European Commission - Speech
[Check Against Delivery]

Remarks by Commissioner Gentiloni at the press conference on the Winter 2021 Economic Forecast

Brussels, 11 February 2021

Thank you. Good morning. Let me begin with five key messages emerging from this forecast:

First, the economic situation this winter remains challenging. Since the autumn, many Member States have reintroduced or tightened containment measures in response to the resurgence in infections and, more recently, to the spread of new, more contagious variants of the coronavirus. To be clear, these measures are necessary. But of course affect economic activity – although to a much lesser degree than in Spring last year.

Second, because the recession in 2020 was not as deep as expected, and thanks to the breakthroughs regarding vaccines, we now project the EU economy will return to its pre-crisis GDP level already in 2022.

This forecast assumes that the current strict containment measures will ease towards the end of the second quarter this year and then more markedly in the second half of the year, when the most vulnerable and an increasing share of the adult population should have been vaccinated. Containment measures are then assumed to be marginal towards the end of 2021, with only targeted sectoral measures still present in 2022.

Overall, EU GDP is now forecast to grow by about 3.7% this year and 3.9% in 2022 after a contraction estimated at 6.3% last year. In a few words compared to our Autumn Forecast: a smaller contraction in 2020, lower growth in 2021 and stronger growth in 2022.

Third, the recovery is set to be uneven across Member States. This mainly reflects differences in the structure of each economy and the relative importance of tourism and leisure activities.

Fourth, uncertainty and risks to the assumptions I have just mentioned remain very high, as all forecasts are at this time. They are linked in particular to the evolution of the pandemic, including the emergence of new variants and the success of vaccination campaigns.

And fifth, this forecast does not take into account the potentially very significant positive impact of NextGenerationEU, because we lack sufficient data for this as I will explain.

The pandemic has tightened its grip on Europe since autumn. The rate of infection has seen an acceleration in many countries, followed by a new surge in hospitalisations and deaths.

More recently, new, more infectious variants of the virus have also started to spread in some countries. National authorities have rightly decided to tighten restrictions, as illustrated by the Oxford Stringency Index and the declining Google mobility index.

However, the economic impact of these new restrictions appears less pronounced than during the first wave of the pandemic. The current measures are less harsh and more targeted compared with those imposed in March and April last year: Industry and construction have been largely allowed to operate. Schools and kindergartens have remained open in most countries.

Together with an extensive use of remote working, these measures have prevented the denting of the labour force.

The third quarter of 2020 saw very strong growth in the European economy, we could not factor into our autumn forecast.

In the fourth quarter, the EU economy is estimated to have contracted by 0.5%. But this decline was not comparable with the sharp drop in the second quarter of 2020, when the first wave of the pandemic hit.

Overall, the European economy contracted less over 2020 as a whole than we had projected back in November.

Over the first weeks of 2021, surveys have continued to suggest depressed economic activity. But

beyond the first quarter, the economy is expected this year to start picking up, in line with our assumption of a gradual lifting of restrictions towards the end of the second quarter.

Looking at the international picture, the global economy rebounded strongly in the third quarter of 2020 after the severe contraction in the first half of this year.

The outlook for the medium-term has improved, thanks to vaccination campaigns in advanced economies and stronger policy support, particularly in the US and Japan.

After an estimated contraction of 3.4% last year, global GDP (excluding the EU) is set to rebound by 5.2% in 2021 and grow by 3.8% and 2022.

Global trade in goods - again excluding the EU – is expected to recover in line with the global economy. This rebound in trade should be beneficial to the EU, in particular to countries most exposed to global demand for goods, since the recovery of trade in services is likely to take longer.

Of course, the picture is far bleaker in the poorest parts of the world. Kristalina Georgieva has warned that *"in low-income countries, the shocks are so profound that we face the risk of a 'lost generation'"* with close to 90 million people likely to fall below the extreme poverty threshold during 2020–21.

The Commission's latest surveys point to ongoing sectoral divergences in Europe. This is not a surprise. While industry is on the mend, services relying on close person-to-person contacts have remained weaker. This does not come as a surprise given the impact of containment measures on demand and supply for services such as travel, tourism, restaurants and entertainment.

As restrictions on services should be gradually eased, the services sector is also set to rebound and to narrow the gap with the industrial sector.

The pandemic, the containment measures, and the resulting sectoral divergences have had uneven implications for the labour market. As I just mentioned, the measures mainly affected contact-intensive services, where employment was restricted or fully suspended. But the containment measures are important for the whole economy.

Compared to past recessions, the increase in the unemployment rate was limited – although unequal between genders, rising slightly more for women than men.

At the end of last year, after having peaked in the summer, the unemployment rate in the EU and the euro area stood only slightly higher than before the pandemic. This is the result of the cushioning by government support for employees and firms, helped also by our indeed successful SURE instrument. Various short-time work schemes kept workers attached to their jobs.

In short, policymakers learned from past mistakes and responded very decisively. National measures with a direct budgetary impact amounted to almost 4% of GDP last year, with liquidity support and guarantees amounting to around 19%.

To some extent, though, the standard labour market indicators hide the impact of the pandemic. Last year saw an increase in underemployment, which is not covered in the unemployment rate. For example, hours worked collapsed in the first half of the year.

In addition, forward-looking indicators of the labour market signal the persistence negative impact of the pandemic. Last month, the Commission's Employment Expectations Indicator remained markedly lower than before the pandemic.

With the recent resurgence of the virus and a less favourable near-term outlook, job retention schemes remain the first line of defence for workers. When, as assumed in this forecast, restrictions are progressively eased later in the year, many people in services and retail are expected to return to their jobs. However, it cannot be taken for granted that all employment relationships will remain intact after the retention schemes are lifted.

So policymakers at all levels must remain very agile.

Underlying price pressures are expected to remain subdued this year and next. However, based on the oil price assumptions and owing to the end of the temporary reduction in the German VAT rate, euro area headline inflation is expected to move slightly higher in the coming quarters. In 2022, once the expected recovery takes hold, upward pressures on inflation should only increase marginally.

Overall, inflation in the euro area is expected to increase from 0.3% last year to 1.4% in 2021 and 1.3% in 2022.

In the EU, it is forecast at 1.5% in both years.

Following the contraction in almost all Member States, except Ireland, GDP is expected to expand in

all Member States in 2021 and 2022. This is the famous light at the end of the tunnel!

As increasing numbers are vaccinated and containment measures are gradually relaxed, economic activity is expected to start picking up.

This means, to speak in terms of the growth map, that "blue waves" are set to lift all boats in the EU, providing we avoid any premature withdrawal of supportive policies.

However, significant country divergences are expected to persist. Such differences are for example related to pandemic developments; to the timing, duration and stringency of containment measures; and to economic structures of different Member States. These cross-country differences result in a wide dispersion of real GDP paths since the beginning of the crisis. Both the downturns last year and the rebounds this year and next are expected to differ widely.

The EU is expected to reach its pre-pandemic level of the fourth quarter of 2019 already in the second quarter of 2022, which is earlier than expected last Autumn. However, one in four Member States with quarterly forecasts are set to need longer.

Moreover, none of the Member States is expected to return in 2022 to the growth path projected before the crisis. In 2022, annual GDP in the EU and the euro area will remain about 4% below what pre-pandemic forecasts had projected.

There are risks to the forecast, of course. Uncertainty remains high and the risks surrounding the forecast remain elevated.

As compared to the autumn, risks have become more balanced.

However, several significant downside risks persist.:

New COVID-19 variants could emerge and spread more quickly than assumed both in Europe but also globally. This could delay the easing of restrictions and interrupt the economic rebound for longer than currently expected.

Moreover, the pandemic could leave deeper economic and social scars than we think. The number of bankruptcies could be higher with a more severe impact on potential output than envisaged in the most forecasts. Structural shifts could also raise the number of unemployed more than currently expected and further worsen inequality, including gender inequality.

Finally, large cross-country divergences could become entrenched, disrupting the functioning of the internal market, cause efficiency losses and ultimately becoming self-reinforcing.

But there are also upside risks.

The vaccination rollout could move more quickly than expected, or effectively hamper virus transmission, which is something we do not yet know. This could lead to a faster improvement in the pandemic situation and allow governments to remove restrictions earlier than currently assumed.

Pent-up demand could prove stronger, coupled with innovative investments. The strength of the rebound could surprise on the upside, if historically high household savings, low financing costs, and supportive policies push demand more than expected.

In short, one could say compared to the autumn, we now face fewer unknown risks and more known risks. Many of these known risks are also policy-dependent. It is up to us to ensure that sufficient support measures are in place for long enough, and that fiscal policy continues to work hand in hand with monetary policy to sustain the recovery.

Finally, I would like to underline that the impact of NextGenerationEU and in particular the Recovery and Resilience Facility has only been very partially factored into this forecast.

This is because, in line with the customary no-policy-change assumption, our forecast only incorporates those measures that have either been adopted or credibly announced and specified in sufficient detail, notably in national budgets.

Following this approach, the economic projections of only a few Member States take account of some of the measures expected to be financed under the RRF for 2021.

What this means is that the economic recovery in 2021 and 2022 should turn out stronger than projected in this forecast, as the national Recovery and Resilience Plans are implemented.

You may recall that our autumn forecast included a simulation of the substantial growth effects that could be expected. There could be a boost of up to 2% of GDP in the years of active operation of the RRF.

More precisely, Member States with below-average GDP per capita levels are estimated to experience the largest boost to output. Considering a six-year stimulus, the level of GDP in 2026 would be between 3% and 3.5% higher, compared to a “no RRF” baseline.

Member States with above-average GDP per capita levels would be likely to experience smaller, but still sizeable, GDP effects.

To put it another way, this is a historic opportunity. We can face the pandemic and rebuild our economies better. Of course, this depends on efficient absorption and smart use of these funds to support productive investment.

We will come back to this and several of the other issues in our Spring 2021 Forecast, which I will present in early May.

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