

SOME DETERMINANTS OF THE GROWTH DIFFERENTIAL BETWEEN THE EURO AREA AND THE UNITED STATES SINCE THE ONSET OF THE PANDEMIC

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In 2020, euro area GDP shrank by 6.7%, almost double the decline observed in the United States (3.5%). This relatively poorer behaviour of economic activity in the euro area reflected not only the deeper economic impact of the first wave of the COVID-19 pandemic, but also the fall-off in activity in the euro area in the final stretch of last year (and in early 2021) with the successive waves of the virus. This downturn was not observed in the United States (see Chart 1).

Moreover, most analysts' forecasts also predict a swifter exit from the crisis in the United States than in the euro area, a typical feature of the recoveries from previous recessionary episodes (see Chart 2). Thus, according to the European Commission's spring forecasts,¹ while the United States would exceed its pre-crisis GDP level by mid-2021, this would not occur in the euro area until early 2022.

Chart 1
GDP
Actual and European Commission's spring forecasts

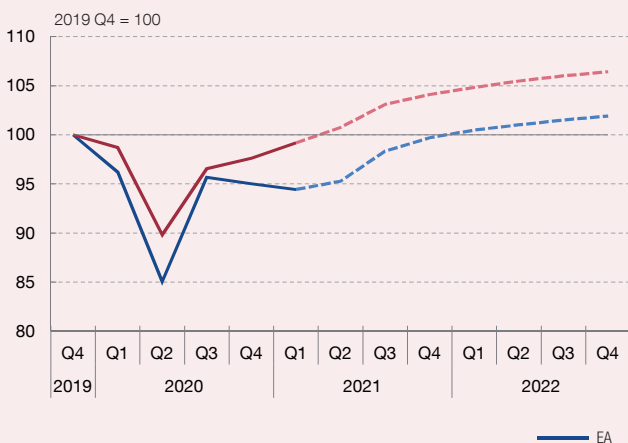


Chart 2
PAST ECONOMIC RECOVERIES
Historical average 1970-2019 (a)

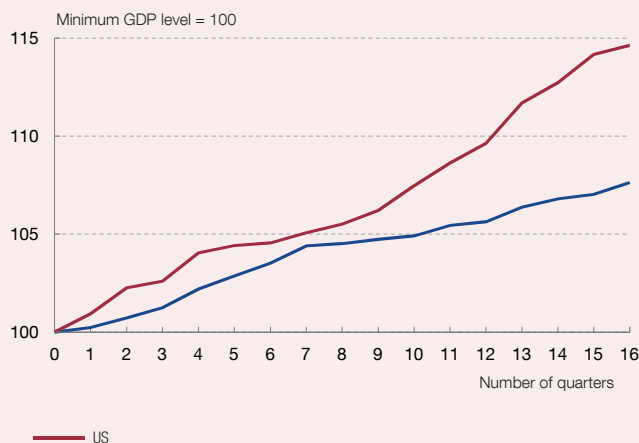


Chart 3
INCIDENCE OF THE PANDEMIC

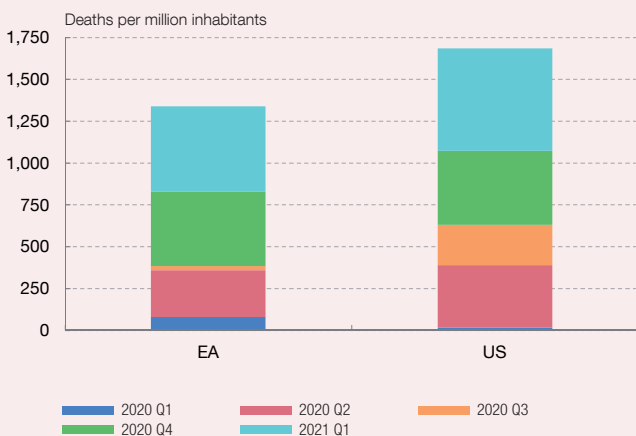


Chart 4
CHANGE IN MOBILITY
Relative to pre-crisis reference period (b)



SOURCES: European Commission, Fred, Google Mobility Report, John Hopkins University and Banco de España.

a Includes four recessions: 1975 Q1, 1980 Q3, 1993 Q1 (1991 Q1 for the United States) and 2009 Q2.
b Quarterly average of daily data on an average index of mobility at grocery and pharmacy stores, retail and recreation centres, workplaces and transit stations. Data to 24 May.

1 See European Commission (2021), *Spring 2021 Economic Forecast: Rolling up sleeves*.

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This box sets out some of the factors that might account for this economic disparity since the onset of the pandemic, paying particular attention to specific aspects of the health crisis.

Firstly, it is worth stressing that, since the start of the pandemic, the restrictions applied to contain the expansion of the virus have been less stringent in the United States than in the euro area. Although this has prompted more unfavourable epidemiological developments in the US economy (see Chart 3),² one consequence has been a lesser reduction in mobility in the United States. Thus, for instance, in 2020 as a whole, the decline in mobility in the United States was 16%, compared with 20% in the euro area (see Chart 4).³ As Chart 5 shows, these differences in the behaviour of mobility – essentially associated with the differing severity of the lockdown measures in each region – help account for around 1 pp of the greater economic impact of the health crisis in the euro area.⁴ Mobility, therefore, is a significant but insufficient factor to fully explain the differential economic impact of the crisis in 2020 in both regions. Moreover, the different share in each region of the services sectors most affected in this crisis does not appear to be a key factor for explaining these differences. This is because these services generally display a relatively similar weight in these economies.⁵ Consequently, the conceptual framework used in this analysis would suggest the presence of other differential factors between the United States and the euro area that are not reflected in the variables considered.

In this respect, one factor not included in the aforementioned analysis and which might, at least partly, account for the bigger average decline in GDP in 2020 in

the euro area, is this region's greater trade openness and, in conjunction, the bigger relative share in its productive structure of manufacturing (16% of GVA compared with 11% in the United States). In 2020 H1, the decline in manufacturing activity totalled 20% in the euro area, set against 13% in the United States (see Chart 6). Such activity was affected not only by the stricter lockdowns across Europe, but also by the severely distorted international trade flows during the first stage of the pandemic.⁶ However, while the subsequent pick-up in manufacturing has been significant, its sharp initial contraction is estimated to have contributed notably to explaining the decline in activity in 2020 as a whole.

In addition, some of the more favourable economic developments in the US may be the result of the impetus from economic policies. For instance, while the central banks' monetary policy response in the euro area and in the United States was admittedly swift and forceful (ensuring favourable financing conditions and, in the case of the euro area, preventing financial fragmentation), in the United States the lowering of the policy interest rates from 1.50-1.75% at the onset of the health crisis to 0-0.25% seems to have provided a further stimulus.

Comparing the fiscal policy response is a complex task⁷ because of, among other reasons, the particular features of the measures approved, the distinct role of the automatic stabilisers in each region and the fact that a significant portion of the euro area's support has been channelled through public guarantees, which do not have an immediate direct impact on the budget deficit. In any event, the usual measurements for quantifying fiscal impulse – depicted in Chart 7, drawing on data from the IMF's April 2021 *Fiscal Monitor* – indicate that to date it

2 See Box 1.1, "Global epidemiological developments", Chapter 1, *Annual Report 2020*, Banco de España.

3 To date in 2021, the fact that the US vaccination campaign has moved ahead appreciably more rapidly than in the euro area has prompted these differences to widen even further.

4 Regression for 27 EU countries and the United Kingdom. The impact of the crisis on 2020 GDP is accounted for by mobility variables, the share of the sectors most affected by the crisis and working from home (specifically, the number of employees who began to work from home as a consequence of the pandemic, according to the Eurofound Survey (2020), *Living, working and COVID-19 dataset*, Dublin). All variables expressed in differences with respect to the United States. The approach by A. L. Gómez and A. del Río (2021) in "La crisis sanitaria y el impacto inicial desigual sobre las economías del área del euro", *Documento Ocasional*, Banco de España, forthcoming, is followed. For similar evidence, see IMF (2021), *Differences in Output Performance between Europe and the United States during COVID-19*, Online Annex, Regional Economic Outlook Update Europe.

5 The services sectors comprising accommodation services and restaurants, artistic and recreational activities, and other services account for around 6% of GVA in the United States and the euro area. At a greater level of aggregation, retail, transport and hospitality, and artistic, recreational and other services have a share of 22% of GVA in the euro area, only marginally higher than the figure for the United States (21%).

6 See Box 2.2, "Global trade flows against the background of the pandemic", Chapter 2, *Annual Report 2020*, Banco de España.

7 See Box 2, "Fiscal policy response to the crisis in the euro area and the United States", "Quarterly report on the Spanish economy", *Economic Bulletin*, 4/2020, Banco de España.

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appears to have been somewhat larger in the United States. Looking ahead, both areas are considering a

further significant fiscal impulse,⁸ with investment, particularly that related to combating climate change,

Chart 5
ECONOMIC IMPACT DIFFERENTIAL VIS-À-VIS THE US IN 2020
Contributions (a)

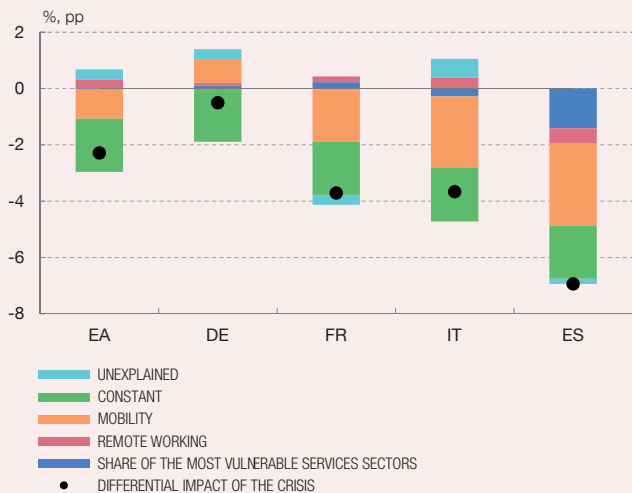


Chart 6
ACTIVITY IN THE MANUFACTURING SECTOR

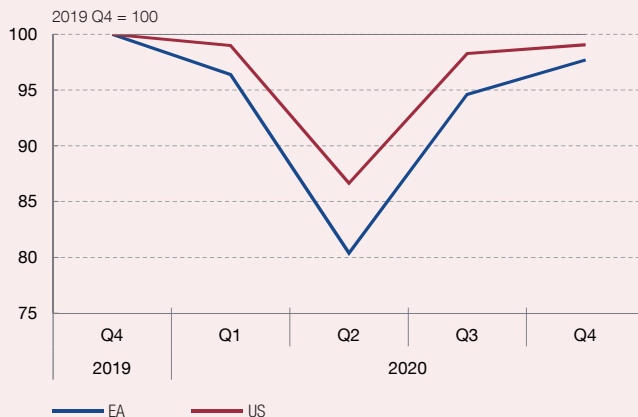


Chart 7
FISCAL IMPULSE
IMF forecasts (April) (b)

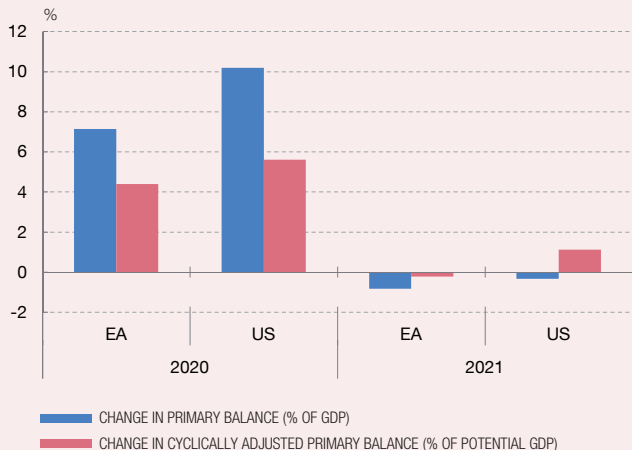
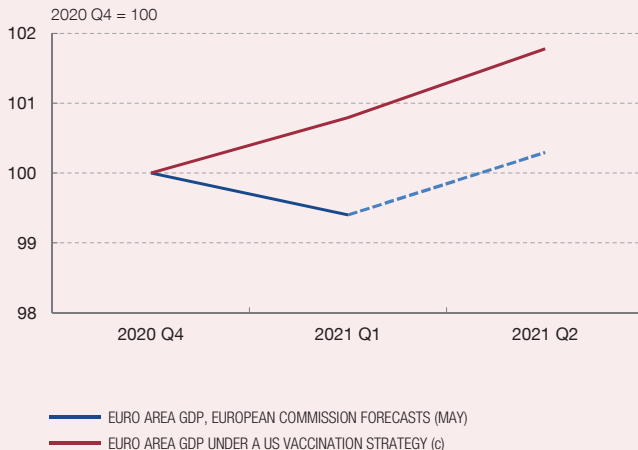


Chart 8
EURO AREA GDP UNDER A VACCINATION STRATEGY SIMILAR TO THAT OF THE US



SOURCES: Bureau of Economic Analysis, Eurostat, IMF and Banco de España.

- a Cross-sectional regression weighted by the size of GDP for the 27 European Union Member States and the United Kingdom. The economic impact is measured as the difference between the change in GDP observed in 2020 and the change forecast before the health crisis, taking into account the European Commission's January 2020 forecasts for all the countries except for the United States, which are drawn from the IMF's January forecasts. All the variables are expressed as differences vis-à-vis the United States.
- b "Euro area" includes the NGEU programme and "United States" includes the plans approved in December 2020 (Consolidated Appropriations Act, 2021) and March 2021 (American Rescue Plan).
- c Rungcharoenkitkul (2021) methodology applied to the six biggest euro area economies. Data to 11 May.

⁸ See Box 3, "Analysis of US fiscal policy plans", "Quarterly report on the Spanish economy", *Economic Bulletin*, 1/2021, Banco de España.

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taking centre stage. In the United States these measures will materialise in the as yet unapproved American Jobs Plan and American Family Plan, the latter more focused on transfers to households, whereas in the euro area the stimulus will take the form of the Next Generation EU (NGEU) programme. The NGEU funds will complement those deployed in the Member States' national plans.⁹

Lastly, the fact that, in recent months, vaccination of the population has progressed more swiftly in the United States than in the euro area would also help explain why the US economy has been performing better. In this regard, by using the quantitative framework for analysing interactions between epidemiological developments, mobility restrictions and economic performance proposed by Rungcharoenkitkul (2021),¹⁰ it is possible to assess the impact that a vaccination strategy similar to that of the United States would have had on GDP in the euro area. Specifically, Chart 8 considers a counterfactual (hypothetical) scenario in which the vaccinated population in the euro area would have reached 29% of the total population at the end of Q1 – rather than the 12% observed – and in which the EU target of vaccinating 70% of the adult population would be achieved at the beginning

of July (instead of before the end of the summer, as envisaged in the EU's current strategy).¹¹ The economic effects of this alternative vaccination scenario would mostly arise in 2021 Q1 and the beginning of Q2, when the drop in mortality stemming from a faster vaccination strategy would have enabled the lockdown measures to have been eased earlier. Indeed, these more favourable epidemiological developments would have prevented the slowdown in economic activity observed in the euro area in 2021 Q1 and enabled somewhat greater growth in Q2. In terms of the year as a whole, this would result in euro area GDP in 2021 being on average 0.7 pp higher.

In short, the economic crisis induced by the COVID-19 pandemic has been less acute in the United States than in the euro area, and the US economy is also expected to recover more quickly. The evidence presented in this box suggests that these differences may be partly explained by the role of public policies, in terms of containing the pandemic and at the economic level, and by other structural factors related to the euro area's greater sensitivity to developments in world trade (which was hit hard in 2020 H1) and to the greater flexibility that the US economy has historically shown.

9 See Box 2.3, "NGEU: an initiative bolstering the EU project", Chapter 2, *Annual Report 2020*, Banco de España.

10 See P. Rungcharoenkitkul (2021), "Macroeconomic consequences of pandexit", Working Papers, No 932, Bank for International Settlements.

11 See Communication from the Commission of 19 January 2021, "A united front to beat COVID-19".