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ΕΛΛΗΝΙΚΟ ΙΔΡΥΜΑ ΕΥΡΩΠΑΪΚΗΣ & ΕΞΩΤΕΡΙΚΗΣ ΠΟΛΙΤΙΚΗΣ
HELLENIC FOUNDATION FOR EUROPEAN & FOREIGN POLICY
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Greek & European Economy Observatory

17th Newsletter on the economic impact of the Covid-19 pandemic

European Developments (10-17/07)

"It is crucial to reach a decision before the end of July and it should not be a downward compromise. That would be unacceptable, both from a political and economical point of view. The victims and the struggling businesses do not deserve it."
Giuseppe Conte, Prime Minister of Italy

"We need a recovery fund, yes. It should be directed to the actual needs and be based on favourable loans and not grants."
Stefan Löfven, Prime Minister of Sweden

"It is clear that keeping the rule of law principle in the Multiannual Financial Framework is one of our central priorities. It is about a much bigger picture and a matter of principle not just money."
Sanna Marin, Prime Minister of Finland

- The Governing Council decided to keep its main rates unchanged. In addition to that, asset purchases under APP will continue at a montly pace of €20bn.

ECB

- The Commission signed an MoU with North Macedonia for the disbursement of €80 m. of financial assistance to the latter.

European Commission

Court of Justice of the EU

- The General Court annuled the fine of €14.3bn imposed by the European Commission on Apple in 2016. The decision was taken on the grounds that the Commission had not proven that Apple's tax treatment was in violation of EU state aid rules.

European Council

- In light of today's meeting, President Charles Michel published his proposal on the MFF. According to it, the size of the MFF is €1.074tr, €36bn less than that of the Commission's proposal. While the recovery component remains intact at €750bn, the President proposed the maintenance of rebates for DE, NL, SE, AT & DK.

National Developments (10-17/07)

South Korea: The President announced a $132bn spending programme by 2025, aiming at creating 1.9 m. jobs.

Canada: The Central Bank kept its benchmark rate unchanged at 0.25%.

USA: The US Budget Deficit in June totalled $864bn, a record high for the USA.

UK: The Office for Budget Responsibility announced that the UK Government borrowing is expected to exceed £370bn in FY 2020-21.

Breakdown of measures[6] (16/03 – 17/07)

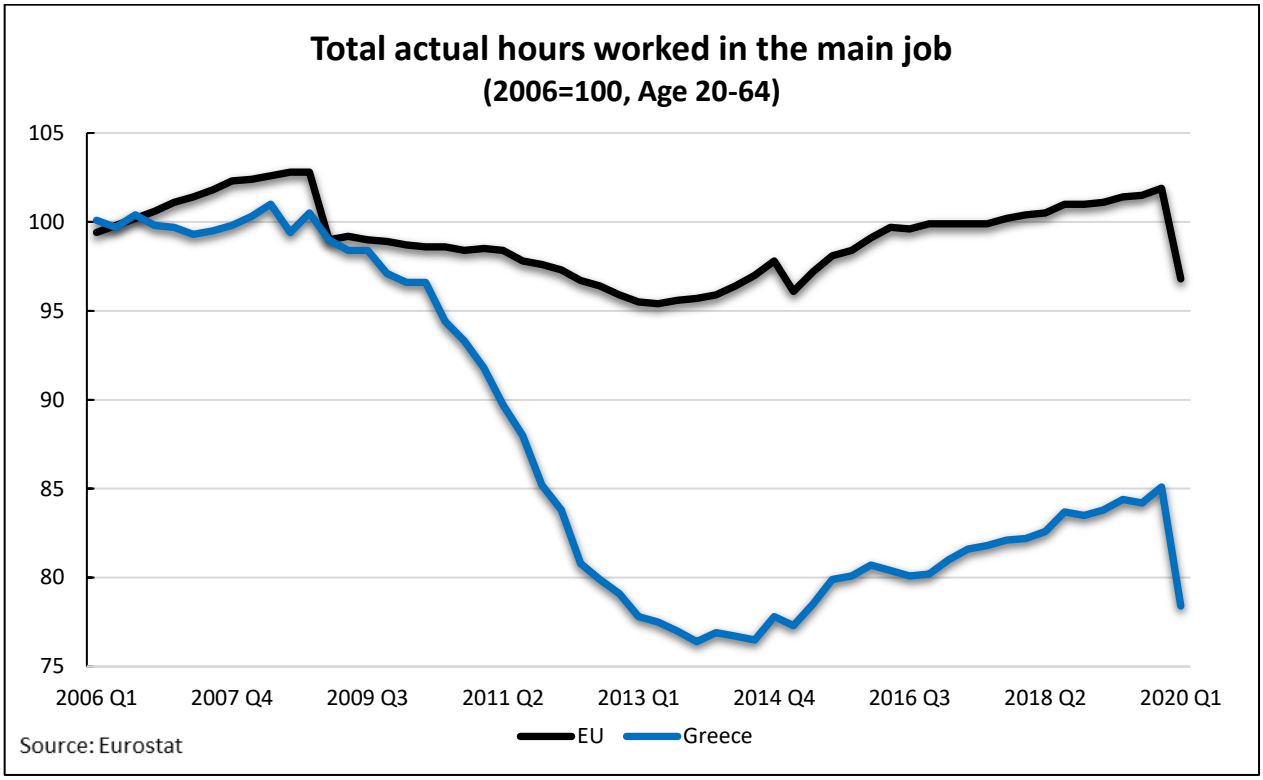
	EU	France	Italy	Germany	Netherlands	Austria	Denmark	Spain	Greece	Portugal	Ireland
A. Fiscal Measures[1]	€65 bn	€135 bn[2]	€52.5 bn	€286 bn	€33.1 bn	€42.2 bn	131.4 bn DKK	€31.2 bn	€24 bn[3]	€1 bn[1]	≈ €6.8 bn[1]
B. Monetary Measures (Total)	€2.6 tr.[4]	-	-	-	-	-	Bank credit facility increased	-	-	-	-
C. Loans/Guarantees	€305 bn	€315 bn	€530 bn	€819.7 bn	Min. €30.6 bn	€9 bn	70 bn DKK	€112.4 bn	Not Specified	€13 bn	Min. €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)

[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.

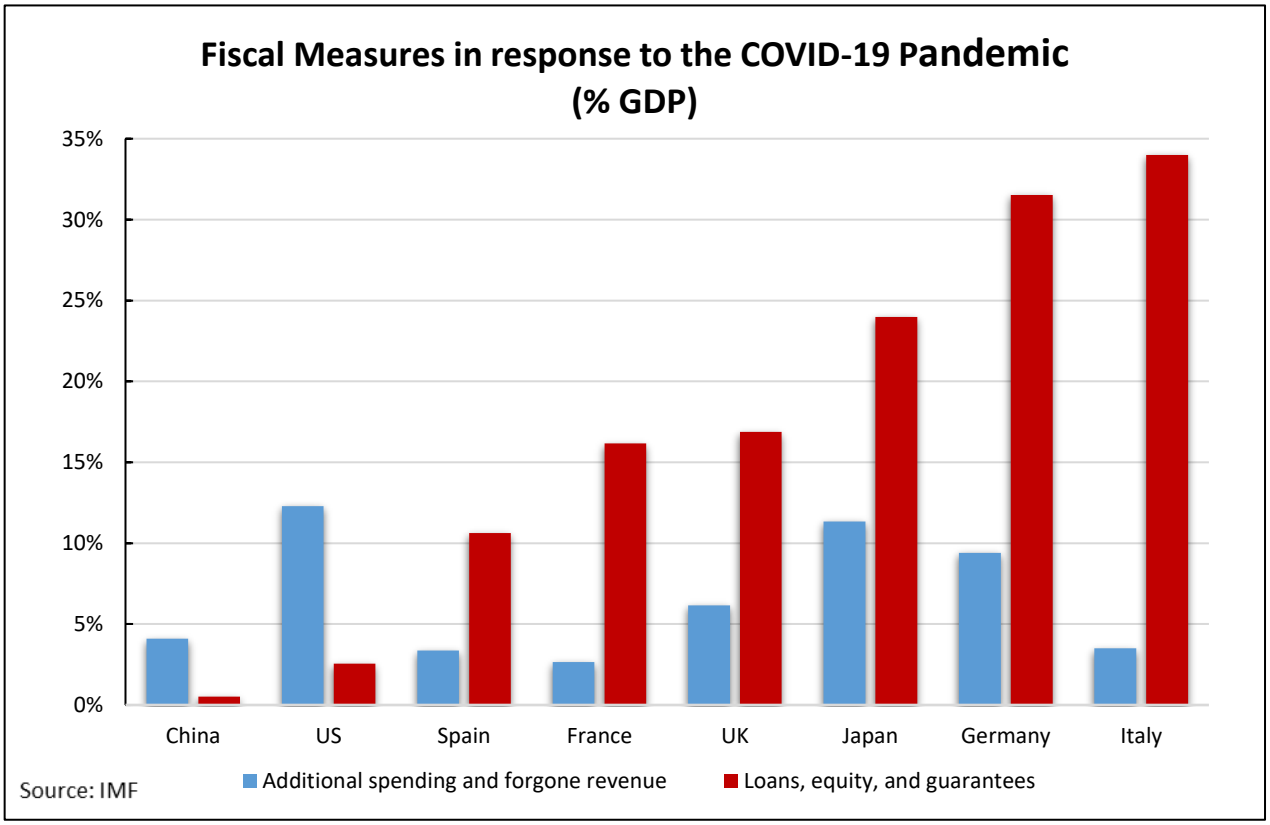
	USA	Canada	Australia	UK	Japan	Russia	India	Brazil
A. Fiscal Measures[7]	≈$1.7 tr.	177.6 bn CAD	133.8 bn AUD	£162.5 bn	¥148.9 tr.[8]	≈3.2 tr. RUB[8]	9.45 tr. INR[8]	≈ 800 bn BRL[8]
B. Monetary Measures (Total)	Unlimited	Not Specified	Min. 90 bn AUD	Min. £940 bn	Unlimited	Not Specified	Min. 3.7 tr. INR	≈ 1.2 tr. BRL
B1. Asset Purchases	Not Specified	Not Specified	Not Specified	Min. £750 bn	Not Specified	Not Specified	Not specified	-
B2. Bank Liquidity	Not Specified	Not Specified	Min. 90 bn AUD	Min. £190 bn	Not Specified	700 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. ¥2.135 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.

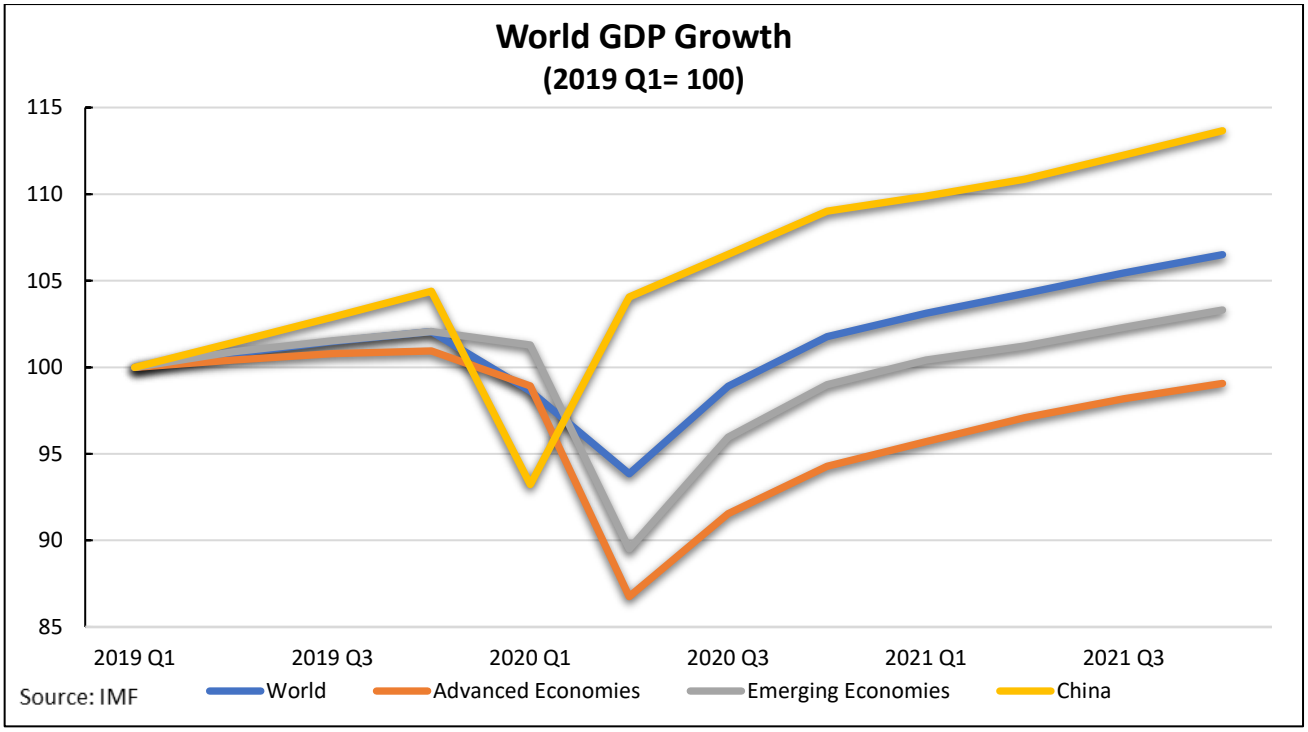
Recent Economic Developments (13-16/07)



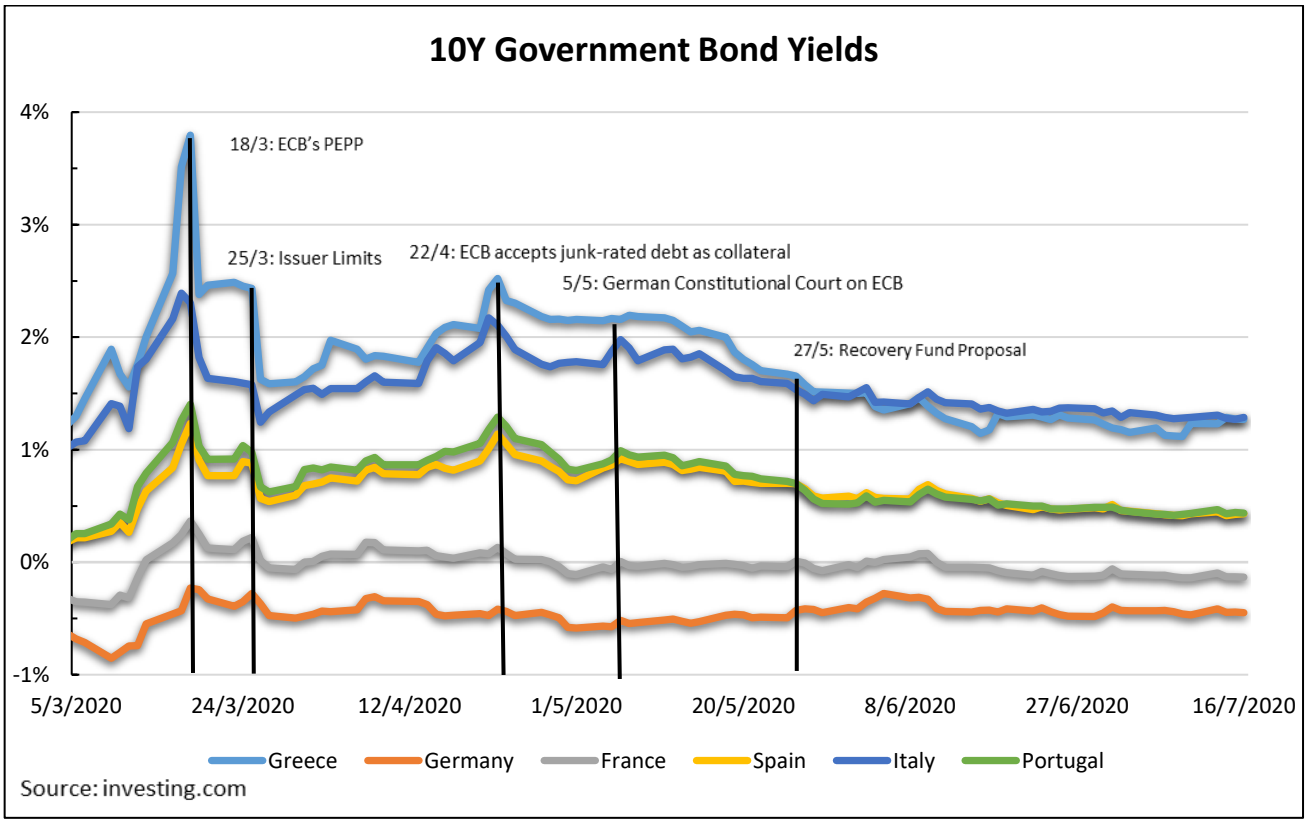
According to Eurostat (8/7), total actual hours worked dropped sharply during the first quarter of 2020, but have not yet reached the low values observed during the eurozone crisis.



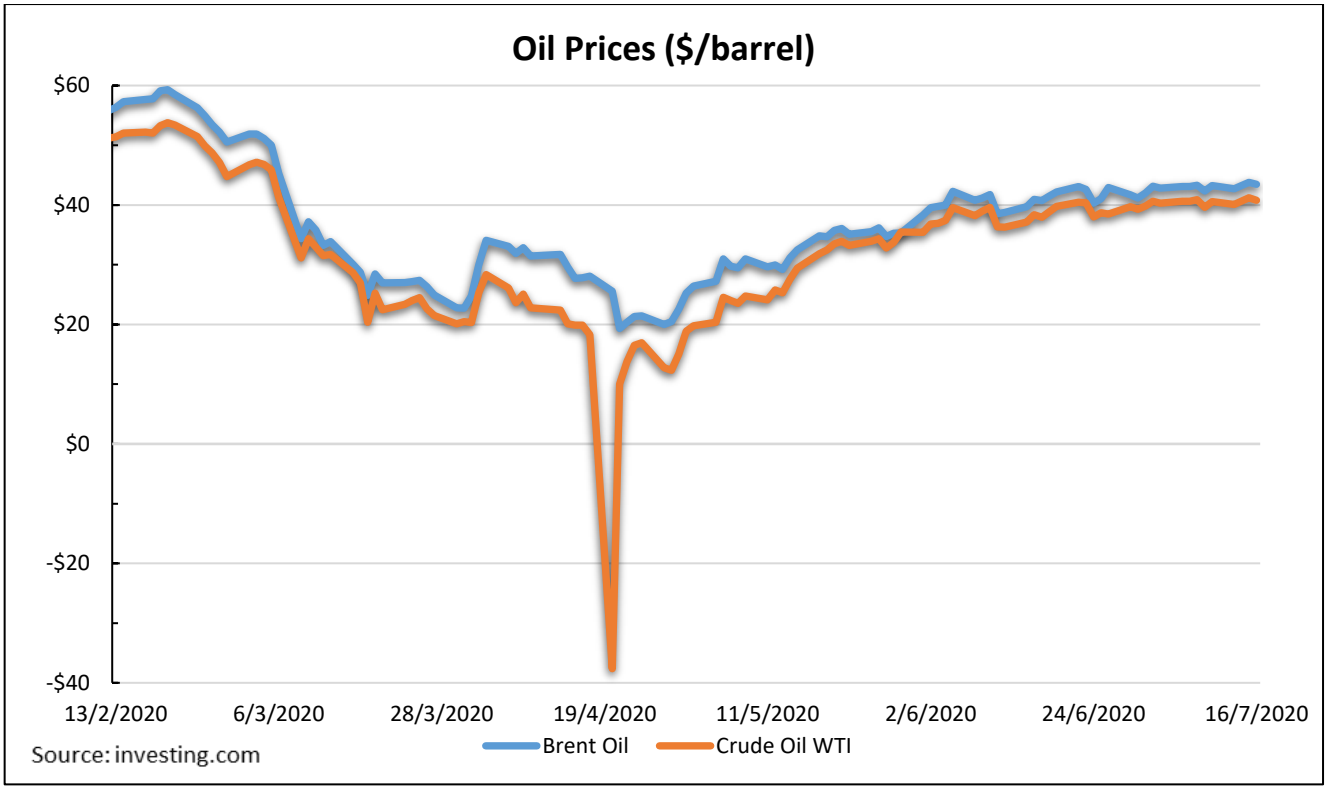
According to the IMF updated WEO (24/6), the direct fiscal measures of Euro Area countries are lower-with the exception of Germany compared to non-Euro Area countries. Euro Area countries seem to have been based more on liquidity measures.



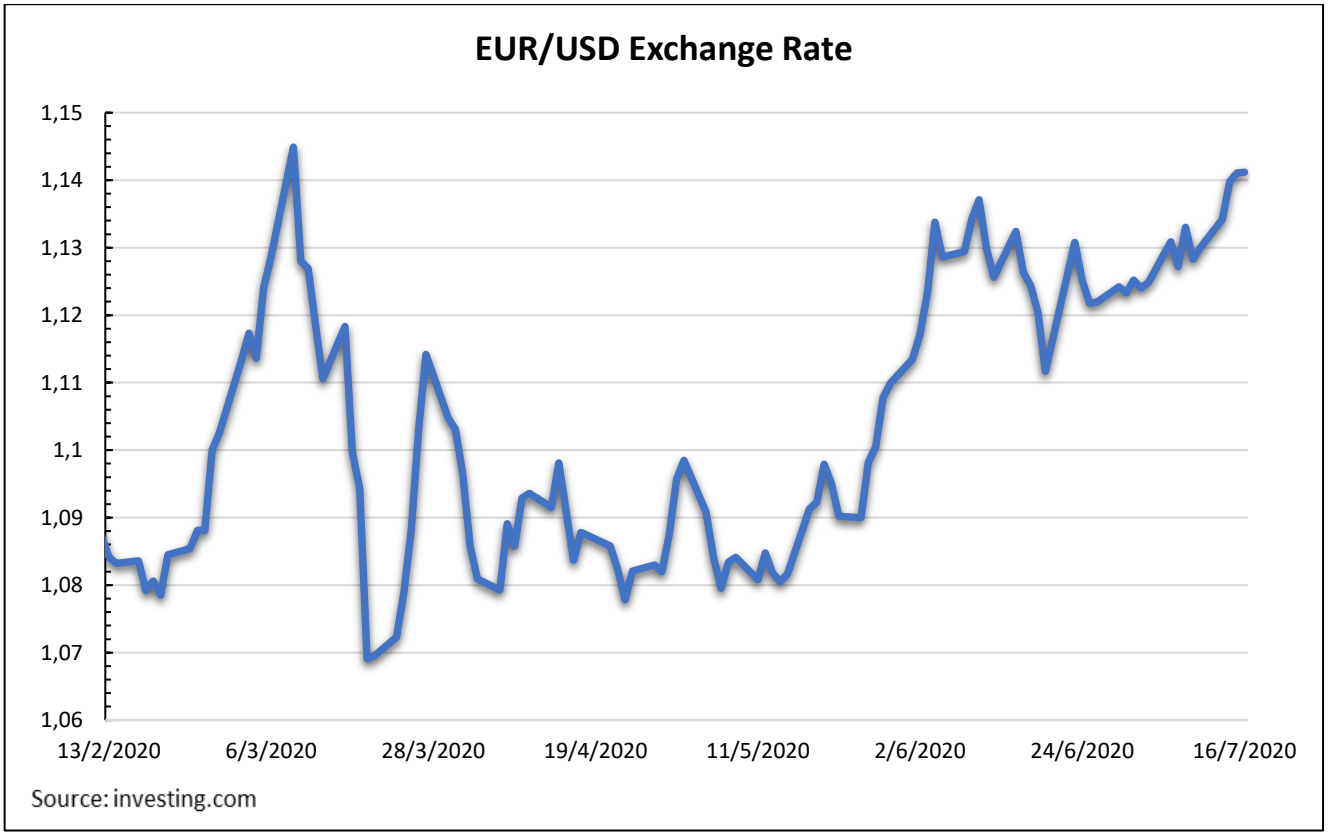
According to the IMF updated WEO (24/6), all economies are expected to recover rapidly after 2020 Q2. These projections however involve high levels of uncertainty.



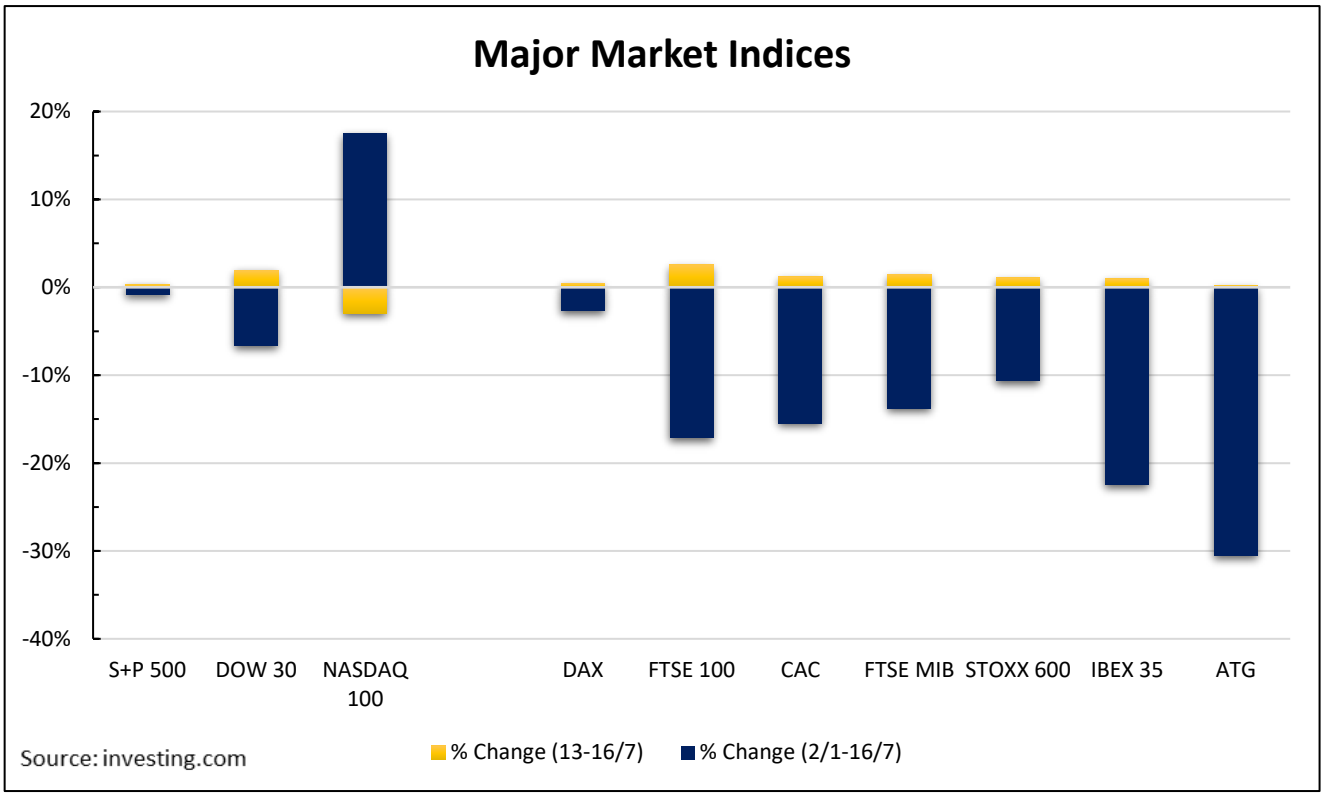
Eurozone government bond yields were stable again this week with investors focusing on the European Council's meeting about the recovery fund.



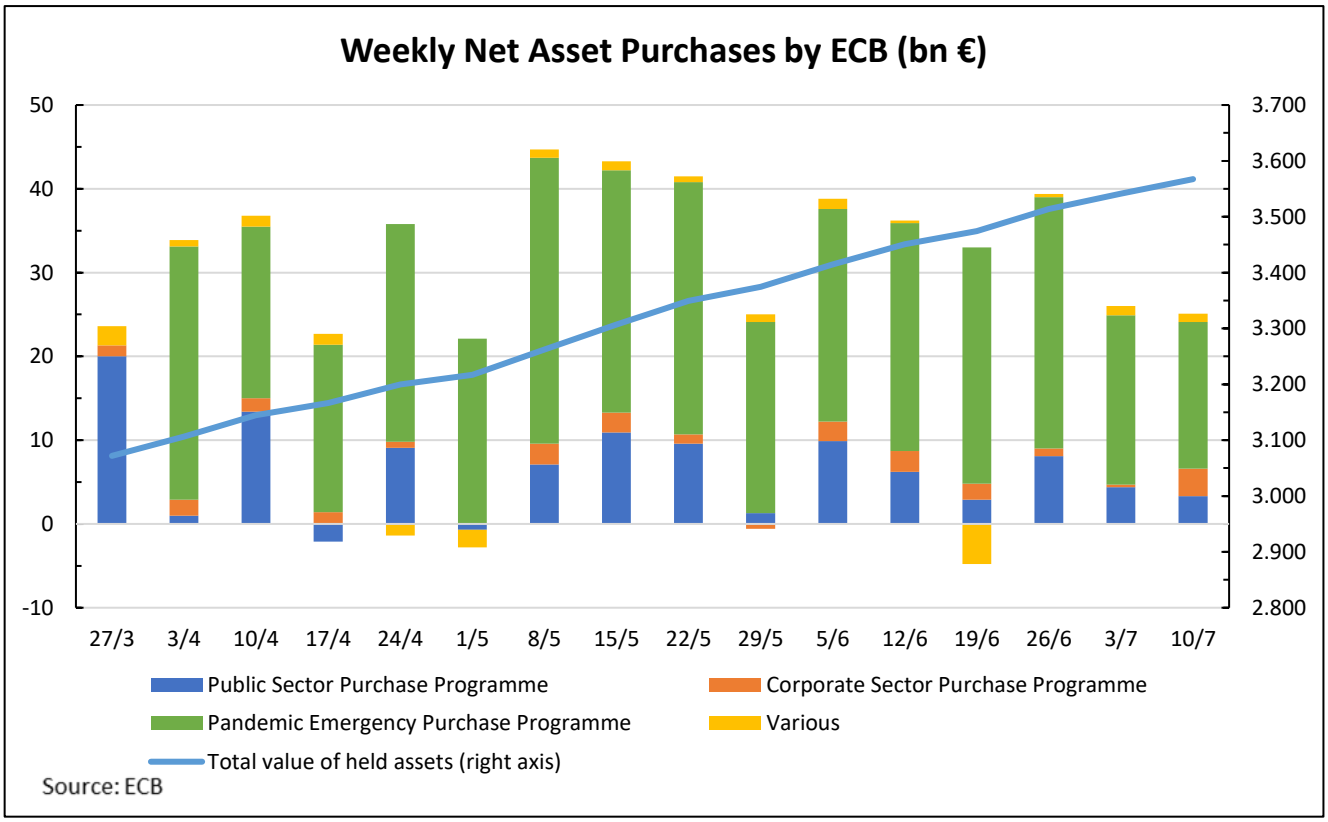
Oil prices settled higher on Thursday with the international benchmark Brent trading at $43.47 per barrel and the American benchmark WTI at $40.77 per barrel.



In the foreign exchange market, the EUR/USD exchange rate increased this week and is currently at 1.1284 $/€



Most Wall Street and European indices climbed this week as hopes for an imminent vaccine for COVID were bolstered.



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.

In Focus

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

In view of the much anticipated European Council of July 17-18, **on the European Commission's scheme to tackle the economic fallout of the COVID-19 crisis across Europe**, Andreas Eisl and Mattia Tomay of the Jacques Delors Institute review previous proposals on debt mutualisation and make the following key recommendations: a) negotiations in the European Council should not deviate from the model of a crisis-specific mechanism for supranational borrowing that relies largely on grants; b) the mutualisation of debt repayment justifies the inclusion of a certain degree of conditionality with criteria, which are concrete, yet also leave sufficient room for countries to set their own policy priorities without excessively interfering with national sovereignty and c) the assessment process of national recovery and resilience plans financed by Next Generation EU should be transparent and allow for accountability, with the Commission being the best-placed institution to make decisions in this regard, subject to the appropriate review of both the Council and the European Parliament.

If the European Commission's proposal for a Recovery Fund is approved by member states, the EU **would become the biggest supranational issuer in the world.** To uphold the EU's extremely high creditworthiness under a massively enhanced borrowing envelope, the Commission proposes that member states transfer up to 0.6% of gross national income to the EU budget per year until 2058, when the last bonds would be repaid. This amount will exceed the EU's plausible annual debt service costs. But, explains Moritz Kraemer on the Centre for European Policy Studies, member states' pledges of future transfers to the EU budget are effectively unenforceable promises. For instance, a deeper political crisis within the EU could lead to promised payments being withheld, immediately jeopardising the EU's timely debt service. As it stands, the biggest European institutional issuance programme would have the weakest of financial safeguards. Member states should provide more robust financial support, such as unconditional guarantees with cross-default clauses (as in the cases of the EFSF or the SURE programme) or a capital cushion (as in the cases of the EIB and the ESM).

The European Single Market despite its successes, has to evolve into a Single Economic Territory, according to Fabian Zuleeg on the European Policy Centre, thus establishing a microeconomic common framework within the EU, fortifying the European economic structure against crises such as the current one. The EU is standing on crossroads regarding economic policy, having the option to return to the pre-COVID19 economic status quo, to resume the ad-hoc governmental intervention in the markets, or to further integrate the whole EU economy into a Single European Territory. The author suggests that the current pandemic has altered the economic structure of the Union far too much, to make a step back. The best response is to make a step ahead and adopt a new, common, European economic approach, to ensure that no member-state is left behind or becomes permanently dependent on bailouts. The main reason to create a Single Economic Territory is to establish a proactive approach to economic policy and microeconomic intervention.

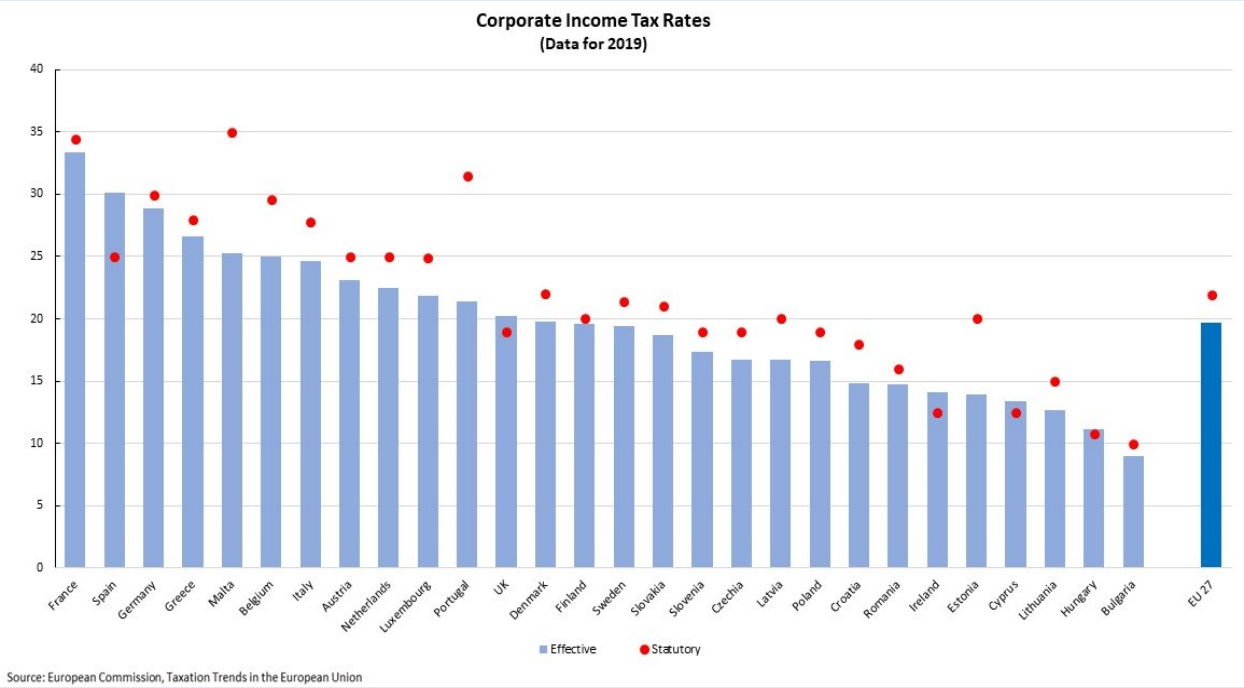
EU leaders stress the importance of the green transition and digital transformation and consider it crucial to the EU's recovery from the coronavirus crisis. Rightly so, according to Annika Hedberg and Stefan Sipka of the European Policy Centre. The European Commission's Green Deal proposal – supported by, for example, the Industrial Strategy, the Circular Economy Action Plan and Digital Strategy – already recognises that the two transitions are closely linked. But the EU should go a step further. It should lead the way and ensure that digitalisation enhances environmental protection and climate action and that the digital sector becomes greener. How? The authors put forward three proposals: a) Create a European 'data space' to accompany the implementation of the Green Deal and allow the free flow of information; b) Invest in digital solutions that can help enhance climate neutrality, sustainable consumption and production, zero pollution efforts and biodiversity, and c) Address the negative environmental and climate impact of digitalisation.

The economic recovery of the EU should be accompanied by the consolidation of the geopolitical nature of the Union. How can France and Germany build a geopolitical Europe, wonder Jana Puglierin and Ulrike Esther Franke on the European Council on Foreign Relations. **France and Germany should use the momentum they created through their agreement on the Recovery Fund to give the EU a stronger geopolitical voice.** Together, they have all they need: connections to the south and the east, as well as ambition and pragmatism. On the one hand, Paris should try more actively and sensitively to work with its partners who are critical of French foreign policy initiatives. On the other hand, Berlin should be more open and flexible in formulating foreign and security policy with smaller groups of member states.

Over the past five years conflict has led to a deterioration of Russo-Ukrainian economic relations while ties with the EU have deepened. This shift is evident in trade flows, as Marke Dabrowski, Marta Domínguez-Jiménez and Georg Zachmann describe on Bruegel: **the European Union has become Ukraine's biggest trading partner, while China is poised to overtake Russia as its second.** Natural gas imports from Russia, Ukraine's prior Achilles heel, have been partially replaced by reverse deliveries from the EU and reduced as result of reform of the gas sector. Nevertheless, the future of economic relations between Ukraine and the EU remains uncertain. For example, completion of the Nord Stream II pipeline project will weaken Ukraine's position in the gas transit market between Russia and the EU, and the introduction of a carbon adjustment tax by the EU would negatively affect Ukrainian metal and chemical exports to Europe.

A single divided country can divide Europe – and **this presidential election has left Poland deeply divided**: old versus young; urban versus rural; east versus west; working people versus those receiving social benefits, according to Pawel Zerka and Piotr Buras on the European Council on Foreign Relations. Duda's nationalist, anti-LGBT, anti-German, and Eurosceptic rhetoric in the campaign not only helped mobilise his core electorate but also did not go unnoticed throughout Europe. At the upcoming European Council meeting, the negotiations for the EU's next multiannual budget, as well as the recovery fund, will enter a decisive stage, and will place Poland's government under international scrutiny. Indeed, the ruling party may also choose to instrumentalise European issues to further divide and rule at home. Duda's voters are distrustful of the European Commission – and therefore might actually believe Duda's and the government's strained relations with Brussels to be a sign of strength rather than weakness.

Amidst this economic and political turbulence, Apple won a landmark court battle in the EU's second-highest court, where EU judges quashed a European Commission order for Apple to pay back €14.3bn in taxes to Ireland. According to Simon van Dorpe and Christian Oliver of Politico, this ruling is no doubt a blow to competition commissioner Margrethe Vestager's efforts to crack down on low-tax regimes in the bloc. Brussels did not succeed in 'showing to the requisite legal standard' that the tech giant had received an illegal economic advantage in Ireland over its taxes. Still the case is not closed, since the Commission will most likely file an appeal, leading the case to the European Court of Justice (ECJ). The court said it supported the EU's right to scrutinise national tax arrangements. However, it is the second time that Brussels has failed to demonstrate that a multinational company benefited from state aid, after another multimillion-euro case against Starbucks was overturned last year. The following chart shows that companies in some EU countries effectively pay taxes well below the statutory rate.



The COVID-19 crisis has not only brought about a double problem on global demand and supply, but also **an assault on the very assumption upon which our societies, economies, and political systems rest: that we operate in a mostly predictable environment.** When this basic conviction breaks down, rational decision making becomes virtually impossible leaving many individuals all but paralysed. As a result, uncertainty shocks can lead to sharp drops of aggregate economic activity. Henrik Müller and Nico Hornig argue on VoxEU that we should prepare for future shocks by designing better early warning systems, so that we have more time to make provisions to cushion the impact, building up a news-based uncertainty indicator. Such an indicator would differentiate between various sources of uncertainty that need not be identified ex ante. While the well-known Economic Policy Uncertainty Indicator is built on a predefined set of policy areas (monetary, fiscal, taxation, regulation) – and consequently responded to the COVID-19 crisis only in early April, when the March data were in and much of Asia and Europe had already been under lockdown for weeks – their indicator is more open to new developments from hitherto unknown directions, whether from politics, markets, or elsewhere and could discover surprising unknowns at early stages as their impact on the economy starts to unfold.

There is a long-standing debate on whether financial crises can be predicted. Robin Greenwood et al. on VoxEU draw on a chronology of past financial crises and data on credit and asset prices for a panel of 42 countries between 1950-2016 and find that if there is a large credit expansion with an asset price boom, then financial crises are highly predictable. These results are used to motivate a simple indicator that identifies periods of potential credit-market overheating. The indicator is shown to predict past crises in advance, with their evidence supporting the view that the economic system is vulnerable to predictable boom-bust cycles driven by credit expansion and asset price growth. Thus, they suggest that policymakers have time to act and take prophylactic policy interventions.

The latest estimates of the severity of the economic downturn due to COVID-19 suggest a **contraction in global GDP of no less than 6% in 2020.** The looming question is whether current bank capital buffers are sufficient to cover potential credit losses. Assessing the gravity of the COVID-19 threat to financial stability is challenging, but Henk Jan Reinders, Dirk Schoenmaker and Mathijs van Dijk on VoxEU use stock market data to estimate it. Using different scenarios for future volatility and incurred losses in case of default, they estimate that the market-implied losses for euro area banks range from 7% to 43% of available bank capital and reserves. These findings suggest that the ECB as supervisor should proactively manage the impact of COVID-19 on banks.

5.4 million people in the USA lost their health insurance during the pandemic, according to a study hosted by The New York Times**.** The study has found that the estimated increase in uninsured laid-off workers over the three-month period was nearly 40% higher, in comparison to the recession of 2008-09. State-wise, in Texas alone the number of uninsured increased from about 4.2 million to nearly 4.9 million, leaving three out of ten Texans uninsured.

Unemployment insurance has played a critical role in the US economic response to the coronavirus pandemic. It has been greatly expanded, extended to new people, and become available for a longer period. As a result, as of late June 2020, about 36 million people were receiving or had applied for unemployment benefits. Unemployment insurance has contributed to the rise of household disposable personal income even as labour compensation has plummeted, protecting both households and the macroeconomy, according to Jason Furman on Peterson Institute for International Economics. The expansion of unemployment insurance ends at the end of July 2020, yet the need for it remains very high to both protect workers from the consequences of this crisis and accelerate the economic recovery. Eighteen million people are still unemployed, and even though the overall labour market has improved, there are still substantial flows into unemployment, with more than 2 million people making initial claims for benefits every week for 16 consecutive weeks ending July 4.

ELIAMEP experts write

"The 'frugals' will most likely get their rebates, they are rich countries and want to get back part of what they contribute to the EU budget. There will be some concessions to the 'frugals', especially the Rutte government, which is the one facing the most acute political challenge; the Dutch Parliament is tough, government majority is narrow, there will be some form of conditionality, an obligation of reforms which will be controlled by the EU and its organs, as precondition for disbursements. How this will happen, what exact form it will take, which process, are all under negotiation. But it is indicative that prime minister Rutte, speaking to the Dutch Parliament, said that during his bilaterals with President Macron and the prime ministers of Italy and Spain listed to them the reforms indicated as necessary by the European Commission under the European Semester. He is following a tough stance, and will ask for the member states with the largest incoming EU funds, grants, to offer important reforms as condition for funding."

George Pagoulatos, Director General, ELIAMEP, *Interview, ERT Radio, 17.07.2020*

"A particularly crucial issue concerns conditionalities. The issue goes beyond the mere choice of areas where resources will be channelled, and is not just about linking national programs to the 'European Semester' process, which has already been established. The so-called 'frugals' are expected to insist on strengthening and expanding the conditionality, to include 'the more efficient use of these resources', 'the changing of the structure of the member states so that grants can actually fulfil their goals' and 'the insurance that the internal policies of member states will guarantee the future'. And perhaps most importantly: the control of both the selection of sectors and implementation should not be solely the responsibility of the Commission, but also of the Council of Ministers and the Eurogroup. The division of member states is not just between North and South, but between those that are monitored and judged and those that judge and enforce rules and principles."

Achilleas Mitsos, Senior Policy Advisor, ELIAMEP, *Ta Nea, 17.07.2020*

"Since the beginning of March, the United Kingdom has officially left fortress Europe. As a third country it finds itself in the transitional phase of negotiations to reach a new trade agreement with the 27 member states. If no agreement is reached by the end of the year then trade will be conducted on the terms of the World Trade Organization, i.e. with tariffs and bureaucratic procedures that burden the economies and labour markets of both parties (EU - UK). However, the British losses will be much greater."

Antonis Trifyllis, Member of the Advisory Board, ELIAMEP, *To Vima, 12.07.2020*