The Post-Pandemic Economic and Financial Prospects for Europe and Cyprus - speech by Klaus Regling

View PDF
24/11/2020
Speeches

Klaus Regling, ESM Managing Director
“The Post-Pandemic Economic and Financial Prospects for Europe and Cyprus”
16th Cyprus Virtual Summit
Online, 24 November 2020

Ladies and gentlemen, good afternoon from Luxembourg.

Europe is experiencing without doubt the most challenging economic and financial crisis in our lifetime. Economic activity came to a halt in March. After bottoming out in April, data confirms a strong recovery phase from May onwards, as the lockdowns were lifted.

However, the recovery lost momentum in August, and now – as are we experiencing the second wave – the pandemic weighs again heavily on our economies. Latest forecasts suggest that economic activity in the euro area will only reach its pre-crisis level again in late 2022. And the recovery is likely to be uneven across member states.

Europe’s response to Covid-19

How has Europe responded to this unprecedented crisis? Looking back at this year, Europe provided a quick and well-coordinated policy response. Already, by the beginning of April, the European economy was protected by three safety nets, worth €540 billion. Each of these safety nets has a different purpose.

First, the ESM's Pandemic Crisis Support helps countries to cover direct and indirect health care costs. And – although no money has been requested – the mere existence of our pandemic credit line has calmed financial markets.

Secondly, the Commission's SURE programme is the safety net for workers.

And the third safety net, the new guarantee fund of the European Investment Bank, can be used to finance additional corporate investments. But the European rapid response did not end there. Monetary policy measures by the European Central Bank stabilised financial markets.

Then, in July, the €750 billion "Next Generation EU" recovery fund of the European Commission was adopted.

The three safety nets and the "Next Generation EU" fund were all designed in a way that countries most affected by the pandemic will receive more support. This unprecedented degree of solidarity is important to protect the EU single market and to avoid excessive divergences in our monetary union.

Cyprus will receive a substantial amount of money from the European funds. This money presents Cyprus with a good opportunity to continue its structural reform efforts.

In addition to these Europe-wide initiatives, all EU Member States responded to the crisis with extensive national fiscal policy measures. Also Cyprus.

A glance at Cyprus

The Cypriot government offered a support package that alleviated the immediate impact of the crisis on the Cypriot economy. A policy package of around €1.3 billion – equivalent to 5.8% of 2019 GDP – limited damage to the country's workers and firms.

But every European country needs to recognise that these immediate measures must be accompanied by longer-term policies. And those policies will need to reflect the particular challenges in each country.

Cyprus is a small, open economy. It is exposed to a number of external risks. For example, during the first half of 2020, tourist arrivals decreased by 85% compared with the previous year. Cyprus could make its economy more resilient by decreasing its dependence on tourism, and diversifying further into other areas.

The European Commission expects economic activity in Cyprus to fall by 6.2% this year, before recovering in 2021 and 2022. And Cyprus has other challenges to overcome, particular in its banking sector. The amount of non-performing loans, in the balance sheets of Cypriot banks, remains the second highest in the euro area.

The Cypriot government has partially addressed this issue. Between 2014 and the first half of 2020, the stock of non-performing loans declined from €24 billion to around €5 billion. However, since non-performing loans will remain a challenge in the future, the legal framework needs to be strengthened, including the insolvency and foreclosure law. These are important challenges for Cyprus.

Challenges for the future

The current crisis is very painful for all of Europe. But, at the same time, it also provides the opportunity to accelerate structural changes in our economies.

And to accelerate progress towards deeper European economic integration, which – I believe – is crucial to overcome this crisis and to position Europe better in a changing world. Future growth in Europe is potentially affected by several problems.

First, the pandemic destroys physical and human capital. Precautionary savings are up and investors will be reluctant to invest for some time. This will depress demand.

Second, the collapse in world trade and de-globalisation mean less competition and thus lower productivity gains and lower growth.

Third, banks continue to make too little profits in Europe and non-performing loans will go up as GDP declines. This may limit banks' ability to provide sufficient credit for the recovery.

Fourth, the higher public debt, although indispensable under the circumstances, can have a negative impact on growth in the long term.

All this comes on top of the well-known demographic problems and is likely to lead to a potential growth rate after the crisis that may well be lower than before the pandemic.

Faced with these challenges, what can we do? The European agenda must focus on productivity and competitiveness; on making the European economy greener and more digital.

That is exactly the objective of the "New Generation EU" recovery fund. A lot of money will be available. It must be used productively for investment and to support reforms in order to strengthen growth and to transform the European economies.

Deepening EMU is key

In addition, we should also continue to deepen our monetary union. Important steps have been taken during the last decade. To complete this process and to make the economic and monetary union more resilient and less vulnerable, additional steps are desirable.

First, the completion of the ESM reform. In the future, with the revised ESM Treaty, the ESM will provide a backstop to the Single Resolution Fund, increasing its financial firepower to deal with bank resolutions. This step is important to complete banking union, which also requires a common deposit guarantee and a better crisis management.

Secondly, we need progress towards a capital markets union that would integrate the 27 national financial markets. Progress on the 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.

Third, a fiscal stabilisation instrument would help to shield economies of the euro area against future shocks. This would allow more fiscal risk-sharing.Such a permanent facility, which would be a revolving fund and not a budget, would give countries the opportunity to expand their fiscal space in a downturn.

Several of the steps I mentioned are rather controversial among our member states. It will take years to reach consensus and to implement them. But it would lead to a more integrated Europe, a more robust economic and monetary union, and stronger growth.

Such measures will help us to reach a vision of Europe that is more innovative, more resilient, and more sustainable – and where the international role of the euro will be stronger. The Europe that we all want. Thank you.

Author

[Klaus Regling](#)
Managing Director (2012 - 2022)

Contacts

Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu