Poul M. Thomsen

Director, European Department, International Monetary Fund (IMF)

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.

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. ●