Finanzgruppe
Deutscher Sparkassen- und Giroverband

Global pandemic and European solidarity

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After a few weeks of shutdown in many countries, a flattening of new infection rates is eagerly hoped for. A discussion about an exit from the containment measures has already broken out. To ask this question is in itself permissible. Early planning considerations for the gradual revival of economic activities may be made. However, this should not give the impression that the exit is imminent. No concrete dates can yet be given. The clear priority, for the time being, is to contain the number of cases. If the measures were withdrawn too early, a second wave could threaten to break out again, which could leave all hitherto efforts in vain. Such a backslash would ultimately increase economic costs even further. A certain amount of patience remains necessary for the time being.

In this newsletter, the international dimension and the dramatic effects in the multitude of affected economic areas are pointed out. Especially in the USA and many emerging markets, political measures to contain the pandemic are only being taken with delay. In the end, the economic slump there will be more severe than in Europe and Germany. Europe has built up reserves following the financial crisis. To further strengthen European solidarity, the Chief Economists of the Savings Banks Finance Group are now proposing a new supplementary path with "stabilisation bonds" to the European Stability Mechanism. This strengthens financial market stability and at the same time also shows solidarity in Europe and provides cohesion for the euro.

The uncontrolled outbreak in the USA

- ➔ The USA have meanwhile overtaken China and Italy in the absolute number of confirmed infections. And the increase in the US so far is mainly unchecked. The course set by the government at the federal level has been insufficient and inconsistent.
- ➔ The economic fallout from the corona crisis in the USA aggravating factor is that the country has less automatic stabilisers than many European countries. Unemployment insurance, continued payment of wages in the event of illness etc. are not as widespread in the USA compared to Europe. Parts of the population have no health insurance or lose this protection quickly with a job loss. And layoffs are becoming the norm in the USA fast. In regular times, this tempts the US labour market into high flexibility and efficiency. But in the current unique situation, this can aggravate the crisis. The income cycles are threatening accelerated collapse.
- ➔ The enormous fiscal stimulus package passed by the Congress in size of a trillion dollars has been decided across party lines. It is very important and necessary. The structurally missing automatic stabilizing forces but cannot completely replace them. The already seen, very strong and early onset of a rapid increase in initial applications on unemployment benefits is a serious warning sign for further escalations in the USA.

Emerging markets hit particularly deep

- ➔ The pandemic affects the world overall. Not only the industrialized countries are infected. Our attention should be more focused on developments in emerging markets and the developing countries around the globe. They often do not have equal medical and also not economic possibilities for action available compared to the industrialised countries to improve their social and support the economic structure in the crisis. Political instability here further exacerbates the mess, so that in addition to the direct health effects of the virus, further humanitarian disasters are imminent. In India, for example, the "shutdown" affects 1.3 billion people. Currently, the traffic infrastructure is collapsing, and to isolate the people is very difficult.
- ➔ On the other hand, for example, the Mexican government with prime minister Andreas Manuel Lopez Obrador have ignored the dangers of the virus for a long time. Fiscal policy is now correspondingly sluggish reactions. However, the Mexican central bank has acted. Like the Federal Reserve, the Banco de Mexico used the unscheduled meeting to cut the key interest rate on 20 March 2020 to now 6.5 per cent. The capital requirements for banks should also be loosened to avoid a credit crunch. The Mexican Peso's coming under pressure. The drop in oil prices is having a strengthening effect here. Thus, the central bank has balance between economic policy and currency stabilization.
- ➔ In some countries, such as Brazil, the government is even negateing the consequences of the pandemic. It is remarkable that in this country's supreme courts have been prohibited a government advertising campaign of the

Bolsonaro government in which the implications of the epidemic is downplayed.

- The currencies of Russia, Turkey and many African countries and other Latin American countries have been downgraded since mid-February, 2020. The pandemic is also hitting these countries through many channels and will lead to deep market downturns. The weaker currencies will make debt servicing more difficult for such countries with a high level of debt in foreign currency. The low oil price and lack of tourists are further factors for a world in an economic recession.

Europe: joint action and solidarity

- In Europe, all countries have drawn up different detailed plans to overcome the pandemic, but basically, they all aim in the same direction: social contacts are reduced, and economic activities are reduced to a minimum. Countries like Italy and Spain are particularly affected by Covid-19. The number of deaths is particularly high there. According to the Johns Hopkins University, there are currently 101.800 infected and 11.600 dead in Italy, 94.500 infected and 8.200 dead in Spain. In other countries, however, the spread of the coronavirus is delayed.
- The European Commission and the European Finance Ministers have now again emphasized at the beginning of the week, that on European level via Cohesion Funds, Structural Funds and unspent funds in sum 75 billion Euro in total this year is available. Also, the European Stability Mechanism (ESM) provides a "lending capacity" of 410 billion Euro. Therefore, the EU finance ministers have decided that each country may get as far as two per cent of its GDP within existing facilities of the ESM. This is an essential sign of European solidarity.
- This solidarity could be further strengthened if the pandemic continues. The health sectors in many countries in southern Europe in particular need support. It is therefore remarkable that yesterday Italian politicians launched a call for European solidarity based on the vote of nine European finance ministers in the FAZ. Solutions must be weighed and enforceable. At present, however, full communitarisation via corona bonds (euro bonds) does not appear to be able to achieve consensus. And unconditionally and without incentives, such construction would place too high a burden on the community, also in view of the time after this crisis.
- The chief economists of the Savings Banks Finance Group, therefore, propose as a compromise that can be achieved, with bonds with a limited maturity - new issues only until 31. 12. 2021 with a maximum maturity of 5 years - to live European solidarity. These “bonds for stabilisation” for the Euro area could be quickly and directly supported by the countries with high fiscal stability before the outbreak of the crisis. In Germany, such relationships and the underlying guarantees, for example with the Economic Stabilisation Funds and then transferred into the ESM in a little perspective.
- It should be examined whether the premium for the guarantee should be paid as a subsidy depending on the maturity could be granted to repay debts or to

strengthen investment. Also, it could be agreed that repayments will only be made reaching certain thresholds of GDP growth become necessary (analogous to the measures in the course of the Greece support).

➔ The main advantages of “bonds for stabilisation” compared to corona bonds are that such “bonds for stabilisation” are still clearly bonds mainly of the respective country. The guarantor eases refinancing and pricing for a limited time. The management of the issuing activity, the choice of instrument and also the marketing remain under the sovereignty of the country which issue the bond. This means that responsibility remains with the respective issuing country. We expect that the conditions for other issues will also be improved when the guaranteed funds are raised, thus providing significant relief in the crisis phase. Furthermore, it should be clear that the probability of default of the country claiming the guarantee will be lower. A positive side effect could be that the guarantee of the Federal Republic of Germany also opens up the possibility for the Deutsche Bundesbank to purchase these guaranteed bonds for the Eurosystem.

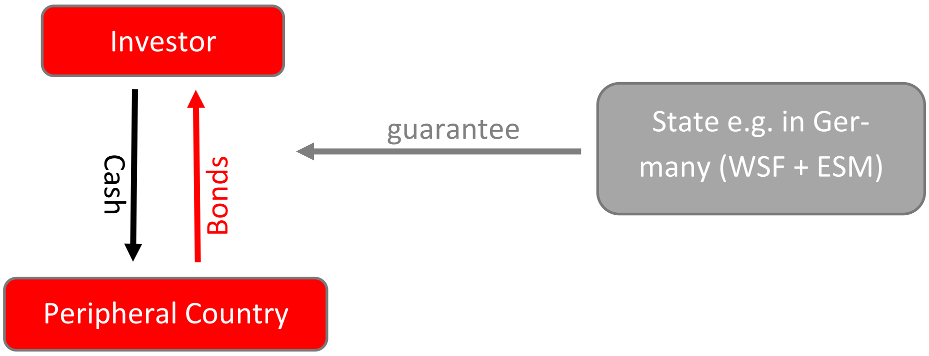
➔ Financially sound states could show based on such stabilising bonds solidarity. This would strengthen the crisis resilience of the whole euro area. There would be a stabilising effect on financial markets. This should be highlighted in the light of increased debt levels after the crisis, that Europe stands together and, unlike many other currency areas, the possibilities for reducing the crisis-related increased debt levels. In the attachment are the main elements of the proposal are summarised below.

Appendix:

Countries that had a high degree of stability before the crisis, help euro area periphery

Possible volumes using the example of Germany

Bn. Euro	Use
400	Euro area stabilisation bonds (included in Economic Stabilisation Fund, [WSF coupled with ESM]) possibly with conversion of the premium for guarantee as a grant + thresholds (GDP growth) for start of amortization Targets: Solidarity, debt repayment and investment



Guarantee to support refinancing on the capital market

Conditions for guarantee:
New issue of government bonds until 31.12.2021
Term of the guarantee limited to a maximum of 5 years
Maintenance of investment grade rating

Emissions:

April/May 2020 - 31.12.2021

Due to the date:

Max. 5 years from start of issue, i.e. max. 30.03.2025-31.12.2026

Source: LBBW

Disclaimer

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