# Fiscal stimulus plans and the impact on FX in a nutshell

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With only a few months left until the end of the year, markets are nervous about several issues that remain outstanding before year end. The state of the US economy going into the election, timing of the US fiscal bill and whether we could expect more stimulus from Europe as it tries to tackle the rise in Covid-19 cases. In this blog, we will aim to address the current state of some of these affairs and provide some insight into factors investors may want to consider when thinking about these key topics.

Let's start by addressing some of the key debates concerning the US in October.

**1.Does the US economy need more stimulus?**

If we consider the US economic data, while we seen increases in the monthly US GDP data for the past few months and the US unemployment rate appears to be falling from the peak levels seen April, the downward trend in weekly initial jobless claims which offer a better picture of the state of the labour market, appears to be stalling. This figure has remained persistently high at above 800,000 a week since the middle of March 2020. If we look at the US economic picture, particularly at the labour market, fixed income markets have been pricing in more stimulus getting approved by Congress for some time but the key question on investors' minds remains to be whether it will happen before the election or after.

**2. Could a stimulus package get approved before the US election?**

It has been a rollercoaster week in terms of the US reaching agreement on a new fiscal stimulus package before the November Election. Around the 6th of October, President Trump requested the administration to stop negotiations with the House until after the election and this sent US Treasury yields lower. As the week progressed, the situation quickly changed with the administration opening negotiation discussions again. And on Friday the 9th of October, President Trump boosted his offer for a new fiscal stimulus package from $1.6 trillion to $1.8trillion. We are still in a gridlock situation because the Democrats in the House who have been pushing for a **much higher $2.2 trillion in new spending** plus several issues that remain unresolved. 1 Two major issues are around an agreement on a strategic plan to tackle the virus and around the level of support that will be deployed to state and local governments in addition to several other unresolved topics. Both sides need to come to an agreement on the bill before it could reach to the next stage which will require the support of the Republican-held Senate. **While we cannot rule out the idea of a stimulus bill before the November election, it is becoming less likely given the number of outstanding issues and the tight timeframe before the US election.**

**3. What factors could impact the US dollar?**

If we get a surprise with a stimulus package approved before the election we could see some strength in the US dollar but ultimately election results and any potential policy implications will weigh into year-end.

Now turning over to the continent where the European Central Bank (ECB) appears in no hurry to increase the size of the Pandemic Emergency Purchase Programme (PEPP) envelope in the near term. During this crisis, the ECB reacted very quickly to launch fiscal stimulus amid the Covid-19 crisis compared to prior crisis faced in Europe. The ECB launched the PEPP in March 2020 at 750 bn Euro. Shortly after, the ECB quickly realized it was not enough and expanded PEPP by another 600 billion in June. Now at the last Monetary Policy Meeting (MPC) in Sept, the ECB left both interest rates and the size of the PEPP envelope unchanged at €1.35trn Euros. And they indicated that they are in no hurry to increase the size of the PEPP. It appears from the tone of the last meeting, that unless there is a drastic change in the economic data coming out of Europe that the ECB is less likely to make a drastic change to the size of the PEPP.

**4. What can investors expect from Europe before year-end?**

Given the yield levels noted in Italian and Spanish Sovereign bonds, investors do not seem concerned about any lack of ECB firepower right now.[2] We continue to see strong performance in European Sovereign bonds year to date[3] and in particular Italian government bond yields have generally gone lower since the PEPP was launched. The overall ECB stance remains supportive of the European economy and the market is awaiting the new European Union (EU) bonds expected to be issued at the end of October to fund the Support for Unemployment Risks in an Emergency programme (SURE) which aims to provide support to the labour market in EU countries. The New EU bond issuance is expected to support Europe amid the crisis and is estimated to provide around 850 billion euro of new EU bond issuance over the new few years. For the EU this is certainly a monumental step towards a more unified Europe and a path towards recovery amid the health crisis.[4]

**5. What factors could impact the Euro?**

As we enter the flu season, if we continue to see an upward spike in Covid-19 cases tied to a rise in localized lockdowns this could hinder growth prospects for the fourth quarter but the market will be heavily watching the Brexit discussions and its implications on the Euro.

[1] Bloomberg: https://www.bloomberg.com/news/articles/2020-10-09/trump-has-approved-a-revised-stimulus-plan-kudlow-says

[2] Bloomberg, 9 October 2020. Italian Sovereign Yield Curve..

[3] Bloomberg, 9 October 2020 considering the Bloomberg Barclays Euro Treasury Bond Index ticker: LEATTREU as a benchmark for the European government bond universe.

[4] https://ec.europa.eu/info/strategy/eu-budget/eu-borrower/investor-relations_en#investor-presentation referencing the EU investor presentation dated 30 September 2020. European Commis-

sion: https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe/pillars-next-generation-eu_en . https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf

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