ECO FLASH

N°21-12

04 June 2021

EUROZONE: PUBLIC FINANCES ARE SORELY TESTED BY THE COVID-19 CRISIS

Frédérique Cerisier

Eurozone member states mobilised massive public resources in response to the Covid-19 emergency, providing support for households as well as companies facing a loss of business. As a result, the public debt ratio rose sharply in 2020 to 98% of GDP.

Since there is still a big need for economic support in the first part of the year, the Eurozone debt ratio will probably cross the threshold of 100% of GDP in 2021.

The ECB plans to continue purchasing assets as part of its Pandemic Emergency Purchasing Programme (PEPP) at least until March 2022, at a time when the Eurosystem currently holds nearly 30 percentage points of GDP in Eurozone public debt instruments.

The first disbursements of the Next Generation EU recovery plan are slated for the second half of 2021. At this point, the European Commission estimates that 40% of the grants allocated by the Recovery and Resilience Facility will be spent by the end of 2022, the equivalent of nearly 1% of EU GDP.

PUBLIC DEBT RATIOS IN THE EUROZONE

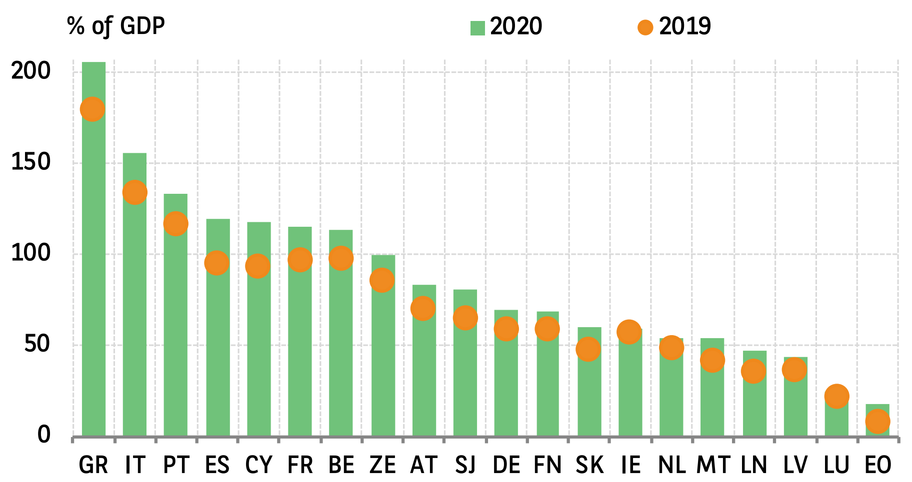

CHART 1

SOURCE: AMECO

THE EUROZONE PUBLIC DEBT RATIO HELD JUST BELOW 100% OF GDP IN 2020

The Covid-19 crisis had a massive impact on the public finance situation in Europe. In all member states, public accounts were sorely tested in 2020 by the economic recession, surging health care spending, and massive government support for households and companies, which will continue to need public support during the first half of 2021.

In late April, Eurostat published its preliminary estimates of debts and deficits in the Eurozone, providing an idea of the size of the bill, at least for the year 2020. Unsurprisingly, these estimates show that in most member states public deficits have soared and the slow movement to reduce public debt in recent years has ground to a halt[1].

From virtually zero in 2018 and 2019, the Eurozone's public deficit soared to 7.2 % of GDP in 2020. At 98% of GDP, the public debt ratio held just below the symbolic level of 100%. Compared to 2019, this is a record increase of about 14 points, which is even bigger than the one reported in 2009 during the financial crisis (about 11 percentage points of GDP). This increase in mainly due to the nominal increase in the gross debt of public administrations of the member states.

1 France and Italy are the exceptions since their debt ratios were entering a stabilisation phase.

The gross debt increased by more than EUR 1 trillion in 2020 (to more than EUR 11 trillion), but this also reflects the decline in the GDP denominator, which contracted by more than EUR 600 billion.

GREATER HETEROGENEITY

The countries hit the hardest were those that reported the most severe recessions, either because of an especially virulent pandemic (requiring longer lockdown periods) or because tourism accounts for a major share of economic activity. Some of the hardest hit countries were Spain, Greece and Cyprus (with debt ratios up by more than 25 percentage points of GDP), and to a lesser extent, Italy (+20 pp) and France (+18 pp). Inversely, among the major European economies, Germany and the Netherlands helped lower the European average (see chart 1).

Looking at the levels at year-end 2020, the debt ratios of the Eurozone member states ended up ranging from 18.2% of GDP in Estonia to 205.6% of GDP in Greece. The big fear is that the Covid-19 crisis could turn into another shock in the dispersion of fiscal positions within the Eurozone, a trend that could be amplified in the years thereafter because the member states whose debt ratios increased the most in 2020 are probably the ones that risk reporting the lowest growth rates in the years ahead.

Although this growing heterogeneity is alarming, it is worth pointing out that the increase in debt ratios was not necessarily accompanied by a sharp deterioration in the sustainability of European public debt last year. The current rebound in growth prospects and the extremely low level of sovereign yields, which will probably remain low for several years, facilitates public debt financing and makes any increases relatively "painless". Moreover, a big share of public debt is currently held by the Eurosystem (see below). For investors who anticipate that principal payments received by the Eurosystem will be reinvested over a much longer period of time than the currently announced schedule, these holdings are a major support factor for the sustainability of public debt in the Eurozone.

THE EUROSYSTEM HOLDS NEARLY 30% OF THE EUROZONE'S PUBLIC DEBT

In March 2020, the European Central Bank (ECB) strengthened its quantitative easing policy as part of support measures for economies confronted with the health crisis. It began making securities purchases again, notably of government bonds in the Eurozone, through the Pandemic Emergency Purchase Programme (PEPP). The breakdown of securities purchases "loosely" follows the ECB's capital key. A waiver of the eligibility requirements authorises the purchase of Greek government bonds despite their speculative grade rating[2].

At year-end 2020, the Eurosystem's holdings of public assets are estimated at more than EUR 750 billion as part of PEPP, while holdings as part of the Public Sector Purchasing Program (PSPP) increased by about EUR 260 billion compared to year-end 2019[3]. Altogether, the value of the Eurosystem's holdings of public debt instruments increased by nearly EUR 1,000 billion during the year 2020, which is virtually identical to the increase in the gross debt of public administrations over the period, which Eurostat estimates at EUR 1,080 billion[4].

PUBLIC DEBT AND DEFICIT IN THE EUROZONE

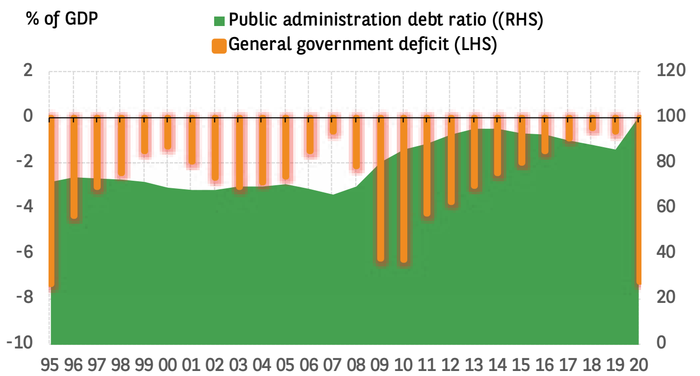

CHART 2 SOURCE : AMECO

ECB HOLDINGS OF PUBLIC DEBT SECURITIES BY COUNTRY

EUR bn	PSPP	PEPP	Total	% of GDP
Austria	71	24	95	24.1%
Belgium	89	30	120	25.0%
Cyprus	4	2	6	25.3%
Germany	599	221	820	23.4%
Estonia	0	0	1	2.2%
Spain	297	104	401	33.5%
Finland	36	15	52	20.8%
France	495	158	653	27.0%
Greece	0	22	22	12.7%
Ireland	39	14	53	13.6%
Italy	425	157	582	33.5%
Lithuania	5	2	7	14.2%
Luxembourg	3	1	5	6.8%
Latvia	3	1	4	12.6%
Malta	1	0	2	11.1%
Netherlands	122	49	171	20.6%
Portugal	46	20	66	31.0%
Slovenia	9	4	13	27.1%
Slovakia	15	6	21	22.0%
Supranationals	262	67	329	2.8%
Total	2 521	900	3 421	28.6%

TABLE 1 SOURCE: ECB, BNPP ESTIMATES

2 This is not the case for the "historic" public securities purchasing programme (PSPP), under which Greek public securities are not eligible.
3 See https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html and https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html#pspp
4 The gross debt of public administrations comprises government debt, including issues by European treasuries, but also bonds issued by local governments and social welfare administrations.

ECB HOLDINGS OF PUBLIC SECURITIES

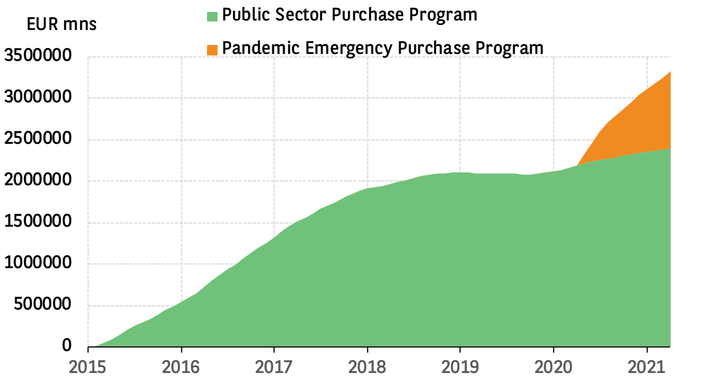

CHART 3

SOURCE: ECB

PUBLIC DEBT AND IMPLICIT INTEREST RATE IN THE EUROZONE

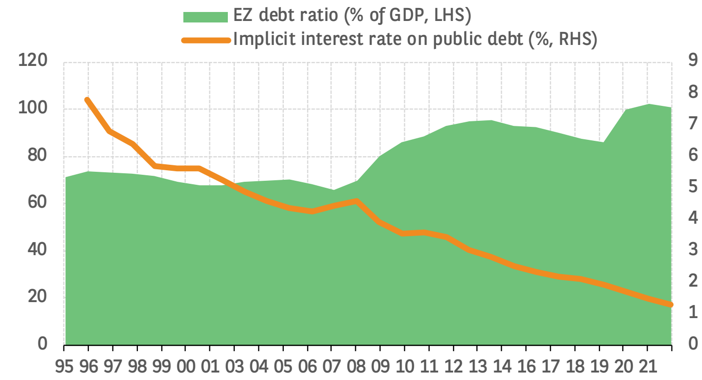

CHART 6

SOURCE: AMECO

SOVEREIGN DEBT YIELDS (10Y)

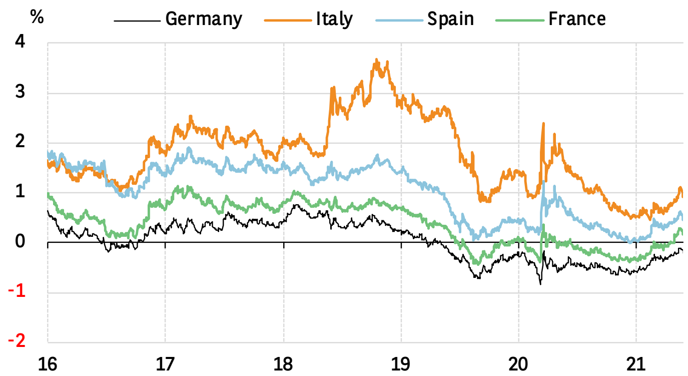

CHART 4

SOURCE: REFINITIV

GENERAL GOVERNMENT BALANCES IN THE EUROZONE

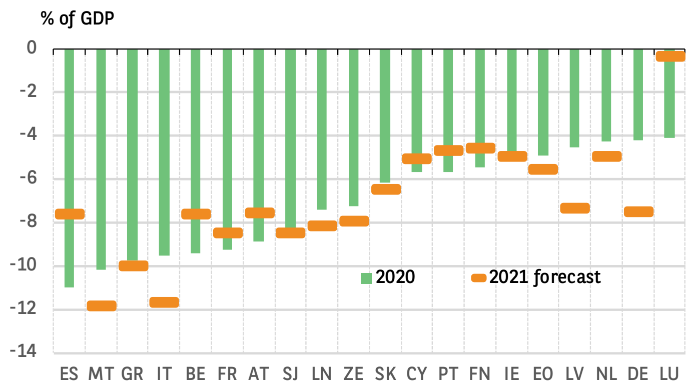

CHART 7

SOURCE: AMECO (EUROPEAN COMMISSION SPRING FORECAST)

EUROZONE COUNTRIES' PUBLIC DEBT AND INTEREST PAYMENTS

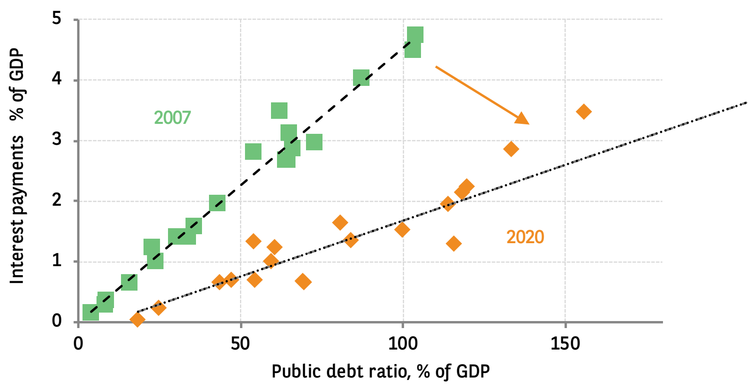

CHART 5

SOURCE: EUROPEAN COMMISSION

On average, asset purchases by the Eurosystem indirectly financed virtually all of the public debt issued in 2020. These purchases come on top of those already purchased as part of PSPP since 2015. Moreover, they will continue: total PEPP funds were increased in December 2020 to EUR 1,850 billion[5]. The ECB Governing Council has pledged to continue its policy of net securities purchases through the end of the crisis, and at least through March 2022. It will continue to reinvest the principal payments from maturing securities at least through the end of 2023. Concerning PSPP, and all asset purchasing programmes in general, the ECB Governing Council also plans to continue its purchases as long as it does not feel the need to raise its key rates, and to reinvest the principal payments from maturing securities for an extended period of time.

Chart 3 shows the increase in the public debt stock held by the Eurosystem since 2015. At the end of April 2021, this stock can be estimated at about EUR 3,400 billion, or about 29% of Eurozone GDP.

INTEREST CHARGE HOLDS AT AN HISTORICAL LOW

In this environment, the European member states saw the cost of financing go down again in 2020. The highest-rated member states benefited from negative yields on increasingly long maturities. For Italian government bonds, for example, the 10-year yield declined by 90 basis points between January 2020 and January 2021.

On the whole, the European Commission estimates that the interest charge of Eurozone member states – which had already fallen to an historical low prior to the health crisis – declined again last year to a Eurozone average of 1.5% of GDP. Since the beginning of 2021, nominal rates have come under pressure due to the rebound in inflation expectations, the upturn in inflation and expectations of a recovery in both the United States and the Eurozone. Yet as long as this movement holds generally in line with the gradual upturn in growth and inflation prospects in the Eurozone, it will not call into question the low level of the cost of financing public debt, which depends, fundamentally, on the spread between the nominal interest rate and the nominal growth rate.

Moreover, the expected upturn in money market rates will only apply to debt that is newly issued or rolled over, given that the average maturity of Eurozone public debt is more than seven years. It is thus perfectly normal that the average cost of public debt (or the implicit interest rate, see chart 6) has not yet bottomed out. The European Commission expects the interest charge paid as a share of GDP to decline again this year and in 2022, despite the upturn in money market rates and the increase in the public debt stock. According to its most recent estimates, the interest charge could slip to 1.3% of GDP in 2022.

THE STANCE OF FISCAL POLICY IN 2021

What direction will fiscal policy take in 2021 and in the years thereafter? In 2021, fiscal policy will depend primarily on the evolution of the pandemic, the successful rollout of vaccination campaigns, and the effectiveness of the vaccines over time. In the first part of the year, most member states have had to maintain or strengthen emergency and economic support measures, above and beyond the allocations in their initial public finance bills, to tackle new waves of the pandemic last winter. They are currently fine-tuning their reopening plans with hopes that a sustainable economic rebound will take shape this summer, although setbacks are possible. There will be no question of gradually withdrawing public support for households and companies before H2 at the earliest, and more likely not until 2022.

For many observers, the Europeans must avoid repeating the errors they made when exiting the 2009 financial crisis. Fiscal policies were tightened too early and the Eurozone slipped back into recession in 2011. At the time, member states were encouraged to limit the deterioration of their public finances as of 2010, and to implement clearly restrictive policies the following year. For a while, all member states were even assigned the same target ("3% in 2013") which pushed them to squeeze domestic demand all at the same time.

To avoid these pitfalls, the European Commission has suspended the rules of the Stability and Growth Pact and extended the period of non-compliance at least until 2022. This time it is calling for the member states to use caution when withdrawing support measures and to better coordinate national economic policies.

For the European Union as a whole, the European Commission's latest economic forecast[6] estimates that emergency fiscal measures by member states will amount to about 4 points of GDP in 2021, the same as in 2020. By 2022, they will account for only 1 point of EU GDP. Looking solely at the Eurozone, after swelling from 0.6% of GDP in 2019 to 7.2% in 2020, the general public finance deficit could increase a bit more this year according to the European Commission's forecast, since the negative impact of higher economic support measures on public finances should exceed the positive impact of the economic rebound. Lastly, the Eurozone deficit is estimated at about 8% of GDP in 2021. By 2022, in contrast, the deficit should narrow significantly with the gradual withdrawal of temporary support measures for economic players and the rebound in economic activity. Even so, the Eurozone deficit is still estimated at 3.8% of GDP in 2022.

PRELIMINARY ESTIMATIONS OF THE EXPECTED IMPACT OF THE EUROPEAN RECOVERY PLAN

By this horizon, the European Commission and the member states are counting on the implementation of the European Recovery Plan to support economic activity a bit longer and to enable member states with the most fragile public finances to continue making investments. In its latest forecast, the European Commission provided preliminary estimates of the expected spending and effects of the European Recovery Plan. These figures are based in part on the information that each member state submitted to Brussels as part of their "national recovery and resilience plans".

Under the Next Generation EU recovery plan, EUR 390 billion in grants will be disbursed to member states by 2026 (including EUR 312.5 bn via the Recovery and Resilience Facility). Another EUR 350 billion will be available as loans, bringing the total amount of the recovery plan to EUR 750 bn (more than 5% of EU GDP). Yet not all member states will take advantage of this possibility, and nothing guarantees that all of the allocated budget will be spent. At this stage, of the major Eurozone economies, only Italy has indicated that it plans to resort to the lending programme.

5 Including purchases of private assets, which are still very minor at this stage.
6 2021 Spring Economic Forecast

For countries that had not provided sufficient information, the European Commission based its estimates on the assumption that the grants paid out under the plan would be spent in a uniform manner through 2026[7]. For other member states, the EC took into account the fact that the grants could be spent much faster: Germany, France and Spain could spend more than half of their allocations over the next year and a half. For the European Union as a whole, the EC esteems that 40% of the Next Generation EU grants could be spent by year-end 2022, for a total of EUR 140 billion (nearly 1% of EU GDP). Of this amount, 30% would be used for public investment, 50% for private investment and 20% for current expenses.

Frédérique Cerisier

MAXIMUM GRANT ALLOCATIONS (CURRENT PRICES, ESTIMATES)

	EUR bn	% of GDP
AUSTRIA	3.5	0.9%
BELGIUM	5.9	1.2%
CYPRUS	1	4.6%
Denmark	1.6	0.5%
ESTONIA	1	3.5%
FINLAND	2.1	0.8%
FRANCE	39.4	1.6%
GERMANY	25.6	0.7%
GREECE	17.8	10.3%
IRELAND	1	0.3%
ITALY	68.9	4.0%
LATVIA	2	6.4%
LITHUANIA	2.2	4.3%
LUXEMBURG	0.1	0.1%
MALTA	0.3	2.2%
NETHERLAND	6	0.7%
PORTUGAL	13.9	6.5%
SLOVAKIA	6.3	6.5%
SLOVENIA	1.8	3.7%
SPAIN	69.5	5.8%
Eurozone	269.9	2.3%
BULGARIA	6.3	9.6%
Croatia	6.3	12.0%
CZECHIA	7.1	3.1%
HUNGARY	7.2	5.0%
POLAND	23.9	4.4%
ROMANIA	14.2	6.1%
SWEDEN	3.3	0.6%
EU 27	338	2.2%

TABLE 2

7 This implies that 27% of the funds would be spent by 2022. In the Eurozone, this is notably the case for Greece and the Netherlands.

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com

ADVANCED ECONOMIES AND STATISTICS

Jean-Luc Proutat US, UK - Head of economic projections, relationship with French network	+33 1 58 16 73 32	jean-luc.proutat@bnpparibas.com
Hélène Baudchon France - Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset Japan - European Central Bank watch, Euro area global view	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Nordic countries	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
Guillaume Derrien Italy, Spain, Portugal - International trade	+33 1 55 77 71 89	guillaume.a.derrien@bnpparibas.com
Raymond Van Der Putten Germany, Netherlands, Austria, Switzerland – Energy, climate	+33 1 42 98 53 99	raymond.vanderputten@bnpparibas.com
Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+33 1 40 14 30 77	thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure Head – Argentina	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Stéphane Colliac Turkey, Ukraine, Central European countries	+33 1 42 98 43 86	stephane.colliac@bnpparibas.com
Perrine Guerin, Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	perrine.guerin@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com

CONTACT MEDIA

Michel Bernardini	+33 1 42 98 05 71	michel.bernardini@bnpparibas.com

CONJONCTURE

Structural or thematic topics.

EMERGING

Analyses and forecasts for a selection of emerging economies.

PERSPECTIVES

Analyses and forecasts with a focus on developed countries.

ECOFLASH

Data releases, major economic events.

ECOWEEK

Recent economic and policy developments, data comments, economic calendar, forecasts.

ECOTV

A monthly video with interviews of our economists.

ECOTV WEEK

A weekly video discussing the main event of the week.

MACROWAVES

Our economic podcast.

HOW TO RECEIVE OUR PUBLICATIONS

SUBSCRIBE ON OUR WEBSITE
see the Economic Research website

&

FOLLOW US ON LINKEDIN
see the Economic Research linkedin page

OR TWITTER
see the Economic Research Twitter page

Published by BNP PARIBAS Economic Research
Head office: 16 boulevard des Italiens – 75009 Paris France / Phone : +33 (0) 1.42.98.12.34
Internet: www.group.bnpparibas.com - www.economic-research.bnpparibas.com
Head of publication : Jean Lemierre / Chief editor: William De Vijlder