Chapter 1
The macroeconomic environment

International environment

Fatality rates (COVID-19 deaths per 100 000 inhabitants)
- COVID-19 is a genuinely global shock to the world’s economy.
- The first wave hit Europe towards the end of the first quarter of 2020 and the second wave in the beginning of the fourth quarter. Others cannot be excluded…
- Imposing lockdowns has, so far, been the policy option to curbing the increase in contamination rates and avoiding bottlenecks in the health system.

Stringency of government measures across the European Union
- Shops, schools and national borders were closed. Gatherings were severely restricted.
- A large part of the decline in consumption and investment was a consequence of the strict government measures imposed to contain the spread of the virus.

A precipitous fall in gross domestic product and a contained increase in unemployment

World exports over world GDP (%)
- Lockdown policies took a toll on economic activity in 2020, with global trade and world gross domestic product (GDP) collapsing.
- Prior to the crisis, globalisation was at a standstill.
- Looking forward, the pandemic may accelerate longer-term shifts toward shorter and less fragmented value chains.

Real GDP (% change vs. a year earlier)
- EU real GDP fell precipitously in the second quarter of 2020, with consumption and investment accounting for respectively 60% and 30%.
- The pandemic hit some European economies harder than others.
- Employment fell, but the decline was contained. Hours worked, however, collapsed.

Unemployment rate (% active population)
- Despite the fall in GDP, the increase in unemployment remains contained but with substantial differences across the European Union.
- Government programs that subsidised reduced working time were the primary reason.
- Employment fell, but the decline was contained. Hours worked, however, collapsed.

Financial markets and banks were supported by the ECB, and initial tensions evaporated - but risks remain

EU stock prices (100=Dec.19)
- The initial contraction could have easily turned into a financial collapse.
- But the European Central Bank (ECB) swiftly dispelled initial fears about the integrity of the euro area and markets rebounded.
- And areas of uncertainty remain.

ECB lending to euro area banks (bn euros)
- For the first time, the ECB acted on both sides - monetary policy and financial prudential policy.
- On the monetary policy side, the ECB deployed several measures to support banks’ liquidity.
- The ECB also strengthened its asset purchase programme.

Net portfolio inflows and euro exchange rate (% GDP and index, 100=1999Q1)
- Long- and short-term rates were already low prior to the crisis. They are most likely to remain low for longer.
- Markets may underestimate the credit risk.
- But, with increasing capital inflows and an appreciating exchange rate, Europe is perceived as resilient.

Policy implications:
- The policy measures put in place have contained the economic damage across the European Union. Removing them too soon might prove devastating as a second wave of infections hit most EU members in the fourth quarter.
- When the pandemic subsides, support should be recalibrated to reduce possible long-term side-effects, but the overriding concern should be to preserve the ecosystem as it was before the pandemic.
- In addition to income support and offsetting negative effects on demand, the policy package could also be instrumental in shaping the future of Europe. The crisis provides an opportunity to address the major challenges facing the European economy, such as climate change and digitalisation.