# WEEKLY UPDATE

## Fiscal Stimulus, EU Style

Over the last couple of weeks, we have analysed the scale and implications of the latest US fiscal stimulus plans. This week, we return to the NGEU – the European Union's €750bn Next Generation EU recovery fund – which was first agreed last summer. When will investments begin and will they be sufficient to kickstart growth? And what does all this mean for markets?

As is often the case in Brussels, the NGEU plan has had a long gestation. Initial opposition led by the "Frugal Four" – Austria, Sweden, Denmark and the Netherlands – focused on the fund's mix of grants and loans and on the plan for the EU to issue bonds jointly guaranteed by all members. In the event, members agreed to go ahead with the joint borrowing and fixed the financing split at €390bn in grants and €360bn in loans, instead of the initial 500/250 proposed by the Commission. Then opponents – led this time by Hungary and Poland – held up ratification because of "rule of law" provisions, before a compromise was struck at the December EU summit which also ratified the multi-annual financial framework (the EU's budget).

And then in late March, a challenge by a group of lawmakers to Germany's constitutional court halted ratification of the fund, despite a 478:167 vote in favour in the Bundestag. Such objections are not uncommon – last year, a challenge on the constitutionality of the European Central Bank's pandemic emergency asset purchases delayed formal approval by Germany until a compromise solution was found. We believe that this pattern will be repeated, allowing NGEU ratification to complete successfully on time thereby enabling disbursements to commence by the summer.

It is striking to note the disparity in size between the NGEU and Joe Biden's $2.29 trillion American Jobs Plan (AJP), some €1.93tn. In part, this reflects the fact that it should be much easier for Biden to obtain approval than it was for the European Commission, which had to break new ground to launch this plan – the US has run a federal budget for centuries whereas the EU still lacks a permanent central fiscal capacity. But in part it also reflects differing starting points and requirements – EU members offer greater welfare provision for citizens, including partial unemployment schemes, while the US had to boost unemployment benefits; moreover, the EU has accumulated a shortfall in investment since the Great Recession whereas the US has underinvested in its physical infrastructure for decades.

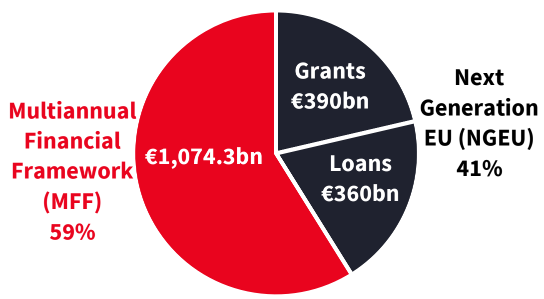
At the heart of the NGEU fund will be the €672.5bn Recovery and Resilience Facility which was established in February 2021, leaving member countries until end April to submit their investment and reform plans in six key policy areas (green transition and digital transformation, 37% and 20% of the total respectively, followed by jobs, social cohesion, healthcare and education and skills). The investments are set to be spread over the next six years, representing over 1% of EU GDP per annum on average. This should help close the EU's output gap, which Deutsche Bank estimates to be around 5% of pre-pandemic potential GDP. All in all, the Commission expects the recovery fund to add some 2% to EU GDP over the next few years.

The financing mechanisms for the NGEU and the AJP will also differ radically. Biden plans to finance the spending via tax increases (see Let's Talk About Tax) while the EU's plan is debt-financed (with 30% coming via issuance of green bonds). This means that some of the economic benefits of the AJP may be blunted by a less-favourable tax regime, a burden which the NGEU is likely to avoid.

**Bottom line.** The jointly-guaranteed borrowing to finance the EU recovery fund will help allay market fears about euro zone break-up, a positive for the single currency. The borrowing will also provide a new benchmark for euro-denominated sovereign bonds, although the negative yields on offer will hold little attraction for investors. The NGEU will provide a solid boost to EU GDP growth in coming years, but this is likely to be eclipsed over the next 18 months by the cyclical recovery we see starting this summer. In sum, we remain Overweight euro zone equities within diversified portfolios.

**Huge fiscal stimulus for European Union**

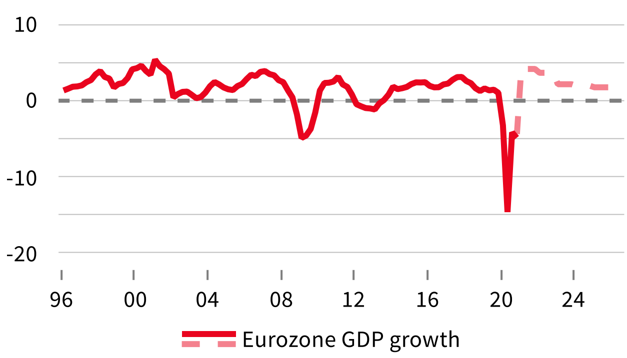
*EU budget 2021-2027 and recovery plan*




*Sources: SGPB, European Commission, 16/04/2021*

**NGEU could add 2% to GDP over the next few years**

*Eurozone GDP growth YoY (%)*




*Sources: SGPB, SGCIB, Macrobond, Eurostat, 16/04/2020*

# OUR MACRO COMMENTS

## This week and next

### EUROZONE

- ECB President Lagarde said that US fiscal support is expected to lift European growth by 0.3% over the medium term.
- Eurozone retail sales came in at 3.0% MoM and -2.9% YoY in February, while economists had forecast a 1.5% rise and 5.4% fall respectively.
- Eurozone industrial production fell 1.0% MoM in February, reversing January's 0.8% increase. Economists had forecast a 1.1% fall.
- The ZEW economic sentiment index for the euro zone fell from 74 in March to 66.3 in April, while analysts expected 73.2. In Germany, the index fell from 76.6 to 70.7 compared to analyst consensus of 79.

| Next week's key events | | *Per.* | *Prev.* | *Cons.* |
|---|---|---|---|---|
| 22 Apr | ECB deposit rate decision | 2021 | -0.5% | -0.5% |
| 23 Apr | EZ flash Markit PMI composite | Apr | 53.2 | 53.7 |

### UNITED KINGDOM

- GDP rose 0.4% MoM in February, partially reversing January's 2.2% fall. Economists had forecast a 0.6% rise.
- Industrial production and manufacturing production came in at 1.0% and 1.3% MoM in February respectively, partially reversing January's 1.8% and 2.3% falls. Economists had forecast a 0.5% rise and a 0.8% fall respectively.
- BRC like-for-like retail sales rose from 9.5% to 20.3% YoY in March, well above expectations of a 12.0% increase.

| Next week's key events | | *Per.* | *Prev.* | *Cons.* |
|---|---|---|---|---|
| 21 Apr | CPI YoY | Mar | 0.4% | 0.8% |
| 23 Apr | Flash Markit services PMI | Apr | 56.3 | 59.5 |

### UNITED STATES

- Fed Chairman Powell said the central bank would begin to slow the pace of its bond purchases "well before" raising interest rates.
- Core CPI rose 1.6% YoY and 0.3% MoM in March, while economists had forecast an increase of 1.5% and 0.2% respectively.
- Retail sales rose 9.8% MoM in March, reversing a 2.7% fall in the previous month. Economists had forecast a 5.9% rise.
- In the week ending 9th April, initial jobless claims fell from 769k to 576k, the lowest level since March 2020, whereas economists had forecast a fall to 700k.

| Next week's key events | | *Per.* | *Prev.* | *Cons.* |
|---|---|---|---|---|
| 23 Apr | Flash Markit manufact. PMI | Apr | 59.1 | 60.0 |
| 23 Apr | Flash Markit services PMI | Apr | 60.4 | 61.3 |

### ASIA & EMERGING

- China's GDP grew by a record 18.3% YoY in Q1, slightly below the 18.9% expected by economists. Quarter-on-quarter growth slowed from 2.6% to 0.6% in Q1.
- Chinese retail sales growth rose from 33.8% in January/February to 34.2% YoY in March, while economists had forecast 28%.
- China's industrial production growth came in at 14.1% YoY in March, well below the 35.1% in January/February and the 17.2% expected.
- Growth in China's FDI rose from 31.5% to 39.9% YoY in Q1, the fastest rate in 13 years.

| Next week's key events | | *Per.* | *Prev.* | *Cons.* |
|---|---|---|---|---|
| 20 Apr | PBoC interest rate decision | 2021 | 3.85% | 3.85% |
| 22 Apr | Japan core CPI YoY | Mar | -0.4% | -0.4% |

Sources: DataStream, Bloomberg, 16 April 2021. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Managers' Index, CPI = Consumer Price Inflation.

## Our 3-month targets for currencies and commodities

| | Thursday close | 3mth target |
|---|---|---|
| EUR/USD | 1.20 | 1.19 |
| GBP/USD | 1.38 | 1.38 |
| EUR/CHF | 1.10 | 1.10 |
| USD/JPY | 108.8 | 107.0 |
| Brent | $67.0 | $65.0 |
| Gold (oz.) | $1766 | $1750 |

NB No changes to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

# MARKET PERFORMANCE

## Interest rates

| Interest rates | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| EONIA (EUR) | -0.48 % | 0 bp | → | 0 bp | 2 bp | -3 bp |
| 3mth Euribor (EUR) | -0.54 % | 1 bp | → | 2 bp | 1 bp | -29 bp |
| 3mth Libor (USD) | 0.19 % | 0 bp | → | -3 bp | -5 bp | -95 bp |
| 3mth Libor (GBP) | 0.08 % | 0 bp | → | 6 bp | 6 bp | -58 bp |
| 10-year US Treasury bond | 1.53 % | -10 bp | ↓ | 43 bp | 62 bp | 89 bp |
| 10-year German bond | -0.29 % | 4 bp | ↑ | 25 bp | 28 bp | 17 bp |
| 10-year French bond | -0.04 % | 4 bp | ↑ | 28 bp | 30 bp | -9 bp |
| 10-year UK bond | 0.74 % | -1 bp | ↓ | 45 bp | 54 bp | 44 bp |

## Credit

| Credit | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|
| BAML EURO Corp. IG | -0.1% | ↓ | -0.6 % | -0.5 % | 6.3 % |
| BAML EURO Corp HY | 0.1% | → | 1.7 % | 2.1 % | 16.2 % |
| BAML GBP Corp IG | 0.4% | ↑ | -2.7 % | -3.5 % | 5.8 % |
| BAML US IG | 0.8% | ↑ | -1.7 % | -2.7 % | 6.1 % |
| BAML US HY | 0.1% | ↑ | 1.4 % | 1.8 % | 18.9 % |
| BAML Global EM Sov. External Plus | 1.1% | ↑ | -1.6 % | -3.2 % | 17.8 % |

## Exchange rates

| Exchange rates | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| EUR/USD | 1.20 | 0.4 % | ↑ | -0.9 % | -2.0 % | 9.7% |
| EUR/CHF | 1.10 | 0.2 % | ↑ | 2.6 % | 2.1 % | 4.9% |
| GBP/USD | 1.38 | 0.4 % | ↑ | 1.5 % | 0.8 % | 10.2% |
| USD/JPY | 108.8 | -0.5 % | ↓ | 4.7 % | 5.3 % | 1.2% |
| USD/BRL | 5.62 | 0.8 % | ↑ | 6.1 % | 8.1 % | 7.2% |
| USD/CNY | 6.52 | -0.4 % | ↓ | 0.6 % | -0.1 % | -7.7% |
| USD/RUB | 76.5 | -0.6 % | ↓ | 4.0 % | 3.3 % | 2.1% |

## Government bonds*

| Government bonds* | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|
| United States (3-7yr) | 0.2 % | ↑ | -1.1 % | -1.5 % | -1.0 % |
| United Kingdom (3-7yr) | 0.1 % | ↑ | -1.2 % | -1.4 % | -0.7 % |
| Germany (3-7yr) | -0.2 % | ↓ | -0.6 % | -0.6 % | -0.7 % |
| Japan (3-7yr) | 0.0 % | → | 0.0 % | -0.1 % | -0.2 % |

## Equities*

| Equities* | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| MSCI AC World | 702 | 1.4 % | ↑ | 7.6 % | 9.2 % | 53.3 % |
| Eurostoxx 50 | 3 993 | 0.4 % | ↑ | 11.4 % | 13.0 % | 46.0 % |
| DAX | 15 255 | 0.4 % | ↑ | 10.6 % | 11.2 % | 48.4 % |
| CAC 40 | 6 234 | 1.1 % | ↑ | 11.3 % | 12.6 % | 46.3 % |
| S&P 500 | 4 170 | 1.8 % | ↑ | 11.1 % | 11.5 % | 52.4 % |
| FTSE 100 | 6 984 | 0.7 % | ↑ | 4.9 % | 9.4 % | 29.1 % |
| SMI | 11 199 | 0.3 % | ↑ | 4.8 % | 6.5 % | 24.1 % |
| Topix | 1 959 | 0.4 % | ↑ | 6.5 % | 9.5 % | 39.4 % |
| IBOV Brazil | 120 701 | 2.0 % | ↑ | 0.3 % | 1.4 % | 53.1 % |
| MICEX Russia * | 3 569 | 1.7 % | ↑ | 3.4 % | 8.5 % | 42.8 % |
| MSCI EM | 1 341 | -0.1 % | ↓ | -0.8 % | 4.3 % | 54.6 % |
| SENSEX 30 India | 48 804 | -1.9 % | ↓ | -0.3 % | 2.4 % | 62.4 % |
| Hang Seng (H-K) | 28 793 | -0.7 % | ↓ | 1.1 % | 6.1 % | 23.3 % |
| Shanghaï Composite | 3 399 | -2.4 % | ↓ | -4.7 % | -2.1 % | 20.9 % |

## Commodities

| Commodities | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| Brent | $67.0 | 5.8 % | ↑ | 21.4 % | 29.1 % | 140.9 % |
| Gold | $1 766 | 0.6 % | ↑ | -3.3 % | -7.0 % | 2.8 % |
| Copper | $9 297 | 3.1 % | ↑ | 17.1 % | 20.0 % | 82.9 % |

Source: DataStream, on 15 April 2021.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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