MUFG Bank Economic Brief

Visegrad: Weaker economic recovery now likely as COVID-19 resurges while fiscal data deteriorates

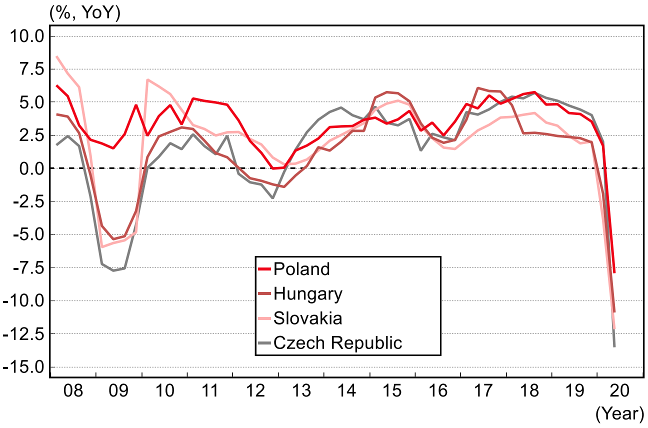
CHRIS J FINDLAY
ECONOMIC RESEARCH OFFICE | LONDON
T: +44-(0)20-7577-1712
E: christopher.findlay@uk.mufg.jp

MUFG Bank, Ltd.
A member of MUFG, a global financial group

29 OCTOBER 2020

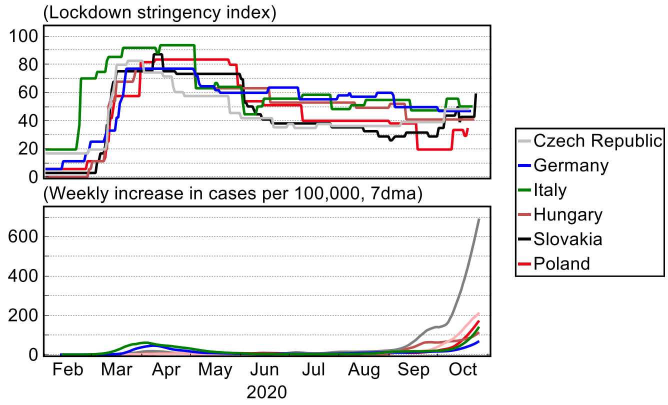
A second wave of coronavirus cases and the extent to which further lockdown measures are implemented will dominate the economic outlook of the Visegrad (Poland, the Czech Republic, Hungary and Slovakia or 'V4'). The clear link between lockdown measures and real GDP was shown by the sharp fall in output in 2Q, and its likely rebound in 3Q. The resurgence of infection rates and weakening economic momentum mean the risk of a further decline of real GDP in 4Q are now materially higher, but it varies across the region. The Czech Republic and Slovakia have re-declared a state of emergency while Poland has also re-introduced restrictions. Meanwhile, scope for further major fiscal policy or monetary policy responses is also more limited this time around. Given this, risks will clearly remain to the downside for the foreseeable future, even as the private sector and public have increasingly adapted to the new environment of lockdown restrictions and greater uncertainty.

Quarterly Real GDP Growth



Source: Eurostat, MUFG Bank Economic Research Office

Lockdown Stringency Index & COVID-19 Cases

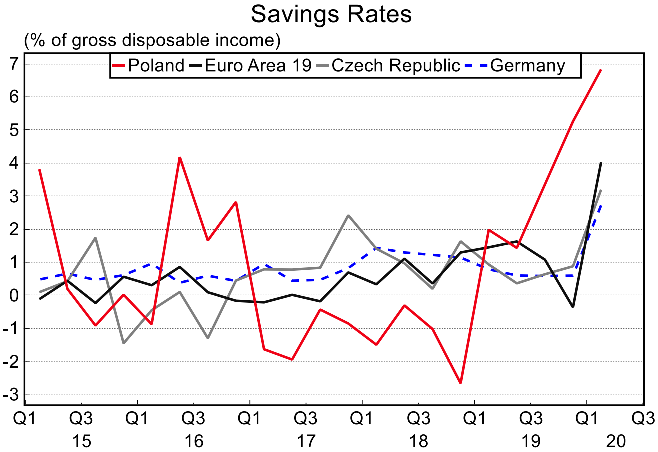


Source: University of Oxford, WHO, Macrobond, MUFG Bank Economic Research Office

COVID-19 Downside Risks to Dominate Outlook

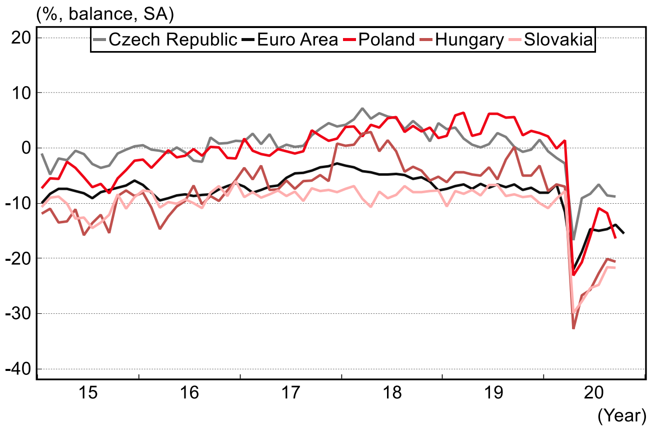
All components of real GDP growth in the Visegrad countries were affected by coronavirus and the imposition of lockdown restrictions in 1H 2020. The usual driver of real GDP, private consumption, took the brunt of the hit from coronavirus in particular, while investment was also affected. Net exports prevented a sharper drop of real GDP in Poland, yet this ultimately came from the decline of private consumption and in turn imports. By sector, services and in particular hospitality and recreation suffered particularly severe drops in output as lockdown measures led to a complete shutdown of activities. There has been a subsequent rebound in some indicators such as retail sales, PMIs and industrial production output in 3Q 2020 as a result of the easing of restrictions. However, as coronavirus cases have increased in recent weeks, wider economic momentum seems set to weaken again.

Savings Rates



Source: ECB, Macrobond, MUFG Bank Economic Research Office

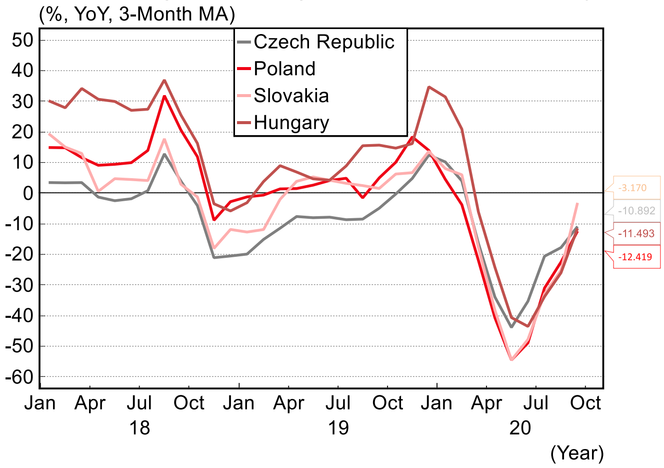
Consumer Confidence



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

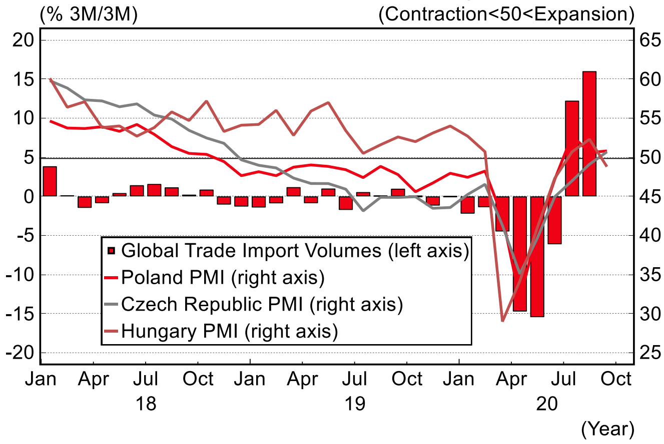
The extent of this weakness and the broader economic outlook for all four countries will clearly depend on the spread of coronavirus cases through 4Q 2020 and whether stringent lockdown restrictions are imposed in response. The Czech Republic, with the sharpest increase in infections, has already re-imposed limitations on social gatherings, and as a result is likely to see a real GDP dip in 4Q 2020. On the other hand, infection rates have not surged to the same degree in Poland, Hungary or Slovakia so we still expect positive real GDP growth in 4Q 2020. However, the ongoing prevalence of the virus will still hamper the economic recovery through its effect on consumer confidence. Households, already cautious as unemployment has risen, are likely to become increasingly wary. Any increase in precautionary saving would drag on consumer spending.

New Passenger Car Registrations, Calendar Adjusted



Source: ECB, Macrobond, MUFG Bank Economic Research Office

Global Trade & Manufacturing PMIs



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

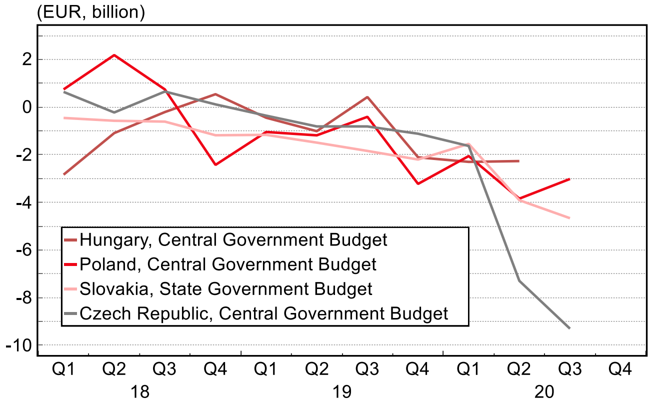
In terms of external demand, the surge of coronavirus cases in Western Europe will also increase headwinds for the regions exports. The automobile sector looks especially vulnerable after a 12% YoY fall in Czech production in August – a month with relatively few restrictions across Europe. Indeed more widely, new car passenger registrations still remain in decline on year-on-year terms (despite a pick-up from June), as manufacturing PMIs remain close to the all-important 50-mark, which distinguishes between expansion and contraction.

Fiscal Metrics Deteriorate, but Risks Low for Now

Crucially, the scope for further full-blown fiscal policy is more limited this time after the strong initial policy response earlier in 2020. Unprecedented government bond issuance was supported by central bank quantitative easing, as well as cuts to main policy rates, which helped to contain government bond yields. However, given that main policy rates are now at record lows, and inflationary pressures remain, there is less scope to cut further.

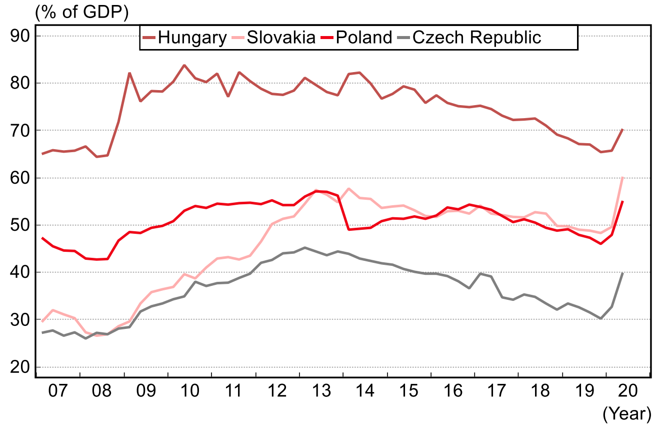
Unsurprisingly, fiscal deficits widened significantly across the board in 1H 2020. Over the first eight months of the year a fiscal deficit of CZK 230.3 billion (USD 10.54 billion) was recorded in Czech Republic, with authorities now targeting a full year deficit of CZK 500 billion (or 8% of GDP). Meanwhile Poland is now forecasting a larger deficit of 12% of GDP this year, before falling to 6% in 2021. The net result is that government debt will rise this year and next, with public finances set to remain permanently weaker.

Fiscal Deficits Widen in 3Q 2020



Source: National Finance Ministries, Macrobond, MUFG Bank Economic Research Office

General Government Debt



Source: Eurostat, Macrobond, MUFG Bank Economic Research Office

We suspect that governments will be under pressure to avoid full lockdowns now that the associated cost for GDP is clear. There is also likely to be more pushback from individuals and the private sector against full scale lockdown measures. Less stringent restrictions would mean that 1) fewer income measures would be required from governments and 2) economic activity would not fall as far as it did in the spring. Both of these factors would limit the short to medium-term effect on fiscal sustainability.

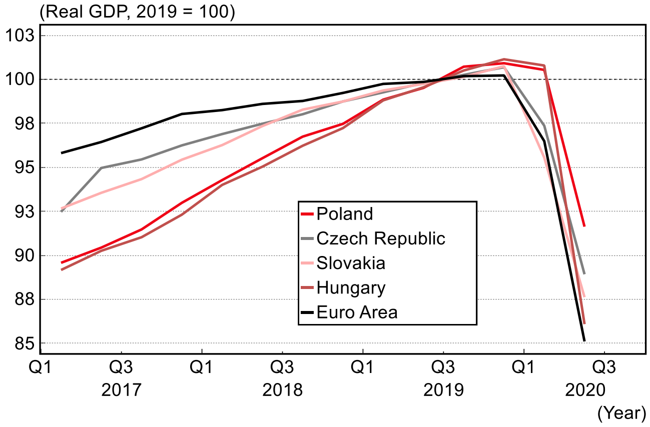
Further ahead, Hungary may be under more pressure to introduce fiscal consolidation measures given higher levels of government debt, but this might not be the case in all Visegrad countries. After the extent of the economic downturn, governments will be in no rush to tighten fiscal policy. The Czech finance ministry has already announced its intention to cut its main rate of income tax from 20% to 15% in 2021 and there will be no corresponding cuts to expenditure or new revenue measures introduced to fund its estimated USD 3 billion cost. Meanwhile, the Polish government has once more delayed the implementation of a retail sales tax (although the delay was due to a European Commission finding that its implementation breached state aid rules). The tax is currently set to be introduced in January 2021.

Overall, both Czech Republic and Poland have lower levels of government debt so can probably afford looser fiscal policy in the near term, but there have been some concerns voiced. The Governor of the Czech National Bank (CNB) has warned that this move could threaten fiscal stability in the Czech Republic. To our minds, fiscal risks seem likely to remain low for now and manageable further ahead, even as government debt levels rise. All four members of the Visegrad have a decent track record of reducing levels of government debt post-2008, albeit helped by strong real GDP growth. Furthermore, investor appetite for government debt has remained firm so far this year, helped by both national and wider global QE measures.

The main risk further down the line is if the potential rate of real GDP growth is reduced by longer-term consequences of the coronavirus shock, which would then feed into weaker government revenues, yet this risk looks limited for now. Despite waning rates of productivity growth post-GFC, the new EU fund will benefit Visegrad members significantly by around 4.0% to 8.0% of 2018 GDP each, and should, in turn, help to bolster wider productivity gains through better infrastructure and education. The programme should also reduce pressure on national budgets.

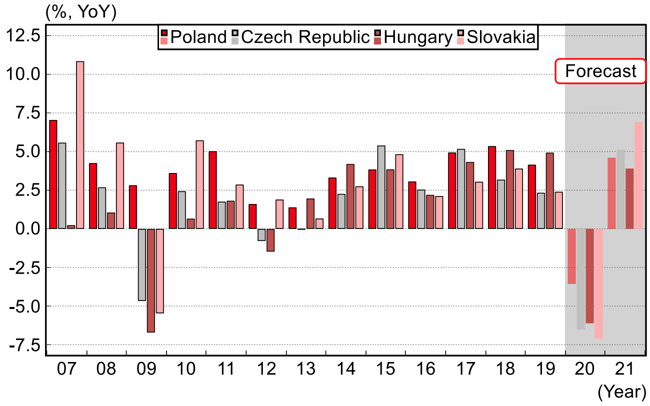
However, as highlighted by the shock to real GDP levels, it will take a while for real GDP levels to recover with Poland perhaps most likely to recover the fastest by mid-2021, whereas Czech Republic is likely to be much longer. Households will remain cautious throughout 2020 and in 2021 given a weaker labour market and the likely persistence of the virus. In the absence of an effective vaccine or treatment, it may be a long while yet until sentiment fully recovers.

Historic Real GDP Drops in 2Q 2020



Source: Eurostat, MUFG Bank Economic Research Office

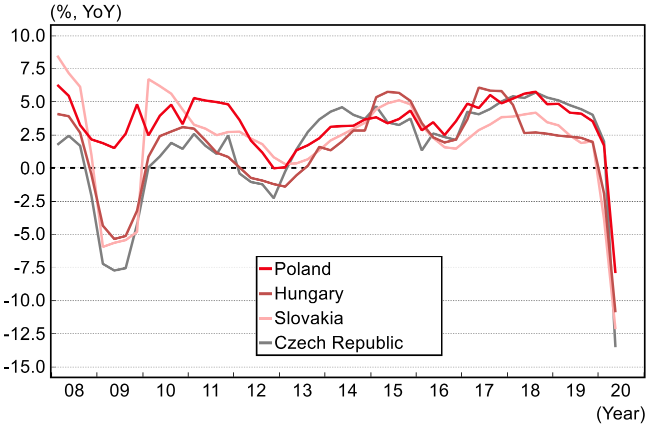
Real GDP Growth Forecasts



Source: IMF WEO, Macrobond, MUFG Bank Economic Research Office

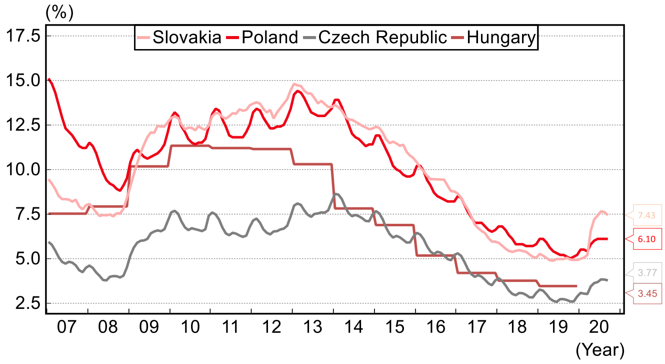
Economic Snapshot: Select Charts

Real GDP Growth



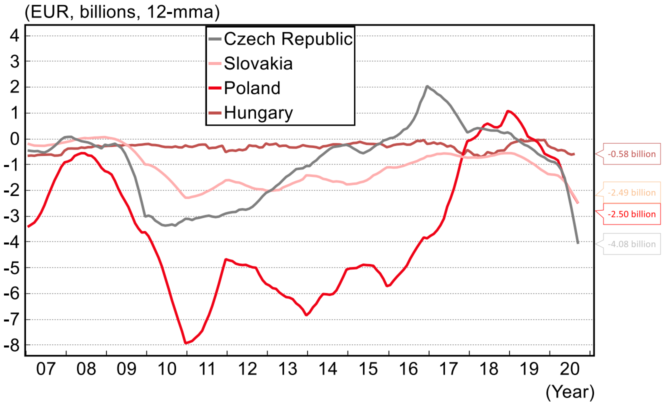
Source: Eurostat, MUFG Bank Economic Research Office

Official Unemployment Rates



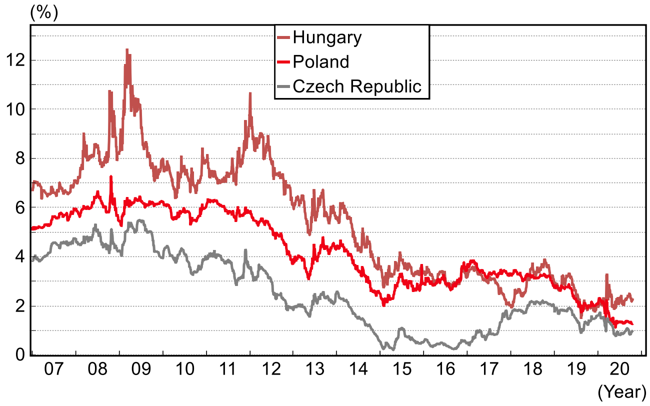
Source: Polish Ministry of Family, Labour and Social Policy,
Czech Ministry of Labour and Social Affairs, HCSO
Slovakian Ministry of Labour, Social Affairs and Family
Macrobond, MUFG Bank Economic Research Office

Fiscal Balances



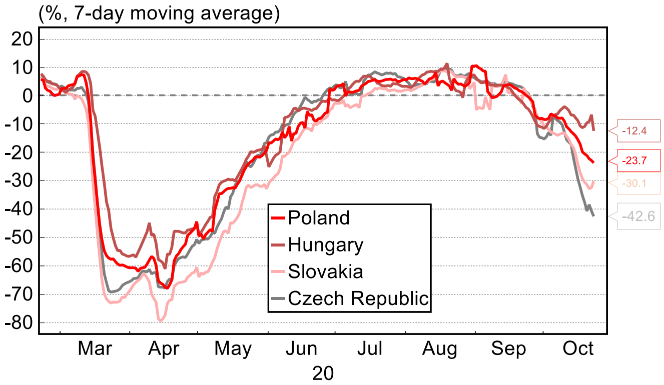
Source: National Sources and Ministries of Finance,
Macrobond, MUFG Bank Economic Research Office

Government Benchmarks, 10 Year Yields



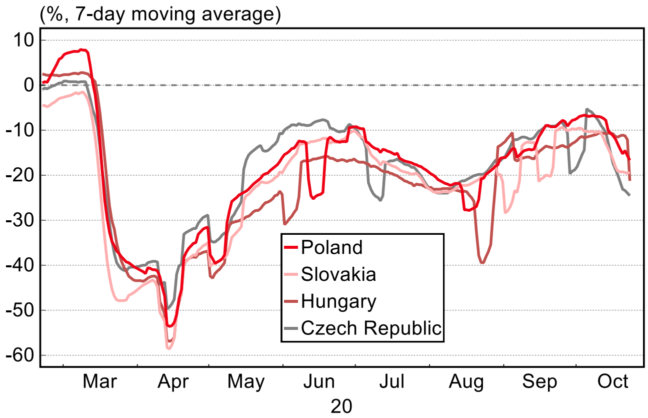
Source: Eurostat, Macrobond,
MUFG Bank Economic Research Office

Retail & Recreation, Length of Stay, Compared to Baseline



Source: Google LLC "Google COVID-19 Community Mobility Reports".
https://www.google.com/covid19/mobility/ Accessed: 9th Oct,
Macrobond, MUFG Bank Economic Research Office

Workplaces, Length of Stay, Compared to Baseline



Source: Google LLC "Google COVID-19 Community Mobility Reports".
https://www.google.com/covid19/mobility/ Accessed: 9th Oct,
Macrobond, MUFG Bank Economic Research Office