European Economics
Policy responses & funding needs

Investment Solutions & Products
European Economics

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Recession & policy responses

- **The euro area will go into recession in 2020**. All EA countries are now all under some form of lockdown. Consequently, the suppression of economic activity means GDP will fall sharply in the first half of this year.

- **We forecast euro area GDP to fall by 5.3% this year.** Our forecast could, however, be revisited depending on the length and severity of the lockdowns. Meanwhile, if restrictions are eased by the summer, and if the economic policy response is effective, activity could recover back to pre-crisis levels next year.

- **Will the economic policy response be effective?** So far, the size of the policy response across the euro area has been encouraging and more should come. We also note that monetary policy and national fiscal policies have been implemented in a coordinated manner across the euro area to help limit the economic damage of the virus.

    1. National governments have reacted promptly and announced large **fiscal packages** to support businesses and households.
    2. **Loan guarantee schemes** were announced to ensure liquidity for businesses.
    3. And the **ECB** announced fresh stimulus measures to finance fiscal packages and provide liquidity.

- The immediate focus has rightfully been on keeping the economy afloat, at all cost. Nonetheless, the impact on public finances will be assessed once the storm has passed.

- **More support could come.** It is an encouraging sign that several euro area governments different proposals to share the burden of dealing with the pandemic. France has proposed a multi-year reconstruction fund; the European Commission has proposed a scheme (worth €100bn) to help businesses keep workers on their payrolls; the Dutch government has proposed a (small) transfer fund to cover emergency supplies; and the SPD wing of the German government has suggested providing ESM credit lines with conditionality.

1. Fiscal responses - *framework*

- Governments across the euro area have announced **generous fiscal packages** to mitigate the effects of the various lockdowns, for:

  1. **Corporates;** by postponing bills, taxes and mortgages payments; and providing financial support for small businesses, etc.
  2. **Workers;** by reducing thresholds for companies to apply for short-term labour, creating wage funds, and providing additional benefits for families, etc.

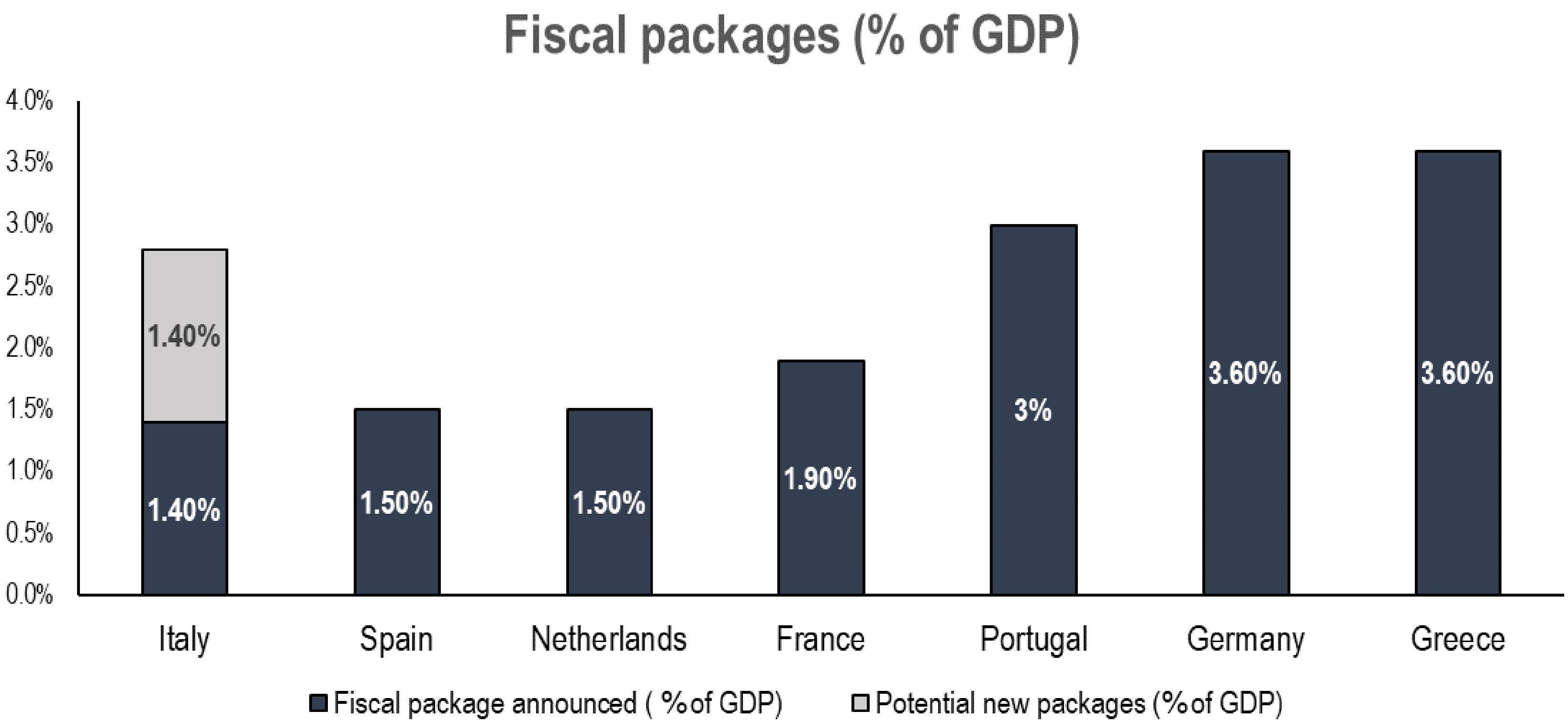
- **The total cost of these policies is not yet known, as more could come.** What is certain is that government deficits will increase in 2020, as the fiscal response will likely be more than the 1.5-3.6% of GDP currently announced by different countries.

- **Our early estimates suggest that the euro area deficit would be around 8% of GDP this year.** Our calculation is based on two assumptions; 1) spending will increase more than has currently been announced by governments, and 2) revenues will fall sharply (by more than was seen in the global financial crisis for certain countries).

- **At the national level, deficits could range between 5-10% of GDP.** That would be the largest deficits increase in over a decade and the risks are that they could be considerably greater.

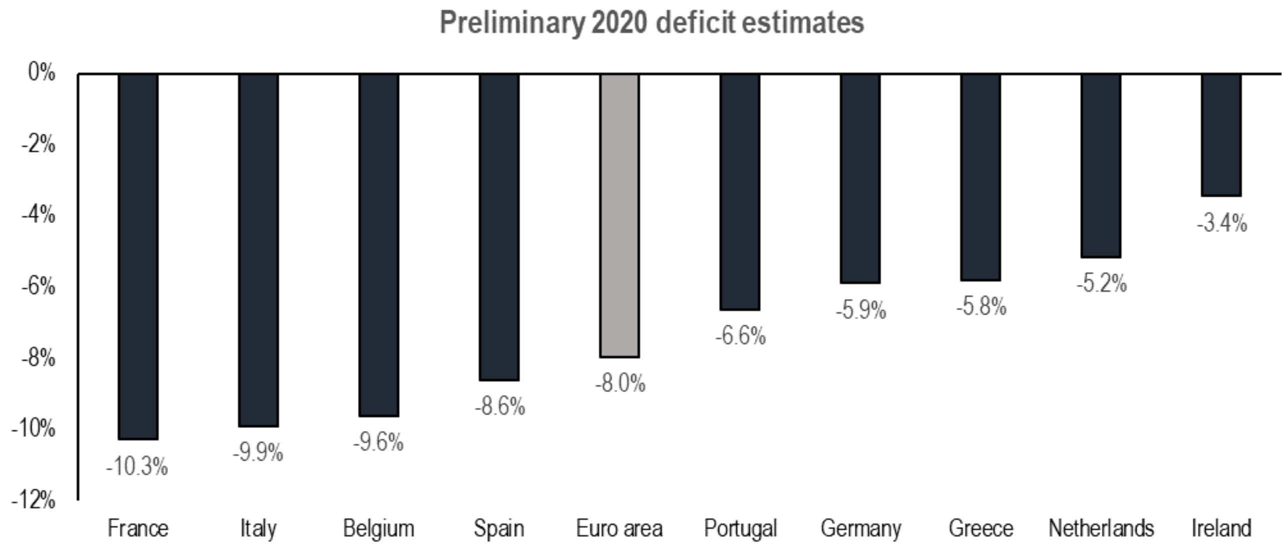
- **The European Commission has been supportive of such measures,** and allowed countries to temporarily deviate from the Stability Pact rules, letting them run deficits above 3%.

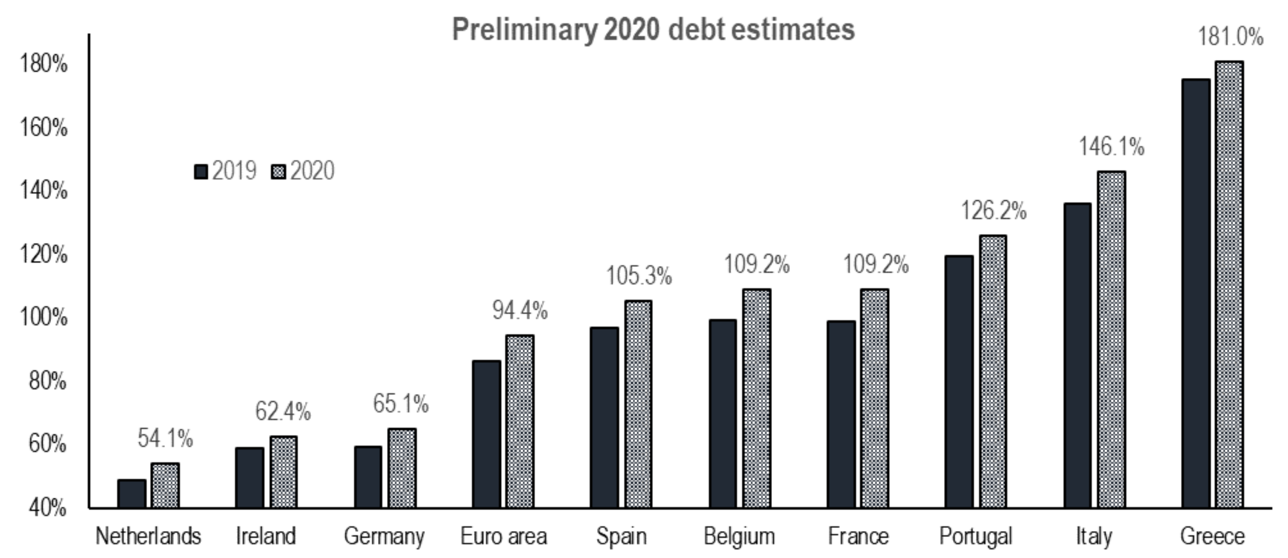
1. Fiscal responses – *size (more should be announced)*



Source: Credit Suisse estimates

1. Fiscal responses – *cost*





Source: Credit Suisse estimates

1. Fiscal responses – *rating agencies key dates*

- Rating agencies will be important this year, given the prospect of large increases in government debt. For certain countries, the risk is an outlook review and/or a downgrade. Countries downgraded below investment grade by all agencies will be able to benefit from the ECB PEPP scheme (Greece is included), but not be eligible for QE.
- In our view, Italy faces highest risk of being downgraded as; both Fitch and S&P (which rate Italy two notch above investment grade, compared to one notch above for Moody's) already have the country on negative outlook, the country will likely be the most hit by the Covid-19 crisis, and we estimate that public debt could increase to almost 150% of GDP.
- For other euro area countries, we believe rating agencies will likely downgrade the outlook rather than the rating in the short term at least. Especially as the virus impact should be temporary, and public finances are expected to return to their pre-crisis trajectory in 2021.

	Fitch				S&P				Moody's				DBRS			
	First review	Second review	Rating	Outlook	First review	Second review	Rating	Outlook	First review	Second review	Rating	Outlook	First review	Second review	Rating	Outlook
Germany	17-Jan	12-Jun	AAA	Stable	03-Apr	02-Oct	AAA	Stable	31-Jan	31-Jul	AAA	Stable	05-Jun	04-Dec	AAA	Stable
France	15-May	13-Nov	AA	Stable	03-Apr	02-Oct	AA	Stable	21-Feb	21-Aug	Aa2	Positive	17-Apr	16-Oct	AAA	Stable
Italy	07-Feb	10-Jul	BBB	Negative	24-Apr	23-Oct	BBB	Negative	08-May	06-Nov	Baa3	Stable	08-May	30-Oct	BBB (high)	Stable
Spain	12-Jun	11-Dec	A-	Stable	20-Mar	18-Sep	A	Stable	20-Mar	18-Sep	Baa1	Stable	06-Mar	04-Sep	A	Positive
Netherlands	24-Apr	23-Oct	AAA	Stable	15-May	13-Nov	AAA	Stable	01-May	30-Oct	AAA	Stable	24-Jan	24-Jul	AAA	Stable
Belgium	03-Apr	02-Oct	AA-	Stable	20-Mar	18-Sep	AA	Stable	29-May	27-Nov	Aa3	Stable	14-Feb	14-Aug	AA (high)	Stable
Ireland	28-Feb	28-Aug	A+	Stable	29-May	27-Nov	AA-	Stable	14-Feb	14-Aug	A2	Stable	31-Jan	31-Jul	A (high)	Stable
Portugal	22-May	20-Nov	BBB	Positive	13-Mar	11-Sep	BBB	Positive	17-Jan	17-Jul	Baa3	Positive	20-Mar	25-Sep	BBB (high)	Stable
Greece	24-Jan	24-Jul	BB	Positive	24-Apr	23-Oct	BB-	Positive	08-May	06-Nov	B1	Stable	24-Apr	23-Oct	BB (low)	Positive

Source: Credit Suisse, Fitch, S&P, Moody's, DBRS

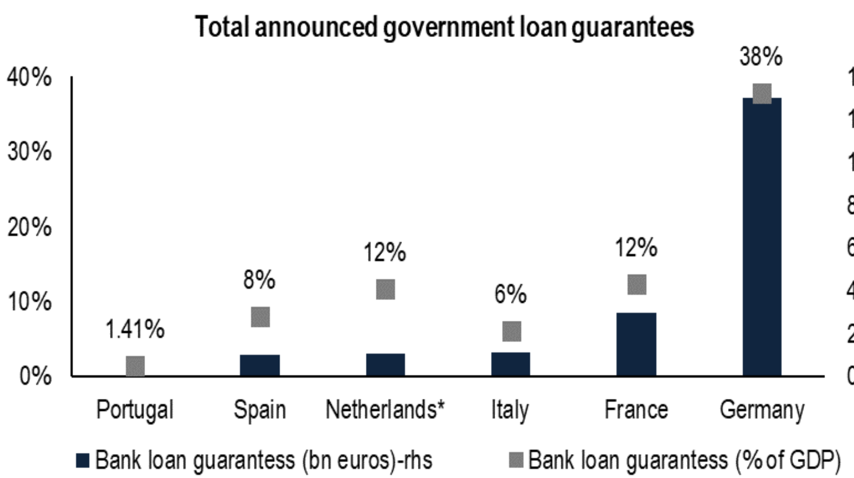
2. State guaranteed loans

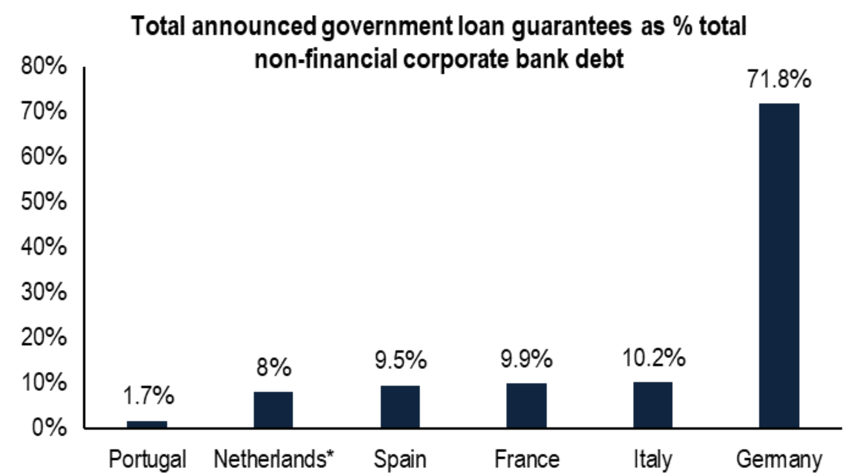
- Many euro area countries announced **state guaranteed loans** to help sustain credit to businesses. Under these schemes, the government assumes, in the event of a default, the debt obligation of the loans granted by banks to companies. This in turn incentivizes banks to allow companies to roll over existing loans and maintain access to working capital. Bottom line, European governments have now guaranteed or underwritten a significant amount of bank lending to non-financial corporates.

- To access this scheme, the French government has asked companies to not pay dividends to their shareholders. More European countries could impose the same conditions.

- The size of these packages vary a lot from one country to another. The biggest euro area countries have announced significant packages **between 1.4% to 38% of GDP.**

- State guarantee loans are not automatically added to the deficit. They will only be a cost for governments if the guarantees are called (i.e. if companies default on banks).





** for Netherlands the government said the cost of the scheme will depend on demand. To find how much the country could borrow, we assume it could need up to 8% of its non-financial corporate bank debt.*

Source: Credit Suisse, ECB

2. State guarantee loans – *conditions*

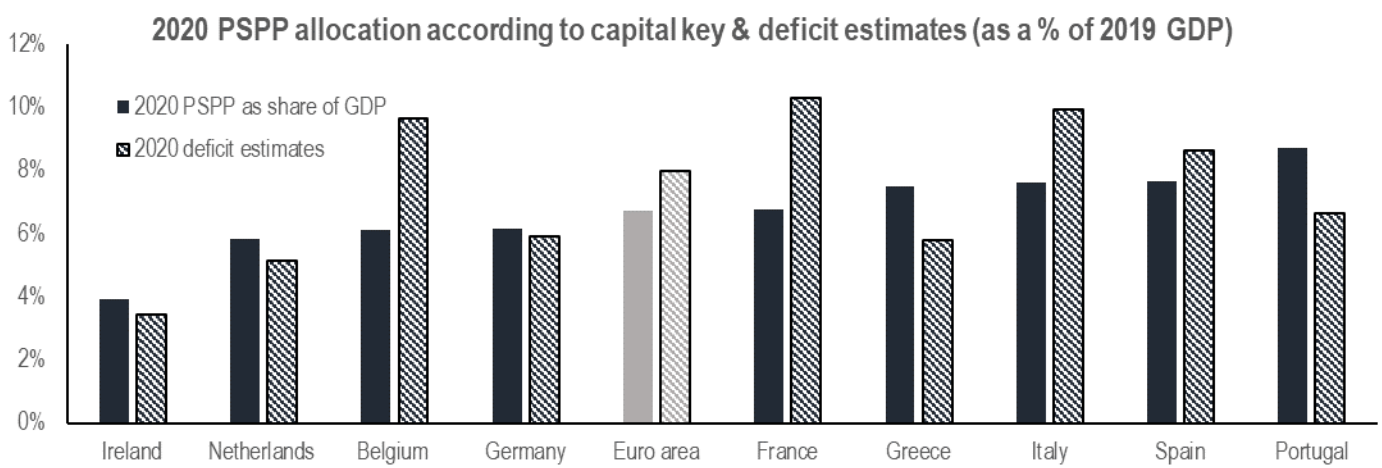
Countries	State guaranteed loans conditions must respect the EU framework (link here)
Germany (Details: here)	*Loan up to €1bn, max. amount is limited to 25% of 2019 revenue, twice the wage costs of 2019 or the current financing need for the next 18 months for SMEs and 12 months for large firms. Loans will need to stay below 50% of the overall debt of a company for loans above €25mil. Companies with revenues below €50mil and fewer than 250 employees, 90% of the loan will be guaranteed by the KfW, for larger companies this guarantee will be 80%. * Participation in syndicated loan structures, for medium and large enterprises. The KfW will take on up to 80% of the risk, but max. 50% of the total debt. The minimum KfW risk needs to be €25mil and the maximum amount is limited by 25% of 2019 revenue, twice the wage costs of 2019 or the current financing need for the next 12 months.
France (Details: here)	*All companies, except civil property companies, credit institutions & finance companies, can benefit from these loans *Max amount: up to three months of turnover, or two years if payroll for innovative companies created since 2019. *No repayment for the first year, companies can amortize the loan over a max period of 5 years. *70-90% will be guaranteed by the state.
Italy (Details: here & here)	*For SMEs (SME Guarantee fund): The maximum coverage % applies (80% for the direct guarantee and 90% for reinsurance) up to a maximum guaranteed amount of 1.5 million per individual company (ordinary coverage applies if this threshold is exceeded). *For big companies (Cassa depositi e prestiti): guaranteed up to 80% and need to respect EU rules (here)
Spain (Details: here)	*Available for all companies except those subject to insolvency proceedings before March 17. *Financing of up to €1.5bn per company. *SMEs & self-employed, will be guaranteed 80%. For companies that do not meet SMEs status, the guarantee will cover a maximum of 70% of new operations and 60% of renewal operations.
Netherlands (Details: here & here)	*The Business loan guarantee scheme - GO (for large and medium-sized companies to borrow substantial amount of money) will be temporarily increased; loan of up to €150mn, 50% guarantee from the government, 8 year term. *Opening of the BMKB scheme (for SMEs) - 90% government guarantee., loans up to €1.5mn
Portugal (Details: here)	*Financing of up to €1.5mn per company *Grace period of 12 months. Maturity of up to 4 years to finance working capital and 3 years for treasury needs. *Guaranteed up to 80% by the government.

3. ECB's monetary policy response

➢ **Who is going to pay for this? In the near to medium term: the ECB.** The central bank announced a series of monetary stimulus to ensure liquidity in the market, help alleviate funding stresses and finance fiscal measures:

1. TLTRO-III operations, which take place between June 2020 and June 2021. The terms of these operation were eased; borrowing allowance increased and the rate at which banks can borrow from the ECB decreased to -0.75% (vs -0.50% previously and below the ECB's deposit rate).
2. Two new QE packages; 1) €120bn (March 12) and 2) a Pandemic Emergency Purchase Programme (PEPP) of €750bn (March 18), which will run through 2020, or longer if need. Combined with the €20bn/per month the bank was already buying, the ECB will be buying c€1.1trn in 2020 (8.9% of euro area GDP).
3. Importantly the ECB has not imposed issuer limits on its PEPP package (€750bn), and Greece was included in the package (despite not being rated investment grade).

➢ **ECB could buy c6.7% of euro area GDP worth of bonds**: If we assume 75% of the QE will be allocated to PSPP, the ECB will be able to purchase nearly 6.7% of euro area GDP. That is close to our early euro area deficit estimation of 8%. To get EA countries estimates, we assumed the ECB will buy bonds according to the capital key. **In short, a large part of the stimulus will be financed by the ECB QE program.**



Source: Credit Suisse, ECB

4. Additional financing tools

- **The euro area is currently discussing additional tools to complement the euro area financing framework.** These tools are not needed immediately; the ECB has announced a large enough package to absorb the financial side effect of the shock. However, they may be needed in the aftermath of the crisis to ensure Europe's future credibility. Some of the tools currently being discussed:

  - **ESM credit lines**: this is an existing instrument which allows EA country to access cheap loans repayable in the future. Every country is liable for its share of authorised capital stock in the event of a default. The ESM lending capacity is €500bn out of which €400bn are currently available (€90bn is already being used by Spain, Greece and Cyprus). There are two forms of credit lines; 1) PCCL, members with sound financial and economic conditions are eligible, conditions are easy, and 2) ECCL, for members that do not comply with the PCCL eligibility criteria, and will be subjected to tougher conditions. Under the ECCL, countries may have access to the ECB OMT program (i.e. unlimited purchases of short end sovereign bonds). Two innovations are currently being discussed; increase the ESM lending capacity, and a change in the conditions attached to credit lines to be more politically acceptable.

  - **Coronabond (eurobond):** joint euro area debt issued by the EIB, for which all countries will be liable. This would be a new instrument that would effectively mutualise euro area debt. Although, this option has been favour by many EA countries (including France and Italy), it has faced strong push back from Germany and the Netherlands. We expect such a tool is unlikely to be created at this stage.

  - **Tensions could arise in Europe if countries failed to find common grounds on these topics.** PM Conte, in Italy, already warned that Europe could loose its purpose if it failed to manage to coronavirus crisis effectively. Nonetheless, we note that is an encouraging sign that several euro area governments different proposals to share the burden of dealing with the pandemic.

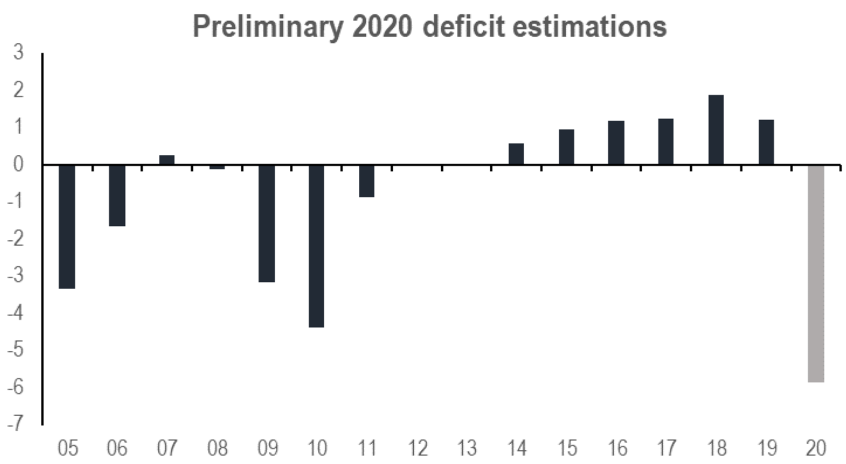
Germany fiscal response

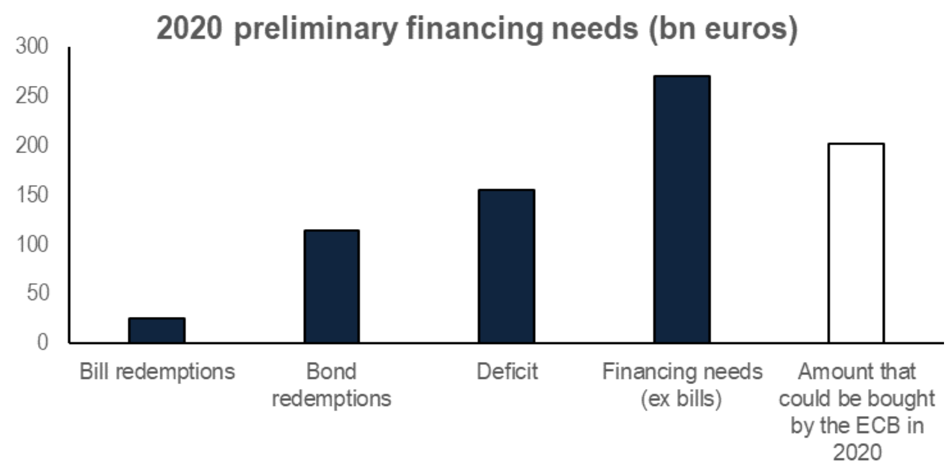
Fiscal response: €122.5bn in 2020, and tax revenues falling by €33.5bn, total borrow of €156bn (c4.5% of GDP)

- Deferred tax payments and social contributions. Temporarily suspension of certain parts of the bankruptcy law.
- Direct cash grants for smaller businesses ranging from €9,000 to €15,000 (€50bn) .
- Lower thresholds for companies to become eligible for short-time work. Companies can reduce workers' hours and pay, while the government compensates workers with around 60-67% of their usual net income. Firms can become eligible for this measure if 10% of the workforce is impacted (instead of 1/3 previously). Furthermore, the measure was expanded to temporary workers and the state will also take on the social contributions of the affected workers.
- Easier access to social benefits for impacted workers (€7.5bn) and increased spending in the healthcare system to buy PPE and support the development of a vaccine and treatment options (€3.5bn). Overall the state has allocated another €55bn to distribute at short notice if needed. Hospitals now facing higher costs will be supported by the state (€2.8bn)

State loan guarantees to sustain credit for businesses: €757bn to €1.3tril (22% to 38% of GDP)

- Loan programs offered by the state development bank KfW have been further increased by €357bn to €822bn and bureaucratic thresholds have been reduced. Additionally, interest rates have been lowered and the government will take on 80-90% of the risk instead of 50% previously.
- Fund to stabilize the economy; €100bn for capital injections, €400bn in guarantees, up to €100bn to refinance existing KfW loans.
- The government will also provide export guarantees in line with the measures implemented during the financial crisis.



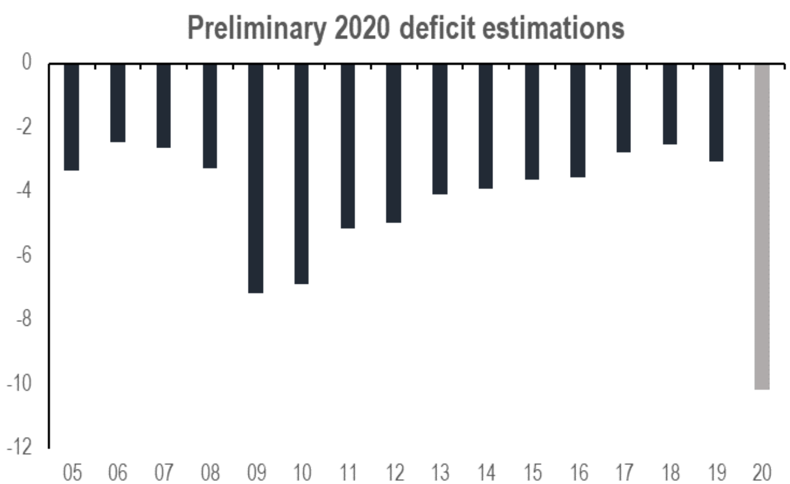


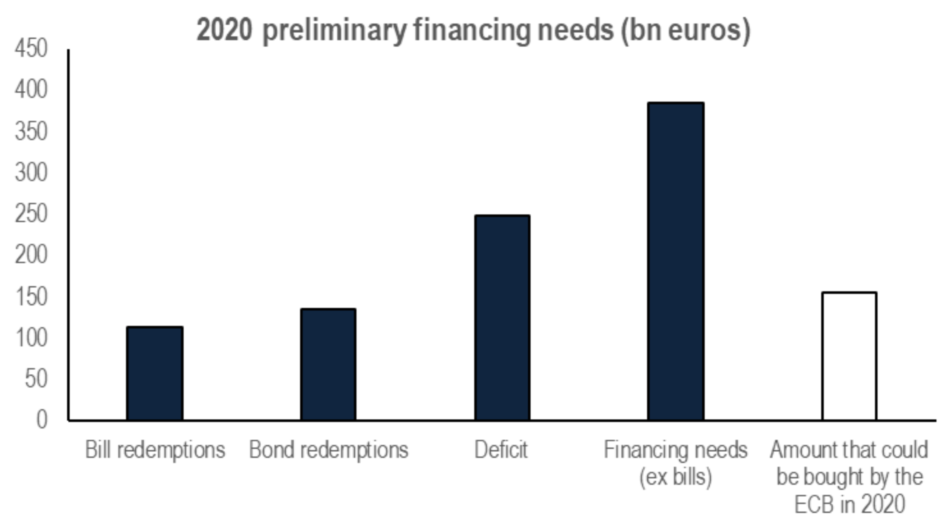
France fiscal response

<u>Fiscal response:</u> €45bn (1.9% of GDP) – €32bn for corporates and €8.5bn for workers

- Utility bills, rents social contributions and tax to be postponed for businesses.
- Companies most hit by the crisis to benefit from tax rebates (decided on a case by case basis).
- Aid of € 1,500 for all small businesses, self-employed, and micro-enterprises.
- Maintaining employment in companies by simplifying and strengthening the partial unemployment system; the application process was reduced from 15 days to 48 hours. In this scheme government compensates workers at 70% of their net income (84% of their gross). So far, 3.6 million workers have applied to the scheme.
- State and local government contracts will not apply any penalties for delay of payments.
- Companies will be allowed to pay tax-exempt bonus to workers.
- Banks have committed to postpone the reimbursement of corporate loans for up to 6 months.

<u>State loan guarantees to sustain credit for businesses:</u> €300bn (12% of GDP)





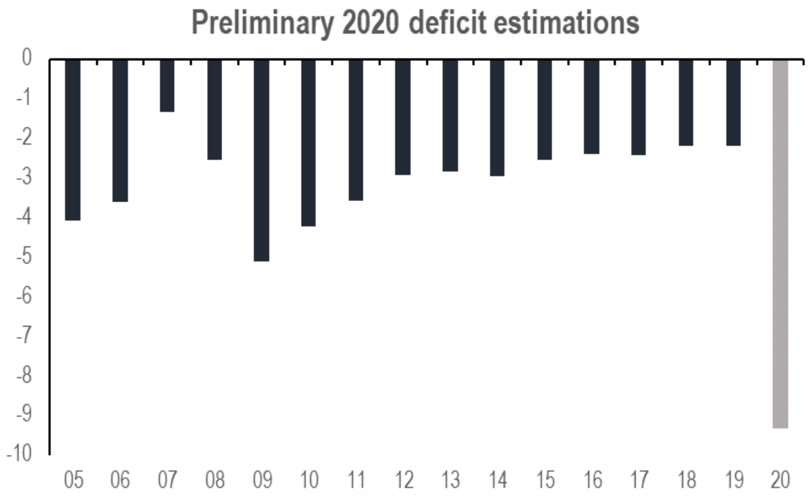
Italy fiscal response

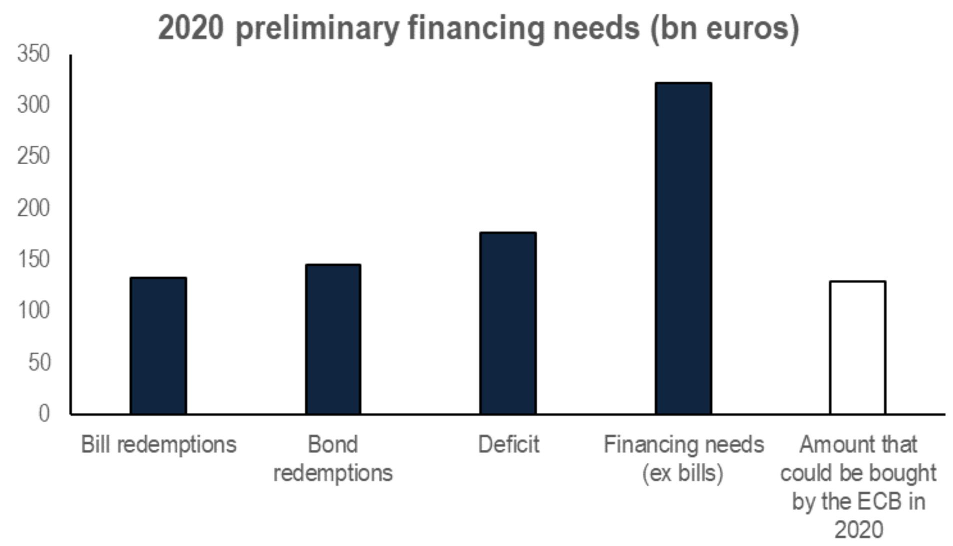
<u>Fiscal response:</u> €25bn (1.4% of GDP), the government should announce shortly a second fiscal package of c€25bn

- Additional funding for the health system (€3.2bn)
- Wage, families and self-employed (around €10.3bn) with; a wage fund (€1.3bn), support for employees that have to stay at home (€3.3bn), 600 euros for self-employed in March (€3bn), 15 days parental leave and a 600 euros baby-sitter voucher for children under 12 years old (€1.6bn).
- Credit and liquidity (€5.1bn), moratorium on loan (including mortgages and overdrafts) repayments for SMEs, incentives for financial and non-financial companies to transfer NPLs through the conversion of their Deferred Tax Activities into Tax Credits.
- Tax and social security payments due in March suspension. These include all businesses and self-employed with turnover below €2mn, as well as taxpayers belonging to sectors heavily hit by the emergency. Help the cargo and freight sectors affected by the crisis; the government provisioned €600mn for Alitalia.

<u>State loan guarantees to sustain credit for businesses:</u> €110bn (6% of GDP)

- SME guarantee fund will provide €100bn for SMEs.
- The Cassa depositi e prestiti (CDP) will provide state guaranteed loans up, to €10bn, for medium to large companies.



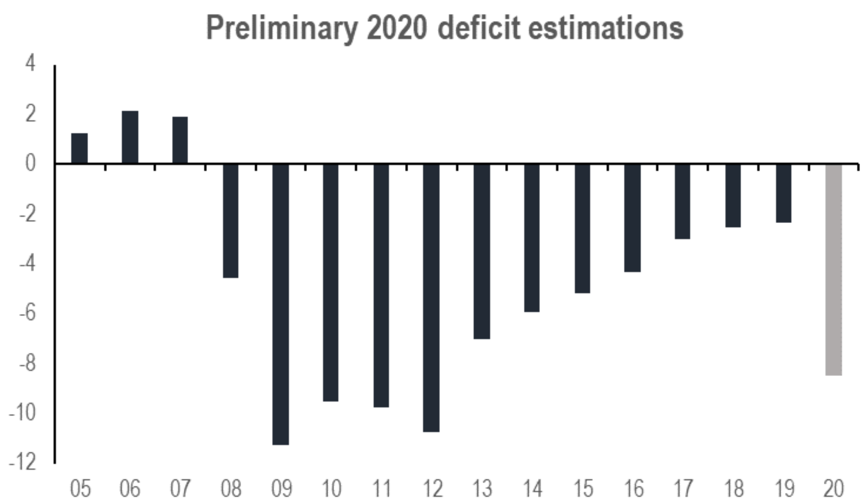


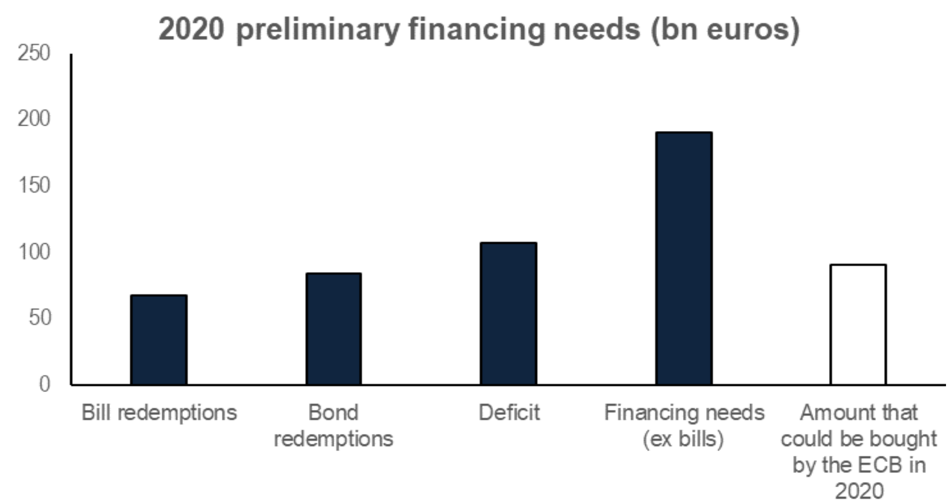
Spain fiscal response

<u>Fiscal response</u>: €18bn (1.5% of GDP) – the cost is probably already higher

- €18bn decree includes actions to strengthen the health sector, protect the well-being of families and provide liquid support to affected companies, particularly in the tourism sector and SMEs.
- Moratorium on the payment of mortgages for workers and self-employed which are impacted by the virus, 100% contribution exemptions for SMEs and 75% for other companies, as well as measures for elderly and vulnerable people.
- Conditions to temporarily lay off workers, under temporary employment adjustment schemes (ERTEs), have been eased. The government forbade firms to lay-off people because of Covid-19 and asked them to apply to the ERTE. Sick pay for Covid-19 infected workers or those in quarantined has been increased from 60 to 75% of their income. Companies that keep their workforce will be exempt from social security payments.
- €600mn have been allocated to provide basic social services.
- Government announced 50 additional measures (no cost estimate): banned evictions of vulnerable households, €700mn credit lines for rents, mortgage payment moratorium for self-employed which suffered loss of revenues, and home owners renting their property, allow workers to access their pension plans, €430 for temporary workers whose contract expired before the virus, social contribution delays for self employed and family workers.

<u>State loan guarantees to sustain credit for businesses:</u> €100bn (8% of GDP)

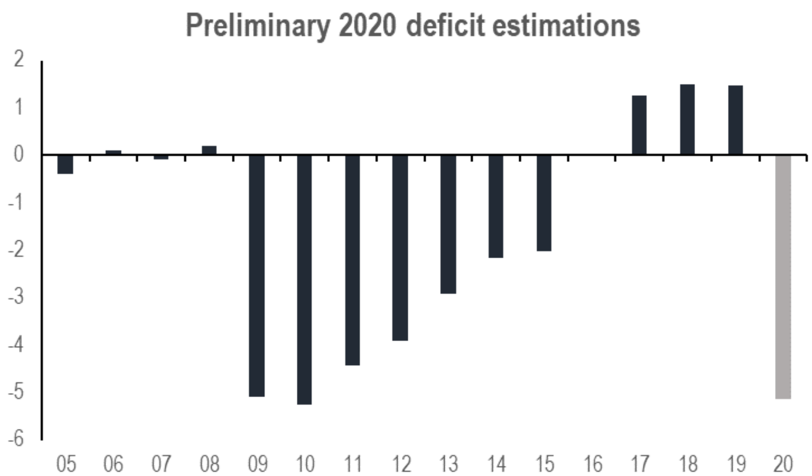


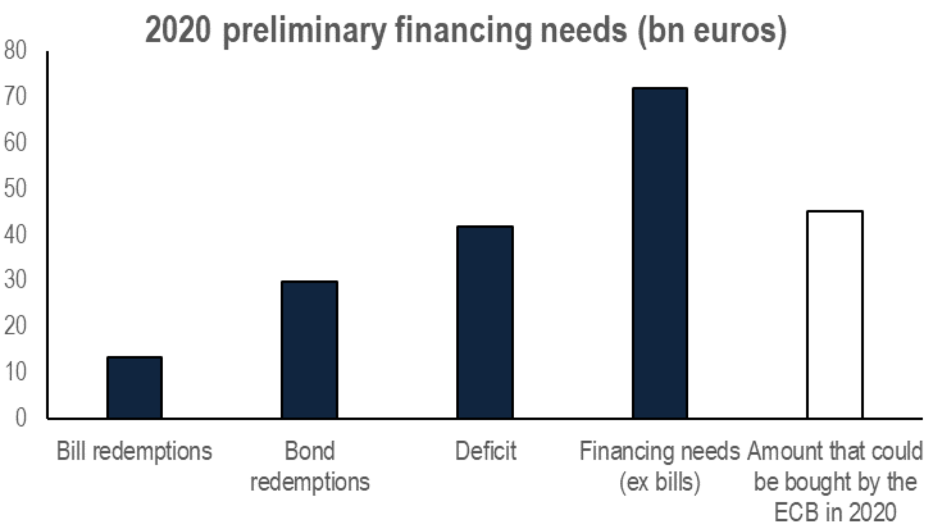


Netherlands fiscal response

<u>Fiscal response</u>: €10-20bn (1-2% of GDP)
- The state will compensate up to 90% of labor costs for companies seeing a 20% decline in revenues.
- Compensation for the most affected sectors (hospitality, travel, leisure, etc.).
- Support for self-employed and entrepreneurs.
- Unemployment benefit to be available for companies which need to reduce at least 20% of their staff.
- Firms most impacted by the virus will be able to request a revision of their tax bills.

<u>State loan guarantees to sustain credit for businesses</u>: Cost will depend on demand
- SME credit guarantee scheme (BMKB) for SMEs.
- Business loan guarantee scheme (GO) for medium and large companies.





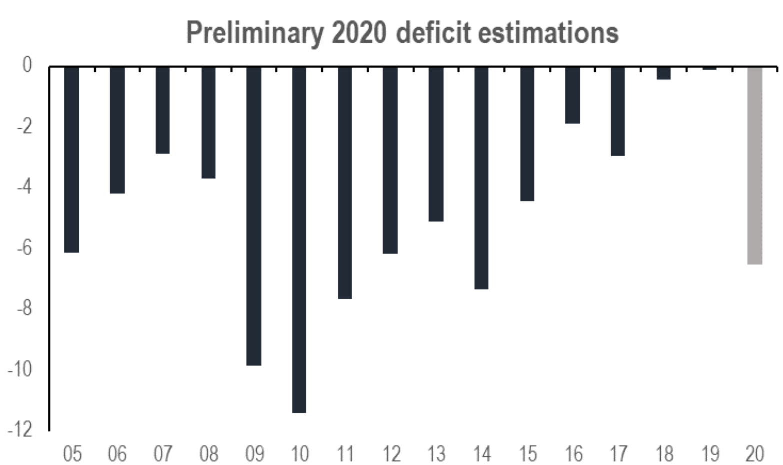
Portugal fiscal response

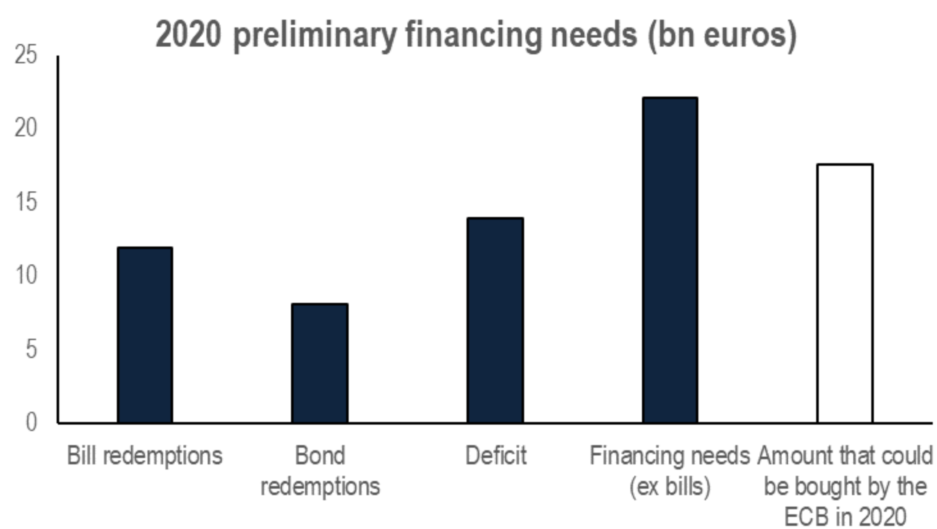
<u>Fiscal response</u>: €6.2bn (c3% of GDP)

- Tax deferrals for companies and employees.
- Relief of social security payments.
- Companies to delay loan payments.
- 6-month moratorium on homes loans (interest & capital) for households and very small, small and medium size companies.
- Lay-off rules simplified, for businesses which have suffered an exceptional drop in turnover of 40% or more in the span of up to 3 months.
- Additional resources to health system.

<u>State loan guarantees to sustain credit for businesses:</u> €3bn (c1.4% of GDP) – aims to expand to €7bn (waiting for the approval of the European Commission)

- State-funded credit lines to loan to companies affected by the virus will be split into 4 sectors; textile and clothing (€1.3bn), tourist developments (€900mn), catering & related sectors (€600mn), travel agencies (€200mn).



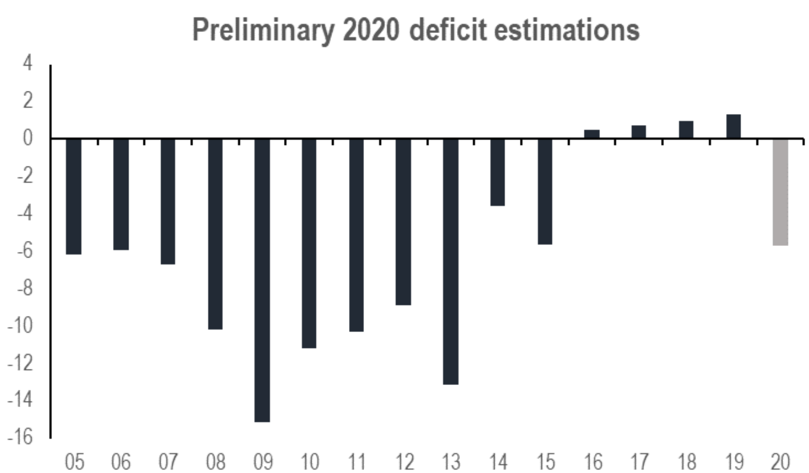


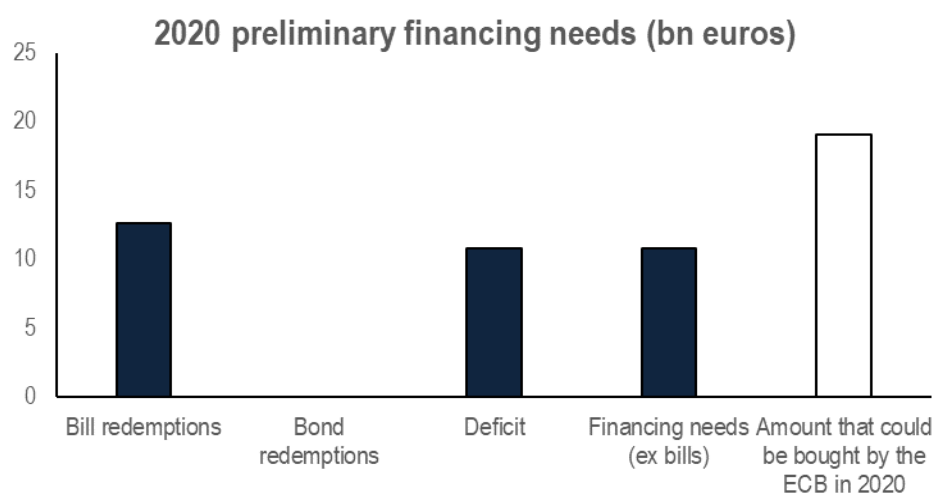
Greece fiscal response

<u>Fiscal response</u>: €6.8bn (c3.6% of GDP) – government working on a new package of €2-3bn

- €2bn should be granted to businesses and workers; 200,000 businesses will be able to delay taxes and social security contributions until July 31.
- Workers temporarily unemployed will be granted €800 in April and the state will cover social security and health costs.
- Self-employed workers will have no tax obligations for the next 4 months, and the most impacted businesses (forced to quarantine) will see their rents reduced by 60% in March and April.
- VAT and social security payments suspensions (4 months) for businesses impacted by the coronavirus.
- Suspension of payment of certified debts to the tax authorities.
- Additional funding for the health system (€ 200mn).
- €600 to high skilled freelance professionals to upgrade their digital skills (€180mn).

<u>State loan guarantees to sustain credit for businesses</u>: €1bn – government could increase the scheme to €6-12bn
Liquidity will be provided to impacted businesses through EU funds, state aid, etc.





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