European Commission - Speech
[Check Against Delivery]

Remarks by Commissioner Gentiloni at the press conference on the Autumn 2020 Economic Forecast

Brussels, 5 November 2020

Let me begin by thanking DG ECFIN and my team for their efforts.

It is not easy to have solid forecasts in such an uncertain situation.

We have with five key messages emerging from the 200 page forecast:

First, the pandemic caused the deepest recession in EU history in the first half of 2020, surpassing that in the Great Financial Crisis. This contraction, which was uneven across Member States, was followed by a strong rebound in the third quarter – a very strong rebound – as containment measures were eased.

Second, in recent weeks we are facing the resurgence of the pandemic and new containment measures have been taken. The economic rebound has been interrupted. Growth is set to stall in the fourth quarter but to pick up again as of the first quarter of 2021.

Overall, EU GDP is forecast to contract by 7.4% this year, before growing 4.1% in 2021 and 3.0% in 2022. For the euro area: -7.8% in 2020, 4.2% in 2021, 3.0% in 2022.

This forecast implies that GDP for the EU as a whole will be just shy of its pre-pandemic level by end of 2022. But unfortunately this is not the case for all Member States.

Third, policy measures taken at national and EU level continue cushioning the impact of the COVID-19 crisis on both households and firms. Furthermore, a highly accommodative monetary policy has supported market funding as well as bank lending. To support confidence and the recovery, it is essential that monetary and fiscal policies continue to work hand-in-hand.

Fourth, given the current exceptional uncertainty, we have made two important "technical" assumptions:

First, we assume that some degree of containment measures will remain in force throughout the forecast horizon. This partially explains the slower path of recovery. However, after a significant tightening in the fourth quarter of 2020, the stringency of the measures is expected to gradually ease in 2021.

Second, and without prejudice to the outcome of ongoing negotiations on a future EU-UK partnership, we assume that the EU and the UK will trade on WTO Most Favoured Nation rules from 1 January 2021.

Fifth, downside risks are exceptionally large, but there are also upside risks to our forecast. I will run through these at the end of my presentation.

Starting with a look at the international situation, global GDP, excluding the EU, is expected to contract by about 3.8% in 2020, considerably more than during the Global Financial Crisis.

It is forecast to rebound by around 4.7% in 2021, and to moderate to 3.7% in 2022.

Coming back to the EU, monthly data confirm that the economy has been on the mend as of May.

Parts of industry, construction and retail trade rebounded vigorously over the summer, driven by strong pent-up demand.

By contrast, services relying on close person-to-person contacts have remained weaker as containment measures have remained in place and also consumer behaviour, affecting demand and supply for services involving such as travel, tourism, restaurants and entertainment.

The flash estimate from Eurostat published last Friday indicates that the third quarter rebound was even stronger than we expected. The rebound was driven by pent-up demand and decisive policy action both by Member States and the EU.

But as I've underlined, the resurgence of infections across Europe in recent weeks is causing renewed disruptions. This is expected to put the recovery on hold in the short term. It also leaves the outlook subject to extremely high uncertainty.

The gradual decline in the level of stringency over the course of 2021 should translate into consumption and investment gradually rebounding. GDP is forecast to continue growing in 2022, but at a somewhat more subdued pace.

In short, we never counted on a 'V-shaped' recovery. Now we know for sure that we will not have one.

The pandemic is evolving by the day, making any forecast subject to high uncertainty.

We have therefore produced two alternative scenarios to complement our baseline forecast.

The downside scenario considers the negative impact on economic sentiment and firms' financing conditions of stricter and more protracted virus containment efforts. As you can see, this downside scenario projects significantly worse economic outcomes in the near term.

By contrast, the upside scenario assumes an earlier and stronger recovery in business and consumer confidence resulting from faster progress in the development of an effective treatment, or a better adaptation by households and firms to the new COVID-19 environment. The depth of the recession in 2020 and the speed of the recovery in 2021 and 2022 are expected to vary widely across Member States.

Nearly half of our Member States are not expected to recover their pre-pandemic level of GDP by the end of 2022.

These divergences reflect the difference in the severity of the pandemic and the stringency of related containment measures. But they also reflect differences in domestic policy responses and economic structures. Namely, countries with large tourism sectors are expected to take longer to achieve a full recovery.

Just as private consumption and investment took a particularly sharp hit in the first half of the year, both are expected to drive the recovery in 2021 and 2022.

Private consumption is set to rebound as households gradually release accumulated savings and adjust their spending patterns.

Investment is set for a gradual rebound over the next two years, benefitting from highly accommodative monetary policy, increased public investment and government support schemes for firms, and the EU recovery package.

Unlike in past recoveries, the European economy cannot count on a significant pull from the external side. As the pandemic has been a truly global shock, net exports are not expected to contribute much to EU growth over the next two years.

All Member States have put in place sizeable discretionary fiscal measures to cushion households and firms from the negative impact of the pandemic.

The social impact should be a shared priority by Member States and at EU-level.

In particular, short time work schemes allow firms to keep workers on their payroll during temporary economic difficulties, thanks to compensation from the government. SURE will now support these schemes in 17 Member States.

As a result, the euro area fiscal stance is set to be strongly expansionary in 2020. Other support policies for corporates without budgetary impact - state guarantees for bank loans and tax moratoria - have aimed to support liquidity and avoid bankruptcies.

At the same time, the ECB's continuation of easing measures, mainly through asset purchases, combined with subdued inflation expectations are assumed to keep real long and short-term interest rates negative. The policy mix appears exceptionally favourable – as it should be – and is expected to support the recovery.

Thanks to ambitious policy measures in all Member States, job losses during the first half of this year were much more contained than the drop in economic activity, but nonetheless unprecedented.

In addition, a significant amount of labour market slack has accumulated since March, reflecting the drop in hours worked as well as workers leaving the labour force. This is set to delay labour market improvements over the next two years. Moreover, employment may encounter further losses when short-time work schemes are discontinued.

Reflecting these developments, the EU unemployment rate is expected to increase from 6.7% in 2019 to 7.7% in 2020 and 8.6% in 2021. It is expected to decline in 2022 to 8.0%.

Inflation recently turned negative, due to a significant fall in energy prices and lower prices of services, especially tourism-related.

In 2021, the assumed stabilisation of oil prices will contribute positively to headline inflation.

Core inflation, which captures all items except energy and unprocessed food, should pick up somewhat as activity resumes.

Still, downward pressures are set to dominate price developments due to weak demand, labour market slack and a strong euro.

Overall, EU inflation should reach 0.6% this year and 1.3% next year.All EU economies are expected to shrink this year, and all are also forecast to growth in 2021 and 2022.

But as I mentioned earlier, both the depth of the recession and the speed of the recovery are expected to vary widely.

Among the largest Member States, only Germany and Poland are forecast to reach or surpass their pre-pandemic GDP levels by the end of 2022.

Thanks to strong growth in the third quarter, Germany's GDP is set to contract by 5.6% in 2020. That's less than the euro area average and less than projected earlier. Further recovery in consumption, industry and exports are expected to drive growth in 2021-2022. Still, the second wave of infections is expected to dampen the rebound next year to 3.5% and 2.6% in 2022.

In France, the economy is forecast to contract by 9.4% in 2020. After the rebound in the third quarter, GDP is expected to drop again in the fourth quarter due to the new restrictions. The high level of stringency is set to persist over the first quarter of 2021, and the rebound next year is set to be partial, at 5.8%. The national recovery plan will support the recovery, as in other countries.

In Italy, real GDP is projected to fall by 9.9% this year and to rise by 4.1% and 2.8% in 2021 and 2022 respectively, close to the euro area average. Policy measures are set to continue supporting jobs and incomes but are unlikely to prevent, unfortunately, a rise in unemployment.

Spain has been one of the most affected countries by the pandemic. GDP is forecast to contract by 12.4% this year, reflecting the impact of the second wave, which hit Spain earlier than most EU countries. We project growth of 5.4% in 2021 and 4.8% in 2022. Short-time work schemes have limited job losses, but unemployment is still projected to increase this year and next, and to decline only in 2022.

Let me add that GDP in the UK is expected to fall steeply in 2020, by 10.3%. It is then forecast to grow by 3.3% in 2021 and by 2.1% in 2022. The move to the assumed WTO Most Favoured Nation trading relations between the EU and the UK, as from the beginning of 2021, is expected to slow down the recovery. Again, this is a technical assumption without prejudice to the ongoing negotiations.

Now the budgetary outlook.

The aggregate fiscal deficit is expected to surge from about 0.5% of GDP in 2019 to 8.8% in the euro area this year. This mainly reflects the collapse of growth and the sizeable discretionary fiscal measures that have been deployed.

In 2021, the deficit is forecast to ease to 6.4% in the euro area, under a no-policy-change assumption. This decrease reflects the expected unwinding of pandemic-related measures and a rebound in economic activity.

The aggregate debt-to-GDP ratio is projected to reach nearly 102% in the euro area this year and 94% in the EU, which is about 15 percentage points above their 2019 levels. In both areas, it is expected to rise by a further 1 percentage point by 2022.

The most severely hit euro area countries are forecast to reach double-digit deficit ratios in 2020, namely, Belgium, France, Italy and Spain.

In 2021, the deficits are forecast to stay above 3% of GDP in all Member States except Cyprus, Luxembourg, Denmark, Croatia and Sweden.

The debt ratio is expected to increase in all Member States in 2020 and to decrease in around a third of Member States in 2021.

Now, to the risks. Risks to this forecast are substantial. First, on the downside:

The pandemic could become more severe and last longer. In such case, more stringent and protracted containment measures would be required in 2021, leading to lower growth and higher unemployment and leaving deeper scars on the corporate sector.

As an open economy, the EU economy would be also be affected if the global economy turns out weaker due to a longer or more severe pandemic at the global level.

Supportive policy measures could be withdrawn prematurely. This concerns both fiscal policy support, in particular job retention schemes, but also health policy measures. There is also the risk that in spite of policy efforts, country divergences might become entrenched, endangering the functioning of the internal market.

Lastly, the possibility of financial market stress, which is not there now, cannot be excluded as a downside risk for the future.

But let me end with a more optimistic message, because there are also a number of upside risks:

Then, faster medical advances could accelerate the relaxation of distancing measures, improve confidence and result in a quicker return to normal. This includes of course the possibility of a swift and widespread deployment of a vaccine next year.

Finally, a future EU-UK trade agreement would mean a positive impact on economic activity from 2021, as compared to the forecast baseline of the UK and EU trading on WTO Most Favoured Nation terms.

Lastly, let me say a few words on NextGenerationEU. Because our forecasts only take into account measures that are publically announced and sufficiently detailed, we have not been able, in most cases, to include in our projections investments that could potentially be financed through NextGenerationEU.

Also, no financing from the RRF has been included on the revenue side of the budgetary projections. Only the 10% pre-financing of RRF grants is included in the forecast for 2021, as a financial transaction with an indirect debt-reducing impact.

NextGenerationEU is of course much more than an upside risk to our baseline. It represents an unprecedented boost to the EU economy. You will find in the forecast document an updated simulation of the substantial growth effects that can be expected: up to 2% of GDP in the years of its active operation.

Moreover, NextGenerationEU will be a strong tool to counter the divergence between countries that I have mentioned, since most of the countries hardest hit according to our forecast are also part of the group of Member States receiving the largest grant contributions, for example Croatia, Italy, Portugal and Spain and Greece.

So, it's essential that we see a swift agreement in the ongoing negotiations on NextGenerationEU so that this game-changing programme of investment and reform can get underway and start supporting the recovery and transformation of our economies.

Thank you. I am ready to take your questions.

SPEECH/20/2040