Towards a sustainable Covid-19 recovery in Europe

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OMFIF (Official Monetary and Financial Institutions Forum)

10 May 2021

Summary

I would like to thank the Official Monetary and Financial Institutions Forum (OMFIF) for inviting me to participate in the event entitled "Towards a sustainable recovery". In my speech, I will focus on three points: the macroeconomic outlook for the Italian economy; the great opportunity, for Italy and Europe, represented by the Next Generation EU (NGEU) programme; and the way forward for fiscal and monetary policies.

The economic outlook for Italy shows signs of improvement according to most indicators. However, it hinges upon the success of the vaccination campaign and the launch of the Italian Recovery Plan, whose investments and reforms are to be implemented swiftly and efficiently. The new waves of contagion keep fiscal support essential in the short run. However, it is important that public money is spent with a vision that goes beyond the short term, recognizing the key role of public investments in infrastructures, including green and digital ones. Going forward, as stressed last February by the Governor at the ASSIOM FOREX Congress, "fiscal policies must have the clear medium-term objective of guiding the debt ratio back to a downward slope". In an environment of secular low interest rates and heightened uncertainty, it is key to foster the interaction between fiscal and monetary policies whereby the latter, by providing favourable financing conditions, can give space to the former for crowding-in private investments. Such an interaction can allow the economic slack – which currently weighs on the subdued outcomes and projections of inflation – to be absorbed. NGEU is a temporary programme whose effectiveness will depend on the validity of the projects contained in the national plans, especially those of the Member States that benefit the most from EU funding. If NGEU succeeds, it can serve as a blueprint for a permanent common fiscal capacity, which can protect our economies from adverse macroeconomic shocks. Moreover, it will further increase the amount of EU safe assets that, by contributing to financial stability and financial integration, can underpin the smooth and homogeneous transmission of monetary policy across different jurisdictions.

Economic and inflation outlook in Italy

- According to the assessment published in our latest *Economic Bulletin*, in Italy GDP appears to have broadly stagnated in the first quarter of 2021, after the contraction observed at the end of 2020 (-1.9 per cent quarter-on-quarter). Industrial activity seems to have recovered (by slightly less than 1 per cent quarter-on-quarter, after declining by -0.4 per cent in Q4 2020), but services are still weak, especially in the retail, hospitality and entertainment sectors, which were hit hard by the containment measures prompted by the resurgence of the pandemic.

- Most indicators show signs of improvement, but restrictions on mobility and the fear of contagion still weigh on the recovery and especially on consumption spending. According to our Special Survey of Italian Households, conducted between February and March, more than one fourth of Italian households still planned to cut their spending on non-durable goods and services in the following quarter. Around 40 per cent of households reported having spent less than their annual income in 2020, thereby managing to accumulate some savings. However, only one third of the savings accumulated are likely to be spent in 2021; just over half will be held in the form of deposits or other forms of investment and the rest will be used to repay debts.

- Capital accumulation is expected to return to growth gradually. According to the firms interviewed between February and March for our Survey on Inflation and Growth Expectations, investment conditions have become slightly more favourable and about one third of firms expect investment spending to increase again in the first half of 2021.

- Assuming that the vaccination campaign follows the path outlined in the Government's plan, the recovery should gain strength in the second half of 2021. Besides the vaccination campaign, a better global outlook and continued policy support, with a prominent role for the projects under the Next Generation EU (NGEU) programme, should contribute to the rebound in economic growth expected from the second half of the year.

- According to the leading forecasters, Italian GDP could expand by more than 4 per cent in 2021. A scenario of a return to sustained and long lasting growth is plausible, though not without risks; it assumes that support to the economy will continue and that the measures being introduced under the Italian Recovery and Resilience Plan will prove effective.

- As regards inflation, in Italy, consumer price inflation decreased to 0.6 per cent year-on-year in March, from 1.0 per cent in February, and the core component declined to 0.7 per cent (from 1.5 per cent), as the upward pressure observed since January due to a host of temporary factors (mostly owing to the clothing and footwear component and related to the postponement of winter sales) eased.

- Inflation is expected to strengthen over the course of this year, mostly reflecting developments in the energy component. Core inflation is also projected to increase, but to a lesser extent. According to the professional forecasters surveyed in April by Consensus Economics, inflation in Italy should reach 1.1 per cent in 2021 and 1.0 per cent in 2022. In our quarterly Survey on Inflation and Growth Expectations conducted in March, firms indicated that they expect their selling prices to increase further, by 1.0 per cent, especially those in the manufacturing sector. Firms also revised their consumer inflation expectations upwards across all time horizons, though they remain low. In the survey carried out by Istat in March, households' one-year-ahead inflation expectations decreased slightly; the balance between those expecting an increase in prices and those anticipating a decrease, which had risen significantly during the first lockdown, has been negative since last July.

Paths to recovery: green revolution and digital transition

- Coping with climate change and digitalizing our economies and societies are two crucial challenges for Europe and for the whole world. This is clearly reflected in the EU multiannual financial framework and in the NGEU, the new temporary instrument designed to boost the recovery.

- Almost 90 per cent of the NGEU resources will be channelled via the Recovery and Resilience Facility (RRF). To be eligible for RRF funds, each country must prepare a detailed Recovery Plan, which includes a coherent package of projects, reforms and investments in six policy areas. At least 37 per cent of the resources must be devoted to the green transition, and at least 20 per cent to the digital transformation. For each measure, the Plans have to indicate the contribution to the achievement of the green and digital goals.

- In a low interest rate environment, programmes such as the NGEU can help monetary policy. They are opportunities to raise the demand for capital and thus give space for equilibrium interest rates to gradually recover from historically low levels, increasing the monetary policy space. The positive consequences on capital accumulation are particularly relevant in the euro area, where there is evidence that public investment tends to crowd *in* private investment, rather than to crowd it *out*.[1]

- NGEU is a temporary program, but it can represent an important initial step: for the first time, the EU finances national investment and reform programmes of common interest through the issuance of common debt; this debt will, in turn, be gradually redeemed, also by introducing new EU-level sources of revenue. If NGEU succeeds, it can serve as a blueprint for a permanent common fiscal capacity to protect our economies from adverse macroeconomic shocks. As an added benefit, it can foster the integration of the European financial system by adding on to the stock of EU safe assets, which would contribute to further reducing fragmentation within the euro area, thereby underpinning the smooth and homogeneous transmission of

1 See Dreger, C. and Reimers, H.-J. (2016), "Does public investment stimulate private investment? Evidence for the euro area", *Economic Modelling*, 58, November, 154-158.

monetary policy across different jurisdictions and increasing the international role of the euro.

- The 2021-27 multiannual financial framework also envisages the green and digital transitions among its priorities. The EU will spend €132.8 billion in the area of "single market, innovation and digital" (€143.4 billion when including the contribution of NGEU); €356.4 billion in the area of "natural resources and environment" (€373.9 billion when including the contribution of NGEU). To support the digital transition, a new funding program, Digital Europe, was established; the digital strand of the Connecting Europe Facility will also receive a significant boost in funding. Concerning the revenue side of the budget, a new national contribution based on non-recycled plastic packaging waste has been introduced and other revenue sources (including a carbon border adjustment mechanism and the expansion of the scope of the EU Emissions Trading System) will be proposed by the European Commission. These "environmentally friendly" revenues should also contribute to repaying the NGEU debt.

- The Italian Government has presented the Recovery Plan. NGEU represents a great opportunity to improve long-run growth prospects and at the same time sustain the post-COVID recovery. Italy can reap the full benefits of the NGEU funds, but our Public Administration will have to engage in a significant planning, implementation and monitoring effort. NGEU projects have to be carefully selected, precisely spelled-out, and completed swiftly and efficiently.

- We welcome the actions envisaged by the European Commission – decarbonizing the energy sector, investing in environmentally friendly technologies, ensuring building efficiency, promoting sustainable urban mobility – to achieve climate neutrality in 2050. Measures to address climate change are "paramount to promoting sustainable growth and protecting the most vulnerable", as recently stressed by our Governor at the Washington Development Committee. To limit the socio-economic impact of the transition, the Just Transition Fund, a program financed by NGEU, has been specifically set up at EU level. Through it, Italy will receive resources worth approximately €500 million.

- More generally, no environmental policy will ever succeed in the long run if we do not carefully understand and address its distributive consequences, across countries, and – within each country – across generations. In the end, the benefits of a greener environment will be shared by the whole future world population, but the costs of the transition should not fall disproportionately on those who are poorer or more vulnerable. For example, the proceeds coming from higher environmental taxes and/or from the removal of environmentally harmful subsidies could be distributed back by giving priority to the poorest people.

The way forward for fiscal and monetary policies

- In the EU, national fiscal support measures – facilitated by the early activation of the general escape clause and the Temporary State Aid framework – have been effective in averting an even larger recession in 2020. According to the European Commission's estimates,[2] together with the liquidity measures implemented by the Member States, they have cushioned the contraction in GDP in 2020 by around 4.5 percentage points.

- The one-off rise in public debt ratios in the euro area was inevitable: it is partly a mechanical effect of the recession and partly due to a justified policy response. Fiscal, as well as monetary, policies have preserved the productive capacity of our countries and averted a financial meltdown, which in the end would also have raised public debts even further.

- Going forward, the appropriate policy mix should be based on accommodative monetary policy measures in order to keep favourable financing conditions for as long as necessary, and on increasing public investment in infrastructure, human capital, and research and development, which can enhance sustainable growth potential. Moreover, public investments can effectively counter the high uncertainty that is discouraging private enterprise.

- As far as Italy is concerned, the fiscal policy reaction has been timely, correctly targeted to the hardest hit firms and individuals, and – in accordance with the nature of the shock – mostly temporary.

- In the current circumstances, it remains indispensable to keep providing economic and financial relief to households and firms. However, it is important that public money is spent with a vision that goes beyond the short term, recognizing the key role of public investments in infrastructures – including green and digital ones, in human capital, and in research and development – in achieving a path of sustained and sustainable growth.

- As stressed last February by our Governor at the ASSIOM FOREX Congress, "fiscal policies must have the clear medium-term objective of guiding the debt ratio back to a downward slope". Higher structural growth rates would in turn alleviate the problems connected with large public debts, both by activating a virtuous circle through the reduction in the burden of debt servicing costs and by making it easier to reach the necessary cyclically-adjusted primary budget surpluses. However, monitoring and spelling-out a credible medium-term consolidation strategy is absolutely essential. It would be imprudent to base the rebalancing of public accounts exclusively on expectations of higher growth.

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2 European Commission, 'One year since the outbreak of COVID-19: fiscal policy response', COM (2021) 105 final; March 2021.

Designed by the Printing and Publishing Division of the Bank of Italy