Visegrad: Wider economic recovery now underway, but downside risks will dominate in 2H 2020

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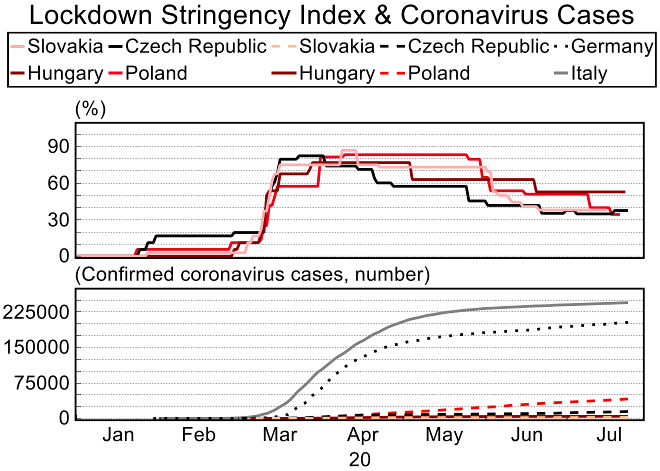
Deep recessions in all Visegrad countries (Poland, Czech Republic, Hungary and Slovakia) are likely this year[1]. Over recent months the impact of the coronavirus pandemic has put a brake on all components of real GDP, and sentiment has suffered as the virus has continued to spread around the world. The IMF forecasts real GDP drops of 6.5% YoY in Czech Republic, 6.2% in Slovakia, 4.6% in Poland, and 3.1% in Hungary in 2020, with risks expected to remain firmly to the downside given the ongoing threat of a second wave of coronavirus.

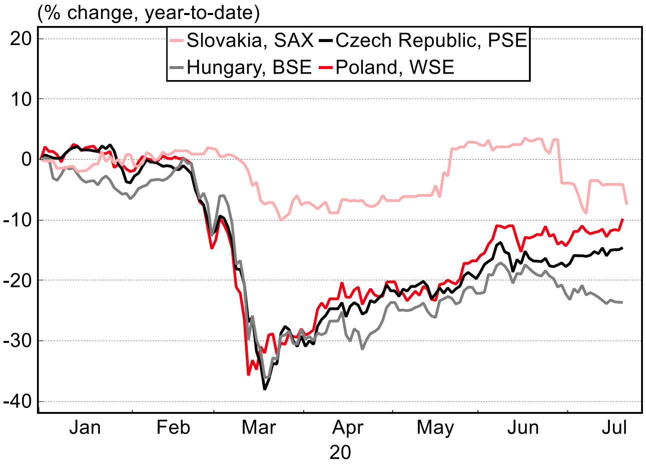
That said, most economic indicators have started to bottom out as mobility data show citizens are responding to the easing of lockdown measures and financial markets have partially recovered. The expected economic recovery, its timeline, components, and associated risks, will now be centre of attention for the private sector (including financial markets) and the wider public alike. We expect that the tentative signs of green shoots witnessed so far will turn into a real GDP rebound from 3Q 2020, but downside risks will continue to dominate.

Lockdown Stringency Index & Coronavirus Cases



Source: University of Oxford, WHO, Macrobond, MUFG Bank Economic Research Office

Equity Indices



Source: Macrobond, MUFG Bank Economic Research Office

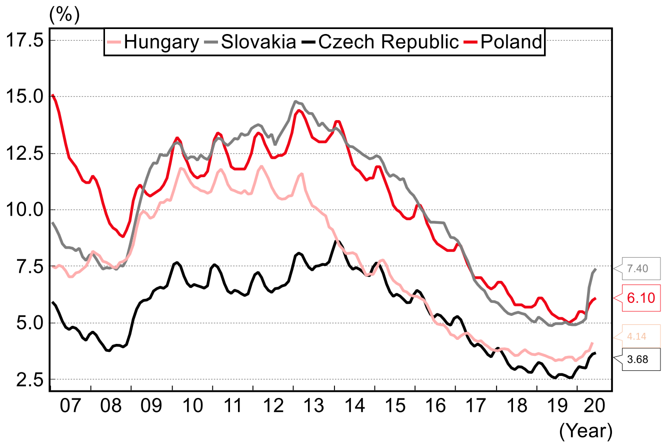
[1] "Recession now expected in larger CEE countries and Russia in 2020" (published on 13th May 2020): https://www.bk.mufg.jp/report/econew/MUFG-Economic-Brief-20200513.pdf

Significant Hit to Private Consumption

Private consumption has been the main driver of real GDP growth over the last five years but has borne the brunt of the hit from coronavirus in 2Q 2020. There will naturally be a rebound as lockdown measures are eased further, but we expect that household spending will remain weak throughout much of this year in the Visegrad due to the impacts of coronavirus on labour markets and consumer confidence.

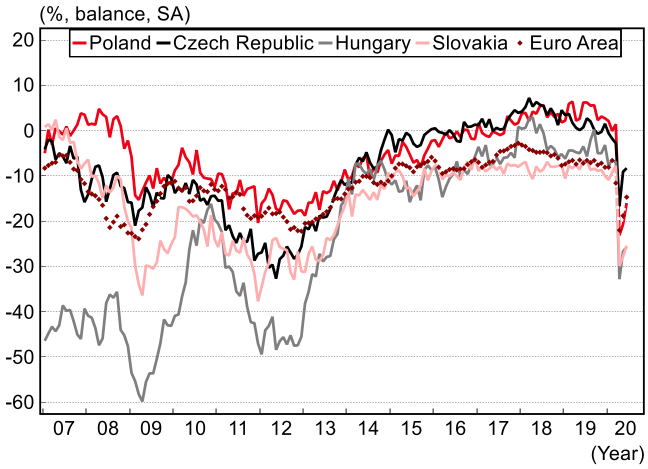
So far, unemployment has risen most sharply in Slovakia, by 2 percentage points, to 7.2% in May from March this year. However, IMF forecasts suggest that unemployment rates will rise in all Visegrad economies this year (to 9.9% in Poland, 8.0% in Slovakia, 7.5% in Czech Republic and 5.4% in Hungary). It will certainly be tricky for governments to taper income support measures without a knock-on effect for employment, especially in sectors such as tourism and hospitality which are likely to face a persistent reduction in demand. Meanwhile, nominal wage growth has already slowed, and the trajectory is likely to worsen. In April, average gross wage growth in Hungary decelerated to 7.8% YoY, the lowest on record since end-2016. With this in mind, household confidence seems unlikely to fully recover in 2020 and there is a clear risk that higher precautionary saving will drag on overall consumer spending.

Official Unemployment Rates



Source: National Sources, Macrobond, MUFG Bank Economic Research Office

Consumer Confidence



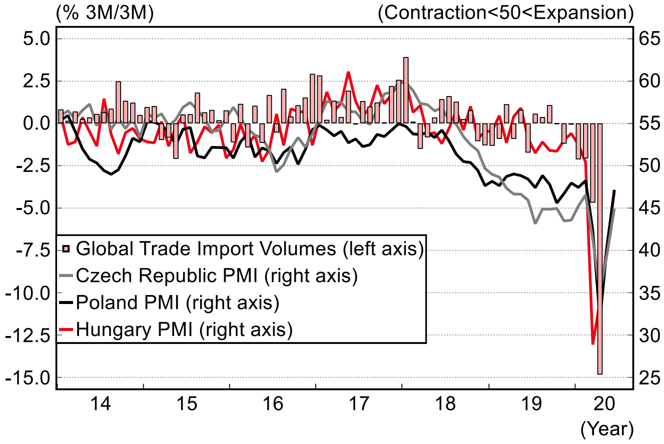
Source: DG ECFIN, Macrobond, MUFG Bank Economic Research Office

Major Hit to Manufacturing Sector

The outlook for the manufacturing sector is also expected to remain challenging over the rest of 2020. Industrial production and exports fell sharply in recent months, and manufacturing PMIs still remain under 50 in June (suggesting month–on-month contraction). The weaker global economy and reduced demand for exports are likely to remain key headwinds for industrial output in the region.

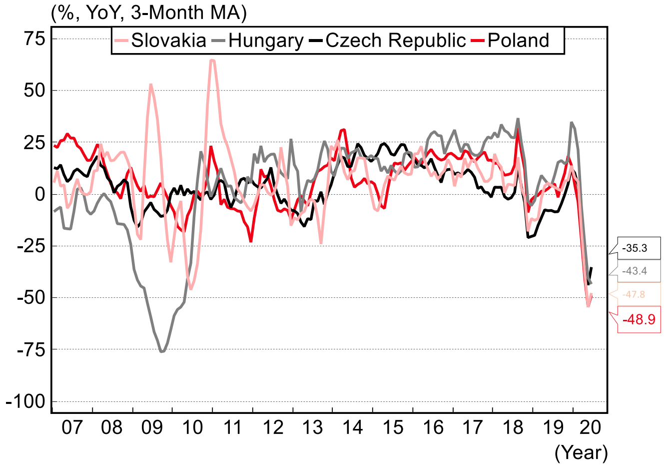
One of the main concerns within wider manufacturing will be the automobile sector, given its strategic importance in the Visegrad. As a share of GDP, the sector represents close to 13% in Slovakia and 9% in both the Czech Republic and Hungary (although just 2.5% of GDP in Poland). It is also a major source of employment, and contributor to labour productivity and exports. The sector is expected to remain vulnerable given the sharp drop in sales over 2Q as a result of weaker private consumption and external demand. The steepest decline in automobile sales came in Poland, where transactions plummeted 67.1% YoY in April. There may only be a limited recovery through the rest of the year; the Czech Automotive Industry Association expects that car production will fall by 20% in 2020.

Manufacturing PMIs Still in Contraction Territory



Source: IHS Markit, HALPIM, CPB, Macrobond, MUFG Bank Economic Research Office

New Passenger Car Registrations, Calendar Adjusted



Source: ECB, Macrobond, MUFG Bank Economic Research Office

The automobile sector is also unlikely to benefit in the near term from the recent announcement of the EUR750 billion EU recovery fund. Once signed off by national parliaments, the EU recovery fund will only become effective from 2021. Moreover, while some scrappage schemes have been extended by a further year to May 2021 in some EU countries such as Germany, this extension will also be of limited value because these scrappage schemes, on a state level, have tended to focus more on electric vehicles (EVs), few of which the Visegrad tends to produce.

Given the weak outlook, a major concern in 2020 will be the knock-on impacts that weakness in the automotive sector could have for growth in gross value added, employment, and exports. In addition, the risk of additional supply disruptions cannot be ruled out during the rest of 2020 given the possibility of a second wave of coronavirus infections.

Coronavirus Impacts: Over the worst?

After the huge hit to economic activity in 2Q, many indicators are now rebounding as lockdown measures have been eased. Higher public mobility data also point towards a gradual recovery. Visegrad governments were very quick to introduce lockdown restrictions and have been able to relax them as the number of coronavirus cases has fallen accordingly. The relatively limited length and severity of containment measures in the Visegrad may help activity to return to normal more quickly than in other countries.

As a result, while real GDP is expected to remain below its pre-virus level for some time[2], output is likely to pick up again in QoQ terms from 3Q 2020. Retail sales[3] and consumer confidence indicators have already shown an uptick which is likely helped by income support

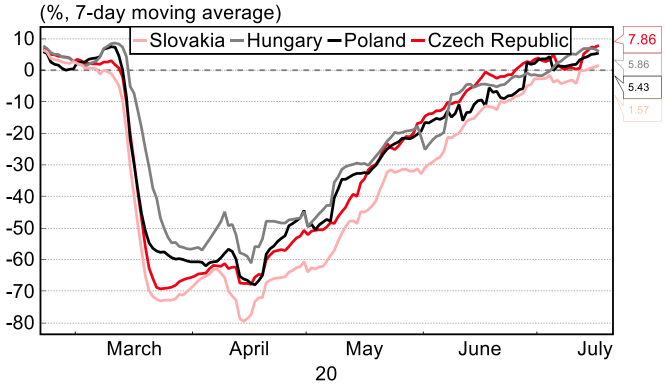
[2] Although uncertainty is still very high, the latest consensus estimates suggest that real GDP may recover to pre-virus levels by next year in Poland. For Hungary, Czech Republic and Slovakia, it may be late 2021 to mid-2022 before there is a full recovery

[3] We note that retail sales may also rebound faster than other areas of the economy due to consumers perhaps substituting one category of consumption for another (i.e. more food and beverage purchases, and less fuel consumption).

schemes (we noted the various government fiscal measures in a previous report[4]). Meanwhile, household balance sheets should be relatively healthy after years of continual wage and real GDP growth which may help many consumers to weather the storm.

Retail & Recreation, Length of Stay, Compared to Baseline

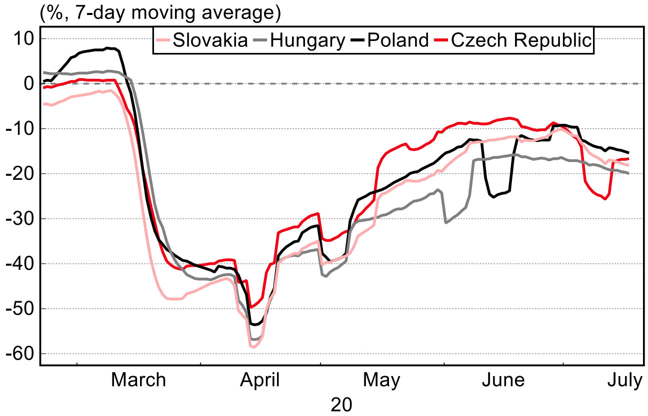
(%, 7-day moving average)



Source: Google LLC "Google COVID-19 Community Mobility Reports". https://www.google.com/covid19/mobility/ Accessed: 14th July, Macrobond, MUFG Bank Economic Research Office

Workplaces, Length of Stay, Compared to Baseline

(%, 7-day moving average)



Source: Google LLC "Google COVID-19 Community Mobility Reports". https://www.google.com/covid19/mobility/ Accessed: 14th July, Macrobond, MUFG Bank Economic Research Office

Recovery Should Prove Quicker than in the Euro Area

In turn, the recovery of private consumption from 3Q (supported by improved retail sales) should drive a real GDP rebound in the four Visegrad countries. Improved confidence may also have beneficial spill over effects for other components of real GDP too. Investment has performed dreadfully over recent months, and could now benefit from improved confidence.

In comparison to the wider Euro area, the return to pre-coronavirus levels of real GDP should prove quicker[5]. On the whole, Visegrad countries have had more limited lockdowns, while authorities have been swift to roll-out fiscal support and monetary policy measures. In addition, the EU recovery fund should further cement this in the longer term, given the fact that the group will be among some of the largest beneficiaries (due to lower real GDP per capita). As of 2021, Visegrad countries could be set to receive from 4.0% to 8.0% of 2018 GDP each. A fairly substantial amount (although still subject to final approval from national parliaments).

All said, while Visegrad countries may be relatively better placed to recover from the Covid-19 shock, it will still be a long road back to normality. Real GDP will remain below 2019 levels through the rest of 2020, at least, in all four countries. Unemployment is set to rise as governments reduce support measures, and private consumption will remain weaker versus previous years. There are also challenges ahead for the manufacturing industry given the weaker global environment. The automobile sector will remain a particular area of concern in Slovakia, Czech Republic and Hungary.

[4] "Recession now expected in larger CEE countries and Russia in 2020" (published on 13th May 2020): https://www.bk.mufg.jp/report/econew/MUFG-Economic-Brief-20200513.pdf

[5] We currently expect a deeper contraction in the euro area (-8% YoY) in 2020 before a limited rebound of 5% in 2021 – and some years before output fully recovers to pre-virus levels.