Economic climate in Central and Eastern Europe during the COVID-19 pandemic

The COVID-19 crisis is going to exacerbate the business activity decline in the EU that has lasted for two years now. / The drop in output and sales recorded in the EU in March and April 2020 was the deepest in the last 20 years. / Indices reflecting changes in the economic sentiments in the Visegrad Group recorded the largest decline in history. / Only 9% of Polish manufacturing and trade companies were not affected by adverse effects of COVID-19 restrictions, while one in four perceived them as severe. / In response to impediments for business activity, companies mostly cut non-employee related expenses (52%) and reduce working time (50%).

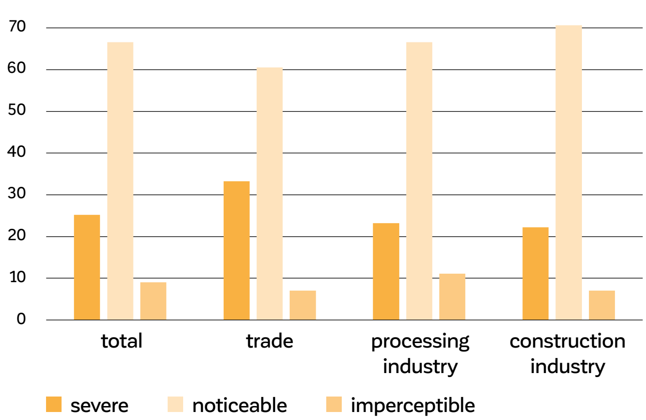
Restrictions introduced after the COVID-19 epidemic outbreak caused an immense economic shock. According to research carried out in April 2020 by the Institute of Economic Development of SGH Warsaw School of Economics, only 9% of Polish manufacturing and trade companies were not affected by the adverse effects of restrictions, while one in four perceived them as severe (Figure 1). Those who suffered the most were trade enterprises. Only 7% of them did not report negative effects of restrictions imposed by the government, while one third considered them to be severe. Those less affected by the crisis were construction companies, as 22% of which regarded the consequences of restriction as severe, and processing industry businesses, 11% of which were not affected by the negative consequences of measures introduced to control the epidemic.

The crisis manifested itself by a drop in basic economic activity measures: rate of output, sales, orders and investments, production capacity utilisation, prices and, to a lesser extent, employment. The slump in sales and prices strongly affected the financial situation of businesses. Economic climate indicators presenting in a synthesized manner the situation in the analysed fields of economy, reached historical lows. The situation in the processing industry, construction and trade has not been so bad in any of the crises during the last 20 years.

In response to impediments for business activity and the resulting decrease in income, companies mostly cut non-employee related expenses (52%) and reduce working time (50%) – Figure 2. In 27% of firms employee wages have been or are planned to be reduced, and every fifth enterprise is cutting down on staff. Measures undertaken in the first place by trade companies include reduction of working time, cutting non-employee related expenses and employment downsizing (63%, 52% an 29% respectively). Construction and industrial companies mostly attempt to cut non-employee related expenses (51% and 53% respectively), followed by employment changes through working time reduction (46% and 47%), workforce downsizing (29% for both types) and redundancies (22% and 17%).

At the moment of the COVID-19 pandemic outbreak the European Union (EU-27) was already experiencing economic slowdown, which began at the turn of 2018, thus ending the long expansion phase lasting from 2014. Restrictions of business activity introduced in March 2020 intensified the decline.

FIGURE 1. Impact of the economy lockdown on the situation of businesses (%)



Source: own study by SGH Warsaw School of Economics

FIGURE 2. Businesses' response to the crisis caused by COVID-19 epidemic (%)

Source: own study by SGH Warsaw School of Economics

TABLE 1. Changes (monthly – m/m, annual – y/y and aggregate since the last upper turning point, UTP) of the smoothed confidence indices in: industry (ICI), construction (CCI) and retail trade (RCI) in the European Union in 2020 (pts)*

	ICI			CCI			RCI		
Month	**m/m**	**y/y**	**Since UTP**	**m/m**	**y/y**	**Since UTP**	**m/m**	**y/y**	**Since UTP**
March	–4.5	–9.5	–18.1	–2.8	–6.3	–7.0	–7.7	–8.1	–6.7
April	–21.6	–28.8	–39.7	–19.4	–24.6	–26.4	–22.8	–29.5	–29.5
May	5.0	–24.8	–34.7	–1.0	–23.9	–27.4	0.9	–28.9	–28.6

* Last upper turning points: ICI – June 2019, CCI – January 2019, RCI – April 2019
Source: own study by SGH Warsaw School of Economics based on data of Eurostat.

TABLE 2. Monthly changes in the smoothed confidence indices in industry (ICI), construction (CCI), retail trade (RCI) and consumer sentiment index (CSI) in the Visegrad Group in 2020 (pts).

Country	Month	ICI	CCI	RCI	CSI
CZ	March	–5.0	0.9	–5.3	–1.0
	April	–20.4	–8.5	–14.4	–13.9
	May	2.4	–1.9	5.9	7.6
HU	March	–2.9	–7.1	–4.2	–0.4
	April	–20.8	–9.5	–23.6	–25.8
	May	–1.5	–9.2	9.1	6.1
PL	March	–21.8	–1.9	–1.5	1.5
	April	–8.0	–28.4	–31.4	–24.5
	May	8.0	3.7	–1.8	2.4
SK	March	–2.3	4.6	2.2	1.4
	April	–39.2	–41	–31.5	–22.1
	May	13.7	–2.4	2.5	2.1

Source: own study on the basis of data of Eurostat and IRG SGH.

The economic downturn was sharp. In the first quarter of 2020 the smoothed index of real GDP lost 3.6 points. Since the peak in the fourth quarter of 2018 the cyclical component of real GDP fell in total by 3.0 points, or on average by 0.6 per quarter. Therefore, the intensity of the fall is only slightly smaller than the one recorded during the global financial and economic crisis. In that time, or from the fourth quarter of 2007 to the third quarter of 2009, the cyclical real GDP was falling on average by 0.9 points per quarter. The GDP drop in the first quarter was coupled with a collapse in private demand. The rate of consumption fell by 4.6 points compared to the fourth quarter of 2019, and the investment rate shrank by 4.9. The demand shock was huge. The drop in the smoothed private consumption index was almost four times bigger than the biggest one recorded before (second quarter of 2000) and the biggest drops in the smoothed fixed assets expenses were recorded only in the first quarter of 2009 (by 6.7 points) and the third quarter of 2019 (by 5.1 points).

An analysis of data available for the second quarter 2020 shows that the crisis in the European Union exacerbated in April. The volume of industrial production decreased (the index shrank by as much as 17 points, in March by 12.7 points), the same happened for construction and assembly production (by 11.4 points and by 15.2 in March) and retail sales (by 11.2 points and 11.4 in March). The drop in output and sales recorded in March and April was the deepest in the last 20 years. The crisis especially negatively affected economic sentiments. The economic sentiment indicator (ESI) fell in March compared to February by 8.4 points, and in April by further 30.8 points (sic) (the biggest monthly decrease in history). The April rate of ESI (63.8) was the lowest since January 1996. Annual drops were also historical: the one from April was by 40.2 points (the largest previously recorded drop was 36.9 in March 2009). In total, since the last peak in August 2018, ESI has lost over 48 points – almost a half, over 39 points of which just in March and April 2020. Similar changes occurred in the industrial, construction and trade sectors (Table 1).

In May most EU-27 states started to gradually lift the restrictions introduced in March. As a consequence, the EU economy saw some symptoms of recovery. In May ESI grew by 2.9 points. Indicators of economic climate in processing industry and trade also improved (Table 1).

Similarly to the European Union, the Visegrad Group states also experienced huge anxiety caused by COVID-19, which accelerated the downturn forecast by economic sentiment indices already in 2018/2019. Indices reflecting changes in the economic sentiments recorded the largest drops in history. Already the decline in March was the deepest in almost 25 years. In April the economic slowdown exacerbated. The economic sentiment index that in a synthesized manner measures the economic situation and confidence of the economic actors, in both months lost: 52 points in Poland, 42.1 points in Slovakia, 31.8 in Czechia and 29.5 points in Hungary (39.2 points in EU-27). Slight improvement was recorded in May, which however did not include Poland, where ESI dropped by 0.3 points. In the three other Visegrad Group countries ESI grew by 3.9, 0.1, 1.2 points respectively (in the EU-27 the growth was 2.9 points). Table 2 presents changes in the fragmentary indices for the last three months. In each case the April drops were the biggest since the beginning of Eurostat's research on the economic situation, as they much exceeded average monthly drops of the indices.

The data presented in Table 2 show that individual economies of the Visegrad Group were differently affected by the crisis, despite its pervasive nature. In Czechia the crisis affected mainly the industry, while the consumer sentiment and retail trade were the least affected. In Hungary the crisis mostly depressed consumer sentiment and decreased consumer spending. The impact was felt most strongly in April and it was short. Consumer sentiment was still bad, although relatively moderate. In Poland the crisis impacted mainly the processing industry. It was felt by the construction industry and the consumers in April. Poland is the country where the May upturn was the best visible. The producer sentiments were most affected in Slovakia – they fell down twice more than in other countries. In May in all the Visegrad Group states the situation in individual industries and consumer sentiments revived, except construction (not in Poland), the recovery of which is visibly more sluggish.

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