ShowCASE

No. 113 | 25.01.2021

CASE - Centrum Analiz Społeczno-Ekonomicznych
CASE - Center for Social and Economic Research

Editorial

The COVID-19 outbreak in the early 2020 has dramatically affected societies and economies all over the globe. It has already claimed two million lives worldwide and lead to an unprecedented contraction of the world's economies. The successful development of the vaccines in the late 2020 and the expected ease of the containment measures coming ahead give rise to optimistic projections for the economic rebound in 2021.

Against this background, the first edition of showCASE in 2021 provides stocktaking of the key economic changes brought by 2020 to the Central and Eastern European (CEE) economies and Poland, in particular, and discusses the outlook for the year 2021 based on the recent CASE projections.

Contents

CASE Analysis

The 2021 Outlook for the CEE Economies. Will 2021 Really be Better than 2020?

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2020 in a Nutshell

As the International Monetary Fund (IMF) projections show, it is expected that the global economy shrunk significantly in 2020 with an estimated 4.4% negative GDP growth rate. The EU economy was not an exception as the economic activity almost halted and the real GDP fell at double-digit rates in the first half of 2020 and it is predicted to close 2020 with 7.4% negative real GDP growth as the recent European Commission forecasts show. The employment has also suffered from a continuous drop in economic activity with the unemployment rate in the EU set to hit 7.7% in 2020 that is one percentage point higher than in 2019.

> » The downturn of economic activity in 2020 is expected to be slightly less pronounced in the CEE countries than globally.

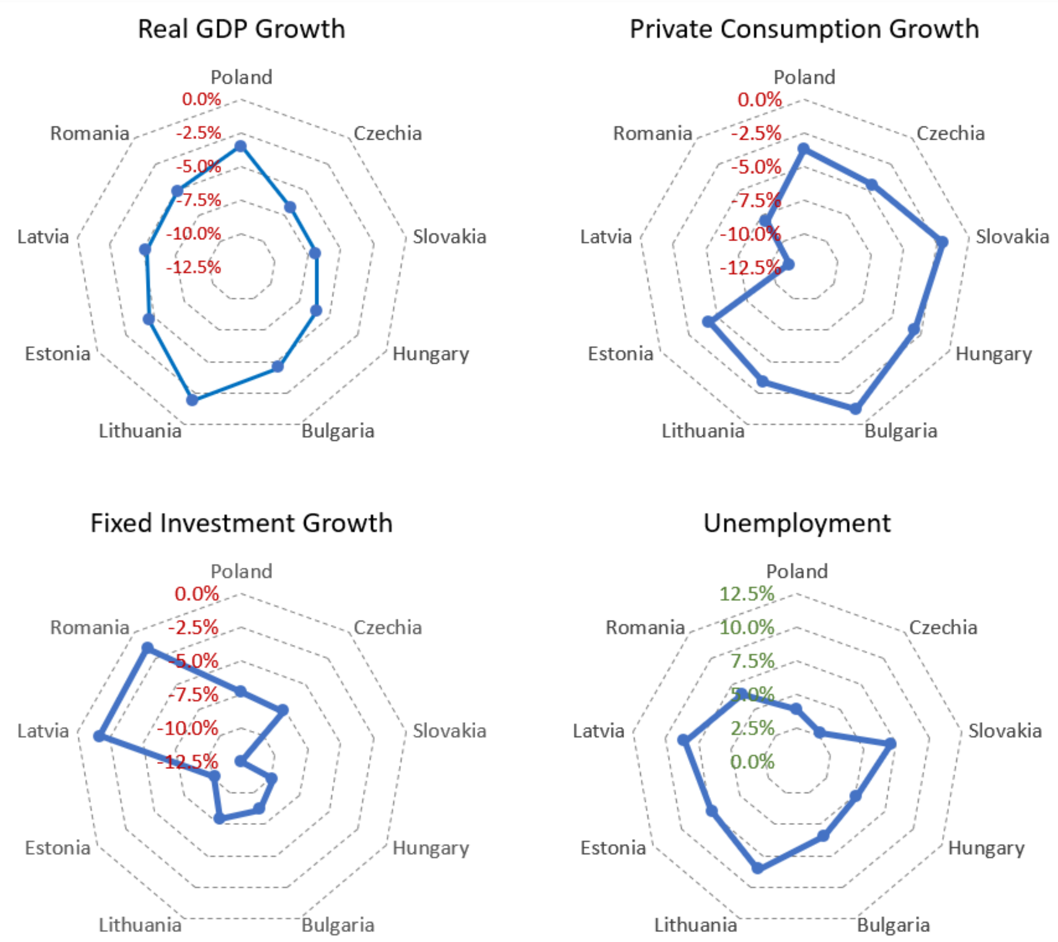
Central and Eastern European (CEE) Countries

The downturn of economic activity in 2020 is expected to be slightly less pronounced in the CEE countries. The recent CASE projections show that the fall of annual real GDP in any CEE country will not reach the EU average. Czechia and Slovakia will suffer the most from the negative impact of the COVID-19 on the regional economy with an expected 6.8% contraction in GDP. Poland and Lithuania, on the other hand, are the two economies forecasted to decline at a relatively low pace with negative growth rates of 1.9% and 3.5%, respectively.

Sharp decline in the economic activity could also be observed on the labour markets as the unemployment rates are expected to range from 2.7% to 8.6%, the lowest in Czechia and the largest in Latvia and Lithuania. The measures undertaken by the Czech government, the pre-crisis tight labour market, and low share of temporary employment contracts are the main contributing factors to the lowest expected unemployment rates in Czechia.

The governments of CEE countries responded to the COVID-19 pandemic through various fiscal measures such as social security contributions, wage subsidies, increased loans guarantees for medium and large companies, additional loans from micro firms, increased unemployment benefits, interest rate subsidies, and public investment supports. These measures are expected to increase government expenditures by on average 4.8% y/y in 2020. Along with decreased tax revenues, elevated

Figure 1. CEE economies forecast for the year 2020



Source: own elaboration based on CASE projections.

expenditures will likely lead to large gaps in government financing.

Poland in a Spotlight

The year 2020 is set to mark the worst performance of the Polish economy in nearly three decades. In response to the COVID-19 pandemic and restrictions imposed on the economic activity, Polish GDP went down by nearly 9% q/q in the second quarter of 2020 with respective 10.5% and 9% q/q decline in private consumption and fixed investment.

In the third quarter of 2020, with the ease of containment restrictions, the Polish economy sharply rebounded, and the GDP soared by 7.9% q/q. The surge in new infections and reintroduction of containment measures were expected to bring a halt to the recovery of the economy in the last quarter of 2020 with the expected annual real GDP growth at negative 3.5% and unemployment rate at 3.8% for 2020.

The increase in the unemployment rate following the pandemic did not go one-to-one with the decrease in the economic growth thanks to the emergency support measures. The main employment-related measures included subsidies for employee remuneration costs and social security contributions for companies that experienced sharp decline in their turnover.

As of March 2020, the Polish Parliament started adopting legislation packages titled 'Anti-Crisis Shields' that, as of January 2021, have already amounted to PLN 312 billion support in a form of credit guarantees, micro loans, and liquidity programs for the businesses. Coupled with the dropdown in economic activity, these measures are expected to significantly deteriorate Polish public finances. CASE projects that the budget balance will reach -9.2% of the GDP in 2020, which could be the largest deficit among the CEE countries. The budget deficit will also push up the public debt in Poland. As a result, the public debt-to-GDP ratio is expected to hit 58.4% in 2020 whereas in 2019 it stood at 45.7%.

Outlook for 2021

CEE Countries

The 2021 GDP in real terms is projected to remain below the levels observed in 2019 with the full recovery of the CEE economies being expected no earlier than in 2022.

Among the CEE economies, the highest GDP growth in 2021 is projected for Slovakia – at 5.4% y/y. As Slovakia ranks first in terms of trade openness[1] in the region, the anticipated restoring of international trade in 2021 is expected to support the recovery. In addition, the forecasted 10.9% y/y growth in fixed investment – the highest among the 9 CEE countries – will be the main engine of the 2021 growth in Slovakia.

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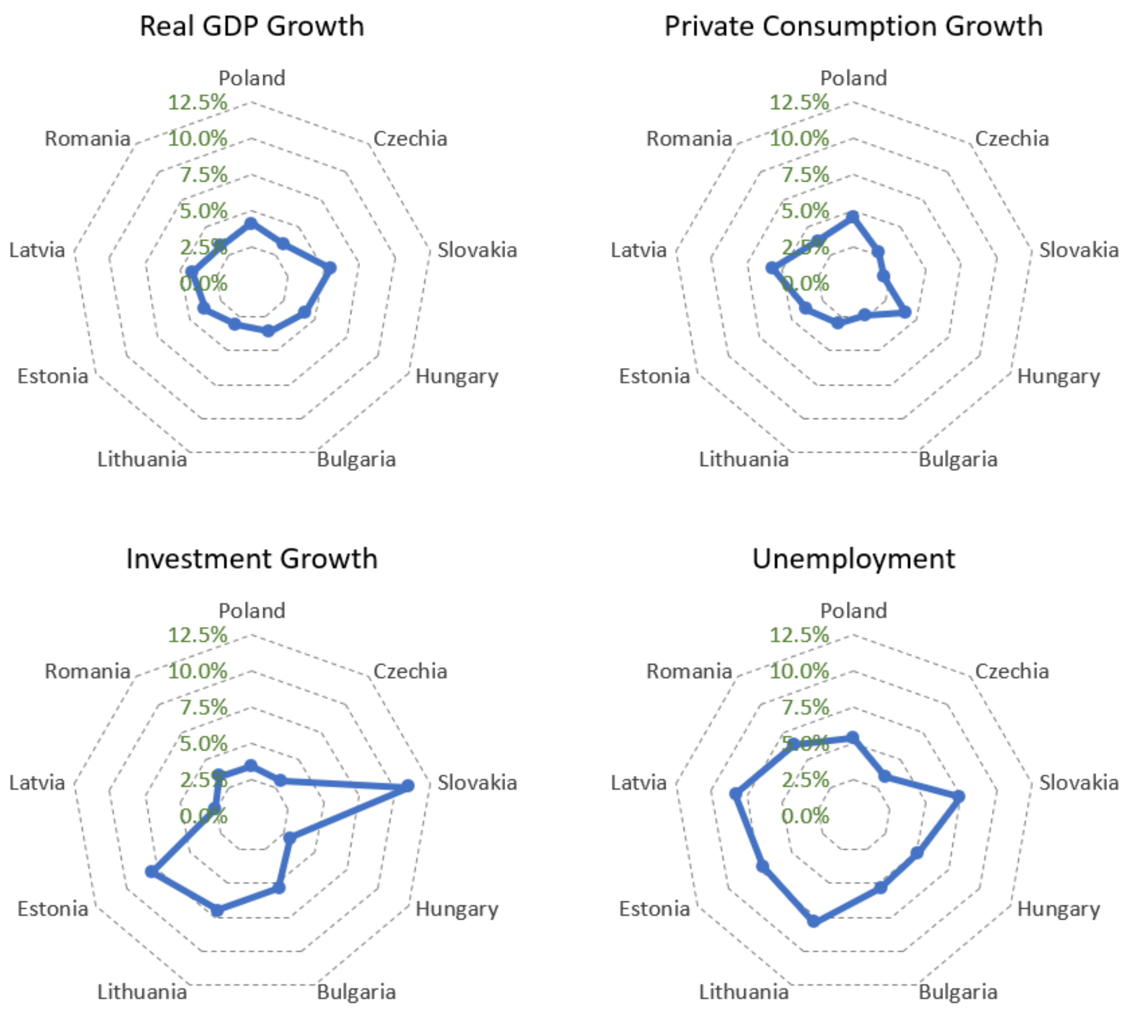
Poland, Hungary, and Latvia are the other economies expected to grow at a fast pace of over 4% y/y in 2021. The rebound will mostly be driven by private consumption that is expected to increase by 5.7%, 4.5%, and 4.2% y/y in Latvia, Poland, and Hungary, respectively. On the other hand, the growth of fixed investment is anticipated to be relatively slow in these countries with a projected rate of around 3% y/y. The other factors that contribute to the GDP growth in Hungary and Latvia diverge. The anticipated recovery in international trade coupled with the recent depreciation in forint will support Hungary's positive trade balance which will contribute the 2021 GDP growth. The opposite is, however, true for Latvia – an expected negative trade balance will constrain the GDP growth, while the projected positive growth in public consumption is expected to stimulate the 2021 recovery of the Latvian economy. In the case of Hungary, an expected cut in public spending will have negative impact on growth.

The growth rates of the other countries in the region are expected to fluctuate between 3% and 4% y/y. Estonia will lead this group with

[1] Trade openness being measured as a sum of a country's exports and imports as a share of that country's GDP.

Figure 2. CEE economies forecast for the year 2021



Source: own elaboration based on CASE projections.

an estimated 3.7% y/y GDP growth, mostly driven by the prospect of the solid fixed investment performance expected to grow by 7.9% y/y in 2021. Although Czechia is expected to have the lowest unemployment rate in the region (3.5%), the anticipations of modest increases in private consumption (2.7% y/y) and fixed investment (3.2%) will help the country to have a 3.5.% y/y GDP growth in 2021.

Lithuania is forecasted to have the lowest GDP growth among the CEE countries in 2021 – at 3.1% y/y. Although the projections for private consumption and fixed investment are not the lowest in the region (3.0% and 7.0% y/y, respectively), the expected negative trade balance in 2021 will pull down the GDP growth rate. The Romanian economy will also follow a similar path with private consumption and fixed investment growth at 3.8% and 3.5% y/y, respectively, yet only 3.3% y/y GDP growth due to the expected negative trade balance and cuts in public consumption.

Poland in a Spotlight

The assumed easing of the COVID-19 restrictions not only in Poland but also in the rest of the EU is expected to help Polish economy to recover in 2021. The annual GDP growth for the years 2021 and 2022 is thus forecasted at 4.1% and 4.0%, respectively. These figures are approaching average annual growth rates enjoyed throughout 2014-2019 (i.e., 4.2%); hence, even in the short-term recovery, the Polish economy is expected to restore its pre-crisis growth trend levels.

Considering the current dynamics, it appears that the 2021-2022 economic rebound in Poland will be primarily fuelled by private consumption which is expected to increase by 4.5% y/y (supported by the build-up of savings and positive consumer moods). The government consumption, fixed investment, and trade balance are also expected to have a positive contribution to the growth in the next two years, albeit at a lower extent. The government consumption is forecasted to grow at a decreasing rate – 3.1% in 2021 and 2.8% in 2022, which, nonetheless, is set to be compensated by the increase in fixed investment – from a 7.4% decline in 2020 to a projected 3.3% and 6.5% growth in 2021 and 2022, respectively.

Conclusions

The forecasts for 2021 are made under the assumption of easing containment restrictions. Thus, for the positive forecasts to realise, it is crucial that the economies in the region succeed in containing infection rates and effectively implement national recovery strategies. In case of a high rate of active cases that would require an extension of the containment restrictions, economic activity risks to drop further which may once again pull down consumer and business confidence and exacerbate the pressure.

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Among the other challenges for the Polish economy in 2021 are phasing-out of support measures that may put downside risk on unemployment, a generous social policy stance that would put pressure on public finances, as well as potential low interest rates and disputes with the European Commission that may stagnate private investment.

Highlights

Trade, Innovation, and Productivity

The lengthy Brexit trade negotiations finally came to an end on 24 December 2020, resulting in a trade and cooperation agreement between the EU and UK. The agreement is focused on four pillars: (i) a free trade agreement; (ii) cooperation on economic, social, environmental, and fisheries issues; (iii) a new partnership for citizens' security, and (iv) an agreement on governance. The free trade agreement is limited to zero tariffs or quotas on all goods that comply with the appropriate rules of origin. Beyond tariffs, lack of liberal provisions in several areas is likely to result in additional border costs and trade barriers. For instance, health certificates and sanitary and phytosanitary controls will be needed for the UK agri-foods entering the EU market. Also, since the EU regulations will gradually diverge with those of the UK, technical barriers to trade are likely to reappear. Furthermore, the UK service providers will no longer enjoy the country-of-origin principle for service trade, allowing automatic access to the EU Single Market for services. They will also lose the mutual recognition of professional qualification and must be certified by each EU Member State if they want to work in the EU. Preliminary general equilibrium simulations of the trade aspects of Brexit show the macroeconomic effects of Brexit significant mainly for the UK (0.9% of GDP in the short-run and up to 1.9% of GDP in the long-run) and Ireland with a limited negative impact on the rest of the Member States (0.1% – 0.2% of GDP). The impact on the UK is likely to depend on the future shape of the UK policy as regards trade with the third countries, i.e., multilateral trade liberalisation is expected to partially alleviate the negative impact on the UK economy.

Labour Market and Environment

According to the latest data from the Polish Office for Foreigners, the COVID-19 pandemic has contributed to an increase in applications for residence permits in Poland, particularly from nationals of neighboring countries. As the Office reports, in 2020 third country nationals (TCNs) submitted 281,000 applications for residence permits (12% more than in 2019) with 76% of proceedings having ended with a positive decision. Ukrainian nationals dominated among those applying for residence permits in 2020 (204,000 – 73%), followed by Belarusians (14,000), Georgians (10,000), and nationals of India and Moldova (6,000 each). The most popular type of residence permit was the temporary residence (260,000 – 93% of applications). The increase in the number of residence permit applications relates to those TCNs who were previously more likely to benefit from circular migration opportunities on the basis of long-term visas.

Macro and Fiscal

The beginning of 2021 brought multiple changes to the Polish taxation framework. Even though the statutory rates of the main taxes remained unchanged, abolition of certain exemptions, hikes in rates, and introduction of over a dozen of new taxes and levies are expected to markedly increase tax burden on many Polish firms and individuals. New levies will cover among others turnover of large-scale shops, ownership of commercial vehicles, oil change in vehicles, consumption of alcoholic beverages sold in small bottles as well as beverages containing sugar which alone are expected to increase tax revenue by over PLN 6 billion per year. In addition, significant hikes will affect levies on electricity generation, public TV subscription, garbage collection and real estate tax. In addition, changes introduced in 2021 will substantially increase income tax liability of individuals with foreign income and tax of income of limited partnerships. The additional revenue in the government budget will surely be reflected in prices of goods and services, and thus will drag the 2021 CPI above the current forecasts of ca. 2.4% on average.

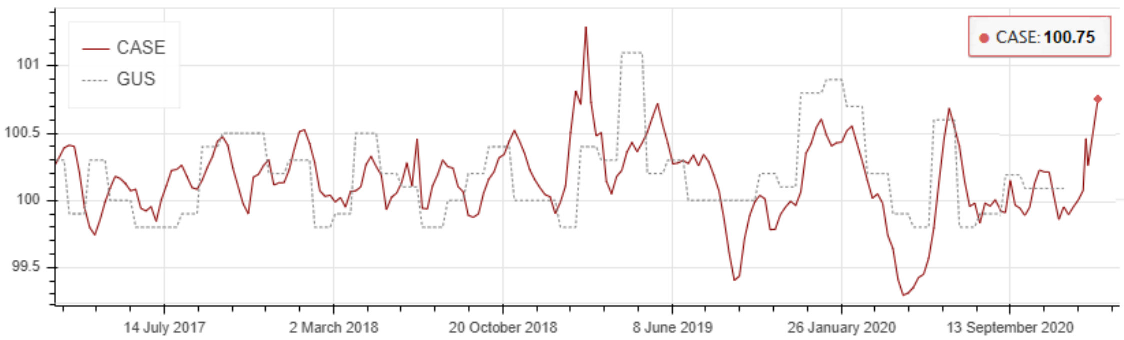
Other CASE Products

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi.

First readouts of Online CASE CPI in 2021 show that price stabilisation which was observed throughout the last months is now over. Even though prices are often changed at the beginning of the year (especially administrative prices), this time the increase seems stronger than in the past years. Two categories of goods and services where the price increase was the most substantial were "Transportation" (1.2%) and "Food and Beverages" (1.1%). "Non-alcoholic beverages" subcategory increased by more than 2% which is most likely a consequence of newly introduced sugar tax. We can expect more increases to come throughout the next weeks as price listings are still being updated (e.g., electricity bills).

Our Weekly Online CASE CPI



Monthly CASE Forecast for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, investments, industrial production, growth of nominal wages, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2021	4.1	4.5	3.3	7.5	2.3
2022	4.0	4.5	6.5	5.9	2.7

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