# Key take-aways from this morning's European agreement

Dear all,

In case of interest, these are my key take-aways from the European agreement announced in Brussels early this morning:

- It's a massively positive agreement, politically and economically (in spite of several small bits and pieces which I don't like much. But, as they say, politics is the art of compromise). The deal has strengthened the German-French leadership of Europe, it has demonstrated a great deal of solidarity, and it'll provide substantial fiscal stimulus – particularly to the most vulnerable EU members – during the critically important recovery phase of 2021-23.
- Also, in my assessment, this agreement may be the first clear sign of the benefits to the EU of Brexit. I strongly doubt that the EU could have reached a deal of this magnitude with the UK as part of the EU. London would have demanded a myriad of opt-outs, which the Frugal Four might well have attached themselves to.
- The agreement now goes to the European and national parliaments for approval. I see little doubt that it'll be approved and becoming effective from the beginning of next year, as intended.

My key take-aways in bit more detail:

**Politically:**

- It's a huge positive signal that Europe is willing to address common issues collectively, and that there is a great degree of solidarity. The pandemic was the trigger (and a driving force), but the real deal is around the common approach to common challenges, including digitalization and ESG. As I wrote in my note yesterday, this is the biggest European initiative since the Single Market was introduced almost 30 years ago.
- While clearly a "one-off deal", it is very likely indeed that it'll end up inspiring further thinking of common fiscal instruments for common objectives in the future. If not before, then up to the 2028 next multi-year budget, when resources will have to be identified to begin to repay the EUR 750bn. Possible "own resources" are mentioned. Part of this will no doubt be new (additional) taxes on e.g. digital industries and non-renewable stuff like plastic and carbon more broadly. But we also know that corporate taxation will be on the table – harmonisation and, ultimately, the transfer of such taxation to a common level.
- Merkel and Macron are the big political winners. With just two months passed since their "500bn grant plan" was announced, the speed has been nothing less than stunning – and it shows what can be achieved when Germany and France get together to lead Europe.
- Other key political winners include Italy, which is now becoming a net financial beneficiary; no doubt an objective for Merkel and Macron from the start to help slow/stop any anti-EU movement in Italy.
- On the issue of "conditionality" for policy reforms and adherence to the "rule of law". For policy reforms, I see Southern Europe (and common sense) as "winner" as the so-called "Emergency Brake" will surely turn out to be toothless. Yes, anyone can bring a debate to the Council of lagging (lacking?) reforms in another country, but the European Commission will be the final decision maker on disbursements. For the adherence to the rule of law, I see "Western Europe" as winner, and those challenging the boundaries of liberal democracy, including Hungary and Poland, as losers. Remember, that presently the Copenhagen Criteria ("rule of law") can only be used to stop payments with a unanimous-minus-one decision (i.e. unanimous decision among everyone but the country in case), and Poland and Hungary

have to a large extent protected each other in this regard. For the EUR 750bn package, however, payments can be stopped for breaching "rules of law" criteria with a "weighted average".

- The European Commission is also a "winner", as it'll all be anchored in the Commission. There were three alternatives to this deal: (i) An Inter-governmental agreement "among the willing", which – I understand – was threatened along the way, and you'll have heard von der Leyen explicitly expressing relief that this didn't happen; (ii) considerable more (coordinated) national fiscal stimulus, which would have led the ECB to further expand its balance sheet; (iii) nothing, leading to considerably weaker – and more differentiated – recoveries, and, quite possibly, political trouble in some countries.
- The key losers: The UK (which will have no influence on key European policy priorities with big impact on the UK down the line), and the much-loved (by the North) rules-based EU, as the frugals demanded (and got) special budget rebates, ala Thatcher. for their support.

**Economically:**

- All of the EU will be winners because this is NOT a zero-sum game. It'll have a relative small effect in 2021, but more material during 2022-23 when most of the disbursements will take place. We'll need a bit more details before we put numbers on this. (The Credit Rating Agencies will also take some time to digest this, but Fitch has already said that the package will limited the otherwise expected deterioration of public finances from 2021.)
- The headline number of EUR 1.8 trillion is misleading. The normal (and, unfortunately, mostly unreformed) Multi-year EU budget of EUR 1.1 trillion is your normal "reallocation" of about 1% of GDP between countries and sectors. The important thing is the EUR 750bn, which will be fiscal stimulus during the next three years, roughly to the tune of 1 3/4% of GDP in stimulus for each of those years, on top of what the national budgets do. (In reality, the stimulus will be a bit less and stretch over a few more years, as some of the commitments in 2022-23 will only get fully disbursed in the following years.) This EU-funded stimulus is particularly important as it's becoming evident that we'll need stimulus for several years to get GDP levels back to where they would have been without the crisis. As such, this package will help tremendously in particularly Southern Europe and the CEE.
- I see a lot of huffing and puffing today among the usual euro-sceptics on the cut in the research budget and in money allocated to climate change, but you need to keep proportions in mind. These are cuts on the order of a few billion euros (up to EUR20bn cut for climate matters) – regrettable for sure, but in a EUR750bn operation with EUR 390bn in grants, I fail to get too worried about cuts or reallocation of EUR 20bn.

Best

Erik

**Erik F. Nielsen**, Global Head of CIB Research, Group Chief Economist (UniCredit Bank, London)
+44 207 826-1765
erik.nielsen@unicredit.eu

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k) UniCredit Bank Romania, Bucharest 1F Expozitiei Boulevard, 012101 Bucharest 1, Romania. Regulatory authority: National Bank of Romania, 25 Lipscani Street, 030031, 3rd District, Bucharest, Romania

l) UniCredit Bank AG New York Branch (UniCredit Bank, New York), 150 East 42nd Street, New York, NY 10017. Regulatory authority: “BaFin“ – Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany and New York State Department of Financial Services, One State Street, New York, NY 10004-1511

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## UniCredit Research*

## Macro Research


**Erik F. Nielsen**
Group Chief Economist
Global Head of CIB Research
+44 207 826-1765
erik.nielsen@unicredit.eu

**Dr. Ingo Heimig**
Head of Research Operations
& Regulatory Controls
+49 89 378-13952
ingo.heimig@unicredit.de


### Head of Macro Research


**Marco Valli**
Head of Macro Research
Chief European Economist
+39 02 8862-0537
marco.valli@unicredit.eu


### European Economics Research


**Dr. Andreas Rees**
Chief German Economist
+49 69 2717-2074
andreas.rees@unicredit.de

**Dr. Loredana Federico**
Chief Italian Economist
+39 02 8862-0534
loredanamaria.federico@unicredit.eu

**Stefan Bruckbauer**
Chief Austrian Economist
+43 50505-41951
stefan.bruckbauer@unicreditgroup.at

**Tullia Bucco**
Economist
+39 02 8862-0532
tullia.bucco@unicredit.eu

**Edoardo Campanella**
Economist
+39 02 8862-0522
edoardo.campanella@unicredit.eu

**Walter Pudschedl**
Economist
+43 50505-41957
walter.pudschedl@unicreditgroup.at

**Chiara Silvestre**
Economist
chiara.silvestre@unicredit.eu

**Dr. Thomas Strobel**
Economist
+49 89 378-13013
thomas.strobel@unicredit.de


### International Economics Research


**Daniel Vernazza, Ph.D.**
Chief International Economist
+44 207 826-7805
daniel.vernazza@unicredit.eu


### EEMEA Economics Research


**Dan Bucşa**
Chief CEE Economist
+44 207 826-7954
dan.bucsa@unicredit.eu

**Gökçe Çelik**
Senior CEE Economist
+44 207 826-6077
gokce.celik@unicredit.eu

**Mauro Giorgio Marrano**
Senior CEE Economist
+43 50505-82712
mauro.giorgiomarrano@unicredit.de

**Artem Arkhipov**
Head, Macroeconomic Analysis
and Research, Russia
+7 495 258-7258
artem.arkhipov@unicredit.ru

**Hrvoje Dolenec**
Chief Economist, Croatia
+385 1 6006-678
hrvoje.dolenec@unicreditgroup.zaba.hr

**Dr. Ágnes Halász**
Chief Economist, Head, Economics and
Strategic Analysis, Hungary
+36 1 301-1907
agnes.halasz@unicreditgroup.hu

**Ľubomír Koršňák**
Chief Economist, Slovakia
+421 2 4950 2427
lubomir.korsnak@unicreditgroup.sk

**Anca Maria Negrescu**
Senior Economist, Romania
+40 21 200-1377
anca.negrescu@unicredit.ro

**Kristofor Pavlov**
Chief Economist, Bulgaria
+359 2 923-2192
kristofor.pavlov@unicreditgroup.bg

**Pavel Sobíšek**
Chief Economist, Czech Republic
+420 955 960-716
pavel.sobisek@unicreditgroup.cz


**UniCredit Research, Corporate & Investment Banking, UniCredit Bank AG, Am Eisbach 4, D-80538 Munich, globalresearch@unicredit.de**
**Bloomberg: UCCR, Internet: www.unicreditresearch.eu**

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