BRIEFING

European Parliament

The economy and coronavirus: Weekly Picks

This paper provides a summary of some recent analyses of the macroeconomic effects of the coronavirus and some policy recommendations made in the public domain to mitigate these negative effects.

Recent growth estimate by S&P:

On Thursday, 26 March, the credit-rating agency Standard & Poor's (S&P) published an economic forecast for the euro area and the UK, assessing effects from the outbreak of COVID-19.

S&P forecasts that the euro area and UK are facing recessions, expecting GDP to fall on average by around 2% in 2020, due to economic fallout from the coronavirus pandemic, while a gradual rebound of at least 3% is expected for 2021.

That forecast counts in that central banks and governments have deployed unprecedented large fiscal and monetary policy packages to help workers and companies bridge the gap to recovery. S&P considers the swift and bold policy responses taken now to be key to avoiding permanent losses to GDP later.

S&P points out, however, that risks are still to the downside, should the pandemic last longer and become more widespread than envisaged. A lockdown of four months, for example, is thought to lower euro area GDP by up to 10% in 2020.

The overall effect is due to both demand and supply side effects: the unprecedented drop in household consumption is driven by the lockdowns, assumed to last until the end of April, reducing spending by about 40%. On the supply side, disruptions to supply chains and partial labour shortage add to constraints on economic activity.

At the country level, S&P expects to see a somewhat higher impact on GDP (minus 2.6%) in Italy, which has a proportionally high rate of COVID-19 infections, than in most other euro area countries (minus 2% on average). S&P expects the GDP of Germany, for example, to shrink by 1.9%, marginally below the average (see table 1 below).

Table 1: S&P Global Ratings European Economic Forecasts (March 2020)

GDP	Germany	France	Italy	Spain	Netherlands	Belgium	Euro area	U.K.
2018	1.5	1.7	0.7	2.4	2.5	1.5	1.9	1.3
2019	0.6	1.3	0.2	2.0	1.7	1.4	1.2	1.4
2020	-1.9	-1.7	-2.6	-2.1	-1.6	-1.7	-2.0	-1.9
2021	2.6	3.2	2.9	3.1	2.7	2.6	3.0	3.8
2022	1.2	1.9	0.9	1.7	1.5	1.3	1.5	2.2
2023	1.1	1.8	0.9	1.6	1.5	1.2	1.5	1.5

Source: S&P Economic Research: COVID-19: The Steepening Cost To The Eurozone And U.K. Economies of 26.3.20

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Focus on Germany and Spain:

On 30 March, the German Council of Economic Experts (GCCE) published its study on the impact of the Corona virus on the German economy: In the baseline scenario, the GCEE assumes that the economic situation will normalise over the summer, similar to the pattern emerging in China. In this case, GDP would grow by –2.8 % in 2020. One risk scenario estimates the economic consequences if the restrictive measures remained in place longer than currently planned. The sharper downturn in the first half year of 2020 would result in a drop in GDP of –5.4 % on an annual average. In 2021, the economy would then grow by 4.9 %.

The Kiel Institute for The World Economy (IfW) released on 19 March 2020 an update for 2020-2021 German's economic outlook, accounting either for a six-week lockdown scenario or a three months one. In both cases, German GDP is expected to fall by 18% in the second half of March and persist at this low level until mid-April. Depending on the duration of the lockdown, the slump of the GDP for 2020 will range between 4.5% and 9%; conversely, there will be a massive recovery in 2021. The crisis will particularly affect the leisure and the car industries as well as the hotels, restaurants and aviation. The IfO Institute also expects a massive downturn for the German economy: assuming a two months shutdown, the costs will range between 7.2 and 11.2 percentage points of GDP. Assuming a three months shutdown, the economic losses will even range between 10.0 and 20.6 percentage points of GDP. The institute also warns about the delicate situation of the labor market, where up to 1.8 million jobs subject to social security contributions could be cut.

A study by the Spanish think tank FEDEA has forecast a fall in the Spanish GDP during 2020 of between 4.1% and 7.9% due to the COVID-19 outbreak. The Authors also consider that the announced fiscal measures could dampen the GDP decrease significantly. According to the Spanish Confederation of SMEs (CEPYME), micro companies (less than 10 persons employed) will be severely affected, absorbing 23% of the resulting unemployment in a one month lockdown scenario.

Some policy recommendations in the public domain: Picks from last week

L. Reichlin and D. Schoenmaker **- Fault lines in fiscal-monetary policy coordination (26 March 2020):**

Fiscal and monetary policy coordination is not working in the euro area. This column argues that in order to rebalance the weight of both during major crises, the asymmetry between decision making at the ECB (by majority voting) and the ESM (by unanimity or qualified majority) must be harmonised. This is urgent since the ESM is the only instrument available to provide the common fiscal capacity needed to fight the COVID-19 pandemic.

G. Claeys and G. B. Wolff **- COVID-19 Fiscal response: What are the options for the EU Council? (26 March 2020):**

Now, it is time for the EU Council to make quick progress on the fiscal front and announce something as soon as possible to show that it has taken full measure of the severity of the situation. Letting every country respond only on its own with only ECB backing could prove an insufficient response, and late fiscal action would likely be more expensive than getting ahead of the markets. Announcing some form of mutualisation would send a strong signal of unity to the world in these difficult times – but it is also fundamental that it is done with strong democratic legitimacy and broad public support. This blog post has aimed to explain the options. It is up to elected officials to see what is democratically feasible and desirable.

D. Gros - This time is different (26 March 2020):

Ultimately the world economy will restart since all the capital, technology and the work force are still there. Experience suggests that consumers will resume their spending pattern much as before. The same happened even after the Spanish Flu of 1918 which led to an estimated 20-50 million deaths. Public health measures at the time (at the end of a long war) were patchy, allowing the virus to return more than once. But despite all this, the recession lasted less than a year.

If the combined effort of central bankers and governments can keep financial markets working and prevent mass bankruptcies, there is a good chance that the now unavoidable recession can be followed by a vigorous recovery once the virus has been contained. It is on this front, how to protect public health, that Western societies have to learn and adapt quickly.

L. Codogno and Paul van den Noord **- [COVID-19: A euro area safe asset and fiscal capacity are needed now](#) (25 March 2020):**

Our simulation suggests that with a safe asset and centralised fiscal capacity, macroeconomic stabilisation becomes much more effective in the face of the outbreak of COVID-19 hitting the euro area economy. Fiscal stimulus at the centre would provide substantial demand offset, with a much more muted increase in government debt in the periphery and a more modest monetary policy response. Both the 'core' and 'periphery' of the euro area would gain. The policy response to the COVID-19 shock is an opportunity to provide a lifeline to the economy while also permanently fixing some of the vulnerabilities of the euro area policy framework.

A. Erce, A. Garcia-Pascual, T. Roldán-Monés **- [The ESM must help against the pandemic: The case of Spain](#) (25 March 2020):**

In this column, we operationalise the proposal by Bénassy-Quéré et al. (2020b). We have calibrated the size and financial conditions of an ESM programme that would work for Spain. It would solidify the sustainability of debt dynamics. As our simulations have shown, the size and financial conditions of the ESM loan can make a substantial difference in terms of interest payments, gross financing needs, fiscal effort required and public debt dynamics.

While the war-chest of the ESM, with current subscribed capital of over €700 billion and ability to lend €410 billion of funds, is large, it may not be sufficient for the scale of funding needs generated by the COVID-19 shock. Italy and Spain alone could use up all available funds. Therefore, a top-up would be recommendable. Bénassy-Quéré et al. (2020b) discuss how to boost the ESM lending capacity beyond the current level.

I. Angeloni **- [European bank regulators aren't yet doing what it takes](#) (24 March 2020):**

Banks are the key to providing financial oxygen to the economy, but the coronavirus pandemic is raising the risk that banks in the euro area will cease to function. This column argues that the return to normality we all crave requires, among other things, that banks be saved, and that this will not happen unless regulation is adapted and more public support is provided.

Regulators – the EU, national governments, law-makers and supervisors – must act decisively and urgently to block this doom scenario. Following a logic applied in other areas – from labour markets to corporate subsidies – the goal should be to ensure that banks overcome the critical phase as unharmed as possible. For that purpose, normal prudential rules should not apply to the effects of the virus on their balance sheets. Such effects should instead be neutralised by public support – capital injections, guarantees, and for what is left, supervisory forbearance. The attack needs conducting on three fronts: bank assets, bank liabilities, and bank governance[1].

F. Giavazzi and G. Tabellini **- [Covid Perpetual Eurobonds: Jointly guaranteed and supported by the ECB](#) (24 March 2020):**

This war-like shock will require very large fiscal support. Its financing cost should be distributed over several generations. This can be achieved by issuing irredeemable or very long maturity Eurobonds. They should be backed by the ECB to keep the financing burden low. This column argues that no institutional or legal constraints prevent this policy response. Prompt action is critical since allowing one crisis to morph into many could disrupt the European project, with far-reaching and unpredictable political implications.

[1] Please note that Angeloni calls to restrcit the distribution of both dividends and bonuses, which is also what the ECON Chair and political coordinators asked for in their joint statement. However, neither the recommendation of the ECB supervisor about not paying out dividends, dated 27 March, nor the related statement from the European Banking Federation of the same day, mention the aspect of bonus payments.

Agnès Bénassy-Quéré et al - A proposal for a Covid Credit Line (21 March 2020):

It is in the interest of every EU member state that countries in the Union hit by the coronavirus are able to take the necessary measures to control the pandemic and deal with the economic consequences without being constrained, and to do so very quickly. This column proposes a Covid credit line in the European Stability Mechanism, with allocation across member states proportionate to the severity of the public health and economic challenges encountered. While it would involve some coordination and solidarity among member states, the dedicated credit line would reduce risks to economic and financial stability for all while allowing members to sustain their efforts by making their borrowing costs less dependent on individual fiscal situations.

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For an overview of the current role and tools of the European Stability Mechanism, please see EGOV document: **The European Stability Mechanism: Main Features, Instruments and Accountability**

For a regular update of measures undertaken at the European Union or Euro Area level, please see EGOV document: **EU/EA measures to mitigate the economic, financial and social effects of coronavirus.**

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You may join EGOV also on Linkedin: https://www.linkedin.com/in/egov-support-unit-640b7a194/

Some official homepages covering the economic effects:

- European Commission: Coronavirus and the Economy
- European Counci/Counci: COVID-19 coronavirus outbreak
- ECB and Coronavirus
- EIB and Coronavirus
- IMF: Policy Responses to COVID-19
- OECD: Tackling the coronavirus (COVID-19): Contributing to a global effort

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This document is available on the internet at: www.europarl.europa.eu/supporting-analyses