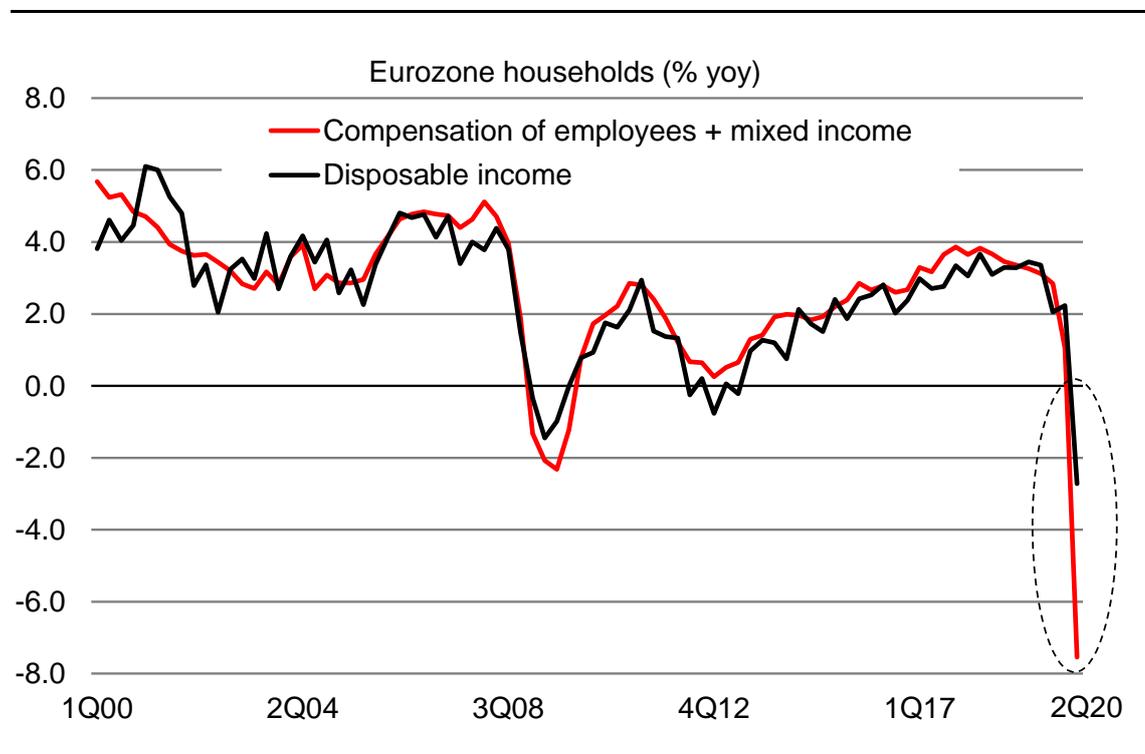


Central banks concerned about fiscal cliff effects



Source: Eurostat, UniCredit Research

- Yesterday, ECB President Christine Lagarde sounded concerned that the latest restrictions to contain the spread of COVID-19 might derail the eurozone recovery, calling for a continuation of fiscal support to avoid the risk of cliff effects. On the other side of the Atlantic, Fed Chair Jerome Powell has been arguing for some time that the US economy needs further fiscal aid and markets certainly did not like it when Donald Trump announced yesterday that he was ending negotiations with the Democrats in Congress on a fiscal package. Our *Chart of the Week* highlights the key role played by government measures in supporting the purchasing power of eurozone households during the first wave of the pandemic.
- The chart shows that over the two decades until the pandemic hit, the disposable income of eurozone households, a proxy for their purchasing power in nominal terms, moved hand in hand with labor compensation (including mixed income, i.e. self-employment income). This tight correlation remained intact during the credit and sovereign debt crises, but has broken down in the wake of COVID-19. The reason seems to be that although labor income was hit massively when many workers were put on furlough schemes, the ensuing drag on disposable income was largely mitigated by a strong increase in fiscal transfers and benefits, as well as automatic stabilizers (i.e. lower taxes) and tax deferrals.
- The resilience of disposable income together with the collapse in mobility and spending caused by the lockdown also explains why the savings rate of eurozone households surged to almost 25% in 2Q20, twice the pre-pandemic level. The speed at which the savings rate returns to normal will be one of the most important drivers of the future trajectory of GDP growth.
- As governments worldwide face the choice of whether to extend, recalibrate or discontinue some of the stimulus measures activated at the peak of the pandemic, major central banks will continue to do their part by “controlling” yield curves and, thus, preserving favorable financing conditions for the public and private sectors. Ms. Lagarde’s call to governments and ECB Chief Economist Philip Lane’s latest explicit remarks (“the less

costly and more prudent approach is to add sufficient extra monetary policy accommodation to boost inflation momentum”) further increase the likelihood that the ECB will announce an expansion and extension of its pandemic emergency purchase program (PEPP) before the end of the year.

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This report was completed and first published on 7 October 2020 at 15:51.

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