

Post-pandemic EU recovery - speech by Klaus Regling

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Speeches

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Good afternoon,

Last week, I travelled to Slovenia to speak at the Bled Strategic Forum, and I also took part in the informal Eurogroup and ECOFIN meetings in Brdo. It’s a pleasure to speak (virtually) in Slovenia again.

Economic activity is picking up

After nearly two years, the pandemic continues to cause hardship around the world. However, while new variants of the virus cause continued uncertainty, containment measures have improved the health situation and helped opening up economies. With rising vaccination rates, the number of new infections has subsided considerably compared to previous peaks and economic activity has picked up.

The revival of economic activity in Europe has also been possible thanks to the comprehensive policy responses to the pandemic, both at the EU and national levels. Hence, the euro area economy is forecast to grow by 4.8% this year and by 4.5% in 2022.

However, to sustain the growth momentum, much will depend on a smooth transition from short-term emergency support measures to long-term support, in particular under the Next Generation EU programme (NGEU).

Significance of NGEU for economic recovery

This €750 billion recovery fund was designed make economic growth as lasting and as sustainable as possible, and to improve the resilience of the EU economy to future shocks. The most important component of NGEU is the Recovery and Resilience Facility (RRF), which will make available €385 billion in loans and €338 billion in grants to EU Member States. To benefit from these funds, Member States have to submit Recovery and Resilience Plans to the European Commission. Each plan sets out the reforms and investments to be implemented by the end of 2026.

Slovenia's recovery and resilience plan was positively assessed by the European Commission in July. This step paves the way for the EU to disburse €1.8 billion in grants and €705 million in loans to Slovenia.

In all Member States, the RRF targets mostly the supply-side of the economy and aims to improve long-term growth with a combination of investments and reforms. That is why EU countries committed to allocate more than half of the RRF resources to green and innovative investments and reforms, which will lead to more sustainable growth. The distribution of funds will be concentrated on the most affected areas of the EU. This not only represents an unprecedented degree of solidarity in the EU; it also fosters convergence across Member States, which protects the single market and the monetary union.

While euro area GDP is expected to come close to pre-pandemic levels in 2022, well-implemented reforms will be necessary to boost potential growth. The recovery plans, provided that their implementation is successful, will not only mitigate the uneven consequences of the pandemic in the euro area but could also generate positive supply-side effects over the medium term. To maximise these benefits, many countries need to significantly improve their absorption capacity for funding, which may be challenging.

You may be aware that there has been a debate on whether NGEU can be transformed into a permanent facility. In my view, this is not possible unless we change its legal basis. NGEU was created based on the article 122 of the EU Treaty, which allows for temporary measures if the EU faces “severe difficulties caused by natural disasters or exceptional occurrences beyond its control”.

That said, if a comparable crisis occurred again, one could use the NGEU again as a model, if it turns out to be successful.

Strengthening EMU for a more resilient euro area

The pandemic has shown once again that EU countries are stronger when they act together and that further integration will be necessary to strengthen cohesion in the euro area and to make it more resilient.

Following the euro crisis, we have considerably strengthened the architecture of Economic and Monetary Union (EMU). We set up new institutions that increase the effectiveness of crisis prevention and crisis management. I am referring to the Single Supervisory Mechanism, the Single Resolution Mechanism and, of course, also to the European Stability Mechanism (ESM) – the crisis fund for the euro area, the institution that I manage.

Speaking of the ESM, our shareholders – the 19 euro area member states – have agreed to broaden the institution’s mandate. Once the amended ESM Treaty is ratified by the end of the year, the ESM will act as a common backstop to the Single Resolution Fund (SRF) – which was established by the EU for resolving failing banks. In the event that the SRF’s resources are depleted, the ESM would be able to lend the necessary funds to finance a resolution. The ESM backstop will double the resources for bank resolution (to around €130 billion) and ensure their immediate availability, if and when needed.

In addition, the reform gives the ESM a stronger role in future economic adjustment programmes and reinforces crisis prevention in the euro area. In collaboration with the European Commission, the ESM will design, negotiate and monitor future financial assistance programmes.

Apart from the ESM reform, several steps remain necessary to make EMU more resilient.

First, we need to complete banking union: it involves strengthening the framework for crisis management, the creation of a European deposit insurance scheme, improved cross-border integration of the banking sector, and the diversification of sovereign holdings by banks. These measures will greatly enhance trust in Europe's banking system and also its competitiveness, which are important to support economic recovery.

Second, we need to create a single market in financial services – a capital markets union. Currently, European capital markets remain small and fragmented; in essence, there are 27 separate capital markets in the EU along national borders. Progress in developing a capital markets union would improve the allocation of capital in the Economic and Monetary Union, lead to more private-sector risk-sharing, increase the growth potential, and make the euro more attractive to international investors.

Another element that would make EMU more robust is a fiscal capacity for macroeconomic stabilisation. It would be used if a country were affected by an economic shock outside of the government's control. Such a fiscal stabilisation instrument would not imply new transfers between Member States. It could take the form of a revolving fund, rather than a budget.

Finally, there is an area that I would call “financial plumbing”, that is, the infrastructure for payment and settlement systems. Work is underway to upgrade Europe's payment system infrastructure, and the ECB is currently working on the creation of a digital euro, which could also improve the efficiency of payments.

How a stronger international role of the euro will benefit Europe and the international monetary system

The euro is the second most important currency in the world; however, the US dollar remains the dominant currency in the international monetary system. Consequently,

US monetary policy and US dollar exchange rate fluctuations also have an impact on other economies, particularly emerging markets.

By reducing the dollar's dominance and moving towards a more diversified system, one could enhance financial stability around the world. This does not mean that the goal is to replace the dollar. We should rather aim for a multi-polar system, in which several currencies have comparable roles, including the dollar, the euro, and the renminbi.

A stronger international role of the euro would have several advantages for the euro area. European businesses would enjoy lower transaction costs and lower risks when trading outside the euro area. Invoicing in euros rather than in foreign currencies will remove the exchange rate risk or hedging costs.

If the euro attracts more investors globally, that would also help ensure more stable financing conditions for European households, businesses and governments. If the euro is seen as a "safe haven", it would ensure a more reliable access to financing, even in periods of external uncertainty and global financial stress.

One serious obstacle to expanding the use of the euro internationally has been the scarcity of euro-denominated safe assets. Currently, the outstanding volume and new issuance of highly rated euro-denominated bonds are much smaller than those of dollar-denominated bonds. More safe assets would support financial stability by allowing European banks to substitute their holdings of national government bonds with the European safe asset. Such diversification would also help reduce the spillover of risks between the sovereign and the banking sector, the so-called "doom loop".

Thanks to the issuance of bonds to fund the NGEU recovery package, the amount of safe euro assets is set to increase substantially – from €800 billion (issued to date by the ESM, EIB and European Commission) to almost €2 trillion over the next five years. If we add the volume of highly-rated national debt [AA+ or higher], the total amount of safe euro assets will reach €5.4 trillion, or 40% of euro area GDP, still less than half the comparable US numbers.

Conclusion

Europe responded forcefully to the pandemic. The Next Generation EU programme will help boost economic recovery in the EU, potentially even leading to a higher growth path than before the pandemic. The focus on reforms, investment, green and digital transition will help us make the EU more innovative, more resilient, and more sustainable.

By pursuing in parallel a set of measures to strengthen EMU, and to enhance the international role of the euro, we can also achieve progress in areas such as financial stability, trade, investment, and access to financing for businesses. This will have a direct impact on economic growth and prosperity in Europe for years to come, and it would strengthen Europe's sovereignty in the world.

Thank you for your attention.

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