Policy Brief 2020-1

Severe recession in 2020, uncertain recovery in 2021

COVID-19 will make 5.2m workers redundant in 2020.

What started as a faraway event in China proved to be particularly damaging for European lives and jobs. Rather than remaining confined to China, the COVID-19 virus spread across continents and drove the global and European economies into deep recessionary territory.

While global GDP is projected to contract by about 3% this year, the pandemic and the containment measures it has necessitated are taking a particularly heavy toll on the European economy. Economic activity dropped by around one-third almost overnight. The coronavirus crisis struck the EU economy when it was already slowing down (with industrial production even negative). Indeed, economic growth in the eurozone stood at only 1.2% in 2019, down from the post-crisis high of 2.7% in 2017.

In its spring forecast published on 6 May 2020, the European Commission estimates that EU output would fall by 7.4% this year, the steepest decline in the history of the EU (the banking crisis in 2009 made the EU economy shrink by 4.5%), with a rebound of 6.1% in 2021. Without the swift and comprehensive policy responses implemented at the EU and the national level, the drop would even amount to 13%. Italy, Spain, Croatia, and Greece will experience the steepest falls in gross domestic product with a slump of more than 9%. But also, the UK and France will see economic growth collapse by more than 8%.

The coronavirus crisis will have a devastating impact on all components of economic demand. Consumption is expected to contract by 9%. This is partly the result of 'forced savings' as consumers do not have the opportunity to spend. But because of uncertainty about future employment and income prospects, 'precautionary saving' is also on the rise. The Commission expects the savings rate to increase from 12.8% in 2019 to around 19% in 2020, the highest level ever in the history of the Union.

Furthermore, companies are likely to postpone or even cancel investments because of the uncertainty on future sales. They will also have to recover from the 'artificial coma' they were put into and restore their balance sheets that suffered from cash drain during the lockdowns. This will negatively impact investments by no less than 13% over 2020.

As the pandemic has halted the free movement of people goods and services, exports are expected to plummet by 13%. The rebound in 2021 is also expected to be limited because some of the disruption in global value chains caused by the pandemic is likely to prove lasting.

Member States acted decisively with massive fiscal support to limit the economic fallout of the pandemic. As a result, the overall fiscal deficit of the EU is expected to rise from 0.6% of GDP in 2019 to around 8.5% in 2020, bringing the debt-to-GDP ratio to more than 100%. This is again re-igniting debt sustainability concerns which are for the time being successfully addressed by the accommodative monetary policies of the ECB.

Despite short-time work arrangements to prevent lay-offs and liquidity support to keep companies afloat, the impact of the coronavirus pandemic on employment is dramatic. The unemployment rate of the EU is expected to rise from 6.7% in 2019 to 9.0% in 2020. In numbers this means an increase from 14.4m to 19.6m (not including short-time unemployment), and an increase by 5.2m over a year. To compare, during the financial crisis 4m jobs disappeared over 5 years between 2008 and 2013. Sectors most affected by the severe economic shock provoked by COVID-19 are firstly the sectors that were directly hit by containment measures, i.e. personal services, retail, travel, hospitality, and tourism. But the lockdowns also deeply disrupted supply chains in industrial sectors such as aerospace, automotive, steel, shipbuilding, and textiles. COVID-19 risks leaving deep scars in these sectors as they risk being confronted with permanent destruction of capital and loss of industrial capabilities.

The employment situation during the year will be particularly dramatic in France (-9.1%), Spain (-8.7%) and Italy (-7.5%) while Germany, Belgium, Austria, and Denmark will lose less than 2% of total jobs. In total employment in the EU will decrease by 4.4% in 2020 followed by a rebound of 3.3% in 2021. Because of these divergent developments the European Commission warns of severe distortions within the single market that could lead to threaten the stability of the economic and monetary union. Indeed, COVID-19 has affected more seriously countries that have the least availability of fiscal space to respond.

The Commission does not expect a fast V-shape recovery, but rather a gradual "U-shaped" return to growth. By the end of 2021, the European economy will still be 3% smaller than before the pandemic. But this will only be the case if the assumptions of the forecasts come true: a gradual lift of containment measures, no second wave of infections, no real economic impact of the remaining containment measures in the second half of this year, effective implementation of the unprecedented monetary and fiscal measures to cushion the immediate and permanent damage to the economic structure. These rather optimistic assumptions mean that the downside risks on future economic growth remain particularly high. Indeed, as long as there is no vaccine or medicine, the pandemic will probably not ebb away and shall stay with us for a much longer period. This would mean that demand in sectors requiring face-to-face contact (i.e. service sectors) will remain subdued and that productivity in sectors requiring co-operation (i.e. industry, construction) will remain below average, limiting the capacity to generate added value. This could result in our economies being trapped in a much deeper and more protracted slump. The pandemic has also added 'health care uncertainty' to the list of risks consumers and companies are confronted with. This novel uncertainty pushes them to delaying decisions to consume, invest, hire, or lend.

In reaction to the latest economic forecasts Luc Triangle stated:

"The depth of this recession will require unprecedented measures. There is no time to lose in establishing a coordinated and large-scale post pandemic recovery strategy with due attention for rebuilding and strengthening our industrial value chains. Bold 'whatever-it-takes' policies will be needed to fend off another lost decade of fragile and unequal growth".

"European economies are very interdependent and industrial value chains do not have borders. So more European determination and coordination is needed to increase the impact of all measures taken. To beat the health and economic crisis we will have to work together and find common solutions. Combating COVID-19 will represent an unprecedented test for European unity and solidarity".

"Key in the recovery strategy should be the promotion of public and private investments to support the twin transition to a digitalised and low-carbon economy. The Green Deal, the Digital Strategy and the recently approved industrial strategy should constitute the foundations for this strategy, that can only be successful if it is supported by appropriate financing", Luc Triangle concluded.