

The contents of this document are preliminary and subject to change.

GRAY/20/3780

December 16, 2020

**Statement by Mr. Mohieldin, Ms. Choueiri, and Ms. Abdelati on Euro Area
(Preliminary)
Executive Board Meeting
December 18, 2020**

1. The COVID-19 pandemic is leading to severe socio-economic dislocations in the euro area, to which the EU and member states responded with unprecedented policy support. In this connection, we applaud the historic nature of the Next Generation EU (NGEU) package, which, once legislated, will help accelerate the recovery. In their well-written report, staff expects a subdued economic recovery and low inflation, with a significant permanent output loss relative to the pre-crisis path.
2. Difficult policy challenges are involved in continuing to counter the pandemic and facilitating a durable recovery. These include tackling the evolving health crisis, containing scarring, supporting a transformation to more green and digital economies, while limiting the effects of the crisis on inequality. The informative Buff statement by Mr. Pösö provides helpful details on the authorities' ongoing and envisaged agenda in these areas. A strong euro area economy has positive spillovers way beyond euro area countries, in economies and regions, including ours, which benefit from close economic cooperation with the euro area.
3. We share Mr. Pösö's assessment that the timely European Central Bank (ECB) monetary policy interventions aimed at keeping the monetary transmission channels intact and safeguarding medium-term price stability. The authorities and staff agree that countries should not withdraw fiscal support too quickly. Countries' draft budgetary plans appropriately aim at maintaining fiscal accommodation next year. EU fiscal policy will also play a major role in sustainably supporting the recovery. The main component of the NGEU package is the Recovery and Resilience Facility (RRF), which is expected to finance countries' public spending in line with EU priorities of growth, employment, resilience, and green and digital transitions. *We would appreciate staff's preliminary assessment of experience with this historic initiative in next year's Article IV consultation.* We understand

the authorities' view that the decision on when to return to normal application of the fiscal rules will depend on the epidemiological and economic situation and the degree of uncertainty being sufficiently lifted.

4. We commend the NGEU funds' objective to promote Europe's green and digital transformations, with 30 percent of the combined EU budget and NGEU package (up to €555 billion over 2021–27) intended to support sustainable development measures, including mitigating climate change. Staff's analysis in Annex I suggests that achieving the EU's emission reduction goals will require combining public investment, more robust carbon pricing, and more ambitious implementation than currently envisaged. These objectives are well recognized by the authorities, and we take positive note of their ongoing consideration of a carbon border adjustment mechanism to address emission leakages. In its December 2020 Economic Outlook, the OECD recommends reallocating resources to activities that are likely to face increased demand. This includes residential retrofitting for higher energy efficiency, which is essential to achieving decarbonization targets. *Staff's views on this recommendation, as well as the call to develop electric vehicles to support innovation and investment, while promoting a green recovery, would be appreciated.*

5. The crisis has exacerbated existing fiscal vulnerabilities. Debt levels are already near 100 percent of GDP and the loan guarantees and other liquidity support have added another 20 percent of GDP. A major second wave would further raise debt levels. Growth friendly and inclusive tax and expenditure measures will help boost medium-term potential growth rates in most euro area countries while ameliorating the impact of the pandemic on inequality and poverty. We would like to hear more from staff on the implications of a no-deal Brexit on the EU and the status of contingency planning for this eventuality.

6. Staff's analysis suggests that the pandemic is expected to exacerbate regional disparities and inequality in the euro area. The impact on contact-intensive (e.g., tourism sector; transport) and "nonessential" sectors is likely to be more severe than in other sectors, resulting in disproportionate effects on some regions and segments of the euro area population. We concur with the authorities that judicious implementation of the RRF would contribute to economic convergence. Staff's proposals on targeted policies to safeguard vulnerable regions, as well as calibrated place-based policies, also deserve consideration.

7. The COVID-19 crisis is likely to have persistent effects on many countries' economic structures. Given the large uncertainties surrounding the post-pandemic landscape, the authorities recognize the need to avoid risks that liquidity problems turn into insolvencies while being mindful to provide continued support to viable firms. In this regard, we share the authorities' view that effective insolvency frameworks play a crucial role in supporting viable firms undergoing temporary problems and providing for the orderly exit of non-viable firms. We appreciate the recommendations provided for dealing with non-performing loans reduction strategies to deal with the COVID-19 pandemic and trust these were well received. Staff considers that a European level solvency support instrument could play an important

role in maintaining the integrity of the Single Market, given countries' differing capacities to inject equity into struggling firms. *Can staff comment on the potential role of existing EU instruments, including the Temporary Framework for state aid and Invest EU, in this regard?* The use of short-time work schemes has been invaluable in protecting jobs and livelihoods during the pandemic, and we welcome the authorities' acknowledgment that labor policies need to remain agile to ease adjustment and support the recovery.

8. We wish to recognize the European Union as a strong supporter of free and fair trade. We commend the authorities' commitment to a rules-based global trading system and their intention to continue working with trading partners to advance WTO reforms.