



EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-UNRESTRICTED

The Covid19 crisis: a litmus test for European integration



October 2021 - online

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* The views expressed are those of the presenter and do not necessarily reflect the position of the ECB

Outline

1 The Economic and Monetary Union

- Key facts
- Policy coordination in EMU
- The quest for a better EMU governance

2 The COVID-19 crisis

- The challenges for the global economy
- The challenges for the European economy

3 EU response to the COVID-19 crisis

- ECB measures
- Fiscal and economic measures
- Where do we stand today

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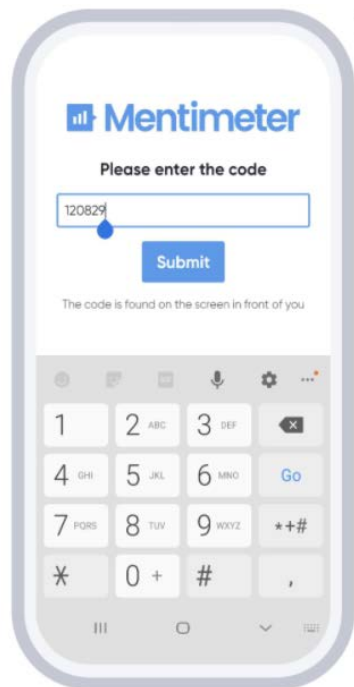
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A quick quiz



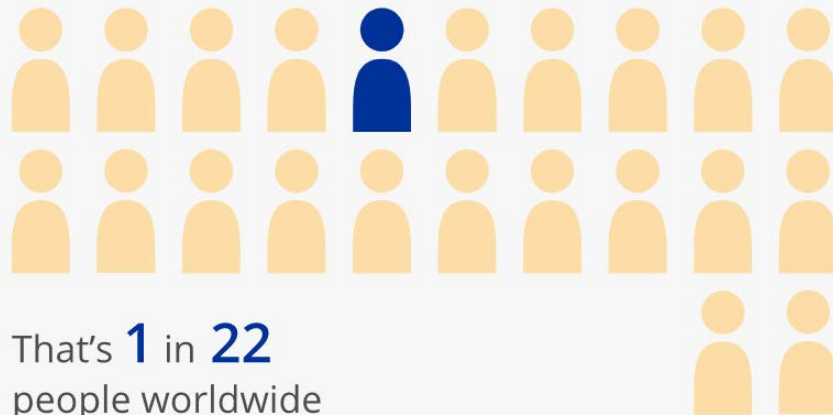
- Go to www.menti.com
- Add **8738 5545** as a code
- **Answer the questions**

The Euro Area



340 million

live in the euro area



That's **1** in **22**
people worldwide

Steps leading to the euro

1968

The Prime Minister of Luxembourg, Pierre Werner, proposed a single currency for Europe.

1979

The push for a common currency was revived. The European Monetary System (EMS) and European currency unit or "ECU" – the forerunner to the euro – were born.

1988

The process gained momentum when European leaders began to build the Single Market. A single currency was also needed for that market to work as well as possible.

1989

Based on the idea of one market, one money, the Delors Committee wrote a report on "Economic and Monetary Union in the European Community".

1992

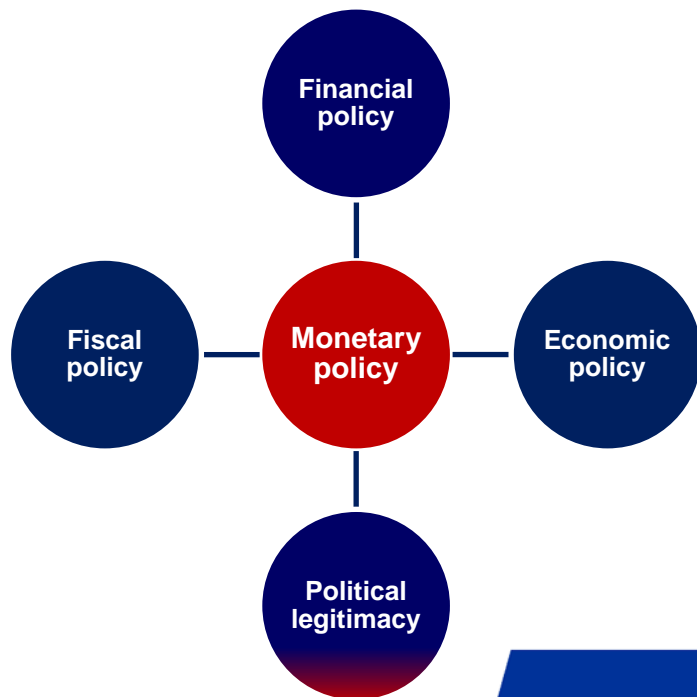
The Maastricht Treaty laid out the framework and further steps for achieving economic and monetary union as well as the criteria that Member States had to meet to adopt the single currency.

1999

The euro was born!

A central monetary policy but more decentralised financial, fiscal and economic policies

EMU of the Maastricht Treaty (1992)



Interdependence
of closely related
policy fields

Single policies....

Single policies: monetary policy and banking supervision

How?

- common policy objectives defined in the EU Treaties
- centralised decision-making
- decentralised implementation

Why?

- externalities/spillovers
- political economy considerations

... and decentralised policies

Decentralised policies: budgetary policies, structural policies ...

How?

- Decentralised objectives and decision-making
- coordination within European framework (e.g. SGP, MIP)

Why?

- Heterogeneous preferences
- Specific national institutional settings
- Policy competition, learning from best practices

Zooming in: The economic policy in the Treaty

Economic policies shall ...

- ... be a matter of common concern, **subject to coordination when not centralised** (see monetary policy)
- ... contribute to the **objectives of the Union** (incl. growth, employment, price stability)
- ... respect the **EU Single Market** (free movement of goods, services, labour and capital)

The three main institutions in EU law-making



European
Parliament



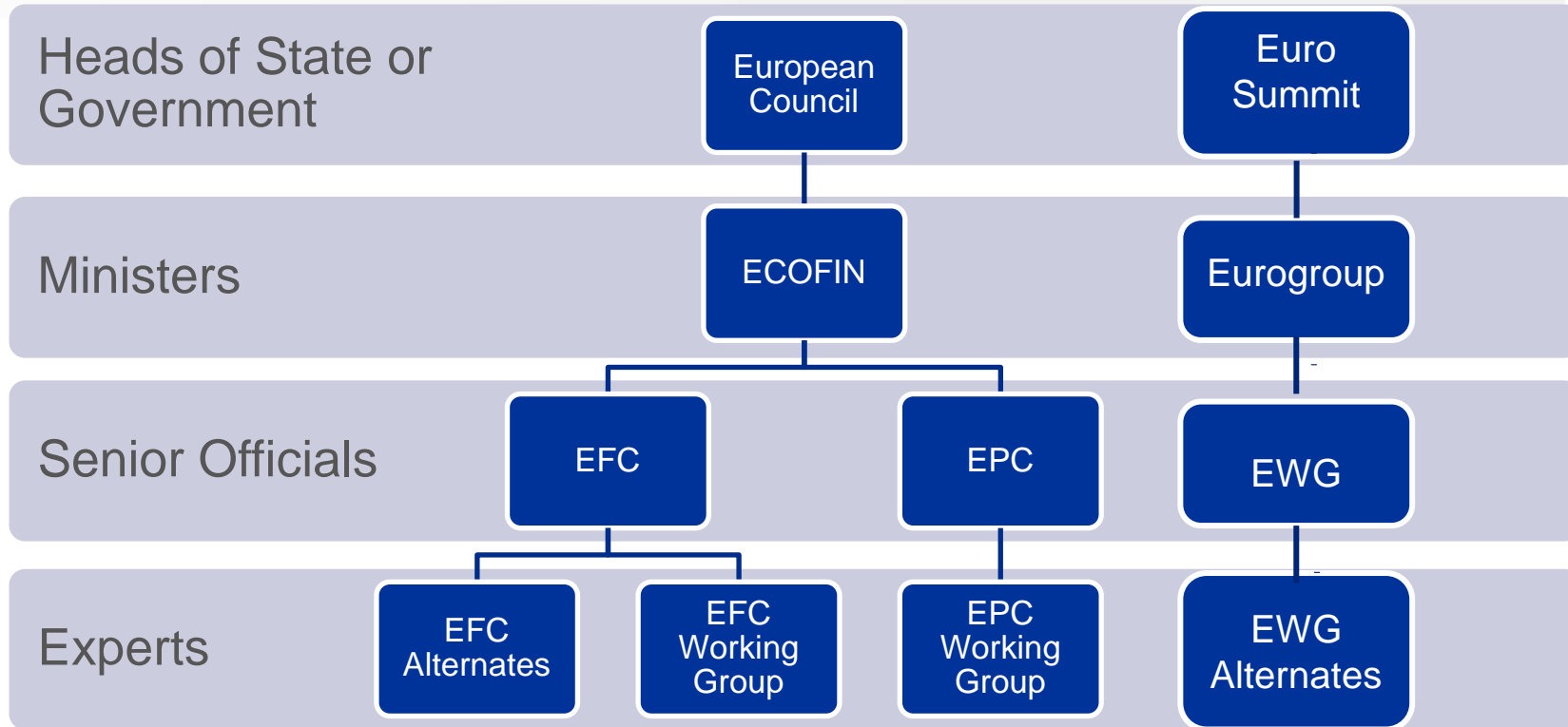
European Council
and Council EU



+ rotating
Presidency



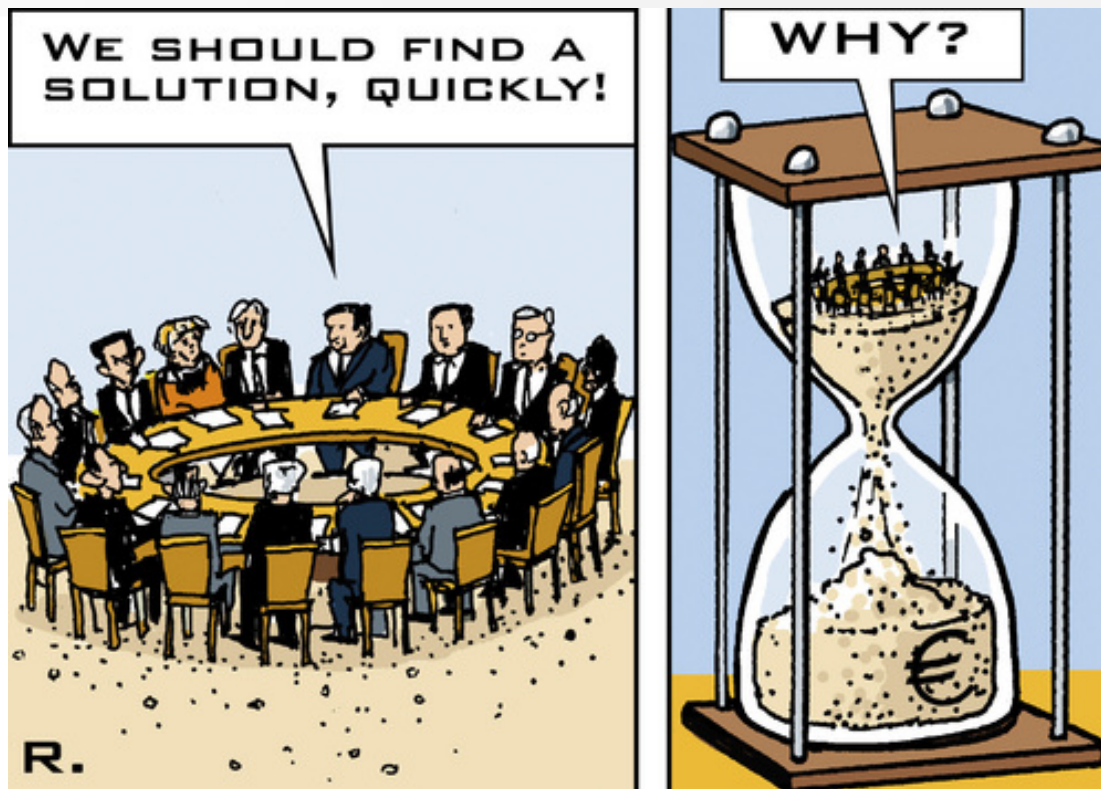
Cooperation within EU and EMU



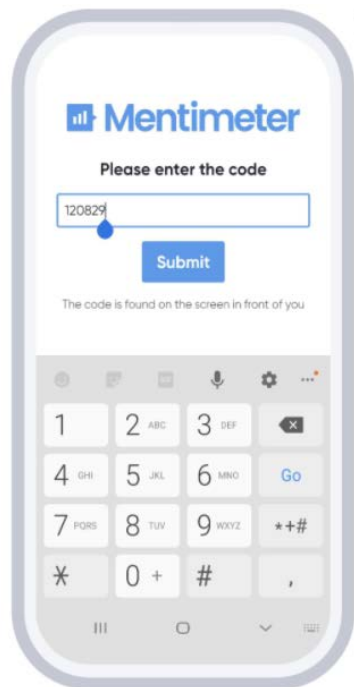
Leading to plenty of interactions

[illegible]

Complex decision-making process



Come back to menti...

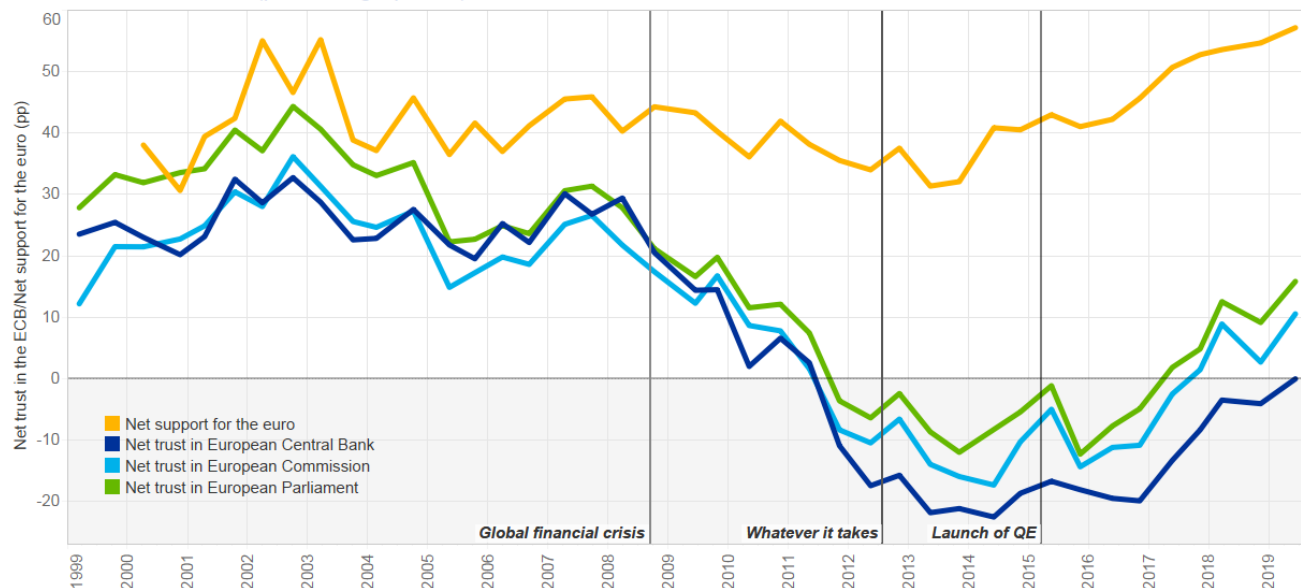


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Support for the euro remains high but trust in the EU institutions has faltered

Net support for the euro and net trust in European institutions

Euro area, 1999-2019 (percentage points)

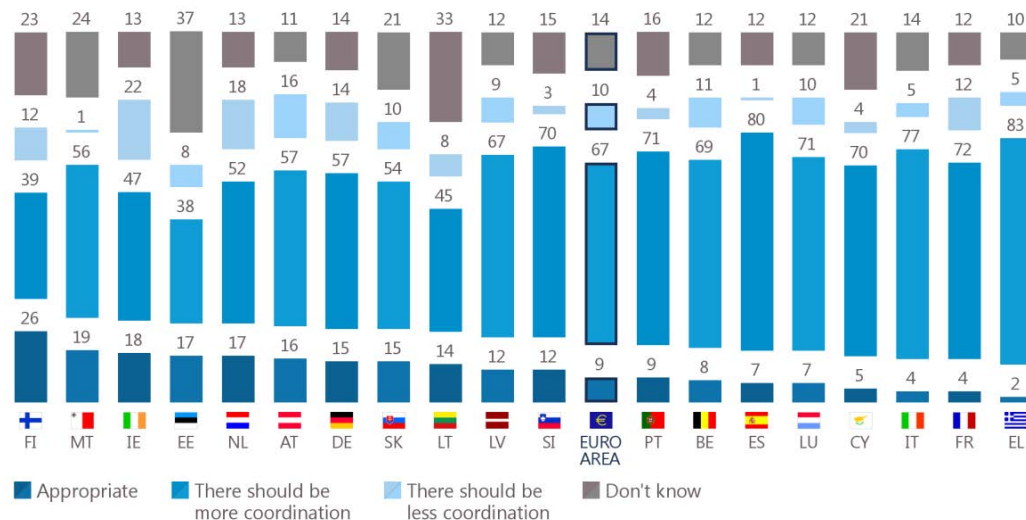
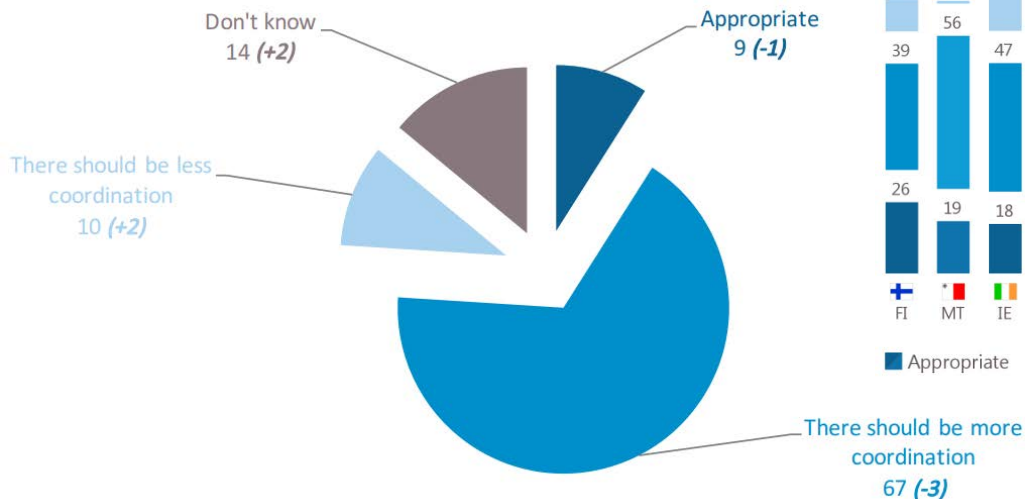


Source: Eurobarometer and ECB Staff calculations

Broad support of economic policy coordination across the euro area

Do you think that the degree to which economic policy, including budgetary policies, is coordinated in the euro area is appropriate? Should there be more or less coordination among euro-area governments?

(% - EURO AREA)



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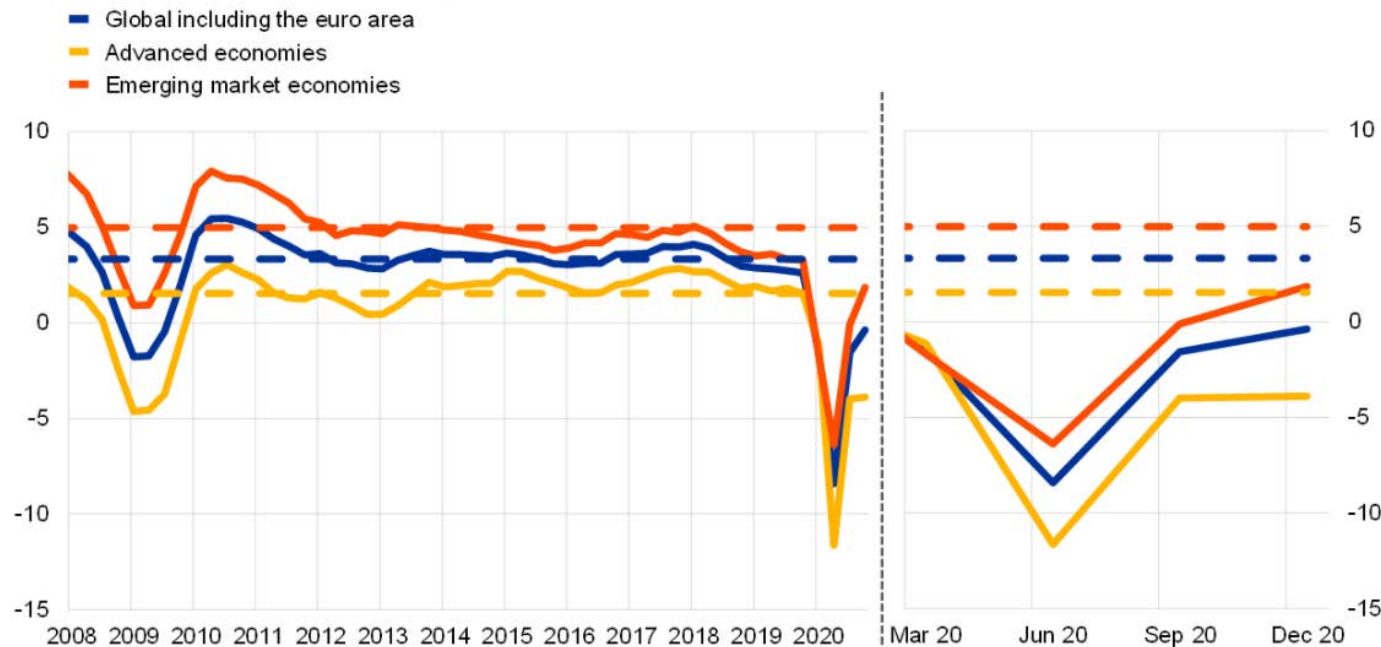
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Severe effects on the global economy (I)

Global GDP growth

(annual percentage changes; quarterly data)

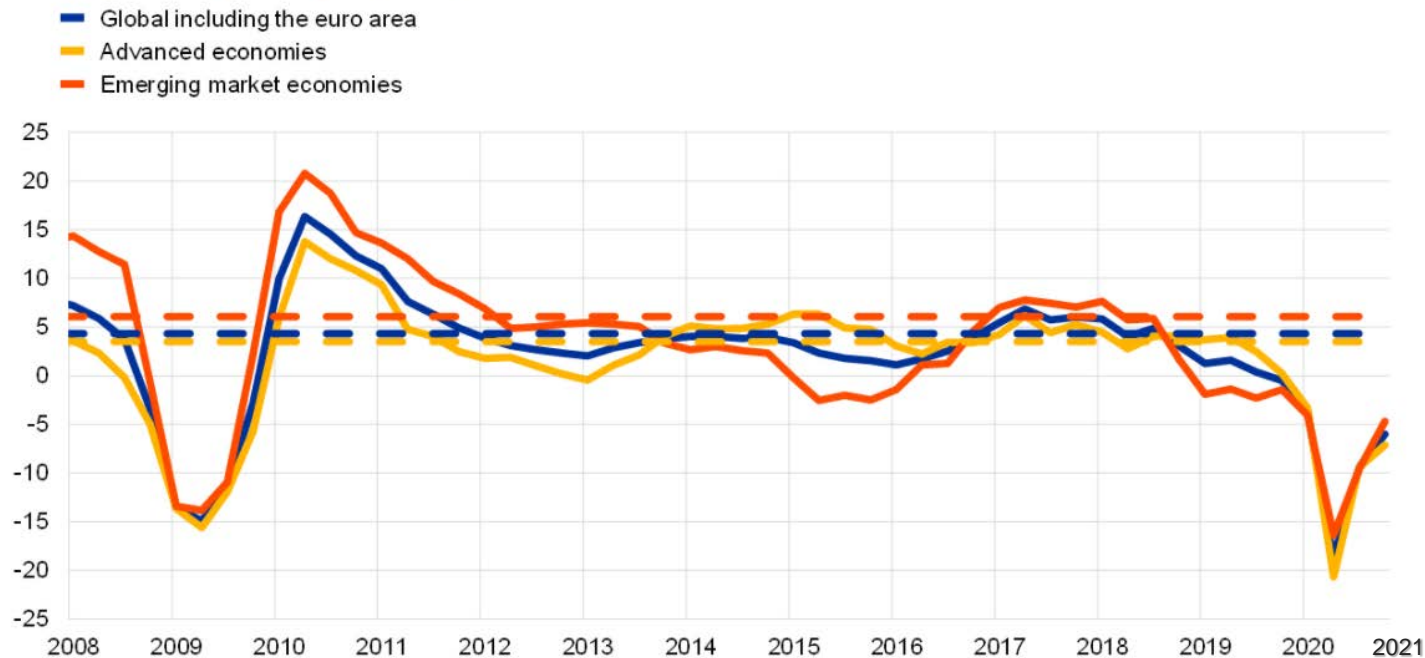


Sources: Haver Analytics, national sources and ECB calculations.

Severe effects on the global economy (II)

Global trade growth (import volumes)

(annual percentage changes; quarterly data)

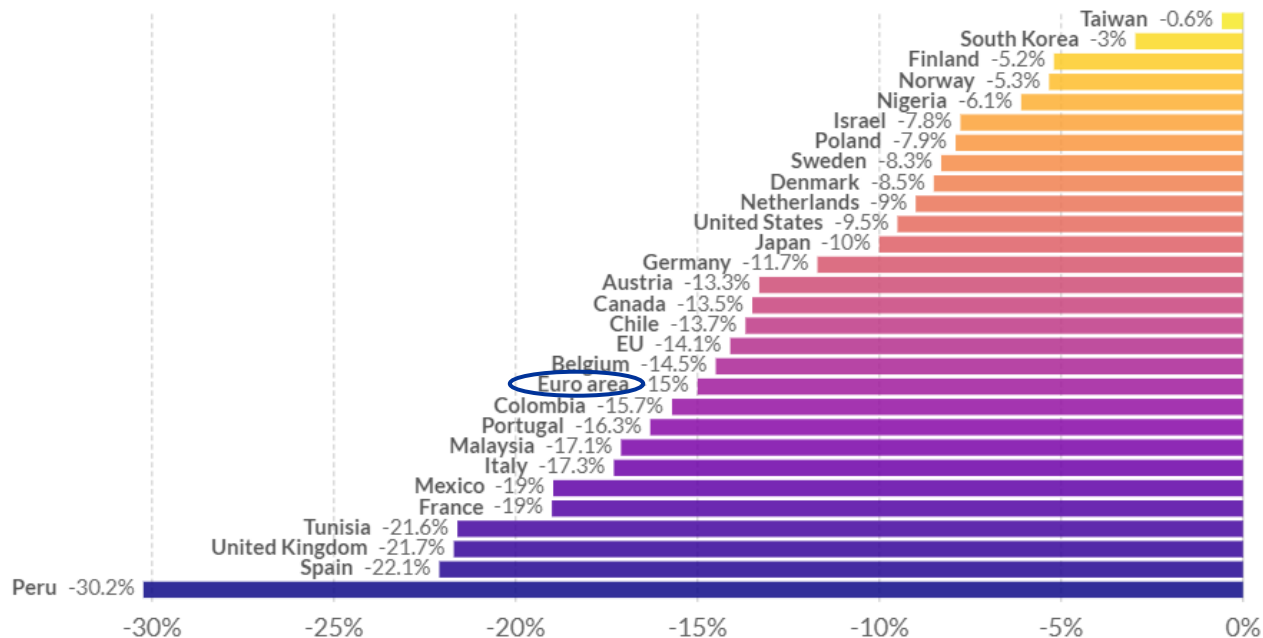


Sources: Haver Analytics, national sources and ECB calculations.

The scale of the economic downturn

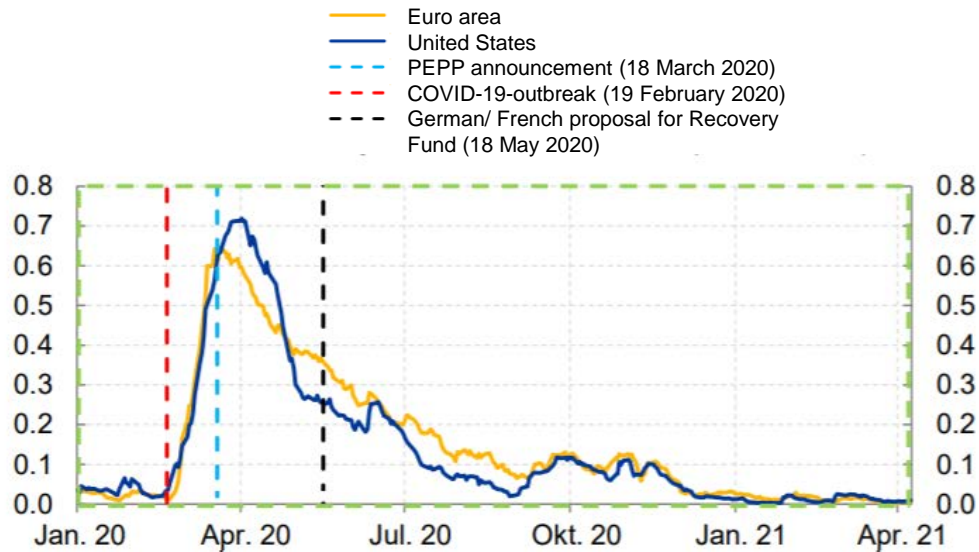
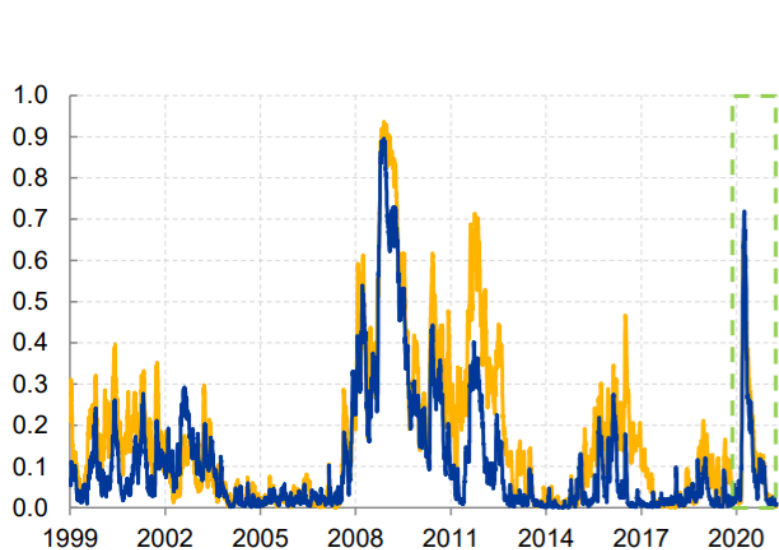
Economic decline in the second quarter 2020

(The percentage decline of GDP relative to the same quarter in 2019. Adjusted for inflation.)



Severe financial turbulences

Indicators of Systemic Stress in the Financial Market (CISS)



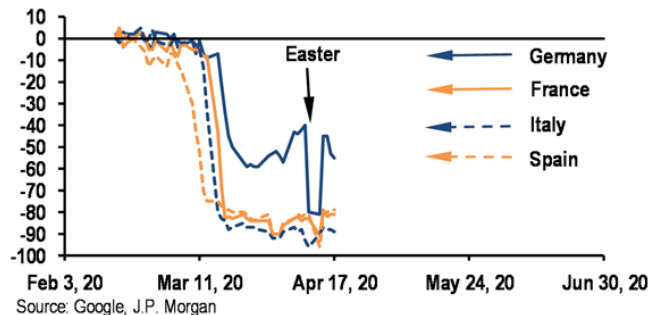
The pandemic has affected all aspects of economic activity



Measuring key variables under lock-downs was tricky

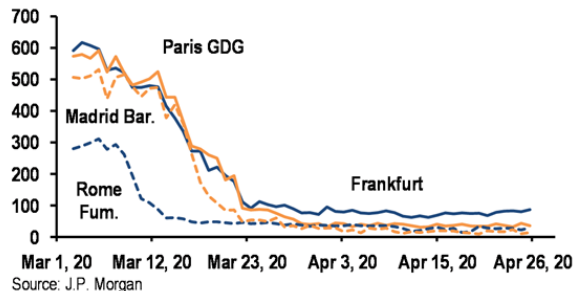
Google mobility report: Visits to retail and leisure places

% visits to places relative to Jan 3-Feb 6 baseline



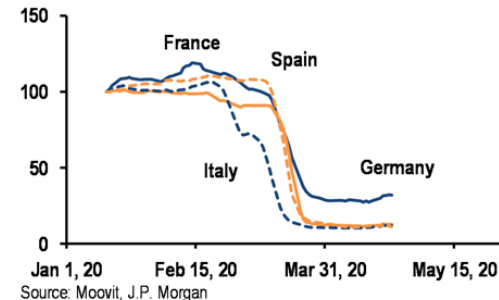
Flightradar tracked flights

Number of daily flights



Moovit public transit app usage index

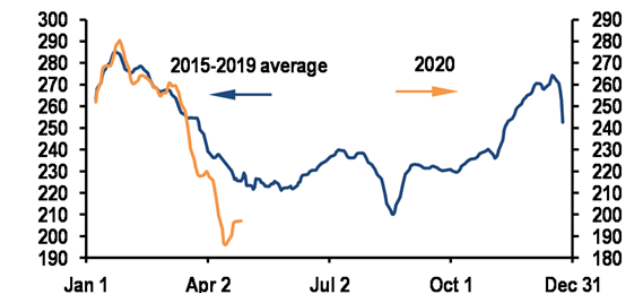
Week ending Jan 15 = 100



Euro area daily electricity consumption

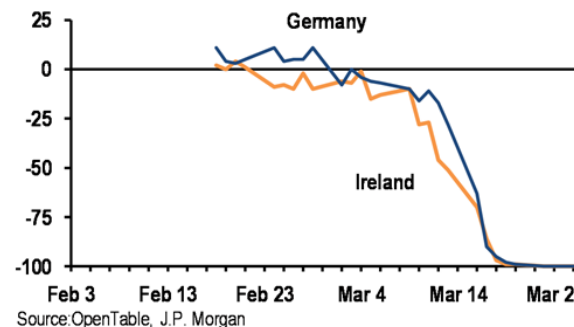
Megawatts, 000s, 5-day ma

Megawatts, 000s, 5-day ma



OpenTable online restaurant bookings

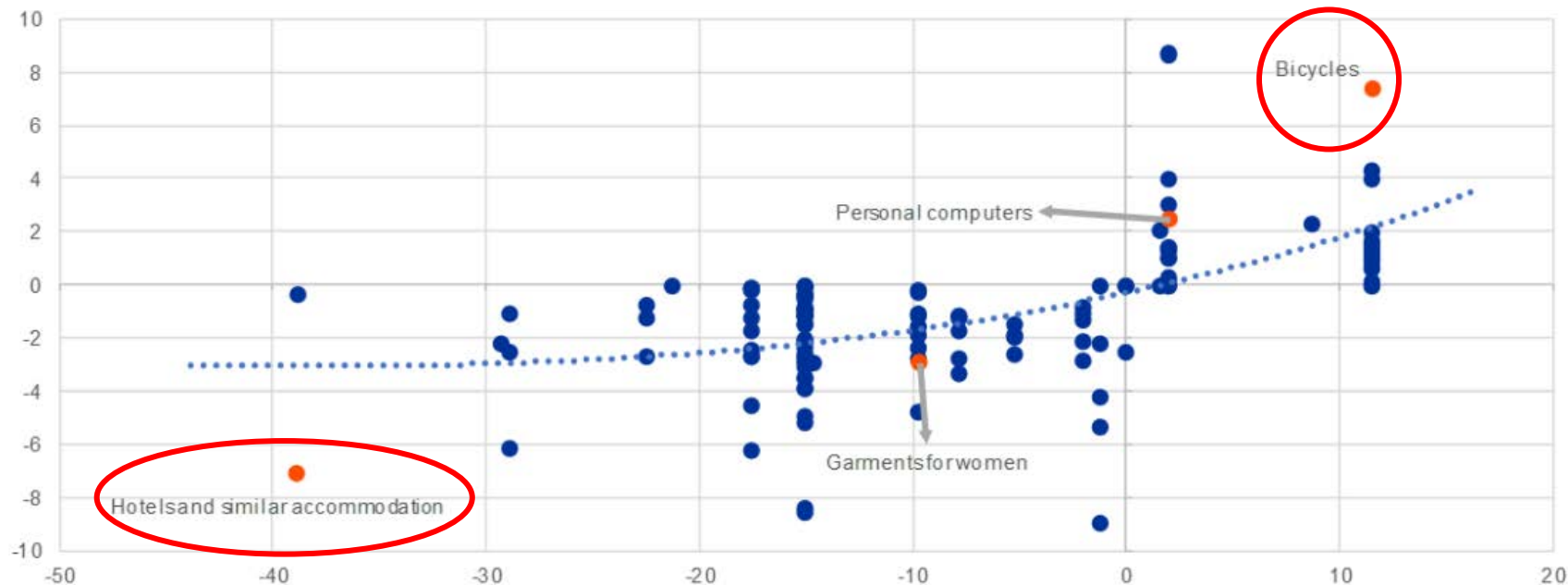
%oya



Pandemic changed consumer behavior in the euro area

Changes in demand and prices for goods and services

(x-axis: year-on-year change in consumption expenditure in Q3 2020; y-axis: change in inflation from January to November 2020 over standard deviation 2018-19)



Sources: Eurostat and ECB calculations.

The economic slump in the euro area in numbers



The economy shrank as a result of the COVID-19 pandemic

-6.6%

Euro area economic activity developed unevenly in 2020 as a consequence of the pandemic, contracting sharply in the first half of the year and recovering partly in the second half. Overall, GDP fell by 6.6% compared with 2019.



Inflation declined over the course of the year

0.3%

Average inflation in the euro area fell to 0.3% in 2020 from 1.2% in 2019, as price developments were also strongly affected by the pandemic.



Extra liquidity supported the funding of businesses and households

€2.2 trillion

Central bank liquidity in the banking system increased by €2.2 trillion on account of the ECB's measures to support funding conditions in the economy and safeguard medium-term price stability.

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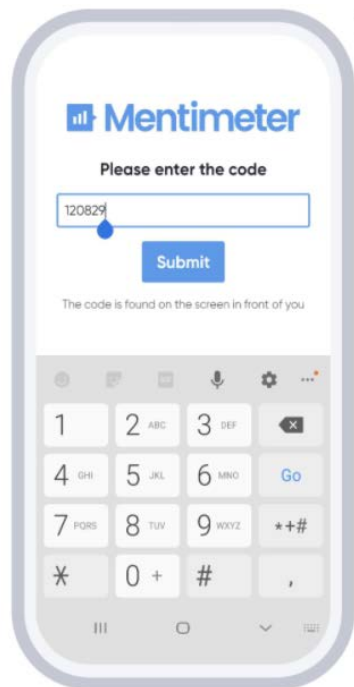
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Last test 😊



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How do central banks influence the economy?

Open market operations
Reserve requirements

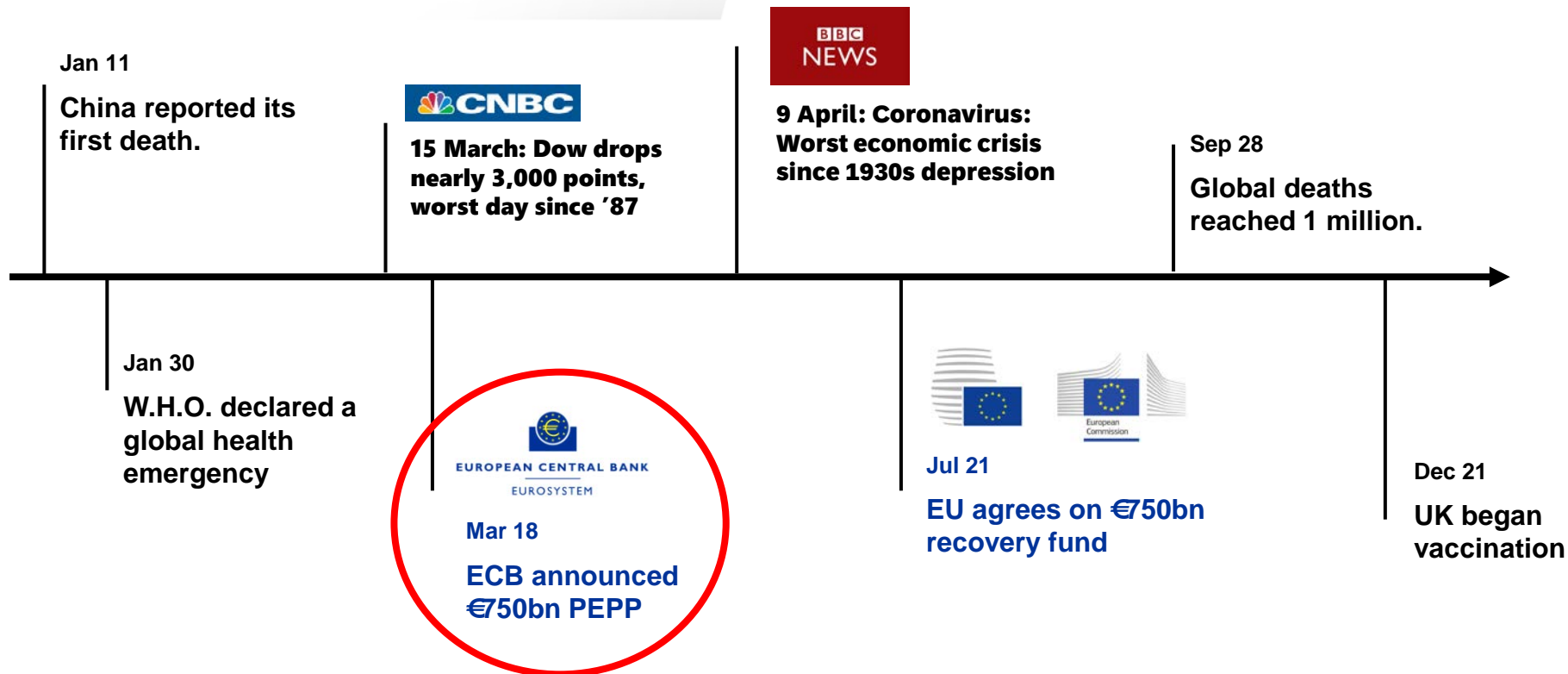
Loans
Deposits



Official interest rates
("price of money")

Commercial bank
interest rates

The ECB was among the first to act



ECB monetary policy measures



We've launched a **€1.85 trillion** pandemic emergency purchase programme that aims to help citizens and firms to access funds if they need them.



We have increased the amount of money that banks can borrow from us to grant **loans to households and businesses**.



We are keeping borrowing affordable via our very **low key interest rates**.



Ensuring short-term concerns do not prevent lending



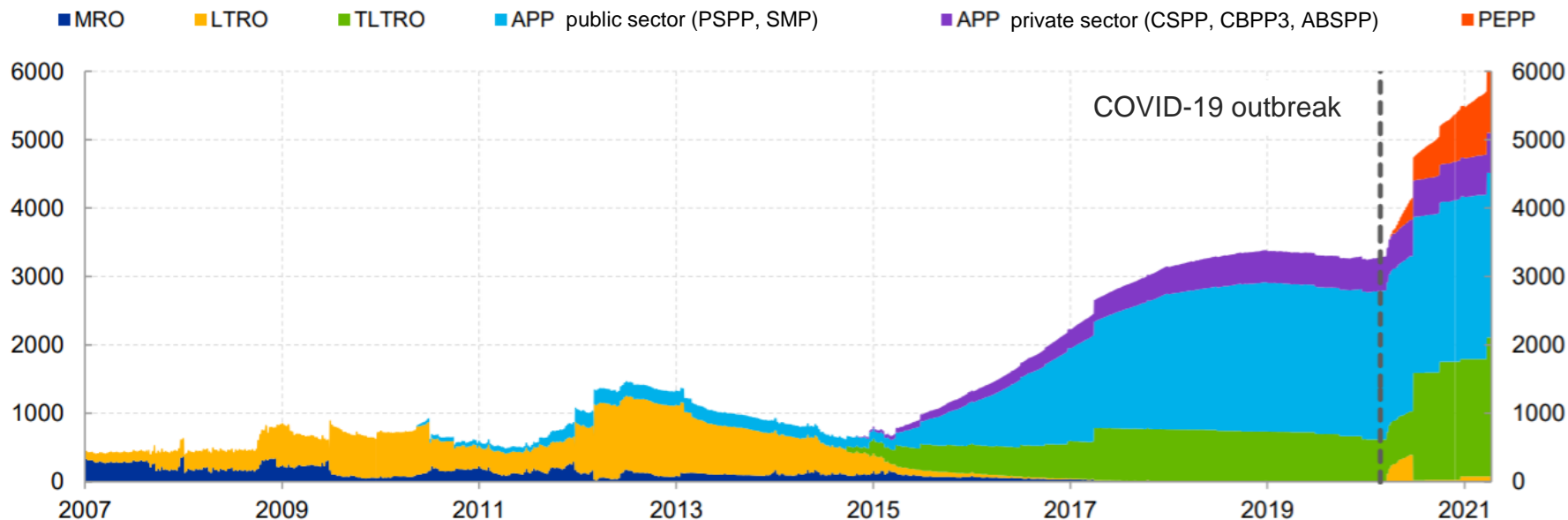
Preserving financial stability through international cooperation



Increasing banks' lending capacity

A forceful reaction by monetary policy...

Balance sheet of the ECB



Pandemic Emergency Purchase Program (PEPP)

PEPP

Introduced in March 2020, expanded in June and December 2020

Overall envelope of €1,850 billion

Objectives:

- ① support economic **recovery** and sustain inflation back towards **price stability**
- ② **stabilise** financial markets and safeguard functioning of **transmission mechanism**

Key feature: **flexibility** of purchases across

- ① time
- ② jurisdictions
- ③ asset classes

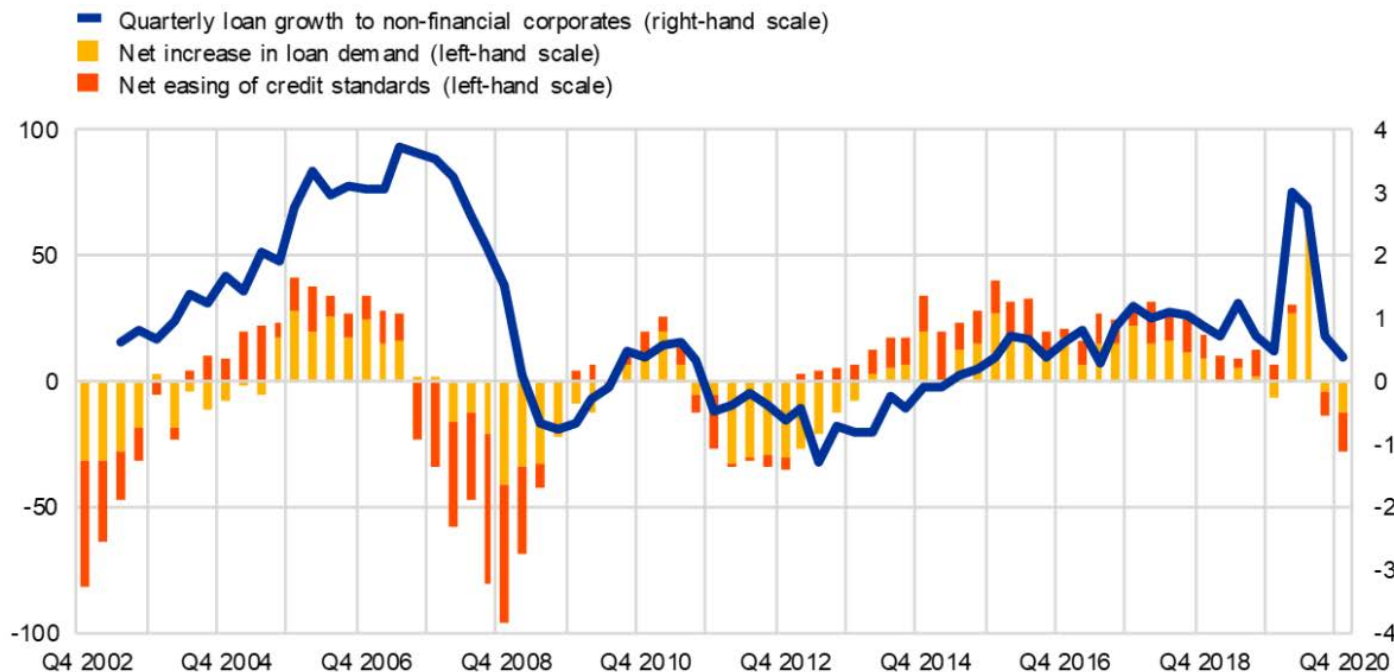


„Extraordinary times require extraordinary action. There are no limits to our commitment to the euro. We are determined to use the full potential of our tools, within our mandate.“

Christine Lagarde, 18 March 2020

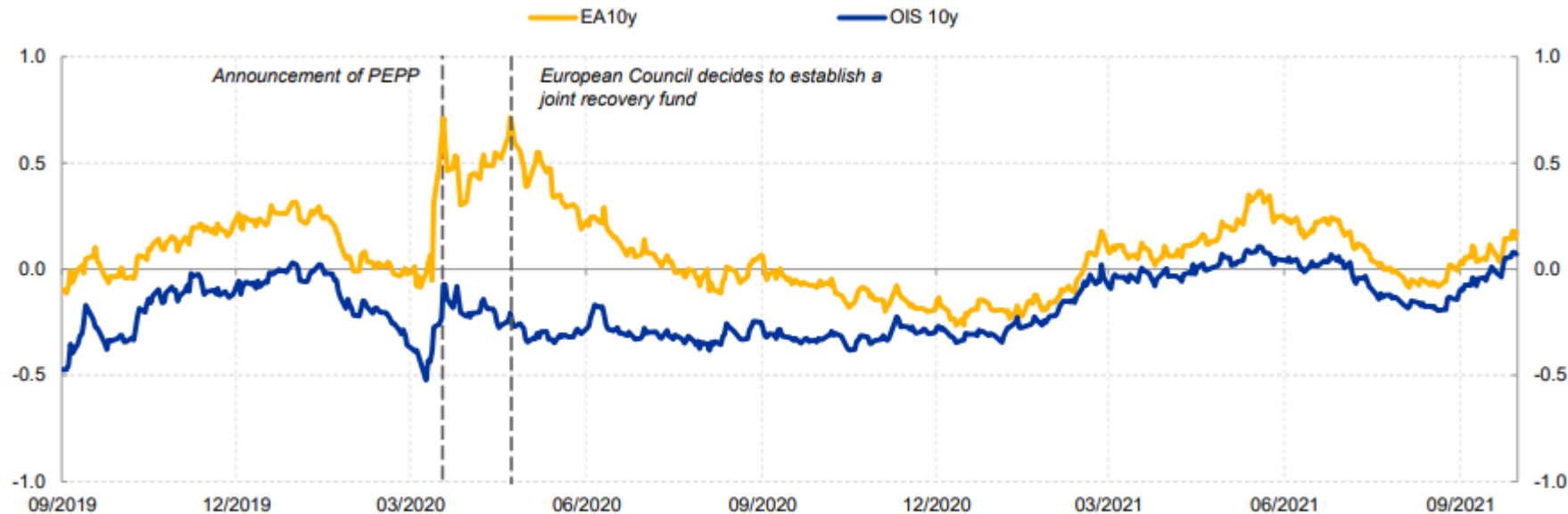
Favourable financing conditions as the compass guiding our policy (I)

BLS bank lending conditions and loan growth to firms



Favourable financing conditions as the compass guiding our policy (II)

10-year GDP-weighted sovereign yield and 10-year nominal OIS rate in the euro area



Sources: Refinitiv, ECB calculations.
Note: OIS refers to overnight index swap.

ECB supervisory measures

Our measures to support the euro area economy



Ensuring firms and households have access to credit



Reducing banks' risks and increasing their lending capacity



Helping banks focus on providing vital funding to the economy

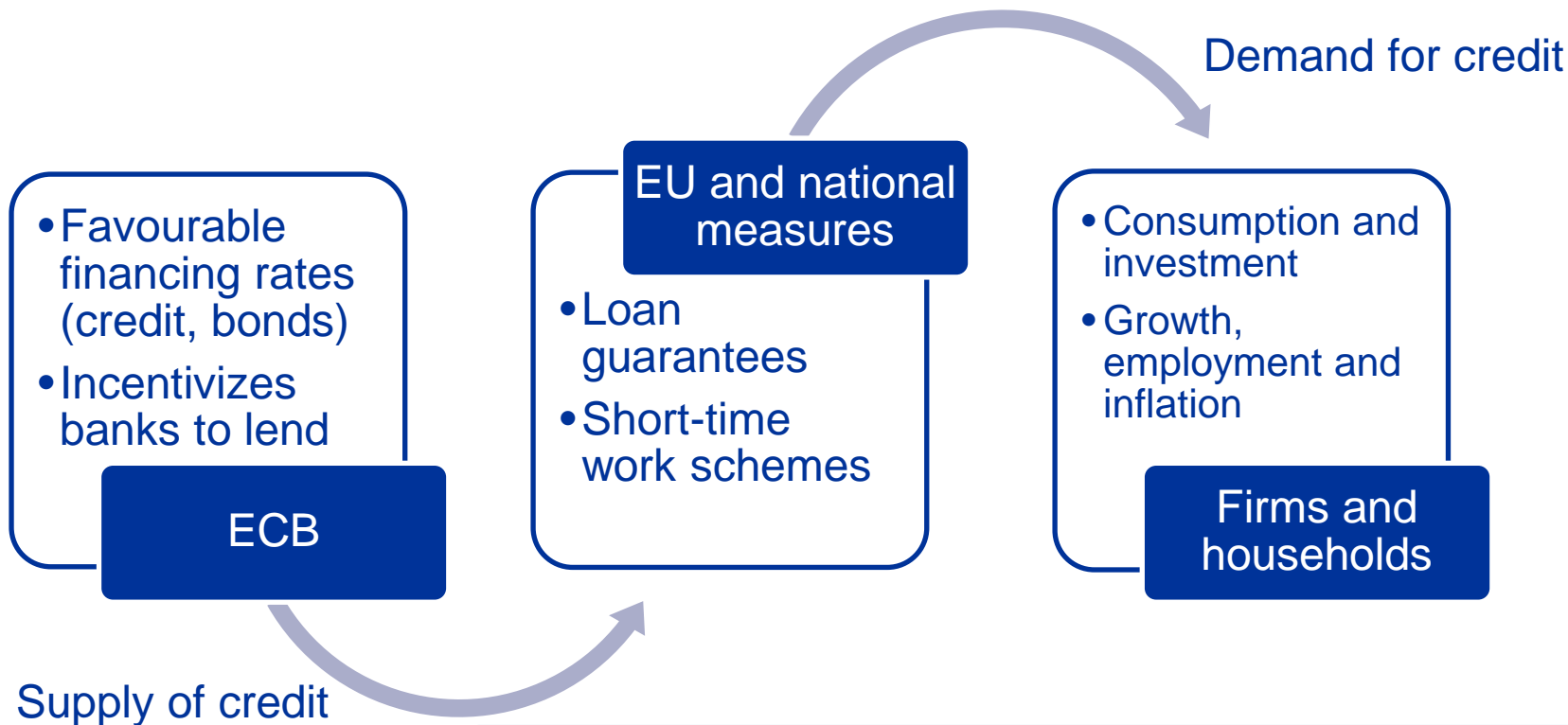


Encouraging banks to do their share



Helping the economy absorb the shock through asset purchases and long-term loans to banks

The ECB's measures go hand-in hand with wider crisis response



Public guarantees played a key role for loan developments

Take-up of and credit standards on loans covered by COVID-19-related public guarantees

(left panel: EUR bn; middle and right panel: net percentages)



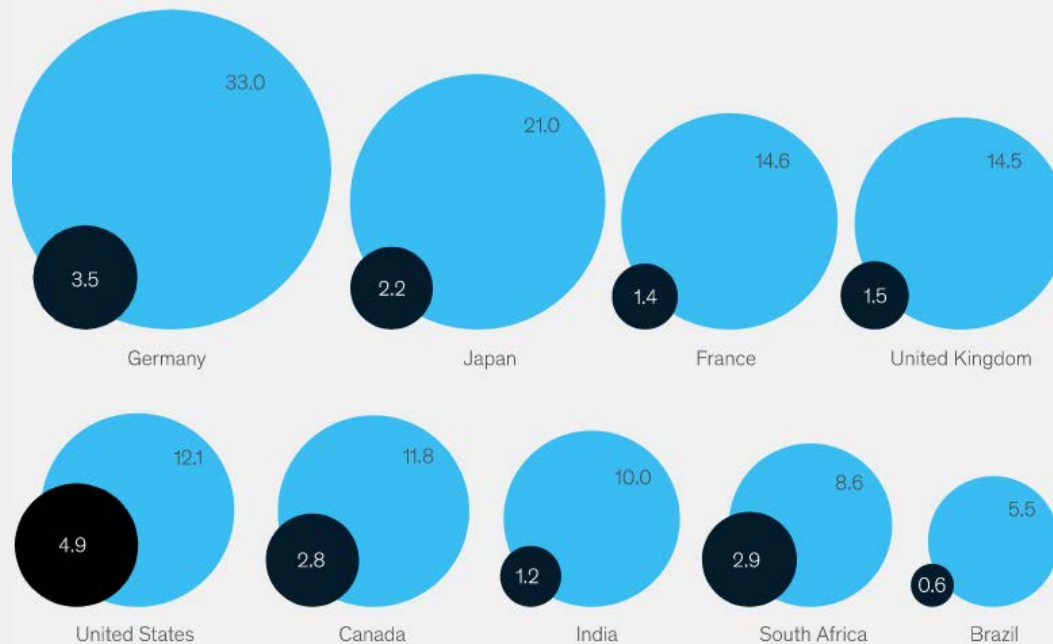
Sources: National authorities and authors' calculations and Bank Lending Survey (BLS). Notes: left panel: The take-up data refer to approved amounts of guaranteed loans. As guaranteed loans can also be granted in the form of revolving credit facilities, the approved amount is higher than the amount actually disbursed. In the absence of a breakdown by firm size for Italy, it is assumed that guaranteed loans to SMEs are those granted via the Fondo di Garanzia, while guaranteed loans to large firms are those granted via SACE (the Italian export credit agency). Middle and right panel: The net percentages of banks for credit standards (demand) are constructed as the difference between the sum of the percentages for "tightened (increased) considerably" and "tightened (increased) somewhat" and the sum of the percentages for "eased (decreased) somewhat" and "eased (decreased) considerably". Latest observation: 2021Q2 for data on guarantee take-up; 2021Q2 for BLS (July 2021 BLS).

99

The key role played by national fiscal policy...

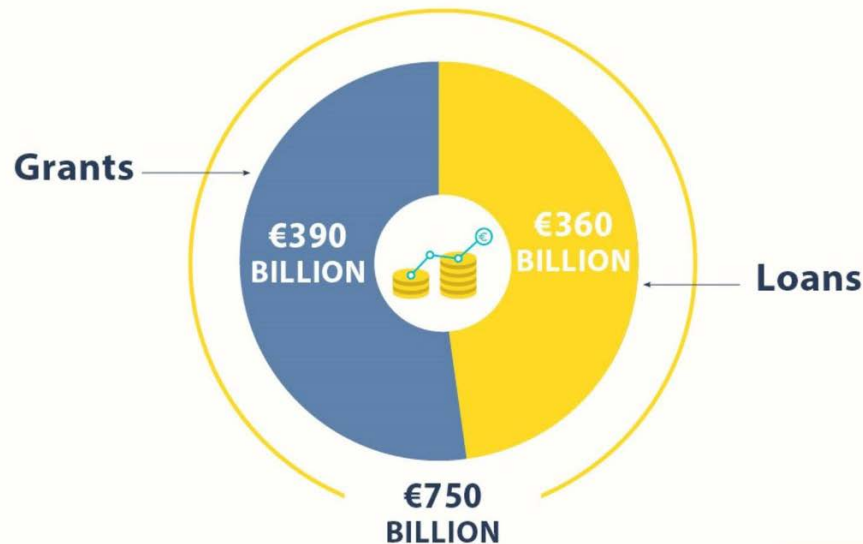
Stimulus responses to the Covid-19 crisis outsize those to 2008 financial crisis

(Economic stimulus crisis response, % of GDP)



...as well as a historical response at EU level

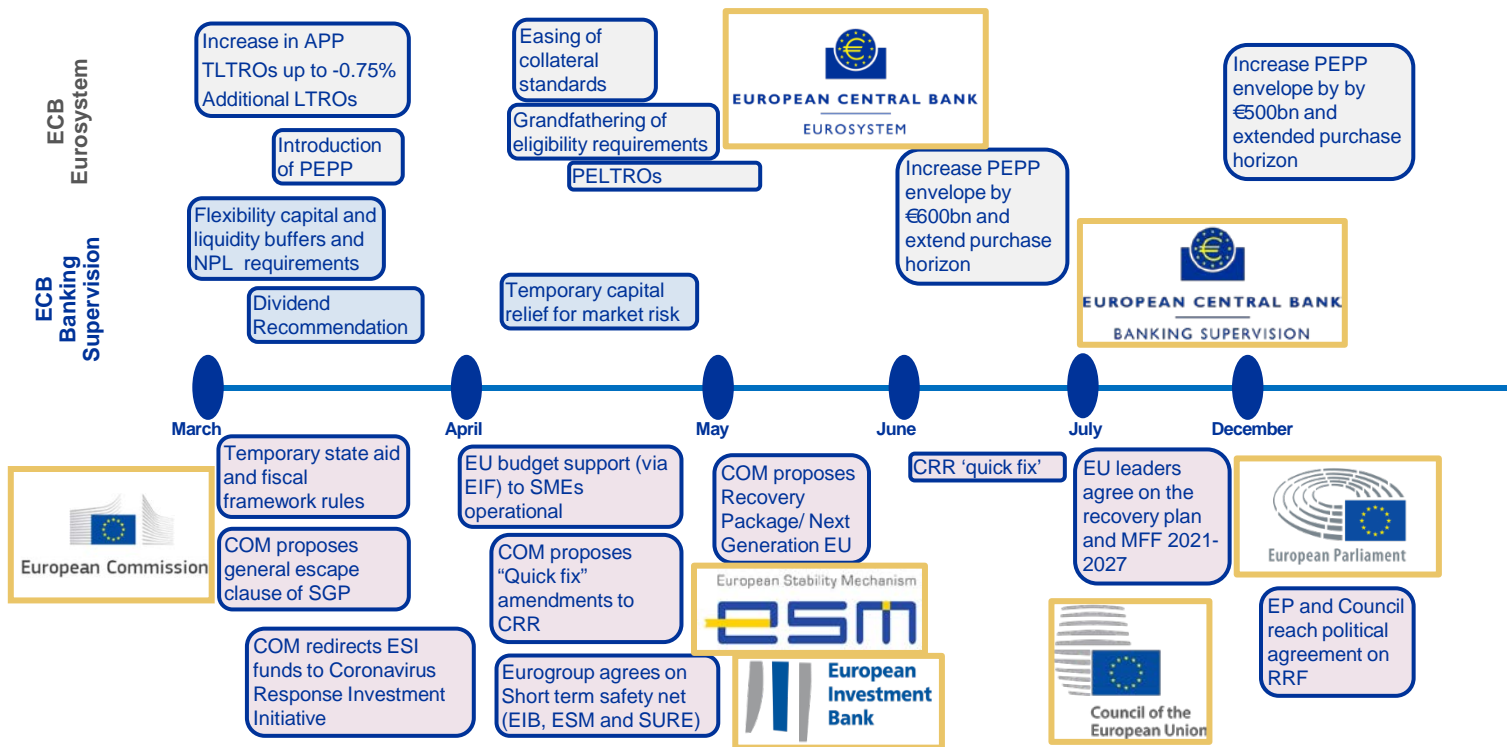
Next Generation EU – COVID-19 recovery package



- Capital raised on financial markets
- Repayment period: until 2058



Overview of European response to Covid-19 crisis



Fiscal and economic measures: short-term measures

	For sovereigns	For firms	For workers
Eurogroup package	Pandemic Crisis Support <ul style="list-style-type: none"> ➤ ESM activation of Enhanced Conditions Credit Line ➤ Up to €240 billion ➤ Funding for direct and indirect healthcare, cure and prevention related costs of crisis (benchmark: 2% of Member State GDP) 	Pan-European Guarantee Fund <ul style="list-style-type: none"> ➤ European Investment Bank ➤ €25 billion funded by national guarantees ➤ Support €200 billion of financing for businesses (focus on SMEs) 	Support to mitigate Unemployment Risks in Emergency (SURE) <ul style="list-style-type: none"> ➤ European Commission ➤ Loans to Member States (backed by €25 billion of national guarantees) ➤ Finance short time work schemes and some health-related measures (up to €100 billion)
Commission measures	<ul style="list-style-type: none"> • SGP escape clause • Coronavirus Response Investment Initiative (€37bn) and extending scope of EU Solidarity Fund (up to €300bn) • Postponement of EU tax measures 	<ul style="list-style-type: none"> • Temporary state aid framework • EU budget guarantee for European Investment Fund (€3bn) • Waiving of VAT, import duties for COVID-10 related goods 	

Fiscal and economic measures: medium- term measures

Recovery Instrument

- Financed through **EU issuance** against larger EU budget headroom
- New €750 bn recovery instrument, Next Generation EU, within the MFF, channeled via EU programmes
- Short-term and include the possibility to frontload part of the investment in 2020

Recovery and resilience tool

- Recovery and Resilience Facility of €560 billion within the EU Semester
- Cohesion fund top-up
- EU-wide, where most affected

Kick-starting private investment

- Strengthen InvestEU
- New Strategic Investment Facility for key value chains

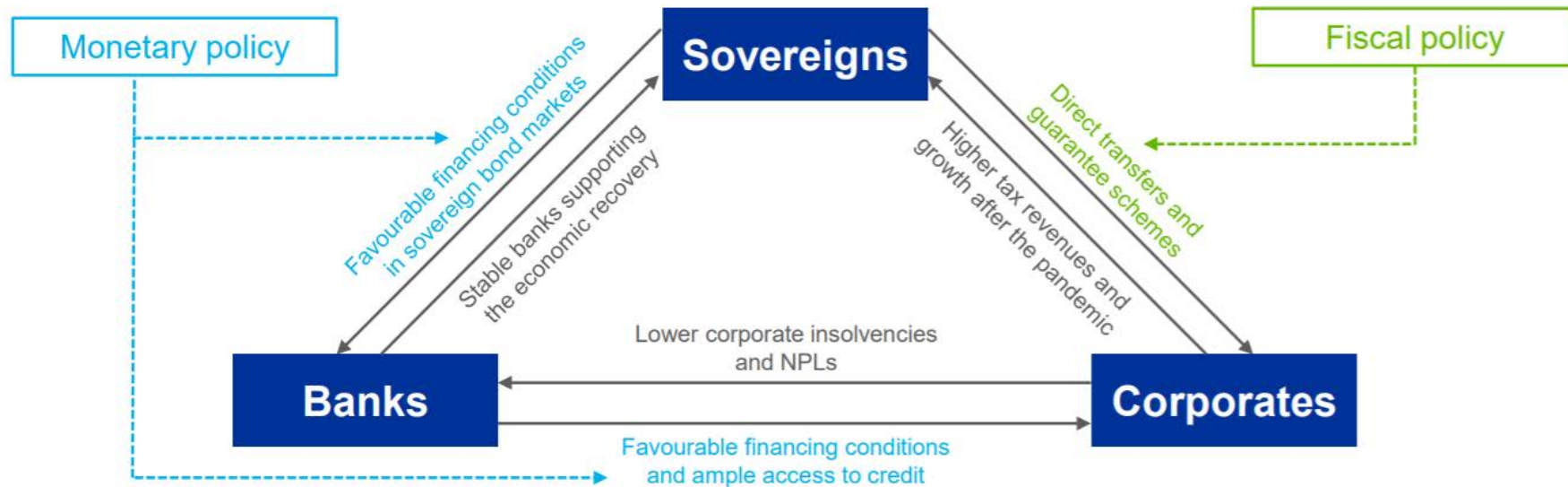
Lessons from the crisis

- Strengthen RescEU and Horizon Europe
- New health programme
- Strengthening support for partners

Roadmap and Action plan to support the recovery

- Developed by the EU Institutions, led by the European Council and Commission, involving the ECB
- To relaunch the EU economy whilst promoting convergence and reducing any fragmentation resulting from the crisis
- Focus on the Single Market, investment, governance, and the EU as a global actor

A virtuous circle between sovereigns, banks and corporates



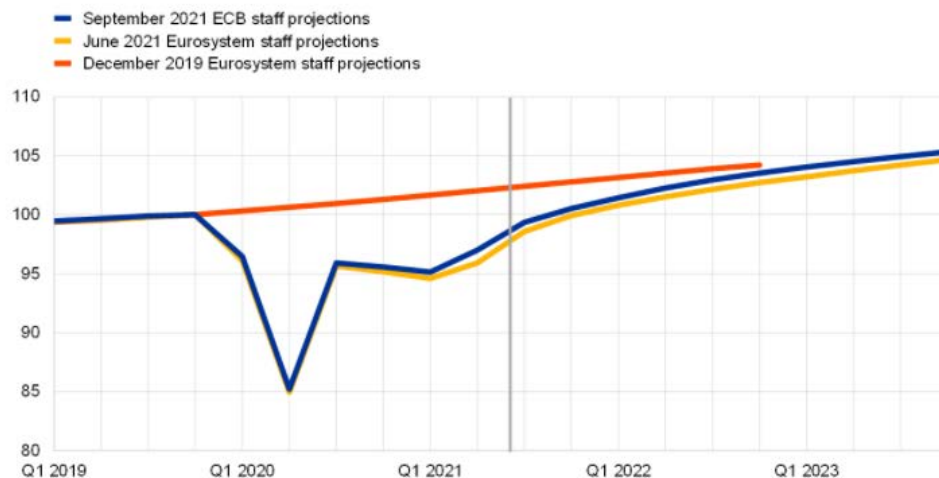
Does it help?



But recovery is proceeding...

Euro area real GDP

(chain-linked volumes, 2019Q4 = 100)

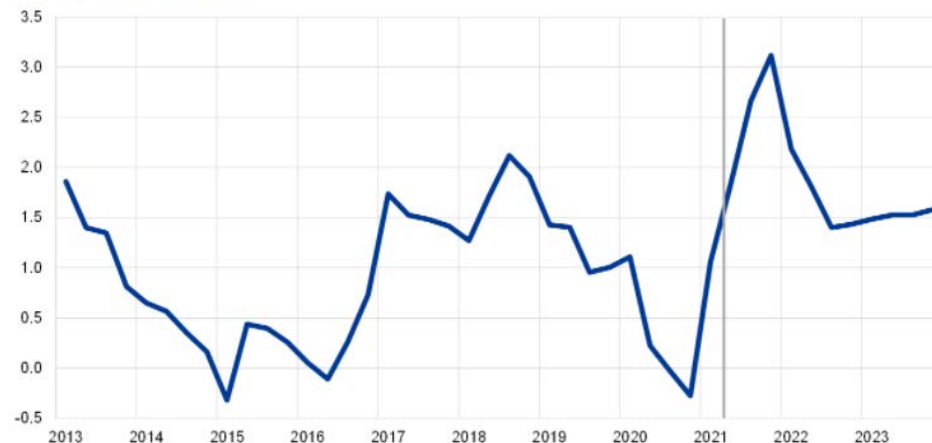


Notes: Data are seasonally and working day-adjusted. Historical data may differ from the latest Eurostat publications due to data releases after the cut-off date for the projections. The vertical line indicates the start of the September 2021 projection horizon.

... and inflation is increasing

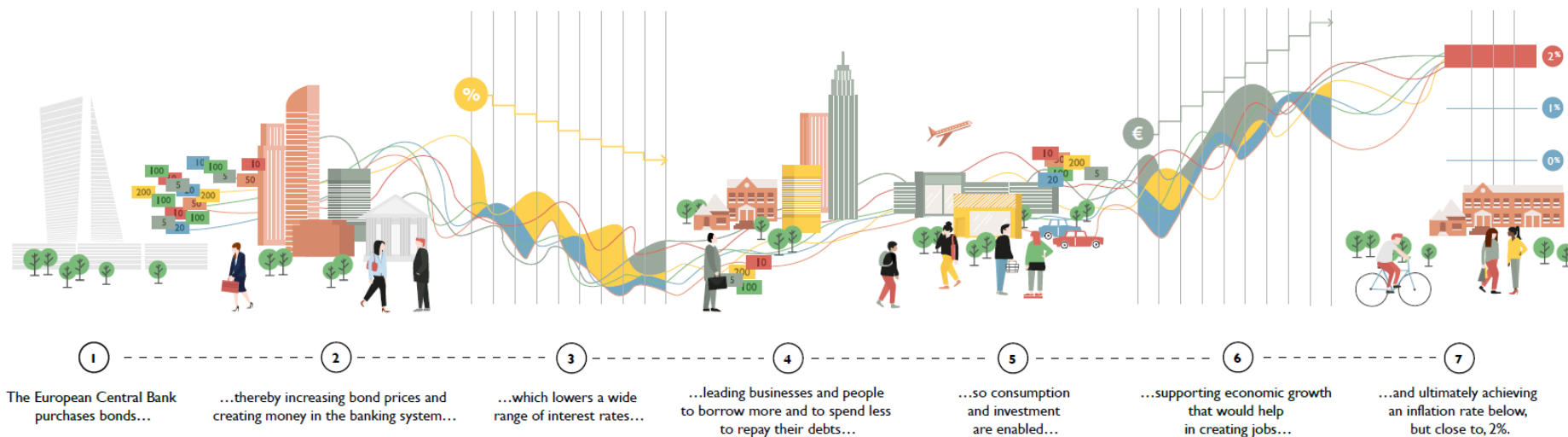
Euro area HICP

(annual percentage changes)



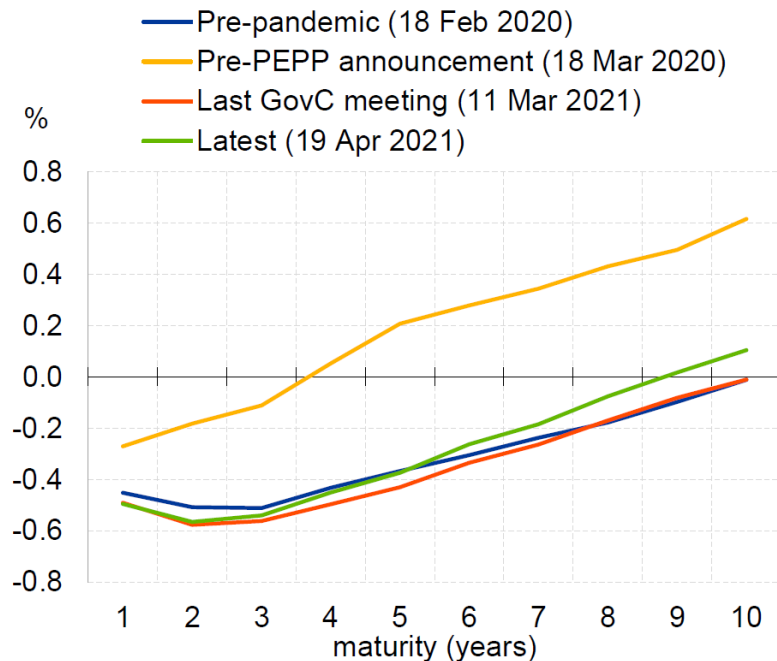
Notes: The vertical line indicates the start of the projection horizon. This chart does not show ranges around the projections. This reflects the fact that the standard computation of the ranges (based on historical projection errors) would not capture the elevated uncertainty related to the COVID-19 pandemic. Instead, alternative scenarios based on different assumptions regarding the future evolution of the COVID-19 pandemic, the associated containment measures and the degree of economic scarring are provided in Box 4.

How asset purchases affect the economy

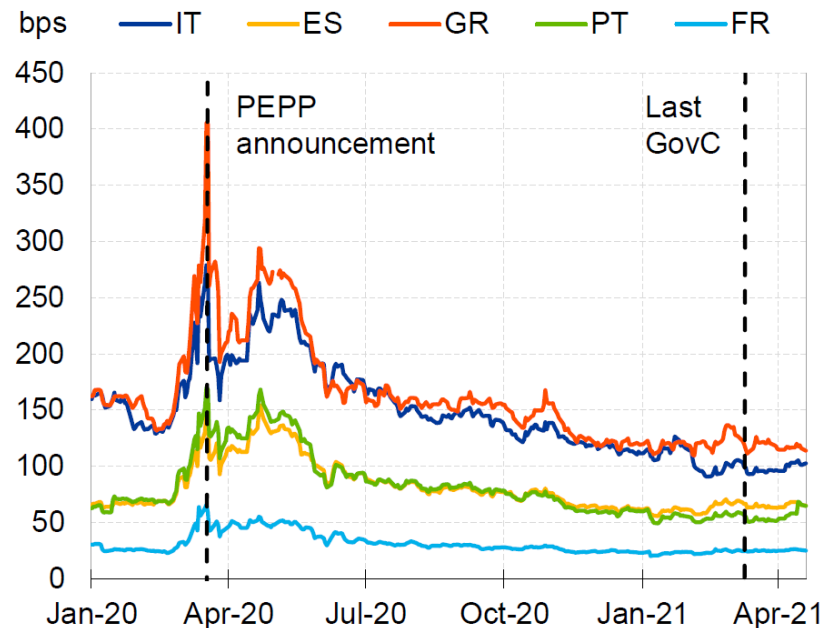


Impact of ECB measures (I)

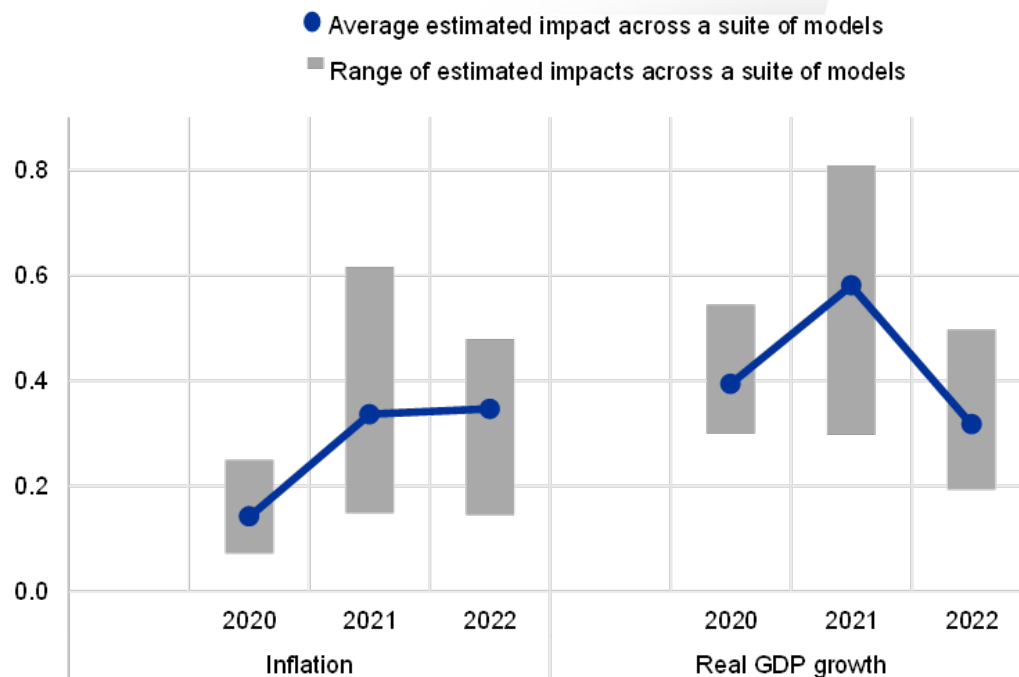
Euro area GDP-weighted yield curve
(percent)



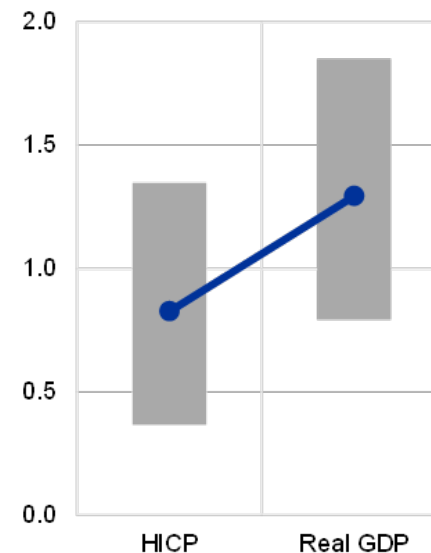
Selected 10-year sovereign yield spreads
(over equivalent German Bunds)



Impact of ECB measures (II)



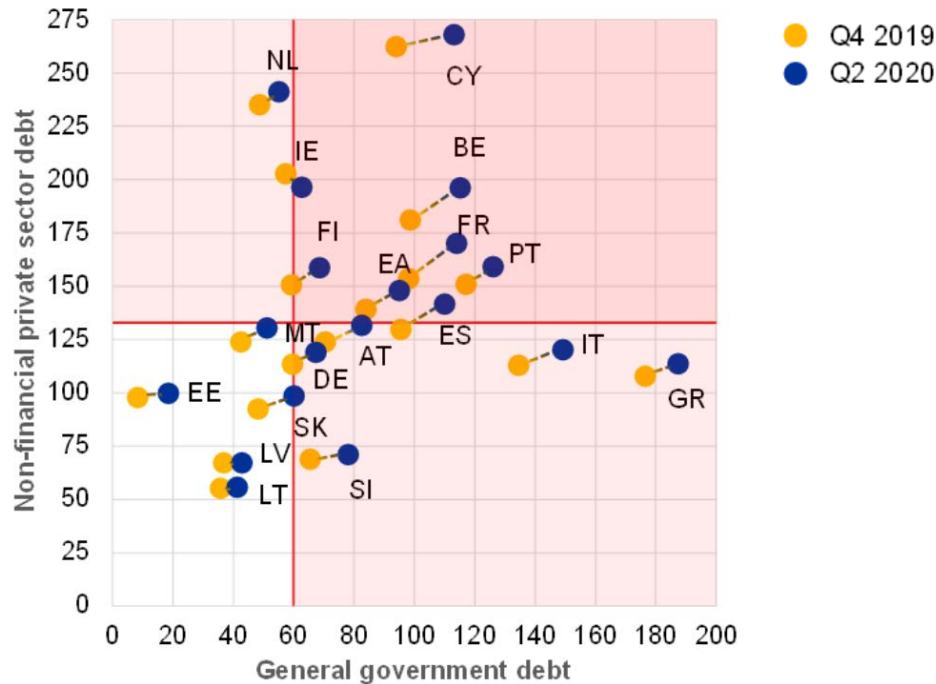
- Cumulated impact 2020-2022 - average across models
■ Cumulated impact 2020-2022 - range across models



Source: ECB calculations. Notes: The estimated impact via a suite of models refers to the average across a set of models used by the Eurosystem, see Rostagno, M., et al (2019), "A tale of two decades: the ECB's monetary policy at 20", ECB Working Paper No 2346

Concerns about debt sustainability?

Indebtedness of the general government and non-financial private sectors across the euro area



Sources: Bloomberg, Thomson Reuters,
Datastream and ECB calculations

Debt is not always a bad thing



"If [...] financing terms remain attractive relative to the growth that can be developed as a result of those targeted temporary measures and productivity-enhancing measures, then **this is debt put to good use.**"

Christine Lagarde, 22 April 2021

"Evidence shows that austerity does not pay off at times of weak growth, even if debt is already high. **Targeted fiscal support will improve rather than harm future debt dynamics** by reducing the scars that the pandemic will leave."

Isabel Schnabel, 26 February 2021



Once support measures are withdrawn, corporate insolvencies may rise

Bankruptcies in 13 advanced economies



“A major wave of insolvencies may yet happen **if crisis management measures are withdrawn too quickly**”

ESRB Report, April 2021



ESRB

European Systemic Risk Board

European System of Financial Supervision

Macro policies for moving from crisis to recovery

Early crisis

Monetary and fiscal policies **support demand**

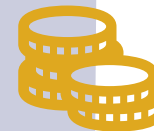


Recovery

Fiscal and structural policies support investment and **transformation**



Higher productivity, employment and **incomes**



Hence ECB calls for:

- Ambitious but targeted **fiscal** policies
- **EU recovery fund** implementation
- Productivity-enhancing **reforms**

Thank you for your attention

For further information or questions

email

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or visit

www.ecb.europa.eu