

US versus eurozone: 'I did it my way'

In this article, we compare the US and eurozone policy response and explore potential differences in the recovery phase



Harder, Better, Faster, Stronger

The monetary and fiscal response to the Global Financial Crisis more than a decade ago was unprecedented, but the scale of intervention in the current crisis and the speed with which it has happened is even more impressive. Within a month, trillions of dollars and euros have been provided in direct payments, asset purchases, liquidity injections, loans and guarantees. This aggressive response offers hope that while this recession will be far deeper than the GFC, the lost output might be recovered more quickly.

Back in the GFC, the policy reaction in the US was much swifter and stronger than in Europe. In the current crisis, European policymakers seem to have learned their lesson and reacted quickly, even though some still criticise the lack of a strong pan-European fiscal answer. Will the US economy again emerge faster and stronger from this crisis than the eurozone?

Hey Big Spenders

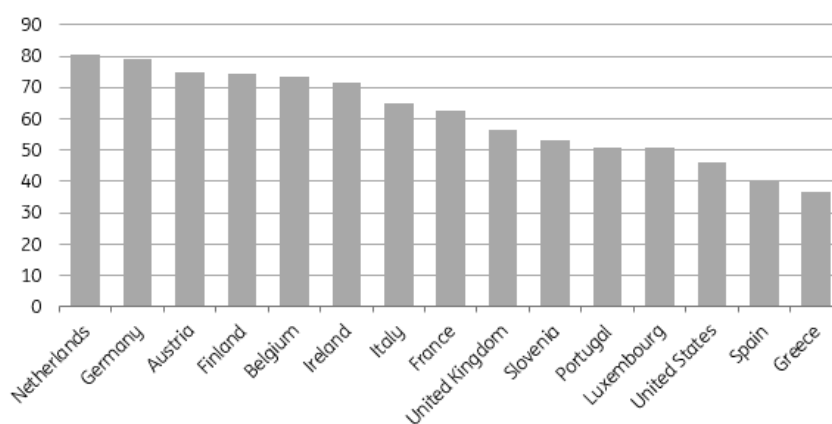
The US fiscal package amounts to around 15% of GDP (half direct spending, half loans and guarantees) while the Federal Reserve has expanded its balance sheet by \$2.4 trillion since early March. The Fed's response has succeeded in calming financial market tensions which is critical

given the US corporate sector is more orientated to obtaining financing through credit markets and we are currently seeing record debt issuance.

Eurozone governments have not been thrifty, either. On average, national governments have announced fiscal stimulus of some 3% of GDP and liquidity support of some 16% of GDP. The ECB has increased its balance sheet by 13% since early March. While the total numbers look similar, the eurozone's disadvantage is that fiscal packages differ significantly across countries, ranging from more than 30% of GDP in Germany to some 4% in Greece. Also, the share of direct 'cash-out' fiscal stimulus is relatively small in most eurozone countries. To be sure, the automatic stabilisers are on average more important in Europe than in the US. However, this seems especially the case in the core countries and much less so in the South.

The importance of automatic stabilisers

Note: The percentage share shows by how much the income decline is offset by automatic stabilisers one year after the shock



Source: OECD, ING

Working Man Blues

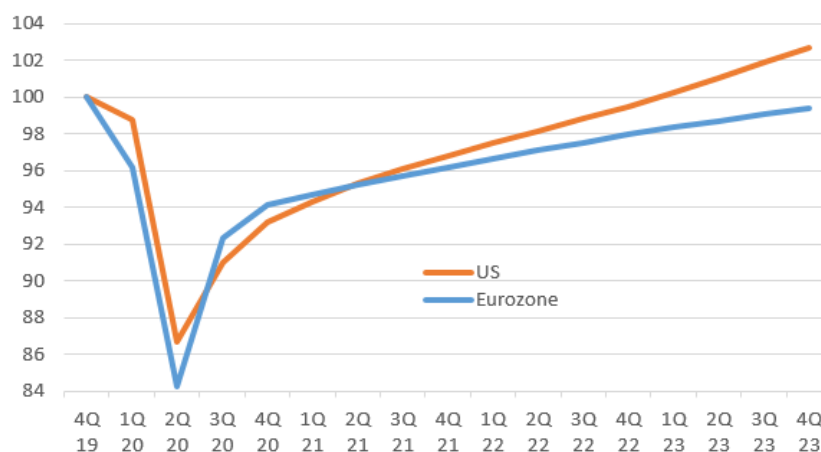
Direct payments to households and improved unemployment benefits should help to tide US households over until the economy reopens and jobs return. However, the US isn't in pole position for everything. Europe's furloughing schemes will ensure more workers keep their jobs and incomes, which could translate into a better environment for growth as lockdowns end and people return to their places of employment.

Much higher US unemployment means more household anxiety and may contribute to a slower rebound in spending initially. European short-term work schemes have an enormous cushioning effect, at least if the crisis doesn't last too long and demand picks up quickly afterwards. That said, the longer the crisis lasts, the higher the chances are that short-term work schemes are just a waiting room for unemployment.

The fact that consumer services and the energy sector are far more important to the US economy could also hinder the initial recovery path relative to Europe. Restaurants, bars and travel, for example, are likely to be far more restricted by social distancing constraints than other parts of the economy, limiting the scope for a sharp recovery. At the same time the oil glut and plunging prices will limit investment and jobs in a sector that was worth 2.5% of the US economy in 2019.

But while the eurozone on average might be less dependent on consumer services, that is not the case for every member state. In the South, tourism is a large chunk of the economy, a sector which is especially vulnerable to the Covid-19 fallout. Also, the eurozone is much more exposed to international trade, an activity also hampered by the pandemic. While we see international trade recovering in 2021, which is likely to give the eurozone a temporary lift, it could take much longer before things get back to normal, as the deglobalisation forces will most probably have been bolstered by the current crisis.

US versus eurozone GDP profile (4Q 2019 = 100)



Source: ING

It's a marathon, not a sprint

The Covid-19 crisis has hit the US economy where it is arguably most susceptible: health, where the most vulnerable workers are the most exposed. It also seems as if the crisis has hit the richer and economically stronger states the most, contrary to what is happening in Europe. With an easing of the lockdown measures having started earlier in some countries, the eurozone could emerge from the crisis faster and possibly even stronger than the US. However, it would only be a sprint start in what will be a long marathon .

As the initial hit to the economy was likely bigger in Europe than in the US, in a first instance, the phasing out of the lockdown measures will automatically lead to optically stronger growth in Europe. In 2021 however, higher potential growth in the US should also lead to more dynamic growth than in the eurozone. Let's not forget that the eurozone was already struggling with a structural growth problem before the Covid-19 crisis erupted, because of its less favourable demographics and dwindling productivity growth. Those problems could even be exacerbated by the current crisis as investment is likely to take a big hit.

On top of that the eurozone's problem will once again be the significant divergence across countries. History could repeat. After the GFC, the US economy had returned to its pre-crisis level after 14 quarters, while it took the eurozone 29 quarters. However, the eurozone number masks that Belgium, France and Germany were faster than the US, while for e.g. Spain it took 35 quarters to regain its pre-crisis production level and today Italy still has lower GDP than it did in 2007!

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

James Knightley

Chief International Economist, US

james.knightley@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.