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?

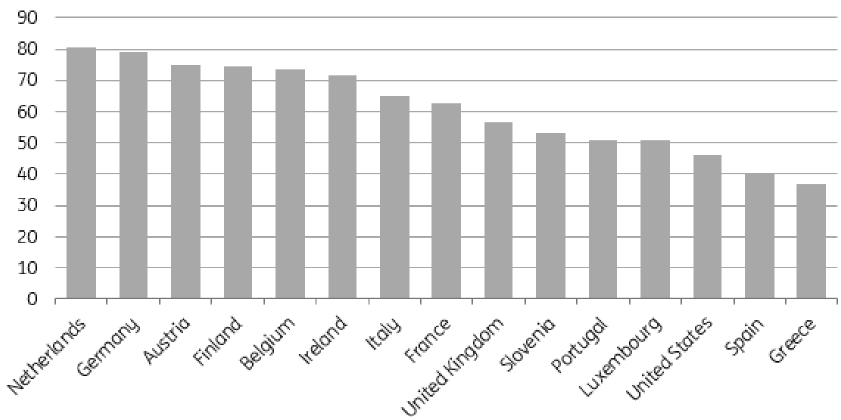
Hey Big Spenders

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

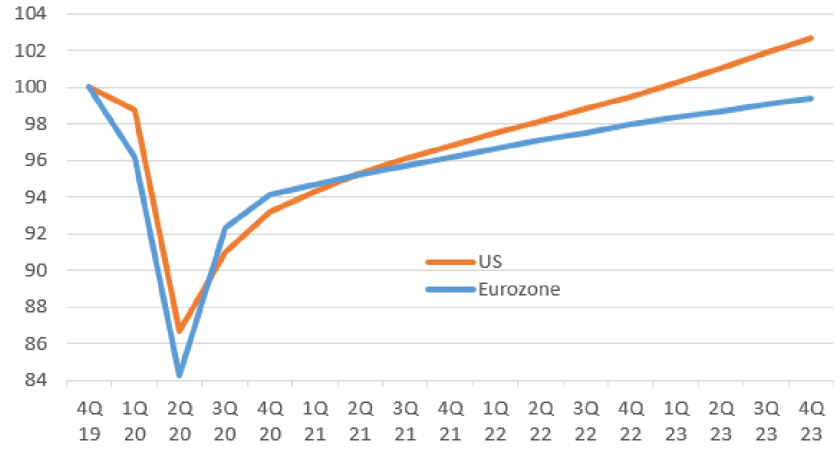
Direct payments to households and improved unemployment benefits should help to tide US households over until the economy reopens and jobs return. However, the US isn't in pole position for everything. Europe's furloughing schemes will ensure more workers keep their jobs and incomes, which could translate 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!

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