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

We thank Mr. Poso in his capacity as President of EURIMF for his insightful Buff statement. We commend the robust response of the EU and its Member States to the pandemic, noting that it helped moderate negative effects. That said, the second wave of infections and associated containment measures have dampened confidence and slowed the recovery momentum, with differentiated effects across countries. However recent progress with vaccines and timely roll-out of immunization should facilitate recovery and help bring the pandemic under control.

Addressing immediate risks and recovery: Given large downside risks, including from the second wave of infections, an appropriate balance between supporting the economic recovery and containing the spread of the pandemic will be necessary in the short term. Given prior vulnerabilities alongside COVID-19 impacts, however, as soon as the pandemic recedes, we urge timely implementation of the Next Generation EU (NGEU) and the Recovery and Resilience Facility package, to avoid damaging euro area recovery prospects. We recognize the important role of the NGEU package in supporting a green recovery and digitalization reforms. We, however, underscore the importance of complementing these measures with robust carbon pricing and public investment policies to mitigate climate change risks and achieve emission reduction goals, as well as with effective regulation to contain corporate power and digitalization risks.

Fiscal policy: The withdrawal of fiscal stimuli by national authorities should be gradual and contingent on the country context once the recovery is firmly established. We see merit in the EU's decision to keep the escape clause in fiscal rules that was activated in 2021 and encourage retaining this waiver until the recovery is well underway to avoid an earlier-than-warranted fiscal adjustment. Given the vulnerability of a large number of households and firms in the wake of this crisis, any movement towards fiscal tightening needs to be gradual. Nevertheless, once the crisis abates, fiscal consolidation will be necessary in high-debt countries to create fiscal space and bring debt onto a sustainable path. To this end, countries with high-debt levels should monitor risks associated with adverse changes in market perceptions, which could further constrain their ability to roll-over and service debt in the future, closely. Many countries will also need credible fiscal consolidation strategies in the medium term.

Monetary policy: While the current accommodative monetary policy stance remains appropriate, further accommodation will likely be needed in response to the second wave of the pandemic and to address disinflation risks. However, the prolonged period of unconventional monetary policy (UMP) also highlights the need for vigilant monitoring and proactive use of macroprudential tools to mitigate financial stability risks. Relatedly, while the asset purchase program (APP) has been effective in the provision of liquidity to the banking system, additional policy options may need to be considered if inflation continues to weaken. Enhancing communications on forward guidance on the path of the policy rate and the APP, is also important.

Financial sector: We support plans to retain borrower support and capital conservation measures until the recovery is well underway, while gradually rebuilding capital buffers. At the same time, balance sheets must be repaired in time, given risks stemming from high NPLs, to support financial intermediation going forward, especially in a downside scenario. We urge the authorities to press ahead with reforms aimed at advancing the banking and capital markets unions, enhancing the EU's crisis resolution capacities, and improving harmonization and centralization of emergency liquidity arrangements, to further strengthen financial resilience. Prudential measures also need to be strengthened to address vulnerabilities in non-bank financial institutions, given their sizable exposure to firms and banks. At the same time, the risks stemming from the sovereign-banking nexus warrant close monitoring.

Structural reforms geared towards supporting job creation, effective reallocation of resources, strengthening social safety nets, and limiting scarring are still needed to reignite inclusive growth. The transition out of crisis should be characterized by targeted support that prioritizes viable businesses while exploring ways to limit the cost for taxpayers. The allocation of EU recovery funds to advance the implementation of structural reforms could also be considered, especially in countries where productivity growth has weakened. Measures to accelerate regional convergence and address inequality and poverty should also be prioritized. Finally, we encourage all authorities to press ahead with reforms to enhance trade liberalization and to support a multilateral rules-based global trading system, and advance WTO reforms.