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Enroute to a European Fiscal Recovery Package



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Leyen, President of the European Commission (EC) has now presented a much-anticipated fiscal response to the Covid-19. The pandemic has dashed all growth prospects for 2020, with the IMF projecting that the Eurozone will contract by 7.5% this year.

As part of

the bloc's 7-year budget proposal (totalling €1.1 trillion for the years 2021 to 2027) €750 billion has been earmarked for the recovery plan: €500 billion in the form of non-repayable grants and €250 billion in the form of loans.

But nothing is set in stone yet: The approval of all member states is still pending.

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After the Eurogroup rolled out a €540 bn emergency fiscal response package, the EC then had the unenviable task of preparing a recovery program that appeased all 27 Eurozone members and addressed their varying needs. Failure to come up with something would come as blessed bread for populist movements and once again threaten the very fabric of the European Union.

In formulating a response, there are various issues of contention. Firstly, in terms of **repayment**: The more fiscally-prudent (the so-called “frugal four” (Austria, Denmark, Netherlands and Sweden) as well as a handful of German politicians) favoured repayable loans rather than grants, whereas Southern European countries, with already sky-high deficits, called loudly for grants. Contention also arose around **funding**, with certain members opposed to issuing joint Eurobonds. In the end, to fund the package, the EU would borrow up to €750 billion on financial markets, while, there is also talk that the EC will create new revenue streams for the EU budget, such as a proposed digital tax, or a carbon border tax. **Allocation criteria** determining how much money each country receives from the rescue package will also be hotly debated.

With regards to the contents of the package, according to Bloomberg, the blueprint sets aside:

- €60bn for a Recovery and Resilience Facility that will give grants and loans to help with investment and reform
- €55bn in cohesion funding to poorer members
- €31bn for an instrument to take equity stakes in otherwise healthy companies

- €15bn
for a fund to make the EU more self-reliant in strategic areas
- €9.4bn
for healthcare programs
- €15bn
for rural development
- €32.5bn
to the Just Transition Fund which will help countries with dirtier power industries as they seek to eliminate carbon emissions

Indeed, fighting climate change seems to have been put at the heart of the package, dubbed the world's biggest "green" stimulus. In addition to and inside of the above, grants and loans will be funnelled into programmes which help achieve the EC's pledge to slash EU emissions from more than 4 billion tonnes each year to "net zero" in 2050, with emphasis falling on clean hydrogen, renewable energy and clean transport. It is hoped that the public funding will catalyse a wave of private investment into these areas.



The plan is now subject to intense negotiation among EU heads given that it requires unanimous approval.

While the devil will be in the details, with challenges to the fine print expected, our investment committee believes that the broader plan will be endorsed, given that

it is not really in the interests of any EU nation state to block a recovery package. It would be a lose/lose situation if an EU member was to fall off the tracks, economically speaking. Furthermore, politicians recognise this pandemic as another make or break test for the eurozone, which was probably the driving motivation behind France and Germany's endorsement of a €500 billion envelope of grants.

Though we are still underweight on European equities, we have slightly increased our exposure, with the bloc on the right path towards a united response. To do so, we sold emerging market equities, given the rising tensions between the US and China.

Discussions on the package will begin at the next EU summit on June 19th, but it is not widely expected that a deal will be reached on this date.

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