



Boštjan Vasle

Governor, Bank of Slovenia

From strengthening post-COVID recovery to greater economic and financial resilience

The COVID pandemic has been permeating our lives and economies for a year and a half now. The initial shock is behind us and we are facing alternating periods of tightening and easing of restrictive measures. However, many of us are now vaccinated, which contributes to the pleasant fact that we can be here in person today.

In this speech, I will focus on policies for strengthening the recovery of the European economy from the pandemic crisis and enhancing economic and financial resilience to potential future shocks. It is important that this severe crisis does not go to waste, to paraphrase Winston Churchill.

Before I develop my main points, let me briefly reflect on recent economic developments and the response of economic policies to this once-in-a-lifetime health shock.

After recovering from the previous financial and sovereign debt crisis, the growth of the European economy had been slowing in 2018 and 2019 under the influence of increased tensions in international trade and other challenges in European industry. Despite this weakening of growth, however, we did not expect such an economic turnaround as happened with the outbreak of the COVID-19 pandemic. Serious disruptions in global supply chains and the announcement of lockdowns affecting large parts of our economies were followed by tensions in the financial markets and the sales revenues of many companies have dried up almost overnight.

The response of macroeconomic policies to this extraordinary health and economic shock has been extensive and well coordinated at both national and EU levels. The exogenous nature of the shock and lessons from previous crises have contributed to a broad consensus between policymakers and international institutions on the need for a strong response from fiscal and monetary policy, each supporting the economy within its own mandate.

Committed to stabilising the financial system and protecting the euro economy, the Eurosystem acted

early and decisively, deploying monetary, prudential and supervisory policies. With our bold response, sovereigns and banks, and thus also businesses and households, have had uninterrupted access to financing under favourable conditions throughout the crisis.

Highly supportive economic policies have mitigated the economic downturn and deflationary pressures, greatly reduced the scope of social hardship, and limited the number of business failures that usually follow an economic downturn. We helped to set the stage for the rapid economic rebound that has followed the reductions of pandemic-related restrictions in the third quarter last year and in recent months.

The economic recovery is strong, but new waves of the pandemic may slow it down. The priority of economic policies is to continue providing support to the economy until the recovery is set to last and uncertainty subsides.

However, as the pandemic has been with us for quite some time now, it is important that policy support is targeted at the most affected and vulnerable households and businesses and that it does not hamper structural adjustment, as this could undermine productivity growth, which has slowed markedly in Europe over the last 25 years. The main operational challenge is how to distinguish between viable and non-viable businesses. For those that have dismal chances of survival, it is necessary to prepare the ground for the most efficient liquidation process. It is important that capital is freed up and directed to promising activities and that workers who are likely to lose jobs are equipped with the skills for reallocation as soon as possible.

The eventual unwinding of the remaining pandemic support measures should be gradual and guided by stable improvement in economic data. In the medium term, fiscal and monetary policy will need to begin rebuilding space to address future shocks. However, planning for necessary structural reforms, to the

pension and healthcare system, for example, should start as soon as possible, as their implementation usually takes time.

The European banking system remains resilient, as shown by recent stress tests carried out by the EBA and the ECB. Its solid position reflects, among other things, the cleaning up of balance sheets, recapitalisations, and strengthening of regulatory and supervisory frameworks after the previous financial crisis. The path of strengthening the resilience of the banking system is not yet complete, however. It is therefore necessary to continue towards the completion of the Banking Union and bank resolution framework, including a common backstop, and with harmonisation of national insolvency laws. As the health and economic situation stabilises, additional attention should be paid to the long-term challenges of many European banks, namely low profitability and the issue of sustainability of bank business models.

As the recovery continues, banks will continue to play an important role in financing businesses and households. However, in the medium term the sources of financing of the European economy should become more diversified, so the action plan for capital markets union (CMU) should be ambitiously pursued.

A further challenge that accompanies the current recovery is, in addition to new waves of the pandemic, asymmetry between sectors and countries. This issue is partly addressed by the recovery and resilience package known as the Next Generation EU. The package has not only been designed to boost aggregate demand in the medium term but also addresses longer-term challenges such as greening of the economy, Europe's lag in digitalisation, country-specific structural challenges and economic resilience in general. The package has been designed to channel more resources to vulnerable, most affected countries. The success of the package is important not only for increasing aggregate demand and strengthening long-term economic potential, but also for the possibility of future use of such a solidarity mechanism of financing investments and reforms. Further progress in European fiscal integration would be welcome, but this should go hand-in-hand with fiscal prudence and reduction of risks.

To strengthen economic and financial resilience, action is urgently needed in various areas, not just economic ones, which is an important lesson from this health crisis. In addition to lowering the risk of future pandemics, which could otherwise emerge more often than in the past, we need to address more consistently the risks related to climate change. Governments and parliaments have a key role to play, but we should also contribute to the efforts, each institution within its own mandate. At the Eurosystem, we are gradually incorporating this ambition into various areas of activity, from monetary policy and management of the non-monetary

portfolio to banking supervision and monitoring financial stability.

The pandemic crisis has accelerated digitalisation, which also represents a path to faster recovery. As our lives become increasingly digital, be this in terms of interpersonal communication, finance or health services, we are becoming more vulnerable to cyber attacks, which continue to spread and are becoming more sophisticated. Efforts need to focus not only on protecting critical infrastructure, but also on raising wider societal awareness and a culture of cybersecurity.

The topics I have touched on will be discussed in the panels of this forum. So let me conclude with a final thought that the decisive and well-coordinated response of national and EU economic policies to the pandemic shock has revealed the power of European unity. In the same spirit, we should head also towards addressing other challenges, especially strengthening resilience, and deepening Economic and Monetary Union.