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Investment Event

EU agrees joint fiscal response

EU finance ministers have agreed a EUR540bn package of fiscal measures to ease the economic impact of COVID-19

The package marks a significant first step in providing a joint response to COVID-19 but concerns remain

Tensions could resurface at future meetings of eurozone finance ministers

EU finance ministers agree on a EUR540bn fiscal package

On 9 April, EU finance ministers agreed a EUR540bn package of fiscal measures to soften the economic impact of the COVID-19 pandemic. Key features of the package include:

1. **EUR240bn released from the European Stability Mechanism (ESM)** to provide loans for direct and indirect healthcare costs amounting to up to 2% of each member state's GDP

2. **EUR200bn of loan financing** for companies with a focus on SMEs, supported by the European Investment Bank

3. A **EUR100bn "Support to mitigate Unemployment Risks in an Emergency" programme (SURE)**, designed to protect workers and jobs by offering member states cheap loans

4. A commitment to create a "**recovery fund**" to help the most affected states spread the "extraordinary costs" of the current crisis over time, with appropriate financing

A first step but concerns remain

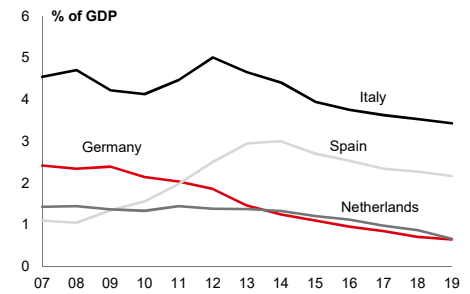
This package marks a small but significant first step in providing a joint EU response to COVID-19. In particular, it should allow member states to access credit on favourable terms, with the EU raising funds from the market backed by guarantees from all EU countries. However, it falls short of the request from some member states to issue so-called Eurobonds or "coronabonds", a debt instrument that would formally share the fiscal burden across the bloc.

Countries in Southern Europe such as Italy and Spain have been in favour of Eurobonds, as they typically have much higher public debt levels and servicing costs (Figure 1), and have imposed some of the most economically damaging containment measures to tackle COVID-19.

After the deal was struck, Italy's PM Giuseppe Conte said he will continue to push for Eurobonds, claiming that the deal was only a "first step". The ESM has been a particular focus of conflict for member states, with Conte suggesting that it is an "inadequate" instrument.

The ESM is unpopular in Italy and other Southern European countries because it can require countries to undertake a programme of fiscal consolidation after the crisis, as a condition for support. Last week's deal formally relaxes this "conditionality" but there are still concerns that restrictions could follow.

Figure 1: Government net interest expenses



Source: IMF, data as of 14 April 2020

While the measures in the deal establish principles of burden-sharing, tensions could resurface over conditionality as well as the size of the relief measures at future meetings of eurozone finance ministers. Nevertheless, sovereign bonds remain well-supported amid reassurance that the European Central Bank (ECB) will continue to keep funding costs for member states low, using its EUR750bn bond-buying programme.

Our views

We are tactically cautious on eurozone equities in our diversified multi-asset portfolios, but recognise that improved valuations present opportunities for investors with a longer-term investment horizon

Meanwhile, we remain underweight eurozone bonds amid the ongoing political tensions within the bloc

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Market considerations

While the eurozone is a large economy that has the resources to fund itself during this crisis, ongoing political tensions over how the burden of rising debt is shared across nation states, the ECB and the bloc as a whole could give rise to further volatility in fixed income markets. Against the backdrop of such tensions and amid relatively unattractive valuations, we remain underweight on eurozone bonds within diversified multi-asset portfolios.

Meanwhile, even though the repricing of eurozone equities experienced in March has created very attractive prospective risk adjusted returns, hurdles to more coordinated and aggressive policy support remain, and present a challenge to the economic outlook. Uncertainty over the duration of containment measures and the efficacy of policy support measures also cloud the outlook. We therefore remain tactically cautious on eurozone equities but recognise that improved valuations present attractive opportunities for investors with a longer-term investment horizon.

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