and it's still growing. For the record, the *Bank of Spain's* recent bulletin—see here—has a good *global* overview too.

The fiscal packages are split between two components; actual increases in spending and investment and pledged support, generally via loan guarantees to the SMEs. Across the major economies, the scale of the first category ranges from around 1.5% of GDP in Italy and Spain, to highs of 2.0% and 3.5% in Germany. Note that the numbers in Italy and Spain were announced relatively early during the epidemic. They will probably increase in due course.

The loan-guarantees are much more substantial. The announced packages go from potentially "unlimited" in Germany to 10-to-15% of GDP in the other major economies. Using the German government's estimate that €650B in guarantees might be needed, we arrive at a number of around 12% of EZ GDP. In total, the tally pledged by governments in the major EZ economies, including the ECB's QE programs, amount to just over €2.5T, which is around 21% of GDP. Add in the smaller countries and this easily swells to 25%. ***This is a huge number, but now comes the difficult bit; how to get the money where it needs to go.***

EZ GOVERNMENTS ARE THROWING THE KITCHEN SINK AT COVID-19

GERMANY

- €150B in direct fiscal measures, 3.5% of GDP, and "unlimited" guarantee for loans. The government estimates €650B, which is around 15% of GDP.

- Tax deferals for firms, easing conditions to move to shorter workhours—*Kurzarbeit*—and support to cover those costs.

- Increased unemployment insurance, rent support for vulnerable households, and support for SMEs with fewer than 10 employees.

- An investment program of €10B between 2021 and 2024, with €55B in reserve. This initiative includes €7B upfront support to the public health system, to alleviate capacity constraints.

FRANCE

- €45B of GDP in direct fiscal measures, 1.5% of GDP, and €300B in loan guarantees, which is 12% of GDP.

- One month deferral of tax and social security charges for firms, and a solidarity fund for small businesses.

- Partial coverage of laid-off workers' salaries for two months, under the *chômage partiel* program. Just over 0.1% of GDP is earmarked for this, initially.

- The loan guarantee program will cover 90% of loans for a firms with revenues under €2M and €50M, at a maximum of €300K and €5M, respectively.

ITALY

- €25B of GDP in direct fiscal measures, 1.4% of GDP, and €350B in loan guarantees, which is 19.6% of GDP.

- Deferral of most taxes for self-employed and small firms with revenues less than €2M until June, and coverage of unemployment benefits for workers laid off in firms most affected by the lockdowns.

- Guaranteed mortgage payment moratorium, and a €600 subsidy for self-employed and low-income workers.

- Free loan guarantees for SMEs, and a moratorium of debt payments in some instances. A €3.5B injection into the health sector, which is 0.2% of GDP.

SPAIN

- €17B of GDP in direct fiscal measures, 1.4% of GDP, and €100B in loan guarantees, which is 8% of GDP.

- Six-month debt and tax moratorium for SMEs, at a max of €30K. A moratorium of mortgage payments low-income workers and the self-employed, and unemployment benefits for self-employed people who ceasing trading.

- Exemption for social security charges for SMEs that retain their workforce through the crisis.

- The loan guarantee program includes a €2B fund to help exporters.

EU-WIDE

- €120B in commitment from various sources, which is around 1% of GDP.

- The creation of a "Corona Response Investment Initiative" totalling €37B, aimed at supporting SMEs, health care systems and other sectors particularly hard hit by the virus, with a further €28B directed from the ongoing structural and cohesion funds framework.

- The mobilisation, by part of the European Investment Bank—EIB—of a €8B working-capital lending program to SMEs, with a commitment to raise this amount by up to €20B. This initiative is estimated to reach 250,000 firms.

- A €10B investment program for SMEs, directed by the EIB, with a commitment of a further €10B.

- An ESM program would be a game-changer for the overall numbers, but it is speculative at this stage. If fully deployed, it would be able to mobilise an aid package to the tune of €700B, which is 6% of GDP. This amount is split between €80B in paid-in-capital, and €620B in debt issuance capability, which presumably would be eligible for ECB QE. Note that countries receiving aid from an ESM program would be subject to conditions, making such a route politically contentious.

Sources: Bank of Spain, Pictet Wealth Management and the EU.

CLAUS VISTESEN **+44 191 2600 308**
claus@pantheonmacro.com Twitter: @ClausVistesen

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, March 30

• **D: Saxony Inflation, Germany (3) 09:00 CET**
Saxony inflation probably halved to **1.0%** year-over-year in March, due to a crash in energy inflation. **Consensus: N/A.**

• **D: EC Sentiment Sentiment, Eurozone (3) 11:00 CET**
We think the economic confidence gauge in the EZ slumped to **93.0** in March, from 103.5 in February. Consensus: N/A.

• **D: Advance Inflation, Germany (3) 14:00 CET**
Headline inflation in Germany likely slumped to **0.9%** year-over-year in March, from 1.7% in February. **Consensus: 1.3%.**

Tuesday, March 31

• **D: Advance Inflation, France (3) 08:45 CET**
We think headline inflation in France fell to **0.7%** year-over-year in March,, from 1.4% in February. **Consensus: 1.0%.**

• **D: Consumers' Spending, France (2) 08:45 CET**
Consumers' spending in France likely rose by **1.2%** month-to-month in February, lifting the year-over-year rate to 1.0% from -0.9% in January. **Consensus: 0.7%.**

• **D: Unemployment, Germany (3) 09:55 CET**
We reckon unemployment in Germany rose to **5.2%** in March, from 5.0%, reflecting a 50K jump in claims. **Consensus: 5.1%.**

• **D: Advance Inflation, Eurozone (3) 11:00 CET**
We think that headline inflation in the EZ slid to **0.6%** year-over-year in March, from 1.2% in February, mainly thanks to a plunge in energy inflation. The core rate is a huge wild card given the uncertainty of firms' pricing behaviour, and data collection issues. We suspect it dipped to by 0.3pp, to 0.9%. **Consensus: 0.8%.**

Wednesday, April 1

• **D: Retail Sales, Germany (2) 08:00 CET**
Retail sales in Germany likely dipped by **0.9%** month-to-month in February, pulling the year-over-year rate down by 0.3pp, to 1.0%. **Consensus: +0.1% m/m.**

• **D: Final Manufacturing PMIs, Eurozone (3) 10:00 CET**
The EZ manufacturing PMI ikley fell to **44.8** in March, from 49.2 in February, in line with the first estimate. **Consensus: 44.8.**

• **D: Unemployment, Eurozone (2) 11:00 CET**
Headline unemployment in the euro area probably was unchanged **7.4%** in February. **Consensus: 7.4%.**

Thursday, April 2

• **No significant data released**.

Friday, April 3

• **D: Final PMIs, Eurozone (2) 11:00 CET**
The composite PMI in the euro area likely crashed to **31.4** in March, from 51.6 in February, in line with the first estimate. The separate Italian data likely will be very bad, considering the extent of the lockdown there. **Consensus: 31.4.**

• **D: Retail Sales, Eurozone (2) 11:00 CET**
We reckon retail sales in the Eurozone edged higher by **0.1%** month-to-month in February. Sales likely took a dive in March, but the headline will have received a boost from a jump in food spending. **Consensus: 0.1%.**

PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

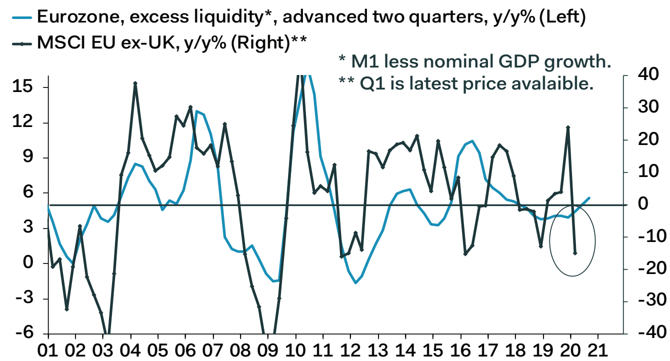
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-0.9	-23.1	-18.6
Dax 30	-0.3	-22.2	-16.4
CAC 40	-0.8	-22.9	-18.7

* P/E ratios in standard deviations from 10y average (>1.5 expensive, <-1.5 = cheap)

Bonds	Curve	Six month change, bp	y/y, bp
GER (10-2)	-4.2	+1.3	-32.2
FRA (10-2)	-3.6	+14.6	-29.1
ITA (10-2)	-3.6	+2.2	-114.8

** Curve in standard deviations from its 10y average (>1.5 = historically steep, <-1.5 = historically flat)

EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)



EZ equities are showing tentative signs of forming a bottom following the ravaging slide since the end of February. It is much too soon to call victory, however. Stimulus is on the way, but the number of Covid-19 cases is rising sharply, and it's difficult to see a sustained rebound until that changes.

PANTHEON'S EUROZONE ECONOMIC FORECASTS (GDP: REAL GDP Q/Q%)*

GDP			
Q4 19	0.1	2017 year:	2.5
Q1 20 forecast	-5.0	2018 year:	1.8
Q2 20 forecast	-15.0	*2019 year:*	*1.1*
Q3 20 forecast	*7.5*	*2020 year:*	*-10.0*
Q4 20 forecast	*5.0*	*2021 year:*	*5.0*

CPI y/y, %		Unemployment, %	
February	1.2%	January	7.4%
March	*0.8%*	*February*	*7.4%*
April	*0.8%*	*March*	*8.5%*
May	*0.7%*	*April*	*10.5%*
June	*0.7%*	*May*	*11.5%*

* FORECASTS ARE SUBJECT TO MORE UNCERTAINTY THAN USUAL AT THE MOMENT