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Statement by Mr. Bevilaqua, Mr. Fuentes, and Mr. Barroso on Euro Area (Preliminary)
Executive Board Meeting
December 18, 2020

We thank staff for the well-written report and Mr. Pösö for his informative buff. With the second wave of the COVID-19 pandemic dragging on across member countries, policymakers in the Euro area need to sustain the policy momentum. Uncertainty continues to be unusually high, with both downside and upside risks gaining relevance, at a time when vulnerability has built up with higher debt in the corporate and public sectors. With new lockdown measures in effect before the vaccine is widely available, job retention schemes and borrower support programs should be renewed, although with progressively better targeting. European level institutions will have a big role to play given countries' different policy spaces, policy frameworks and pandemic exposure levels.

The strong solidarity signaled by the NGEU program provides adequate ground for fighting economic scarring and strengthening Euro area institutions. European Council disposition to accommodate emergency fiscal expenditure by member states is also crucial given that domestic fiscal policy represents the backbone of the short-term response. Indeed, emergency support is still necessary to minimize economic scarring from new lockdown measures. We look forward to the definition of the funding structure and the operational mechanism. While we take note of staff estimates that the program alone could lift EU27 growth by 1.5 percentage points, this will require strong frameworks within member states to ensure resources are properly employed. Furthermore, progress in the implementation of country-specific reforms will also be crucial to support the NGEU's expected impact on growth. An effective and swift implementation of the NGEU program could play a catalytic role in favor of a permanent central fiscal capacity to bolster coordination and sustainability. We take note of the European Commission's hesitation to reform fiscal rules at this juncture, although it could, in principle, contribute to address growing concerns with fiscal sustainability and signal strong commitment to resolve them.

We welcome the additional support provided by the ECB to cope with the second wave of the pandemic. The substantial increase in asset purchases and the use of targeted extended longer-term refinancing operations at favorable conditions agreed by the ECB's Governing Council meeting in December are timely and prudent measures to provide further monetary accommodation as inflationary pressures remain subdued. In this process, as recommended by staff, clear communication regarding the guidelines for asset purchases and its overall compliance with the capital key is critical. Direct support to the nonfinancial sectors may be a sensible tool in extreme scenarios, although it is more appropriate to address liquidity constraints. Regarding the ECB strategy review, we welcome the progress achieved in the recent months and the productive discussion with staff during this process. In particular, we see merit in expanding discussions on the potential benefits of adopting a symmetric point inflation targeting regime to better anchor inflation expectations and its consistency with other policy objectives such as financial stability and employment.

Downside risks to the financial sector have increased and banks need to be ready to the phase-out of borrower support measures once the recovery is underway. Authorities need to stand ready to replenish facilities such as ESM's PCS and the RRF in case downside risks materialize. With significant solvency gaps in the corporate sector and borrower support measures posed to expire, authorities should expect a significant weakening of the lending channel. At the same time, as NPLs are expected to rise again authorities must maintain focus on asset quality and continue working on NPL resolution. It is important to coordinate towards more uniform regimes, including on the operation of asset management companies for distressed assets. *More broadly, we would like to hear from staff about how well-positioned are Euro area banks to address legacy NPLs once the pandemic abates and to tackle structural low profitability in the banking system in a low interest rate environment.* In addition, we look forward to the implementation of FSAP recommendations on the crisis resolution framework and support the development of a macroprudential framework for non-bank financial institutions.

Structural policies are critical to ensure a healthy recovery, minimize downside risks and improve medium term-growth prospects. Vulnerable worker relations, high corporate debt and reasonable concerns with government debt and contingent liabilities remain important drags to economic activity and job creation. Therefore, improving national social safety nets and insolvency frameworks is key to minimize economic scarring. Public investment can partially substitute the private sector and, more importantly, nourish network effects towards new sectors and technologies and foster convergence among member states. We encourage both authorities and staff to deepen the discussion of carbon border adjustment proposals, including its legal standing under WTO rules and global spillovers. More broadly, it is important that the Fund anchor its surveillance in an unbiased conceptual framework that creates a level playing field and ensures global convergence of living standards.