Europe’s way to recovery - speech by Klaus Regling

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A warm hello from Luxembourg,

It was my wish to travel to Asia and speak to you in person, but travel restrictions still make that impossible. It is now six months since the pandemic reached Europe. We are experiencing without doubt the most challenging economic and financial crisis in our lifetime. Uncertainty is high and it looks like GDP in the euro area will not return to its pre-crisis level before 2022.

From March to May, Europe’s economy collapsed. Supply chains and production lines have been disrupted, trade in goods and services declined significantly, and household spending and private investment shrunk to historic lows. Passenger travel was in some countries down by 85% compared with the year before.

After bottoming out in April, the economy entered a strong recovery phase in May, alongside the gradual lifting of the lockdowns. Activity indicators rebounded sharply over more than two months, with some of them getting close to pre-pandemic levels.

However, the recovery lost some momentum in August, as uncertainty about the outlook and risks of a second wave of infections in some euro area economies remains high. Just as the impact of the pandemic hit countries differently, the recovery seems to be uneven in China too, increasing the risk of rising divergences across countries and regions.

Going forward, we must make sure that policy actions balance these divergences across households, sectors and countries, and prevent distortions in the EU's single market. The single market is one of the EU's greatest achievements, because goods and services can move without any internal borders or other regulatory obstacles.

I. A concerted response

When the pandemic reached Europe, EU policy makers reacted swiftly with an array of different policy actions that calmed markets and were designed to help the most affected countries.

At the European level, Finance Ministers decided in April on a **first support package** to mitigate the economic impact of Covid-19. Three EU safety nets have been created to lessen the burden of this catastrophe for member states. Each of the three safety nets has a different purpose: The ESM's pandemic crisis tool has been tailored to the needs of **sovereigns** and supports countries to cover their health-care related costs. SURE is the backstop for **workers** managed by the European Commission, while the EIB's Guarantee Fund helps **businesses**. This first support package amounts to €540 billion. And the European Central Bank, responsible for the 19 euro area countries that share the euro as their currency, contained fragmentation by significantly expanding its asset purchase programme.

A **second policy package** was agreed in July: the €750 billion "Next Generation EU" recovery fund that will boost the normal EU budget. In order to strengthen the resilience and competitiveness of economies, support from the recovery fund will be accompanied by reforms. The focus on investment will improve the medium-term outlook for all European economies.

In addition to the efforts at EU level, countries undertook swift and extensive policy actions at the national level. Even though varying across countries, euro area member states reacted to the pandemic with very sizable fiscal measures summing up to a third of total economic activity. This is a fiscal policy response of unprecedented proportions and bigger than during the Global Financial Crisis. Euro area countries supported their economies through discretionary fiscal measures, guarantees, liquidity support, and deferrals for taxes. And automatic stabilisers are working fully.

In my view, all these measures were adequate and necessary, as they will help to limit the economic damage of this crisis. Without them, the decline in euro area economic activity (i.e. GDP) would be much bigger than the 8.7% we expect now. The measures at the European level were designed to provide more assistance to countries most affected by the crisis, to protect the single market and to avoid divergences in the euro area. This provides an unprecedented degree of solidarity.

II. Challenges for the future

Nevertheless, we will need to ensure the efficient use and implementation of the unprecedented amounts of public money available. Also, it will be challenging for many countries to manage the fiscal situation in the medium-term against the background of great uncertainty about a second pandemic wave and future economic developments.

On top of that, I see three more points that might affect future growth:

First, the **potential growth rate**, the output an economy can produce if it runs at full capacity and everyone is employed, is likely to be lower in the future than before the crisis. The pandemic destroys physical and human capital, it leaves investors reluctant to invest, given the high degree of uncertainty, and has led to much higher precautionary savings.

Second, the **collapse in world trade** means less competition and therefore smaller productivity gains. Smaller productivity gains imply lower trend growth. The collapse in world trade comes on top of the de-globalisation trend that started before the pandemic and also depressed competition and productivity gains.

Finally, **higher public deficits and debt** are necessary and legitimate in response to the crisis. But higher debt can depress future growth as economic research has shown.

Given these challenges, it is important that Europe’s economic policies will focus on enhancing competitiveness and investment while supporting the greening and digitalisation of the economy. We aim for a stronger, more innovative and sustainable Europe.

III. Deepening EMU remains on the agenda

Apart from all the action at EU and country level to overcome the economic damage of Covid-19, we continue our work on deepening Economic and Monetary Union further:

i. completing the ESM reform to ensure financial stability in the euro area,
ii. completing banking union with a common backstop and a common deposit insurance,
iii. creating a capital markets union to harmonise all 27 national financial markets, and
iv. increasing the volume of safe euro assets.

All this will lead to a more integrated Europe and a better functioning monetary union. The role of the euro in the international monetary system will be strengthened as we move towards a multipolar currency system.

With this vision for the future, I would like to conclude here and I wish you an interesting and successful conference.

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