Recovery Fund: Gamechanger?

Summary

- EU leaders have agreed on a special recovery fund to combat the economic impact of Covid-19 via a mix of grants and loans.
- The plan breaks new ground as it includes mutualised debt issuance for the first time.
- Our net assessment: The outcome is supportive of our 12-month bullish EUR/USD view and preference for Euro area equities.

Background

- European Union (EU) leaders from all 27 members nations have agreed on a significant stimulus package to aid their economic recovery following the impact of Covid-19. The deal is subject to individual country parliamentary approval.
- The EUR 750bn special recovery fund has two significant characteristics. It will be financed mutually for the first time by AAA-rated European Commission bond issuance, as opposed to individual country bond issuance. Also, the dispersion of funds will include EUR 390bn of non-repayable grants, while the balance will be in the form of low interest rate loans.
- Grants will be provided to qualifying countries to boost their longer-term growth potential, support employment and improve longer-term economic and social resilience. Spending will conform to the EU’s environmental and digital policies and financing of the debt will include some new “green” taxes.

What does this mean for investors?

- We see this agreement as strongly positive for the EU on multiple levels. First, and perhaps most importantly, this plan is likely to be a “game-changer” as a possible first step towards closer fiscal integration across the EU, a factor often cited as a weakness of its approach to economic policy. Second, the size and composition of the plan should have a positive impact on economic growth. Third, the commitment and process behind this agreement should strengthen confidence in the EU’s ability to act in a more unified way going forward.
- We have a bullish 12-month view on EUR/USD, and this agreement reinforces this view. We believe the USD long-term uptrend is peaking and the EUR is likely to become a favoured USD-alternative. We expect strong support between 1.1170 and 1.1350 to hold as the pair tests the March high at 1.1495, targeting 1.16 initially and then 1.1820.
- We also view Euro area equities as preferred (ie. expect them to outperform global equities) on a 12-month horizon, expecting a “catch-up rally” given they have lagged global equities recently. The region’s equities should benefit from increased direct spending from the recovery fund as well as foreign flows. For Euro Stoxx 600, we see technical targets at 400 and then the February high at 434, while 345 should now act as support.

More upside likely for EUR/USD following recovery fund agreement given the bullish technical context

EUR/USD with key technical levels

Source: Bloomberg, Standard Chartered

Euro area equities remain preferred

Stoxx 600 with key technical levels

Source: Bloomberg, Standard Chartered
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