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Euro area economy now recovering quickly, but after-effects of COVID-19 crisis still visible

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The global economy is recovering from the COVID-19 pandemic with the support of vaccines and economic policy. Inflation, or the increase in the general level of prices for goods and services, has accelerated globally as the economy has recovered. The increase in the pace of inflation will, however, begin to flatten out next year. The economy has recovered more rapidly in the United States than in the euro area. Forecasts suggest the euro area economy will reach its pre-crisis level towards the end of the current year. Central banks and governments in different countries have supported the economy in a variety of ways during the crisis. These stimulus measures have accelerated the economic recovery, but many countries have become heavily indebted during the pandemic. Reducing the debt burden is actually the next long-term economic challenge.

The decline in the euro area and global economies due to the COVID-19 pandemic has been very steep, but the recovery has also been swift. The general recovery has been supported by the rapid recovery of the US and Chinese economies. In addition, central banks and the governments of many countries have softened the impact of the virus through stimulus measures, such as tax relief and direct support for businesses. As one example, service sectors have experienced considerable difficulties during the COVID crisis, as people have stayed home either in fear of the virus or in response to the restrictions introduced. However, a major wave of bankruptcies has been avoided, particularly as a consequence of government support measures.

For the current year, the global economy is forecast to show growth of around 6%. Year-on-year growth for the euro area and the United States is forecast to be 5% and around 6%, respectively. The US economy has already, in the first half of the year, reached its pre-crisis level, and the euro area is forecast to do the same by the end of the year.

The rapid reaction to the COVID crisis by central banks and governments can be considered a success. When the crisis broke, many feared that its impact on the economy would be long-term, but the vigorous economic policy measures would appear to have reduced the expected damage. The recovery from the crisis is, however, still incomplete, and appropriately targeted and timed measures on a suitable scale can further reduce the long-term negative effects of the pandemic. In particular, measures that boost recovery in labour productivity, employment and investment are supporting growth.

The stimulus measures do, however, have their down side. They have led to large increases in government debt levels, leaving a long-term mark on general government finances. Public debt in the euro area is expected to rise to around 99% relative to GDP in this current year. Before the COVID crisis, in 2019 the debt ratio was 84%. When the economic situation improves, we must gradually wind down the previously implemented stimulus measures. It will only be possible to reduce the level of indebtedness once the crisis has passed.

Measures not aimed directly at the economy per se can also influence the economy. For example, vaccination coverage will have a major impact on the economic recovery in different countries. As ever more people get vaccinated against COVID-19, decision-makers and authorities can target their restrictions more precisely in order to reduce the spread of the disease. This will mean a reduction in the number of infections and more freedom for consumers to purchase goods and services, and in this way contribute to the economic stimulus. In the developing world, vaccine coverage is lower, and infections are still running high. This will cast a shadow over the international economic outlook for a long time to come.

COVID crisis affected prices

The COVID-19 crisis also had an effect on prices, and e.g. in the euro area consumer prices actually declined between August and December 2020. Thus there was a significant slowdown in inflation; but this year, as the economy has gradually reopened, prices, too, have recovered, and inflation has picked up in many countries, particularly the United States. The European Central Bank forecasts that prices in the euro area will rise this year by around 2.2%. The forecast for next year is that the rise will flatten out at 1.7%.

The acceleration in year-on-year inflation is partly explained by the fact that the comparison period, i.e. 2020, was so exceptional. As annual inflation is measured by comparing current prices against those of the previous year, last year's low level makes for rapid inflation this year. The rise in inflation is influenced by, for example, the collapse in the price of oil in 2020 and its recovery this year. On account of the pandemic, many places are currently experiencing a shortage of e.g. electronics components, and the transportation of goods has been hampered by a shortage of containers. At the end of the day, such factors affect the prices of everyday consumer goods in Finland and around the world.

New monetary policy strategy supports achievement of inflation target – 2% annual inflation

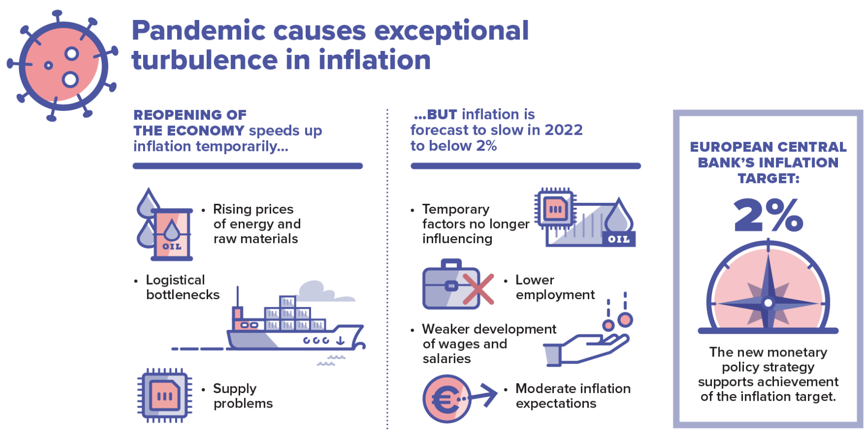
The aim of monetary policy is to ensure inflation remains stable and predictable. Price stability is in fact the primary objective of the Eurosystem, i.e. the European Central Bank and the national central banks of the euro area.

The European Central Bank adopted a new monetary policy strategy this past summer. According to the new strategy, price stability is best maintained by aiming for 2% inflation over the medium term. Both negative and positive deviations from this target are considered to be equally undesirable.

The level of prices will be kept stable by applying the appropriate monetary policy instruments. Different sorts of instruments can be used in combination and separately.

The main policy interest rate influences market rates and hence the activities of businesses and households. Recent years have seen significant changes in the economy, and other instruments have been introduced alongside the policy rate. At present, the economic recovery is being accelerated by granting banks favourably priced loans and purchasing securities on the markets.

Chart 1.



Source: Bank of Finland

Tags

recovery, COVID-19, COVID-19 pandemic, euro area, COVID-19 virus, global economy