Recovery: step by step - speech by Klaus Regling

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(Please check against delivery)

Ladies and gentlemen,

Last time I attended the Economist Roundtable – which is always a pleasure – nobody thought of a pandemic. Now it is more than six months since the coronavirus reached Europe.

We are undoubtedly experiencing the worst economic crisis in 100 years, and I do not expect economic performance in the euro area to return to pre-crisis levels before 2022, at the earliest.

Between March and May this year, the European economy suffered a brutal collapse. After the economy reached its lowest point in April, we saw clear signs of a recovery from May onwards. Many indicators improved significantly in the following three months. But the recovery lost momentum again in August, as uncertainty about a second wave of infection remains high in some euro area countries.

The pandemic – although it was a symmetric shock – has had different economic impacts in different member states. This increases the risk of economic fragmentation between countries. That is why it was important that measures were taken at the European level aimed at preventing distortions in the EU’s single market and divergences in the monetary union.

Europe’s response to the pandemic

Europe responded quickly to the pandemic with several policy measures designed to help the most affected countries. At the beginning of April, euro area finance ministers agreed on three safety nets worth a total of €540 billion.

Each of these safety nets has a different purpose: The ESM's Pandemic Crisis Support helps countries to cover direct and indirect health care costs. The Commission's SURE programme is the safety net for workers. The new guarantee fund of the European Investment Bank can be used to finance corporate investments.

At the same time, monetary policy measures by the European Central Bank have stabilised financial markets. I am sure Fabio Panetta will explain the ECB’s actions in a moment.

And in July, the €750 billion "Next Generation EU" recovery plan of the European Commission was adopted. This is a lot of money, and as the President of the European Council Charles Michel said last week, it “is not a three- or seven-year strategy. It's a thirty-year strategy”.

Complementary to the work at the European level, euro area countries responded with very extensive national fiscal policy measures. All euro area countries support their economies through discretionary fiscal policy measures, guarantees and liquidity support and deferrals for taxes and social security contributions. In total, these measures amount to more than one third of euro area gross domestic product (GDP).

Automatic stabilisers amount to around 5% of GDP. Consequently, the budget deficit for the euro area as a whole is estimated to reach around 10% of GDP this year and around 5% next year – but this depends, of course, crucially on the progress of the pandemic, the strength of the economic upswing next year and the extent to which the state guarantees will then be called upon.

The Greek economy had to cope with the pandemic, too.

Greek economy

The pandemic has put an additional and unexpected strain on the Greek people, economy and its public finances.

The Greek economy is particularly affected by the pandemic due to its large services sector, especially tourism, and its large share of small and medium-sized companies.

The Greek government has managed to contain the spread of the virus and mobilised a large set of support measures to mitigate the burden on its population and the firms.

The flexibility of EU fiscal rules has also helped, although we will see large budget deficits in all European countries this year, due to the economic downturn and fiscal measures to deal with the pandemic.

To ensure the sustainability of public finances, and to increase the economic welfare of Greek citizens, it is crucial to place the economy on a higher long-term growth path while maintaining a prudent fiscal stance.

Over the past years, Greece’s economy experienced a large capital depletion and it very much needs investment to rebuild its capital stock. So far, the investment rate remains well below the euro area average, holding back potential growth.

That is why policy reforms need to focus on structural growth-friendly initiatives with a special focus on improving the quality of institutions and the business environment in Greece. These reforms should mainly aim at boosting the country’s long-term potential instead of focusing on short-term gains. Domestic and foreign investment need to be incentivised, also through more public investment.

In this regard, we acknowledge the government’s steps to further improve the business environment, and to remove structural obstacles for implementing the public investment budget.

We also welcome the growth strategy presented in the “Pissarides” report. It proposes to increase the openness of the Greek economy, which would help attract foreign investment to Greece.

Looking ahead, working on a credible reform agenda and remaining on a prudent fiscal path, is important for supporting the country’s exit from the recession and for helping the country sustain growth in the medium and long-term.

Challenges affecting future growth

The current crisis is very painful for all European countries and actually for almost all countries in the world. At the same time, it has the potential to accelerate structural changes in our economies and to make progress in European integration. This is crucial, because I see four problem areas that could negatively affect future growth:

First, **potential growth**, i.e. the possible growth rate of an economy at full capacity utilisation and full employment, will probably be lower after the crisis than before the crisis. The pandemic is destroying capital – including human capital; it is causing businesses to invest less given the high degree of uncertainty and has led to much higher private savings, which is reducing overall economic demand.

Second, the **collapse of world trade** means less competition and thus lower productivity gains. The collapse of world trade comes on top of the trend of de-globalisation already visible before the pandemic, which also dampens potential growth.

Third, I am concerned about the **banking system**. Banks continue to make too little profit in Europe, there is overbanking in some countries, and there will be an increase in non-performing loans due to the economic downturn. All this can affect the credit supply to the economy. This would also reduce growth.

Fourth, higher **public debt**, which is now indispensable, can have a negative impact on growth in the long term. The return to a sustainable fiscal situation will not be easy.

Given these challenges, all European countries should prioritise strengthening productivity and competitiveness in the future, while promoting a green and digital economy. We need a more resilient, more innovative, more sustainable Europe.

Deepening EMU remains important

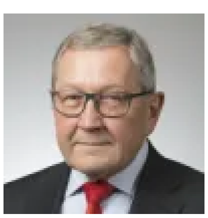
This also implies further deepening of monetary union. This will help us face future crises with even greater strength. The agenda is well known and contains the following points:

(i) Completion of the **ESM reform** to ensure financial stability in the euro area,
(ii) Completion of **banking union** with a backstop and a common European deposit insurance scheme,
(iii) the creation of a **capital markets union** to harmonise all 27 national financial markets,
(iv) the creation of a **fiscal capacity for macroeconomic stabilisation** to cushion economic downturns, which remains controversial among member states;
(v) increase the volume of **safe euro assets** further to strengthen the international role of the euro.

Let me conclude here and handover to Fabio Panetta. Thank you very much.

References:
ESM (2020), Financial Assistance
Charles Michel (2020), Recovery Plan: powering Europe's strategic autonomy

Author



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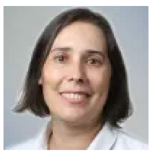

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