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Investment Event

EU recovery fund deal agreed

European Union (EU) leaders have reached an agreement over a EUR750bn support package

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EU leaders reach a deal on a EUR750bn package

European Union (EU) heads of state have reached an agreement over a EUR750bn package of grants and low-cost loans for member states, after four days of negotiations. The centrepiece of the rescue package is a EUR312.5bn fund (2.3% of EU-27 2019 GDP) set aside for direct grants to member states (see Table 1).

Table 1: Summary of EUR750bn New Generation EU package

Facility	Description	EUR
Recovery and Rescue Facility	Direct grants paid to member states over three years from 2021. EUR81bn to Italy, EUR72.7bn to Spain, EUR28.8bn to Germany (4.5%, 5.8%, and 0.8% of respective countries' 2019 GDP)	312.5bn
	Low-cost loans offered to member states	360bn
ReactEU	Support for regions hardest hit by Covid-19	47.5bn
Other programmes	Funds for regional development, climate transition and research & development	30bn
	Total	**750bn**

Source: European Council, HSBC Global Asset Management, as at 21 July 2020

While payments from this fund will be allocated according to a range of metrics including each state's pre-Covid-19 unemployment rate, some of the countries hardest hit by Covid-19 such as Italy and Spain will receive relatively more support than others such as Germany. The grants will be spread over three years, with 70% of the funds paid in 2021 and 2022, subject to governments committing to economic reform plans.

The EU is expected to raise debt at low rates in financial markets with a maximum maturity of 30 years. Repayments on the bonds issued to fund the grants are likely to begin only after 2027 and will be sourced from the EU's 'own resources', including national budget contributions and revenues from the bloc's tariffs and levies on carbon, digital activities and financial transactions.

Our views

We believe the package of measures justifies a more constructive view on eurozone equities in the context of attractive valuations, ongoing European Central Bank (ECB) policy support, and relatively favourable Covid-19 case dynamics in Europe

A small step towards fiscal union, but challenges remain

The deal overcomes longstanding opposition within the bloc to fiscal transfers from richer to poorer member states. As a result, the EU has taken a small but important step towards fiscal union. Arguably, this reduces the risk of a eurozone break-up in the longer term, as there is now precedence for economically-weaker member states to receive financial support from the bloc meaning they are less vulnerable to financial market pressures in economic downturns.

Nevertheless, some challenges remain:

- The cyclical boost from the package will be relatively limited given it is spread over a number of years. For some eurozone economies GDP is likely to remain below pre-Covid-19 levels until at least 2022 and highly-indebted countries – particularly Italy – are likely to require further assistance from the European Central Bank's EUR1.35tn emergency bond-buying scheme to keep borrowing costs low
- Some member states remain sceptical about fiscal burden sharing
- EU treaties still commit some countries to reducing their debt levels in the medium-run. Given the large increases in member state borrowing so far, the risk of a period of austerity that weighs on economic growth after the crisis remains high

Investment implications

The recovery fund can help support the medium-term growth prospects of more vulnerable European economies as they recover from the Covid-19 shock.

In our view, the fund should also help diminish the risk of more economically fragile member states exiting the eurozone, due to financial market pressures or Eurosceptic political forces. Indeed, a repeat of the rolling crises we saw in the aftermath of the global financial crisis may now be less likely. Over time, this can help compress the “political risk premium” we believe is embedded in the pricing of European risk assets.

We therefore hold a more constructive view on eurozone equities in the context of attractive valuations, ongoing policy support from the European Central Bank, and evidence that European governments have managed to broadly suppress the virus for the time being.

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