Christine Lagarde: The path out of uncertainty

SPEECH

Remarks by Christine Lagarde, President of the ECB, via videoconference at the inaugural session of the Italian National Consultation

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There is no doubt that the economic situation we face today is characterised by profound uncertainty. Looking into the future has rarely been harder.

But, as Abraham Lincoln said, “the best way to predict your future is to create it”. And this is the theme that I want to emphasise in my remarks today.

Obviously there are some major unknowns that we cannot do much about, such as possible second waves of the virus or when exactly vaccines will arrive. But there are steps we can take to help navigate out of the fog of uncertainty.

Most importantly, we need to elaborate and propose a reliable compass – that is, a positive vision of what our economy will look like after.

Our economies are entering an inevitable phase of transformation, but if policymakers can demonstrate that we will emerge together from the crisis stronger – with more agile, more modern and more equal economies than before – we can ensure a more resilient recovery today and more sustainable growth in the future.

Uncertainty in euro area economy

The crisis is weighing heavily on the euro area economy. Business investment looks to have collapsed in the first quarter, even more strongly than GDP. Measures of consumers' propensity to save have surged to historical levels, far above what we saw after the Lehman crash.

Some of this reflects "forced saving" because people have been unable to spend and will therefore reverse naturally. But we are also seeing significant precautionary saving, which is a sign that households are preparing for an uncertain future, and uncertainty is likewise a key factor in weak business investment.

There are two main sources of uncertainty today.

The first source is uncertainty about how the economy will recover from the coronavirus (COVID-19), which is evident in the Eurosystem's latest macroeconomic projections.

Our baseline projection sees GDP falling by 8.7% this year, but this is surrounded by a wide range of potential scenarios. In our mild scenario, the drop in GDP would be 5.9% this year, and in our severe scenario it would be 12.6%. In this latter case, output would still be well below its pre-crisis level at the end of 2022.

Faced with such an outlook, it is understandable that households are anxious about their future incomes and firms are hesitant about making irreversible decisions. In particular, many citizens fear that, in a slow recovery, some jobs will be lost once government support schemes are phased out.

This underlines why it is so important that the recovery is properly managed and that the economy is adequately stimulated. Confidence in government policies is critical to reducing uncertainty, which is itself a form of stimulus.

In fact, results of a survey conducted at the ECB show that households that assess government policies as adequate have lower uncertainty about their future income.

The second source is uncertainty about how the economy will change in response to COVID-19.

It is becoming increasingly clear that the crisis will restructure our economies in fundamental ways. In the manufacturing sector, we are likely to see a push to make supply chains more resilient, which will likely lead to a greater focus on "proximity", i.e. on-shoring of production and reinforcing of strategic value chains.

In the services sectors, by contrast, the pandemic is likely to shift the economy towards more "distancing" via more digitalisation.

We are already seeing this transition accelerate as retail trade gravitates towards e-commerce, services that we previously thought were “non-tradeable” start being traded online, and more remote working becomes possible.

As the workplace changes profoundly, it will take time for the new equilibrium in the economy to appear. Some sectors will grow and create more jobs as their reach increases – think of communication or education and training, for example.

But other sectors could undergo significant changes if, say, people no longer need to commute into work to the same extent, or to make as many business trips or attend as many conferences where they consume hospitality services.

This rebalancing should lead to higher investment in intangible capital, but part of the capital stock related to tangibles could be superseded. If such changes happen too rapidly, they can lead to temporary disruptions in the labour market.[1]

So it is natural for people to wonder what the economy will look like in the future and how we will ensure sustainable growth. Our task today – if we want to prevent a persistent increase in precautionary saving and instead to direct such saving towards needed investment – is to provide them with credible answers.

Transitioning to the post-crisis economy

Dealing with uncertainty about the outlook is the task of stabilisation policies, and here the ECB will continue to take all necessary steps within our mandate of price stability – for all euro area citizens in all parts of the euro area.

Already our policies have dispelled tail risks in financial markets that could have led to self-reinforcing vicious circles. We are now orienting our measures to ensure that the right financial conditions are in place to support a recovery from the crisis.

This was the motivation behind our recent decision to expand our pandemic emergency purchase programme to €1.35 trillion, coupled with the up to €3 trillion we are making available to banks that lend to the real economy.

But monetary policy cannot address the more profound questions about how the economy will look in the future. Historical experience suggests that major economic shifts like the one we are going through today require government action to foster change and smooth the transition to the new normal.

In particular, governments need to foster innovation by providing the right framework to encourage experimentation and risk-taking in new and growing sectors, and to support the transition to new jobs for people working in “sunset” sectors.

In parallel, they need to ensure that the conditions are in place to direct investment towards the technologies and sectors of the future.

This requires sufficient financing. The European Commission estimates that the investment needs for delivering the digital transformation as well as the green transition will be at least €1.2 trillion over the next two years.[2]

But in a number of countries – Italy among them – mobilising investment requires above all a business-friendly economic environment, with efficient and agile public and private services, adequate physical and digital infrastructures, a well-functioning judicial system and a strong financial sector.

If such actions are taken, this crisis can engender a period of positive transformation. It offers an opportunity to policymakers to take a decisive step forward towards more inclusive, greener and more digital growth.

A renewed focus on the digital economy, for example, can help break the negative feedback loop we see in Europe between fragmented markets, low economies of scale and weak investment in digital capacities, which has at times resulted in the knowledge economy in the euro area contributing only about half as much to productivity growth as in the United States.[3]

Greater digitalisation would in turn help accelerate the shift in Europe towards what the economist Carlota Perez has termed “smart green growth”, which is not only about renewables and sustainable goods, but also about innovation in the productivity of resources and the shift from tangibles to intangibles.[4]

Europe already hosts the largest eco-innovation and circular economy industry in the world[5] and the euro is the currency of choice for global green bond issuance.[6] In the twentieth century, Europe was also at the forefront of the creation of the welfare state. The crisis today offers a possibility to consolidate and expand our global leadership on the environmental front and to make it converge with more digital lifestyles – producing a new, more sustainable economic model.

Finally, the drive to build more resilient supply chains could be the catalyst we need to definitively complete the Single Market. If we are to “de-globalise” while also achieving allocative efficiency and strategic autonomy, we will have no choice but to make full use of the size and diversity of our continent-wide economy.

So the potential to frame a positive European vision should, I hope, be compelling. The Commission’s recovery fund proposal is clearly a key building block in delivering on this goal. But the European level cannot be expected to do it alone.

Crucially, the recovery fund will only reach its full potential if it is firmly rooted in structural reforms conceived and implemented at the national level. We will get a “bigger bang” for each euro spent if countries conduct the structural reforms they need at the same time.

As an illustration, ECB research shows that in the event of a common shock hitting all euro area countries – of the type we have just seen – those with less efficient economic structures can on average suffer up to twice the output loss of a country that is at the frontier of institutional parameters.[7]

The Country Specific Recommendations identify further helpful reforms. In Italy’s case, I understand that these recommendations call for, among other things, investing in digital infrastructure for education and training, promoting renewable energy production, developing e-business models and modernising public administration.

Such reforms – designed and owned by you – are indispensable to capitalise on this moment.

Conclusion

I therefore encourage you, as policymakers, not to let this crisis go to waste.

My institution, the ECB, will play its part within its mandate. But it is for you to prove to citizens that our societies will emerge from this transformation stronger and greener.

If we are collectively successful, uncertainty will start to turn into confidence, and then a real recovery can begin.

Press release – EU-UK talks: MEPs united behind EU stance, rejecting UK cherry-picking

In a draft resolution, adopted ahead of the 15 June High Level Conference with UK Prime Minister Boris Johnson, European Council President Charles Michel and Commission President Ursula Von der Leyen and the participation of EP President David Sassoli to take stock of the achievements of the negotiations up to this point, MEPs regret that no real progress has been achieved so far and that the divergences remain substantial.

They warn against the UK government's current piecemeal approach and emphasise that a comprehensive agreement is in the interest of both parties. Having the UK cherry-pick certain policies and its access to the single market after Brexit is "unacceptable" for the EU, says the text.

The draft resolution also reiterates Parliament's full support for the EU's Chief Negotiator Michel Barnier in his talks with the UK, based on the political mandate given to him by the EU member states and Parliament resolutions.

Withdrawal obligations

The faithful implementation of the Withdrawal Agreement, including on citizens' rights is a precondition to ensure the trust needed to conclude a deal on the future relationship, notes the text.

MEPs also call on the parties to ensure a strict implementation of the Protocol on Ireland and Northern Ireland.

Competition on equal footing, fisheries

The text emphasises that Parliament's consent to any future trade agreement with the UK is conditional on the British government agreeing to a level playing field (common rules and standards) in the area of, among others, environmental protection, labour standards, and state aid, and on the conclusion of an agreement on fisheries. The UK has so far not engaged in negotiations on the provisions ensuring equal competition, the draft notes.

The draft resolution, involving input from 17 specialised committees and Parliament's United Kingdom Coordination Group (UKCG), was passed by 85 votes in favour, six against and 17 abstentions.

The text will be available in full here.

David McAllister (EPP, DE), Chair of the UKCG and of the Committee on Foreign Affairs

"The report that has been adopted today in the Committees on Foreign Affairs and International Trade, and which incorporates the opinions of no less than 17 committees, delivers a clear and strong message of unity ahead of the plenary vote next week. The European Parliament stands firmly behind the EU Chief Negotiator. The UK Government needs to start translating the Political Declaration into a comprehensive and fair agreement that lays the foundations for a long-term, mutually beneficial relationship. This agreement must be premised on the effective implementation of the Withdrawal Agreement and of its three Protocols. The High-Level Conference is a good opportunity to give new impetus to the negotiations.”

Bernd Lange (S&D, DE), Chair of the Committee on International Trade, member of the UKCG

“The European Parliament is very clear in its strong preference for a comprehensive economic and political partnership with the UK reflecting the interconnectedness of our economies, the geographic proximity, the common values of the EU and the UK and the Political Declaration of 2019. Now is the time of truth and the European Parliament stands united with the European Commission and the Council in rejecting the piecemeal approach by the UK government to these negotiations leading to separate agreements. In this respect, it is no surprise that the EP will reject a trade agreement that does not include robust guarantees for fair competition and fair trade.”

Kati Piri (S&D, NL), co-rapporteur

“The UK’s expectation to keep the benefits of a member state without agreeing to any obligations, including a clear level playing field and governance provisions, is simply not realistic. The UK made a conscious decision to leave the single market. We respect this. So should the United Kingdom.

It is now time for the UK government to deliver on its own promises of a comprehensive agreement and fair competition with clear social, environmental and labour protection in which the European Court of Justice remains the sole interpreter of EU law. This is what Prime Minister Johnson and the EU signed up to only months ago in the Political Declaration. None of this should be in any way controversial. The EU continues to stand ready to negotiate in good faith. An ambitious and comprehensive future partnership is in the best interest of both EU and UK citizens.”

Christophe Hansen (EPP, LU), co-rapporteur

“The full, effective and timely implementation of the Withdrawal Agreement is not only a non-negotiable pre-condition for the conclusion of a deal, but it is also a litmus test for the good faith that the UK brings to the negotiations on the future partnership. We need to see clear progress well before the end of the transition period. Failing to properly implement the Withdrawal Agreement would leave citizens on both sides of the Channel in the cold, endanger the Irish peace process and unravel the integrity of the Single Market. Parliament will make sure this does not happen.”

Background

The EU and the UK signed and ratified the Withdrawal Agreement on the rules of the UK’s departure from the EU and the Political Declaration on the future relationship in October 2019. The EU has been in negotiations with the UK since March 2019 based on a negotiating mandate that the EP strongly supported in February 2020. On 1 January 2021, the United Kingdom will exit the EU customs union and the single market.

Joint statement of ministers responsible for the internal market and industry on the Recovery Plan for Europe

The Ministers responsible for Industry and Internal Market recognised the severe impact of the COVID-19 crisis on the EU economy, jobs and society and therefore acknowledged the need to prevent future economic shocks, restore the Single Market and strengthen Europe's resilience.

They stressed that solidarity, convergence and close cooperation between the Member States and the EU institutions should be at the heart of the policies to initiate a sustainable recovery that accelerates the transition to a green and digital economy.

The Ministers highlighted the importance of the recently presented "Recovery Plan for Europe", which is expected to play a crucial role in leading the EU economy back on the path of growth and making it fit for the future.

They also recalled the need for a coordinated approach to deconfinement and recovery. The instruments provided in the Recovery Plan can only be successful when supported by an operational internal market and a collaborative and multi-level approach in the fields of industrial policy and SMEs, based on the policy objectives presented in the "March 2020 package". Furthermore, the significant investments required to relaunch the EU economy should be targeted at accelerating the green and digital transitions and at making the EU more resilient.

In this spirit, the Ministers:

- Welcomed the overarching objectives of the Recovery Plan for Europe, with a focus on supporting public and incentivising private investments;
- Highlighted that the re-establishment, strengthening and deepening of the Single Market in all its dimensions is a precondition for industrial competitiveness, and that restoring and reinforcing the Single Market will be one of the criteria for the success of the European economic recovery; called for the need to implement the Single Market enforcement action plan without delay and would additionally welcome more specific proposals to strengthen its resilience in the face of crises;
- Stressed the importance of both the green and digital transitions as drivers for European recovery and emphasized that the European Green Deal should be the EU growth strategy transforming the EU into a sustainable, climate-neutral and circular economy;

- Underlined that the acceleration of the digital transformation will be an essential component of the EU’s response to the economic crisis generated by the COVID-19 pandemic;
- Underlined the importance of strengthening the EU’s economic resilience, while upholding the principles of an open economy including free and fair trade, and strategic autonomy across key technologies and value chains;
- Recalled that Important Projects of Common European Interest are one of the relevant tools for supporting strategic value chains at EU level; took note of the different strategic value chains highlighted in the Recovery Plan and await the Commission’s work on a targeted approach, in consultation with the Member States and stakeholders;
- Took note of the Commission’s analyses that identified 14 industrial ecosystems and look forward to the further examination of the concept and outcomes of the Commission’s analyses; keenly await the decision on the mandate and tasks of the new multi-stakeholder dialogue in the field of industrial policy, such as the Industrial Forum mentioned in the industrial strategy;
- Emphasized the need to assist workers and SMEs in the transition to a green and digital economy; underlined the necessity to enhance the innovativeness of the economy by implementing a skills agenda for workers and increasing the cooperation and productivity of SMEs;
- Emphasized that free and fair competition and a level playing field should be ensured within the Single Market and globally, and reiterated the need to review the European competition framework to new technological and global market developments;
- Highlighted the continued relevance of the objectives of the “March 2020 package”, which set out a new industrial strategy, an SME strategy, an action plan for Single Market enforcement, an analysis of remaining barriers to the Single Market and a new circular economy action plan;
- Called upon the Commission to follow-up the measures foreseen in the “March 2020 package”, and to monitor and analyze the need for updates or further action, where necessary, including in light of the recovery;
- Stressed the continued relevance of the “February 2020 Package” which set out the digital strategy, the data communication and the white paper on artificial intelligence;
- Reiterated the importance to keep the competitiveness of the European economy under constant monitoring and review and the need for defining an indicator framework to benchmark the policy measures set up to stimulate and renew the European economy and strengthen its growth, recovery, resilience and green and digital transformation;
- Underlined that the Competitiveness Council should coordinate and monitor the industry and Single Market dimensions of the EU Recovery Plan and their implementation in a systematic manner, while putting SMEs at the heart of EU action.

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