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EUROGROUP: ACCEPTABLE ECONOMICS, UNFORTUNATE POLITICS

Berenberg Macro Flash

Pandemic update: The virus continues to spread rapidly on both sides of the Atlantic. In Europe, the total number of confirmed infections has risen by 28% within two days to 218k as of the morning of 25 March (down slightly from 29% between 22 and 24 March and 41% between 20 and 22 March), according to the Johns Hopkins University. From a lower level, the US is following Europe with a 57% surge in the last two days to more than 55k (down from 74% between 22 and 24 March and 88% in the two days before that).

Whatever it takes: Following on the heels of major fiscal support programmes across Europe, the US Senate last night moved forward with a US package of close to $2trn. Expect the House to act fast as well and President Trump to sign it within days. This is a big welcome step, in line with expectations that, under the pressure of the health emergency, fiscal policy would shift into "whatever it takes" mode.

EUROZONE SUPPORT FOR ITALY – SORT OF

Governments in the Eurozone will help Italy and other hard-hit members, but only on a modest scale and in a somewhat contorted way. The potential support outlined by Eurozone finance ministers last night will most likely suffice to keep Italian borrowing costs down, in our view. However, the half-hearted nature of the semi-deal could raise serious political risks.

At the „Eurogroup" meeting last night, Eurozone finance ministers last night agreed in principle on some key elements of a potential offer to member countries in need:

- The existing European Stability Mechanisms (ESM) will be used for such support.
- Countries can ask for a credit line from the ESM of roughly 2% of their GDP, which would translate into c€35bn in the case of Italy.
- The credit line, probably as part of the "Enhanced Conditions Credit Line (ECCL)" facility, will be granted with limited conditionality linked largely to the pandemic response.

Once a country has an ESM credit line, the European Central Bank (ECB) would be free to decide, at its own discretion, whether to deploy its OMT bazooka, that is its "Outright Monetary Transactions" instrument to potentially buy that country's bonds with a maturity of up to 3 years without a preset limit. The ECB has never used the OMT before. OMT is the way in which the ECB had put Mario Draghi's July 2012 promise to "do whatever it takes" into practice.

According to Eurogroup chief Mario Centeno, finance ministers signalled "broad support" for this approach at the meeting. EU leaders will discuss the idea and provide more guidance on the still contentious issues at their video summit on Thursday before finance ministers hammer out the final details next week.

WHATEVER IT TAKES? NOT QUITE ON THE EURO LEVEL YET

Responding to the pandemic, the ECB has switched fully into "whatever it takes, whatever works" mode over the last two weeks with two decisions to raise 2020 its bond purchases to €1.1trn. Individually, finance ministers of Eurozone countries followed suit with unprecedented national support programmes to ease a dangerous liquidity crunch and prevent mass dismissals and bankruptcies. Collectively, however, they have not gone for "whatever it takes" at the Eurozone level. Relative to the domestic responses, a mere use of an existing ESM facility with cheap credits to the tune of 2% of a country's GDP looks unimpressive, to put it mildly.

In economic terms, the proposal to use the ESM in this particular way and pave the way for a potential use of the ECB's OMT is probably good enough. It constitutes a big Euro-level response. Italy and/or other hard-hit countries can get funds at generous terms. Markets would know that ECB could scale it up if need be. Because markets understand OMT, the ECB may actually never have to activate it. The mere knowledge about a safety net could encourage investors to buy enough Italian bonds at terms that are tolerable for the Italian government even without actual ECB purchases.

In political terms, the deal outlined but not finalised by Eurogroup finance ministers falls short of the required signal of unique solidarity in a unique crisis. It contains a risk of a backlash in popular opinion in Southern Europe against the North which could significantly complicate future cooperation within the EU/Eurozone. If there ever was a time for solidarity in Europe, it is now. To which extent Europeans help each other in this acute emergency can shape popular perceptions of what Europe stands for – and for a long time to come. Well-handled solidarity in an emergency that affects the entire continent can debunk the narrow "my country first" narrative. Solidarity that is perceived as not sufficient enough may risk a dangerous anti-EU backlash instead. Next to TV pictures of Chinese and even Russian teams helping in Italy, Europe should have sent a much stronger signal of solidarity, in my view.

A chance remains that the EU video summit on Thursday will send a stronger message, possibly even looking at the idea of corona bonds (see our case for corona bonds). While that remains possible, it does not seem highly likely after German finance minister Olaf Scholz reportedly argued against a much bigger Eurozone response according to some wire service reports.

Unfortunately, the Eurogroup result shows once again that, once it comes to actions of seriously impressive scale in the Eurozone, the ECB is the only institution capable of that, at least so far.

For our core convictions on the economic consequences of the pandemic, see the macro essentials. See also our Covid-19 chartpack.

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