The impact of the COVID-19 shock on euro area potential output a sectoral approach

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Date:2022-09-09

Keyword:NA

Url:[click here](https://www.ecb.europa.eu/pub/research/working-papers/html/papers-2022.include.en.html)

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From:ECB-working\_paper

AbstractThe COVID-19 crisis has affected economic sectors very heterogeneously, with possible risks for permanent losses in some sectors. This paper presents a sectoral-level, bottom-up method to estimate euro area potential output in order to assess the impact of the crisis on it. The estimates are based on a supply-demand shock decomposition and are meant to quantitatively support the estimation of scarring effects stemming from the pandemic. The results show that sectors of “trade, transport and accommodation”, “other services” and “industry” may suffer a loss in trend output of around 1.4-1.6% by 2025. Aggregate potential output in 2025 might be about 0.8% lower than it would have been without the crisis, and importantly, without support from the Next Generation EU (NGEU), signalling somewhat larger losses than embedded in the Autumn 2021 forecast of the European Commission (which takes the NGEU into account).JEL CodeC32 : Mathematical and Quantitative Methods→Multiple or Simultaneous Equation Models, Multiple Variables→Time-Series Models, Dynamic Quantile Regressions, Dynamic Treatment Effect Models, Diffusion ProcessesD24 : Microeconomics→Production and Organizations→Production, Cost, Capital, Capital, Total Factor, and Multifactor Productivity, CapacityE32 : Macroeconomics and Monetary Economics→Prices, Business Fluctuations, and Cycles→Business Fluctuations, CyclesE37 : Macroeconomics and Monetary Economics→Prices, Business Fluctuations, and Cycles→Forecasting and Simulation: Models and Applications