Visegrad: Hungary and Slovakia take matters into their own hands amid slow EU vaccine distribution

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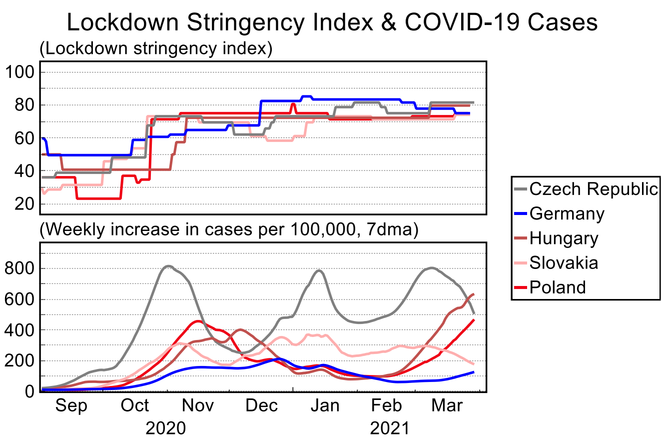
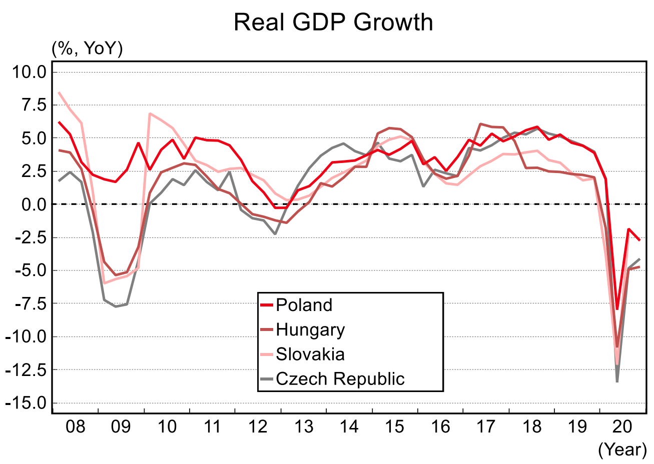
Czech Republic Worst Affected as GDP slips back again at the end of 2020

A second wave of COVID-19 infections and a subsequent increase of lockdown restrictions caused another decline of real GDP in Q4 2020 in the Visegrad. The growth rate of COVID-19 infections has been most pronounced in the Czech Republic despite fairly minor differences in the stringency of lockdown measures, which suggests greater prevalence of more infectious strains. At the same time, the Czech Republic and Hungary experienced the steepest drops of real GDP growth of 4.7% YoY and 4.1% YoY respectively, while Slovakia declined by 2.7% YoY. Poland fared slightly better but still experienced a decline of 1.8% YoY. This said, on the whole the fall of real GDP in Q4 2020 was significantly softer than the drop in Q2 2020 after the initial COVID-19 wave. As in other countries, activity has generally proved more resilient to later lockdowns. Both hard data such as industrial production and surveys, such as the PMIs, show that the manufacturing sector has been increasingly unaffected by restrictions, even as public mobility data has shown that more people are staying at home.



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



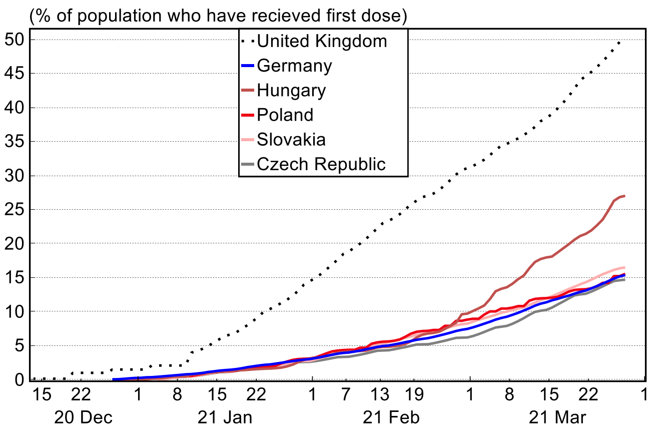
Source: Eurostat, MUFG Bank Economic Research Office

Slow Start to Jab Roll-out Dampening Outlook for Recovery, but some countries have managed to secure additional doses

The success of vaccination programmes is now by far the most relevant factor for the easing of virus containment restrictions and the likely subsequent economic rebound. In the interim, lockdown measures will need to remain in place and may be intensified if COVID-19 cases increase. Risks around the medium-term outlook remain to the downside. Recent surges of COVID-19 cases owing to more transmissible strains of the disease highlight how easy the virus has been able to spread even in the face of fairly tight lockdown restrictions. Meanwhile, concerns over the efficacy of vaccines against more infectious strains of COVID-19 remain. Several highly infectious strains have been found in Brazil, South Africa and the UK, and the chances of further significant mutations seem likely.

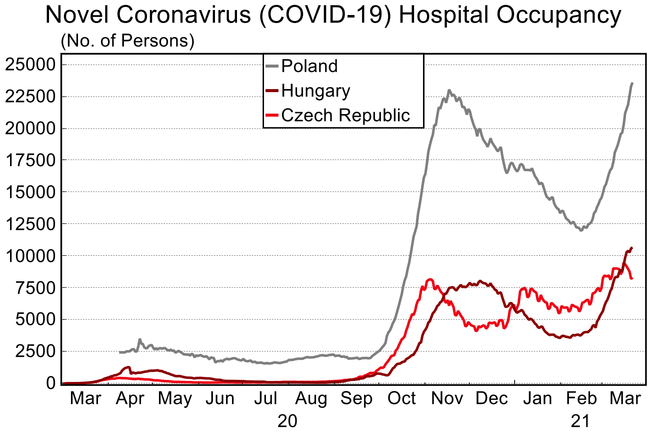
The roll-out of COVID-19 vaccinations in Poland, Czech Republic and Slovakia has been slow. Fewer than 15% of people in all three countries are now vaccinated, and under current trajectories it would take until mid-2023 to attain herd immunity levels, currently estimated at around the 80-90% of total population level. The EU has a target to vaccinate 70% of adults by the end of the summer, but the collective programme has had an inauspicious start relative to other countries. So far the EU has vaccinated 12% of its population. This has been predominantly due to supply constraints. AstraZeneca was expected to supply the EU with 30% of the 100m vaccines that had been promised by the end of March but was prevented by manufacturing issues. More recently, several EU countries have also suspended the roll-out of AstraZeneca jabs due to concerns over blood clotting, which could not only further delay the wider roll-out of the vaccine but also increase vaccine hesitancy.

COVID-19 Vaccination Doses Administered



Source: Our World in Data, Macrobond, MUFG Bank Economic Research Office

Novel Coronavirus (COVID-19) Hospital Occupancy



Source: European Centre for Disease Prevention and Control, Macrobond, MUFG Bank Economic Research Office

As a result, several countries have resorted to bilateral agreements with other vaccine manufacturers outside of the EU's programme. This has meant that national regulators have bypassed the European Medicines Agency (EMA) assessment of the vaccine's safety and efficacy.

Hungary is the first EU member to deploy Russia's Sputnik V vaccine, after receiving 600,000 doses in February, on top of another 500,000 doses of China's Sinopharm vaccine. This additional supply means that it has been able to accelerate the distribution of vaccines to its population. Overall, Hungary has ordered enough doses of the Sputnik V to inoculate 1 million people, while the Sinopharm vaccine can inoculate 2.5 million people, which should go some way to fulfilling the Hungarian government's aim of vaccinating 6.8 million people (70% of the population) by June.

Slovakia has followed suit with a purchase of 2 million doses of the Sputnik V vaccine, with 1 million shots arriving from March to April and a further 1 million arriving in May and June. The Czech Republic has now also requested a batch of Russia's Sputnik V vaccine.

Vaccination rates in these countries are likely to outstrip that of the EU as a whole over the near-term, and the fall in COVID-19 hospitalisation and fatality rates should be especially pronounced. But we are confident that a reduction of supply-bottlenecks should see vaccine distribution in the EU gain some speed over the next few months. The EU has a large vaccine portfolio and new types, including the one shot J&J vaccine, should be added to the programme over coming months.

Moreover, the EMA is also running a rolling review on the Sputnik V vaccine despite this being controversial given weak EU relations with Russia. The decision by the EMA could be taken by May at the earliest. If approved it would then be up to individual countries if they wish to purchase the Sputnik V vaccine or not. In the event the vaccine is approved, we note there would likely be a split between those who would purchase the Russian vaccine and those who would not. Several major EU economies such as Germany and Italy have expressed an interest so far, which could pave the way for others to follow. That said, a number of Eastern European countries are likely to remain staunchly opposed to a Russian vaccine. If the pace of the current EU programme improves then political pressure on national governments to secure additional supply will diminish.

Meanwhile, vaccine hesitancy rates remain high in the Visegrad, in particular with respect to the Sputnik V vaccine which is likely to remain an issue even with EMA approval. So far, vaccine rate data looks to be unaffected by vaccine hesitancy, but as the younger, less vulnerable cohorts become eligible it may become more apparent.

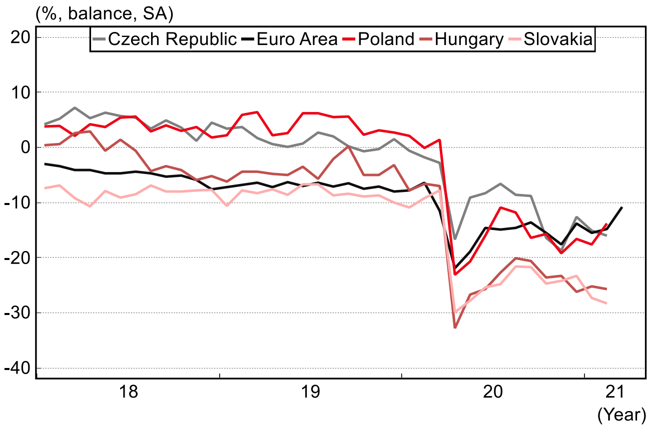
Weak Short-term Outlook

In the face of the current 'third wave' of the virus, any improvement in economic activity or confidence over coming months is likely to be gradual. Poland introduced a three-week lockdown from 20th March, while Czech Republic has extended its state of emergency to the end of April. Until COVID-19 cases are brought back under control yet again, economic activity will be negatively affected, while consumer sentiment will remain weak. We note, against more infectious variants of COVID-19, lockdown measures are likely to have to remain more stringent. It appears lockdown measures may have been prematurely eased over recent months, and only the most stringent lockdown measures are now enough to contain further waves of COVID-19 in the absence of a quicker vaccine roll-out.

In the interim, confidence will remain weak and unemployment is likely to rise. Slovakia has seen the largest increase in unemployment, from 5.2% at the onset of COVID-19 to 7.8% this January, while unemployment rates in both Poland and the Czech Republic have increased by upwards of 1.0 percentage points. Concerns around further job losses mean that consumers are likely to remain wary for a while.

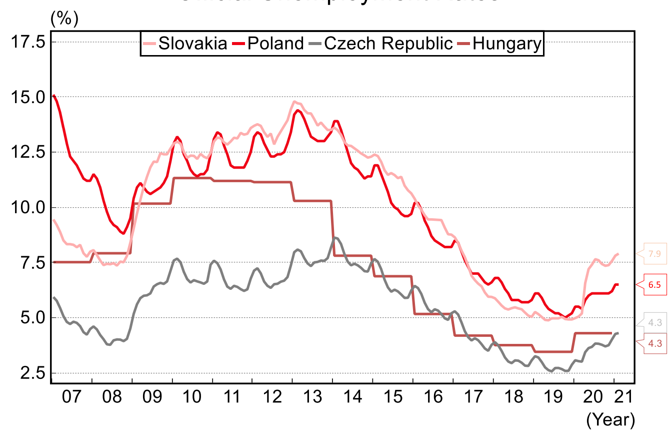
Investment is likely to remain weak over coming months as companies remain reluctant to invest amid a backdrop of further lockdown measures and weaker private demand. Compared to 2019, investment was still down by 10% in both the Czech Republic and Slovakia, and 5% in Poland at the end of 2020. In fact, Hungary was the only Visegrad country to see an increase in investment by 0.3% versus its 2019 level. That said, some investment surveys have started to show signs of improvement. This may reflect the disbursal of Next Generation EU Funds as well as the supportive national policy backdrops. An investment recovery should now take place in 2021, but the timing of this would be dependent on the easing of lockdown restrictions.

Consumer Confidence



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

Official Unemployment Rates



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

On the external side, demand for exports will remain dependent on the global recovery and the spread of COVID-19 globally. That said, a stronger-than-expected US recovery supported by fiscal stimulus may have some positive spill-over effects on EU demand for Visegrad exports, but rising US yields may be a concern. Hungary and Czech Republic are forecasted by the IMF to have current account deficits (CAD) of between 0.5 to 1.0% of GDP, while Slovakia is forecast to have a much larger CAD of 4.1% of GDP due to a larger trade deficit. Poland is the outlier with a forecasted current account surplus of 1.8% of GDP in 2021, after a 30-year record current account surplus of 3.0% of GDP in 2020. Poland benefited from a faster rebound of external demand from Germany and the United Kingdom (it remains to be seen whether trade with the latter is affected by Brexit-induced friction this year).

Fiscal Policy Supportive over Medium-Term

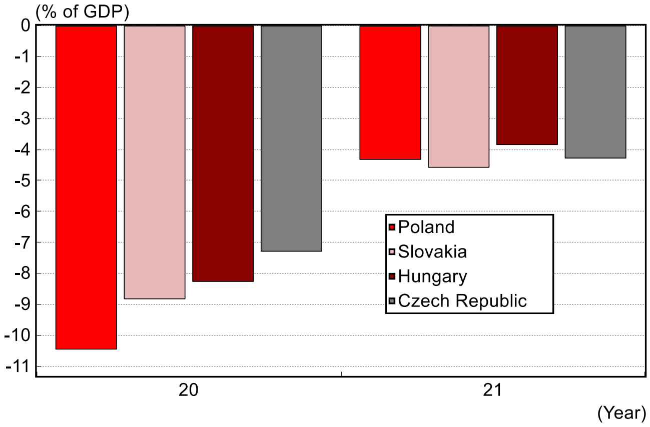
Real GDP will be supported by still fairly generous fiscal support measures in 2021, although government COVID-19 support measures will be more targeted given the need to rein in fiscal deficits. In 2020, COVID-19 government fiscal response packages together with the decline of real GDP led to sizeable fiscal deficits. Poland was the most generous in terms of its policy response with an estimated package of 10% of GDP in 2020, while Hungary was at the lower end of the spectrum and ran a government fiscal deficit of 7.3% of GDP.

However, fiscal deficits are likely to be more similar in 2021. Government debts has risen across the board, and while not a major concern to Visegrad economies in the medium-term given the need to get national economies up and running again, it may become more of a focus further ahead. Overall, Slovakia is forecast to run the largest government fiscal deficit of 4.6% of GDP in 2021, while both Poland and the Czech Republic are set to run fiscal deficits of

4.3% of GDP, and Hungary 3.9% of GDP, according to the IMF. As noted, measures will be more sector-specific in 2021 given fiscal pressures and greater understanding of the effects of COVID-19 and lockdown measures on local economies. So far, Poland has received EU state-aid approval for a number of schemes to support SMEs in 2021, on top of wider sector-specific measures to support companies in gastronomy, fitness, fairs, stage, film, entertainment and recreation, among other sectors.

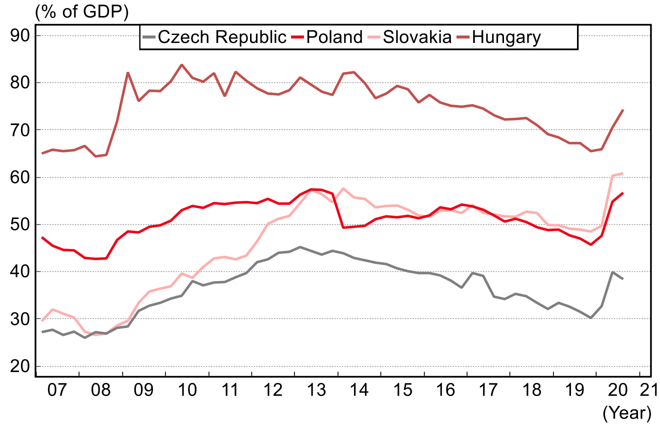
Nonetheless, fiscal deficits will still remain subject to a great deal of uncertainty depending on the extent of COVID-19 infections. The Czech Republic is notable in the fact that it is now suffering from its third significant wave of COVID-19. At present, authorities have allocated CZK 170bn (USD 7.7 billion or 3.1% of 2019 GDP) in pandemic support commitments for 2021. However, this figure is not a ceiling. First, the government has struggled to contain the COVID-19 spread, which could mean further fiscal measures. Next, elections this year are likely to mean pressures on the incumbent government to increase government spending will be higher. That said, the government only managed to spend about 55% on pandemic support of the initially planned allocation in 2020, so there is some leeway for additional spending.

Government Fiscal Balance



Source: IMF, Macrobond, MUFG Bank Economic Research Office

General Government Debt



Source: Eurostat, Macrobond, MUFG Bank Economic Research Office

Next Generation EU Funds Key in Long-Run

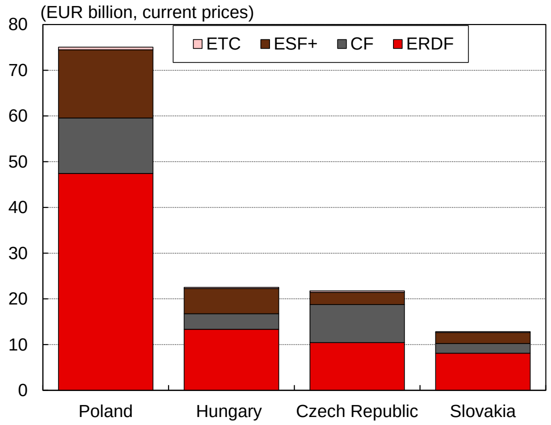
In the long-term, Next Generation EU funds will be key, although this still remains subject to the approval by national parliaments. EU funds comprise both the Multiannual Financial Framework budget (MFF) of EUR 1.075 trillion and the recovery fund of EUR 750 billion, both of which will run over 2021 to 2027. The MFF will be funded from normal budgetary resources, whereas the recovery fund will be financed by extraordinary debt issuance, which the EU plans to pay back by the end of 2058. The Visegrad will be a big benefactor of the MFF and the recovery fund over the medium-term as the support largely benefits countries with lower GDP per capita.

According to the EU, Poland is eligible for EUR 75 billion, with Hungary and the Czech Republic set to receive amounts of around EUR 20 billion and Slovakia just upwards of EUR 10 billion. In terms of 2019 GDP, this is around 13.8% in Hungary, 12.6% in Poland, 12.2% in Slovakia, and 8.7% in the Czech Republic. The European Regional Development Fund (ERDF) will be the most important component of the MFF. The ERDF aims to strengthen economic and social cohesion between EU member states, and focuses on innovation and research, digital agenda, low carbon economy and SMEs, all of which will be important for future productivity gains.

The MFF will be complemented by the recovery fund, which comprises grants of EUR 390 billion, of which EUR 77.5 billion will be used to top up the MFF fund. Recovery fund grants will be allocated according to the magnitude of COVID-19 effects, and will be based on measures such as unemployment before and after the crisis. That said, countries will not gain automatic access – in order to access the funds, member states will need to formulate national recovery plans that give at least 37% of funds to a greener economy, and 20% to initiatives that encourage digitalisation. Approval by national parliaments will also be needed. However, this could prove difficult given tensions between the EU and national governments over linking EU funds to the rule of law, which nearly resulted in Poland vetoing the EU budget and recovery fund last year. More recently, Poland and Hungary have both filed complaints to the European Court of Justice (ECJ) against the bloc's plan to link payments to the rule of law mechanism. There might also be some domestic political difficulties. In Poland, the government might be forced to rely on opposition votes to pass key legislation, an unprecedented position.

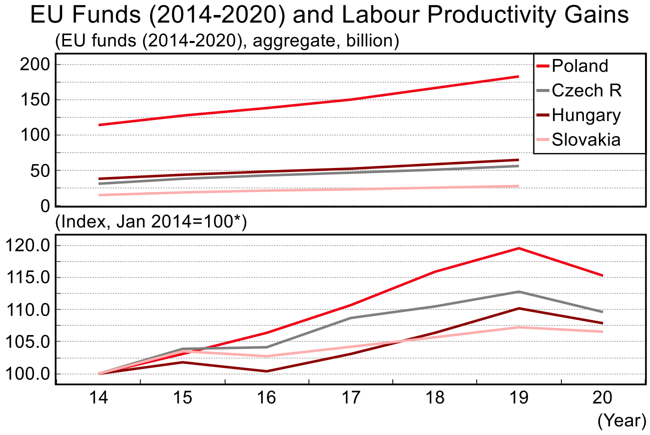
If approved, recovery funds would be disbursed from H2 2021 up until 2023. Overall, EU next generation funds should go some way to support the rebound of labour productivity in Visegrad economies, which is integral to longer-term real GDP and incomes. The effects of COVID-19 have knocked labour productivity back to 2019 levels, and a full recovery could take a few years at least. Data suggests that it can take up to three years after ERDF funds are disbursed for labour productivity to make gains, while the more immediate effects are an increase of firms' employment, turnover and capital stock per employee, according to the OECD.

Next Generation EU Funds, 2021-2027



Source: European Commission, MUFG Bank Economic Research Office

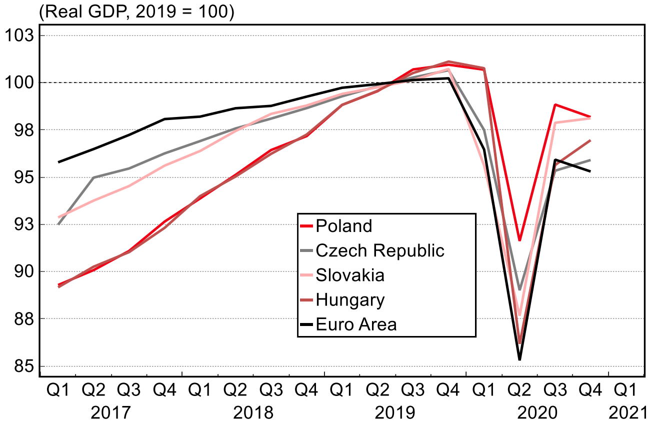
EU Funds (2014-2020) and Labour Productivity Gains



*Note: Jan 2014 has been used as base year for 2014-2020 EU Budget cycle
Source: ECB, Macrobond, MUFG Bank Economic Research Office

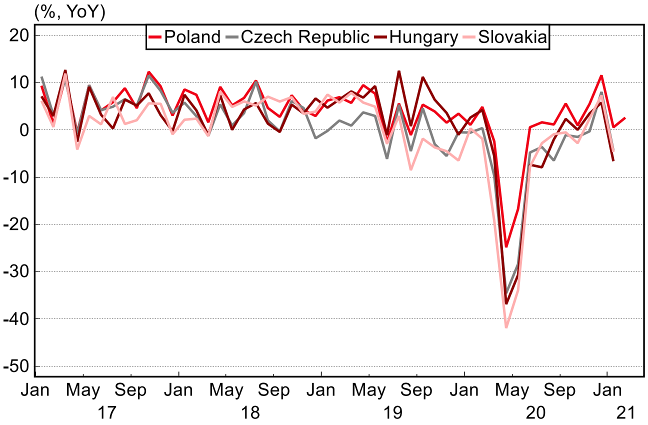
Economic Snapshot: Select Charts

Real GDP



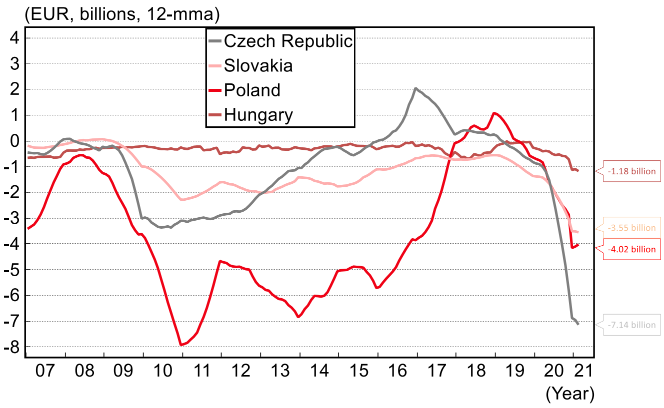
Source: Eurostat, MUFG Bank Economic Research Office

Industrial Production



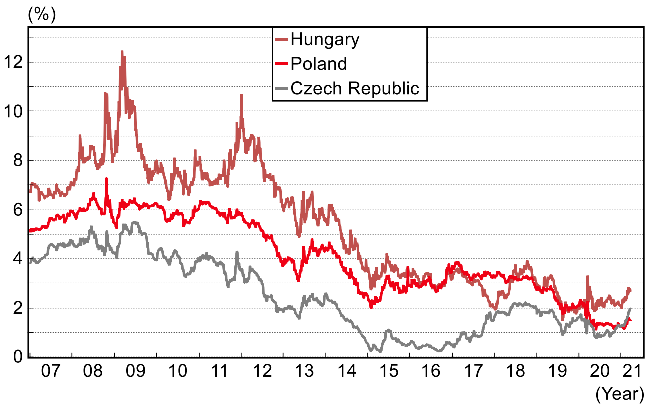
Source: World Bank, Macrobond, MUFG Bank Economic Research Office

Fiscal Balances



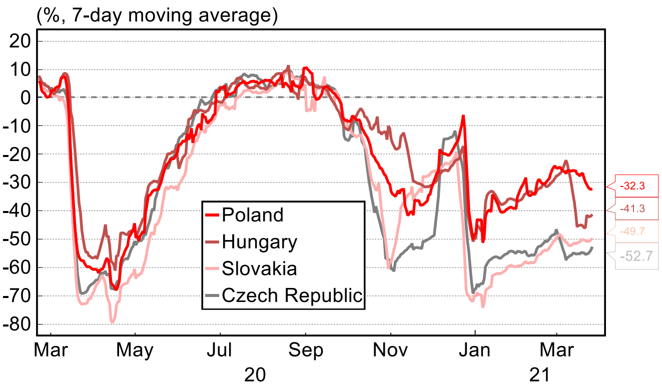
Source: National Sources and Ministries of Finance,
Macrobond, MUFG Bank Economic Research Office

Government Benchmarks, 10 Year Yields



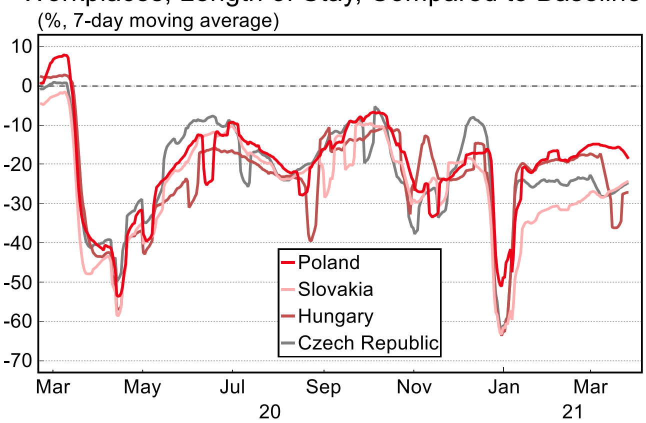
Source: Eurostat, Macrobond,
MUFG Bank Economic Research Office

Retail & Recreation, Length of Stay, Compared to Baseline



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

Workplaces, Length of Stay, Compared to Baseline



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