

Outlook for selected CESEE countries

Economic activity in the CESEE-6 region will take a deep dive in 2020 and then recover hesitantly, Russian economy set to contract in 2020^{1,2}

Against the background of the evolving coronavirus crisis, economic growth in the CESEE-6 countries³ is expected to plummet from 3.9% in 2019 to –4.5% in 2020. For 2021 and 2022, we project a rebound to 3.0% and 3.3%, respectively. Thus, economic activity will remain notably below the baseline of our previous forecast over the whole forecasting horizon. Apart from public consumption, all components of GDP will contract in 2020. A nosedive of gross fixed capital formation and private consumption will push the growth contribution of domestic demand deep into the red. In line with much weaker projections for euro area import growth, CESEE-6 export growth will also lose substantial steam in 2020. The high import content of exports and fading domestic demand imply a strong decline in import growth that will translate into a roughly neutral growth contribution of the external sector. The expectation of a recovery in 2021 and 2022 rests on a rebound of domestic demand amid a positive base effect and substantial fiscal and monetary stimuli. Export and import growth will reaccelerate as well, but the growth contribution of net exports should remain negligible overall. Among the CESEE-6, the decline in economic activity in 2020 will be particularly pronounced in Croatia, Bulgaria and Romania. Risks to the forecast are high and mostly tilted to the downside. They mainly stem from the further development of the coronavirus crisis and its possible impact on global value chains and the international division of labor.

Table 1

OeNB-BOFIT GDP projections for 2020 to 2022 compared with the IMF forecast

	Eurostat/ Rosstat	OeNB-BOFIT projections April 2020				IMF WEO forecast April 2020			Difference between OeNB-BOFIT and IMF		
		Forecasts									
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022	
	Year-on-year growth in %							Percentage points			
CESEE-6	3.9	-4.5	3.0	3.3	-4.9	4.8	..	0.4	-1.8	..	
Bulgaria	3.4	-6.4	4.3	3.7	-4.0	6.0	..	-2.4	-1.7	..	
Croatia	3.0	-7.6	4.2	4.5	-9.0	4.9	..	1.4	-0.7	..	
Czech Republic	2.5	-3.8	2.9	2.8	-6.5	7.5	..	2.7	-4.6	..	
Hungary	4.9	-3.5	3.2	3.9	-3.1	4.2	..	-0.4	-1.0	..	
Poland	4.1	-4.3	2.8	3.3	-4.6	4.2	..	0.3	-1.4	..	
Romania	4.2	-4.9	2.7	3.1	-5.0	3.9	..	0.1	-1.2	..	
Russia	1.3	-3.0	2.0	1.8	-5.5	3.5	..	2.5	-1.5	..	

Source: OeNB-BOFIT April 2020 projections, Eurostat, IMF World Economic Outlook (WEO) of April 2020, Rosstat.

Note: 2019 figures are seasonally adjusted data.

¹ The projections for the CESEE-6 countries were prepared by the OeNB, those for Russia were prepared by the Bank of Finland in cooperation with the OeNB. Cutoff date for data underlying the outlook for the CESEE-6 region: March 30, 2020. CESEE-6 projections are based on the assumption of an eight-week shutdown in the euro area followed by a slow recovery in the remainder of 2020.

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³ CESEE-6: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania.

The coronavirus pandemic and falling oil prices have seriously eroded prospects for the Russian economy.⁴ Thus, we expect Russia's growth to turn negative this year, reaching –3%. Growth is expected to revive next year as the outlook for the global economy recovers and Russia's public sector spending rises further. The risk of a weaker than expected outcome is significant due to the uncertainty in commodity markets and effects from the coronavirus pandemic.

1 CESEE-6: coronavirus pandemic has fueled uncertainty and will lead to a broad-based decline in economic activity

The outbreak of the coronavirus in China and its development into a worldwide pandemic is deemed to be the largest crisis since the end of World War II by many European policymakers. This crisis has thoroughly altered the outlook for the CESEE economies.

Even before the outbreak of the pandemic, a slowdown in economic momentum for the CESEE region was evident, given the U.S.-China trade conflict, shrinking world trade amid weaker global growth in general, and a sluggish performance in Germany. In the fourth quarter of 2019, average quarter-on-quarter growth in the CESEE-6 countries stood at 0.7%, the lowest level in three years. Nevertheless, at 3.9%, average growth for the whole year 2019 came in only moderately lower than in 2018 (4.4%).

Since the beginning of the year, and even more so in recent weeks and days, a completely new situation has been rapidly unfolding. At the cutoff date for this forecast, far-reaching economic restrictions have been imposed across CESEE and the duration, coverage and extent of these restrictions remains unclear. For several sectors of the economy, activity has been brought close to a standstill and a general economic recession is becoming inevitable. The question how deep the recession is going to turn out, however, is surrounded by an extraordinarily high degree of uncertainty.

First, there is still a lack of hard data for February and March that could provide facts on the impact of the coronavirus pandemic on CESEE economies and that could inform projections for the following quarters. One of the few available figures is the latest release of the European Commission's Economic Sentiment Indicator (ESI). The March reading of the indicator for the CESEE-6 countries came in at an average of 97.3 points, 3.6 points lower than in the previous months. While this represents the lowest value since early 2014, the drop in the euro area's ESI reading was even more pronounced (–8.9 points to 94.5 points). The comparatively low decline in the CESEE-6 countries could be related to the timing of the fieldwork for the survey (between February 26 and March 23); it cannot be ruled out that most survey responses were collected before strict containment measures were enacted.

Second, the duration of shutdown measures (and consequently the depth and duration of recession) is wide open and depends on how well people will comply with hygiene and social distancing requirements and on the subsequent development of coronavirus infections.

Third, national authorities have entered partly uncharted territory with the policy measures taken to contain the economic fallout from the crisis. The current crisis is unique in that it stems from a politically imposed, almost complete reduction

⁴ The oil price assumption used by the Bank of Finland is based on the average price for oil futures contracts for the five days preceding April 3, 2020, yielding the following oil prices per barrel: USD 36 in 2020, USD 39 in 2021 and USD 42 in 2022.

in economic activity for public health reasons, resulting in a drastic shortage of supply and a subsequent loss of demand. Against this backdrop, previous crises can only partly serve as a blueprint for finding an adequate policy mix and gauging the current situation's implications for near- and medium-term economic developments.

Fourth, individual sectors of the economy will be affected to a very different degree. While sectors like tourism, arts, cultural, recreational and sports activities, as well as large parts of wholesale and retail trade are literally lying idle, other sectors are running at full speed (e.g. health care, trade of daily consumer goods). The composition of the slump in economic activity will therefore differ markedly from previous crises. We have reason to expect that private consumption will collapse to a much greater extent than in previous recessions and – on the supply side – the service sector will not be able to act as a stabilizing element.

Fifth, given the very nature of this crisis, a rather swift rebound in economic activity after the lifting of containment measures cannot be ruled out. As most CESEE economies entered the current downturn in generally solid economic shape without any major macroeconomic imbalances, impediments to kick-starting economic activity should, in principle, be low. However, a swift rebound crucially depends on a number of factors: how long the shutdown measures will last (the longer they last, the more likely they will have an impact on the growth potential), whether disruptions of the global value chains are of a temporary or permanent nature and how the international environment will evolve. The major regions of the world economy are sequentially entering the shutdown phase and the question arises whether the lifting of related measures will occur simultaneously or in a more staggered approach.

Decline in economic activity stronger than during great financial crisis

Given the lack of data available to capture the impact of the coronavirus pandemic, we assume a moderately negative shock to economic activity in the first quarter of 2020, a strongly negative shock in the second quarter of 2020 and, again, a moderately negative shock in the third quarter of 2020. Given positive base effects and catch-up effects buttressed by massive demand-side fiscal and monetary support, we have penciled in a moderately positive shock for 2021.

Against this backdrop, we project real GDP growth to decline to an average of -4.5% in 2020. This is a hard brake on economic activity compared to 2019 ($+3.9\%$). The projected recession will be even deeper than in the year 2009 at the height of the global financial crisis (-1.8%), mostly because the Polish economy will no longer act as a stabilizing anchor for the region. On the country level, we expect output to decline, with rates ranging from -3.5% in Hungary to -7.6% in Croatia. The response to the shock will strongly depend on idiosyncratic factors such as the availability of fiscal space and the specific structure of the economy.

In general, we are currently witnessing an unprecedented decline in growth projections for the CESEE region as is shown by a comparison of different forecast vintages. This is illustrated in chart 1, which shows projections for the year 2009 at different points in time compared to projections for the current year.

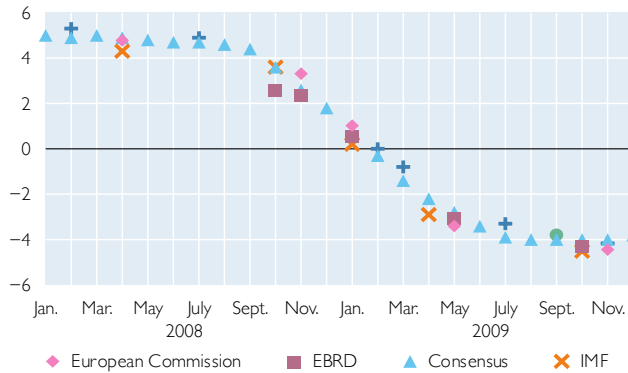
For the year 2021, we see a muted recovery to an average growth rate of 3.0% , mainly on the back of positive base effects and fiscal and monetary stimuli for the region. Furthermore, we penciled in a somewhat stronger rebound of investment spending as the financing periods of the EU multiannual financial frameworks for 2014–2020 and 2021–2027 overlap. However, the level of economic activity will remain notably below the baseline of our previous forecast, not least given

Chart 1

CESEE EU Member States: growth projections for 2009 and 2020 over time

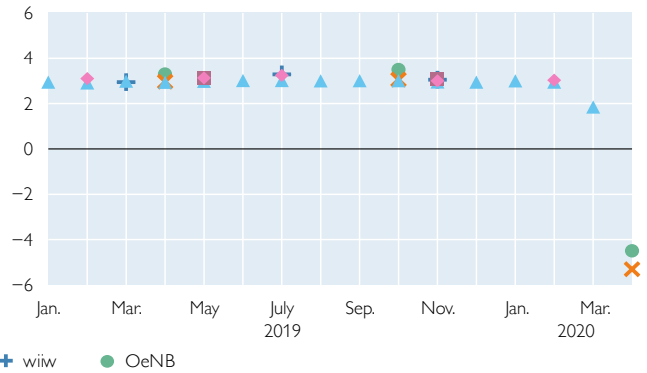
Economic growth projections for 2009 over time

Real GDP growth in %



Economic growth projections for 2020 over time

Real GDP growth in %



Source: European Commission, EBRD, Consensus Economics, IMF, wiiw, OeNB.

second-round effects of the recession (e.g. higher unemployment, weaker wage growth and a deterioration in consumer confidence). Real GDP growth will return to positive levels in all CESEE-6 countries in 2021 and range from 2.7% in Romania to 4.3% in Bulgaria.

Economic dynamics in 2022 will be very much like those expected in 2021, with an average real GDP growth rate of 3.3% and a broadly similar range of outcomes at the country level as in the previous year.

The downturn in 2020 will be broadly based and encompass all components of GDP except for public consumption. The largest negative growth contributions will come from private consumption, but gross fixed capital formation will have a largely equal negative impact on growth in Romania and Poland. In line with weaker projections for euro area import growth, CESEE-6 export growth will also substantially lose steam in 2020. Given the high import content of exports and fading domestic demand, however, we also project a strong decline in import growth. This translates into a roughly neutral growth contribution of the external sector.

Comparing these trends with the experience of the 2009 recession, we expect a broadly similar decline of investments but a much larger contraction of private consumption in the current year than back then. Furthermore, the external sector will not act as a stabilizing element as it did in 2009, as the collapse of imports will not be more pronounced than the collapse of exports according to our projections. (Import growth in the global financial crisis had come down from very high and partly unsustainable levels.)

The recovery in 2021 and 2022 will be just as broadly based as the downturn in 2020, with all components of domestic demand bolstering GDP growth. The growth contribution of net exports will remain about neutral, as both, export and import growth are set to accelerate. Compared to 2009, we project a stronger rebound of domestic demand on the back of comprehensive monetary and fiscal measures and a larger base effect.

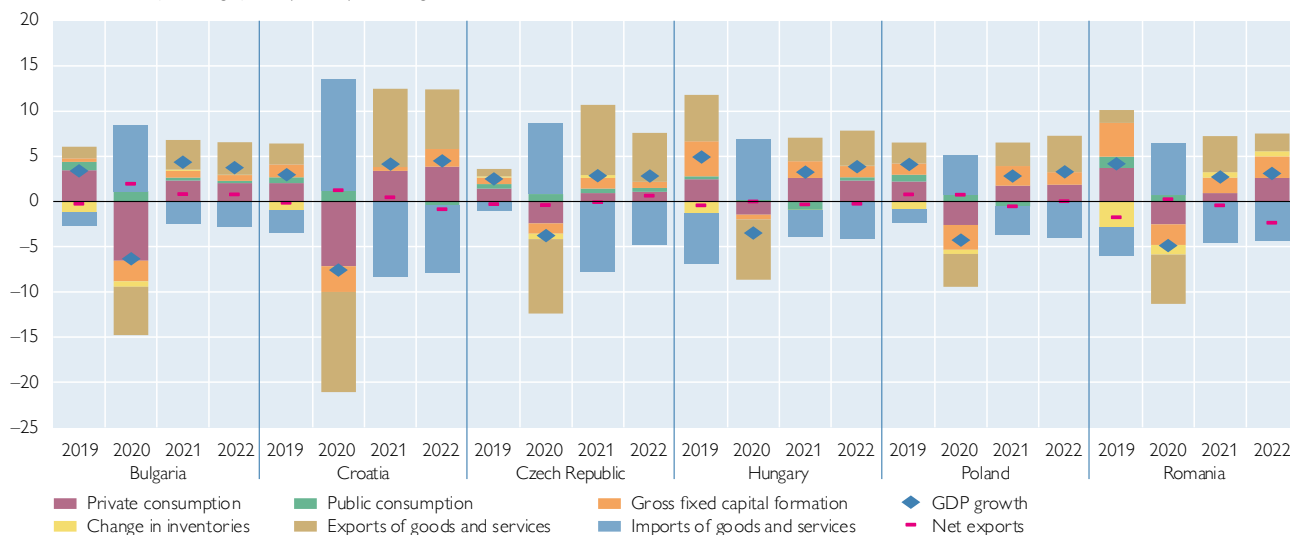
As outlined above, the current situation is surrounded by an unusually high degree of uncertainty. Therefore, the risks to our CESEE-6 forecast are high and crucially depend on the accuracy of the assumed shocks our projections are based on.

Broad-based recession in 2020 affecting all GDP components

Risks to projections are extraordinarily high and mostly tilted to the downside

CESEE-6: GDP and GDP components

GDP contributions in percentage points, year-on-year GDP growth in %



Source: Eurostat, OeNB.

Note: Realized data for 2019, projections for 2020 to 2022.

The most important risk relates to the duration of the shutdown measures. Far-reaching restrictions to economic activity beyond the second quarter of 2020 represent the most important downside risk to our forecast. A quicker lifting of restrictions than assumed in our scenario represents an upside risk to our forecast. Furthermore, the possibility of repeated waves of infections (and shutdown measures) until the development of a vaccine also is a downward risk that could alter the outlook for 2021 and 2022.

Certainly, economic growth of the world economy, in general, or the euro area, in particular, could turn out higher (or lower) than assumed in our baseline scenario and would thus translate into higher (or lower) growth prospects for the CESEE-6 countries. A better than expected coordination of the international policy response to the approaching recession represents an upward risk to our projections. In our overall risk assessment, however, we conclude that the risks to external demand are tilted to the downside. The U.S.A. – the largest economy of the world and an important component of final demand for CESEE products – are currently developing into a hot spot of the coronavirus pandemic and infection is spreading at alarming speed. The U.S.A. have so far been rather reluctant to fight the spread of the virus, but the introduction of more full-fledged (European style) measures is becoming more likely. At the European level, there are still many uncertainties regarding the future relationship between the U.K. and the EU.

The coronavirus crisis could potentially accelerate the process of de-globalization that we have been witnessing in recent years and thus impact negatively on supply as well. The closing of European (and international) borders, the ensuing interruption of the free flow of goods and people and the consequent scarcity of supplies that are vital to our economies and health-care systems (the most prominent example being protective masks) could lead to a reconsideration of the current international division of labor. A shift or a complete dismantling of global production

chains would be especially harmful for CESEE, as the region is tightly interwoven in such structures. However, in the medium term, the region could also benefit from a reallocation of production capacities from more remote destinations to Europe and closer to European consumer markets given the still existing wage advantage vis-à-vis Western Europe.

The CESEE-6 countries' ability to manage a quick economic recovery after the acute phase of the crisis might be impaired by a permanent loss of productive capacity, following waves of bankruptcies and surging unemployment. A shift in demand patterns and/or a substantial sectoral restructuring would render previous investment decisions and qualifications obsolete and thus cause notable hysteresis effects. While policy measures are being introduced to avoid such a scenario, it still represents a downside risk especially for the years 2021 and 2022.

Governments throughout CESEE are trying to shield companies, workers and households from the most severe consequences of the coronavirus-induced economic slump by lending fiscal support, which will lead to higher public debt. A drastic tightening of global financial conditions and/or the deterioration of sentiment could impinge on (re)financing this debt. The same is true for other European countries, especially those with already high debt levels. Should the solvency of a core member of the euro area be at risk, a general loss of confidence in the single currency could not only have detrimental effects on the euro area but also on the CESEE region. This represents a negative tail risk.

2 Projections for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania

Even though, at the time of writing, Bulgaria belongs to the group of European countries with a comparatively contained number of reported coronavirus infections, the country will likely be hit very strongly in economic terms. Based on the assumption that the nationwide shutdown prescribed in mid-March 2020 will only gradually be lifted starting in mid-May 2020, together with sharply reduced economic activity worldwide (Italy being one of Bulgaria's major trading partners), both domestic and external demand will shrink considerably this year. As during the 2008–2009 crisis, we expect that net exports will make a positive growth contribution due to a stronger decline in imports than exports. Among the domestic demand components, only public consumption will expand (considerably) this year and thus serve as a certain cushion. An important issue regarding the intensity of the recession this year will be the developments in the summer season as Bulgaria relies comparatively strongly on tourism. Several factors render it more probable that the recovery will start in the fourth rather than in the third quarter: the gradual lifting of anti-pandemic measures, not only in Bulgaria but also in other European countries, a probably short-run hesitance on the part of tourists to fully resume their traveling plans, and production capacities that can only be rebooted stepwise due to interrupted value-added chains. Unless any new infection wave hits the country and/or its major trading partners, 2021 will be characterized by a marked economic rebound – helped by favorable base effects – before economic developments will return to pre-crisis dynamics in 2022.

The projected V-shaped impact of this once-in-a-lifetime shock is obviously subject to the country's resilience and crisis mitigation capacities. The largest short-run risks are related to the poor quality of the health-care system due to

Bulgaria: economy severely hit by the coronavirus shock despite considerable crisis mitigation efforts, marked rebound in 2021

underinvestment and emigration of medical personnel in the past years. According to the OeNB's Euro Survey (2018 wave), 80% of respondents in Bulgaria are dissatisfied or very dissatisfied with the public delivery of health-care services – one of the highest rates in the region. As regards the scope for countercyclical fiscal policy measures, Bulgaria's government is in a comfortable position, having produced budgetary surpluses in recent years that are partly stored in the Fiscal Reserve Account, which can now be tapped. Bulgaria is also by far less indebted than other EU countries, with a gross public debt-to-GDP ratio of only slightly above 20% in 2019. However, an extensive use of discretionary fiscal stimulus measures is de facto limited by the currency board arrangement in place. The latter remains comfortably backed by a comparatively large share of gross official reserves (excluding gold) – nearly 40% of GDP at the end of 2019. As regards the scope for countercyclical financial sector policies, the Bulgarian banking sector has overall been well capitalized and profitable, and additional leeway has been created by the Bulgarian National Bank (BNB) by requiring full capitalization of the banking system's profit and by canceling the planned increases of the countercyclical buffer in 2020 and 2021. Moreover, several liquidity-enhancing measures have been implemented by both the BNB and the state-owned Bulgarian Development Bank, most notably a temporary moratorium that suspends or postpones payments on bank loans, portfolio guarantees on bank loans and interest-free consumer loans for citizens on unpaid leave.

Croatia: coronavirus
containment
measures threaten
main tourist season

Our first point estimate for Croatian GDP growth foresees a sharp contraction of 7.6% in 2020, largely based on the assumption of severe tourism-related revenue losses this year. Tourist revenues in the second quarter of 2020 will likely be completely lost due to coronavirus containment measures. It seems plausible to assume that border restrictions will be among the measures that will be lifted comparatively late and that the uncertainty regarding a renewal of measures, combined with lost holiday leave entitlements and income across Europe, will also have severe negative effects on the main tourist season in the third quarter. The tourism sector has an indirect share in total employment and in gross value-added of around 20% to 25%.

The current forecast projects a drop in private consumption of 12%. We assume that, in the second quarter of 2020, domestic consumption will experience a much sharper drop due to the closure of shops, restaurants, etc., but that these domestic containment measures will be slowly lifted in the course of the same quarter. The Croatian government has passed an economic package worth 7.5% of GDP to support businesses and households. Whether this package will prove sufficient to shield the private sector from major permanent income and job losses that would weaken consumption even further will depend on how soon domestic businesses and trade relations can return to some normality. The weak tourist season will, however, dampen the recovery of consumption in the second half of 2020. Public consumption is expected to grow by 6% year on year in 2020, largely on the back of higher health-care expenditure, and then shrink due to fiscal consolidation needs.

Gross fixed capital formation is expected to shrink by 12% in 2020. The uncertainty triggered by the coronavirus crisis, revenue losses and higher debt levels for businesses will weigh on private investments. However, a much larger share of investments in Croatia is related to EU funds, for which we assume only short-lived disruptions during the second quarter of 2020; over the remainder

of the forecast horizon, fiscal consolidation needs could negatively impact the co-financing of EU-funded projects.

Our assumptions for the tourism sector imply a sharp drop in service exports and thus overall exports (–23%). Moreover, Italy is Croatia’s largest trading partner, which worsens supply chain disruptions for Croatian firms and the outlook for goods exports. However, given the high import content of private consumption, investments and tourism, we project a similarly sharp drop in imports (–24%) for 2020.

We currently see mostly downside risks to our GDP forecast for 2020. On the back of strong tourist seasons in 2021 and 2022, Croatian GDP growth will start to recover. The rebound will likely be moderate, however. While purchases of goods may just have been postponed during the crisis and may help a strong rebound later, revenues from services, such as tourism, are likely permanently lost. Moreover, income losses, lower savings and higher debt in the private sector as well as fiscal consolidation needs as a result of the downturn in 2020 will likely dampen the recovery. We estimate GDP growth to reach 4.2% and 4.5% in 2021 and 2022, respectively. Croatia will therefore need some years to recover the GDP losses of the current crisis. Notwithstanding the current economic downturn, Croatia’s plans to enter ERM II and to adopt the euro remain unchanged.

Economic growth in the Czech Republic has been gradually losing steam for some time, coming down from 4.4% in 2017 to 2.4% in 2019. Even before the coronavirus shock, a further slight moderation of GDP growth was expected for 2020. The coronavirus pandemic and the worldwide containment measures seen since early March have turned the entire economic outlook on its head within a couple of weeks. Not only has the forecast growth performance changed dramatically but also its structure has made a U-turn. From the current perspective – which is obviously subject to an enormous amount of uncertainty and significant downside risks – the Czech economy seems to be headed for a deep recession in 2020, which will be at least as pronounced as seen in 2009. Only a gradual recovery will follow in the medium term. With respect to demand-side components, the slide will be driven predominantly by private consumption and investment as a result of the shutdown measures.

Concerning actual health risks, the Czech health-care system appears better suited to cope with the pandemic than the health-care systems of many other countries in and beyond the CESEE region as various health-care indicators and rankings suggest.⁵ More importantly, the Czech government introduced rather strict containment measures very early into the pandemic. Only 11 days after the first confirmed coronavirus patient on March 1, the government declared a state of emergency and by mid-March the country had largely closed its borders, most shops, restaurants as well as cultural and sports venues, had forbidden the entry of foreigners and issued a nationwide curfew. In addition, virtually the entire automobile industry – the lung of the Czech economy, making up nearly 25% of the country’s industrial production and exports as well as roughly 7.5% of GDP and all FDI – will come to a total standstill for at least four weeks. Moreover, the very

Czech Republic:
economic
rollercoaster with
domestic demand in
the driving seat

⁵ For example, with respect to the number of critical care beds available per unit of population, one of the indicators that particularly matter in the current crisis, the Czech health-care system matches the EU average. However, the range is very broad, and the Czech Republic operates only one-third of beds compared to Germany but twice as many as Sweden (see <https://www.researchgate.net/publication/229013572> *The variability of critical care bed numbers in Europe*).

high level of internationalization of the Czech economy and its deep integration in global value chains are likely to amplify the extent of the shock.

Overall, such massive domestic impediments magnified by an unprecedented drop in external demand will have a devastating impact on private consumption, investment as well as trade in goods and services, probably well beyond the period of the acute coronavirus threat. The damage to the economy is likely to rise over time. Hence, we expect the Czech economy to remain in a strong recession with a pronounced anti-inflationary effect for the rest of the year and only a gradual recovery in the medium term. Domestic demand will contribute to the decline in economic activity most strongly. The unprecedented monetary and fiscal stimulus measures as well as a weaker koruna, which has depreciated significantly as a result of the dramatic economic outlook and financial market panic, may partly offset the economic damage but only in the medium term.

Hungary:
coronavirus crisis
will moderate GDP
growth path over
2020–2022

Hungary's GDP growth in 2019 surpassed our expectations (4.9% against 4.4%) and thus decelerated only slightly compared to 2018. However, we now expect a contraction of GDP by around 3.5% in 2020, to be followed by a gradual recovery in 2021 and 2022.

The pandemic will knock down private consumption, which will be directly hit by the suspension of entertainment activities and the closure of shops, restaurants and cafés. Second-round effects will likely include an increase in unemployment, potential wage losses due to temporary layoffs or shorter working hours, weaker wage growth, a deterioration in consumer confidence and probably weaker household credit growth (owing to greater caution on part of both households and banks). The moratorium on debt servicing until end-2020, the introduction of a temporary interest rate cap on consumption loans, the temporary suspension of tax payments and reduction in social security contributions in sectors most affected by the pandemic and the fact that households' net financial wealth is at record highs are expected to provide a cushion. With pandemic effects easing off toward end-2020, we expect a recovery of private consumption in 2021 and 2022.

We expect economic policy to continue counteracting the impact of the coronavirus pandemic. The Hungarian central bank (MNB) has substantially expanded its liquidity provision to banks via stepped-up foreign currency swaps and the introduction of new collateralized loan facilities. It has also taken several measures to ease the administrative and regulatory burden of banks, while at the same time strengthening banking sector stability. The government and parliament have already enacted various temporary measures. The government will also make substantial changes to the 2020–2021 budget to restructure expenditure and possibly increase the 2021 deficit target to up to 3% of GDP. We expect some fiscal correction in 2021 (if, as assumed, the pandemic recedes by end-2020), to be followed by a temporary acceleration in 2022, in line with the electoral cycle (parliamentary elections in spring 2022). Hungary's emergency law that enables the prime minister to rule by decree without time limits has been met with international criticism.

Investment activity was set to decelerate in 2020 and 2021 already in our baseline scenario, mostly on account of weakening public sector investments and housing construction. As a result of the coronavirus crisis, we expect deteriorating household income and consumer sentiment and a potentially weaker uptake of subsidized loans to additionally slow housing construction in 2020. Capacity

utilization in industry has already fallen back to its long-time average and is now expected to drop further in the coming months. Companies will likely cut back investments in 2020 in response to the damage to global value chains, weaker near-term demand prospects (affecting both domestic and export demand) and likely deteriorating economic sentiment. Favorable and abundant financing facilities (not least due to the central bank's various funding schemes) should partly mitigate the decline in investment activity. Investments are expected to rebound in 2021 and continue to be supported by EU funds.

We expect exports to contract sharply in 2020 as the pandemic is causing notable damage to global value chains, foreign supplies are being interrupted, foreign demand is nose-diving, and short-term global growth prospects are deteriorating. Given the high import content of exports and the decline in domestic demand, we expect imports to contract somewhat more than exports, leading to a small positive contribution of net real exports to overall GDP growth in 2020. For 2021 and 2022, we expect a recovery of exports, as foreign demand recovers and additional impulses come from new production capacities going online. Imports are expected to rise on the back of recovering domestic demand, leading to a minor negative contribution of net real exports to the GDP growth rate.

In Poland, GDP is forecast to decline by -4.3% year on year in 2020, after growth of 4.0% in 2019. In the last quarter before the coronavirus outbreak, export growth had declined further and imports even slightly contracted, while domestic demand growth had remained stable at almost 3% . The economic fallout from the coronavirus crisis in 2020 will arise from both gross exports and domestic demand, with the former having a weight of about 35% in total final demand. Given our assumptions about the developments in the euro area, Poland's main trading partner, exports of goods and services are forecast to decline by about 7% , with nominal depreciation of the currency helping preserve Polish market shares in the euro area. Domestic demand in Poland, like in all other countries, will be severely hit by the health policy measures, implying a contraction by about 4% to 5% – indeed, there is not much scope for repeating the exceptional relative performance of 2008–2009.

In 2021, the economy is forecast to expand by almost 3.0% , 2.8% to be specific. Despite starting from a significantly lower level and being supported by a beneficial base effect, growth is forecast to be smaller in absolute terms than during the previous decline, on account of economic hysteresis effects and a protracted route toward normalization in terms of health policy measures. While exports will start expanding again, driven by the recovery of demand in the euro area, some export-oriented SMEs will likely vanish, and others struggle to regain their previous strength. Together with a recovery of sentiment in the financial markets, these losses are forecast to dampen the speed of export growth.

As a result, imports are forecast to decline even more strongly than exports in 2020, reflecting the price effect of currency depreciation and the significant contraction of domestic demand on top of the impact of the export decline. Thus, there will be a positive contribution of net exports to GDP growth of almost 1 percentage point. By contrast, in 2021, import growth is forecast to outpace export growth, as pent-up domestic demand will compound the effect of restarting foreign demand growth. This will cause the contribution of net exports to GDP growth to enter negative territory, reaching almost -1 percentage point.

Poland:
coronavirus-induced
output loss in 2020
will not be fully
recovered in 2021

Looking at the components of domestic demand, in the last quarter before the coronavirus outbreak and at the beginning of the year, consumption had already received several stimuli, ranging from fiscal transfer measures, including the widening of family benefits to include higher income segments and the one-off thirteenth-month pension payment, and an increase in public sector wages, to changes in the personal income tax system. At the same time, enterprises had been in a favorable financing situation with respect to both own funds (profitability, accumulated deposits) and external funds (low interest rates). These factors are expected to provide some cushion against the immediate impact of the coronavirus-related health policy measures. In addition, monetary policy easing (rate cut, reserve requirements, repo operations and outright government bond purchases), commercial banks' moratorium offers to households and SMEs of up to six months, the exemption of self-employed people and micro-companies from social security payments and the economic/fiscal support package of EUR 46 billion (about 10% of GDP) will help contain a domestic demand contraction in 2020 and support a re-start in 2021. Fixed investment will be hit particularly hard in 2020, as the coronavirus effects exacerbate the already ongoing slowdown due to the impact of the fading-out EU funding cycle on local governments and (publicly owned) companies.

Romania: from overheating to recession with limited policy space

After a period of strong growth with signs of overheating, Romania will experience a deep recession in 2020. Both domestic and external demand will be substantially hit by the economic impact of the spread of the coronavirus and related containment measures. While the first quarter of 2020 will already be partly affected, a deeply negative growth rate is projected for the second quarter. The recovery will likely be gradual, as uncertainties will depress economic sentiment and hysteresis effects stemming from rising unemployment and insolvent companies will prevent a more forceful recovery.

The temporary closure of the two major car producers Dacia and Ford and other companies in the manufacturing sector starting from mid-March, will have an immediate impact on exports. We do not expect a fast return of production to full capacities, though closures were initially announced to last only for some weeks. In addition to supply-side factors, exports will also be negatively affected by plummeting external demand in 2020. After a marked decline of exports in 2020, base effects and recovering external demand will enable exports to grow again in 2021. Due to the high import content of exports and shrinking domestic demand, imports will also contract considerably in 2020. This might induce a very small, positive contribution of net exports in 2020, which will turn negative in 2021.

High wage growth will come to an end due to rising unemployment and wage losses triggered by temporary layoffs. This will add to the negative impact of containment measures (such as restrictions on movement) and confidence effects on private consumption. Hence, we expect negative private consumption growth in 2020, followed by a hesitant recovery in 2021 and 2022. Households' deteriorating income position and loss of confidence will also have an impact on capital formation, in the form of less residential building construction. While debtors are allowed to postpone their loan repayments, demand for new housing loans might decline during the economic downturn. Residential building investment is likely to recover only slowly but investments supported by EU funds will enable some recovery of capital formation (provided the Romanian government manages to free up budgetary resources for cofinancing). At the same time, shrinking earnings and

confidence effects will negatively affect corporate investment – definitely in 2020 and possibly also beyond. However, state guarantees for investment loans to SMEs will provide some cushion. In the medium term, Romania could benefit from a reallocation of production capacities, as multinational European companies might try to increase capacities in Europe to make production chains less vulnerable to global disruptions.

As growth in recent years was fueled by procyclical fiscal policy leading to a high budget deficit, fiscal space to counteract recessionary developments appears limited. Fiscal consolidation is inevitable in the near future and will slow down the recovery in 2021 and 2022. By purchasing government bonds on the secondary markets, the central bank has supported the financing of public spending. Yet, monetary policy is subject to certain constraints, too. In this respect, the current account deficit and the remaining stock of foreign currency loans, in particular in the household sector, should be noted. External imbalances might reinforce depreciation pressures on the exchange rate in times of international financial market turbulences. Hence, under tense market conditions, the central bank needs to strike a balance between managing the exchange rate (to contain balance sheet effects) and injecting more liquidity. It should be noted that cutting minimum reserve requirements for leu and foreign currency liabilities still is available as a policy option for the central bank.

Negative spillover effects from Italy cloud the outlook for the Romanian economy further due to a comparatively high degree of trade integration, the presence of Italian investors and the declining income of labor migrants. On a positive note, the impact of the crisis through tourism will be quite limited in Romania, as tourism plays a much smaller role in Romania than e.g. in Croatia and is also markedly less relevant than in neighboring Bulgaria.

3 Russian economy set to contract in 2020

Russia's GDP growth slowed down last year to 1.3% due to lower growth in private consumption resulting from the hike in value-added tax and because of shrinking exports. The coronavirus pandemic and falling oil prices have seriously eroded prospects for the Russian economy. Thus, we expect Russia's growth to turn negative this year, reaching -3%. Growth is expected to revive next year as the outlook for the global economy recovers and Russia's public sector spending rises further. The risk of a weaker than expected outcome is significant due to the uncertainty on commodity markets and effects of the coronavirus pandemic.

If the weakening of the global economy remains temporary, Russia is expected to stick to its current spending plans. Under the approved 2020–2022 budget framework, public sector spending will increase by 6% to 7% a year in nominal terms. With the current oil price outlook, however, the net deficit will turn negative this year. Russia's ability to deal with external shocks is supported by the Russian government's comfortable financial position. The Russian government carries little debt (14% of GDP), but U.S. sanctions restrict its ability to borrow internationally. Russia has also built up its sovereign wealth fund again. The National Welfare Fund now holds about USD 150 billion in liquid assets (9% of GDP). So far, public sector support measures related to the coronavirus situation have been relatively limited in terms of spending and have been realized within the current budget framework, but additional measures may be decided.

Consumption is expected to contract this year hampered by slower economic activity and measures to contain the coronavirus pandemic. Recent ruble depreciation is likely to increase inflation and thus reduce purchasing power. In addition, consumption growth will be restrained by lower growth in consumer credit due to tighter regulation. In coming years, consumption growth is expected to pick up, supported by a gradual rise in incomes, including planned increases in social spending. Fixed investment recovered slightly last year, growing by slightly more than 1%. Fixed investment is expected to decline substantially this year due to the deteriorating economic outlook over the near term; notably, private sector capital formation is expected to decline sharply, whereas public sector investment may slightly increase, with the government attempting to push forward national projects. Fixed investment should then gradually pick up in the coming years as spending on national projects gets into full swing.

Russian exports contracted by 2% in 2019 for the first time in decades. Much of the contraction was due to a decline in metal and grain exports. Exports are expected to contract even more this year due to the weakness in the global economy. Exports should recover gradually next year as demand returns. Russian imports grew moderately last year supported by ruble appreciation. Imports are expected to fall substantially this year, constrained particularly by ruble depreciation from lower oil prices. Imports should also be dampened by investment demand's public sector focus, which favors domestic suppliers. In addition, imports of tourism services will fall substantially due to the coronavirus pandemic.

In the current situation, forecasting risks are exceptionally high. Russia's economic development may turn out considerably weaker if the coronavirus pandemic is prolonged and oil prices fall further for an extended period. Russia, however, has the capacity to soften the impact of negative shocks through government support. The planned referendum on changes to the Russian constitution and the State Duma elections in 2021 could also create pressure to increase public sector spending. In addition, a stronger than expected fall in imports could mitigate the GDP contraction.