Economic impacts of the Covid-19 crisis and policy responses

Klaas Knot

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A new impetus for international cooperation

Challenging economic and financial conditions are often a catalyst for stronger international cooperation. The whole history of the European Union is a clear example of this. The EU has faced many challenges in the past, but it has always found a way to overcome them, based on the principle of seeking constructive compromises and joint solutions. This approach of common interests and shared responsibilities has determined the international success of peace and prosperity within the EU.

Likewise, in the midst of the global financial crisis of 2008/2009, the financial sector faced existential threats. At that moment and in a unique atmosphere of joint global effort, the G20 developed a comprehensive international reform programme to stabilize and reform the global financial system. This was key to restoring confidence in the financial sector and global economy. It also led to the creation of the Financial Stability Board, to monitor financial stability and coordinate the implementation of regulatory reforms. Implementation of the post-crisis G20 reforms has made the core of the global financial system more resilient and in a better condition to face the unprecedented current economic shock of COVID-19.

The turbulence on financial markets and the effects of the economic fall-out from the pandemic confront us with new challenges. It reminds us that our economies and financial systems are closely interconnected and that developments in different jurisdictions have important contagion effects across the global financial system.

In this context, the FSB will have a coordinating role to share information, closely monitor risks and coordinate action to maintain global financial stability and keep markets open. In close cooperation with national authorities and the international Standard Setting Bodies, jurisdictions are encouraged to make use of the flexibility within existing international standards to provide continued access to funding and ensure that adequate capital and liquidity resources are available where needed within the financial system. This will preserve the financial system's capacity to support and finance economic growth. The FSB will focus on the critical nodes of the global financial system, including the functioning of funding markets, international capital flows and unintended effects in different types of intermediaries. The FSB will monitor the policy responses and report to the G20.

For Europe in particular, the current situation should be used as an opportunity to improve international cooperation. Now more than ever, progress towards completing the European banking union is essential to break the interconnectedness between governments and their domestic banking sector. The current unfinished agenda makes the European financial sector fragmented along national lines and vulnerable to idiosyncratic shocks. The unique characteristics of the European Union require further and well-designed steps to foster integration and strengthen the functioning of the single European financial market. In this context, additional measures are also needed to further develop the European Capital Markets Union to support open, integrated and developed capital markets to facilitate private risk-sharing and reduce systemic risks.

The unprecedented experiences of the dealing with the challenge of COVID-19 and resulting economic and financial fallout will test our dedication. Yet, as it has been in the past, it also creates new opportunities. There is ample evidence that policy responses are most effective when they are conducted in a joint and comprehensive approach, based on international standards.

In this spirit, I am convinced that the COVID-19 pandemic will provide a new impetus for international cooperation as the most effective path to ensure global financial stability. ●

Stipe Župan

State Secretary, Ministry of Finance of the Republic of Croatia

Towards a future-proof EU fiscal framework

Member states' fiscal outcomes ultimately emanate from domestic political choices across policy domains and from exposures to exogenous shocks. The financial and the sovereign debt crisis, pointed to the need for a closer coordination of national fiscal policies to address the risk of spill-overs within the Economic and Monetary Union. This resulted in a strengthened Stability and Growth Pact, a review process of euro area countries' draft budgetary plans, and the golden "balanced budget" rule of the intergovernmental Fiscal Compact.

These coordination tools have been instrumental in guiding member states towards sounder fiscal positions. In the context of the EU economic governance review and related public consultation, initiated by the European Commission in February 2020, a reflection has started on whether improvements to the common fiscal rules are necessary based on both a backward- and forward-looking assessment.

However, since the review was launched, the world has changed considerably in the wake of the coronavirus pandemic. The focus of fiscal policy is now squarely on facilitating the resolution of the acute health crisis and mitigating the socio-economic fallout of COVID-19, which has triggered the worst economic downturn since the Great Depression. Member states have acted swiftly and decisively by directing the necessary resources to health and civil protection services, supporting liquidity and credit for businesses, and protecting the incomes and jobs of workers.

As part of a broader European coordinated policy response to complement these national efforts, the European Commission, supported by the Council, activated the SGP's general escape clause to temporarily set aside the budgetary requirements that would normally apply, in order to tackle the economic consequences of the pandemic.

Large-scale national fiscal stimulus coordinated at EU level was undoubtedly the right response to avoid permanent damage to the economy's growth potential and ultimately, to debt sustainability. Nevertheless, it is clear that the public deficit and debt levels relative to GDP will be increasing significantly. These will have to be put on a downward path, which in particular for public debt proved difficult in some countries already before the crisis. At the same time, national fiscal policies should not become procyclical, but rather provide adequate support for rebuilding the economy. This is also related to the issue of the appropriate aggregate fiscal stance to increase the effectiveness of monetary stimulus. In addition, fiscal policy will have to cater for new priorities such as environmental sustainability and the digital transition.

Looking ahead, it will be important to achieve a common understanding on how to ensure that the EU's fiscal framework remains fit for purpose and is able to reconcile these different objectives. Striking the right balance will require careful consideration but should be feasible. If the fiscal rules were for instance to further promote public future-oriented investment, preferably in areas consistent with EU priorities such as environmental sustainability or the digital transition, this would not only be conducive to the economic recovery, but also constitute an opportunity for increasing the economy's growth potential and competitiveness. This would in turn benefit the long-term sustainability of public debt.

Looking ahead, it will be important to achieve a common understanding on how to ensure that the EU's fiscal framework remains fit for purpose and is able to reconcile different objectives.

Possible trade-offs could also be eased by having a fiscal framework that encourages a more growth-friendly composition of national budgets. This could be achieved through a better prioritisation and targeting of national public expenditure as well as through less distortionary taxation. This in turn underscores the importance of pursuing fiscal and structural reforms.

Finally, it will be important to ensure that possible changes to address the above-mentioned challenges do not come at the expense of the transparency and predictability of the common fiscal rules, which should remain an anchor of confidence for markets and citizens. ●

Poul M. Thomsen

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Europe's Response to the COVID-19 Crisis

The COVID-19 shock is unprecedented in recent times, in both nature and size. About half of humanity is under lockdown at the time of writing.

Europe is particularly affected as it accounts for about half of the global total of confirmed COVID-19 cases at present. In Europe, nonessential industries closed by governments account for about one-third of output: that means that each month these sectors remain closed translates into at least a 3 percent drop in annual GDP. Consumer and business confidence are already deteriorating sharply: the composite PMI for the euro area fell in March to levels lower than in the global financial crisis. Financial conditions have tightened sharply, reflecting the extent of the real economic damage. A deep European recession this year is a foregone conclusion. Precisely how deep and how long remain highly uncertain.

Policymakers in Europe have generally responded with speed and tenacity, deploying instruments tailored to both the specificities of the crisis and its scale. The most urgent priority is of course to save lives: a battle to stagger transmission and ramp up critical-care capacity to minimize the number of seriously ill patients that will be denied life support. This requires a massive investment in healthcare, on a war footing, accompanied by macroeconomic policies to ameliorate immediate hardships. Some of these actions will also help limit more persistent effects. In the near term, policies include supporting households and firms directly affected by the crisis, and providing abundant liquidity to offset financial stability risks. If there ever was a time to use available buffers and policy space, this is it.

But policy space for the response differs markedly across Europe. Advanced European economies have been able to launch large-scale fiscal and monetary support. EU fiscal rules have been suspended, bold monetary policy actions taken, and selected prudential norms for banks temporarily relaxed. Most countries in this group have announced large health outlays, employment subsidies, and guarantees, loans, subsidies, or capital to hard-hit businesses, while in some cases allowing tax payments to be deferred or cancelled. Fiscal deficits will balloon, and this is entirely appropriate. In the euro area, the large-scale interventions by the European Central Bank, and leaders' calls for the European Stability Mechanism to provide a supplement to national fiscal efforts, are particularly critical in ensuring that countries with high public debt will have the fiscal space they need to react forcefully to the crisis. The determination of euro area leaders to do what it takes to fight this crisis should not be underestimated.

> *Policymakers in Europe have generally responded with speed and tenacity.*

Emerging-market economies that are members of the EU but not the euro area should now use the buffers that they have cautiously built in recent years, through sustained reduction of fiscal and external deficits and a continuous strengthening of their bank systems.

Smaller countries outside the EU, however, will find it difficult to finance large budget deficits due to their limited access to external capital, less developed banking systems, and lack of potential access to EU financial support. Excluding Russia and Turkey, most of the nine non-EU emerging economies in Central and Eastern Europe have already applied for emergency assistance from a $50 billion pool available via the IMF's rapid financial support facilities. In this way and others, the IMF stands ready to help Europe and all of its membership. ●

Pervenche Berès

MEP from 1994 to 2019, European Parliament

The specificities of the Covid-19 crisis and how to respond

When the Covid-19 pandemic exploded, there was a temptation to refer to the Global Financial Crisis (GFC). But these two cataclysms may have little to do with each other.

The differences are huge. This crisis originates from a biological virus and not from toxic subprime mortgages. It is a health crisis and not a financial market one. This crisis spreads at a high speed and Members States or EU institutions have been reacting much faster than in 2007-2008. This crisis is a systemic one, with no place for a debate on moral hazard.

This crisis is deadly, it hits people first and its impact on the real economy is of a complete different magnitude, even though a big open question is its duration.

One way to fight this virus and its spreading is to enhance the surveillance of citizens' mobility. Advocates of full transparency of financial transactions should in democracy ask themselves more questions about the full tracking of individuals. Monitoring financial transactions and jeopardizing the freedom of movement of people are not the same.

But somehow, we observe the same mistakes and lack of solidarity.

Sub-primes were viewed as a US disorder against which EU fundamentals and automatic stabilizers were supposed to resist. This time, Covid-19, like Ebola or SARS, would not hit Europe; even when it arrived in Italy, there was some kind of condescending blindness. Like a reflex, the same group of Member States shot again first rejecting any strong EU solidarity and fiscal stimulus. On the front line a country, known for opposing reforms to rebuild a EU and Members States capacity through a fair corporate taxation regime, notably for platforms.

There is hardly any health coordination at the EU level even if this is mainly an area of national competence and that there have been few cross-border transfers of severely sick patients. But the trading of drugs and medical equipment remains a jungle with no internal market.

We would be much better off today if we had drawn all the lessons of the GFC and the legacy of the latter was a better-equipped EU to face crisis. This is true when it comes to have a revision of the Stability Pact to support long term investment, to establish a euro area budget to absorb symmetric shocks, even though up to now this crisis has no euro area specifying impact, to integrate the European stability mechanism (ESM) into the EU legal framework, to set up an unemployment benefit scheme acting as an automatic stabilizer or to issue Eurobonds. But, fortunately, one should also recognize that we have learned some lessons from the GFC. Some Members States have quickly put in place partial unemployment schemes, deferrals of tax and loan guarantees. Banks have much thicker liquidity buffers.

Mistakes vis-à-vis Italy were corrected, at least in the wording and after some hesitations, EU institutions reacted much more rapidly, the ECB with its 750 billion euro Pandemic Emergency Purchase Program (PEPP), the Commission with the suspension of the Stability Pact, decisions regarding state aids, structural funds, and the launch of SURE (Support to mitigate Unemployment Risks in an Emergency). While writing this paper, let's hope that Members States will demonstrate the same wisdom to commit to real fiscal solidarity.

What should we worry about for tomorrow? President Trump could for once be right! "We cannot let the cure be worse than the problem itself". In the short term, we need to have at our disposal a complete range of tools to tackle the different dimensions of the crisis, knowing that there is a dilemma: the more we are careful about people's health and smoothening the curb of hospitalized persons, the more we damage the economic situation.

For the future, to respond to the challenge of EU sovereignty and common goods, many EU policies will need to be reshaped; this is true for competition and industrial policies, trade, economy and taxation, notably of digital economy, but also for foreign affairs and development, having in mind the geopolitical implications of such a global pandemic.

No doubt that after this crisis the debt issue will be once more on the table, even though there are still two unknowns, the crisis duration and the debt level. This should only be evaluated at the end of the period as a one-off debt without making the same mistake made with the Greek debt.

Nevertheless, and on top of that, the question of fiscal tools and how to finance public services and public goods will have to be reopened.

The greatest risk would be to rush to restart the economy at any price, ignoring the still-valid urgency to lead the ecological transition. In the aftermath of this crisis, we will have no choice but to rebuild our economy around priorities for people, health and environment. This time, the main answers will not come from financial markets. One should make sure that they remain sustainable and contribute to collective preferences. ●

Andrew McDowell

Vice-President, European Investment Bank (EIB)

A pan-European response to a disease that knows no borders

Even as the spread of Covid-19 slows, and discussions commence on how to ease the economic shutdown, otherwise healthy European businesses are still failing by the thousands, suffocating from a lack of revenues and financing.

This pan-European pandemic calls for a pan-European economic response. This is why EU Finance Ministers have endorsed the European Investment Bank (EIB) proposal for EU Member States to create a €25 billion Guarantee Fund to enable the EIB Group to mobilise up to EUR 200 billion in funding for distressed sectors, as part of the wider EUR 520 billion package of EU crisis response measures agreed on April 9.

How the guarantee fund would work - The €25 billion guarantee fund will – subject to national confirmation and approval processes – be financed by EU Member States pro-rata to their shareholding in the EIB and/or other institutions. It is limited to addressing the Covid-19 shock, but could form a bridge between the crisis and the recovery periods.

With the benefit of a counter-guarantee from the Fund, the EIB Group – the Bank and the European Investment Fund (our specialist SME guarantee and equity subsidiary) – will unlock financing to the real economy by ramping up guarantees to local lenders, national promotional institutions and other financial intermediaries.

The products to be rolled out under the Guarantee Fund will likely be dominated by capped (first loss) and uncapped guarantees on portfolios of SME loans originated by local lenders and other forms of risk-sharing on new and existing corporate loan portolios. Some of these will provide regulatory capital relief.

Other products will also be considered, including participations in Asset Backed Securitisations to free up lending capacity, as well as equity investments in venture capital and private equity funds supporting innovative firms.

This fund should also allow EIB to counter-guarantee some national guarantee schemes already in place, thus sharing across the EU the risk of these schemes and increasing their firepower. The focus will be on SMEs, though it is proposed that mid-caps and larger corporates will also be eligible for support. All must be viable in the long-run and, in the absence of the Covid-19 pandemic, would meet commercial requirements for financing.

EIB and EIF have years of experience in these products, and through existing network of hundreds of counterparts can quickly channel financing to markets and sectors most in need. While there will be no quotas for any country, we have proposed upper concentration limits to ensure an equitable allocation of the firepower, always guided by EIB's usual assessment of economic and social impact.

A pan-European response to the pandemic - I see four key advantages of supplementing – at the EU level – the many national guarantee schemes that have already been rolled out.

Firstly, as with the Covid-19 health crisis, we need a co-ordinated approach to managing the economic crisis. No country will recover alone. Even the largest is influenced by what happens in terms of overall EU demand, intra-EU trade, intra-EU value chains, overall EU market confidence and financial market loops.

A study by the European Central Bank shows that 1% symmetric decline in the GDP of each Member State brings, after the initial mechanical effect, an additional 0.6-0.8% decline in the Euro-area GDP growth, due to the direct and indirect spillovers in trade. The EIB's own data shows that 40% of economic growth and growth in jobs from the operations we finance comes from cross-border spill-overs.

Secondly, by pooling credit risk across all of the European Union, the overall average cost of the fund could be reduced, compared to national schemes. Thirdly, the use of the EIB also means that guarantee schemes – and their SME and corporate beneficiaries – across the EU could benefit from the the bank's AAA rating, even in financially weaker Member States which lack fiscal space and a top credit rating. With the suspension until December 2020 of normal state aid restrictions, this can help to level the playing field for businesses across EU countries during both the crisis and recovery period.

Finally, Europe's venture capital and innovation ecosystems are trans-national by nature – no individual Member State has adequate incentives to fully protect them, calling for a pan-European perspective and policy instrument.

The broad product mix being proposed will ensure that in every country we will find a way to complement national schemes to best effect.

The economic and financial dynamics immediately ahead of us are approaching a tipping point: we have little time to put in place measures to safeguard the European economy from this unprecedented shock. By responding to this crisis with a spirit of solidarity and enlightened self-interest, we can start to strengthen confidence among markets and citizens in Europe's capacity to weather the storm. Together, Europe can emerge from this crisis even stronger. ●

Jordi Gual

Chairman, Caixabank

Europe's greatest challenge

We are experiencing a global health crisis unprecedented in recent history. The immediate priority must be saving lives: procuring all the resources the health system needs and taking the necessary measures to slow down the spread of the pandemic. In turn, the health crisis and the lockdowns that we are using to fight it have resulted in a deep economic recession that must also be faced resolutely. We have the capacity to manage both crises and lay the foundations for an economic and social recovery.

It is important to keep in mind that we are facing a public health shock that should be temporary if the epidemic is controlled in the near future. The goal of economic policy must be precisely to prevent it from having lasting economic effects, something that would happen if companies go bankrupt, if jobs are permanently destroyed or if companies and families emerge from this situation weakened by a heavy debt burden.

The response must combine policies that satisfy the liquidity needs of companies and families, favor temporary adjustment mechanisms for employment levels, and transfer public resources to companies and families to mitigate income losses. All European governments have already announced different measures in line with these priorities.

There is no doubt that the great fiscal effort implied by all these measures will suppose a significant increase in public debt. Such measures are essential to contain the economic and social impact of the health crisis. In their absence, the recession will be deeper and more protracted and the resulting fiscal costs from it, even higher. Moreover, some of the deterioration in public accounts this year should be reversed automatically with the recovery of economic activity.

These extraordinary times demand a shared fiscal effort by all Eurozone countries. It is not just, or even mainly, a matter of solidarity towards those countries that may end up being most affected. It is the most consistent approach with the fact that we are all members of a single monetary area.

By creating the euro, member countries gave up their monetary sovereignty and thereby gave up the support they could receive from their national central banks as lenders of last resort in exceptional circumstances. Certainly, the European Central Bank has shown its willingness to intervene in public debt markets to avoid an excessive increase in risk premiums, but this is not comparable, for instance, to the unlimited support that the Federal Reserve is providing the United States Treasury.

The Eurozone needs a single fiscal authority that can counter a shock like the one we are experiencing, an authority with the ability to issue a safe asset and that counts on the central bank as a lender of last resort. Indeed, lacking a fiscal union weakens our capacity to respond. This is the right time to take an additional step to strengthen the European Monetary Union and create it. In this regard, the Recovery Fund to be discussed soon by the European Council provides a unique opportunity to consider different options to start moving in the right direction. The stakes are high: the credibility of the European project in the eyes of the world and, most importantly, of its own citizens. ●

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Bernd Spalt

Chief Executive Officer, Erste Group

Coronavirus has the power to transform Europe towards deeper integration

Without question, the coronavirus crisis is the largest threat to public health in living memory. Even though the real economic impact is not fully visible yet, most experts agree that we are facing an unprecedented hit on both the supply and demand side, with a lasting impact comparable only to such major disruptions as the global financial market crisis of 2007/08 or the oil crisis of the early 1970s. Above all, this crisis falls into the category of 'black swan events', which are hard to foresee and even harder to prepare for.

The sheer magnitude und unclear progression of the current crisis have the potential to stun the global economy far beyond the second half of this year, as is now commonly assumed. But there is one element of encouragement as efforts ramp up to address this challenge: despite the world's rather inevitable unpreparedness for this particular black swan, most economies were actually in rather good shape when the coronavirus first hit. Also, central banks and governments have reacted quite swiftly, which may be a lesson from the 2008/9 crisis, when the first round of reactions in parts of the world were too slow and faint-hearted.

As the infection numbers start to peak in Europe and the US, the focus of public debate is shifting from protecting people's lives and livelihoods to restarting the broader economy. That is also why this is the right moment to take a closer look at what has changed in the economy and what this means for the banking sector.

Currently, governments are acting swiftly to keep their economies afloat. There is no doubt that they are guided by the right motivations, even as many details of these measures' implementation are still being worked out. All these measures have bought us some time, but we all know that the relief they offer can only be temporary and efforts to further strengthen the real economy will be needed in the coming months. We as the banking sector stand firmly by our commitment to support the customers and finance the real economy. Banks understand that they are key parts of the critical infrastructure on which societies rely (especially in such crises) and have undertaken massive – and successful – efforts to keep things up and running for their customers. Banks like Erste Group have been able to rely on their sustainable and resilient business model, with its digital offering and physical branch infrastructure. More generally, banks have shown that they are ready to support society by addressing the needs enterprises have in order to overcome their short-term difficulties. It is in the private sector that jobs are being created, where families generate their income, and where Europe produces its wealth.

> *Going forward we need a medium-long term framework to organize and coordinate the management of this crisis.*

Going forward we need a medium-long term framework to organize and coordinate the management of this crisis – a framework which takes into account the specific roles of politicians, banks and supervisors alike. In some markets we do see first signs of patchwork-like actions at national levels that fail to reflect the need for coordinated responses within the broader European context. We, as banks, need flexibility to be able to help. What is not needed are any additional obstacles to the free movement of capital or ring-fencing measures. What's more, governments should try to remove any unnecessary hurdles in the existing frameworks.

As a strategic investor in Central and Eastern Europe, Erste Group remains strongly committed to its home region. For this reason, we believe that a coordinated response involving all relevant stakeholders at the regional level makes sense and could draw on the successful model provide by the Vienna Initiative. It is astonishing that a virus that does not stop at any border has been treated – from an economic perspective – almost independently by all countries. This virus has the power to transform Europe, either towards more nationality or towards deeper integration. Going forward we remain committed to capital market development, support the European Banking Union and ultimately support any measures to foster deeper European integration. ●

Dr. Karl-Peter Schackmann-Fallis

Executive Member of the Board,
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Solidarity and Stability in Europe

The economic consequences of the Corona Pandemic are tremendous and rapidly deteriorating. After China and Europe, now the US, emerging and developing economies are hit most severly. In the US the initial response has been insufficient and inconsistent for a long time. An aggravating factor for the leading Western economy will be that it has less automatic stabilizers than most European countries.

There is hope that in many European Union countries the further spread of the disease can be controlled. Discussions about the appropriate exit strategy are beginning. Yet, the clear priority still has to be to limit new infections. If containment measures were to be withdrawn too early, a second wave could increase economic damages even further.

The Corona shock is symmetric, hitting the real economy with full force. Everything possible must be done to support and stabilise the economy. Capital stock and labour force potential must be maintained as much as possible. They form the basis for the economic recovery. Europe and the Member States have taken action: fiscal policies are delivering "whatever it takes". The rules of the Growth and Stability Pact are suspended for the duration of the pandemic, and rightly so. It is now important to make full use of all possibilities via the ESM and the EIB. The 500 billion Euro programme recently agreed by the Eurogroup is a fundamental sign of European solidarity.

A well-functioning financial services infrastructure will be vital to channel funds as quickly as possible to the real economy. That is why we are asking legislators and regulators to lower operational and administrative burdens for the banking sector now and to adjust implementation and application timeframes for all levels of legislation to the impact of COVID-19.

Within just 11 bank working days the German savings banks have had more than 704.000 conversations with their corporate customers. All systems are working to the limit of their capacities. In most cases these contacts involve general advice, utilisation of existing credit lines or fresh loans from the respective savings bank. In 20-30 % of cases it is a matter of suspending interest and repayment of principal or of loan applications to access public support programmes. In total, the savings banks have suspended interest and redemption payments for more than 200.000 clients already and the numbers are increasing. Thus, emergency measures clearly are transmitted via the locally active savings banks.

Once more this is proof of bank finance based on local banking networks being quicker and more efficient than capital markets-based finance.

This crisis of the real economy could certainly become a problem for the euro area, if credit ratings of individual countries are lowered below investment grade, potentially leading to a further downturn of the European financial markets.

European solidarity will therefore be needed. Solutions must be balanced, acceptable and enforceable. A full mutualisation of public debt via so-called "Corona Bonds" does not appear to reach consensus. Without conditionality or other incentives, such a tool could indeed place too high a burden on all member states.

Yet, much more money will be needed. Innovative ways of financing those needs to avoid turbulences on the capital markets are necessary. Using the excellent credit rating of some member states could be made available via a guarantee, limited in time to EU countries with a lower credit ratings or countries having lost market access.

Such bilateral guarantee-relationships between countries of differing credit ratings could be a core element of the European recovery fund without the need of expensive equity. The default risk of such instruments would be lower than that of Corona- or Eurobonds. New or ongoing ECB purchasing programmes would also reduce risks for the guarantor of the bonds.

Based on these "Stability Bonds" solidarity on a European level could be provided. They would strengthen the crisis resilience of the whole euro area and have a stabilising effect on financial markets. The message behind those bonds would be that Europe stands together in times of increased financial pressure. But that Europe, unlike other currency areas, still keeps an eye on managing increased crisis-related debt levels, thus creating a solid foundation for renewed sustainable growth. ●

Dr. Jérôme Haegeli

Group Chief Economist, Swiss Re

Post-crisis recovery agenda: we need it now

None of us have ever experienced anything remotely similar to the ongoing situation, not even post-war generations. Governments globally face a unique health crisis which has seen no borders. Combatting it has meant taking a deliberate, difficult and delicate trade-off versus economic growth. As a result, the Covid-19 induced recession will be one of the deepest on record. The good news is that it may also be one of the shortest on record, however, there will be long lasting ramifications beyond the containment of Covid-19. Such ramifications will result in paradigm shifts that will take societies, policy making and the economic framework into a new era, including the following: 1) further innovation from the ECB, 2) monetary and fiscal policy coordination and implicit debt monetisation, 3) bigger role of governments in capital makets, 4) peak of globalisation and emergence of parallel supply chains, 5) possibility of a stagflationary environment, and lastly 6) accelerated digital transformation.

These paradigm shifts highlight the importance for the Eurozone to adapt and evolve if it wants to remain one of the major global economies. Even more importantly though, the challenges arising from Covid-19 have brought the euro area to a pivotal point where it will either "make it or break it", with the region at greater risk of falling apart now than during the Greek debt crisis. As such, it is vital for the euro area to witness an upsurge in solidarity if it is to survive. At present, already existing tensions amongst member states risk being exacerbated by the important disparities in the fiscal responses.

Although the massive global fiscal stimulus[1] is cushioning the blow to the economy, it will not absolve countries of all the challenges. This will result in governments not being able to take away the massive fiscal measures any more than they were able to after the GFC. Given the similar demographic profile to Japan, it is critical that Eurozone governments provide support to companies and sectors with strong potential for future growth to avoid replicating Japan's growth trap.

Governments around the world have so far focussed on attenuating the impact of Covid-19 on their economies. Although this is necessary, European leadership should also consider the ongoing disruptions as a window of opportunity to secure higher trend growth, ensure economic resilience and achieve political stability throughout the region. In addition, with Covid-19 being a temporary, albeit painful, disruption, persistent issues such as climate change will remain at the forefront of global dialogues. The Eurozone could position itself to spearhead the climate change dialogue. We therefore propose the following actions to policy makers:

1. **Common green innovation fund** – establishment of a euro area-wide fund to support innovative technology, with a special focus on low-carbon technologies to meet global climate change objectives all the while increasing productivity.
2. **Common resilience fund** – establishment of a common resilience funding pool that members can draw from in times of shock without the debt mutualisation aspect. The fund would include pre-defined trigger levels for fund access, with proceeds earmarked for targeted investments in alignment with Europe's economic and political ambitions.
3. **Digital alignment** – smoothing of the large digital disparities across member states and the creation of a digital single market. Europe is in some ways in a luxurious position as the Union can start from scratch without a pre-existing, institutional legacy on this front.
4. **Infrastructure spending** – emphasis should be on sustainable infrastructure, with spending done at a national and eurozone level. Transport infrastructure will be key to help the region transition to a low-carbon economy, while supporting the shift to parallel supply chains.
5. **Financial integration** – improvement of the euro area financial system's capacity to channel surplus funds to parties in need of financing for consumption or productive investment. Better integrated asset markets should help smooth income and consumption growth, and hedge against country-specific sources of risk.

Ultimately, the European integration is a peace project which builds on solidarity and a joint future. The Eurozone therefore needs to act now while it still can and before what were once shared values drift further apart from each other. ●

1. Global fiscal stimulus will exceed 3% of world GDP in 2020, which compares to 1.6% in the GFC. This number only reflects stimulus that flows into the fiscal deficit this year, and excludes all loan guarantees