Probable impact of the Corona virus in the case of Romania – balanced scenario

In the context of Sars-2-COVID 19 epidemic having outburst in China at the end of 2019, the spring forecast economic growth perspectives worldwide are heavily uncertain.

The rapid propagation of the pandemic in Europe and on the American continent has affected so far almost 2 million citizens, from over 180 states. Thus, Sars-2-COVID 19 pandemic has changed into the most important negative shock addressing the world economy after the economic-financial crisis in 2009.

The pandemic has determined many governments to set up public policies targeting at the improvement of the health management and the prevention of further collapse of the sanitary systems. These are priority measures, imposed by the sanitary system situation, so that there is no large room left for other options, as the main priority is the citizens' health. The consequences of such measures are the temporary lockdown of many businesses, major constrains for travel and mobility, turbulence on the financial market and erosion of trust. On a permanent changing context, it's very difficult to quantify the magnitude of these measures' impact on GDP growth, but obviously it involves output contraction, diminished household expenditures, investment and international trade.

The impact of Sars-2- COVID 19 on economies will differ from country to country and will depend on the degree of severity the economy has been hit with, the sanitary system's capacity and the pack of measures adopted by each country in order to limit the effects on the economy.

The international context is further affected by the decrease in the oil price. After repeated rounds of negotiations in the view of stabilizing the market, OPEC+ representatives have recently come to an agreement for the reduction of the oil production during May and June 2020.

According to the most recent World Bank's estimates, published at the beginning of April, the two scenarios estimate an economic contraction on the European and Central Asian Zone, so that the growth will be between -2.8% and -4.4%. Such margins reflect a high degree of uncertainty, caused by the duration of the pandemic and the magnitude of its impact on each economy. Further to the growth perspectives having been initially affected by the impact on the international production and trade chain, presently the negative impact is also amplified by the domestic consumption and lack of investment.

According to the World Banks estimations, the anticipated impact of the COVID 19 pandemic on the Romanian economy will be substantial, at least for the first half of 2020. On this background, the economic growth for this year is estimated at +0.3%. This projection is based on the assumption that the growth will recover in the second half of 2020 and will accelerate as at 4.4% in 2021. Nevertheless, a substantial recession risk for 2020 persists, as many segments of the European economy are blocked because of COVID-19 and the supply and commercial exchange global chains are deeply affected.

Regarding the **recent (April 14th 2020) IMF estimations,** the extremely significant degree of uncertainty of the worldwide forecasts is also underlined. In this context and pursuing the assumption that the economies will begin to recover in the second part of this year, the global economic contraction is anticipated as by 3% in 2020, with a deeper diminution in the advanced economies (-6.1%), while for the European economy the economic contraction is estimated at the level of 7.5% (Germany -7%, France -7.2%, Italy -9.1%). For Romania, FMI estimates a 5% economic contraction for this year, followed by a 3.9% growth in 2021.

However, the economic impact depends on hardly estimated interacting elements, including the pandemic curve, the intensity and effectiveness of the protection measures, turbulences which occur on the supply chains, consequences of the tightening conditions on the global financial markets, the altered consumers behaviour, the effects on trust and the evolution of the ware prices.

Taking into account that the economic recovery will depend on a series of above-mentioned factors, as well as on the possibility for the epidemic to result in structural changes, two evolution scenarios (V" and "L"- shaped) have been considered.

The "V" shaped recovery scenario is the one who depicts the classic impact of a shock, with a pronounced decrease, followed by an almost integral recovery. This scenario has been considered as the most plausible on the basis of the domain’s literature (HBR), developed when similar shocks (SARS, H3N2, H2N2, Spanish flu) were assessed. Thus, the subsequent economic evolutions lead to a "V"-shaped recovery. Therefore, the presented forecast option considers an intermediate-shaped economic recovery, combining the "V" (closer) and "L" -shaped scenarios, with a concrete recovery in the fourth quarter.

There is a set of constraints on the model, imposed by estimation of the macroeconomic impact on the economic growth, as result of Sars-2-COVID 19 pandemic. In the actual scenario, these constraints refer to:

- the actual context, characterised by high uncertainty, from both the statistic (lack of information, data for February – pre-crisis period- has just been released) and the economic (new situation for all the European territory, as the Euro area and the neighbour countries are still unable to clearly assess the economic impact) points of view;
- the information available for the time being, in respect of the stage of infections and of the possible time and space extension rate, throughout the Romanian territory;
- **a negative, but limited as duration /approximately 4 months (March-June) economic impact**, followed by a partial recovery in July-August, based on China's experience, where signs of recovery are noticed after 4 months ;
- **the restrictive conditions related to the isolation and the state of emergency will be totally relaxed starting from June**; any delay in social and economic unlocking will probably have irreversible consequences on the degree of recovery;
- the determined impact is a predominant result of the external shocks, especially in tourism, transport and industry, and on the internal market the effects of the pandemic being more visible on some categories of services for the population during the April-May peak period;
- the areas affected by the external trade relations taken into account in the current scenario **are China - partly for March-May (30% -40%** - the impact being indirect, in relation with Germany), **Italy, with a peak in April (65%)**, **Germany** (with a stronger impact on the auto and electrical equipment industry), **France** and **Spain**, all three areas **with a balanced impact in April-May (on average about 55%)**;

- the impact for all areas will extend beyond the maximum affected period, respectively in **March and June-July by about 20%,** until the end of the year when it is gradually reduced below 5% compared to the winter scenario (without pandemic);
- **favorable macroeconomic conditions will continue to act**, especially starting from the third quarter, taking into account the fact that foreign markets will not be lost, and the economy has the potential to recover through government's measures to conserve income and restart measures (i.e. advantageous credits to SMEs), so that the reversible factors will prevail over the irreversible ones;
- the measures adopted by the Government in order to support the affected companies and employees will have a mitigating effect of the negative impact, both on the number of employees and on the average gross earning on the economy;
- **the economic situation will recover moderately from the third quarter, following an accelerated growth in the latter part of 2020**, but below the scenario in winter - macroeconomic hypothesis;
- trade and tourism will react with a delay, compared with industry and transport (both with a moderate annual growth of about 1% in the third quarter), exports and imports (both returning on growth in the fourth quarter);
- the availability of the population for recreational activities, tourism, services, will turn to normal, but dominated by a prudent attitude.

In order to capture as accurately as possible the effects of coronavirus propagation on macroeconomic indicators, the short-term forecast, respectively at monthly level, was used from the NCSP winter forecast, which represents the baseline scenario.

The impact of the Sars-2-COVID 19 phenomenon on the economy dynamics results from the sectoral level assessments (SQS sector - companies) for certain indicators, respectively:

- Industrial production, being particularly affected the branches with a high export share.

Reductions in the volume of industrial production for the relevant activities, determined in the previously mentioned assumptions, between **March and May 2020 compared to the similar period of 2019**, are presented in the table below. The likely impact on the total industry on the growth in the 3 months most affected is **about 19% compared to 2019 as well as to the winter**

forecast. **The annual impact** on the winter forecast for the industry is **6.9 percentage points** on the growth:

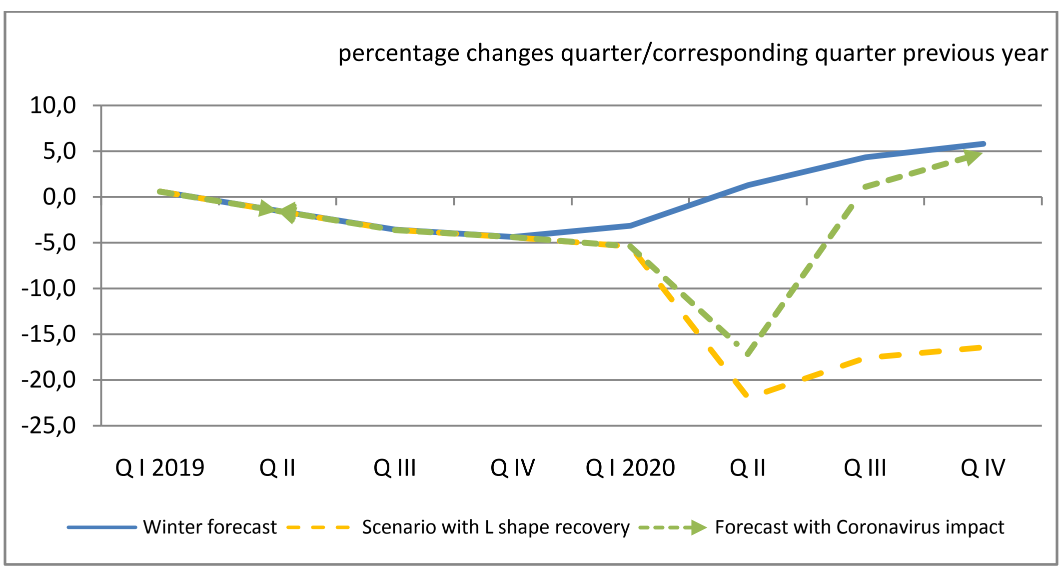
Table 3. Impact of pandemics Sars-2-COVID 19 on industrial output

	Base Structure 2015	**March-May 2020 vs. 2019**
TOTAL	**100.0**	**-19.4**
MANUFACTURING	**79.5**	**-17.7**
Textile products	1.6	-43.0
Clothing articles	5.1	-43.2
Leather goods and footwear	2.0	-37.2
Wood and wooden products manufacturing	3.1	-31.2
Chemical substances and products	3.1	-14.6
Rubber and plastic products	5.5	-27.3
Metallurgy	3.2	-28.2
Metallic construction and metal products	6.1	-15.5
Electric machinery and appliances	3.9	-18.4
Machinery and equipment	4.3	-24.4
Means of road transport	13.3	-34.9
Furniture	2.6	-25.4

Source: National Commission for Strategy and Prognosis

The evolution of industrial production is presented in the figure below, where the L-shaped scenario is hypothetical.

Figure 2. Quarterly evolution of industrial production in 3 scenarios



Source: NCSP computations besed on NIS data

The trend shown is similar for other macroeconomic indicators, the magnitude of the contraction being different.

- **Export of goods,** the influences due to the reduction of the external demand, but also to the limitation of the transport in the red areas. It is estimated a **negative impact at the level of 2020 of 11.3 pp compared to the winter forecast and a reduction with 7.3% compared to 2019.**

- **The import of goods** is affected both at the level of intermediate imports and consumer goods. The effects of the Sars-2-COVID 19 pandemic lead to a **decrease of imports of goods at the current year level of 10.9 pp, and compared to 2019 we have a 6.1% reduction.**

- **The transport services** were estimated to fall in the category of road and air transportation. **The negative impact was estimated at 11.2 pp compared to the winter estimate and 32.3% for the period March-May 2020.**

- **Tourism, hotels and restaurants.** The tourism sector will face a contraction of activities of travel agencies by reducing the departures of Romanian tourists abroad, but also a declining demand for services in hotels and restaurants. This sector is most affected by the Sars-2-COVID 19 pandemic, **for April and May being supposed to reduce the turnover by 60% -70%. 2020 is expected to see a 17.8 pp decrease compared to the winter forecast.**

Table 4. Impact of pandemics Sars-2-COVID 19 on services

	March-May 2020 vs. 2019
TRANSPORTATION	**-32.3**
Hotels and restaurants	**-45.8**
Retail trade	**-7.7**

Source: National Commission for Strategy and Prognosis

- **The retail trade**, for which it is estimated that it will have a **reduced decrease of about 4.9 percentage points at annual level compared to the winter version**, given that the trade sector will register structural changes.

- **The average number of employees** will follow an intermediate trajectory in the form of "V" to "L" similar to that expected for the economic activity, but with a significantly smaller amplitude. Employees entering technical unemployment are also considered methodologically as belonging to the category of active employees, which comes in accordance with a level of the "masked" unemployment rate, slightly modified compared to the winter scenario;

- Under these circumstances, the average number of empoyees is projected to 5087 thou persons, down by 1.6% compared to 2019, bearing in mind the impact of 3 percentage points drop compared to winter scenario; it is worth mentioning that in the Winter 2020 forecast, the growth rate of number of empoyees despite in positive territory, was forecast to 1.7% which coresponded to an average numer of 5242 thou employees (against a background in which further negative impact of world trade on Romanian industry was expected);
- Gross average wage is forecast to 5212 lei/month, down by 4% compared to the amount estimate in Winter forecast and takes into account the effect from the persons benefiting from thechnical unemployment.

The slowdown in the growth rate of sectoral indicators mentioned above led to a revision of the forecast GDP pace in the coronavirus scenario by around 6 percentage points, i.e. from +4.1% to -1.9%.

Table 5. Impact of coronavirus on PIB

	Winter forecast (%)	**Spring forecast (%)**	**Influences (pp)**
GROSS DOMESTIC PRODUCT	**4.1**	**-1.9**	**-6.0**
Expenditures for private consumption	4.8	-0.7	-5.5
Expenditures for government consumption	2.3	2.4	0.1
Gross fixed capital formation	6.8	-2.6	-9.4
Exports of goods and services	4.6	-6.7	-11.3
Imports of goods and services	5.7	-5.6	-11.2
GVA in industry	2.9	-4.2	-7.1
GVA in services - Total	4.2	-1.4	-5.6
- GVA in trade, transport and storage, hotels and restaurants	5.1	-3.7	-8.8
- GVA in social work activities, arts, entertainment and recreation, other services	4.6	-6.7	-11.2

Source: National Commission for Strategy and Prognosis

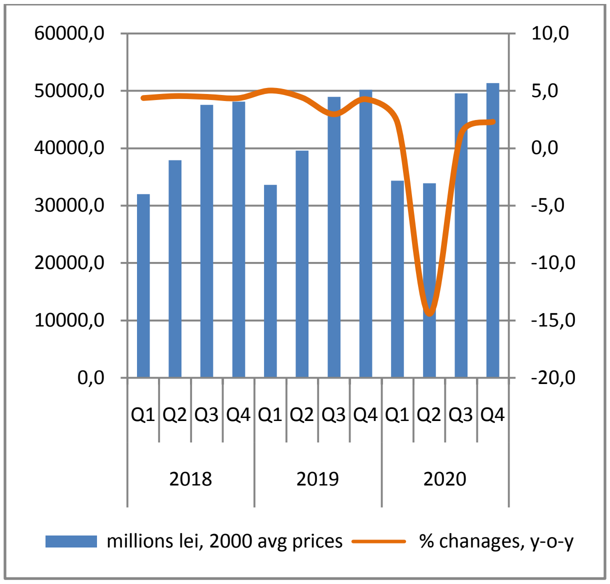
On the supply side, expected decreases in activity are expected in industry (-4.2%) and construction (-1.7%), in the first case the COVID-19 crisis leading to a worsening in a downward trend that started in Q2 2019 already.The impact of COVID-19 on construction will be more severe, with a reduction in growth rate by more than 7 percentage points, while in the case of services by 5.6 percentage points with the most hit sectors: social work activities, arts, entertainment and recreation, other services (by around 11 percentage points compared to winter scenario), trade, transport and storage, hotels and restaurants (-8.8 pps) and real estate (-9 pp).

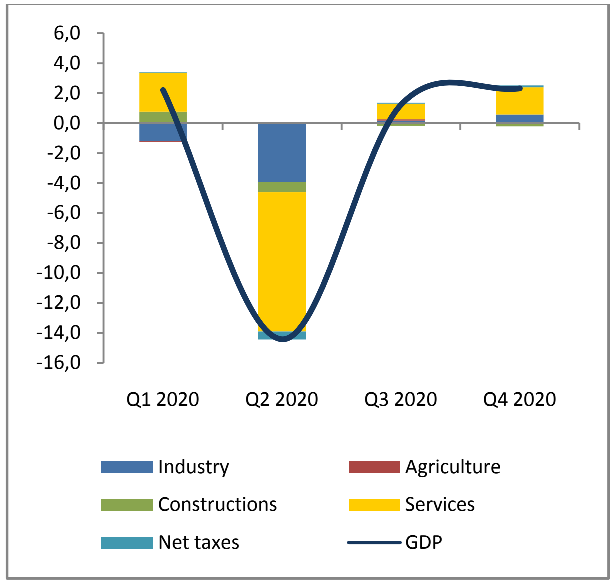
On the demand side, the gross fixed capital formation will drop down by 2.6% compared to the previous year (by 9.4 percentage points lower than in the winter scenario) with the COVID-19 impact being significant and leading to a more restrictive investment behavior of the private sector. To a lesser extent, the expenditures for private consumption that are underpinned by a moderate increase in net wage as a result of the measures taken by the Government in order to control and seize the effects of epidemics, will be affected.

In the conditions of malfunctioning of trade relations in the external markets, the current account deficit is expected to shrink from 4.6% of GDP in 2019 and 4.5% of GDP in the baseline scenario to 4.1% of GDP in the current estimation. The narrowing of the current account gap is caused by a contraction in the trade deficit (from -18.6 bn euros in the winter forecast to -16.8 bn euros). On the other hand, the service account is foreseen to narrow its surplus by 0.7 bn euros due to expected drops in transportation and tourism.

The short term profile of the economic growth follows a severe drop in activity in the second quarter by more than 14% compared to the similar period of the previous year, followed by a mild recovery of 1.2% in Q3 and a slight acceleration to 2.3% to the end of the year. During the maximum negative impact of coronavirus, the services will render a negative contribution of 9.3 pps to GDP growth followed by industry (-3.9 pps). The service sector will be hit in this period by real estate, reacreational activities, maintenance, hotels and restaurants.

Figure 3. The evolution of GDP and sector's contribution to economic growth





Source: NCSP computations besed on NIS data

The economic growth needs substantial support tghrough fiscal incentives coordinated at EU level and from the Government of Romania. The support is focused on fiscal expenditures aimig at diminishing the effects of pandemics, postponement of taxes, liquidities to the companies, SMEs and companies from sverely hit sectors such as transportations and tourism as wel as support for the impacted workers and freelancers.

In this respect, the EU launched an initiative to answer to COVID-19 amounting 37 bn euros focused on healts services, SMEs, labor market and other vulnerable fields of the European economy. Overally, it is envisaged that the stimulus will reach 1% of the EU GDP in 2020. The growth will benefit from spillovers from the global fiscal losening in a context of low prices to fuels.

A loger lasting a more severe crisis tha initially anticpated will shadow the growth perspectives and will damage the companies and employment. At the same time, a prolonged slowdown of the European economy, and especially Germany and Italy, the main trading partners of Romania, would put additional pressure on the national economy. On the other hand, a rapid and focused fiscal stimulus, coordinated at national and the EU level would limit the effects of the crises and foster the recovery.

The current measures taken by the Governemnt have a positive alleviating impact during wage blockdowns by partially maintaing the levels of salaries, diminishing the wage costs of companies allowing for a recovery of the economy on an upward path during the last quarters of 2020.

The current scenario might be revised once fresh statistical data covering the period March-June are released, most probably with the occasion of the budget rectification in summer. The medium term scenario will be probably built at the beginning of May, even thou there is not an agreement at European level many member states chosing to postpone the Sprin forecast.