THEMATIC GLOBAL VIEWS

# You asked, we answered

**Our Global Views team attempts to answer some of the questions often asked by our clients**

**Didier BOROWSKI,**
*Head of Global Views*

**Pierre BLANCHET,**
*Head of Investment Intelligence*

**Tristan PERRIER,**
*Global Views*

### What are the next steps for the NGEU?

The *Next Generation EU* fund was agreed in July 2020 after weeks of acrimonious negotiations between EU member states which pitted the "frugal four" against the rest of the union. **The €750bn plan, comprising €390bn in grants and €360bn** in loans to member states, is actually built around a newly created €672.5bn instrument known as the Recovery and Resilience Facility (RRF), which was fully adopted by the European Council on 11 February 2021.

**EU countries have until 30 April 2021 to submit their national recovery and resilience plans.** They also need to set out their reform and investment agendas for the next five years. This can be an issue for countries, which are struggling to implement structural reforms and/or have upcoming elections, as is the case in France and Italy. Then, the EC will have up to two months to assess each plan, following which the Council will have four weeks to approve them. Grants and loans are given according to achievements and agreed milestones. Assuming that the ratification process is completed by 1 May, member states should receive the first funding by 1 August.

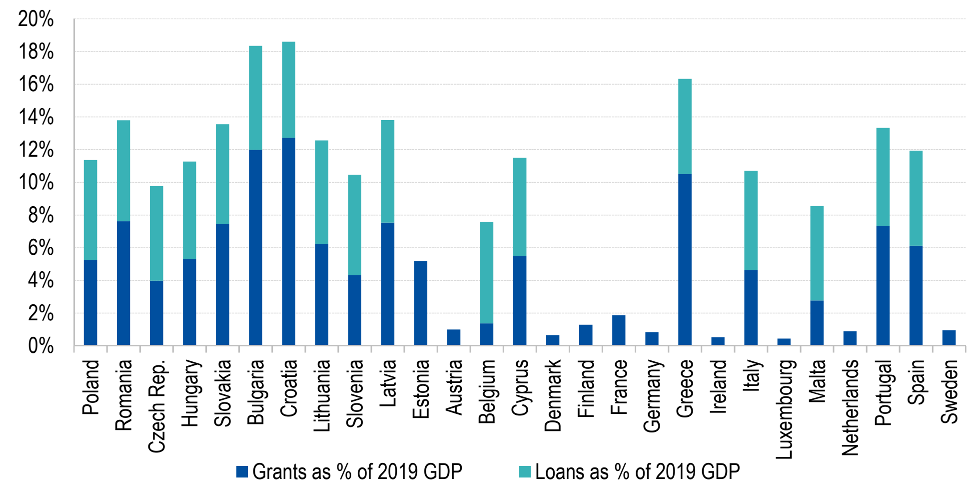
70% of the RFF's grants (€312.5bn) will be committed in 2021 and 2022, based on the unemployment rate in 2015-2019, inverse GDP per capita and population share. The remaining 30% will be fully committed by the end of 2023, based on the same criteria plus the drop in real GDP.

Several member states have started the ratification process ahead of the Council decision. At the time of writing, 11 out of 27 members have ratified the NGEU, with those 11 roughly divided between northern and southern states. The slow process is due to national parliamentary agendas and legal constraints, although so far it remains in line with EU budget timeline.

**The European Commission (EC) is expecting to launch the fund and provide initial financing over the summer.** However, the German ratification has been jeopardised by the Constitutional Court ruling on 26 March. The bill was passed by both the Bundestag and Bundesrat, and was about to be signed by President Steinmeier, but an appeal was made by a group of Eurosceptics. The Karlsruhe judges need to decide whether the "new own resources" i.e. taxes the Commission will create to finance the NGEU, are aligned with EU Treaties. The plaintiffs are not opposing the recovery fund *per se* but the fact that the new resources and debt issued are *de facto* leading to a fiscal union which violates the German constitution.

**The plan has strong political backing in Berlin and should eventually be approved. Yet, the EC cannot raise money for the fund before all countries have ratified the NGEU,** and therefore distribute 13% of the total amount in H2 2021 as planned. European economies need that funding as business activities are suffering from lockdown measures and low vaccination rates. We believe the pressure on politicians and judges will be significant enough over the coming weeks for the NGEU approval process to go through, and the first projects to be funded by September.

1/ **NGEU grants and loans**




Source: Bruegel Institute estimates, Amundi Research - Data as of March 2021

THEMATIC GLOBAL VIEWS

Key agenda this year

- 30th April : member states need to submit their national recovery and resilience plans setting out their reform and investment agendas until 2026
- End June: The Commission will have up to two months to assess the plan
- 1st August: the Council has four weeks to adopt its decision on the final approval of each plan and send the funds to member states (first 13%)

### Toward the creation of bad banks in Europe?

**Given the public support measures, the Covid-19 crisis has not resulted in a significant increase in outstanding Non-Performing Loans (NPLs)**. European banks are well capitalised and there is no need to worry if an economic rebound materialises this year. It is worth remembering that it took until 2019 for European banks to return to their pre-2008 crisis NPL levels. The total amount of NPLs carried by European banks is currently around €600bn (the average NPL ratio, at 2.8% in Q3 2020, is low but there are significant differences between countries). Looking ahead, banks may need direct public support to ensure that increased NPLs do not limit bank-lending volumes.

**The good news is that the European authorities have a clear strategy to remove NPLs from bank balance sheets in order** to preserve the distribution of credit and **protect banks from a deteriorating economic situation**. The European Commission and the ECB have finally converged. The creation of a single European "bad bank" was initially preferred by the ECB but this is not the solution that is now envisaged. Indeed, the European Commission supports the creation of national "bad banks" that would instead be called Asset Management Companies (AMCs) to facilitate the management of NPLs. This network of AMCs would securitise and sell NPLs to final investors. **This is a key milestone that should increase the eurozone's resilience to external shocks.**

### What are the impacts of the US vs. eurozone growth differential?

*Towards a mini boom in the US in 2H21*

**One year after the start of the crisis, we can assessment of the impact of the Covid-19 crisis.** As far as the victims are concerned, the US has suffered a greater disaster than the eurozone (543,000 deaths vs. 445,000) despite having a slightly smaller population (330 vs. 342 million). This is due to the less restrictive measures imposed in the US. As a result, real GDP fell less in the US than in the eurozone last year (-3.5% vs. -6.8%). Given the new set of restrictive measures put in place in Europe, GDP growth may remain sluggish in Q2, while US economic activity will continue to expand at a brisk pace. It is therefore clear that the US is doing better than the eurozone from an economic standpoint. In recent months, the consensus has been continuously revised upwards in the US and downwards in the eurozone. As a result, it is now estimated that real GDP will return to its pre-crisis level by this summer in the US, but not before the end of 2022 or even the beginning of 2023 in the eurozone. This means that there is a 12- to 18-month cycle gap between the US and the eurozone.

**The consequences for US interest rates are important.** Firstly, because it reinforces the idea that inflation will materialise in the US first. However, in the wake of its strategy review adopted last year (the objective is now to raise inflation to an average of 2% over a cycle), the Federal Reserve (Fed) has time before it will need to hike rates, even if inflation surprises on the upside. We do not expect the first rate hike before 2023.

**The USD 1.9 trillion (9% of GDP) fiscal stimulus package adopted by Congress will likely trigger a mini boom in 2H 2021**. Even more so as a plan for some USD 2 trillion in infrastructure investment is likely to follow by year end. The Fed has committed to keeping its key rates unchanged in the short term, but not long-term interest rates. Its purchases of Treasuries (currently USD 80bn per month) have not been enough to prevent the rise in long-term bond yields (1.7% for the ten-year), driven by both real interest rates and inflation expectations. For the time being, there is no question of the Fed tapering its asset purchases, but eventually it will have to reduce its degree of monetary accommodation as the output gap closes. This decision would inevitably push US long-term interest rates higher.

**In contrast, the ECB will oppose a movement on long-term interest rates should it be disconnected from eurozone fundamentals.** The economy is too fragile, credit conditions need to remain easy, and some ECB members thus believe that further steepening of the yield curve would be premature. Inflation is still far from threatening the area and the fragmentation between core and periphery is still too large. It is therefore too early for the ECB to reduce the size of its APP.

**The rise in US yields will be capped.** In an environment of low interest rates, the rise in long-term rates in the US would eventually lead to a renewed appetite for US Treasuries from both domestic and foreign investors searching for yield. This would limit the rise in US long-term interest rates and may as a result temporarily strengthen the dollar against the euro.

**However, the cycle gap will not continuously widen in favour of the US over the next 12 months, quite the**

THEMATIC GLOBAL VIEWS

**contrary.** On the one hand, growth in the eurozone is expected to accelerate strongly in the coming quarters, while on the other, overheating in the US could lead to a boom/bust cycle, with growth falling back abruptly in 2022-23 as the effects of the fiscal stimulus fade away.

**The European equity markets could benefit** both from a positive trend in profits on the back of the recovery of the global cycle and prolonged accommodative monetary conditions should support valuations. The overrepresentation of technology stocks on the American market, which are sensitive to the rise in long rates, is causing a rotation in favour of cyclical and financial sectors which are more represented in European indices. This configuration of desynchronised growth should paradoxically benefit European markets, which offer a more limited risk of loss on sovereign and corporate bonds and a more attractive equity risk premium.

*The case for a larger stimulus in Europe is likely to build*

### Should we expect further stimulus in Europe?

The short answer is yes, both regarding **fiscal support during the crisis and recovery stimulus after the crisis**.

**Regarding short-term fiscal support,** the slow start to the European vaccination campaign means that the reopening of closed sectors seems, as of today, a more distant prospect than in the US or UK. Governments will therefore need to continue the same kind of support measures that have been used extensively since the beginning of the crisis (mostly support for short-time work schemes, specific aid for hard-hit sectors and public guarantees on corporate debt), at a higher fiscal cost than forecast at the end of 2020. Germany, in particular, announced in March a debt-financed supplementary budget of €60bn that could increase its net borrowing to a record high of €240bn in 2021 (7% of GDP), although whether all this extra capacity will be used is highly contingent on future Covid developments.

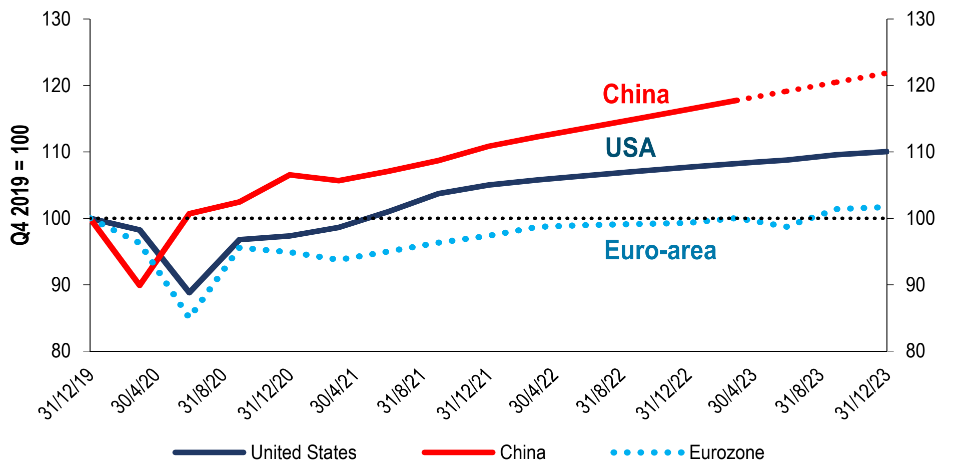
**Recovery stimulus** pursues a different logic. It can only be fully deployed once the economy re-opens, with plans mostly (although not entirely) focusing on investment rather than income support to households and life support to corporations. In this respect, the *Next Generation EU* (NGEU) recovery fund, that will be available from H2 2021 on, will be an essential tool, supplemented by efforts at the national level in the countries that have the capacity to do so. As the crisis has lasted longer than initially forecast, the residual damage that will need to be repaired after closed sectors are allowed to reopen will also be greater. The case for a larger stimulus is therefore likely to build. While it may be politically difficult to extend the NGEU (which was only agreed after tense negotiations in July 2020), greater efforts can probably be made at the national level, thanks to a prolonged waiver of EU budget rules. Note that prominent decision-makers (President Macron of France and ECB Board Member Isabel Schnabel) have recently called for more European-level fiscal stimulus.

### What is America's new geopolitical agenda?

Anthony Blinken's very first foreign policy speech was quite insightful. The new administration aims to tackle the climate crisis and drive a green energy revolution, secure US leadership in technology, and last *but not least* manage its relationship with China, a relationship that has been called *"the biggest geopolitical test of the 21st century"*.

Trump's unilateralism is certainly over, and Biden's United States is based on a foundation of values and objectives shared with Europe (building a more inclusive economy, fighting global warming, consolidating democracies, fighting racism and inequality, etc.). But the multilateralism

2/ **Path to recovery post Covid-19**




Source: Amundi Research - Data as of 31 March 2021

THEMATIC GLOBAL VIEWS

*China real GDP per capita will double by 2035*

advocated by Blinken is quite different from what Europeans have in mind. It is striking to observe that the European Union (EU) as a political entity is not mentioned once in this speech, while China is mentioned 17 times. And if Europe is mentioned at all, it is only once, and only in the same breath as the other continents, as the US wants to reinvent partnerships with its old allies (*"countries in Europe and Asia"*), as well as with its new partners *"in Africa, the Middle East and Latin America"*.

This obsession with China's rise corresponds to a tangible reality. It is estimated that China's real GDP will double by 2035, which roughly corresponds to a doubling of GDP per capita within 15 years. China is making no secret of its technology ambitions. **The US is seeking to maintain its dominance.** The EU is ultimately caught in a vice between the US and China.

For Blinken, artificial intelligence and quantum computing are the two pillars of tomorrow's technology. The technological competition between the two blocs has only just begun. It is no coincidence that this speech comes two days after the publication of the National Security Commission's report on artificial intelligence[1]. This report clearly aims to establish the way to maintain US leadership. It states that the US could lose its technological and military superiority to China over the next decade, something not seen since the end of WWII. The report therefore calls for a rapid fiscal effort of several hundred billion dollars to safeguard national security and US supremacy, without worrying about the resulting deficits. For example, in the context of a global semiconductor shortage, the report calls for the US to stay "two generations ahead" of China in semiconductor manufacturing and suggests significant tax credits.

**Ursula von der Leyen's EU is certainly not to be outdone**, claiming that Europeans are ready to assume and strengthen their power. The EU has just announced that it wants to double its semiconductor production by 2030 to 20% of world production. The concepts of strategic autonomy and European sovereignty are increasingly being put forward. However, they are not precisely defined, and their use is still controversial. On the economic front, the NGEU recovery fund adopted last year will certainly make it possible to deploy investments in key areas. But any delay in the start-up of the fund would have serious consequences.

**A tactical alliance between China and Russia** on the one hand, **and the US and Europe** on the other, seems to be emerging, particularly with regard to democracy and human rights. But when it comes to economics, all blocs have divergent interests and will compete.

*Finalised on 31 March 2021*

[1] *See www.nscai.gov*

# Amundi Research Center

**Find out more about Amundi publications research-center.amundi.com**




Document issued by Amundi Asset Management, “société par actions simplifiée”- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com
Photo credit: ©MDelporte - iStock/Getty Images Plus - piola666

**Chief editor**
**BLANQUÉ Pascal**, *Group Chief Investment Officer*

**Editor**
**DEFEND Monica**, *Global Head of Research*

**Deputy-Editors**
**BLANCHET Pierre**, *Head of Investment Intelligence*
**BOROWSKI Didier**, *Head of Global Views*

**With Global Research contributers**
**AINOUZ Valentine**, *Deputy Head of Developed Markets Strategy Research, CFA*
**BELHAJJAM Inès**, *Strategist*
**BELLAICHE Mickael**, *Fixed Income and Credit Research Strategist*
**BERARDI Alessia**, *Head of Emerging Macro and Strategy Research*
**BERTONCINI Sergio**, *Senior Fixed Income Research Strategist*
**BLANCHET Pierre**, *Head of Investment Intelligence*
**BOROWSKI Didier**, *Head of Global Views*
**CESARINI Federico**, *Cross Asset Research Strategist*
**DELBO’ Debora**, *EM Macro Strategist*
**DROZDZIK Patryk**, *EM Macro Strategist*
**DRUT Bastien**, *Chief Thematic Macro Strategist at CPR AM*
**GEORGES Delphine**, *Senior Fixed Income Research Strategist*
**HERVÉ Karine**, *EM Macro Strategist*
**HUANG Claire**, *EM Macro Strategist*
**LEONARDI Michele**, *Cross Asset Research Junior Analyst*
**MIJOT Éric**, *Head of Developed Markets Strategy Research*
**PERRIER Tristan**, *Global Views*
**PORTELLI Lorenzo**, *Head of Cross Asset Research*
**STRENTA Aurelien**, *Emerging Market Analyst (V.I.E)*
**USARDI Annalisa**, *Senior Economist Cross Asset Research*
**VARTANESYAN Sosi**, *Sovereign Analyst, Emerging Macro & Strategy Research*

**With the Amundi Insights Unit contribution**
**BERTINO Claudia**, *Head of Amundi Investment Insights Unit*
**FIOROT Laura**, *Deputy Head of Amundi Investment Insights Unit*
**DHINGRA Ujjwal**, *Amundi Investment Insights Unit*
**PANELLI Francesca**, *Amundi Investment Insights Unit*

**Conception & production**
**BERGER Pia**, *Research*
**PONCET Benoit**, *Research*