Visegrad: Steady real GDP recovery expected, as Delta variant highlights continued COVID-19 risks

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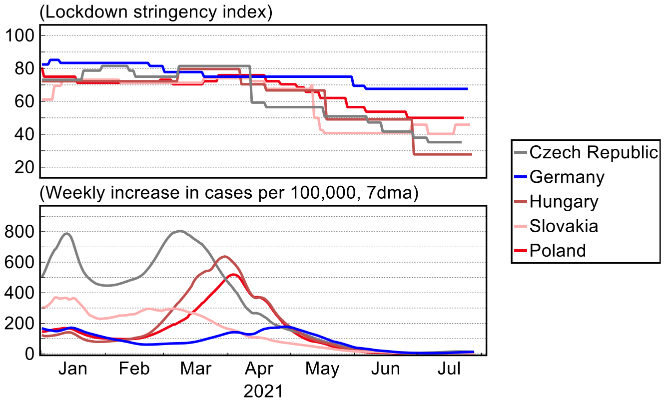
Outlook looks brighter despite concerns about new variants and higher inflation

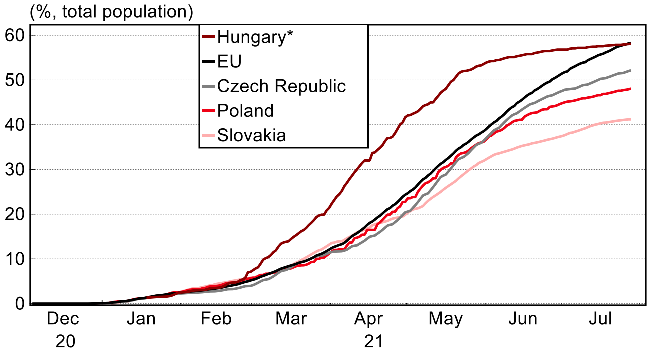
The economic outlook for the Visegrad is looking brighter. Vaccination coverage has expanded, which should help to contain future hospitalisation rates, and allow a gradual easing of lockdown restrictions. There could also be some bumps on the way to the full re-opening of national economies – the recent spread of the delta variant is the obvious risk – but the fact that the vaccination roll-out has progressed well (compared to other EM's) should mean that the majority of lockdown restrictions can be lighter. In Hungary, at least 57% of the total population have now received one dose of the COVID-19 vaccination, while in the other three countries vaccine rates for first doses are between 40-50% of total population. In addition, early data on the efficacy of existing vaccines against newer variants has also been encouraging. This leads us to expect a firm recovery in private consumption over 2H 2021.

Lockdown Stringency Index & COVID-19 Cases



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

Share of People That Have Received at Least One Dose of the COVID-19 Vaccine



Note*: Hungary has benefited from gaining access to both Russian Sputnik V & Chinese-made Sinopharm vaccines which has sped up the overall process
Source: Our World in Data, Macrobond, MUFG Bank Economic Research Office

Good Progress Made on Vaccination Roll-out, but Further Work Needed

The success of vaccination programmes has been by far the most relevant factor for the easing of virus containment restrictions and the likely subsequent economic rebound in the Visegrad and across the wider EU. As a result, the outlook has improved since our last quarterly[1] due to the roll-out of vaccinations after a slow start due to supply constraints. In turn, we expect lockdown restrictions to remain easier in 2H 2021 given the combination of increased vaccination coverage and promising data on the efficacy of existing vaccines against newer variants (especially after two doses are administered). Hospitalisation rates are likely to be lower in the case of future waves of COVID-19 given already high rates of vaccinations in more vulnerable groups, which should reduce the need for higher levels of lockdown measures.

At the same time, vaccine hesitancy has not been as much of an issue as previously reported, even despite the disruption caused by concerns over the Astra-Zeneca jab and blood clots, which has limited its use. The fact that supply of more favoured vaccines (for example Pfizer) should now increase means we remain cautiously optimistic for younger cohorts, which previously had high reported rates of vaccine hesitancy. The data suggests that, actual uptake by younger cohorts that have been offered the vaccine, is more encouraging than previously reported high levels of vaccine hesitancy had suggested.

This said, the pace of the vaccine roll-out in the Visegrad has slowed in recent weeks, while the pace of the vaccine roll-out in the EU has remained the same. Naturally, this was always likely due to the timeframe needed to effectively administer second jabs. At the same time, citizens vaccinated in other EU countries have not been captured in the statistics. However, Czech Republic, Poland and especially Slovakia remain below the EU-average as a result of difficulties due to the non-use of Astra-Zeneca jabs, and on current trajectories, trends suggest that most people in the Visegrad will have only just received their first jab by the end-2021 at the earliest. Clearly, if these difficulties can be ironed out, this would go some way to cementing the progress made so far, and would benefit the recovery. As noted, the EU is trying to supply more spare Pfizer jabs (the more favourable vaccine) to help countries in Eastern Europe catch-up, while it has made further orders for the future.

There could of course be some delays to the full-easing of lockdown restrictions given protection against newer variants is only provided after full vaccination (i.e., both doses), but the outlook has improved since our previous Visegrad quarterly.

Precautionary Household Savings Could be More Important to Recovery

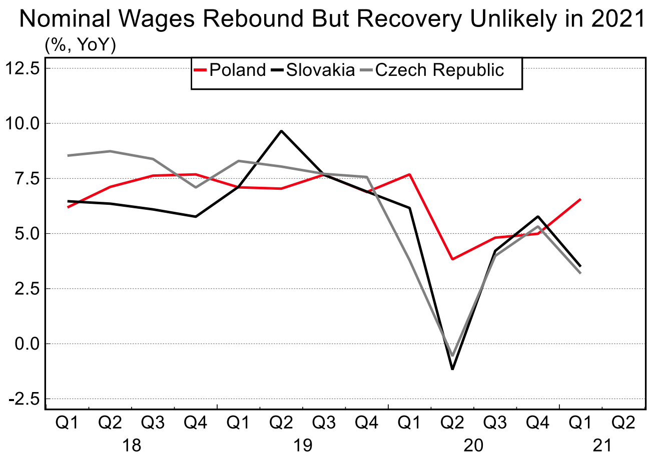
If vaccinations continue to proceed smoothly to cover the majority of the population, then the focus will shift to the pace with which COVID-19 restrictions can be removed and the scope for a subsequent bounce in real GDP. By component, we expect private consumption, which has historically been driven by strong real wage growth, to be the biggest contributor to the real GDP rebound over 2H 2021. We note, while real wage growth (both public and private) in turn is expected to be one of the main drivers of private consumption in 2H 2021 after strong real wage growth in 1H 2021 (driven by industry, transport and technology sectors) it may start to slow slightly in 2H 2021. As a result, consumers use of precautionary savings accumulated during lockdown periods over 2020 could then be important to the recovery of private consumption.

[1] Our latest report was published on 12th April: “Visegrad: Hungary and Slovakia take matters into own hands amid slow EU vaccine distribution”. Link to report here: https://www.bk.mufg.jp/report/ecoeu2021e/MUFG-Economic-Brief-20210412.pdf

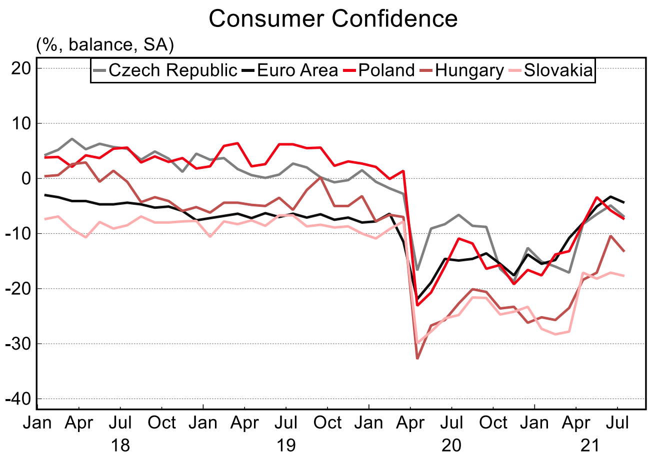
As noted real wage growth could start to slow. This could come about as government labour market support measures end this summer which could lead to higher unemployment and could weaken the case for wage increases in those sectors that are most reliant on face-to-face interactions such as the tourism sector. At the same time, given the fact that there is slack in labour markets- headline unemployment rates have increased by an average of 1 percentage point across all four countries since April 2020- persistently stronger wage growth is unlikely. Unemployment could take a while before it recovers to pre-pandemic levels. Central banks have also raised policy rates too in some instances which will be a headwind for wages.

Meanwhile, if newer variants of COVID-19 depress household confidence some households may be more reluctant to dip into savings in order to fund purchases. The roll-out of vaccines programs should help households to feel more confident and dip into savings but if there are virus related set-backs, household confidence may take longer to recover.

Overall, given the aforementioned headwinds, we expect a more gradual recovery of private consumption in 2H 2021 versus 1H 2021. Consumers will likely gain confidence as vaccination coverage increases, but the recent spread of more transmissible variants of COVID-19 could still concern some households and any future improvement in sentiment could be steady. Consumer confidence has picked-up over recent months but still remains below pre-pandemic levels. At the same time, while more timely data for gross household saving rates are not yet available for 1H 2021, gross household saving rates are quite likely to have remained elevated over this period and could remain so due to fairly stringent lockdown measures. Gross household savings rates have generally increased when lockdown measures have been tightened.



Source: Macrobond, MUFG Bank Economic Research Office



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

Other Components of Recovery Could be Even More Gradual

While consumer spending is likely to pick up through the year, we are slightly less hopeful for the other expenditure components of real GDP. Net exports are likely to drag on real GDP growth in all countries apart from Poland, which should continue to benefit from strong external demand for its products, which include electronics (such as TVs and car batteries) on top of some of its traditional longer term products, in particular, furniture, which has been in high demand and is likely to remain so as lockdown measures are eased further. These trends will be underpinned by steady demand from the Euro area, as consumers here too dip into precautionary savings that they have accumulated over the course of the last year.

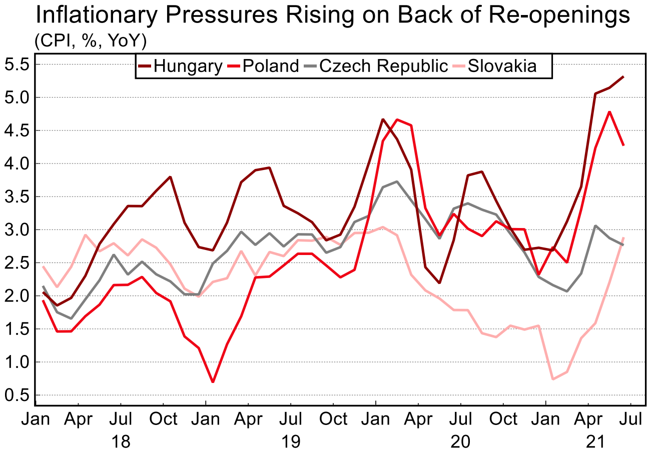
Meanwhile, the outlook for private sector investment is likely to be weak. The private sector has faced a number of headwinds this year after a disastrous 2020. Foremost among these has been dealing with the effects of COVID-19 lockdown restrictions, but more recently higher input prices have also become a headwind. Indeed, this component of real GDP fell the most in 2020. Gross fixed capital formation (GFCF) deducted some 5.7 ppts from annual real GDP growth in the Czech Republic in 2020, while this figure was 5.1ppts in Slovakia, 3.0 ppts in Poland and 2.6 ppts in Hungary. Given the fact that there is now less certainty on the monetary policy front (see below), we note that companies are likely to be wary about making any future investments at this current time and investment could take longer to recover back to pre-pandemic levels. There is likely to be some upside from Next Generation EU funds, but this will mainly boost public sector investment in the near-term although it could eventually support private sector investment further ahead.

Central Banks Turn Hawkish

Higher inflation this year was always likely due to base effects following the plunge in energy prices at the start of the pandemic. However, recent CPI readings over Q2 2021 have surprised to the upside as higher commodity prices and supply side constraints have raised headline rates even higher. This has led central banks across the grouping to shift to a more hawkish policy stance in recent weeks, as some have already raised policy rates.

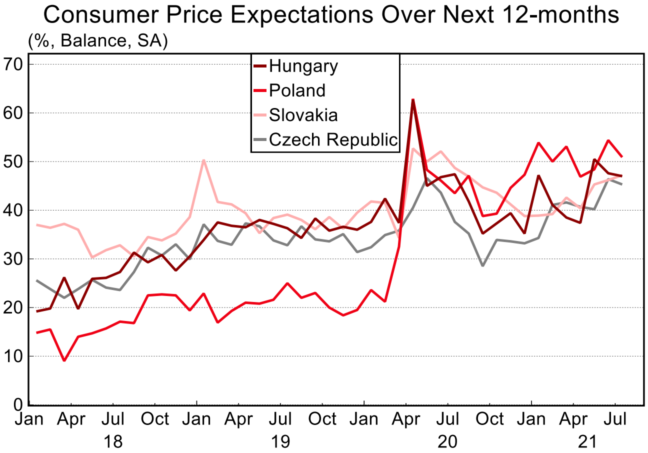
The Czech National Bank (CNB) raised its key policy rate to 0.5% from 0.25% in June and announced that a hike was possible at “every coming meeting” (although it hoped this wasn’t necessary). Meanwhile, the National Bank of Hungary (NBH) has raised its key policy rate twice to 1.2% from 0.9% in July, from 0.6% in June, and signalled further hikes could be on horizon until the outlook for inflation stabilises. The National Bank of Poland (NBP) has not raised policy rates just yet but has increased CPI projections. Meanwhile, in the case of Slovakia, the European Central Bank (ECB) has been under far less pressure given far lower recent core inflation of just 0.9% YoY.

Inflationary Pressures Rising on Back of Re-openings



Source: Macrobond, MUFG Bank Economic Research Office

Consumer Price Expectations Over Next 12-months



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

Monetary authorities have reacted quickly driven by concerns that recent inflation rises could lead to a more permanent upward shift of inflation expectations. Not only has recent data for core inflation together with consumer and producer prices and other national indicators highlighted an upward trend, but so too have more forward looking indicators. Consumer surveys suggest shoppers continue to expect prices to rise over the next twelve months. The main concern would be that a shift to higher inflation expectations among the public could become self-fulfilling leading to higher wage demands in turn forcing firms to raise prices.

At the same time, a large inflow of EU funds is expected later this year which could affect CPI, while the external backdrop may be potentially less benign as the US Fed grapples with inflation at home. Therefore, central banks in the grouping have reacted fairly swiftly by raising policy rates in order to keep inflation expectations in line. Inflations expectations still remain well-anchored in Czech Republic, and others, but clearly it is better to tackle higher CPI readings earlier rather than later.

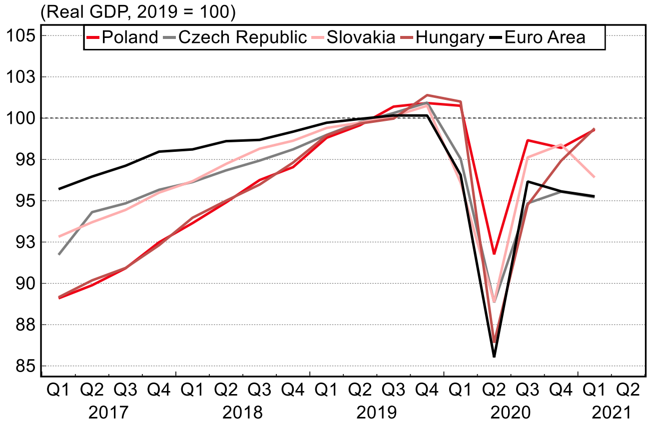
Brighter Outlook, but Higher Inflation Could Complicate Policy Mix

Given the successful roll-out of vaccinations, real GDP growth forecasts for 2021 in all four countries are likely to be upgraded over the next couple of months. The likelihood of real GDP returning to pre-pandemic levels by the end of 2021 is certainly higher. That said, rising inflation is now a major concern that was not previously anticipated and could complicate the policy mix this year after very loose fiscal policy during the most acute phase of the crisis.

Clearly central banks will want real GDP to return back to pre-pandemic levels as quickly as possible (Poland and Hungary look closest to 2019 levels), but the fact that central banks have turned more hawkish while some have raised policy rates means that they are not taking any risks with the recent increase of inflation. They have reacted swiftly to ensure inflation expectations remain well-anchored, even if the US Fed and the ECB have been more cautious in policy normalisation. There could be some consequences for the speed of the real GDP recovery through private consumption and investment channels, but the greater risk would likely be if transitory price increases prove to be more sticky than expected.

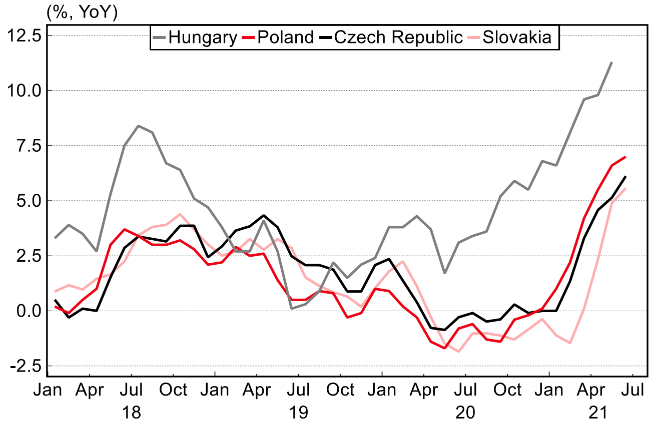
Economic Snapshot: Select Charts

Real GDP



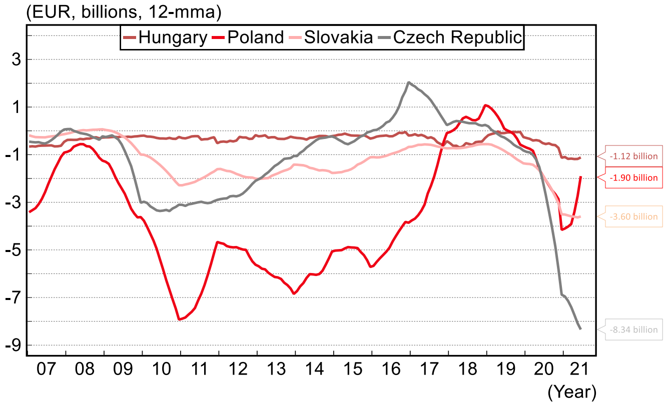
Source: Eurostat, MUFG Bank Economic Research Office

Producer Prices Increase



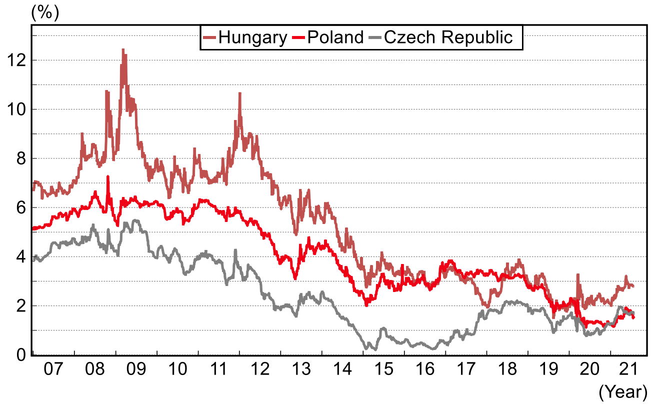
Source: National Sources, Macrobond, MUFG Bank Economic Research Office

Fiscal Balances



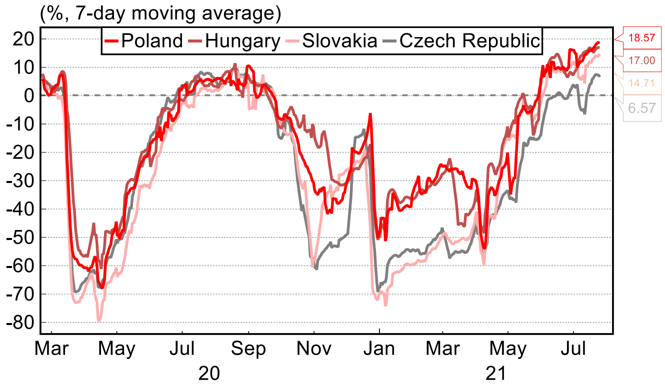
Source: National Sources and Ministries of Finance,
Macrobond, MUFG Bank Economic Research Office

Government Benchmarks, 10 Year Yields



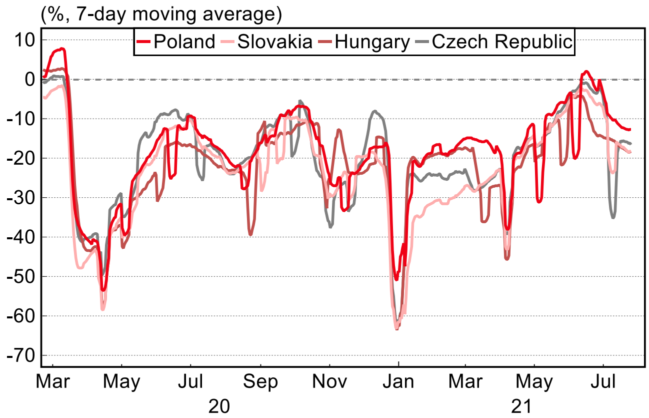
Source: Eurostat, Macrobond,
MUFG Bank Economic Research Office

Retail & Recreation, Total Visitors, 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, Total Visitors, Compared to Baseline



Source: Google LLC "Google COVID-19 Community Mobility Reports".
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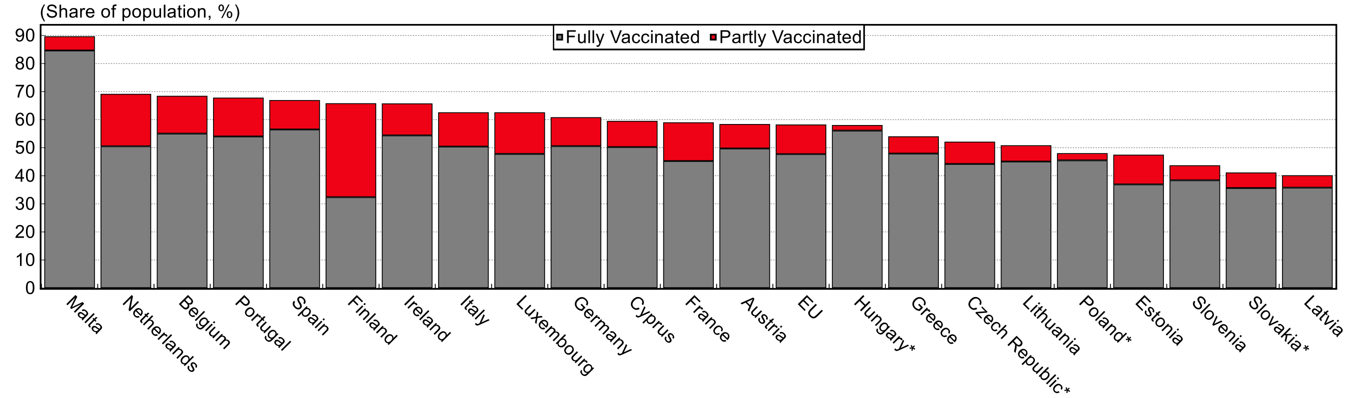
Euro-Area and Visegrad Latest: COVID-19 Vaccinations



Note*: Visegrad members
Source: Our World in Data, Macrobond, MUFG Bank Economic Research Office