European Commission - Speech

[Check Against Delivery]

Remarks by Commissioner Gentiloni at the press conference on the Spring 2020 Economic Forecast

Brussels, 6 May 2020

The coronavirus pandemic has drastically altered the outlook for the European and world economy. It has also made this forecast particularly challenging and uncertain. I want to thank DG ECFIN for the excellent management of this challenge.

Let me share with you six key messages emerging from this forecast:

First, it is now quite clear that the EU has entered the deepest economic recession in its history. The EU economy is expected to contract by a record 7.4% this year, 7.7% in the euro area. More than in 2009, where the contraction was around 4.5%. In 2021 we expect a rebound of 6.1% in the EU and 6.3% in the euro area – not enough to fully make up for this year's loss.

Second, both the recession and the recovery will be uneven. These aggregate figures mask considerable differences between countries.

Third, inflation will also be significantly weaker. Consumer prices are expected to fall significantly this year, reflecting the sharp weakening of demand as well as the steep fall in oil prices.

Fourth, unemployment is set to increase, though policy measures should limit its rise. The impact of the pandemic will be felt on the labour market, bringing to an end a decade-long period of improvement. But timely and sizeable policy measures, from governments and EU institutions, should help to limit job losses. A massive drop in hours worked is expected.

Fifth, bold and necessary policy measures will cause public deficits and public debt to rise in 2020. Governments have reacted decisively to the pandemic by implementing fiscal measures aiming at limiting the social and economic damage. This will inevitably lead to a marked deterioration of public finances this year in all Member States.

Sixth, the risks to this outlook are exceptionally large and, unfortunately, they are to the downside. Let's begin to describe this general situation. COVID-19 abruptly changed our outlook. Economic activity in the EU dropped by around one third, practically overnight. The disruption resulted in a series of shocks to demand, supply, industrial output, investment, trade and capital flows.

That said, once the pandemic is under control and containment measures can be progressively eased, the European economy should start to recover in the second half of this year.

But given the severity of the economic fallout this year, our economy is not expected to have fully made up for these losses at the end of 2021. Output at the end of next year is set to be about 3% lower than expected in our autumn forecast.

All demand components will be hit hard by the pandemic, except government consumption. There will be a sharp contraction in household consumption. Private consumption should recover gradually once containment measures are lifted. But this recovery is set to be incomplete: restrictions in tourism, recreational and cultural activities are set to remain for longer. And uncertainty about employment and income prospects will likely make households cautious about spending for some time.

Business investment is likely to take a double-digit hit this year. European exporters will be faced with a sharp drop of global demand and the severe disruptions to the free movement of people, goods and services.

The current pandemic is a truly global shock. Overall, global GDP is projected to contract by about 3% this year. Again, a sharper drop than experienced during the financial crisis. It is then expected to rebound by 5% in 2021.

Global trade is expected to take an even sharper hit. World import volumes (excluding the EU) are likely to fall by more than 10% this year. Real-time indicators reveal this shock. The downturn was so abrupt that it is not easy to have 'hard' data capturing the impact. However, data available at higher frequency, such as daily electricity demand and air traffic confirm completely the exceptional drops in activity in March as Europe locked down.

Survey data also point to a sharp decline in activity. Flash indicators available for April reveal the magnitude of the downturn. The collapse is particular visible for services and reflects the halt to travel, tourism and catering. While the declines in the Manufacturing and Construction have been somewhat less sharp, they also point to a record contraction.

Financial market resilience has been tested. The shock led to a sudden repricing of risks in March. In Europe, equities and high-yield corporate bonds saw the fastest sell-off in a century. This reflected the deterioration of the economic outlook, profitability prospects, and the severe liquidity dry-up that companies suddenly faced.

In euro area sovereign debt markets, the outbreak brought an increase in spreads, pointing to investor concerns that the crisis could lead to divergences in the euro area and that the policy response be insufficient.

The monetary and fiscal policy response, globally and in the EU, has been swift and strong. Unprecedented measures have been taken to contain the economic fallout and ease liquidity pressures. These policies helped stabilise markets in April. Spreads narrowed for corporates and sovereigns and equity markets recovered part of their losses.

The outbreak of has also completely changed the prospects for European labour markets. The confinement has led to a massive drop in hours worked. Policy measures taken to mitigate the labour market impact include short-time work schemes, wage subsidies for the self-employed and liquidity measures for firms. These should help work to resume smoothly once restrictions can be relaxed. Assuming that these measures are effective, the fall in employment this year is expected to be more moderate than the decline in output. And more moderate than in other parts of the world, if we look, for example, to the US. This will leave the number of employed people in the EU, about 1% below the one reached in 2019. The EU unemployment rate is expected to increase from 6.7% last year to about to 9% this year. But behind this unemployment rate, don't forget that we will have a massive drop in hours worked.

Governments have provided sizeable state guarantees for loans to firms and other liquidity support worth 22% of GDP. EU initiatives are complementing these liquidity measures for an additional 4.4% of EU GDP. These decisions are helping to avoid that firms' liquidity shortages evolve into a solvency crisis. Sizeable discretionary fiscal measures have also been announced at national and EU levels for a total of 3.2% and 0.4% of GDP, respectively. As a result, the aggregate fiscal stance for both the euro area and the EU is expected to be very expansionary in 2020. Meanwhile, the ECB's broad range of easing measures taken in response to the crisis are expected to keep real short and long-term interest rates clearly in negative territory over the forecast horizon.

As far as inflation is concerned, during the lockdown, some supply chain disruptions may result in temporary increases in certain prices. We have already seen this in the April increase in the prices of unprocessed food. But these effects are likely to be outweighed by a lack of demand translating into lower domestic price pressures. Hence, core inflation is forecast to decrease this year and pick up only gradually next year. Overall, inflation in the euro area is projected at 0.2% this year and 1.1% in 2021. In the EU, inflation is forecast to reach 0.6% this year and 1.3% next year.

The common crisis will have different consequences. How well countries emerge from this crisis will depend on the severity of the pandemic and the stringency of their containment measures. It will also depend on their openness and the exposure of their economies to sectors that have been hit the most. Above all, the size of the policy support they undertake will be key. By the end of 2021, only Germany, Austria, Croatia, Slovakia and Poland are forecast to recoup the level of economic activity seen in the last quarter of 2019. By contrast, the level of output in Italy, Spain and the Netherlands is forecast to remain more than 2% below the end-2019 level.

Investment is likely to contract substantially. Faced with heightened uncertainty about future sales prospects, firms are likely to postpone or even cancel their investment plans. As it is the case for the economic activity as a whole, an incomplete and asymmetric investment recovery is expected across the Union next year.

As I mentioned in my introduction, all EU Member States are forecast to endure a severe recession this year. Economic activity in Greece, Italy, Spain, Croatia, and to a lesser extent France are forecast to contract the most. Among the largest Member States, Italy was struck first, and most forcefully. The economy is expected to contract by about 9.5%.

With containment measures now starting to be removed gradually, the economy is projected to start recovering from the second half of 2020. Nevertheless, Italy's recovery is forecast to take longer than in other Member States.

The pandemic has hit the Spanish economy about as strongly as the Italian economy. Real GDP is forecast to contract by almost 9.5% this year, with a sharp contraction in investment. Despite annual

growth expected at 7% next year, Spain's recovery is set to be incomplete.

In France, the economy is expected to shrink by about 8% this year. The economy is forecast to start recovering gradually in the second half of 2020. As for most Member States, France is set to be supported by fiscal measures aimed at ensuring firms' liquidity and protecting employment.

Finally, Germany is expected to endure a less steep contraction than most Member States and recover faster to pre-pandemic output levels. Still, Germany is set to experience its deepest recession since the War, at -6.5% in 2020. The lack of demand and disruptions in value chains should severely hamper the country's exports.

Coming to the budgetary outlook, the aggregate fiscal deficit is expected to surge from 0.6% of GDP in 2019 to around 8.5% % of GDP in both the euro area and the EU this year. In 2021, the deficit is then forecast to decrease to around 3.5% in both areas due to the expected economic rebound and the unwinding of most of these measures. Consequently, the euro area's debt-to-GDP ratio is projected to peak close to 103% in 2020 after having decreased for five consecutive years. It should decrease by about four percentage points, to reach around 100%, next year based on a no-policy-change assumption. Let me stress that without these decisive, but costly, policy actions to contain the pandemic and limit its economic impact, the long-term budgetary impact of the current crisis would be worse.

The most severely hit countries are forecast to reach double-digit deficit ratios in 2020, namely, Italy and Spain, while France should be close to 10% of GDP. Deficits in Belgium, Poland, Slovakia and Romania are expected to exceed the EU average deficit at over 8% of GDP.On the other side of the spectrum, in Ireland, Sweden, Hungary, Luxembourg and Bulgaria, deficits should remain below 6% of GDP.

Let me conclude on the risks, unfortunately. I say unfortunately as these risks to this forecast are concentrated on the downside:

A prolonged or more severe spread of the virus would yield an even worse downturn. Containment measures would have to be maintained or reinstated, further damaging the economy and the rebound that we are forecasting in 2021.

Moreover, financial turmoil cannot be excluded if the liquidity shock hurting the corporate sector leads to unexpectedly severe solvency problems.

The recovery could suffer from insufficiently coordinated national policy responses, or a too limited common EU response. This would be hurt the countries that are hardest hit and whose fiscal space to respond is limited, increasing economic, social and financial divergences. This would lead to serious distortions to the Single Market and our economic and monetary union.

Finally, the pandemic could trigger more drastic changes in attitudes towards global value chains and international cooperation, leading to a rise in protectionism.

These are the downside risks of our forecast, but let me end with two more optimistic messages, upside risks to our forecast.

First, the Commission continues to prepare further steps of our common response. By acting together with a strong, well-finance and coordinated recovery plan, we can mitigate some of the risks I have mentioned and strengthen the rebound.

And second, given the huge efforts undertaken at the global and EU levels to develop a vaccine that could overcome this virus, a faster-than-anticipated return to a more normal economic situation would lead to a more benign outcome than forecast here.

And now, I am ready to take your questions.

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