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1.1 COVID-19 inflicted a massive shock on economies throughout the world

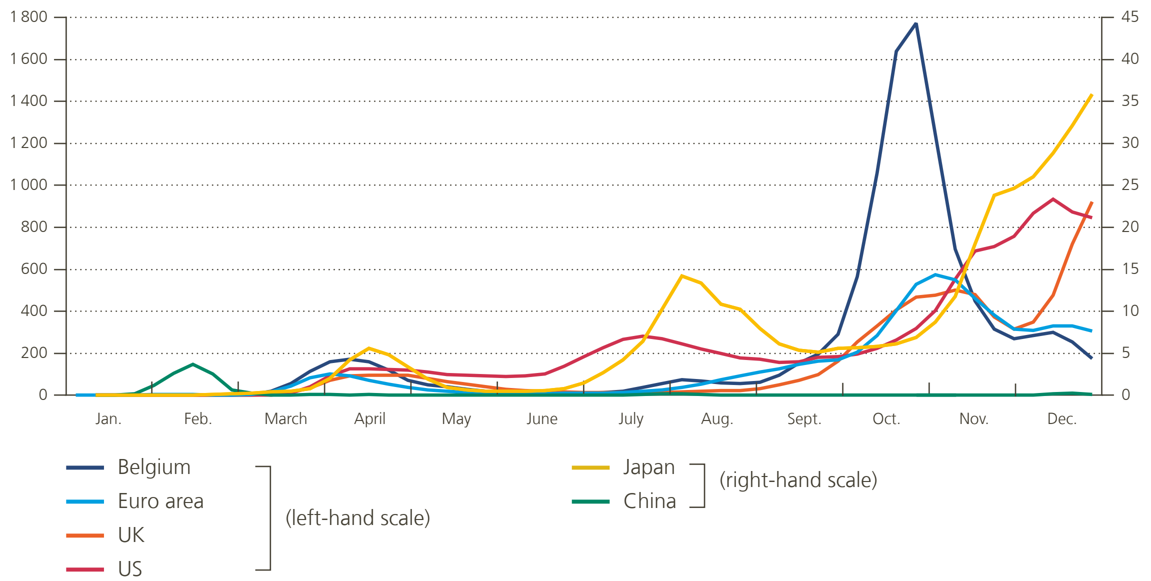
A year like no other

In December 2019, a lethal, contagious disease emerged in China, caused by a new coronavirus. This disease, officially known as COVID-19, rapidly turned into a pandemic. While China swiftly succeeded in containing the spread of the virus within the country by taking draconian measures, in March and April 2020, most of the advanced economies faced a first, strong wave of infections which they struggled to stamp out. In the summer, the virus had a severe impact in South America and India, in particular, while the United States also faced a resurgence of the virus. At that point, the situation appeared to be under control in Europe. However, the start of the autumn coincided with a third wave in the US and a second wave in Europe. The number of confirmed cases in Europe then significantly exceeded the level recorded in the first wave, although these figures must be interpreted with due caution: for example, the average number of tests carried out in October was three times higher than in April. Nonetheless, the seriousness of the autumn wave was also confirmed by other indicators, such as the percentage of positive samples in the population tested, the number of hospital admissions

Chart 1

The pandemic hit the major economies in waves

(total number of new cases confirmed in the preceding two weeks, per 100 000 inhabitants)



Source: ECDC.

and the number of deaths. In China and Japan, the number of cases remained fairly low until the end of the year.

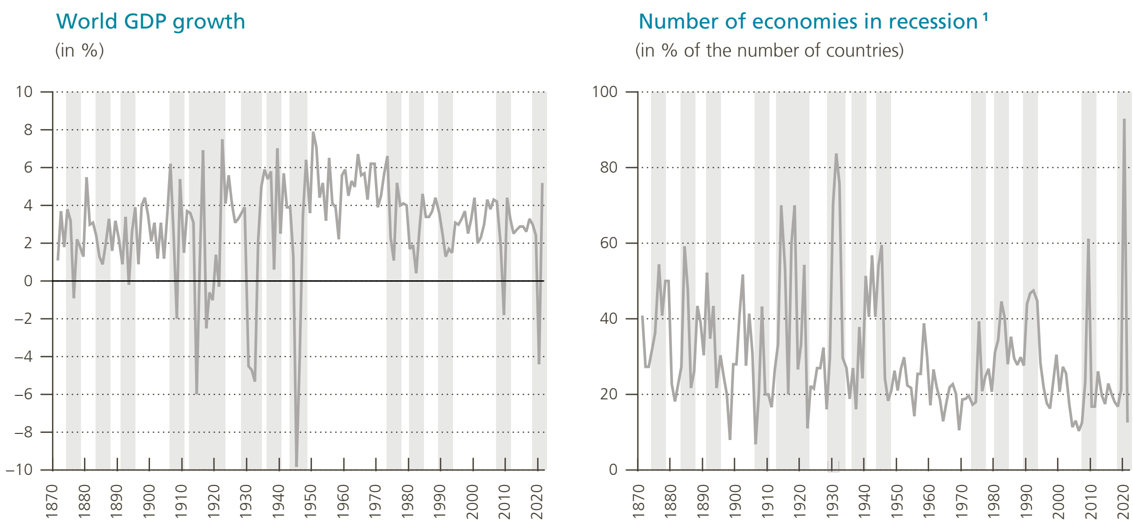
Almost throughout the world, governments adopted unprecedented public health measures at national or regional level in order to curb the spread of the virus, to prevent the available hospital capacity from becoming overwhelmed, and to limit the number of deaths. Broad swathes of economic activity and all social and cultural life were temporarily suspended. China's experience had in fact shown that a strict lockdown was an effective way of cutting the number of new cases, enabling the most stringent measures to be rapidly eased. This tough approach therefore offered the prospect of a prompt recovery. Moreover, it was necessary because the human and economic costs of a scenario with no lockdown would have been even more serious in the medium term. The number of patients and deaths would then have rapidly escalated, adversely affecting economic activity because part of the labour force would be unavailable and people would have been induced to avoid crowded places and close contact until a vaccine or herd immunity offered sufficient protection. In contrast to what happened in China, a single lockdown nevertheless proved insufficient to contain the virus in several large economies. Its resurgence led to the reintroduction of certain restrictions, bringing the fragile recovery to a premature end.

The 2020 global economic crisis unprecedented since World War II could give way to a strong recovery once the pandemic is under control

For the first time in modern history, a pandemic was consequently the sole factor behind a major global economic crisis. This is the most synchronised crisis ever seen, with all the major countries except China going into recession in 2020. This crisis is also the most severe since World War II. In 2020, the immediate contraction of global GDP year-on-year was more than twice that recorded at the time of the global financial crisis which, barely ten years ago, had already beaten all the post-war records. COVID-19 in fact represents an external shock with a direct and almost simultaneous impact on the real economy of every country. In contrast, the global financial crisis had been due largely to global macroeconomic imbalances which had accumulated over the years, and first affected the financial sector

Chart 2

The pandemic drove the world economy into a synchronised deep recession



Source: World Bank.
1 A recession is defined here as a year-on-year reduction in GDP per capita.

Table 1

GDP of the major economies

(percentage changes in volume compared to the previous year, unless otherwise stated)

	2018	2019	2020	*p.m. Contribution to world growth (in percentage points)* *2020*	*p.m. Share of world GDP[1] (in %)* *2019*
Advanced economies	2.2	1.6	−4.9	*−2.1*	*43.1*
of which:					
United States	3.0	2.2	−3.4	*−0.5*	*15.9*
Japan	0.3	0.3	−5.1	*−0.2*	*4.1*
Euro area	1.9	1.3	−7.3	*−0.9*	*12.5*
United Kingdom	1.3	1.4	−10.0	*−0.2*	*2.4*
Emerging economies	4.5	3.6	−2.4	*−1.4*	*56.9*
of which:					
China	6.7	6.0	2.3	*0.4*	*17.4*
India	6.1	4.2	−8.0	*−0.6*	*7.1*
Russia	2.5	1.3	−3.6	*−0.1*	*3.1*
Brazil	1.3	1.4	−4.5	*−0.1*	*2.4*
World	3.5	2.8	−3.5	*−3.5*	*100.0*
p.m. World trade[2]	*3.6*	*1.0*	*−9.6*		

Sources: ECB, IMF.
1 According to the IMF definitions and calculated on the basis of purchasing power parities.
2 Average of imports and exports of goods and services.

before the fall-out spread to the real economy. Nonetheless, in the case of the coronavirus crisis, there is the prospect that easing of the lockdown measures will bring immediate relief for the economy, whereas the correction of macroeconomic imbalances takes more time. The recovery once the coronavirus crisis is over should therefore be faster than the one that followed the global financial crisis and, after a few years, that would reduce the difference in terms of total cumulative impact. Nevertheless, even when considered over a longer period, the COVID-19 pandemic will cause the most serious post-war economic crisis.

In 2020, the world economy contracted by an unprecedented 3.5 %, whereas a year previously the IMF had still predicted positive growth of 3.4 %. All the major countries except China posted decidedly negative growth, although there are wide variations between countries due to a range of factors, such as epidemiological developments (notably the intensity of the pandemic), the effectiveness of the policy response, and the structural characteristics of each economy and each health system. In addition, even before the pandemic, many countries were already facing anaemic growth for reasons that included the uncertainty surrounding the tensions between the US and China, Brexit, and Western sanctions against Russia. These factors continued to apply in 2020, even though the pandemic pushed them into the background.

COVID-19 not only had a direct impact on the individual economies, but the resulting shock also spread indirectly, for instance via the financial markets, commodity prices and trade.

The financial markets reacted sharply but recovered fairly quickly

The eruption of the pandemic was accompanied by extreme uncertainty, as the progress of the virus is unpredictable and its economic impact remains unclear so long as no effective vaccine is widely available. That uncertainty combined with the prospect of sudden interruptions in economic activity and the associated unpalatable outlook also affected the financial markets.

At first, the financial markets remained calm when, in January, the emergence of the coronavirus in China was reported around the world. At that time, on the basis of past experience with SARS, MERS and the Ebola virus, the markets still assumed that the spread of the virus could be contained. But that sentiment was rapidly reversed when a first cluster of cases was discovered in Codogno (Northern Italy) at the end of February, and reports of new infection hotspots emerging in other European countries and in parts of the US followed in rapid succession. Panic spread across the financial markets worldwide, and risky investments were dumped *en masse* in a flight to safety and liquidity. Between the end of February and the end of March 2020, the stock markets of the main advanced economies dropped by 30 % or more, the biggest crash since the global financial crisis. At the beginning of March, the "dash for cash" actually caused deadlock in the other market segments essential for funding businesses (such as the corporate bond or commercial paper segment), just at the time when firms needed additional liquidity to tide them over their shutdown period.

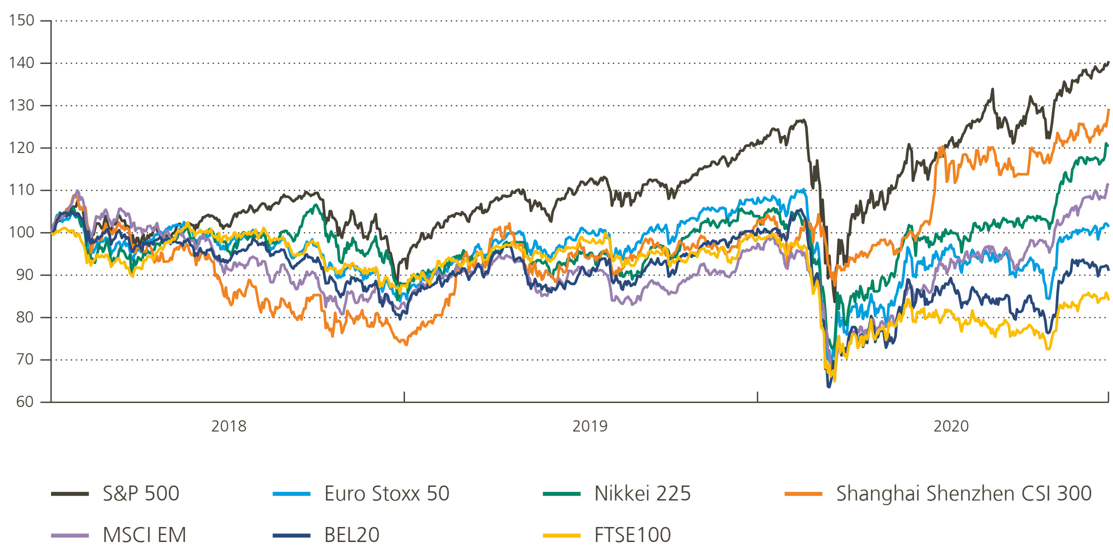
However, calm was soon restored on the financial markets once the central banks of advanced and emerging economies alike announced a range of strong measures which often went beyond the action taken during the global financial crisis. Those measures aimed not only to stabilise the markets, but also to safeguard the flow of credit for businesses, households and even governments. The stock markets therefore recovered steadily in April and May.

Since the virus had been swiftly contained in most of the advanced economies and monetary policy was expected to remain extremely accommodating for a long period, stock markets rallied from the beginning of July. In some countries such as the US and China, stock market prices even surpassed their pre-pandemic peaks. As actual developments and reports in the media were only

Chart 3

The selling wave on the main stock markets in March was short-lived

(indices 1 January 2018 = 100)



Source: Refinitiv.

moderately favourable at that time, there was talk of a disconnect between the financial markets and the real economy. However, the share price rally proved very variable from one branch of activity to another, and even between firms in the same branch. Owing to the sudden switch to online shopping and remote working, it was mainly firms in various spheres connected with ICT – such as online retailers or producers of IT hardware and components – that made substantial gains on the stock markets. This upward trend was further reinforced by very marked optimism among investors concerning certain technology firms. Conversely, stock market quotations of firms in the sectors hardest hit by COVID-19 – such as energy, tourism, the motor vehicle industry and banks – languished well below their pre-crisis value. The unevenness of the stock market revival is also due partly to differences in the composition of stock exchange indices between the main countries.

From September, the extreme severity of the new coronavirus wave hitting the US and Europe once again dampened optimism. Some of the countries and regions which had been relatively spared by the virus in the spring, such as Greece, Austria and Eastern Europe, were also severely afflicted. Nonetheless, successive announcements of the development of highly effective vaccines gave a further boost to the stock markets in November 2020.

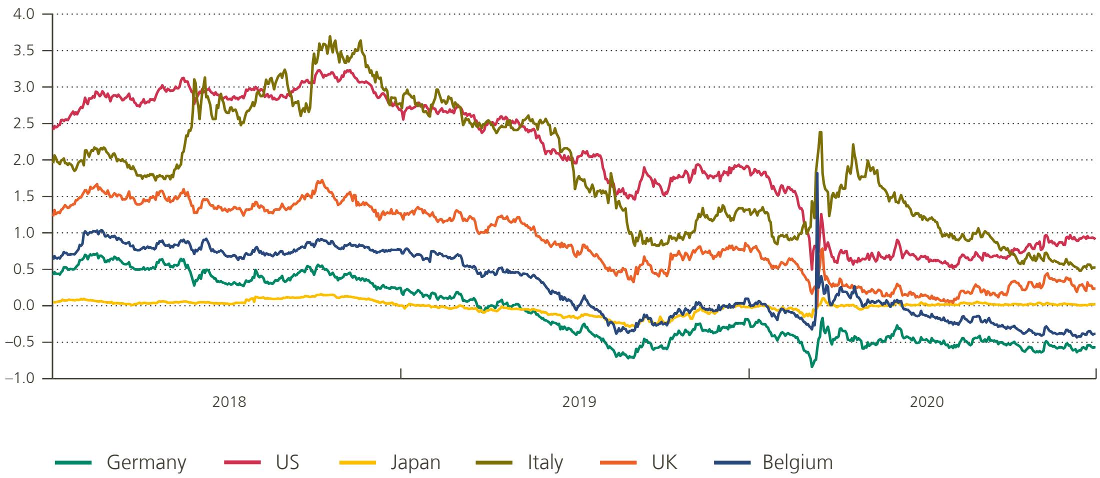
At first, the sell-off wave on the stock markets at the beginning of March was accompanied by heightened demand for safe investments such as long-term government bonds of advanced economies, and that was reflected in lower yields on those investments. Nonetheless, as the virus spread through Europe and the US and it became evident that governments would take on huge amounts of additional debt on the financial markets to support their economy, government bond yields began rising again in the US, the UK and all the euro area countries. The biggest rises concerned the economically most vulnerable countries in the euro area, namely Italy and Spain, those two countries having been worse affected by the pandemic and having gone into the crisis with a higher level of debt. However, the mass government bond purchases by all large central banks prompted a rapid reversal. Government bond yields stabilised everywhere at historically low levels, while the fragmentation pressures in the euro area also subsided.

The capital flight to safe-haven assets at the beginning of March also triggered a general appreciation of the US dollar and, to a lesser degree, the yen,

Chart 4

Government bond yields stabilised at a historically low level in the advanced economies

(daily data, in %, ten-year government bonds)



Source : Refinitiv.

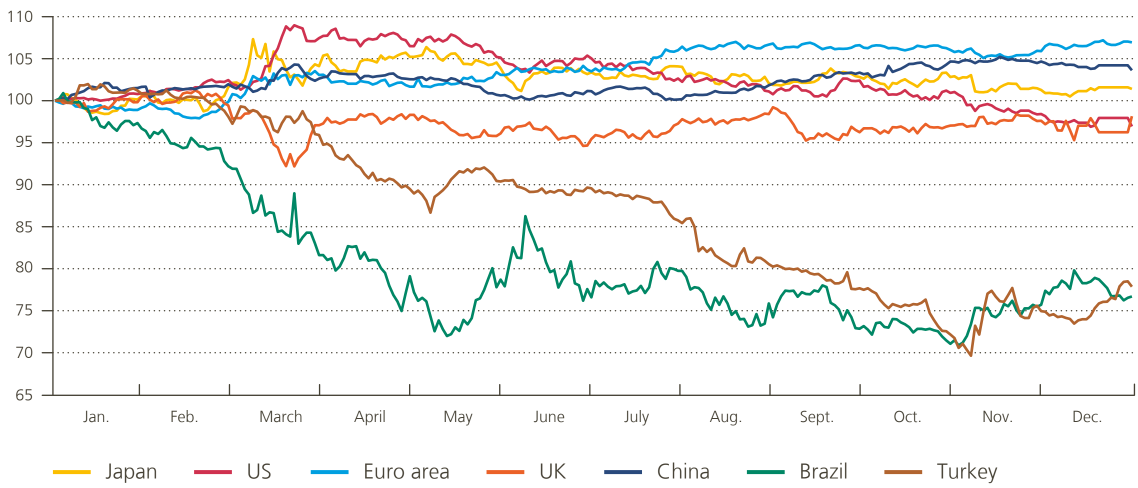
against most other currencies, while the currencies of most emerging economies plummeted. As on the other financial markets, the panic was short-lived and most exchange rates soon stabilised.

The euro started to strengthen again as from May, on the back of growing confidence in the recovery of the European economy. Investors welcomed the May announcements in Germany and France concerning the creation of an ambitious European recovery fund, and the ECB's June announcement that it would maintain an extremely accommodative monetary policy during the coronavirus crisis. The optimism was fuelled by the low number of new

Chart 5

The euro strengthened against most currencies in 2020

(nominal effective exchange rate, indices 1 January 2020 = 100)



Source : Refinitiv.

infections in most European countries, whereas the virus was raging unchecked in the US, India and Brazil and gathering momentum in Japan. The dollar depreciated against most currencies, but particularly against the euro, partly owing to the larger relative fall in yields on US government bonds. Finally, the Chinese renminbi saw a controlled appreciation in the second half of the year against most other currencies, against the backdrop of an effective economic recovery and positive interest rate differentials.

The pandemic had an uneven impact on commodity prices

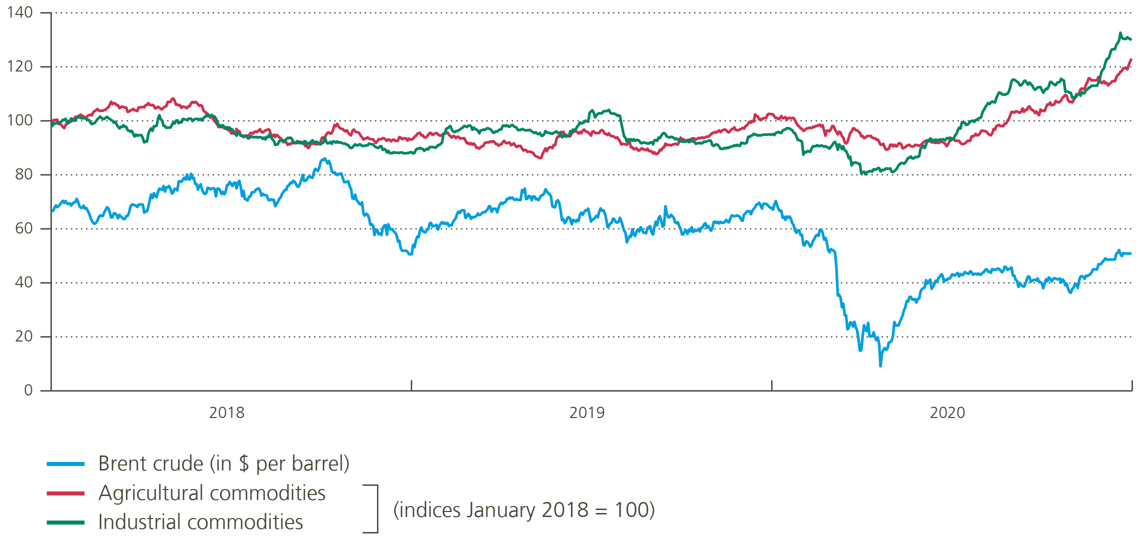
Following the lockdowns imposed first in China and then in much of Europe and the US, all commodity markets suffered a negative demand shock. However, the prices of the various commodities displayed widely differing movements during the year. Towards the end of the year, the breakthroughs in the search for a vaccine triggered a wave of optimism, which also drove up commodity prices.

In the case of oil, demand initially slumped as a result of the worldwide dramatic decline in industrial production and mobility, owing to the ban on non-essential travel. Limited storage capacity at the main transshipment sites further exacerbated the shock. Finally, on the supply side, the price war between Russia and Saudi Arabia was also a key factor in the collapse of oil prices, which dropped below $ 20 per barrel of Brent in April. In the face of this extreme pressure, these two countries and the other oil exporters agreed on drastic cuts in their oil production. That led to a partial recovery in oil prices, which then stabilised at around $ 40 per barrel, considerably below the level prevailing in previous years. Demand for oil remained slack, as air transport had hardly picked up at all and new waves of COVID-19 impeded the revival of other forms of travel and economic activity. At the end of the year, the price per barrel of Brent regained some ground to approximately $ 50, thanks to the improvement in the outlook.

The exceptionally low oil prices eroded the foreign exchange revenues of the oil-exporting countries. Moreover, for many of them, a price of around $ 40 per barrel – which prevailed for much of the year – is considered too low to maintain a balanced budget, even disregarding the additional expenditure incurred to combat the virus. In the US, these low prices meant that many shale oil producers with higher production costs were driven out of the market. Conversely, oil-importing countries benefited from the positive impact of the lower oil prices,

Chart 6

Oil prices remained persistently lower after the initial shock



Source: Refinitiv.

although the effect was moderated by the slowdown in economic activity.

The prices of most other commodities made a complete recovery. The trend in prices of industrial commodities such as iron ore and copper is closely linked to developments in China. That country is one of the few to have regained its pre-pandemic level of industrial production, partly thanks to a strong government boost in the form of new infrastructure investment. Interruptions in mining output due to restrictions in a number of countries also exerted upward pressure on metal prices. Finally, the price index of agricultural commodities nudged upwards during the second half of the year.

International trade gradually strengthened following its collapse in the spring

The impact of the COVID-19 shock was further heightened by a steep decline in world trade. Waning demand in the countries in lockdown, interruptions in global supply chains following the temporary closure of businesses and temporary transport blockages caused a substantial downturn in trade in goods in the first half of the year. In May 2020, at the peak of the first wave, trade in goods was down by 17 % year-on-year, the biggest decline ever recorded since the Dutch Central Planning Bureau (*Nederlands Centraal Planbureau* or CPB) first began collecting data in 2007. It is true that, in proportion to the contraction in economic activity, the decline in trade during this crisis was less severe than during the global financial crisis: in 2009, the highly trade-intensive industrial branches were seriously affected, whereas in the current crisis it is services involving close contact that suffered the most; except for tourism, these services are less likely to be traded internationally. In addition, as explained below, the expansion of global value chains has stagnated since the global financial crisis, reducing to some extent their relative importance in total trade.

On average, trade in goods declined more steeply in the advanced economies than in emerging countries, and the recovery was also slower there. Some emerging economies were able to take advantage of the economic recovery in China, which – by way of exception – managed to relaunch its exports rapidly. The sectoral composition of its exports was beneficial here: China is in fact a global player in certain products which were much in demand during this crisis, such as the equipment needed for remote working and home entertainment, medicines and personal protection equipment (such as face masks). The rebound in industry and the broadening of the economic recovery also revived demand for Chinese imports. Conversely, in most of the advanced countries, the relaunch of international trade was more hesitant, owing to uncertainty and the resurgence of the pandemic. In the euro area, the adverse repercussions on trade were further exacerbated by the high degree of trade integration between Member States specific to European integration, which has many advantages but also means greater vulnerability in the event of a trade shock.

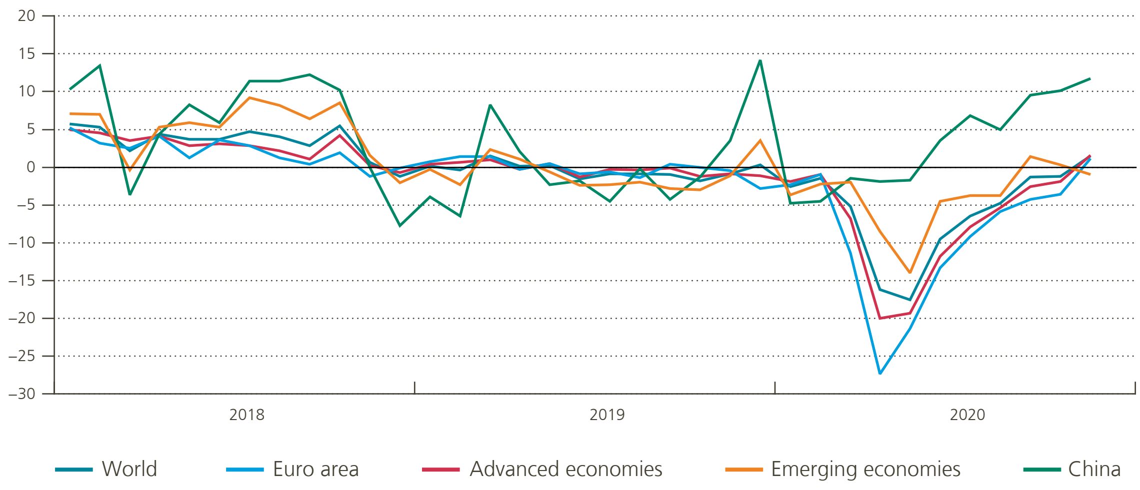
International trade was also affected by new protectionist measures dictated by national security motives. For instance, at the peak of the pandemic, temporary restrictions were imposed on exports of medical devices relevant to COVID-19. Moreover, tensions between the United States and China persisted, despite the signing of the Phase 1 trade agreement at the beginning of the year. American producers and their partners in the global semiconductor value chains faced heavy restrictions on their exports to China. And China imposed trade sanctions on Australia, in retaliation for Australia's calls for an independent international inquiry into the origin and initial management of the coronavirus crisis in China.

The expansion of the global value chains stagnated after the global financial crisis, owing to structural factors such as digitalisation, but also growing protectionism. The coronavirus crisis gave rise to the perception that these chains were insufficiently resilient in the face of the resulting disruption to transport and supplies; however, these problems were not directly due to the value chains themselves, but rather to the lockdowns in a number of countries. The export restrictions introduced by some countries at critical moments heightened concerns about excessive dependence on a small number of foreign players for essential products. This caused a growing number of countries to adopt a more aggressive industrial policy aimed at boosting domestic production in "sensitive" sectors. Combined with the geopolitical tensions, proliferating trade restrictions and a marked shift from multilateralism to bilateral

Chart 7

World trade collapsed

(monthly data, average imports and exports of goods, annual percentage change)



Source: CPB.

and regional trade agreements, this crisis could thus contribute towards global value chains becoming shorter or more regional.

Despite these protectionist tendencies, the EU abided by its principles of an open trade and investment policy. At the end of 2020, after seven years of negotiations, it concluded an investment agreement with China. This agreement further opens up the Chinese market to European investment, notably in electric cars, financial services and private hospitals. China is also addressing some of the EU's concerns by prohibiting forced technology transfers and ensuring greater transparency regarding subsidies. However, the scope of this agreement is limited in comparison with the trade agreement which the EU concluded with the UK at the same time.

The Brexit process ended with a trade agreement

The year 2020 ended with the conclusion of a new trade deal between the EU and the UK, which left the EU at the end of January 2020. Up to the end of December, trade relations with the UK were still subject to EU rules. At the end of that transition period, on 1 January 2021, the UK – with the exception of Northern Ireland – left the Customs Union and the Single Market.

On 24 December 2020, the British government and the President of the European Commission concluded a Trade and Cooperation Agreement, determining *inter alia* future trade relations between the EU and the UK. This Agreement came into force provisionally on 1 January 2021, pending its approval by the European Parliament.

In commercial terms, this is a free trade agreement. As regards trade in goods, the Agreement stipulates that there will be no customs duties or quotas on any goods except those with insufficient content produced in the EU and the UK. It also provides for very open markets, especially for public procurement, transport and energy, including nuclear power. In order to ensure fair competition, the parties undertook to maintain high levels of protection for workers, social security, the environment and climate, and common principles on state aid. The commitments regarding services are relatively limited. Nevertheless, there could be further agreements covering financial services and other aspects in the future.

In view of the close economic ties between the UK and the EU and their geographical proximity, the Agreement goes further in some respects than existing agreements between the EU and other countries, including those concluded or implemented recently, in terms of both market access and regulatory alignment. Nevertheless, non-tariff barriers – notably customs formalities, health and plant health controls, and the obligation to respect rules and standards, which may evolve in different ways in the UK and the EU – will be reintroduced, thus increasing the cost of trade between the two parties.

Although a broad agreement was concluded, Brexit means the reintroduction of trade barriers between the EU and the UK

To limit the short-term economic damage, provision was made for a five-and-a-half-year transition period for fisheries. Furthermore, the EU countries most affected, including Belgium, will also benefit more from the € 5 billion Brexit Adjustment Reserve managed by the EC, the bulk of which will be made available to the Member States in 2021.

The pandemic caused a severe global contraction, followed by a fragile, uneven and incomplete recovery

The sectoral impact of the COVID-19 crisis differs greatly from experience during the global financial crisis. At that time, producers of investment goods and consumer durables were hit hardest, while services held up well, except in the financial sector. In contrast, in 2020, the restrictions necessary to flatten the epidemiological curve had on average a more severe impact on services than on industry. In many countries, industry was the first to benefit from the easing of the restrictions and was spared in subsequent lockdowns. In contrast, some services were unable to reopen in the absence of a vaccine, while the easing of restrictions still left others subject to strict rules, such as the obligation to maintain an adequate physical distance.

This was all clearly reflected in the trend in business confidence. During the first wave of COVID-19, confidence collapsed worldwide, particularly in the services sector. After recovering more or less everywhere as summer approached, in the case of the services sector, it levelled out (e.g. in the US and China) or even weakened (in the euro area and the UK). At the end of the year, business confidence thus displayed an obvious dichotomy in the economy: while industry continued to pick up, activity slowed again in the services sector, particularly in the euro area and the UK.

This crisis also differed from the global financial crisis in the speed with which economic activity succumbed, sparing neither private consumption nor business investment. During the period when non-essential shops and service businesses were closed, consumption took an immediate nosedive. Despite catching up to some extent when businesses reopened, consumption did not regain its pre-crisis level owing to the continuing restrictions and spontaneous changes in behaviour to avoid infection. In addition, the great uncertainty surrounding future income and the labour market outlook also led to higher precautionary savings. The restrictions likewise disrupted business investment projects. In general, investment recovered more slowly than consumption, as businesses chose to bide their time, owing to the high level of uncertainty over the erratic progress of the pandemic and potentially permanent changes in consumption behaviour once the crisis is over. For some businesses, investment projects were also held back by loss of turnover and mounting debts. However, a slow recovery is not unusual after a violent shock: that pattern was evident at the time of the global financial crisis, too. Conversely, government consumption played a somewhat countercyclical role thanks to the purchase of equipment and the stability of public sector employment.

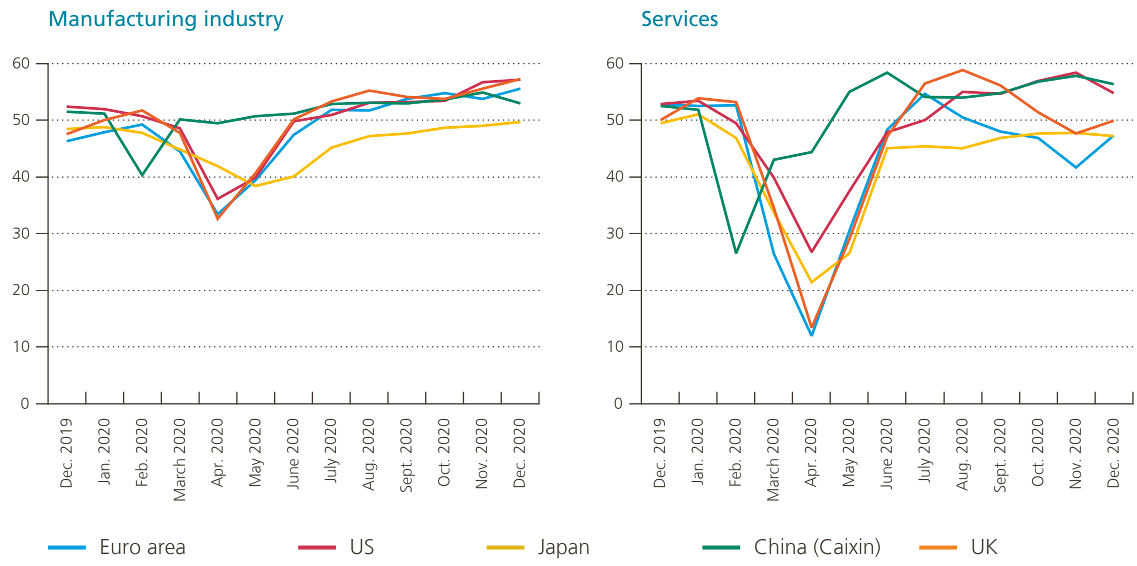
The outcome was an unprecedented decline in GDP in the second quarter. That is due mainly to the collapse of private consumption during the lockdown, whereas in a "normal" recession consumption is less cyclical than investment. A strong rebound occurred in the third quarter, but the recovery remained incomplete.

The vagaries of the coronavirus had a major influence on GDP growth in each country. For instance, the movements in Chinese GDP preceded those in the other large economies by three months, as China was the first country to be affected by COVID-19. Being spared by the second wave, China managed

Chart 8

The services sector was hardest hit by the pandemic

(PMI indices [1])



Source: Refinitiv.

1 The PMI indices range between 0 and 100. A value of more than 50 indicates a rise in production, while a value of less than 50 indicates a fall.

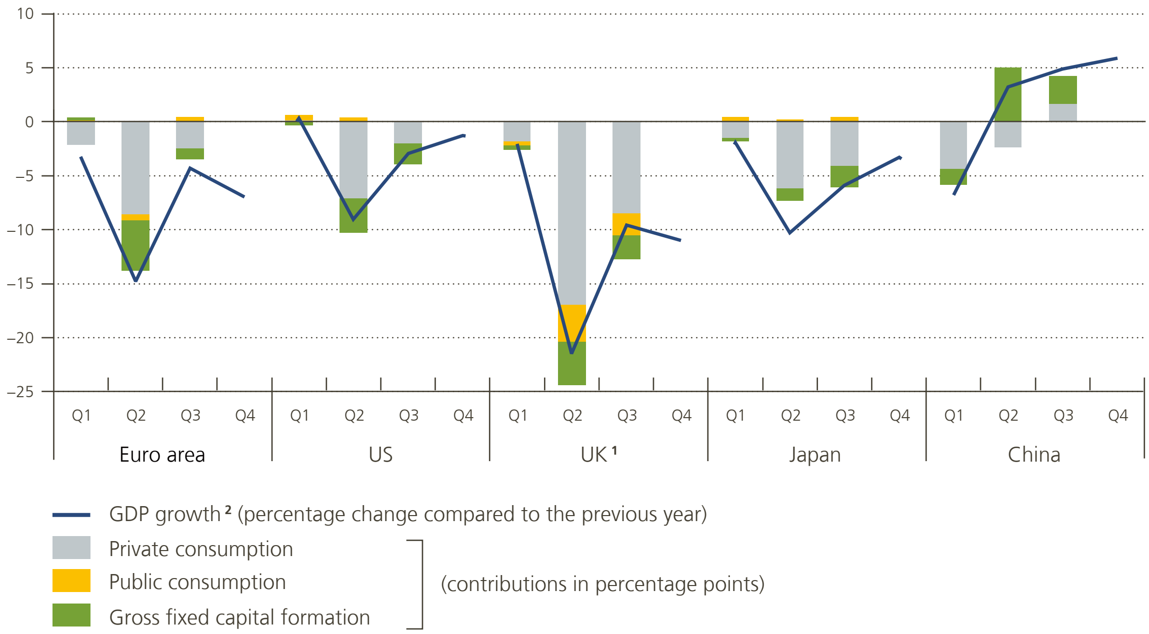
to consolidate its recovery in the second half of the year. In contrast, the virus spread like wildfire in the US, the UK and the euro area in the autumn, so that the relaxation measures which had encouraged the recovery in those countries came to an abrupt halt. However, the new restrictions imposed in the fourth quarter were less damaging to the economy than the spring lockdown. Businesses and workers were now better prepared for organising remote working, while schools and nurseries have generally remained (partially) open, making it easier for parents to combine work and family life. Finally, the experience of the first wave had demonstrated that manufacturing industry, construction and the retail trade could continue to operate without serious risk of spreading infection, provided they adhered strictly to the health safety measures.

The uneven recovery in the main economies is also due partly to governments' fiscal response, in terms of both scale and composition. In the US, policies focused on support for household incomes, to the extent that net household incomes there actually rose, in contrast to what happened in other countries. These measures cushioned the decline in consumption in America. The Chinese government once again opted for public investment, in cooperation with state enterprises, an approach which had already proved its worth in previous crises. In China, the rebound was therefore driven more by investment than by consumption.

While the Chinese economy still posted 2.3 % growth in 2020, the other emerging economies were severely affected by the crisis: on average, excluding China, the emerging economies recorded a contraction of 3.2 %. The spread of the coronavirus and the associated restrictions had major, direct repercussions on economic activity in those countries, further exacerbated by external shocks triggered indirectly by the pandemic via global trade, tourism, commodity prices and international financial markets (including foreign exchange markets). During the global financial crisis, those countries remained the driving force behind the global economy, recording 2.8 % growth in 2009, as at that time, they were not at the epicentre of the shock and only suffered its fallout indirectly.

Chart 9

The quarterly profile of GDP was extreme in all the main economies



Sources: Consensus Economics, national sources.

1 In the UK, the national accounts are drawn up from the production angle. Teachers' pay during the school closure periods was therefore not included in public consumption.

2 Estimated GDP for the fourth quarter of 2020 is based on the Consensus Forecast of 4 January 2021.

BOX 1

The emerging countries lost their status as the driving force of the global economy in 2020

At first, the emerging economies felt the indirect effects of the coronavirus crisis, in the wake of developments in China and the advanced countries. They suffered several external shocks which, though often similar to those at the time of the global financial crisis, were generally larger. Fears concerning the repercussions of COVID-19, notably for the growth models of those countries – often based on trade, commodity exports and/or global value chains – prompted international investors to back off. In March 2020 alone, those countries experienced a portfolio capital flight of more than $ 80 billion, far exceeding the amount withdrawn during the global financial crisis. From June onwards, foreign institutional and private investors returned, but the recovery was limited and patchy. The large initial capital outflow was accompanied by a marked deterioration in financial conditions: the currencies of the countries concerned depreciated sharply, stock market prices recorded the biggest falls ever seen, and interest rates on their bonds and other financial instruments went up.

The pandemic, which also had a direct impact on many emerging countries during the second quarter, inflicted a new blow on their already struggling economies. This was further exacerbated by the specific characteristics of their economic structure, growing vulnerabilities in their budgetary and external positions since the global financial crisis, and their limited room for manoeuvre.

In the emerging countries, the informal economy generally represents a relatively large share of activity, which aggravates the effects of COVID-19 in various ways. For instance, informal workers often live and work in densely populated places where the coronavirus can spread more easily. Also, informal businesses often operate in the services sector which was harder hit by the lockdowns and other restrictions. For informal workers, remote working is often impossible, so that they suffer even more from the restrictions imposed. As well as that, they are generally ineligible for government assistance and could only count on meagre savings to cushion the temporary loss of income due to the lockdowns.

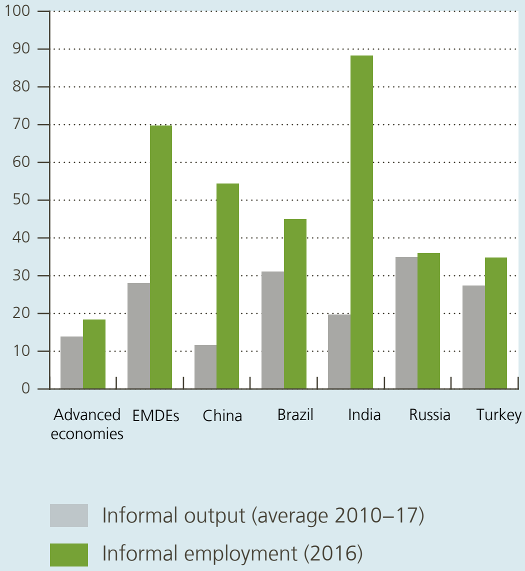
In recent years, the total debt level of most emerging economies has risen. In almost all countries, government, corporate and household debt expressed as a percentage of GDP has increased, albeit at varying speeds and from different starting positions. There is every indication that the COVID-19 crisis will cause a substantial rise in government debt, owing to a sharp slowdown in economic growth, a further marked deterioration in fiscal balances, and the potential implementation of State guarantees. Higher debt levels could jeopardise the future debt sustainability of some countries. That applies in particular to those exhibiting other vulnerabilities, such as a large fraction of debt denominated in foreign currencies and with a short maturity, or those whose debt is held largely by non-resident investors.

In 2020, the pandemic pushed more than half the low-income countries into a precarious situation, making them dependent on the IMF and new multilateral initiatives. A first initiative was adopted by the G20 in April, when it was agreed that 73 of the poorest countries were eligible for a temporary suspension of capital repayments and interest due on official bilateral loans granted by G20 countries. In November, members of the G20 also reached an agreement on a common framework for substantial debt relief. Conversely, they have not yet agreed on an increase in the special drawing rights allocated by the IMF which could provide additional liquidity as they did at the time of the global financial crisis.

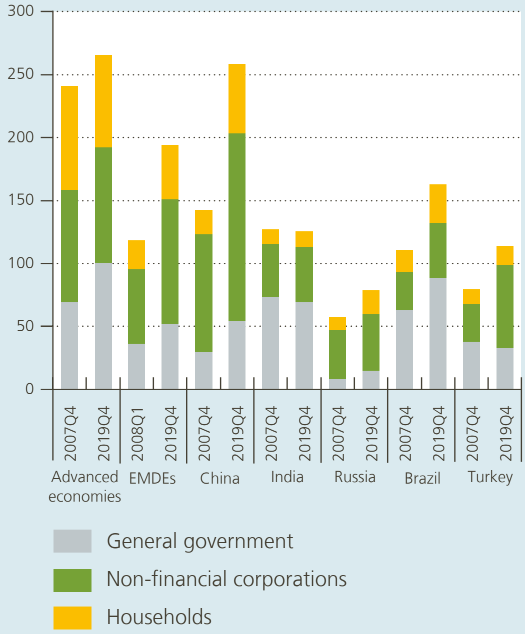
▶

The emerging countries have a large informal economy and a rising debt burden

Prevalence of the informal economy [1]
(% of GDP/total employment)



Total debt by economic sector
(% of GDP)



Sources: BIS, ILO, Medina and Schneider (2019). *Shedding light on the shadow economy: A global database and the interaction with the official one*, CESifo, Working Paper, 7981, December, ILO.

1 The informal sector encompasses all economic activities which, for fiscal, regulatory or institutional reasons, are concealed from the official authorities. Informal employment includes employers and workers operating for their own account in the informal sector, unpaid family members and workers with no formal contract

The pandemic caused a major shock in the euro area, but with varying consequences for individual Member States

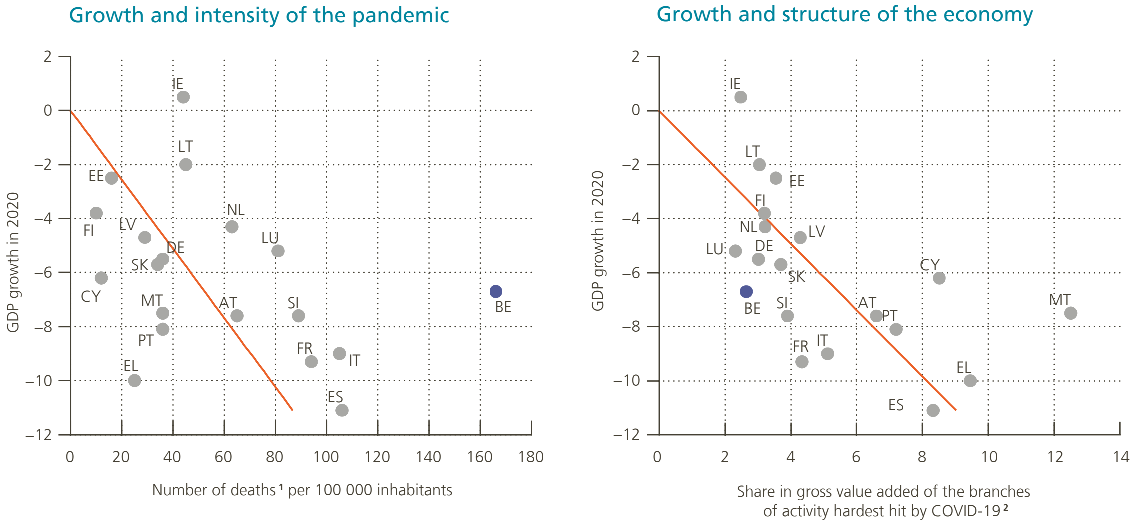
According to the ECB's autumn estimates, the euro area's GDP contracted by 7.3 % in 2020. There were wide disparities between Member States. One group of economies (Finland, the Baltic countries, the Netherlands) managed to limit the decline to less than 5 %, while Ireland actually recorded slightly positive growth, but economic activity in the southern countries (Spain, Italy, France and Greece) was down by 9 % or even more.

One first, obvious explanation for these divergences lies in the coronavirus itself, which did not hit all Member States equally hard. The seriousness of the pandemic in the various countries was quite clearly affected by a range of structural factors, such as the proportion of elderly people in the population, population density and household composition. However, it was possible to mitigate it. Thus, governments acted with varying speed to introduce containment measures, and the population modified its behaviour to avoid infection. Although the national authorities of all the Member States adopted such restrictions, the ones in the worst affected countries had to impose stricter measures and maintain them for a longer period. Although these measures were necessary to keep control over the public health impact of the pandemic, they also had a direct economic cost. The countries worst afflicted by the pandemic – evidenced, for example, by the higher number of COVID-19-related deaths per 100 000 inhabitants – therefore posted a sharper fall in their GDP in 2020.

A second factor lies in the economic structure of the countries. As already stated, the effects of the pandemic on the various branches of activity were decidedly uneven. The difference is first apparent between the manufacturing industry and the services sector, but there were also wide variations within the latter sector itself. The containment measures such as travel restrictions and the social distancing obligation particularly affected tourism and services involving close contact. A number of national studies following the first lockdown showed that the loss of turnover in those sectors had amounted to between 60 and 80 %, or even more in some countries. When most European countries eased

Chart 10

Several factors contributed to wide variations in growth between the euro area Member States



Sources: ECB, ECDC, Eurostat.

1 The number of COVID-19 deaths is not entirely comparable between countries.

2 The branches of activity hardest hit by the COVID-19 crisis are "accommodation and food service activities" (NACE code I), "arts, entertainment and recreation" (NACE code R), "air transport" (NACE code H51) and "travel agency, tour operator and other reservation service and related activities" (NACE code N79).

the lockdown, that brought some relief, although a return to normal was out of the question since the virus was still circulating and no vaccine was yet available. Furthermore, in countries where the hardest-hit branches of activity represent a larger share of economic activity, the impact of COVID-19 on GDP is automatically greater. In view of the importance of tourism, this factor was particularly relevant for the southern countries, such as Greece and Spain. The same applies to other popular holiday destinations, such as Italy and France, albeit to a lesser degree as those countries have a more diversified economic base.

Similarly, the share of SMEs and micro-enterprises in the economy and in employment may be part of the reason for the disparity between euro area Member States. In comparison with larger businesses, smaller operators were usually only able to bridge a shorter period before facing a working capital deficit. Also, SMEs are generally less well-informed of the relevant support measures, and they are less capable of adjusting to the new working protocols which had to be introduced. In addition, they are more likely to operate in the hardest hit branches of activity.

Finally, among all the other factors which may have played a role, there is also the available budgetary margin and the quality of the public institutions, which affect an economy's dynamism in the event of an external shock.

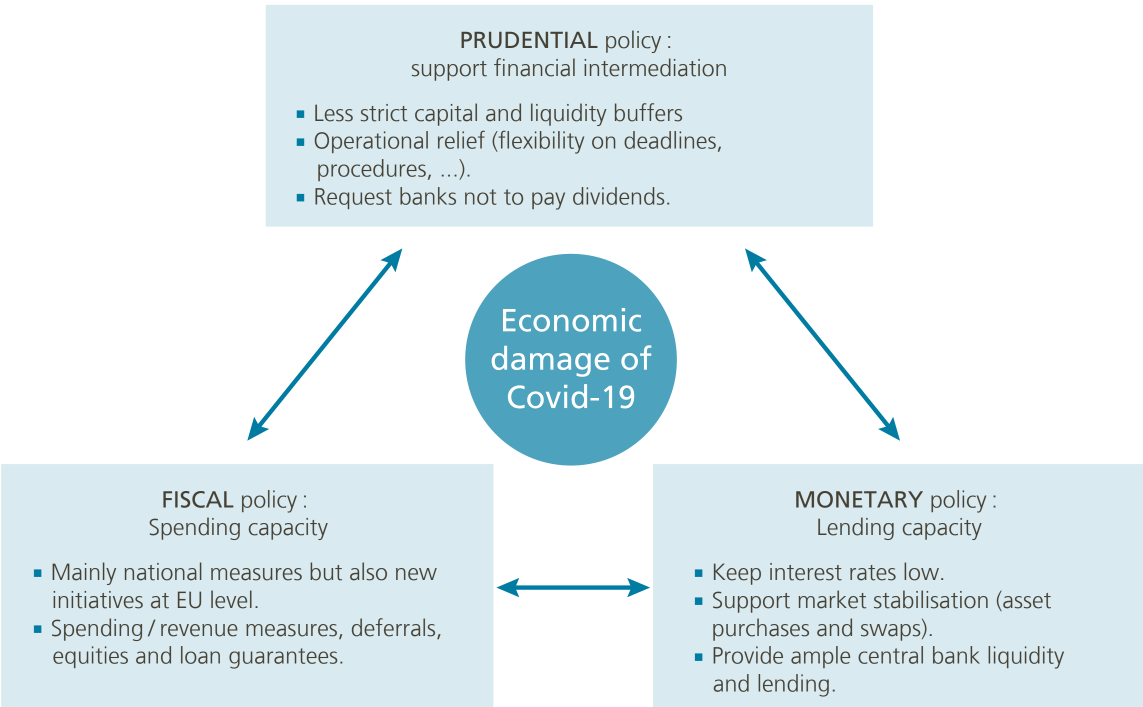
1.2 Resolute and decisive economic policy measures

In response to the crisis, governments, central banks and prudential authorities across the world took measures which were unprecedented in both their scale and their speed of implementation. In so doing, they prevented the recession from turning into a deep and lasting depression accompanied by a financial crash.

These actions were primarily dictated by the unique character of the COVID-19 crisis. As the health emergency forced governments to shut down whole sections of the economy, the top priorities were to preserve the economic fabric during the lockdown and protect the persons most directly affected by the shutdown of activities so as to ensure the general conditions for a lasting recovery once the pandemic has been eradicated. Urgent economic and social measures were therefore needed to stabilise the financial markets and safeguard the funding of the economy on favourable terms, to maintain employment and household incomes as far as possible, while providing

Chart 11

The measures taken by the fiscal, monetary and prudential authorities reinforce one another



Source: Boeckx J., M. Deroose and E. Vincent (2020), "The ECB's monetary policy response to COVID-19", NBB, *Economic Review*, September.

sufficient liquidity for businesses. As the crisis persisted, it was necessary to prevent permanent scarring of the economic potential, caused by the failure of viable businesses or by a rise in structural unemployment. The main economies deployed similar instruments operating on the monetary, prudential and fiscal front.

Central banks were the first to respond to the COVID-19 shock. They used their entire array of instruments in order to stabilise the financial markets, restore their smooth operation and avoid any excessively sudden tightening of financial conditions. In practice, they lowered their key interest rates wherever the available margins still allowed rate cuts and they set up programmes for the purchase of financial assets or reinforced existing programmes, in particular by expanding purchases of private sector or government securities. In their communication about their prospective monetary policy, so-called forward guidance, central banks reiterated their determination to keep interest rates low until their respective inflation targets had been achieved. Central banks also made sure that the monetary stimulus actually benefited the private sector, either via direct business lending programmes, as in the US, or by attaching specific conditions to their liquidity provision to banks. To address the shortage of international reserve currencies (mainly the US dollar and the euro), central banks reactivated or concluded swap agreements with one another. The central banks of some emerging countries also had to purchase securities denominated in local currency on their domestic markets, in addition to intervening on the foreign exchange markets in response to the mass exodus of capital.

The various governments took resolute measures to support households and firms

The availability of bank credit was likewise supported by the easing of the prudential requirements with regard to banks' equity capital and liquidity. The prudential authorities thus gave the banking sector additional room for manoeuvre to support the real economy in their capacity as financial intermediaries. They allowed the banks to use the capital and liquidity buffers built up since the global financial crisis. They also made their procedures and deadlines more flexible : for instance, the European Banking Authority (EBA) postponed its stress tests by one year. Finally, the prudential authorities required – or at least recommended – financial institutions to refrain from paying dividends to their shareholders or from equity buybacks, in order to consolidate their balance sheet position.

Through the operation of the automatic stabilisers supplemented by massive discretionary impulses, governments limited or even prevented the decline in household disposable income. The measures also aimed to alleviate pressure on the cash position of firms by limiting their financial outlays or making up for part of their lost profits. Temporary lay-off schemes, varying in design from one country to another, played an essential role here by shouldering a large share of the employers' labour costs for businesses that had to close, while largely safeguarding the workers' jobs and incomes. As well as transferring financial resources, governments also supported firms' liquidity by allowing them to delay their tax payments and by setting up various loan guarantee schemes (sometimes accompanied by private and/or public moratoria on existing loans). This safeguarded firms' access to bank credit. To attenuate the corporate solvency risk, in the case of businesses which had been viable before the crisis and strategic enterprises the authorities also sought to strengthen the firms' own funds, in particular by means of capital injections and subordinated loans. In Europe, the prompt, decisive action by national governments was supplemented by major initiatives taken by the European institutions to address the public health and economic problems resulting from the crisis and to lay the foundations for the recovery.

The measures adopted in the various economic policy spheres interact with one another. For instance, the State guarantees for loans and the easing of prudential rules reinforce the effect of the central banks' liquidity measures designed to support credit for the private sector. In addition, by exerting downward pressure on interest rates, sovereign bond purchases help to increase governments' fiscal space at a time when they urgently needed to implement support policies which were adding to the public debt. These various measures are described in more detail in subsequent chapters.