COULD EU BONDS PROVIDE THE JUICE TO BOOST?

Wisdomtree EU
08 Dec 2020

With a vaccine in phase 3 testing, how could this impact the outlook for the real economy?

The prospect of viable vaccine solutions near-term provides more of a vision for an alternative measure to lockdowns and the economic impact will likely be seen late next year, and into 2022, but not necessarily for the next six months. European Central Bank (ECB) and government support will remain an important path to economic recovery in Europe[1]. On the one hand, one could conclude that the most severe scenarios are less likely now and we may be surprised to the upside in a number of sectors including European banks if we see the economy recover quicker than anticipated curbing the size of future loan loss on bank balance sheets. In this blog, we will briefly explore the state of the economic recovery in Europe and key measures the ECB and the European Union are taking during this crisis.

What is the ECB and European Union (EU) doing during this crisis that is different from the last crisis which can help the economy recover?

The ECB reacted very quickly early in the pandemic by launching the Pandemic Emergency Purchase Programme, also known as PEPP the asset purchase programme, which now has an envelope of 1.35 trillion Euros[2]. This has really helped support lower European government bond yields especially for countries such as Spain and Italy.

During the pandemic, the EU has also taken a huge step towards a more unified Europe by proposing to issue around 850 billion Euros of new EU bonds, joint union debt[2]. This is a massive issuance of new EU bonds nearly 16 times what is available today.

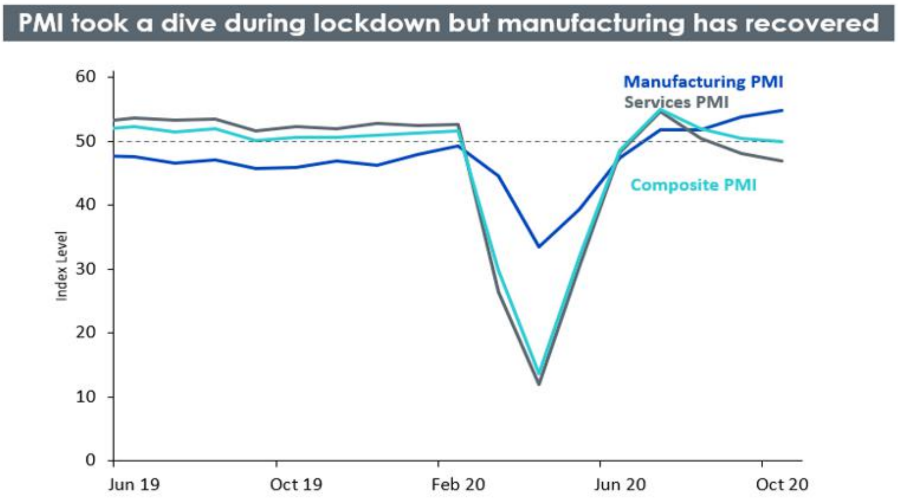
European Union bonds indicate a true union across the Euro-area in times of crisis and provide investors with AAA rated supranational bonds[2] that are not linked to one country and benefit from the support of all EU member states. One can draw a comparison of EU bond to US Treasuries in the United States.

What does Markit Eurozone Purchasing Manufacturers Index (PMI) data indicate about the shape of the recovery?

In Europe, we can note that services PMI is currently below 50 and contracting meanwhile manufacturing PMI has been holding up quite strongly above 50 and expanding. Please refer to Figure 1 below. In the US, the picture is currently expansionary for both services and manufacturing PMI. While the third quarter growth data from the Eurozone revealed a boost to growth compared to the second quarter 2020, renewed lockdowns across

Europe will certainly weigh heavily on growth for the fourth quarter and into the new year. The impact of the second lockdown on the economy is likely to be less severe than the first, which caused a -11.8% QoQ GDP[3] slump, given that manufacturing has been generally excluded from renewed lockdown measures thus far.

Figure 1. Markit Eurozone Purchasing Manufacturers Index data



Source: Bloomberg. Period is based on data availability and cover from 30 November 2017 to 31 October 2020. A reading above 50 is indicative of expansionary activity and a reading below 50 is indicative of contractionary activity.

Historical performance is not an indication of future performance and any investments may go down in value.

What is the status of EU bond issuance expected to support EU member states amid the pandemic?

The third issuance of EU bonds under the Support to mitigate Unemployment Risks in an Emergency (SURE) programme was sold to the market in November 2020 and once again received overwhelming demand from investors. It consisted of a single tranche due for repayment in November 2035. “There was very strong investor interest in this highly rated instrument, and the bond was over 13 times oversubscribed4.” According to the European Commission’s press release, 15 EU Member States have received €40 billion from the three issuances of EU bonds under the SURE programme in the period from late-October to end-November4. This is only the start of future EU bond issuance and the Commission has indicated additional issuance in 2021 with the maximum available ceiling of €100 billion under the SURE programme. The EU is also in final discussions for the approval of the Recovery Fund programme which is anticipated to have an EU bond issuance envelope of another €750 billion. Could this provide the necessary juice to boost?

Source

[1] https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in201122~3a68c446f1.en.html

[2] European commission website and https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/eu_en_10-2020.pdf

[3] Bloomberg, as of 30 November 2020.

[4] https://ec.europa.eu/commission/presscorner/detail/en/mex_20_2207#4

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