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HELLENIC FOUNDATION FOR EUROPEAN & FOREIGN POLICY
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Greek & European Economy Observatory

11th Newsletter on the economic impact of the Covid-19 pandemic

European Developments (29/05-05/06)

"In the current rapidly evolving economic environment, the Governing Council remains fully committed to doing everything necessary within its mandate to support all citizens of the euro area through this extremely challenging time."
Christine Lagarde, President of the ECB

"Hamilton understood he could not just solve the problem of the time without getting political progress in the union. This is also a moment where we should do some progress."
Olaf Scholz, Minister of Finance of Germany

"The Commission's proposal, together with the European budget and the reconstruction fund, would mean that Austria would have to contribute nearly 2% of its GDP. That would be twice as much as in the past. For us, that's unacceptable."
Gernot Blümel, Minister of Finance of Austria

- The Commission submitted a proposal to increase this year's budget by €11.5 bn which will be provided to REACT-EU, the Solvency Support Instrument and the European Fund for Sustainable Development.

European Commission

- The Governing Council decided to:
  - increase PEPP purchases by €600 bn and to extend its duration to at least the end of June 2021;
  - continue purchases under APP at a pace of €20 bn per month;
  - hold the main rates stable.

ECB

National measures (29/05-05/06)

Germany: The coalition parties agreed on a new stimulus package of €130 bn which includes mainly a VAT rate cut and a one-off allowance of €300 for every child.

Romania: The Government established a fund of €1.65 bn to support large companies with loan guarantees and grants.

UK: The Government will create a £10 bn fund to provide trade credit guarantees.

Canada: The Central Bank held its benchmark rate stable at 0.25% and announced that purchases of government and corporate bonds will continue.

Australia: The Government will provide extra 500 m. AUD to alleviate the adverse phychological effects of the pandemic on the population.

Saudi Arabia: The Central Bank has provided banks with further liquidity worth $13.3 bn to support private businesses.

International Monetary Fund

- From 29/05 to 04/06 the IMF has approved the requests of 6 countries for financial support through the Rapid Credit Facility, Rapid Financing Instrument and Catastrophe Containment and Relief Trust. Total amount approved: 1.037 bn SDR ($1.423 bn)

Breakdown of measures[6] (16/03 – 05/06)

	EU	France	Italy	Germany	Netherlands	Austria	Denmark	Spain	Greece	Portugal	Ireland
A. Fiscal Measures[1]	€65 bn	€110 bn[2]	€52.5 bn	€286 bn	€33.1 bn	€12.2 bn	120.9 bn DKK	€31.2 bn	€24 bn[3]	€1 bn[1]	≈ €7.3 bn[1]
B. Monetary Measures (Total)	€2.6 tr.[4]	-	-	-	-	-	Bank credit facility increased	-	-	-	-
C. Loans/Guarantees	€305 bn	€315 bn	€530 bn	€819.7 bn	Min. €12.1 bn	€9 bn	70 bn DKK	€112.4 bn	Not Specified	€6.8 bn	€5 bn[1]
D. Tax Deferrals	-	Not specified	€27.5 bn	€500 bn	€36 bn	Up to €10 bn	208 bn DKK	Min. €14 bn	Not Specified	€7.9 bn	Not Specified
E. Labour Market Measures[5]	SURE: Fund to provide loans to member states targeted to employment schemes. Total value: €100 bn	Income support subsidy of 70% for workers in partial unemployment status	Temporary prohibition of redundancies and prolongation of unemployment benefit	Further financing of the existing income support scheme for the unemployed	Wage subsidy of up to 90% (for businesses reporting revenue reduction of at least 20%)	Progressive wage subsidy based on the size of salary of up to 90% of working time	Wage subsidy of up to 75% (for businesses reporting revenue reduction of at least 20%)	Wage subsidy of 70%[6]	Measures include the continuation of the special allowance to workers, a wage subsidisation scheme and the extension of the unemployment benefit	Wage subsidy of up to 75% (for businesses reporting revenue reduction of at least 40%)	Unemployment benefit increase and wage subsidy of up to 70% (capped at €410/week)

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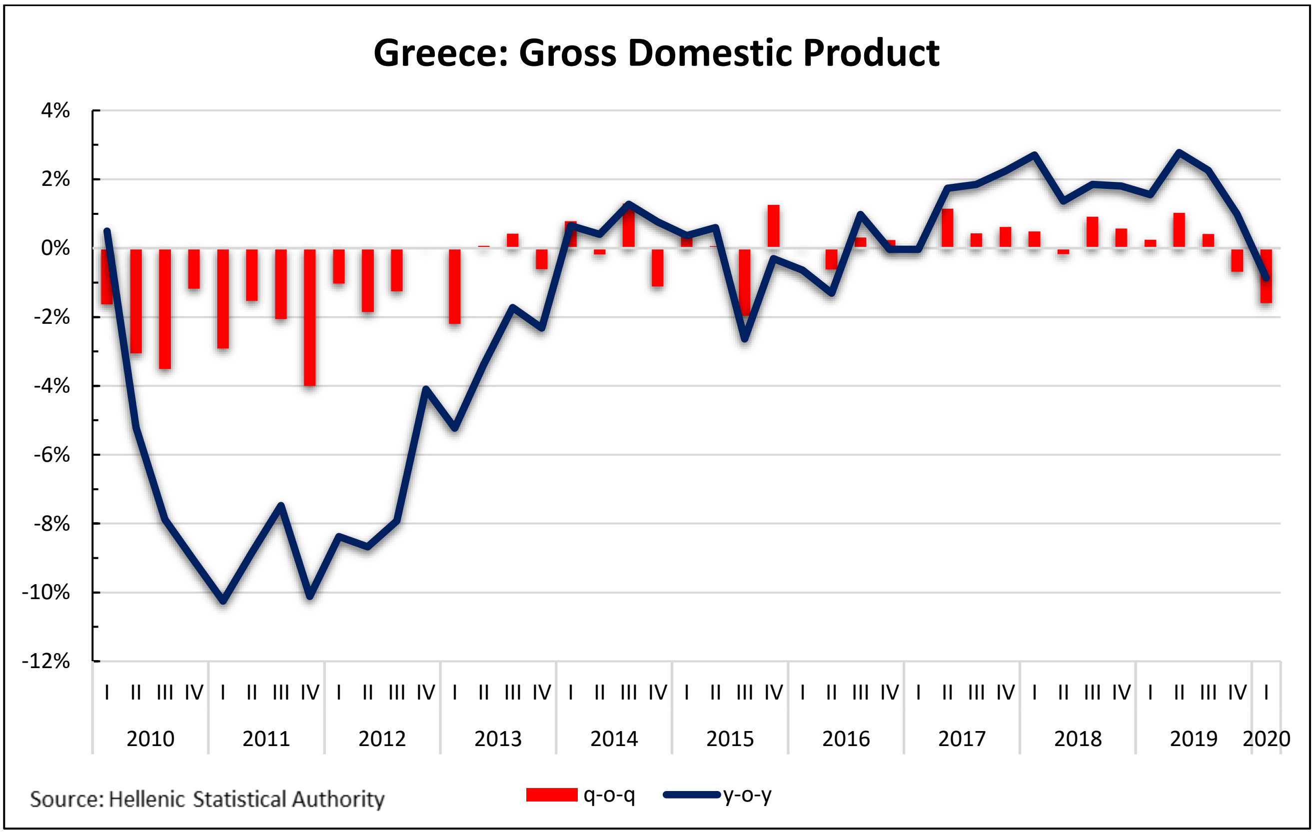
[1] The total value of these measures is greater as the cost of several measures has not been estimated yet.
[2] Includes tax deferrals that are not specified separately.
[3] Includes tax deferrals and loans/guarantees.
[4] Includes the Pandemic Emergency Purchase Programme (PEPP), totalling €750 bn, the additional asset purchases of €120 bn within the framework of the Asset Purchase Programme (APP), additional liquidity of €1 tr. provided to banks through the TLTRO III programme and capital relief of €120 bn due to easing of regulations. These figures represent the total value of assets and bank liquidity that will have been added to ECB's balance sheet by the end of the respective programmes. For further details on the evolution of ECB's asset purchases, see the diagram of Weekly Net Asset Purchases below.
[5] The amount of these measures – if specified – is included in the fiscal measures.
[6] Main source: IMF Policy Tracker. Other sources: OECD Country Policy Tracker & official government announcements.

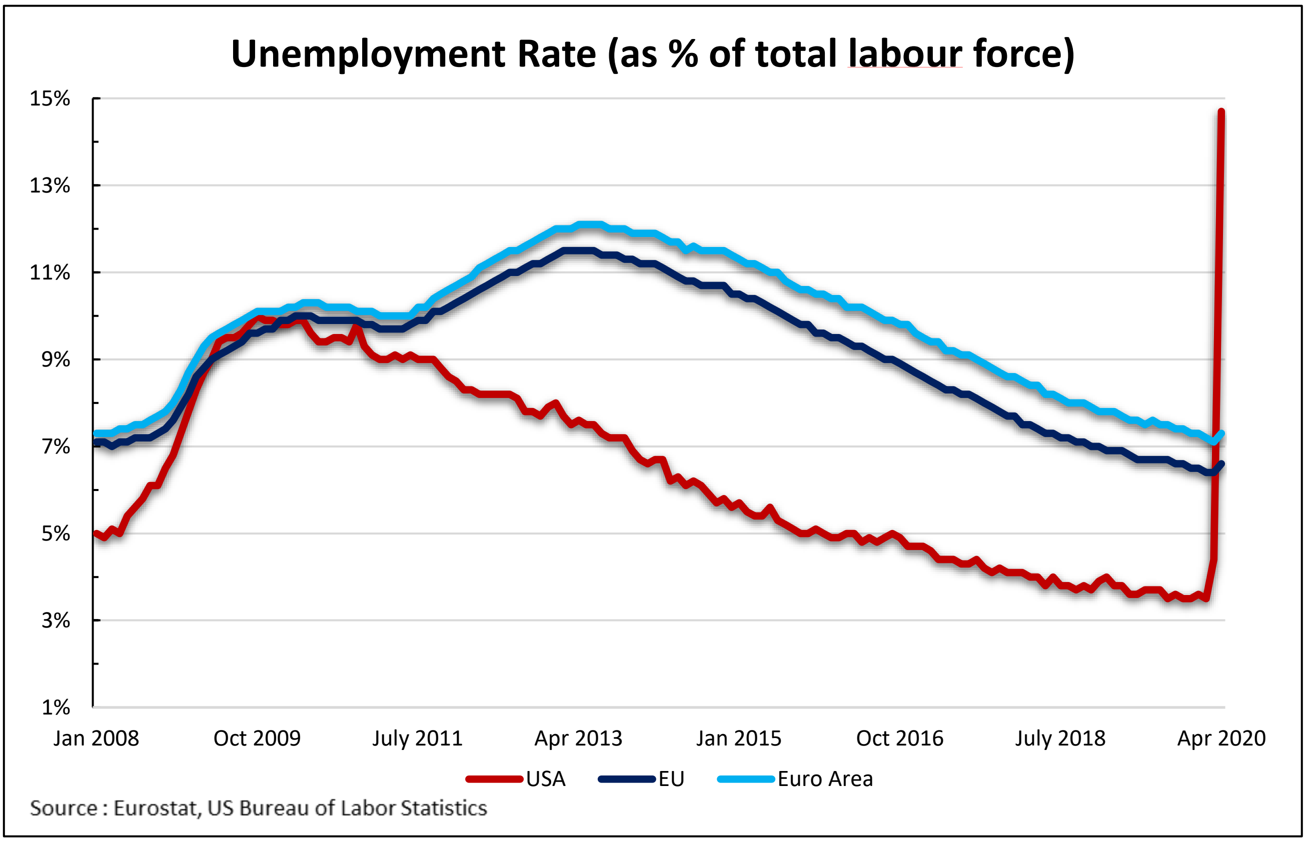
	USA	Canada	Australia	UK	Japan	Russia	India	Brazil
A. Fiscal Measures[7]	≈$1.7 tr.	108.3 bn CAD	133.8 bn AUD	£120.1 bn	¥148.9 tr.[8]	500 bn RUB[8]	9.45 tr. INR[8]	≈ 580 bn BRL[8]
B. Monetary Measures (Total)	Unlimited	Not Specified	Min. 90 bn AUD	Min. £645 bn	Unlimited	Not Specified	Min. 3.7 tr. INR	≈ 1.2 tr. BRL
B1. Asset Purchases	Not Specified	Not Specified	Not Specified	Min. £645 bn	Not Specified	Not Specified	Not specified	-
B2. Bank Liquidity	Not Specified	Not Specified	Min. 90 bn AUD	Min. £190 bn	Not Specified	500 bn RUB	Min. 8 tr. INR	≈ 1.2 tr. BRL
C. Loans/Guarantees	$1.242 tr.	65 bn CAD	35 bn AUD	£330 bn[9]	Min. ¥2.1 tr.	Not Specified	-	≈ 253 bn BRL
D. Tax Deferrals	$561 bn	85 bn CAD	-	Min. £3.1 bn	Not Specified	Not Specified	Not Specified	Not Specified
E. Labour Market Measures[10]	$250 bn (Unemployment benefit increase)	Allowance of 2000 CAD/month to workers whose income was impacted & wage subsidy of 75% for affected businesses	Wage subsidy of 1500 AUD per employee per fortnight	Wage subsidy of 80%	-	Reduction of social security contributions for SMEs & unemployment benefit increase	Wage increase for those working in state employment schemes for the agricultural sector	Allowance of $120 for the unemployed and informally employed

[7] Does not include funds allocated for tax deferrals and loans/guarantees.
[8] It includes the funds allocated for tax deferrals and/or loans/guarantees, as the exact breakdown of the package is not specified.
[9] Supported by the BoE
[10] The amount of these measures – if specified – is included in the fiscal measures.

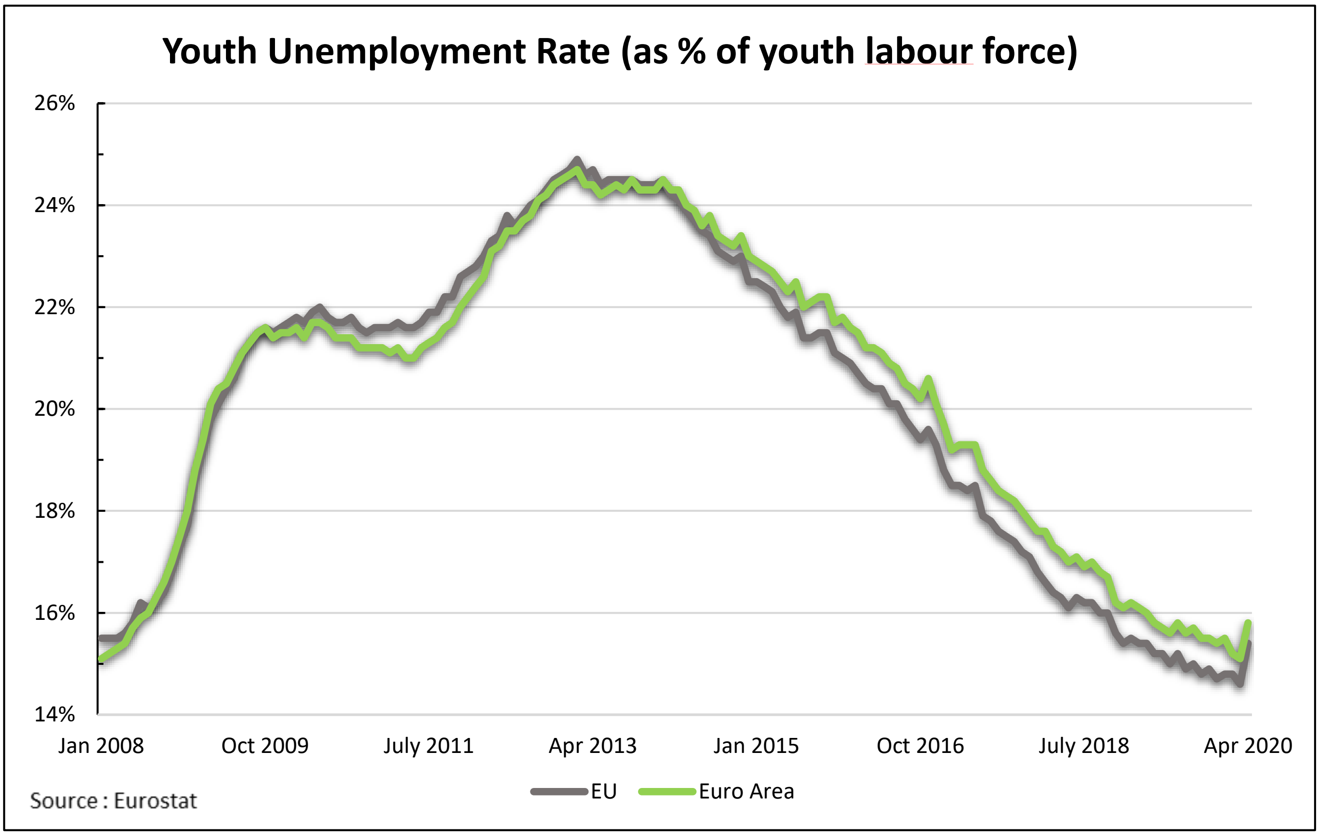
Recent Economic Developments (01-04/06)



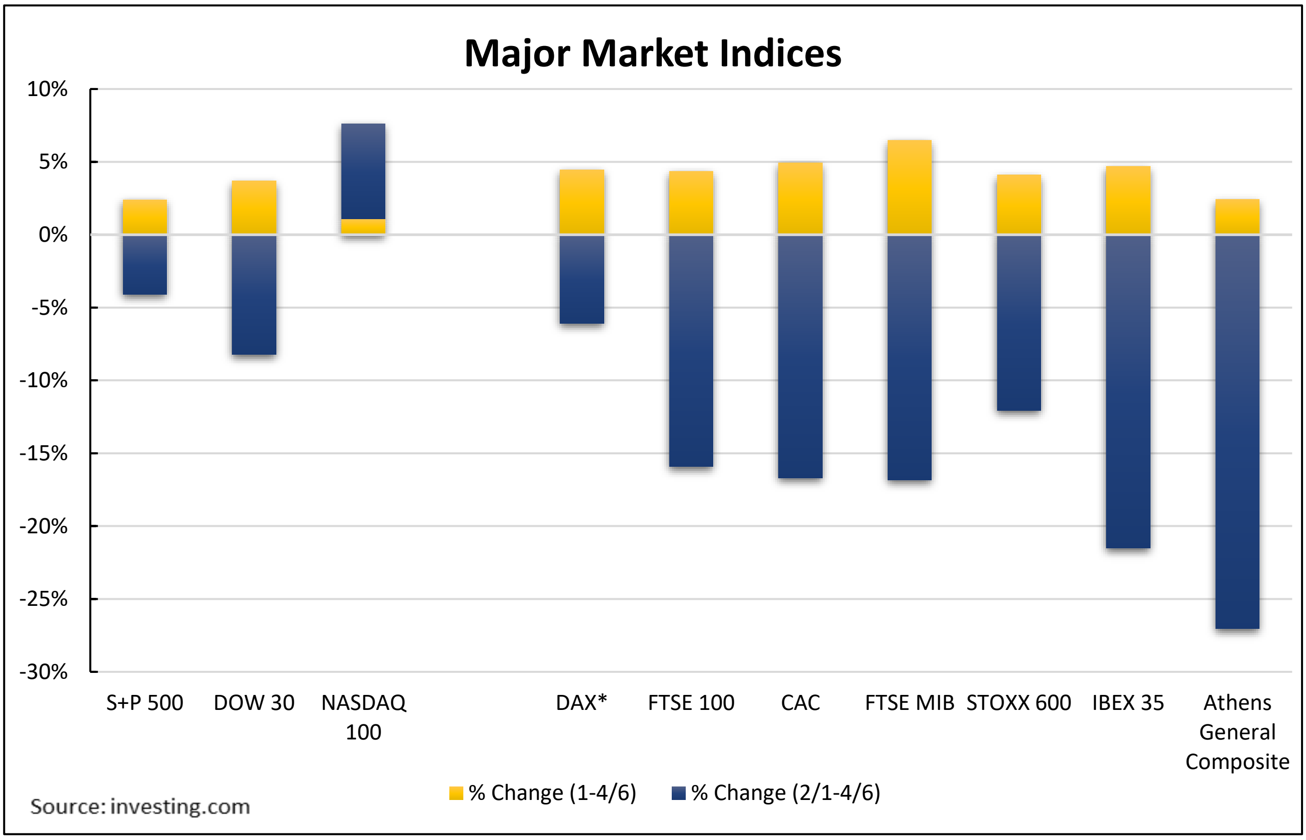
According to the Hellenic Statistical Authority (4/6), in the 1st quarter of 2020, GDP decreased by 1.6% compared to the previous quarter and by 0.9% compared to the 1st quarter of 2019.



According to Eurostat (3/6), the unemployment reached 6.6 % in the EU and 7.3% in the Euro Area in April 2020. According to the US Bureau of Labor Statistics, the unemployment rate in the US increased in April to 14.7%, which is the highest recorded rate since 1948.

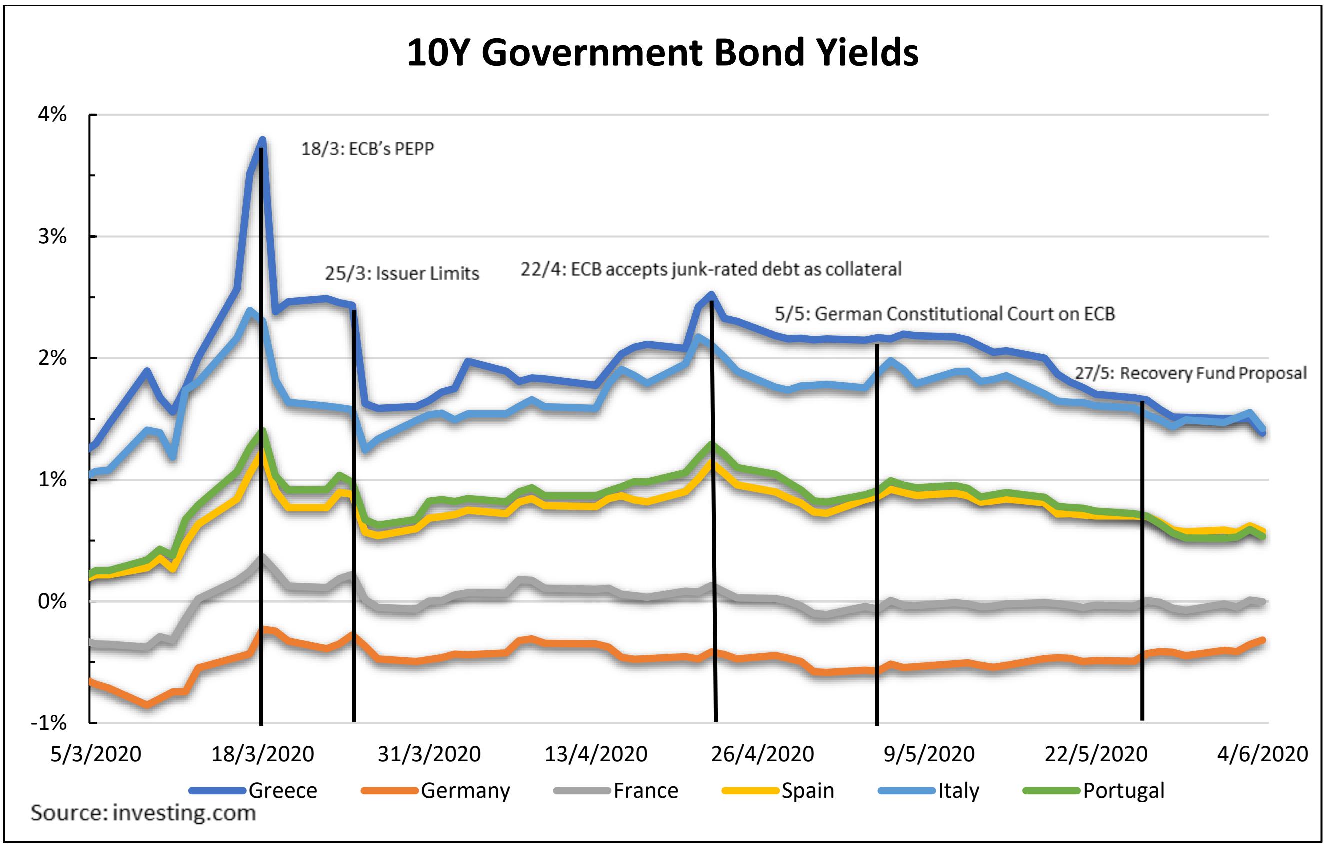


According to Eurostat (3/6), in April 2020, the youth (under 25 years) unemployment rate was 15.4% in the EU and 15.8% in the Euro area.

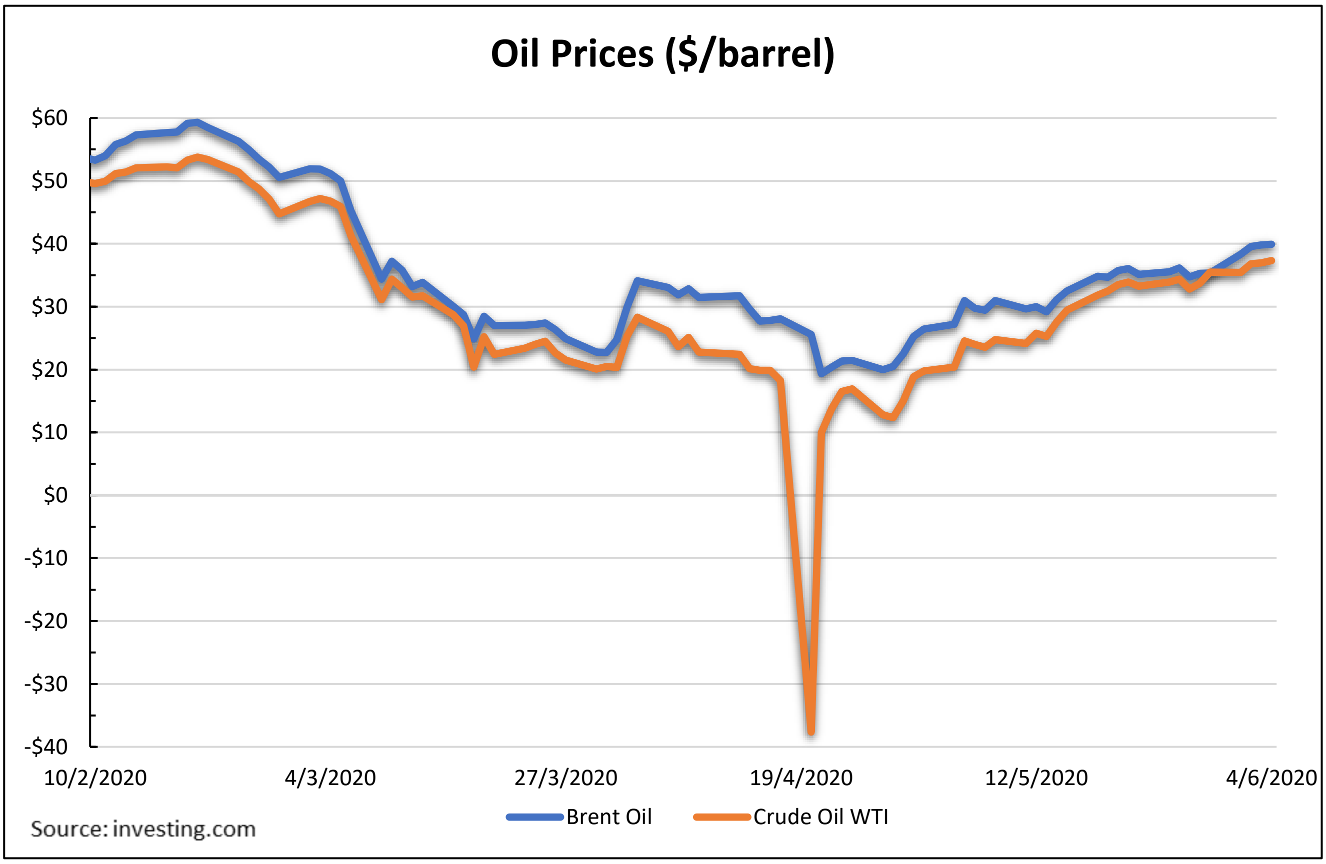


* % Change 2-4/6.

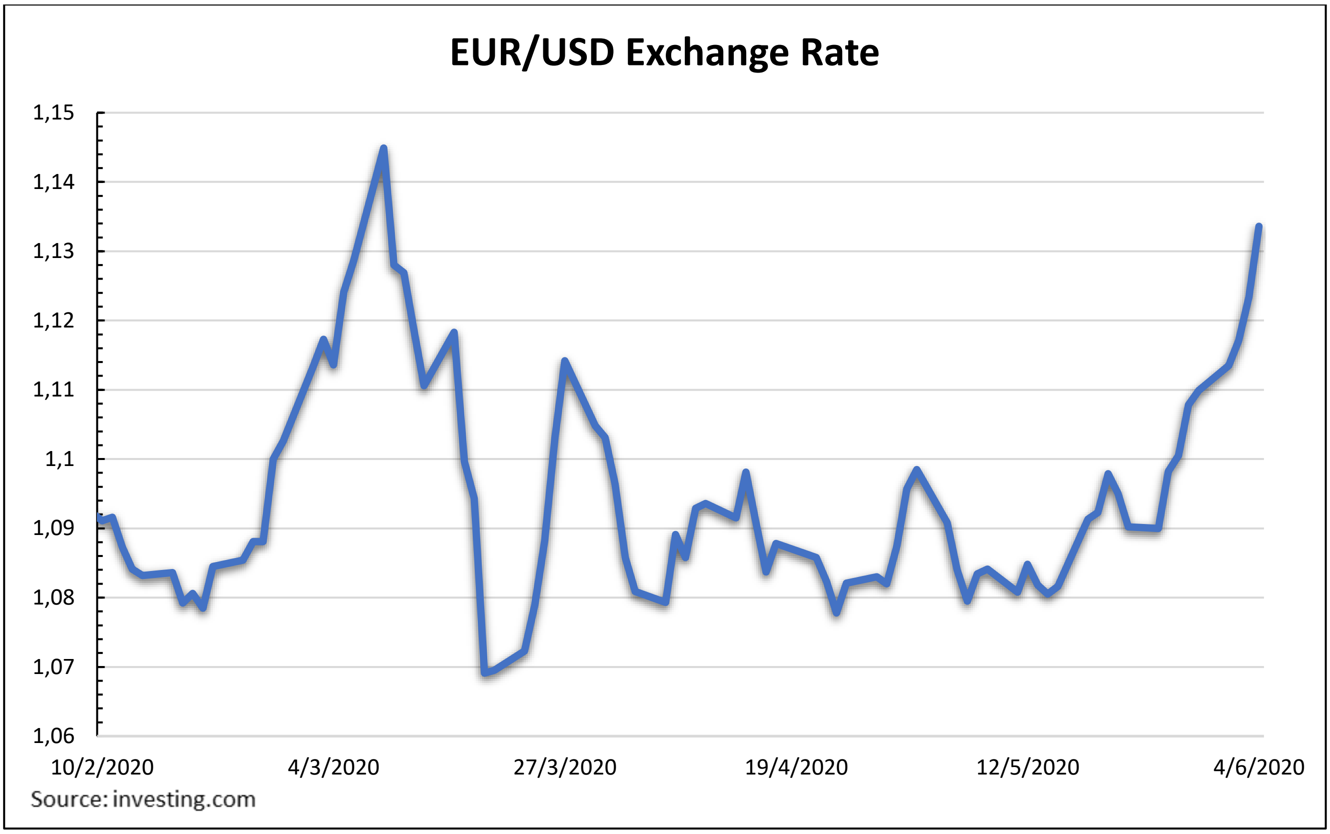
Both Wall Street and European indices climbed this week. European markets powered higher following the ECB's statement for the expansion of the PEPP by €600 bn.



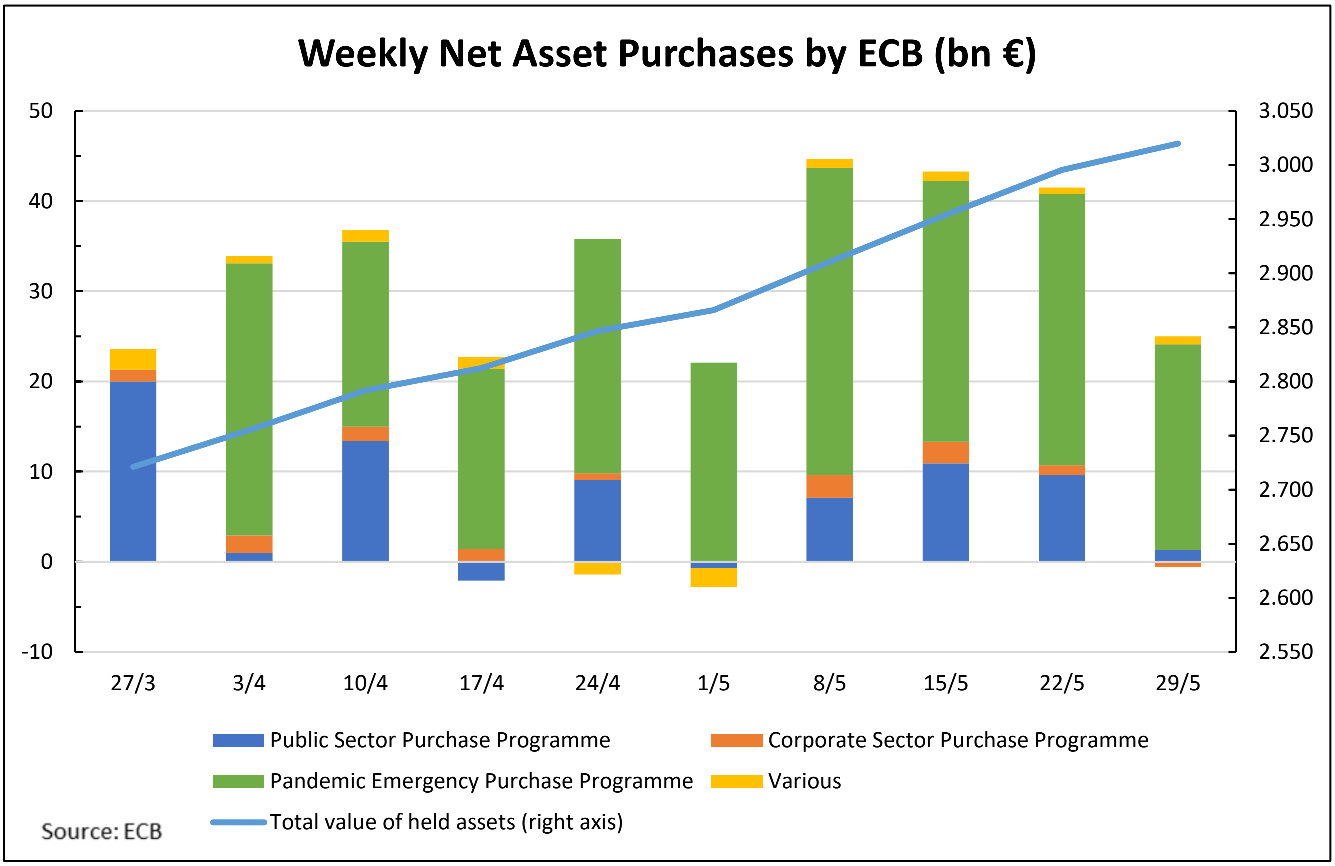
Most European government bond yields fell following the ECB's (4/6) statement for the expansion of the PEPP by €600 bn.



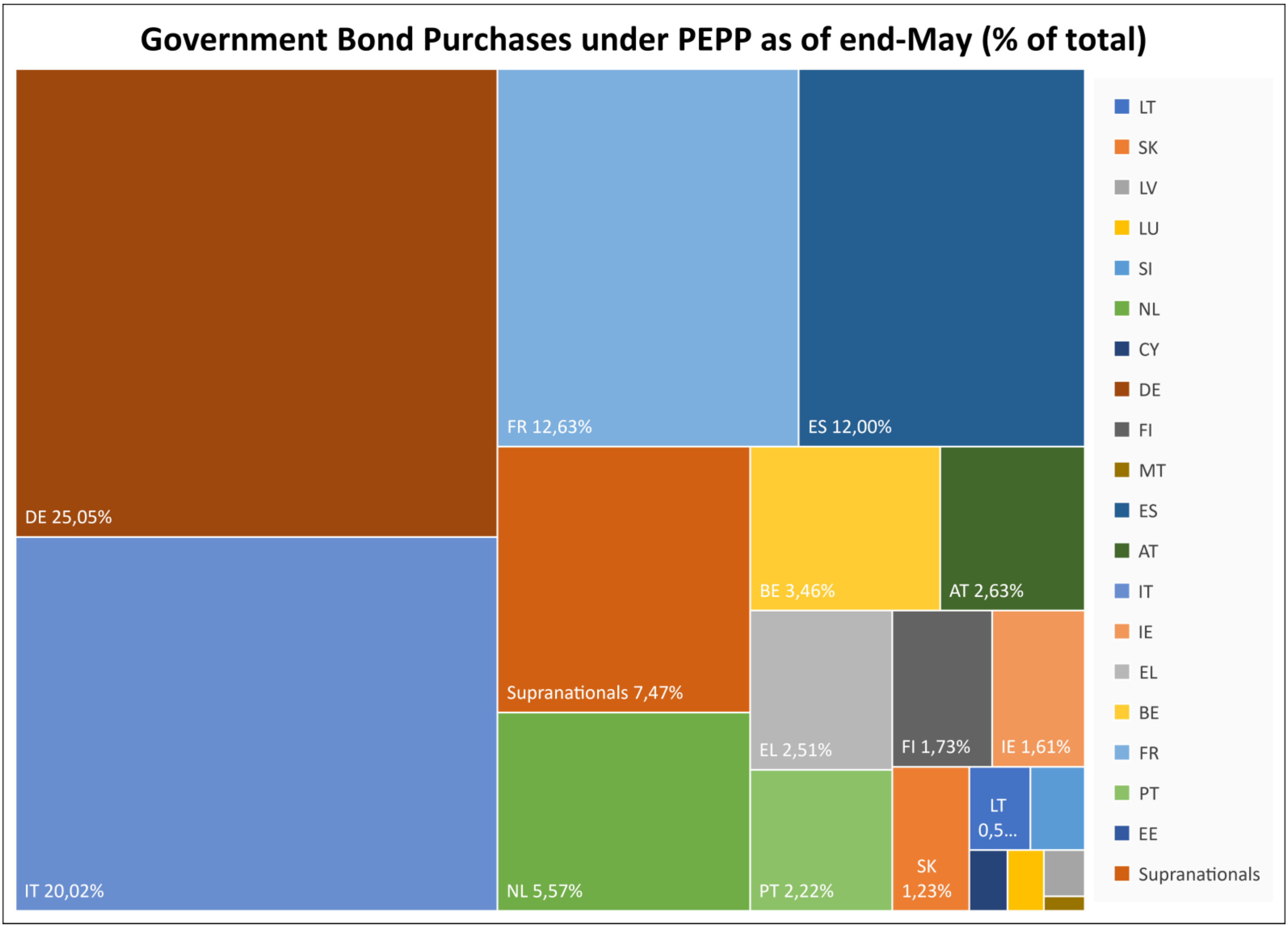
Oil prices settled higher on Thursday with the international benchmark Brent trading at $39.91 per barrel and the American benchmark WTI at $37.31 per barrel.



In the foreign exchange market, the EUR/USD exchange rate increased further this week and is currently at 1.1136 $/€.



On 18/3, the ECB announced a new asset purchase programme (PEPP) totaling €750 bn. Furthermore, the ongoing APP, which is in force since October 2014, was boosted on 12/3 with an additional envelope of €120 bn. The bars represent weekly net asset purchases per programme whereas the line represents the weekly evolution of the cumulative value of all assets held by ECB as part of all past and current asset purchase programmes.



Since the crisis outbreak the ECB has boldly stepped in to defend EA financial stability. This map shows the current share of PEPP bond purchases by member state. 37% of government bond purchases under PEPP have been directed to Southern Europe (IT, ES, GR, PT) exceeding their total participation (circa 27.5%) in ECB capital.

In Focus

Commentaries, analyses, forecasts on the economic dimensions of the pandemic

EU's current COVID-19 response plan hardly amounts to a radical break with 'business as usual', according to Nouriel Roubini and Brunello Rosa on Project Syndicate. Although any common European approach to the COVID-19 crisis is a step in the right direction, celebrations of the EU's long-awaited 'Hamiltonian moment' are premature. Firstly, the bond issuance will not come with a 'joint and several guarantee' and thus would not constitute genuine debt mutualization. Secondly, if the funds do not become available by this summer, it may already be too late for hard-hit countries such as Italy, Greece, and Spain. Thirdly, the recent ruling of Germany's constitutional court in addition to the hard stance of 'the frugal four' member states, sets severe political limitations. However, **for the Euro to survive, both a monetary and a fiscal backstop are needed.** And even with those in place, the EU needs to address other unresolved problems, such as Italy's surging public debt. The EU now must demonstrate that it is up to the challenge of completing its integration process. In any other case, it could confront a 'Jeffersonian moment', returning to some form of confederation, with only limited shared sovereignty.

The potential of monetary policy is now reaching its limits, according to Paola Subacchi on Project Syndicate. In the current crisis, it is imperative that funds reach those most in need as quickly as possible, especially the high number of unemployed workers**.** Therefore, what most countries need is a fiscal-policy push, undertaken in coordination with monetary policy. A fiscal expansion should have two objectives. Firstly, it must help individuals, households, and firms weather the crisis. Secondly, it needs to drive economic recovery by supporting domestic demand. While the US and the EU have responded adequately to the former objective, their decisions fall short regarding the latter one. **Extreme monetary policies reduce the effectiveness of interest rates, exacerbate pre-pandemic vulnerabilities, and keep bankrupt 'zombie' companies artificially alive.** The space for fiscal policy is narrow, but the current emergency calls for bold, 'unconventional' fiscal policies supported by other tools, such as the European Recovery Fund, and innovative capital-market instruments like perpetual bonds.

The position of the European Central Bank is also presented as constrained. Erik Jones paints a picture of **the ECB as hostage** – to the effects of the crisis, the actions of the European Council, and the economic and political consequences (both real and imagined) of its own policy response. The unique element of the ECB lies in its independence from member-states and the absence of a clear, overarching political authority to which the Governing Council must answer. At the same time the treaty makes it clear that the ECB should play a role in supporting the wider economic objectives of the European Union. Nevertheless, since the last crisis, these 'privileges' of the ECB turned out to be constraints. The Governing Council could not achieve its policy mandate without engaging in activity that looked a lot like the direct government financing and it also could not seek authorization from any higher political authority, including the European Council, for either bending or ignoring the constraints on its purchases of government debt.

Despite its limitations, the ECB's measures remain decisive in the European context. The EU-wide response to the COVID crisis had been rather weak until the Commission put on the table a drastically new proposal: the creation of a new recovery facility, 'Next Generation EU', that would borrow money in the name of the EU to finance member states in need. Nevertheless, according to Zsolt Darvas of Bruegel, the changes to the proposed seven-year budget that accompany the Commission's proposal are small, suggesting that an opportunity to reform the EU budget is missed, **casting doubts over the effectiveness of Next Generation EU**.

Another problem of the initiative is that **Next Generation EU bonds might face a credit-rating challenge**, according to Moritz Kraemer, Centre for European Policy Studies. If fully implemented, the Commission's Next Generation plan would increase the EU's financial obligations fifteen-fold. Two-thirds of the envisaged €750 billion of bonds receipts will fund grants and, for the first time, will not be backed by guarantees of individual member states borrowing the proceeds from the EU. Instead, according to the Commission, the support for the massive borrowing programme will come from the EU's strong credit rating. Indeed, the EU currently enjoys a top-notch AAA-rating from all agencies except Standard & Poors (which gives it an AA-rating). Nevertheless, under Article 323 of the TFEU, member states are legally obliged to 'ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties.' The problem of this loose form of callable capital is that the actors making the call are the same ones having to make the payment. Given the untested nature of capital calls, rating agencies have treated callable capital as less secure than paid-in capital. This would be even more true for the more undefined obligation to make good on any shortfall in the EU budget. Without a capital buffer or legally enforceable guarantees, uninterrupted and unwavering AAA-member support is critical.

The very sharp fall in GDP resulting from health-related restrictions, as well as individuals' own decisions, is not the main concern according to Jonathan Portes' analysis on VoxEU. Instead, **the main concern is to prevent permanent damage or 'scarring', of the economy**. For instance, unemployment and its particularly severe impact on youth, firms' liquidity problems, business investments are some of the potential lasting scars of the COVID-19 crisis. In the short to medium term, action like furlough schemes to keep firms in business and keep workers employed in their current jobs is justified. But over the longer term, the main channels should be individual-specific, focused on human capital. At some point the focus needs to switch to active labour market policies – including subsidies to facilitate retraining and labour reallocation. While the natural resilience of market economies will significantly attenuate the damage, there is no reason to believe it will repair it entirely – which is why aggressive policy action is essential.

On the Brexit front, Jannike Wachowiak of the European Policy Centre expects that Boris Johnson will not agree to a Brexit extension. The May 2020 report of the Bank of England has forecast **the UK economy will experience the deepest recession in 300 years!** Adding the economic shock of Brexit to this mix seems reckless. An extension to the transition period is urgently needed to avert reinforcing the economic damage caused by COVID-19. However, the UK government is adamantly opposed to an extension and there is not much time left to come to an agreement. Under the terms of the Withdrawal Agreement, an extension must be approved before the 1st of July. Nevertheless, the UK government seems to believe that by running down the clock, it will be able to secure concessions from a 'weak and divided' EU at the last minute. This kind of thinking underestimates the EU's willingness to protect the integrity of the Single Market, and the European project as a whole. It is true that **the EU wants a deal, but certainly not at any cost**.

From an international angle, according to Alicia Garcia-Herrero and Elina Ribakova of Bruegel, **COVID-19 is by far the biggest challenge policymakers in emerging economies have had to deal with** in recent history, due to their excessive dependence on external financing. The sudden increase in global risk aversion arising from COVID-19 has caused investors to rush to safe assets and to the dollar, away from no-reserve currencies, reducing their markets' access to dollars, exports, tourism receipts and even remittances, as the shock also affects the countries where migrants earn their incomes. The fiscal and monetary room emerging economies have to respond is limited, and the lack of automatic stabilisers on the fiscal side also means that fiscal policy does not have the same redistributive effects during a severe shock as in the developed world. The IMF remains the most obvious lender of last resort for emerging economies, but it needs to make two changes to become more effective: a more targeted set of facilities with quicker disbursement and less conditionality; and increased financial resources.

The essential role of migration in a globalized economy has also been highlighted by the COVID-19 crisis, writes Giulio Di Blasi on Social Europe. With international travel suspended, enterprises around the world have experienced severe shortages of workers. As crops start to rot and health systems are being overwhelmed, some countries, such as the UK, Italy, and Canada, allow charter flights to bring in essential workers. Beyond industrialized countries, fragile regions, such as Latin America and South-East Asia, are affected as well, due to remittance flows shrinking by about 20% this year. Therefore, it is clear that **global migration should be incorporated into the recovery strategy**. Doing so will require four paradigm shifts. Firstly, interior ministers should consult with economic and social actors in order to redesign migration policies and develop legal mobility channels. Secondly, migration pipelines should integrate health concerns. Thirdly, governments and civil society need to prevent the proliferation of false and misleading narratives about migrants. Last but not least, authorities need to formulate recovery plans that are inclusive.

Relations between Europe and the US were already in a poor condition before the coronavirus pandemic. Trump's response will make tensions worse. Luigi Scazzieri of the Center for European Reform argues that while the Federal Reserve has opened emergency currency swap lines with other countries to help stabilize their economies by allowing them to obtain dollars, the US government has shown little interest in international health or economic co-operation. This approach will lead the US and Europe on a clash over two key issues. Firstly, regarding China, Europe will likely be reluctant to back a much harder US stance towards Beijing. Secondly, regarding security, the economic fallout of the pandemic will create transatlantic tension over defense spending within NATO. If Joe Biden wins the incoming election it is possible that these tensions would ease. However, if Trump secures a second presidency, the US and Europe would increasingly diverge. If Europe's internal challenges are not addressed, this could also drive a deeper rift within the EU**, with some member states turning towards China, while others latching onto the US**.

From the Greek perspective, the 15th of June is the landmark date of the Greek government for reopening national borders to tourism. Even though this summer has been irreversibly derailed**, there are initiatives from abroad, which indicate that the tourism season for Greece could still be saved.** The German diplomatic mission in Greece has circulated an article which contains all the vital information about travelling in Greece. German interest in Greece has skyrocketed, and even local newspapers include articles or directions for vacations in Greek islands. The Bealeric Islands were a favorite German destination, but Spain was particulary struck by the pandemic, meaning that the Spanish tourism industry will be likely put on hold for the rest of 2020.

ELIAMEP experts write

"Europe, and particularly Germany, realized that any potential scenario in which the European Union fails to do what is required, fails to protect the Eurozone and the single market *acquis*, threatens the standing of Europe in the global scene. This goes beyond an internal financial crisis or even a political crisis. Inspired by this realization, this strategic decision [to introduce the 750bn proposal] shows that the EU has matured, graduating into a new geopolitical logic. This new understanding prioritizes EU strategic autonomy, and to achieve that on a global scale Europe must show it can effectively manage one of the most acute crises it has faced over the last 70 years."

George Pagoulatos, Director General, ELIAMEP, *interview, Greek Public Television, ERT1, DEKA, 01.06.2020*

"So far, national governments and the ECB have mainly carried the burden of dealing with the crisis. Financial intervention at the European level remains limited in terms of amounts, but also in form, as it consists mainly of loans based on government guarantees. The Commission's new proposal is groundbreaking and could change the picture. Although the forthcoming negotiations are expected to be particularly difficult, the support of Germany, for which, ironically, the decision of the German Constitutional Court seems to have been a catalyst, creates optimism for a successful outcome."

Dimitris Katsikas, Head of the Greek and European Economy Observatory, ELIAMEP, *Online Lecture at the Aristotle University of Thessaloniki, 02.06.2020*

"Brexit is not being overturned because the driving force of nations is not only the economy, but also their national identity, says Francis Fukuyama, known for his older book *The End of History*, in his latest book. Therefore, the best we can do is wait for an extension of the last moment of the transition period. Forecasts estimate the budget deficit for 2020 at 337 billion pounds, instead of the 55 billion estimated in 2019. Where is this money to be found, to avoid a credit crunch, as in 1976 when a lack of liquidity led to the Great Britain in the arms of the IMF?"

Antonis Trifyllis, Member of the Advisory Board, ELIAMEP, *tovima.gr, 31.05.2020*

"In Europe, the transition to the post-pandemic era is already linked to the European Green Deal, which provides for economic revival and reduction of inequalities through action against climate change and the expansion of the circular economy."

Emmanouela Doussis, Senior Policy Advisor, ELIAMEP and **George Kostakos**, Co-Director of the Greek Forum of Sustainable Development (ELFOVA, a FOGGS-ELIAMEP joint initiative), *tanea.gr, 05.06.2020*