

EURO SHRUGS AS EUROPEAN LEADERS REACH HISTORIC DEAL FOR RECOVERY PACKAGE

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After a marathon negotiation session, EU leaders have finally unanimously approved a fund consisting of € 390bn of grants and €360bn of low-interest loans.

The total size of the seven-year EU budget is €1047bn, as proposed by EU Council President Charles Michel. The "frugal four" countries opposed to the disbursement of funds as grants were given boosts to rebates on their contributions to the EU budget.

The bulk of the €90bn in grants will be used to fund a Recovery and Resilience Facility.

Italy and Spain are likely to receive large shares of the grants, as high as 70-80bn, and although the exact disbursements are not yet clear, money will be allocated on the basis of the economic harm done by the pandemic. A dispute mechanism has been included, in the event that a grant recipient does not comply with reform commitments - although the European Commission will ultimately adjudicate disputes.

The euro is trading water this morning despite the historic nature of the EU recovery fund, in a classic case of "buy the rumour, sell the fact". The writing was on the wall for some type of deal with substantial grants as early as May, when Angela Merkel and Emmanuel Macron made a public joint proposal for mutualised debt to fund grants. Markets correctly predicted the outcome of the last couple of weeks of horse trading with the "frugal four", and traded the euro higher accordingly.

“ Although euro traders priced in the development weeks or even months ago, the significance of today's deal is hard to overstate: there will finally be a joint European debt instrument. Although the €750bn package may be relatively modest in comparison to fiscal stimulus in the US, this is besides the point. ”

A mutualised debt instrument allows governments such as Italy and Spain to deploy recovery funds without further stressing their debt sustainability. More importantly, it sends a signal to markets that the European Union remains willing to evolve in response to existential threats, and that in future crises the Union may be less reliant on unilateral heroics from the European Central Bank.

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