



EU FISCAL POLICY RESPONSE IN TIMES OF CRISIS

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EU FISCAL POLICY RESPONSE IN TIMES OF CRISIS: A TALE OF TWO STORIES

- During the pandemic: strong response

- ...broad-based fiscal and monetary policy intervention

- ...inflation remains low

- ...public-risk sharing skewed towards the most vulnerable members

- The Russian invasion of Ukraine and the energy crises, a different story:

- ...monetary policy support restrained by high inflation,

- ...fiscal policy cannot fully mitigate the income loss (terms of trade shock)

- Policy challenges ahead

- ...striking the right balance between consolidation and stabilisation

- ...coordinating EU response

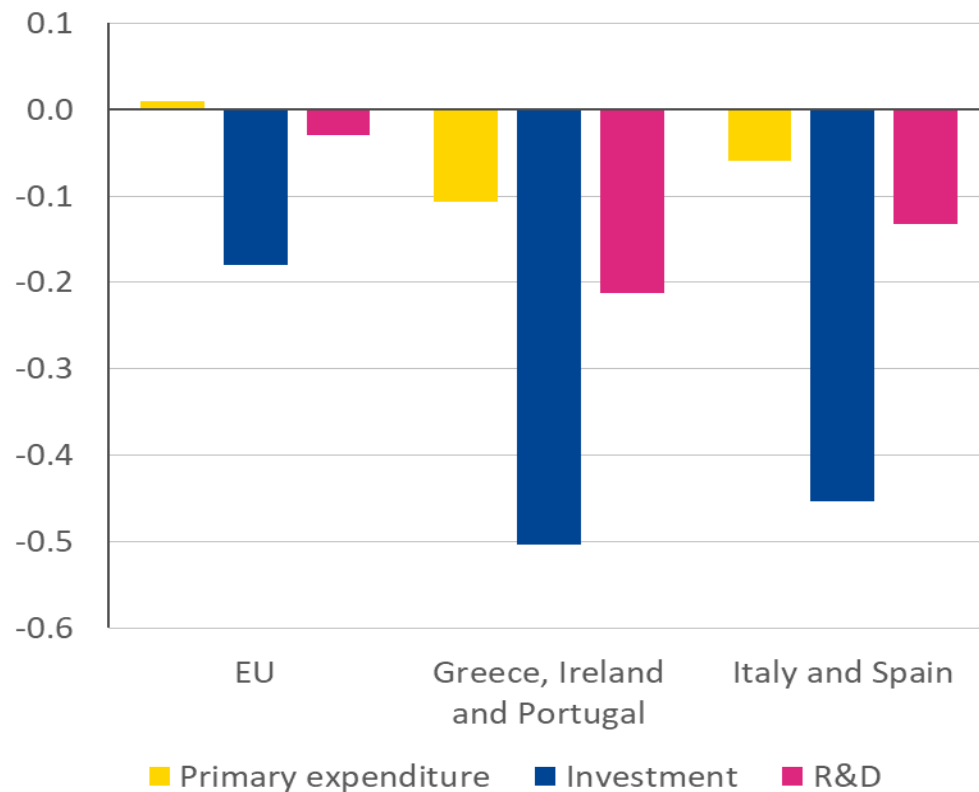
FIRST TALE: POLICY RESPONSE DURING THE PANDEMIC



THE EURO AREA ENTERED THE PANDEMIC FROM A BETTER POSITION THAN THE GLOBAL FINANCIAL CRISIS

Public expenditure adjustment after the GFC

(% change in constant price values 2009-2013)

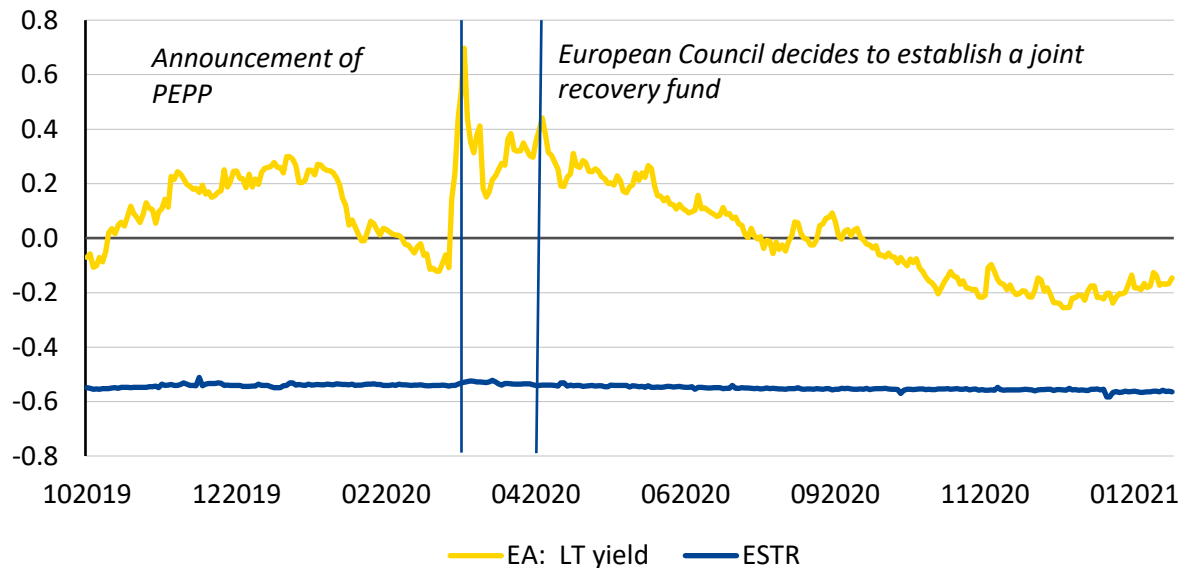


- Debt-to-GDP ratios decreased
- Imbalances have decreased
- Financial sector had higher buffers
- New institutions in place

Source: Eurostat 2022, Bruegel 2021.

ECB REACTION RESTORED MARKET FUNCTIONING AND MITIGATED FRAGMENTATION RISKS

Euro area GDP-weighted sovereign bond yields and ESTR rates (in %)



Source: Haver and ECB, chart based on the ECB

Note: ESTR refers to Euro Short Term Rate (ESTR, % p.a.) and EA: LT yield refers to the EA GDP weighted sovereign bond yields on 10-year government bonds of selected euro area countries (AT, BE, FI, FR, DE, EL, IE, IT, PT, SI, ES).

ECB took swift policy action

March 2020:

- Existing TLTRO: lowered interest rates
- Additional longer-term refinancing operations
- Additional asset purchases of €120 billion combined with the existing asset purchase
- PEPP programme of €750 billion: private and government sector securities
- Relaxed collateral standards to provide easier access to liquidity

April + June 2020:

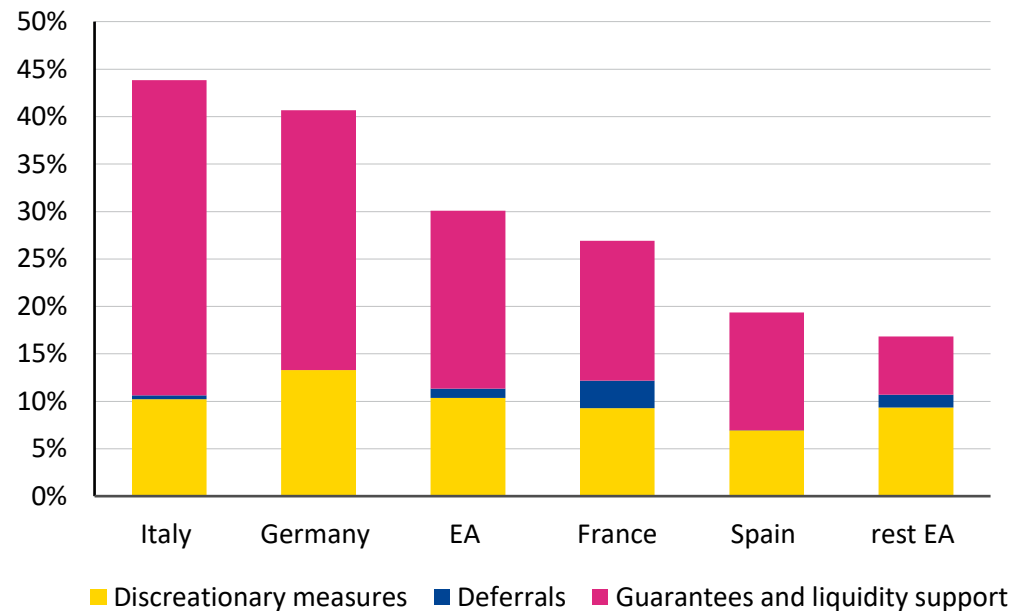
- Further collateral easing
- More flexible and extended PEPP
- Creation of a series of non-targeted pandemic emergency longer-term operations (PELTROs)

Source: EFB, 2020.

PANDEMIC YET ANOTHER TEST FOR SINGLE CURRENCY: ADDRESSED BY A STRONG NATIONAL POLICY RESPONSE...

National fiscal response to Covid-19

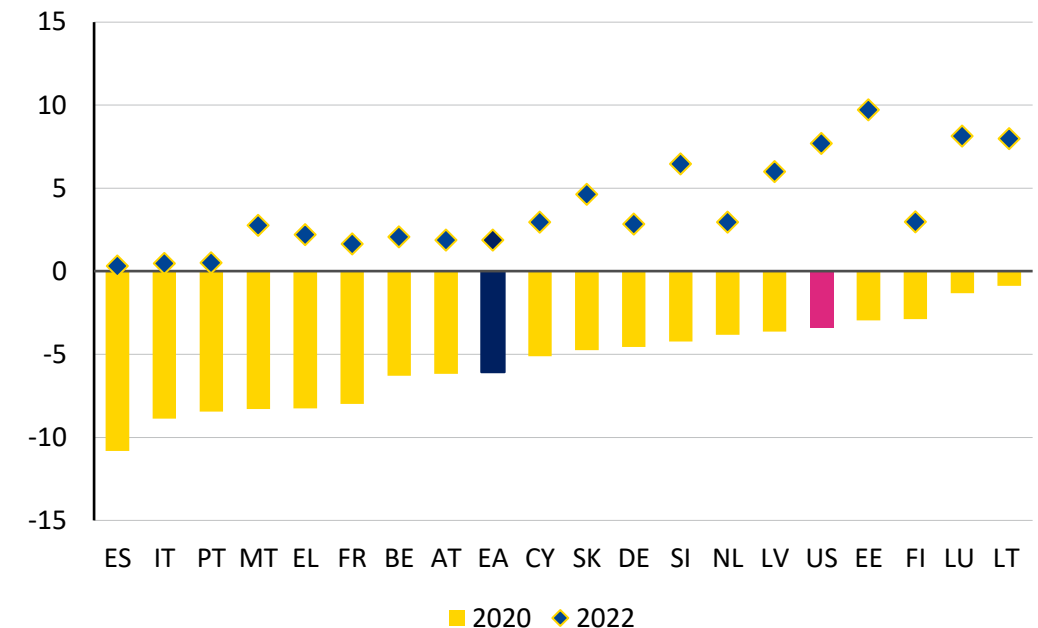
(% of 2019 GDP, measures announced since March 2020)



Note: ESM calculations based on the IMF, July 2021 WEO. The chart summarises key fiscal measures governments have announced or taken in selected economies in response to the COVID-19 pandemic as of 5 June, 2021 for selected economies. It includes COVID-19 related measures since January 2020 and covers measures for implementation in 2020, 2021, and beyond. The actual take-up rate of guarantees varies across the member states.

EA countries and the US: Real GDP compared with pre-crisis level

(% of 2019 GDP)



Source: IMF October 2022 WEO.
Note: Ireland was omitted as an outlier.

... AND INCREASED EU PUBLIC RISK-SHARING...

In May 2020, the EU Heads of State committed € 540 billion to fight the Covid-19 crisis



Support for workers:

Up to €100 bn in loans to EU member states under the **European Commission's SURE** programme in support of national unemployment schemes.



Support for companies

A pan-European **guarantee fund** by the European Investment Bank (**EIB**) of €25 bn, which could provide around €200 bn of financing for companies (SMEs)



Support for countries

The **ESM's Pandemic Crisis Support**, a precautionary credit line with a total volume of up to €240 bn, available to all EA countries until the end of 2022 to support healthcare-related costs of up to 2% of GDP.

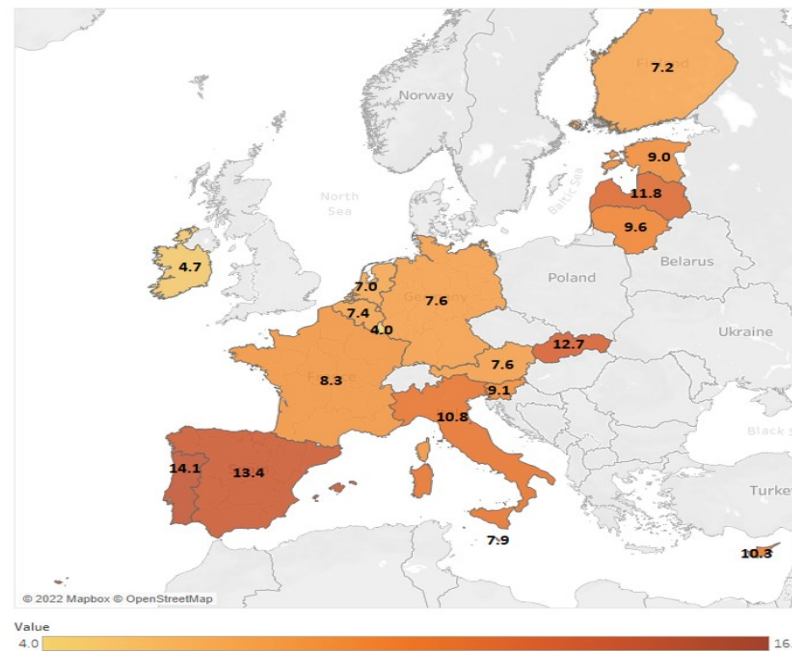
CORE EU ACTION: TARGETED THE MOST VULNERABLE MEMBERS AND STRUCTURAL CHALLENGES

Next Generation EU package, total amount: €750 billion

Recovery and Resilience Facility: grants and loans: maximum allocations
(In % of 2021 GDP)

Contribution key:

- Skewed towards countries most hit by the pandemic
- **REDISTRIBUTION TOWARDS THE MOST VULNERABLE MEMBERS**



Recovery and Resilience Facility

- 37% green, 20% digital transitions
- Grants (€312.5 bn) and loans (€360 bn)
- High degree of solidarity
- National Resilience and Recovery Plans

Contribution to other EU programs

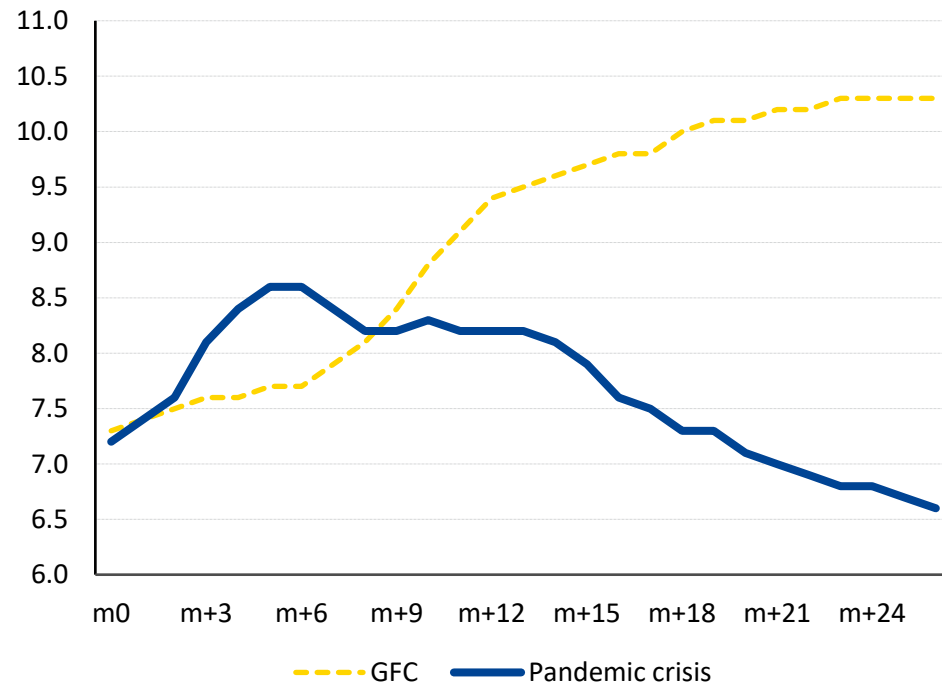
- Regional and rural development;
- climate neutrality;
- research and innovation

Source: European Commission, European Parliament.

Note: Grants distribution is computed based on European Commission June 2022 update. The maximum volume of the loan support for each Member State corresponds to 6.8 % of its 2019 gross national income (article 14 (5) of the RRF Regulation).

COORDINATED ACTION PRESERVED EMPLOYMENT AND CREDIT

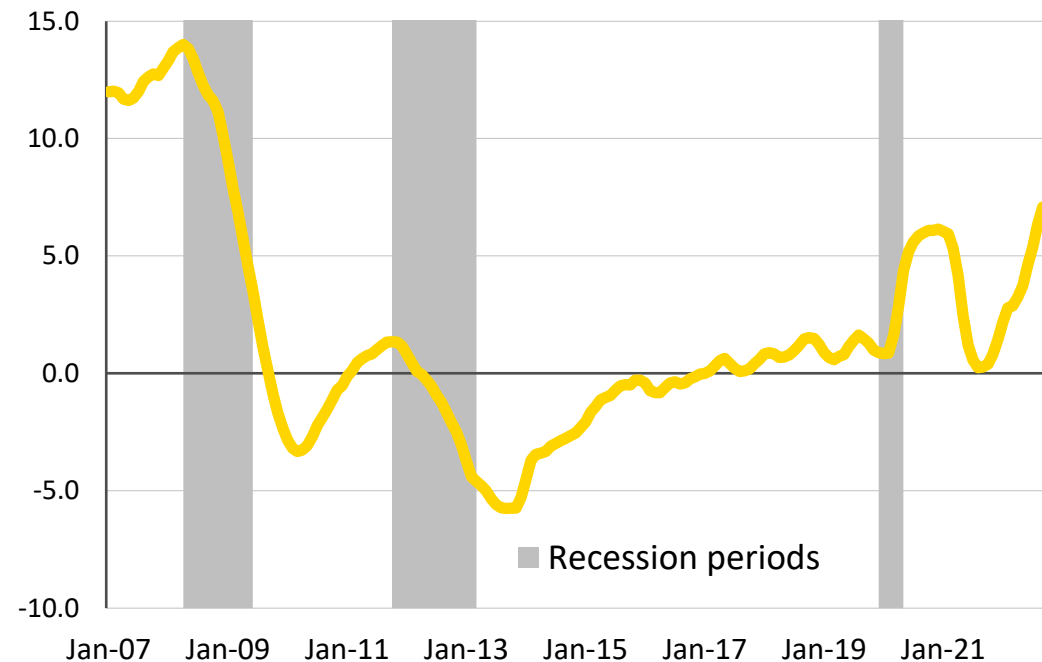
EA unemployment rate
(% of labour force, s.a.)



Sources: Eurostat.

Note: in Pandemic crisis, m0=Feb-20, in Global Financial Crisis (GFC) m0=Mar-08.

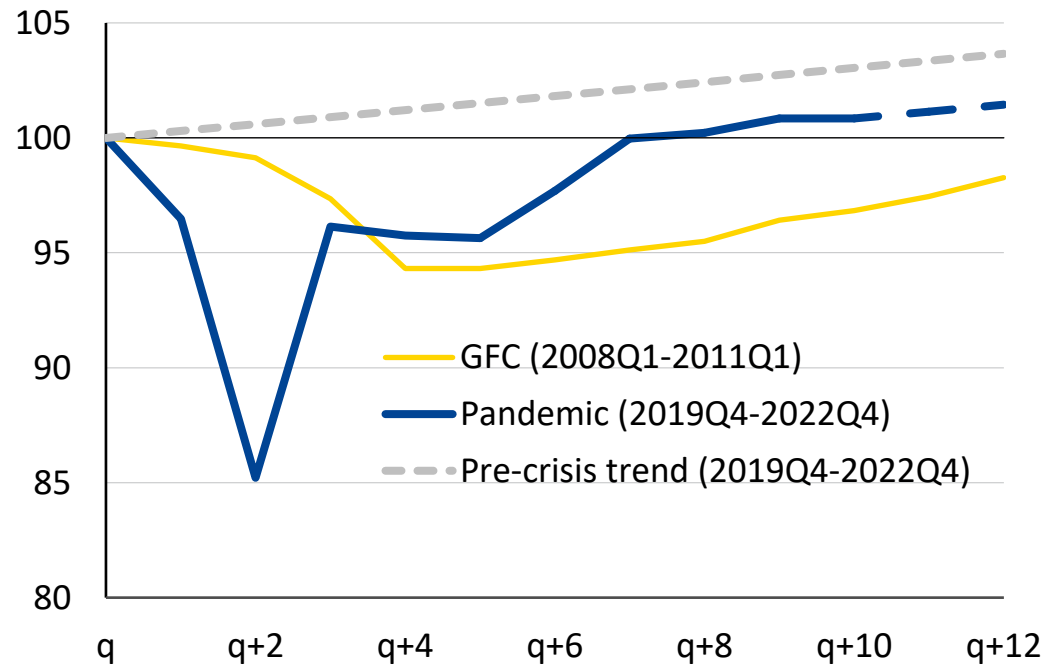
EA: Credit to non-financial corporations
(% yoy, 3m avg)



Source: ECB and Haver. Monetary Financial Institutions' assets: loans to domestic NFC. Loans are adjusted for loan sales and securitisation.

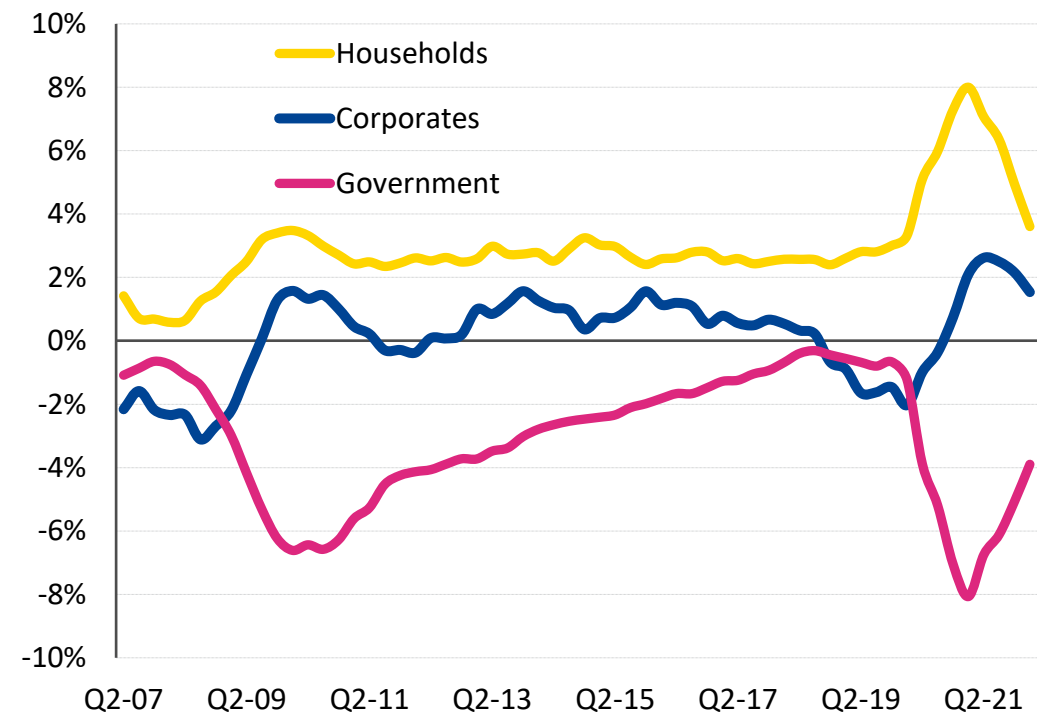
THE ECONOMY RECOVERED FAST, PUBLIC BUDGETS ABSORBED THE SHOCK AND FISCAL VULNERABILITIES INCREASED

**EA real GDP level since the pandemic:
comparison with global financial crisis**
(Index pre-crisis quarter = 100)



Sources: ESM calculations based on EC 2022 Summer forecast and Eurostat. Note: 2022Q2 data point is based on latest Eurostat flash estimates.

Non-financial sector: net lending/borrowing
(% GDP, cum 4Q)



Source: Eurostat.

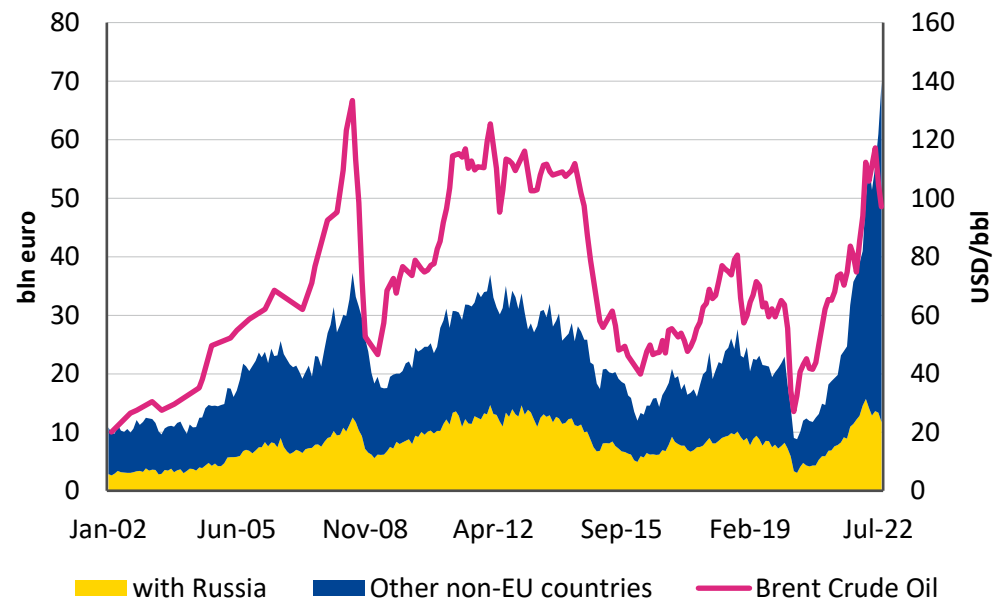
SECOND TALE: THE RUSSIAN INVASION OF UKRAINE AND THE ENERGY CRISIS.....THIS TIME IS DIFFERENT



ENERGY PRICE SHOCK: PERMANENT TRANSFERS OF INCOME ABROAD...

Increase in energy prices results in transfers of income abroad

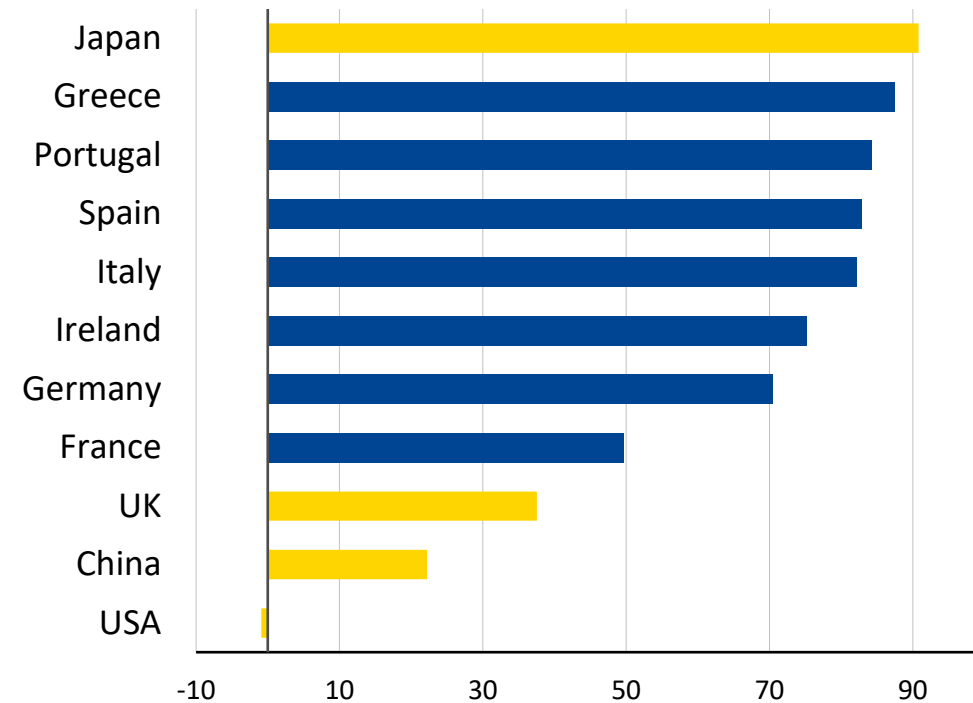
(EU energy trade deficit and oil prices on rhs)



Source: Eurostat and Haver Analytics.
Note: Last data point 30 August 2022.

Energy dependency

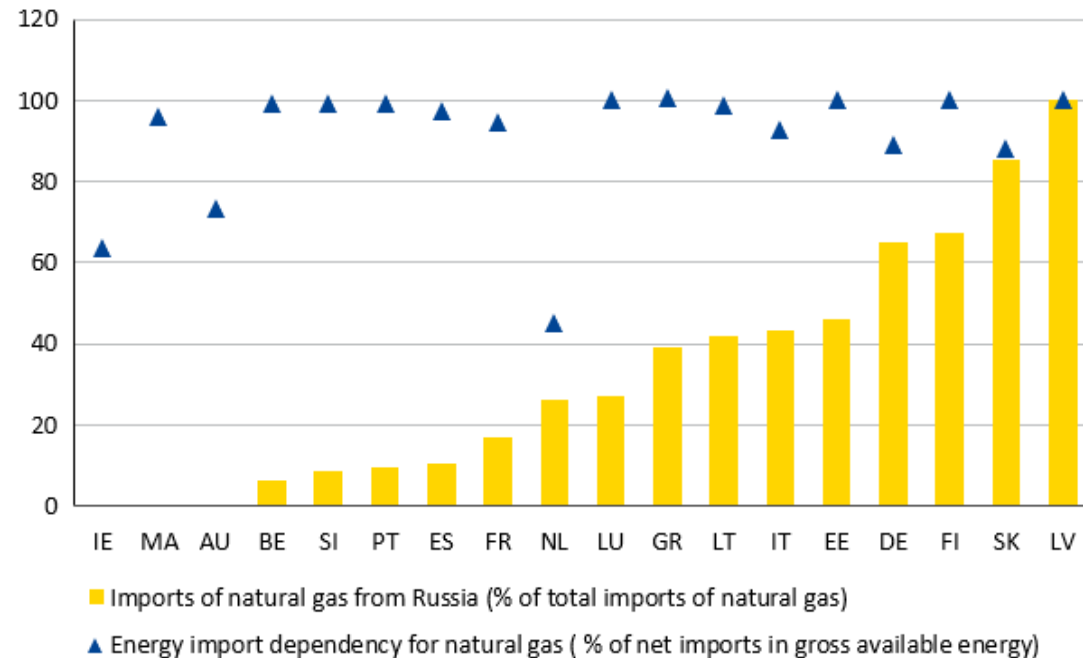
(net imports of energy goods/ total supply,%)



Source: International Energy Agency (IEA). Note: Latest available data from 2019.

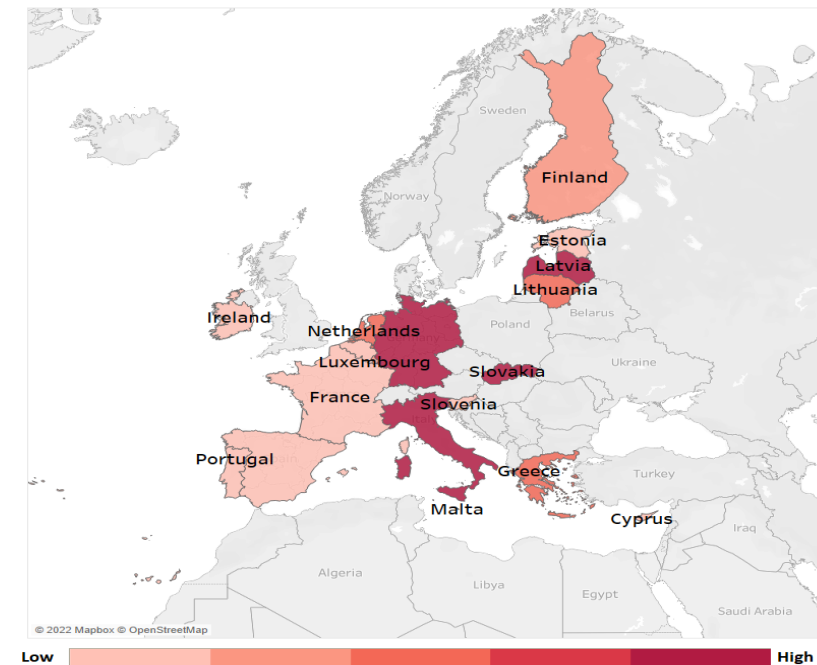
... DIFFERENT COUNTRIES BECOME VULNERABLE ...

EA imports of natural gas
(%, 2020 data)



Source: Eurostat. The energy import dependency is calculated from energy balances as net imports divided by the gross available energy. Energy dependence = (imports – exports) / gross available energy.

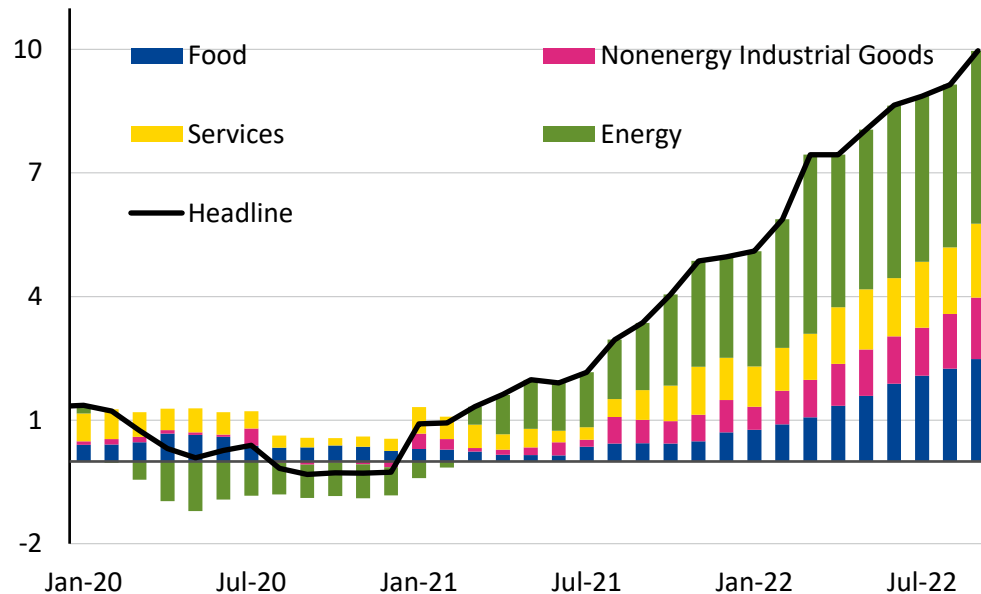
EA countries exposure to disruptions in
Russian gas supply: vulnerability map



Source: Eurostat and ESM calculations. Note: The map is built on the basis on an index measuring each country's vulnerability to a possible disruption (or reduction) of Russian gas supplies. The index accounts for: (i) the consumption of natural gas in each country's national energy mix and (ii) the share of natural gas imported from Russia as a share of total gas imports.

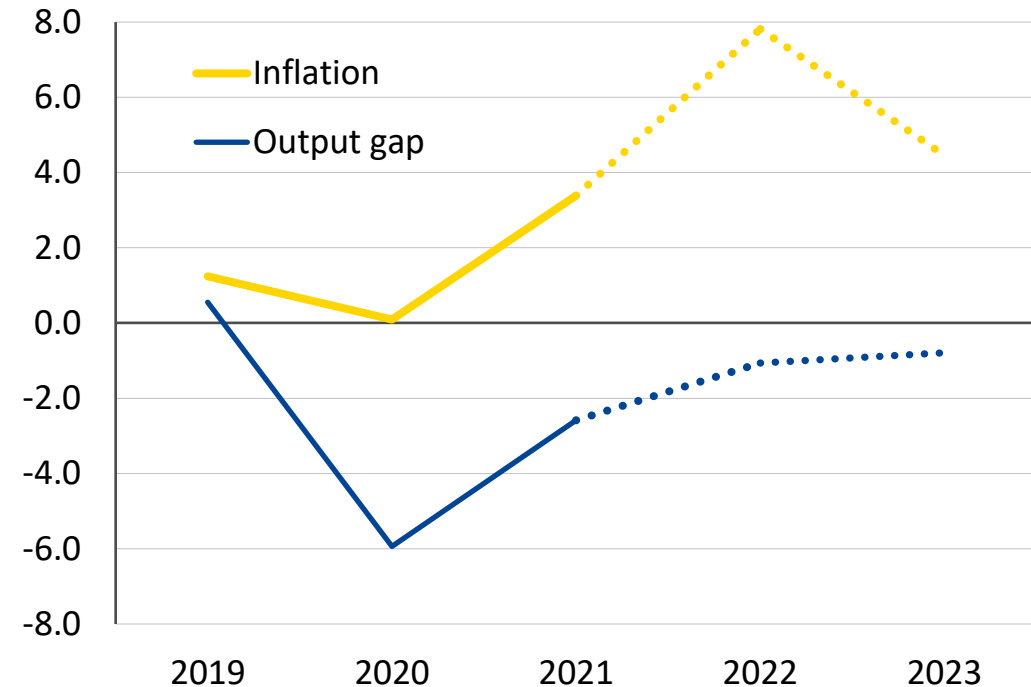
MONETARY POLICY IS FOCUSED ON PRICE STABILITY

HICP inflation and components (yoy growth rates in %)



Source: Eurostat.

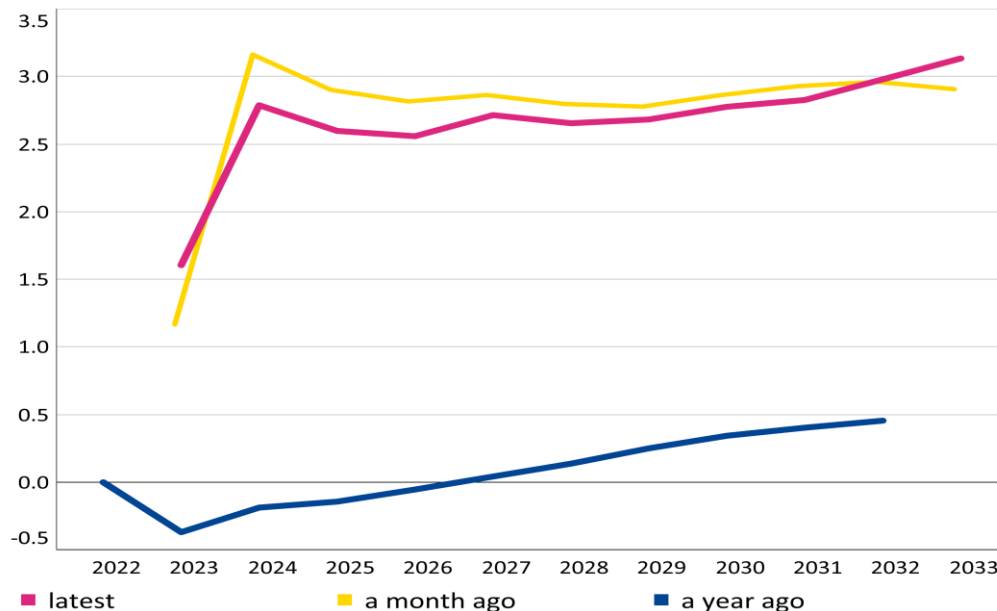
EA inflation vs output gap: average estimates of EC, IMF and OECD (in % yoy and % of potential GDP)



Source: EC May and July 2022, OECD June 2022, IMF October 2022.

ASSET PURCHASES CONTINUE TO CONTAIN FRAGMENTATION RISKS

Market-implied path of short-term rates (ESTR 3m, %)



Source: ESM based on Bloomberg

Note: The latest refers to the latest data point available – 26 October 2022.

PEPP reinvestment flexibility:

- Reinvestments skewed towards Italy, Spain, Greece, Finland, and Portugal.

ECB's Transmission Protection Instrument:

- TPI designed to ensure smooth monetary policy transmission if spreads widen beyond fundamentals
- The purchases subject to eligibility criteria, including **fiscal sustainability**
- When assessing public debt sustainability, the ECB to take into account analyses conducted by the institutions incl. ESM

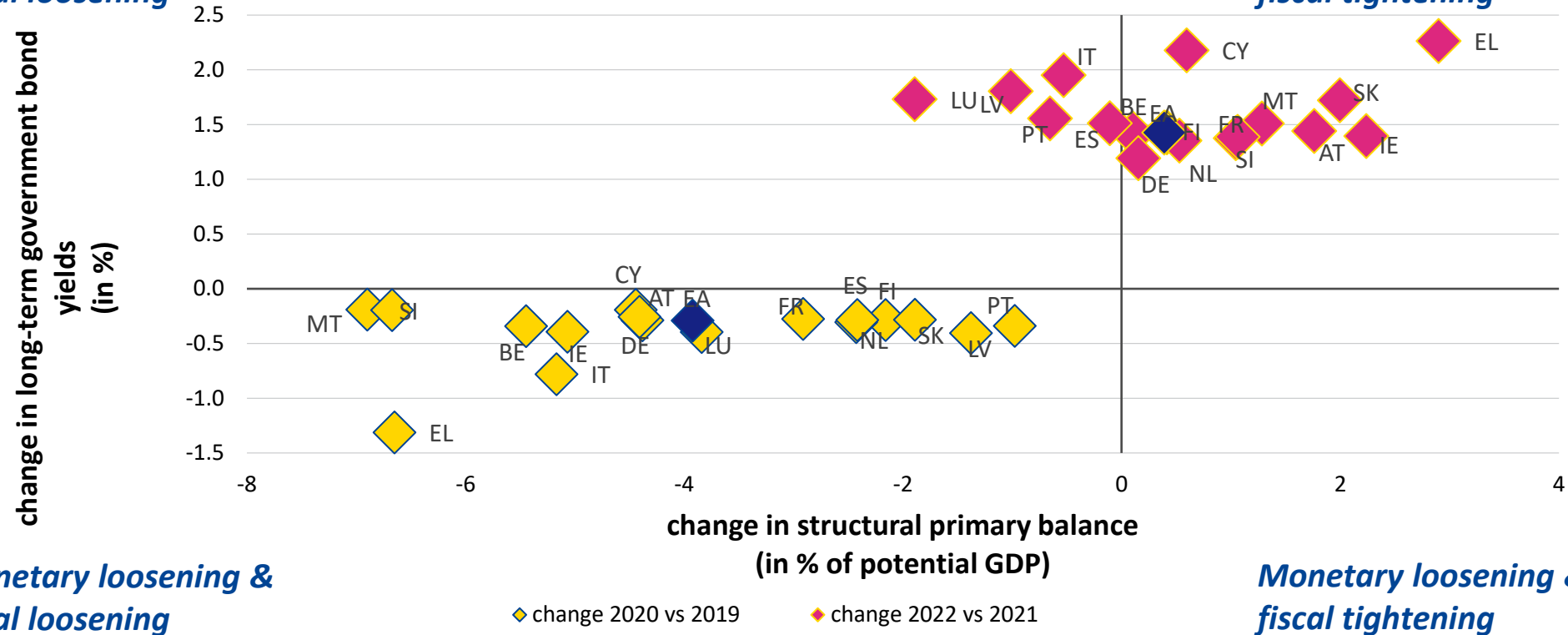
Outright Monetary Transactions:

- Contingent on “strict conditionality” attached to an ESM credit line or adjustment programme.

FISCAL VS MONETARY POLICY INTERACTION

Monetary tightening & fiscal loosening

Monetary tightening & fiscal tightening



Source: IMF WEO and Fiscal Monitor database, ECB and Haver.

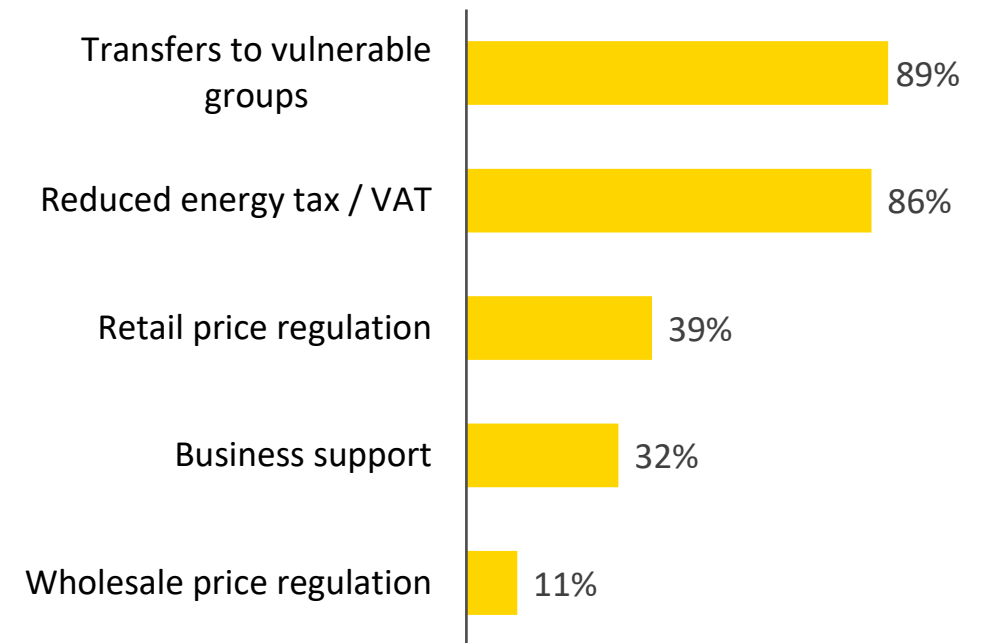
Note: The change in primary structural balance was computed by subtracting the 2019 from 2020 and similarly 2021 from 2022. Estonia and Lithuania are not depicted due to the missing data.

EFFECTIVENESS OF RESPONSE TO RISING ENERGY PRICES – TRADE-OFFS IN A SUPPLY SHOCK

Policy measure	Reduce inflationary pressure	Incentivise to reduce energy consumption	Effectively protect vulnerable
Price cap	Yes	No	No
Tax reduction (VAT, energy)	Yes	No	No
Income support	No	Yes	Yes (if targeted)
Energy voucher	No	Yes (if constrained)	Yes (if targeted)

Source: ESM based on various sources Pisani-Ferry, J., Blanchard, O. (April 2022), OECD (2022), ECB (2022).

EU: National policies vs energy prices (% EU countries)



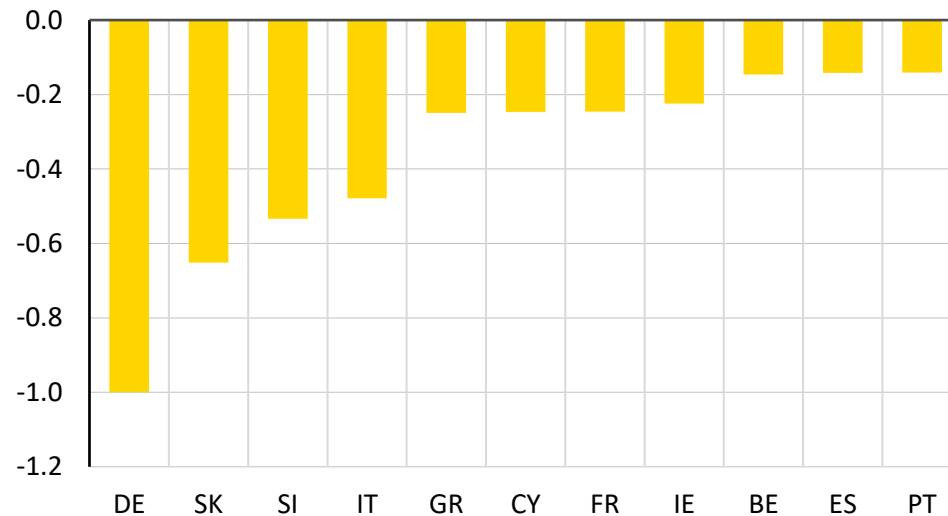
Source: ESM based on Bruegel database- Sgaravatti, Tagliapietra and Zachmann (2022).

Note: The graph covers measures enacted or proposed in all EU countries

SPILLOVERS FROM NATIONAL RESPONSE

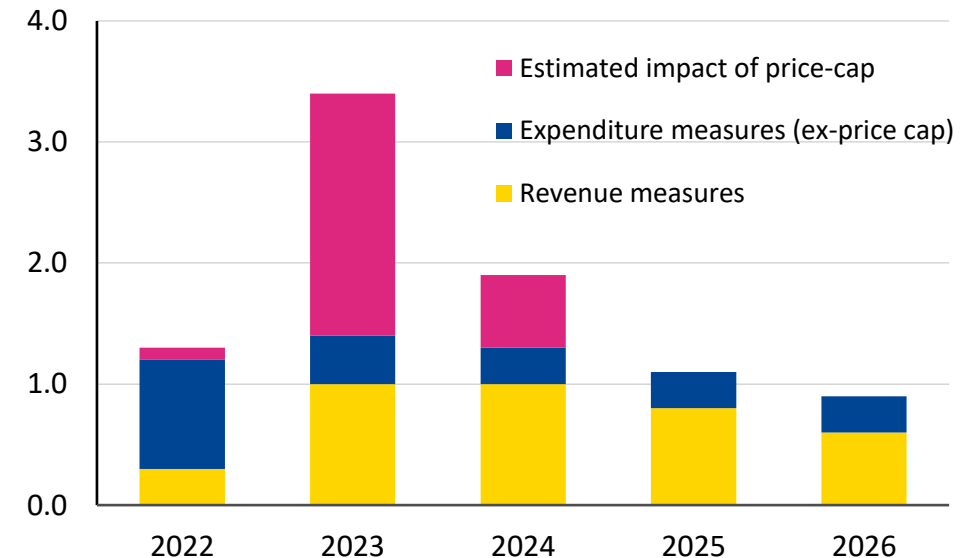
- Spillover risks from Germany to other economies through both supply and demand channels
- Estimated fiscal costs of the Germany support package: up to 9% GDP over 5 years

Demand-side spillovers from DE to other EA countries
(elasticities representing impact from a 1% fall in Germany's GDP)



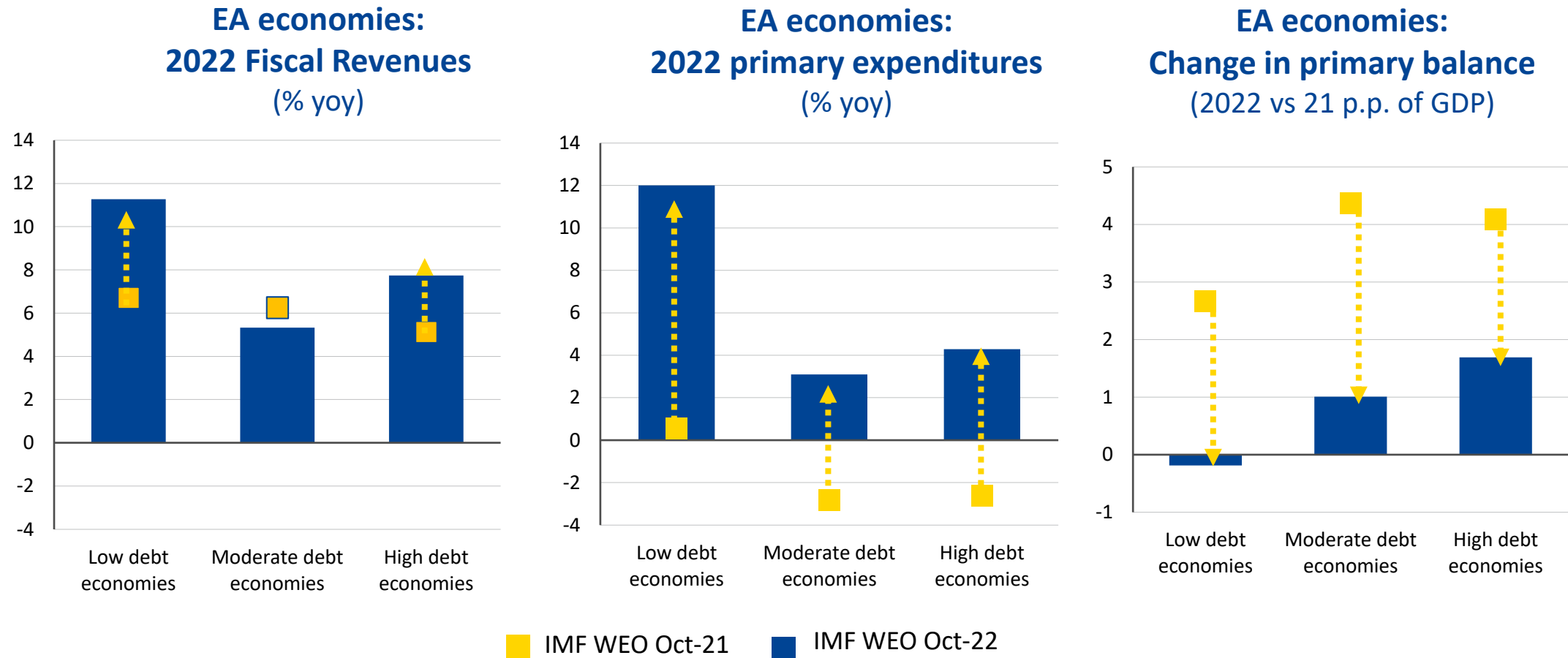
Source: ESM estimates. Results are based on a Vector Autoregressive model. A demand spillover is defined as a shock that affects Germany's GDP growth by more than other countries.

Germany: fiscal impact of energy relief measures
(% of GDP)



Source: ESM calculations and 2023 Draft Budgetary Plan.

FISCAL PERFORMANCE IN 2022

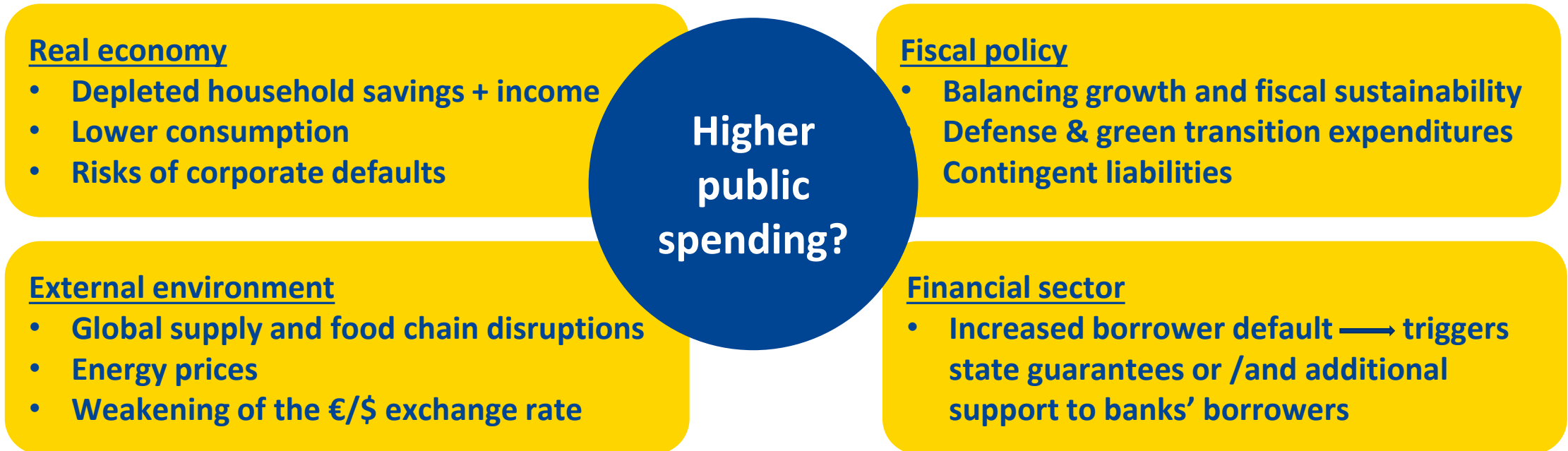


Source: Own calculations based on IMF WEO database. Note: Countries grouped based on their average public debt to GDP ratio in 2012-20. Low debt countries (debt ratio below 60%) = EE, LU, LT, LV, MT, SK; Moderate debt countries (debt ratio between 60% and 90%) = NL, IE, FI, DE, SI, AT; high debt countries (debt ratio above 90%) = CY, FR, BE, ES, PT, IT, EL. Variables calculated as 2021 GDP-weighted average of each group

WAY FORWARD



FISCAL CHALLENGES AND RISKS AHEAD



Pandemic shock + energy crisis = Need for structural change

EU FISCAL POLICY COORDINATION: EU FISCAL RULES REFORM

Reduce
complexity

Expenditure rule

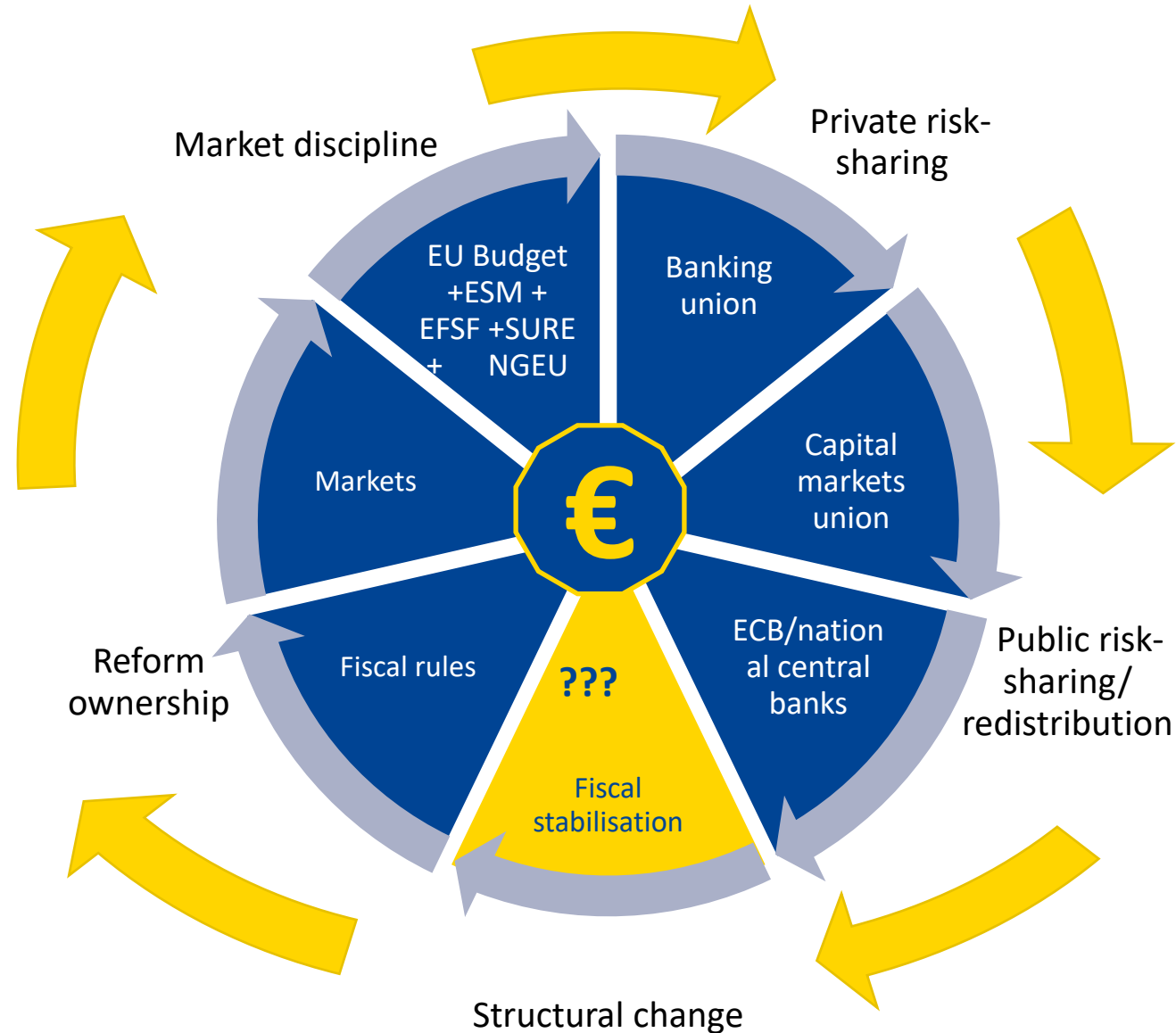
Ensure
sustainability

Credible debt adjustment
path as an anchor

Improve
enforcement
and ownership

Scaling incentives &
strengthening of national
institutions

MORE PUBLIC RISK-SHARING TO COMPLEMENT PRIVATE CHANNELS?



THANK YOU

