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December 16, 2020

Statement by Mr. Ronicle and Ms. Andreicut on Euro Area
(Preliminary)
Executive Board Meeting
December 18, 2020

We thank staff for the informative report and Mr Pösö for his helpful buff statement.

The COVID-19 pandemic has had a profound impact on the euro area, despite a significant strengthening of the economy in recent years. While there were positive recovery signs following the first wave of the pandemic, the ongoing second wave is casting doubts on the near-term growth outlook and the October 2020 WEO forecast. We broadly share staff's assessment, including on: setting policy in response to an uncertain outlook; the challenge of preventing scarring, and; the delivery of a more inclusive and sustainable recovery.

A swift and comprehensive set of policy measures, taken both at euro area and member state level, was instrumental in containing the pandemic and supporting the recovery. We commend the authorities for the comprehensive and timely measures taken, drawing lessons from the previous crisis. Next Generation EU (NGEU) breaks important new ground. And the widespread use of job retention schemes has been critical in minimizing the impact of the pandemic on employment. The ECB played a decisive role in mitigating the impact of the pandemic, both through its accommodative monetary policy stance and through the regulatory relief measures provided by the SSM, which allowed banks to continue lending to the real economy. The ECB's response to the March market turmoil episode, alongside advanced economy peers, helped ensure market functioning and ease liquidity strains.

Monetary policy and the ECB strategy review

We agree with staff that the COVID-19 crisis will lead to a sizeable output gap and further downward pressure on prices, requiring further policy action. We commend the ECB for its comprehensive policy response to the pandemic, and its recent announcement on further asset purchases, but we concur with staff on the need for further monetary policy accommodation to bring inflation, and inflation expectations, back into line with target and support the recovery. We also agree that the benefits of further monetary loosening outweigh potential side effects to financial stability, not least because, like the ECB, we see macroprudential tools as the first line of defense against risks to financial stability, including in a low-for-long environment.

We also welcome the staff reflections on the ongoing ECB Strategy Review and their initial advice on a clear and well communicated symmetric point inflation target. We also agree that further steps, such as a move to average inflation targeting, might be warranted if inflation expectations continue to undershoot the target. We encourage staff to continue engaging with the ECB as the review progresses, both to provide an independent and authoritative voice in policymaking, and to further deepen the Fund's engagement and expertise on monetary policy, in line with the recommendations of the IEO report on Unconventional Monetary Policy.

Financial sector policies

We welcome the ongoing support provided by banks to the real economy and stress that bank lending remains key to sustaining the recovery. We are pleased to see that bank capital remains robust, but also take note of existing risks related to asset quality deterioration in a prolonged pandemic environment. We agree that regulatory relief measures should be unwound only gradually, to avoid undermining the recovery. We also thank staff for their proposal for a comprehensive non-performing loan (NPL) strategy to address the spillover effects of COVID-19. We particularly welcome the tailored advice for the reopening and recovery phase respectively, as they both present different challenges. **The crisis episode also provides a strong incentive, and potentially momentum, for completing outstanding financial sector reforms. This includes the missing piece of the Banking Union, the European Deposit Insurance Scheme, as well as reforms in the non-bank financial sector**. The crisis exposed significant vulnerabilities among non-bank financial institutions which need to be addressed. We welcome the recent FSB "Holistic Review of the March Market Turmoil" as well as the ECB's engagement with the FSB on non-bank vulnerabilities. We look forward to their ongoing collaboration throughout the delivery of the FSB work plan. We agree with staff that risks to non-banks should be carefully monitored.

Fiscal policies

We commend the scale and speed of the fiscal response, both at the national and EU level. Sizeable automatic stabilizers, discretionary fiscal stimulus and guarantees provided by national authorities played an essential role in addressing the impact of the pandemic. These efforts were complemented by comprehensive EU support, which permitted the use of full flexibilities within EU fiscal rules, helped mitigate unemployment risk and laid the foundation of the historic NGEU agreement, which will shape the COVID-19 recovery.

Looking ahead, we see a premature withdrawal of support as the biggest risk. We encourage the authorities to make full use of the flexibility embedded in existing fiscal rules in order to ensure that policy is not tightened prematurely. However, we appreciate that some member states have limited fiscal space, placing even more emphasis on the importance of an effective deployment of NGEU funds. Given that EU fiscal rules represent a hard-fought compromise, we wonder whether – in the absence of a clear emerging consensus – it is wise to expend political capital reopening these, as opposed to pursuing reform in other areas.

NGEU, climate change and structural policies

We agree with staff that the NGEU funds have the potential to provide a sizeable boost to GDP in the euro area (and the EU more broadly) and we welcome last week's news that an agreement on the NGEU has been reached. We also share staff's view that the growth impact of the funding will depend on the quality of the spending and the policies targeted.

NGEU funds should play an important role in accelerating the green transition. We thus strongly welcome the authorities' plans to spend 30% of the combined EU budget and NGEU funds on sustainable development measures – and commend their broader efforts to take the action necessary to tackle climate change. We also very much welcome last week's European Council endorsement for a binding EU target of a net reduction of at least 55% in greenhouse gas emissions by 2030. We consider staff's recommendations on a potential policy package for achieving the EU's emission reduction goals very helpful. We fully support the integration of climate considerations into Fund surveillance and hope to see similar pieces of analysis in more bilateral surveillance products.