AFTER THE ARDUOUS EUROGROUP AGREEMENT ON PANDEMIC RELIEF, NOW FOR THE DIFFICULT PART

The Eurogroup has reached an agreement on bringing EUR 500 bn -4.2% of eurozone GDP- of additional firepower to attenuate the immediate economic impact of the Covid-19 pandemic. Three tools will be used: the SURE programme to temporarily support national safety nets, the EIB guaranteeing lending to companies -in particular SMEs- and a Pandemic Crisis Support via the ESM. The work on the creation of a Recovery Fund to boost European investments will continue. The difficult part will be to agree on its funding.

It took many hours of negotiation during two videoconferences this week, but there is an agreement within the Eurogroup at last. It brings EUR 500 bn –about 4.2% of eurozone GDP- additional firepower to attenuate the immediate economic impact of the Covid-19 pandemic.

To this end, three types of tools will be used. Firstly, the SURE programme[1] -a temporary European instrument to support national safety nets- will bring EUR 100 billion to the countries facing the greatest pressures. The European Investment Bank will create a pan-European shield to guarantee EUR 200 bn of lending, in particular to SMEs. This is very important because, given their size, SMEs have less diversified business models, both in terms of products and services, but also geographically. In addition, they represent two-thirds of private sector employment in Europe[2] and they play a key role in creating new jobs. Finally, a Pandemic Crisis Support has been established for an equivalent of 2% of members states' GDP, i.e. close to EUR 240 bn. It will be available to all ESM members. Eurogroup President Centeno's remark that *"the average Euro Area Member State affected by the COVID-19 crisis should be able to identify expenditures directly or indirectly related to healthcare, cure and prevention amounting to 2% of GDP"*[3] underlined the expectation that many ESM members will apply for these funds. This should avoid being stigmatised but, in doing so, it will, more importantly, enhance the macroeconomic impact. The conditionality attached had been a sticking point in the negotiations. In the end, the Eurogroup agreed on very soft conditions, the only requirement being that the credit line is used *"to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID 19"*.

Beyond these pandemic relief measures, there will also be a need for fiscal policy to spur growth, considering that the recovery post-lockdown will be very gradual and uneven: lockdowns will probably be lifted in stages, companies will wait for better visibility before starting to invest again whilst households, faced with a difficult labour market environment, will also remain rather cautious.

A fiscal stimulus implies debt issuance and, eventually, the risk of higher bond yields and spreads versus Germany, although ECB QE and its Pandemic Emergency Purchase Programme should limit this effect. A jointly-financed initiative to boost growth is another way to address the potential impact on funding costs for countries which already have a high public debt compared to their GDP. However, while making considerable sense economically speaking, it is politically clearly difficult. Eurozone President Centeno mentioned that the next EU budget will be a key component of the EU's post-lockdown strategy. However, one should not forget that, several weeks ago, an agreement could not be reached on the EU's multiannual financial framework for the years 2021-2027, so adding a layer to significantly boost growth makes this even more challenging.

In the end, there was agreement to continue the work on a Recovery Fund *"which would turbo-charge the European investments that we will need to build a better, greener, more resilient and more digital economy."* However, the subtle phrase that some members are of the view the funding should come from common debt issuance whereas others push for alternative ways reminds us of the challenge of coming to an agreement.

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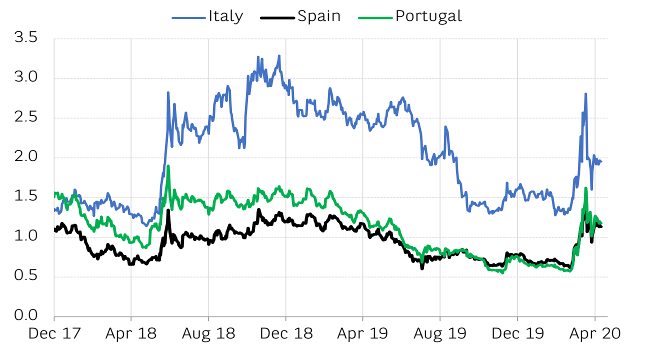
10-YEAR GOVERNMENT YIELDS, SPREAD WITH GERMANY



SOURCE: DATASTREAM, BNP PARIBAS

1. SURE is a new instrument proposed by the European Commission that will provide up to o countries. The loans will be based on guarantees provided by Member States. All Member States will be able to make use of this but it will be of particular importance to the hardest-hit. "SURE will support short-time work schemes and similar measures to help Member States protect jobs, employees and self-employed against the risk of dismissal and loss of income. Firms will be able to temporarily reduce the hours of employees or suspend work altogether, with income support provided by the State for the hours not worked. The self-employed will receive income replacement for the current emergency." (source: European Commission press release, Coronavirus: the Commission mobilises all of its resources to protect lives and livelihoods, 2 April 2020
2. Source : Eurostat
3. Source for this and the remaining quotes: Council of the EU, Remarks by Mário Centeno following the Eurogroup videoconference of 9 April 2020

> The key challenge in setting up a Recovery Fund will be agreeing on its funding and whether there will be risk-sharing.