Key economic and financial priorities for the euro area and the EU–27

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Klaus Regling

The Chair opened the session and welcomed participants to the discussion about crisis measures. Europe is coming out of the deepest economic crisis of the last 100 years. The recovery has been strong since the lockdown ended, but, given how bad the decline in economic activity was earlier this year, it will still take two years to get back to 2019 activity levels.

The policy measures put in place during the last few months are rightly unprecedented in light of the crisis. At the national level, on average for euro area countries, they amount to almost one-third of euro area GDP. A combination of automatic stabilisers, discretionary fiscal action and liquidity provision guarantees means that the euro area countries will average a fiscal deficit of 10% of GDP. European measures have complemented the national ones, with two packages agreed by the Eurogroup: the first of €540 billion and then the summit in July agreed the Next Generation EU package of €750 billion. The European measures are designed to help countries that are particularly affected by the crisis more, to protect the single market and ensure that divergences among euro area member states do not become too great.

Without these measures at national and European levels, the decline in GDP, which is bad enough, would have been much worse. The ECB announced the most recent estimate for the average for the year as a whole at -8%. That is the position in September of this remarkable, unusual year. The Chair asked Roberto Gualtieri whether the two packages agreed so far at the European level and the national measures are adequate to deal with the consequences of the coronavirus crisis.

Roberto Gualtieri

Roberto Gualtieri noted that there were often complaints that Europe is not doing enough and that measures are incomplete. For once, Europe has been up to the unprecedented challenge being faced. After some initial hesitation, it has been possible to put in place another great fiscal response to the crisis and this has been done thanks to a sequence of decisions. The first and easier were regulatory decisions. The decision to suspend the Stability and Growth Pact and state aid rules put member states in the condition to do what was needed, but this alone would not have been sufficient. On the contrary, it would have produced a path of divergence, because the fiscal space is different and, without any formal support, not all would have been able to borrow the necessary amount of resources.

The second step was a bold monetary decision by the ECB - In particular, the envelope for the pandemic emergency purchase programme (PEPP) of a total amount of €1,350 billion - and that has had a powerful effect on the markets. Also essential is the third wave of fiscal decisions. There were two sequences of decisions: the first was the €540 billion with the three emergency instruments in April and then a more structural agreement that was finalised in July, but there was a process where the idea of borrowing at the EU Commission level to commonly finance common expenses for the recovery was gradually perceived as a realistic outcome since May. This created the environment where every country has been able to deploy the necessary fiscal stimulus to contain the economic impact of the virus.

As mentioned, the latest forecast at the euro level foresees an annual real GDP growth at -8% Forecasts said Italy would be at -11 or -12%. That is a sharp and unprecedented decline of GDP, but fiscal measures in the form of grants and guarantees have been fundamental for avoiding the destruction of productive capacity and to keep the economy in the condition for a recovery. But the economy has rebounded much strongly than expected… In 2020, the European economy suffers a brutal collapse, but Europe is standing and able to start again, protecting the financial system, protecting the productive system, protecting workers, and protecting families, but now it is necessary to shift the nature of interventions from a net of protection to a boost to recovery and productivity, which is the aim of Next Generation EU.

Klaus Regling

The Chair thanked Roberto Gualtieri and turned to João Leão for his opinion on the packages agreed by the group of finance ministers under the chairmanship of his predecessor, Mário Centeno.

João Leão

João Leão agrees the response was significant and concerted, and made use of flexibility on fiscal policy, state aid and the financial freedom of frameworks. The fiscal and monetary policy response was strong. Even with the strong fall in GDP, unemployment in Europe did not increase that much, compared with the US, and that is a signal that Europe responded strongly and positively.

As noted, the economy remains constrained by social distance measures. 2019 GDP levels will probably only return in 2022. So, there will be a period when the economy is well below its potential and the 2019 level, and where social distancing measures will constrain the economy on the supply side. The recovery fund is vital for the next stage, shifting from supporting firms and employment to enabling the economy to reach full capacity.

The EU recovery fund is extremely important, as it will take some time to implement expenditure and investment measures. This fiscal instrument must be complemented by next year at least with a quick boost in demand that helps the economy recover 2019 levels quickly. Especially when the COVID-19 pandemic is over and the economy can start working at full capacity again, a quick response is essential to avoid keeping the economy subdued and below 2019 levels for a while. The time and how quickly the EU recovery fund can be implemented is a problem. It should be complemented with other measures to help the economy for a while.

Klaus Regling

The Chair noted that the panel's positive view is shared widely around the world, certainly in the financial markets. Contacts with market participants demonstrate a positive attitude towards Europe that has not been seen during the last 10 years. It is better than any time in the last 10 years, so this view that Europe did the right thing is widely shared, but the work may now begin, because implementation will be key.

There are concerns looking at the medium and longer-term. Europe is coming out of the deepest economic crisis ever, but there are concerns that the potential growth rate after the crisis might be lower than before it, because capital – physical, human capital – is being destroyed. There has been a collapse in world trade and deglobalisation already for some time that means less competition, which means less productivity growth. He asked what should be done next, given that there are also huge challenges from demographic and climate issues, and digitalisation needs.

Roberto Gualtieri

Roberto Gualtieri acknowledged that the challenges are huge. It cannot be said that the pandemic is over and phase two is here. Phase one has not finished, either from a sanitary or an economic point of view. Lockdowns are not happening anymore and hopefully will not be needed again, as measures for containing the second wave to a low level are better, but it is essential not to lose the fundamental sense that the first and most effective economic measure is to contain the virus. That is more important than any other measure.

The transition phase must balance what is needed and not withdraw support too early but realise that the task is now different. The transition is complex, but there is a broad and high level of consensus around what will be done next year in the sense of focussing on growth potential, innovation and the new supply chains. These are fundamental for the economy of the future, focusing on sustainability and the goals of the programme of the European Commission, which are at the core of Next Generation EU. At the same time, it is vital to quickly deploy investment so as not to lose the momentum of the recovery and also, which is more difficult, to have a new kind of investment in place to have an immediate macroeconomic impact.

It is necessary to be ready to start on 1 January 2021 and disbursements from the EU budget should be available to Member States at the beginning of next year. There is already a legislative procedure with the European Parliament to conclude and to go into the official journal and the EU agreement needs to be ratified by Member States. This has to be done quickly first without reopening things that have been decided. Second, the right mix of productive investments that are quicker to deploy and have a huge macroeconomic impact are needed, such as railways, highways and so on, but, not only programmes based on this because, on the contrary, programmes must have a strong transformational impact on the economy, as well as recovery and resilience – and there must be not only investment but packages of investment and reform to address the immediate economic impact of the slowdown and the crisis, as well as structural bottlenecks that were inherited from the past, things which were in countries for years or decades, and problems that are very well known.

The next step is to look to the future, not just at fixing old issues, but knowing that there are deep structural changes to be made, and such changes will follow, as with other crises. Things will never be exactly as they were before and so the right mix and the right level of ambition is needed. This is a moment for being ambitious in identifying significant changes in economies and in the ways in which society is connected to the economy and public administration. This requires a high level of ambition, and the deployment of the recovery plan as quickly as possible. It is complex, so governments are working to make this better mix of ingredients. This is a unique opportunity and it must not be missed.

Klaus Regling

The Chair asked for insight on the Portuguese experience. A deep crisis eight years ago was followed by good growth performance and a balanced budget in 2019. João Leão was part of that development and the Chair asked him about the challenges for Portugal.

João Leão

João Leão advised that the medium-term challenge is implementing the EU recovery fund to improve public administration, especially the courts, health and education. A great deal of investment in digitalisation is planned, as that is a key priority to make the state work better so that both citizens and firms have a state that is more friendly and promotes growth. The environment is a key priority, so a large part of the plan is the environment and green energy. From a macro side, the recovery fund will help create fiscal space over the next four to six years, which is important for the euro area as well.

For 10 years, the euro area has had interest rates close to zero. There is a liquidity trap, so the potential or ability of monetary policy has been constrained and limited. Fiscal space is needed for a few years and that is provided by the recovery fund. It should be a target to deal with the main issues and reforms that need to be implemented to promote growth in individual countries.

The Stability and Growth Pact rules are suspended and likely to remain so next year. In 2022, it will be crucial to think about phasing these rules in. It should be gradual and compatible with the macroeconomic needs of the economy, as the world is now different from before. Most countries have high levels of debt. Interest rates are low and there is a limited space for monetary policy. The compromise between macroeconomic needs and the need for fiscal rules that are key to providing sustainability to debts must be achieved gradually. Consideration should be given over the next year how to how to phase in these rules.

For Portugal, the budget rules are likely to be easier to reach at some point as Portugal recorded a fiscal surplus in 2019 and expects a deficit of 7 -8% of GDP lower than the European average. On the other hand, the level of public debt is one of the highest in the euro area, so how fast debt needs to decrease must be considered when implementing the Stability and Growth Pact rules, given the public debt of Portugal will reach 135% of GDP this year. It is important for Portugal and Europe overall that this is done reasonably and there is a compromise between the sustainability of debt and the need for some space for Europe to recover from the crisis.

Klaus Regling

The Chair concluded by saying that Europe is coming out of an unprecedented crisis, but the challenges ahead are also, in a way, unprecedented. There are unusual positive elements, the fiscal space is bigger than normal. There will be a great deal of money available, probably the more than governments have seen in a long time, maybe most in a lifetime, so it is crucial to use that well.

Implementation will be key to address the real underlying problems, strengthen competitiveness and productivity, but also the green agenda, digitalisation and ensure that society is kept together in a way that equality is preserved. It must be balanced with sustainability concerns and moving back to a sound fiscal situation. It will be hard work for the next few years. The Chair thanked participants for joining the meeting. ■