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CIO Flash

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DWS

Marketing Material

EU RESCUE PACKAGE CLEARS DECISIVE HURDLE

The EU will provide generous aid to countries particularly affected by Covid. It remains to be seen to what extent this can trigger a sustained boost to productivity.

IN A NUTSHELL

_ The EU has averted the imminent danger of economic imbalances in some countries in the usual manner at the last minute.
_ It remains to be seen whether the 750 billion euro rescue fund that has now been negotiated will serve as an initial spark for reform in the countries most concerned.
_ By generously issuing its own bonds and raising taxes on its own, the EU Commission is taking a step towards fiscal union that could be more than just temporary.

July 21, 2020 will go down as a historic date in the history of the European Union (EU). The heads of government of the 27 member states agreed on a trillion euro aid package to benefit the countries most affected by the consequences of the Covid-19 pandemic. The heads of state and government agreed after long negotiations not only on a European rescue fund, but also on the EU's medium-term budget plan. Another European compromise won the day after the red lines that had long dominated the negotiations were blurred.

From the markets' point of view, another date was also crucial. On May 18, Emmanuel Macron and Angela Merkel surprised the public with a 500 billion euro rescue package, which many saw as an about-turn in German European policy, as the defensive attitude toward debt pooling seemed to crumble. The capital-market data illustrate investors' views: the stock markets of the European Union (EU) have since risen much more strongly than global markets; the euro has risen from 1.08 to 1.1415 dollars and the risk premium of Italian 10-year government-bond yields over German Bunds has fallen from 210 to 150 basis points. Only German government yields themselves have not budged: they are at -0.45% now, almost exactly where they were on May 18. However, it is likely that the markets would have lost most of the ground they had gained if white smoke had not come out of Brussels' EU buildings on Tuesday morning.

A final assessment of the package is still premature, as many details, including important ones, are still not firm. Only time will tell whether the restriction that the money should only be disbursed for "meaningful" projects, and only in countries that comply with EU values, proves effective. The possibility that Italy, under Prime Minister Giuseppe Conte, could use the fund as an initial spark for a far-reaching reform that would ultimately increase productivity are certainly higher than they had have been under many previous governments. Similarly, only time will tell whether the fund proves to be a first step toward a fiscal and debt union. Some heads of state and capital-market participants would certainly like that, but in our view reform steps on the EU side, for example with regard to the competences of the parliament, are lacking.

THE AID FUND IN DETAIL

The 750 billion fund had been long awaited by the capital markets. It is equivalent to around five percent of the EU's gross domestic product (GDP) and adds to the measures already adopted nationally. The fund is divided into grants of 390 billion euros and low-interest loans of 360 billion euros. Contrary to the EU Commission's proposal, the share of loans has been significantly increased thanks to interventions by the Group of Five (Netherlands, Austria, Sweden, Finland and Denmark). 70% of the grants are to be paid out as early as 2021 and 2022 and should therefore already be reflected accordingly in the economic figures of these countries.

HOW DO THE COUNTRIES GET THE MONEY?

Anyone wishing to receive funds must draw up a so-called "National Recovery and Resilience Plan" for the years 2021 to 2023, which will be evaluated by the EU two months after the deployment on the basis of the country-specific recommendations. The country will receive support for the projects if they concern climate policy or digitalization. Finally, the Council will decide on the projects by qualified majority. Thanks to an intervention by the Netherlands, the funds cannot be completely blocked, but they can still be postponed if a country does not act in the spirit of the EU. However, the hurdles for implementation of this veto are set quite high.

WHO GETS HOW MUCH?

Italy and Spain will receive around 20% of the funds which, in the case of Italy, are equivalent to 7% of GDP, and in the case of Spain 10%, but spread over several years.

HOW IS THE FUND FINANCED?

The EU Commission will obtain the money for the fund by issuing its own bonds on the capital market. Repayment will be made through contributions from the member states and through funds raised by the Commission, for example through a tax on plastic packaging from 2021 onward and a CO2 tax by 2023. The financial-transaction tax has not yet completely disappeared from the agenda.

EU MEDIUM-TERM FINANCIAL FRAMEWORK

The financial framework for the years 2021 to 2027 has a volume of 1,075 billion euros, which corresponds to approximately 1.1% of European economic output for these years. As in the past, around one-third of the expenditure will go to agriculture, while only around 12% will benefit digitalization and innovation. Measured against the goal of becoming more sustainable, this is not yet a big success.

CAN THE PLAN STILL BE OVERTURNED?

All national parliaments and the European Parliament still have to approve the plan. We do not expect any of these parliaments to overturn it, but the European Parliament in particular will still be tempted to leave its own traces. The Commission expects to have all the approvals by autumn. Nevertheless, launching the fund as early as the beginning of 2021 looks ambitious.

GLOSSARY

One basis point equals 1/100 of a percentage point.

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

The euro (EUR) is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

The European Commission (EU Commission) is the executive body of the European Union (EU) which represents the interests of the EU.

The European Union (EU) is a political and economic union of 28 member states located primarily in Europe.

Government (sovereign) debts/bonds are debt/bonds issued and owed by a central government

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

The U.S. dollar (USD) is the official currency of the United States and its overseas territories.

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

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