AURORA

Europe Chartbook – 2Q24: Return to Politics, Return to Growth

June 6, 2024

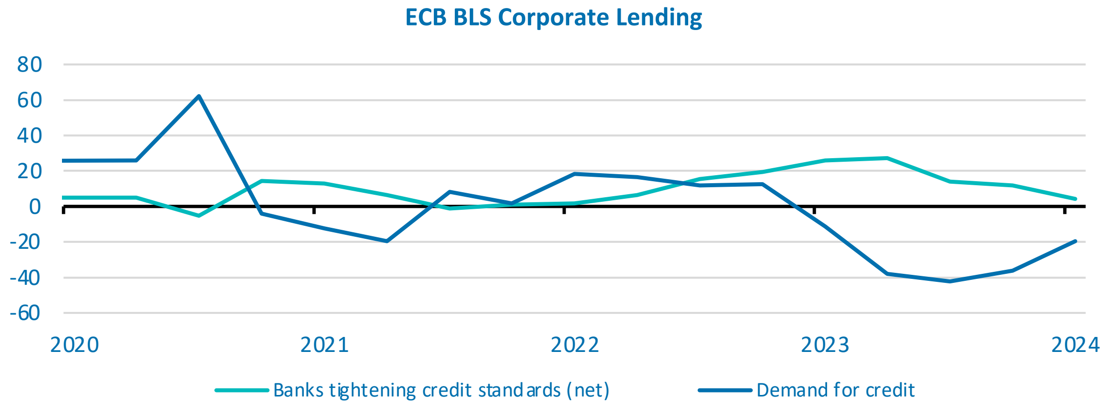
EU 2Q24 Update: On the growth runway

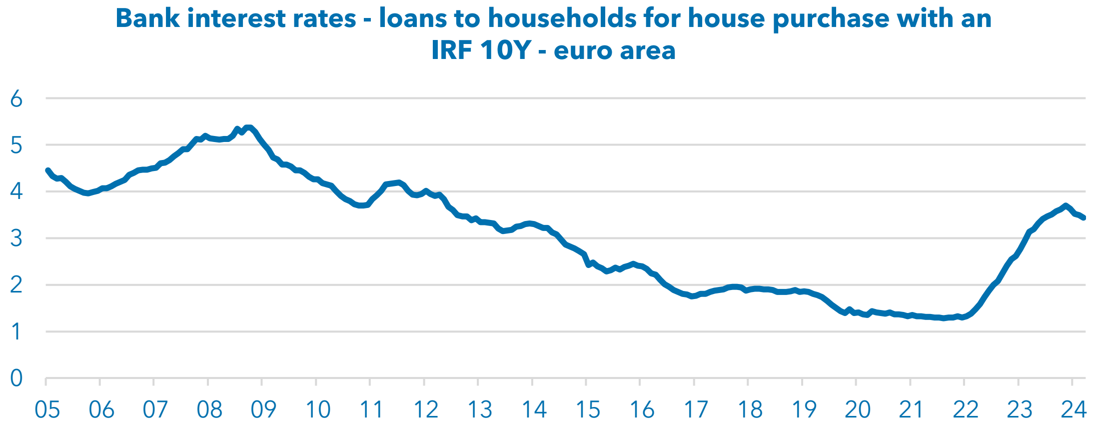
1. We are **cyclically optimistic** on the Eurozone economy—as expected in our 1Q update, growth has returned and the trend is likely to persist.
2. **French political upheaval** is bad news for the country, and we think OAT spreads have further to widen. But contagion seems limited.
3. The ECB cut rates at its latest meeting, delivering badly-needed impetus to credit creation—the key growth variable in the EU.
4. **The European elections** will not lead to significant policy change—save for a weakening of resolve on climate issues.
5. Following the EPP's clear victory, we still expect **von der Leyen** to be reappointed as Commission President.
6. The U.S. elections may end up being more consequential, forcing the EU to adopt a **more assertive role in trade and defense**.
7. **Fiscal headwinds** will remain, capping the EU's growth potential. The European Semester will come back to the fore.
8. Over the medium term, the **main risk is non-renewal** of NGEU and associated issuance.

Jun 27-28	European Council meeting
Jun 30	**French Legislative Election**
Jul 02	HICP – Flash
Jul 04	**UK General Election**
Jul 07	**French Legislative Election**
Jul 15	**Eurogroup Meeting**
Jul 18	**ECB Meeting**
Jul 23	Flash Consumer Confidence
Jul 31	HICP - Flash
Aug 14	Q2 GDP - Prelim
Sep 01	**Germany Sachsen, Thüringen elections**
Sep 12	**ECB Meeting**
Sep 13	Job Vacancies – Flash
Sep 22	**Germany Brandenburg elections**

The ECB cut rates, putting an end to the long winter of European de-leveraging. Monetary policy is about to be politicized.

- In line with our expectations, the ECB moved to cut rates in June, well ahead of the Fed.
- It was sorely needed: the latest Bank Lending Survey indicated that banks had broadly stopped tightening standards (a process that began in 2022)–but demand remains tepid--a trend that started in 2023.
- Substantially higher mortgage rates cooled household borrowing as well.
- In contrast to the U.S., the EU did experience a hard landing: lowering inflation was in part accomplished by crushing demand.
- After June, we expect two more cuts: one in September and one in December. Thus, we are slightly more dovish than the market.
- Following the French elections, interest rates will become more politicized, upping the pressure on the ECB to cut.

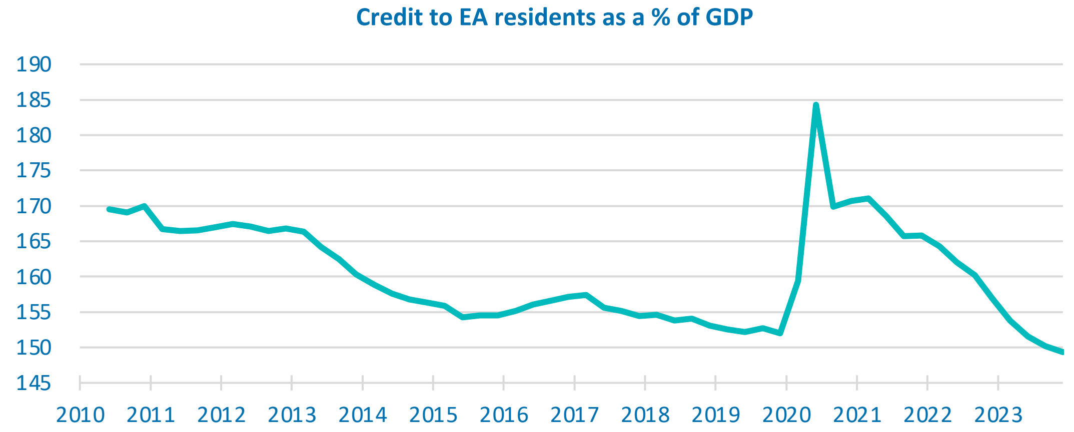


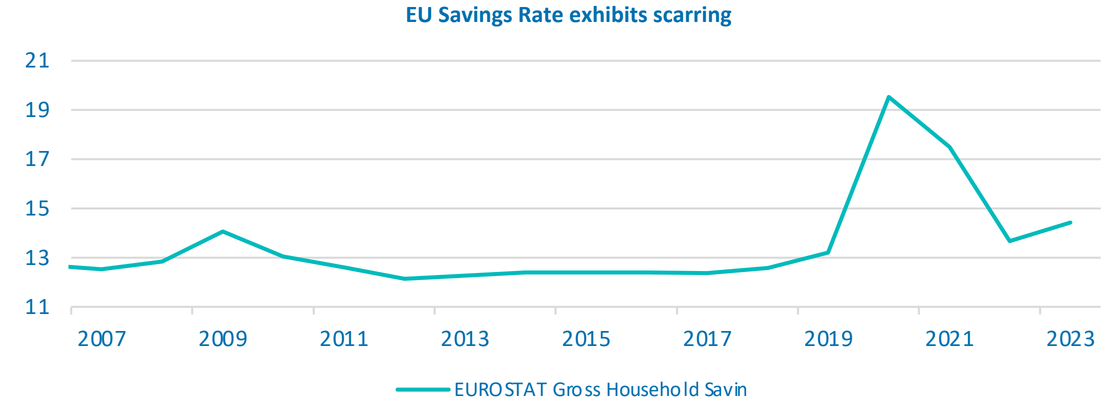


Source : BLS and Eurostat

The good news is that an underlevered private sector should permit an easy acceleration to growth—above current low-ball estimates.

- Unlike in the U.S., in Europe the long pandemic left households and corporates scarred and underlevered.
- Total bank credit to non-financial corporates is at post-2008 lows.
- Meanwhile, the household savings rate remains substantially higher than pre-COVID—in sharp contrast to the U.S.
- The flipside is that this situation leaves much low-hanging fruit for growth once financial conditions ease.
- As rates subside and real wages pick up, we expect consumption growth to rebound strongly—above market consensus estimates of 1% and closer to the pre-COVID 5-year average of 1.5%
- As a result, we also expect Eurozone GDP growth to accelerate past the street's current low-ball estimates of 0.7%.



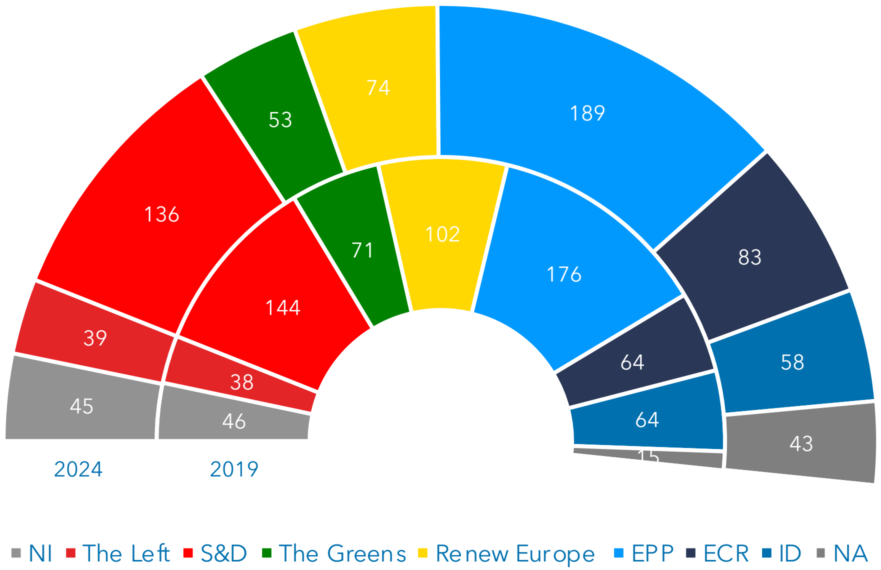


Source : Bloomberg

Meet the new leadership, same as the old leadership

- European elections held earlier this month saw the highest turnout since 1994 at 51.1%.
- They delivered a slight right tilt in the European Parliament, with the center-right and the far-right gaining seats mostly at the expense of centrist and green parties.
- But the leadership is unlikely to change, and the EU will continue to be run by the three main centrist parties in coalition.
- Given the EPP's strong performance, we expect Ursula von der Leyen to be reappointed as Commission President.
- The main policy changes will be on the green agenda, where opposition from within the EPP will hamper further action.

Election Results - European Parliament

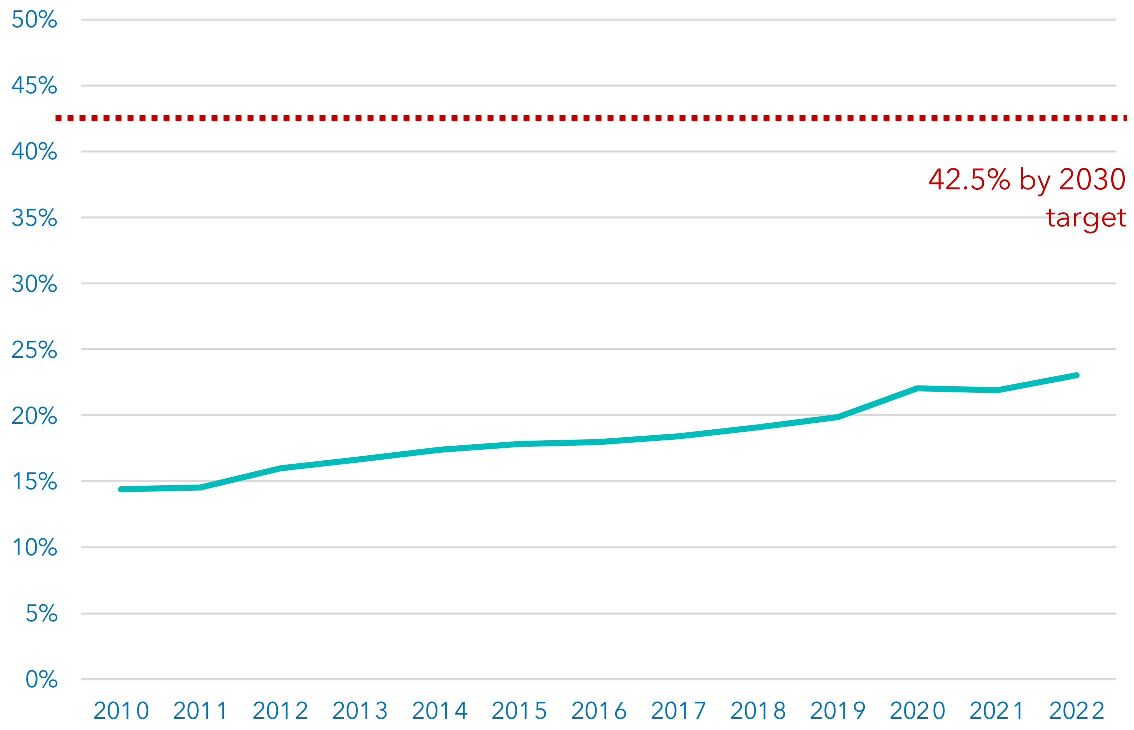


Source: European Parliament

A paler shade of green

- While European centrists retain a majority, internal opposition to green policies has grown.
- The much-discussed nature restoration law passed this week—but only after Austrian Environment Minister Leonore Gewessler defied her government to vote in favor in Council.
- As a reminder, in 2022 the EU generated about 23% of its energy from renewable sources.
- The current legislated target calls for this to increase to 42.5% by 2030—a rough doubling in only 6 years. The last such doubling took 15 years.
- With political commitment to net zero fraying across the EU, it is hard to see how such an ambitious target can be achieved this decade.
- More likely, the EU will have to include nuclear energy to meet clean, if not renewable targets.

Share of energy from renewable energy sources EU - 27 countries

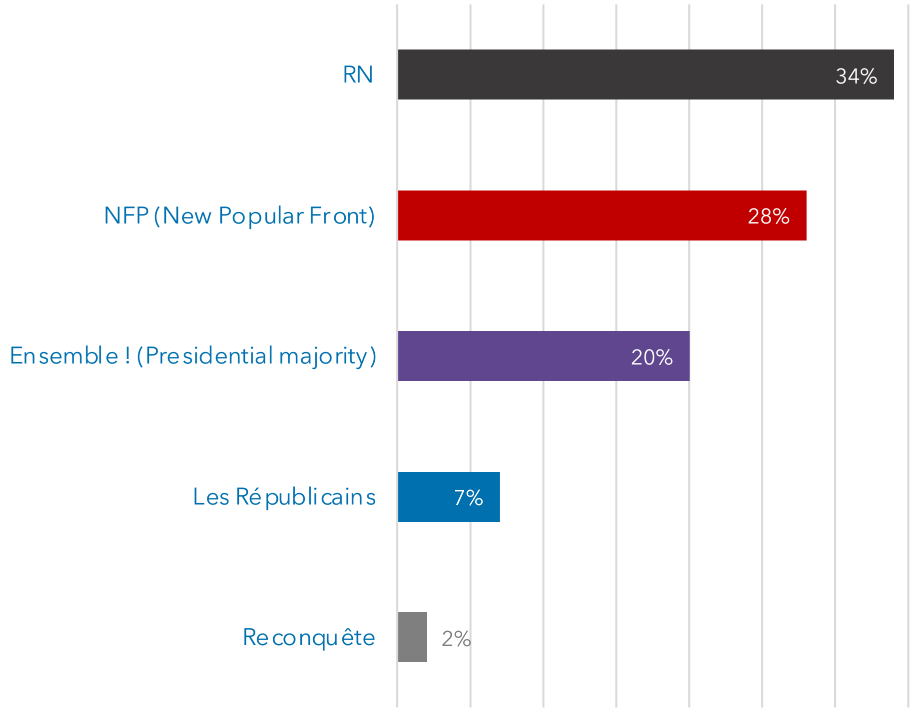


Source: Eurostat

The French Question

- At the national level, the most consequential results of the European election were seen in France.
- President Emmanuel Macron dissolved parliament and called new legislative elections, to be held on June 30 and July 7.
- The far-right RN is widely expected to come ahead. But it is possible that the left/far-left coalition NPF secures the most deputies after the second round.
- Either party would be a market-negative development. Their fiscal plans are wildly irresponsible for a country already in excessive deficit procedure.
- The worst (and less likely) outcome would be an outright majority by either extreme.
- French tax receipts already make up 46% of GDP–by far the highest figure in the OECD, leaving little fiscal headroom.

Current Polls – Legislative Elections



Source: Various

Back to School: European Semester Preview

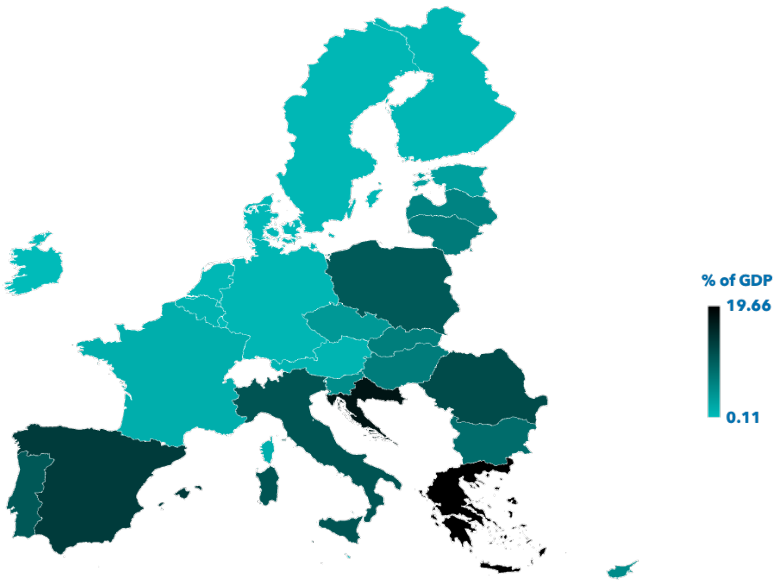
- The current European Semester promises to be the most aggressive one in nearly a decade.
- In its June report, the Commission proposed opening executive deficit procedures for Belgium, France, Italy, Hungary, Malta, Poland, and Slovakia.
- Italy remains the weakest link, having run deficits around 8% for the past three years and carrying an excessive debt load as it is (137.3% of GDP).
- The procedure may also set the stage for a fight with France's next government. Both parties vying for a majority have wildly aspirational fiscal plans. (for more on this, see our French Election: All You Need to Know)
- We anticipate a bruising battle between the Commission and both France and Italy as a result.
- The Commission is likely to win–the question is just how far spreads will widen before it does.

15-Jul	Eurogroup Meeting
16-Jul	**Economic and Financial Affairs Council (ECOFIN), Council adopts the final country-specific recommendations**
16 Jul - 8 Oct	National semester, translation of the CSRs into measures, draft budget
18-Jul	ECB Meeting
12-Sep	ECB Meeting
20-Sep	**Deadline for draft Budget, unless special agreement to extend**
7-Oct	Eurogroup
8-Oct	Economic and Financial Affairs Council
17-Oct	ECB Meeting
18-Oct	European Council Meeting
4-Nov	Eurogroup Meeting
Nov	Publication of the Autumn Package
5-Nov	Economic and Financial Affairs Council
15-Nov	**Economic and Financial Affairs Council (Budget)**
20-Dec	European Council Meeting
Nov-Dec	Member States adopt their budget
Nov-Jun 25	**States in EDP must implement their Autumn package, or be sanctioned if they fail to do so**

NGEU: The trillion-euro question

- The Next Generation EU investment program was deployed in the aftermath of COVID-19. It has a total envelope of EUR 807BN in 2021 prices, or about 5.5% of EU GDP at the time.
- Based on demand for loans, the EU estimates about 712BN of that will be deployed.
- The program's concentration in Southern economies goes some way toward explaining their economic outperformance.
- Nonetheless, for countries increasingly reliant on NGEU funds, the key question will be whether the plan will be renewed.
- We remain pessimistic—even though the EU will maintain some fiscal capacity, NGEU 2.0 is likely to fall far short of the first program's scope.
- This month, MSCI's refusal to include EU issuance in its government bond indices dealt a further blow to the asset, which now trades cheaper than Belgium.

RRP Allocations as % of GDP



% of RFF allocation payments made to date

France	Germany	Italy	Poland	Spain	Portugal	Greece
58%	22%	53%	19%	24%	35%	41%

Source: NGEU Tracker, European Commission

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