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The European deal and its repercussions on companies

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At dawn on Tuesday, European leaders succeeded in reaching an agreement on the European fund.

After 4 days of exhausting negotiations, the 27 European countries approved an agreement to launch a € 750 billion aid package, 390 of which in the form of grants and the remaining 360 in loans. On numerous occasions, the final agreement was at risk of floundering. Only some last minute adjustments made it possible to "clinch the deal". Among these adjustments there is also a "cash back" mechanism that essentially provides for lower contributions to be paid to Europe by "Nordic" countries like Austria, Sweden, Denmark, Germany and Holland. This package provides cash back for an amount of 50 billion over a period of seven years after the agreement.

Basically, these Countries pay more now in order to make lower payments in the future. Furthermore, the important thing about the agreement is that countries like Italy will be under significant pressure to implement reforms that have not been made for years (justice and public administration above all).

This political agreement has allowed everybody to emerge as victors. The individual leaders have maintained their position in the eyes of their electors, and, at the same time, Europe has emerged intact.

The launch of this package serves a dual purpose: political and economic. From a political point of view, it sends a very clear message. When Europe wants to be, it is united and supportive. This is the political message that brought about the strengthening of the euro which, in a few weeks, went from 1.07 to 1.15 against the dollar. The same message of political cohesion has pushed further buying flows on European stock exchanges for the benefit of stock prices.

The economic side of the plan is also important because it will enable the countries that were worst hit by the virus, like Italy, to receive a particularly generous packages that will enable them to overcome the crisis faster. On the basis of the distribution of the allocated funds, Italy will get € 82 billion as a non-repayable grant and € 127 billion in loans.

However, there is now another key question we should ask ourselves and that is: which future factors will make the markets rise again after the 40% rise from the lows of last March?

The ECB has already used up all of its ammunition. It could certainly prolong the PEPP beyond the set expiry dates, but will that be enough? The European Fund package has been approved.

In the next few weeks, the market will focus increasingly on macro and micro data. After all of these political and monetary supporting manoeuvres, the markets need feedback in terms of hard data and not just sentiments. Macro and micro data (company business results) will therefore be the real driver of stock market and currency performance. In the meantime, the tech bubble in the US continues to grow. Even yesterday was a dotcom bubble day, and the FAAMNG stocks raised prices once again. The problem with tech stocks is that expectations continue to rise, which is what happened with Netflix last week, and it does not take much to disappoint the expectations of investors. Moreover, this time, the most problematic area for the spread of COVID-19 is precisely the US, where consumers are again forced to stay at home in order not to risk their health. The third quarter will most probably be more difficult than expected for US companies, while the situation is relatively calm in

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Europe. This fact, together with the approval of the Recovery Fund, is weakening the dollar, which in turn is pushing up the prices of raw materials from precious metals (silver +20% in one month) to oil and, in the last few days, agricultural goods. The rise in the prices of raw materials, such as that seen in stock exchanges, is very much linked with the continuous fall in real interest rates. Today, the yield of the 10-year US government bond is 0.60%. Considering an expected average annual inflation of 1.5%, this means that whoever buys a US government bond to keep for 10 years will lose 0.90% in terms of purchasing power. Central banks are clearly trying, with the support of their governments, to raise the rate of inflation while, thanks to their purchases of securities and the large amount of liquidity they dispose of, they keep nominal government bond yields low. Furthermore, if the US dollar should continue to weaken, we will witness a sharp rise in the prices of raw materials of any type that could cause both an increase in the rate of inflation, forcing central banks to slow down their ultra-expansive monetary policy, and pressure on company profit margins. On the positive side, this would help some emerging countries that are very much tied to commodities.

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