

The Coronavirus Crisis: Current Outlook, Policy Responses, Longer-term Challenges

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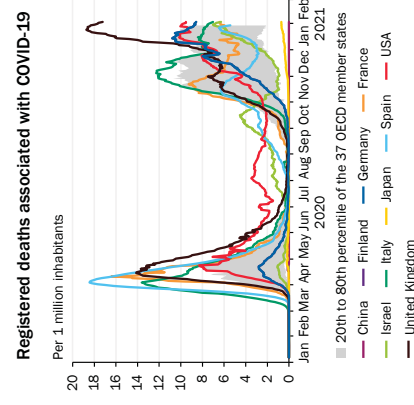
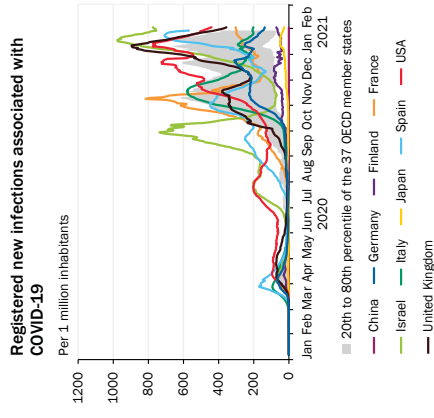
Municipal Guarantee Board
Online Webinar, Februar 4, 2021



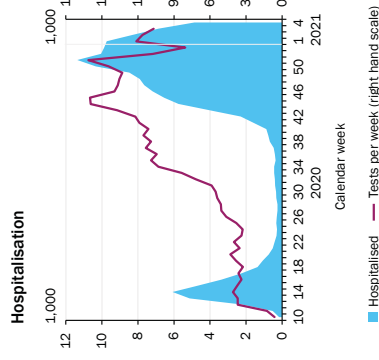
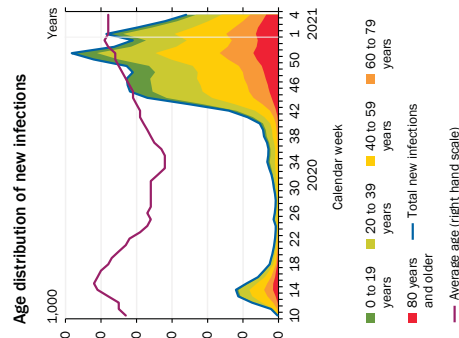
Three issues for today

- I. Current outlook: The pandemic and the economy
- II. Stabilization policy: Measures and what has been achieved
- III. Challenges beyond the crisis and how to address them

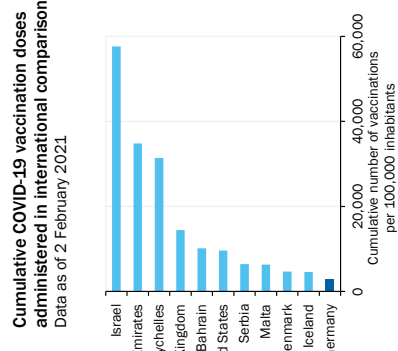
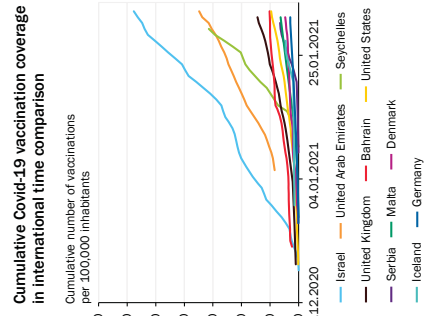
Current developments of the pandemic



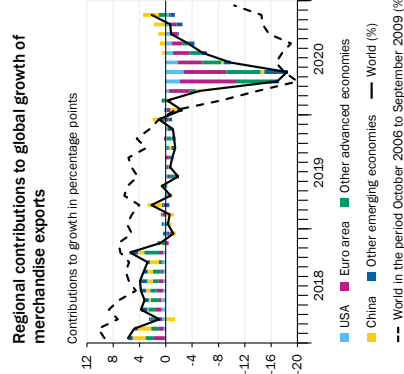
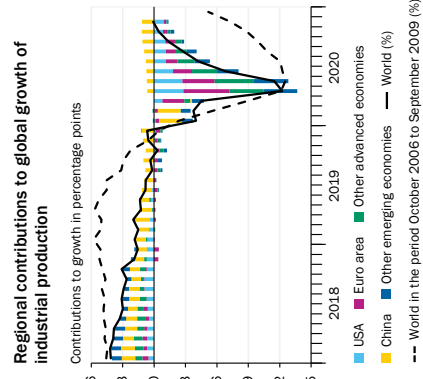
Germany: Age distribution with infections, testing and hospitalization



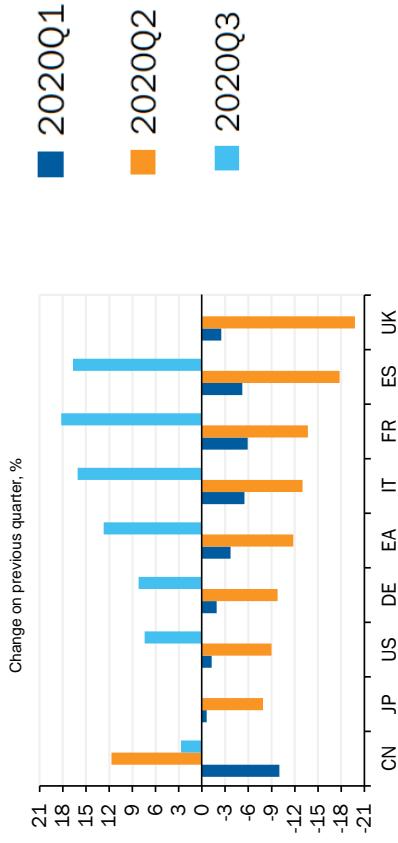
Vaccinations: International comparison



World: So far faster recovery of industrial production and trade than during the global financial crisis

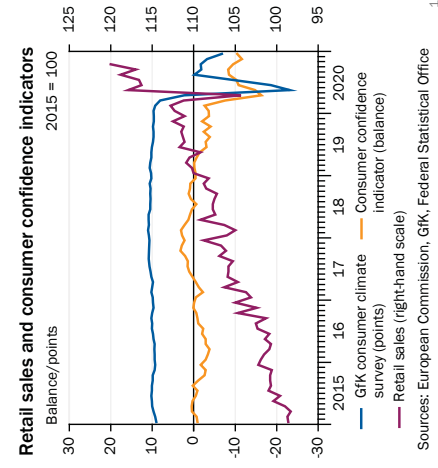
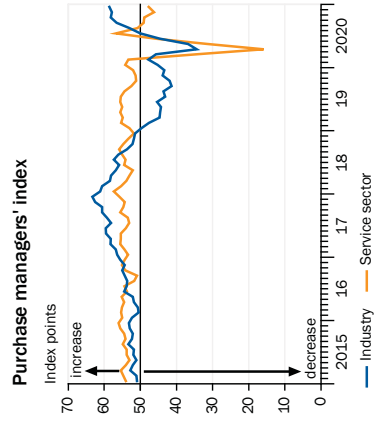


Substantial differences in 2nd quarter GDP decline in the large economies



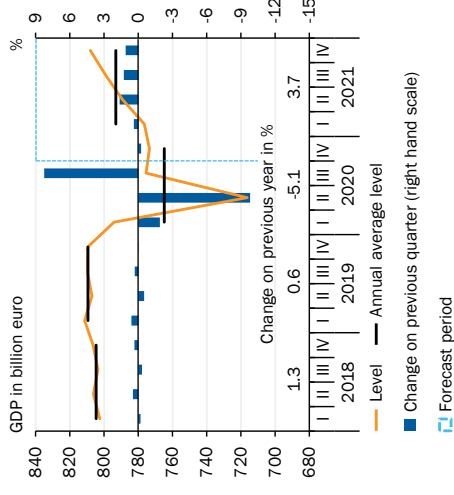
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Germany: Industry still picking up, services and consumer confidence weakening



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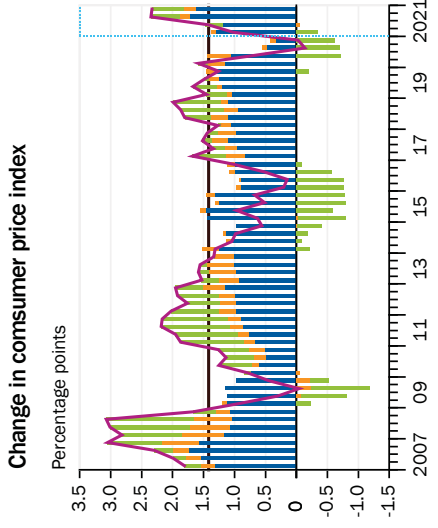
GDP in Germany: GCEE forecast (Nov 2020)



- Sharpest quarterly decline since start of quarterly accounts
- Strong recovery in summer, small decline in winter due to 2nd wave, pre-crisis level early 2022.
- GDP 2020: March risk scenario -5,4%, June -6,5%, Nov -5,1%, Actual - 5,0%.
- Q4 stagnation, 21 Q1 decline, return to pre-crisis level delayed due to 2nd wave.

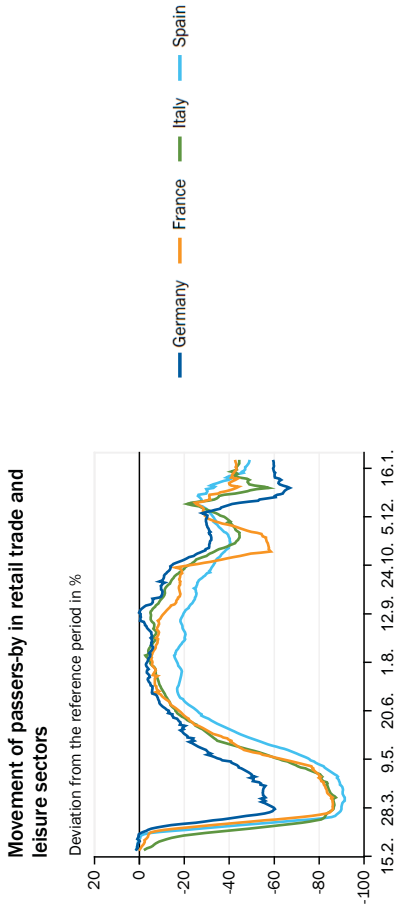
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Germany: Consumer price inflation picking up due to CO2 pricing and VAT increase



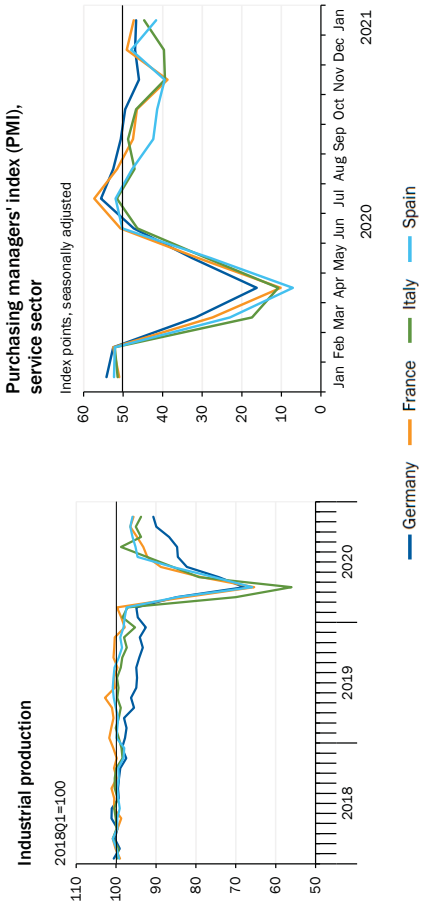
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Real-time mobility indicators in large euro area member economies



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Industry and services in large euro area member economies



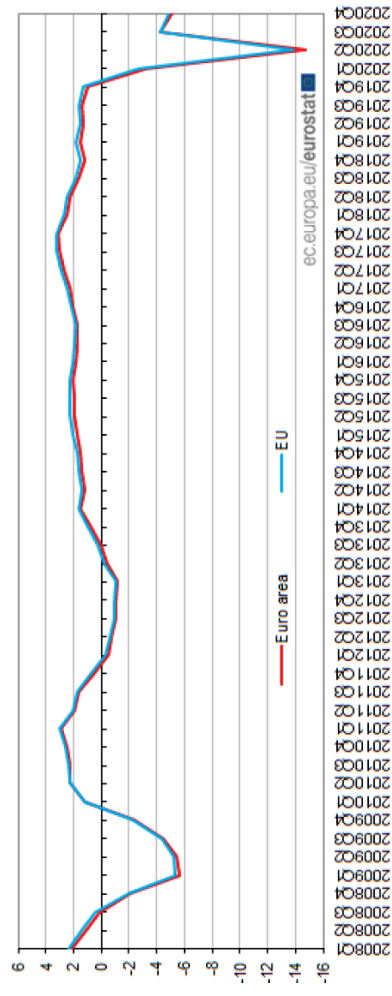
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Quarterly GDP growth in the euro area

	Percentage change compared with the previous quarter			
	2020Q1	2020Q2	2020Q3	2020Q4
Euro area	-3.7	-11.7	12.4	-0.7
Germany	-2.0	-9.7	8.5	0.1
Spain	-5.3	-17.9	16.4	0.4
France	-5.9	-13.7	18.5	-1.3
Italy	-5.5	-13.0	16.0	-2.0

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Euro area GDP growth relative to same quarter of previous year (% change)



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Euro area: GCEE forecasts

Gross domestic product, consumer prices and unemployment rate in the euro area

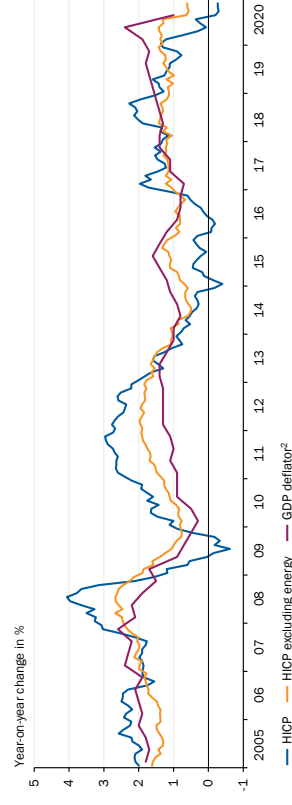
Country/ country group	Weight in % ¹	Gross domestic product (calendar-adjusted) ²			Consumer prices (HICP) ³			Unemployment rate ⁴		
		2019	2020 ⁵	2021 ⁶	2019	2020 ⁵	2021 ⁶	2019	2020 ⁵	2021 ⁶
Euro area ⁶	100	1.3	- 7.0	4.9	1.2	0.3	1.1	7.5	8.0	9.4
including:										
Germany	28.9	0.6	- 5.5	3.7	1.4	0.5	1.7	3.1	4.1	4.2
France	20.3	1.5	- 8.7	6.8	1.3	0.5	0.9	8.5	7.7	9.8
Italy	15.0	0.3	- 8.7	5.5	0.6	- 0.1	0.4	10.0	9.6	11.4
Spain	10.4	2.0	- 11.1	5.9	0.8	- 0.3	0.8	14.1	15.8	18.6
Netherlands	6.8	1.6	- 3.8	4.0	2.7	1.0	0.9	3.4	4.1	5.9
Belgium	4.0	1.7	- 6.7	5.2	1.2	0.5	1.1	5.4	5.2	6.8
Austria	3.3	1.4	- 6.9	4.4	1.5	1.5	1.6	4.5	5.2	5.0
Ireland	3.0	5.9	- 1.0	3.0	0.9	- 0.5	0.1	5.0	5.2	6.2
Finland	2.0	1.1	- 3.1	2.5	1.1	0.5	1.2	6.7	7.9	8.6

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Euro area inflation: Differences in HICP and domestic inflation

Growth rates of HICP and GDP-Deflator in the euro area¹



1 - Working day and seasonally adjusted, 2 - Quarterly data.

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3 Phases

Phase 1: Spring 2020, wide-reaching shutdown, supply chains cut off, capacity substantially constrained, activity to stay low to prevent infection spreading.

Policy response: bridging support for households and companies.

Phase 2: Since summer. Shutdown eased. Demand possibly not keeping pace with increasing supply capacity. Possibly recurring (limited) shutdowns.

Policy response: earlier measures and new measures can have stimulative effect on demand, on top of support.

Phase 3: Sometime in 2021. Strong and sustainable recovery taking hold.

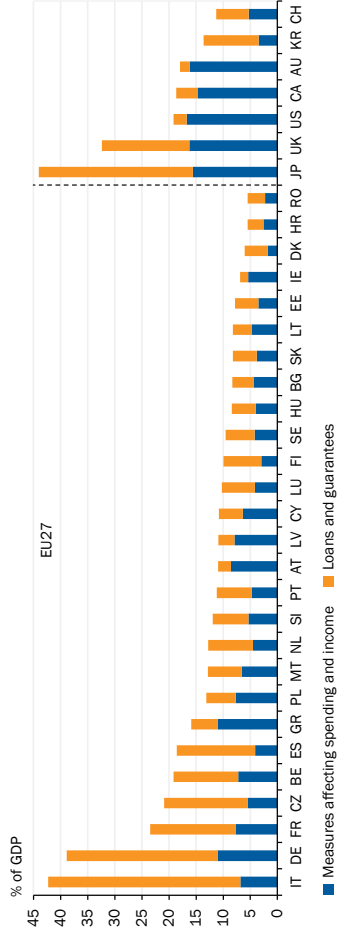
Policy response: Growth-friendly exit from emergency support measures. Do not prevent adjustment to structural change. Policy normalization.

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II. Stabilisation policy: Measures and what has been achieved

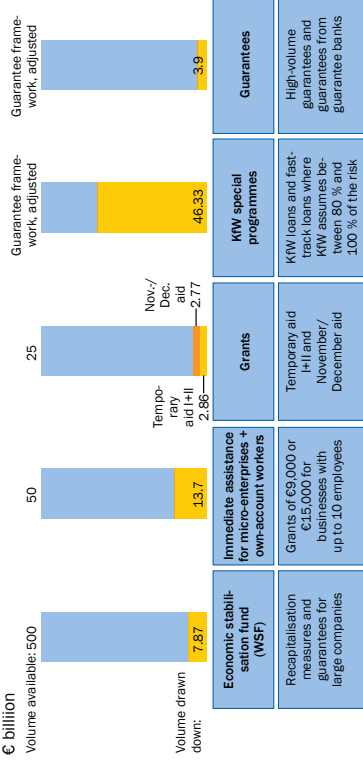
Extensive support measures in advanced economies: Liquidity, transfers, loans and guarantees

Measures announced as of Dec 31, 2020



Germany: So far only a small part of the support programs for companies has been used

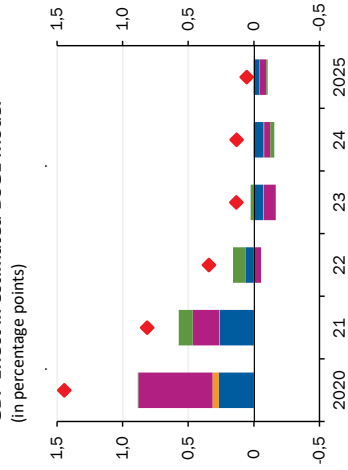
Only small percentage of coronavirus assistance for businesses drawn down so far



Sources: Federal Ministry for Economic Affairs and Energy, Federal Ministry of Finance, KfW, Association of German Guarantee Banks
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Germany: GDP effect of stimulus package (0,7 to 1,3% in 2020)

GDP Effect in estimated DSGE Model

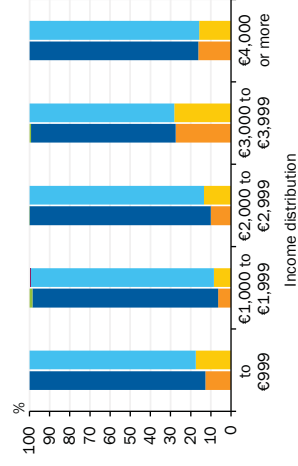


Impact (left-scale, p.p.) due to
Public investment
Transfers to Households
Consumption Tax and Renewable Energy Levy (EEG Umlage)

- Simulation of DSGE model with detailed fiscal sector estimated for Germany.
- Estimated effect of package: GDP in 2020 by **0,7% to 1,3%** higher.
- Range** relative to baseline (in chart) due to different parameter settings (credit-constrained households, labor supply elasticity, ..), and different consolidation strategies.
- Multipplier between 0,6 and 1.

Red diamonds: Fiscal impulse (right scale % of GDP)

Survey conducted with Infas on temporary VAT cut



"Following the VAT cut, are you now buying more goods or more expensive goods than before?"

Yes No Don't know / no input

"Are you planning to bring forward any major purchases that you would not otherwise have made until next year, or have you already done so?"

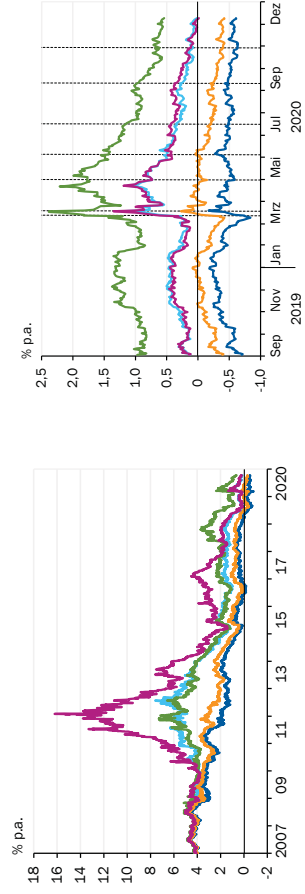
Yes No Don't know / no input

First set of European fiscal support measures

- Package with **three safety nets** in May 2020
- SURE
 - 100 bln Euro Loans for funding of **national short-time working schemes (by October 2020, 87.9 bln approved)**
 - Loans are underpinned by a system of voluntary guarantees from Member States.
- ESM
 - 240 bln Euro for **precautionary credit line** „Pandemic Crisis Support Instrument“
 - Up to 2% of respective GDP, conditional on use for domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis.
 - **So far it has not been used** in spite of low financing cost
- EIB
 - 200 bln Euro guarantees for financial intermediaries **granting loans to SMUs (till October 2020, 22.4 bln €)**

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Interest rates remain very low: 10-year yields

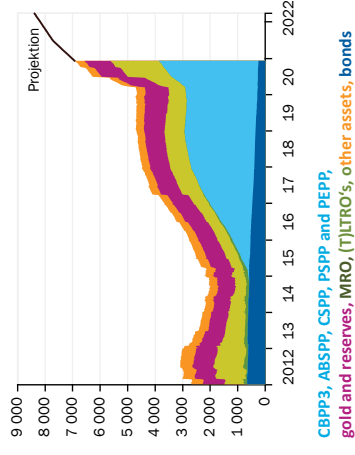


Spain Portugal Italy France Germany

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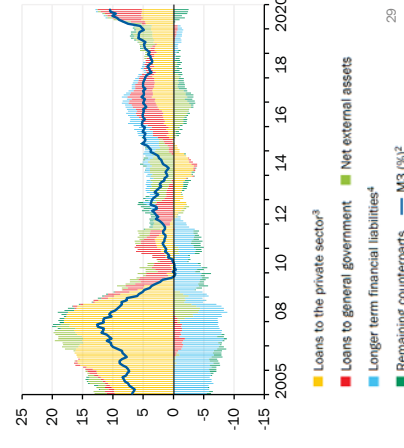
ECB: Substantial monetary policy easing (PEPP, TLTRO), broad money growth also increases quickly

ECB balance sheet expands quickly (bln Euro)



CBPP3, ABSPP, CSPP, PSPP and PEPP, gold and reserves, MIRO, TLTRO's, other assets, bonds

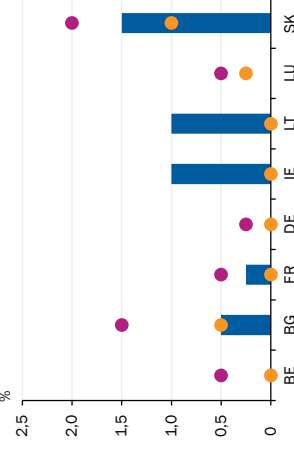
Euro Area M3 growth up due to public loans (growth contributions in perc.points)



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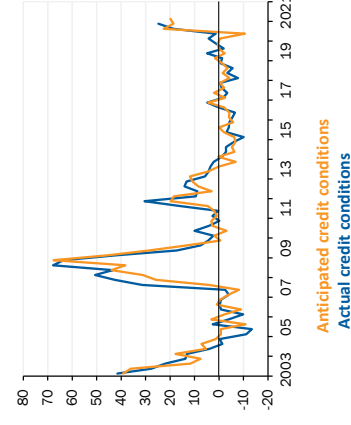
Reduction of capital buffers in spring, credit conditions tightening in fall

Reduction in anticyclical capital buffers since start of crisis



Planned increases, Current Level Level in December 2019

Tightening of credit conditions for companies



Anticipated credit conditions Actual credit conditions

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When recovery has strengthened, need to rebuilt policy buffers

- Work on regaining policy space to enable appropriate response to any future crisis
- Ensure sustainability of public finances, consolidation needs to account for economic situation and promote growth
- ECB should communicate strategies for policy normalisation

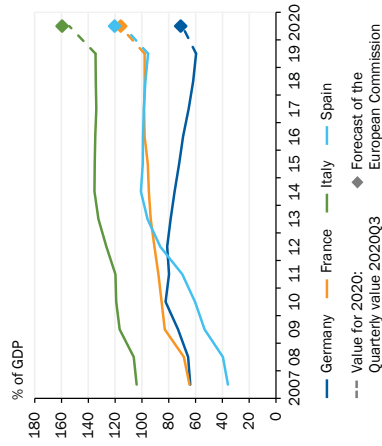
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III. Challenges beyond the crisis and how to address them

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EU: Improve resilience and raise growth and productivity

Debt-to-GDP ratio fell to pre-crisis level only in Germany after the financial crisis

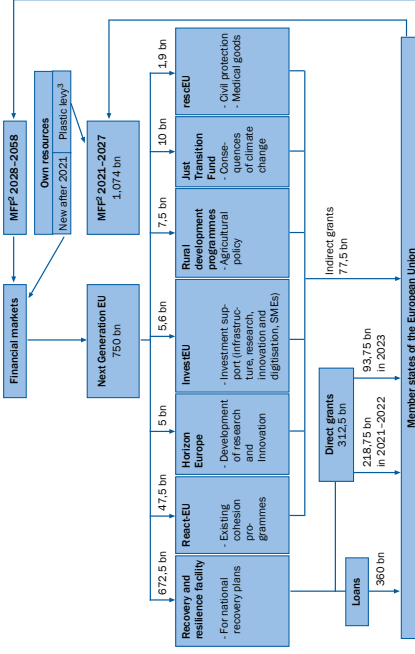


- Sustainability of public finances, effective fiscal framework, stability of financial system
- Reinforcing the EU single market
- More diversified supply chains and European warehousing
- Concentration on tasks that would be better located at EU level
 - Stronger role in foreign policy, defence policy, migration and asylum policy, the fight against international crime, climate protection and research funding

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EU Recovery plan and further development of the EU

The recovery plan includes direct and indirect grants and loans (Euro)

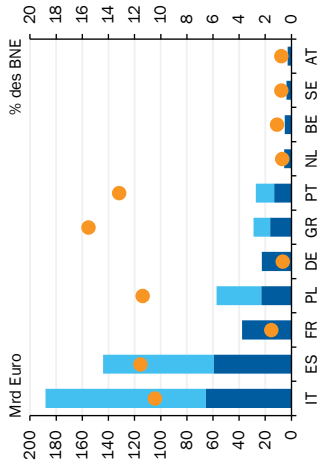


- Temporary recovery fund
 - Opportunity to overcome the crisis together and improve resilience
- Substantial EU borrowing
 - It cannot continue longer-term without transparent transfer of responsibilities and accordingly relinquished sovereignty

Sources: European Commission, own illustration

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Potential funds from recovery package per member state

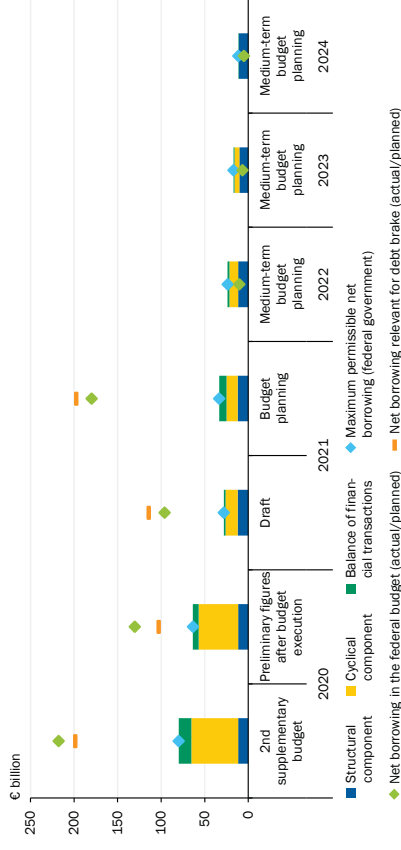


Loans, transfers (left scale, bln euro)

Total in percent of gross national income (right-hand scale)

- Many member states might not use loans
- Competing with ESM credit line and ECB purchases of national debt
- Use of funds needs to be checked

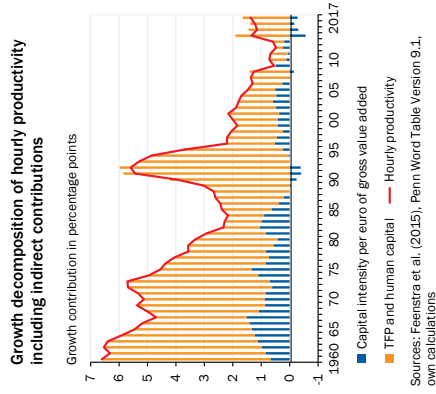
Germany: Permissible net borrowing under fiscal rules



International division of labor

- There are substantial welfare and productivity gains from trade and the international division of labor
 - Normalisation in world economy and trade important for recovery in Europe
- New protectionism should be resisted
- Climate change can only be stopped globally
 - Potential for partnerships in hydrogen strategy
 - Transition from national and sectoral goals to sector-encompassing EU-ETS

Long-term challenges: Innovation and climate change



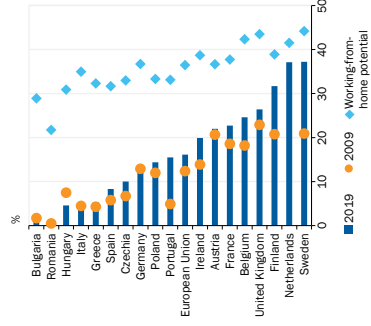
- Decline in productivity growth
- Technological change, especially digitalisation
- Transition to a climate-neutral economy
- Demographic change

Extra material on digitalization, innovation and climate change

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Digitalisation

Share of employees working from home



Sources: Dingel und Neiman (2020); European Labour Force Survey (EU_LFS); own calculations
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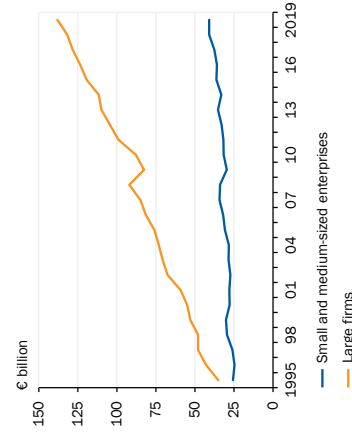
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- Digitalisation helps to cushion effects of pandemic in many areas of economy
 - Homeoffice to enable companies to continue operating
- Pandemic has also highlighted deficits
 - Public administration
 - Health system: Targeted use of digital technologies could help to contain pandemic
 - Education system: Online solutions that can be implemented at short notice in case of further school closures

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Innovation and Digitalisation

Innovation spending by large firms and SMEs in Germany



Sources: Mannheim Innovation Panel (MIP), ZEW

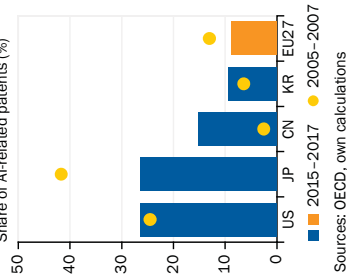
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- Innovation process plays key role in long-term growth
- Private sector accounts for 2/3 of R&D expenditures
 - Concentrated on large firms: Strengthen incentives for innovation for SME

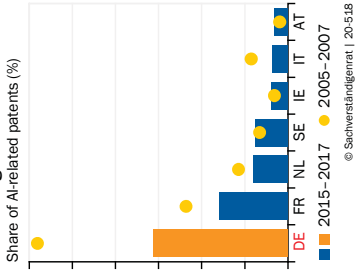
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Innovation and Digitalisation

Top 5 inventor countries for patents relating to AI
Share of AI-related patents (%)



Other inventor countries for relating to AI
Share of AI-related patents (%)



- Innovation process plays key role in long-term growth

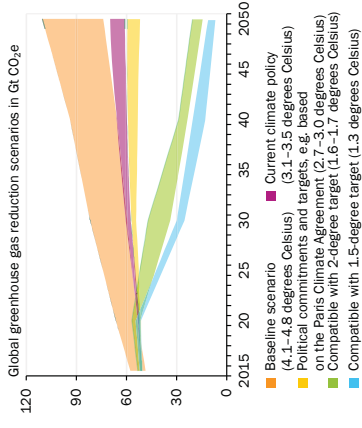
Sources: OECD, own calculations

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4.4

Long-term Challenges

Scenarios of global greenhouse gas reduction



Source: CAT

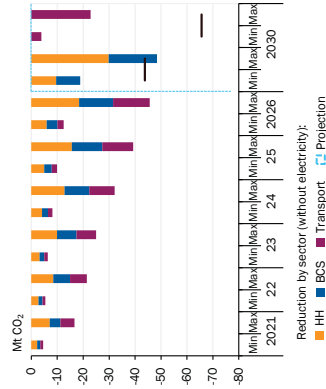
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- Long-term challenges, from which also opportunities may arise for Germany
 - Decline in productivity growth
 - Technological change, especially digitalisation
 - Transition to a climate-neutral economy

4.5

Private and Public Investment

Reduction of carbon emissions through national carbon price compared to year 2018



Sources: AG Energieblanzen, Bach et al. (2019), Eurostat, Federal Statistical Office, Umweltbundesamt, own calculations

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- Long-term challenges require high levels of investment
- Private: Economic framework and incentives are crucial
 - Climate policy: Cross-sectoral carbon pricing and elimination of government-induced distortions (Energy price reform)
- Public: Significant portion of economic stimulus package and EU recovery fund
 - Targeted implementation can increase long-term growth
 - Bottlenecks, which prevent timely implementation

4.6