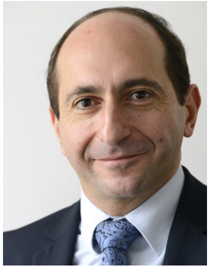
THEMATIC

The Eurozone's quantum leap: on the road to debt mutualisation



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The tools that will be used to deal with this crisis will shape the debates once the crisis is over

As part of Global Research, the main mission of the newly established Global Views team is to strengthen Amundi's thought on key cross-cutting thematics

The Eurozone's architecture does not allow it to contain all the risks arising from the current shock. Recourse to an European Stability Mechanism (ESM) credit line without strong conditionality is a de facto first step towards debt mutualisation. Looking ahead, this could pave the way to a European budget and a common debt.

Economic policies implemented on both sides of the Atlantic are unprecedented on both the fiscal and monetary fronts. **We are witnessing a *de facto* merger of central bank and state balance sheets.** Let us consider the guarantees provided by EZ governments for companies whose business activity has suddenly stopped. Given the scale of the looming recession, public debts will rise very sharply, and bond yields would soar if there were no QE from central banks (ECB, BoE and the Fed). Subsequently, central banks' balance sheets will soar in tandem with public debts. **Governments have become the buyers of last resort, while central banks are playing their role as lenders of last resort. Fiscal and monetary policies have become intertwined, and this is not reversible.**

Financial crises provide an opportunity for institutional reform

Historically, economic and financial crises have always given the authorities an opportunity to equip themselves with the appropriate instruments to contain them. Indeed, it was following the crisis of the 1930s that the Fed adopted the statutes that enabled it to deal with the GFC. And it is thanks to the 2012 EZ sovereign debt crisis that the ECB is today able to support (among other things) the guarantees provided by the governments. Most of the tools mobilised (or that could be mobilised) by the ECB today were put in place after 2012 to save the euro.

Over the decades, the US policy mix has become more flexible and transparent. Actually, the Eurozone has not yet reached the same degree of policy maturity. So, debt monetisation is a distinct possibility in the US while it is still a taboo for some EZ countries.

The EMU is incomplete

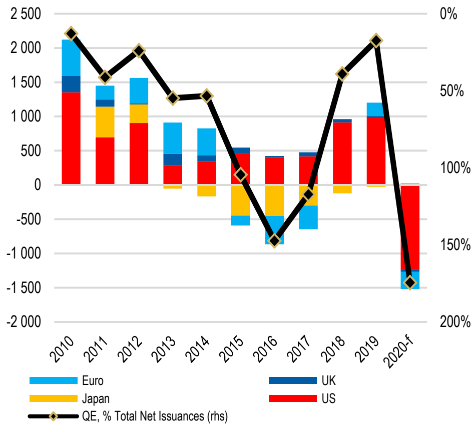
The EMU cannot cope with a systemic shock with the tools at its disposal now. Irrespective of the debate on monetisation, **the EZ's institutional and financial architecture is not in a position to contain *all* the risks incurred from the current epidemic shock.** In the absence of a federal budget, governments were initially forced to act individually by taking poorly calibrated measures, particularly in the weakest countries. **It probably won't be enough**. Interestingly, the Eurogroup on Tuesday 23 March suggested mobilising the European Stability Mechanism (ESM) by opening a special credit line (ECCL), amounting to 2% of GDP for all EZ States that request it. This credit line would only be conditional upon a "return to stability". The absence of strong conditionality was clearly not in the original spirit of the ESM financial assistance created in 2012. However, the coronavirus epidemic constitutes a symmetric external shock, and the objection of moral hazard should disappear.

Surprisingly, the European Council of Heads of State and Government held two days later did not adopt this proposal. For the moment, two countries – Germany and the Netherlands – still refuse to go in this direction. However, we continue to believe that the ESM credit line will, at some point in time, be mobilised. And if so, it **would *de facto* be a first step towards debt mutualisation.**

Ultimately, the tools that will be used to deal with this crisis will inevitably shape the debate once the crisis is over. European leaders will then be forced to recognise that a single federal budget and a single financing instrument for the EZ would have been more efficient to manage the crisis. **The birth of a European budget and a common debt (possibly monetised) will perhaps be the institutional traces that this crisis will leave in history: a forced march towards more Europe!**

Finalised on 30/03/2020

Sovereign issuances net of redemptions and central banks purchases (USD bn)



Source: Amundi, Data as of 31 March 2020

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Document issued by Amundi, "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
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