



HRVATSKA NARODNA BANKA

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**Pandemic and the growth potential – which shape will  
the recovery take and what are the risks?**

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# Large and diverse shock

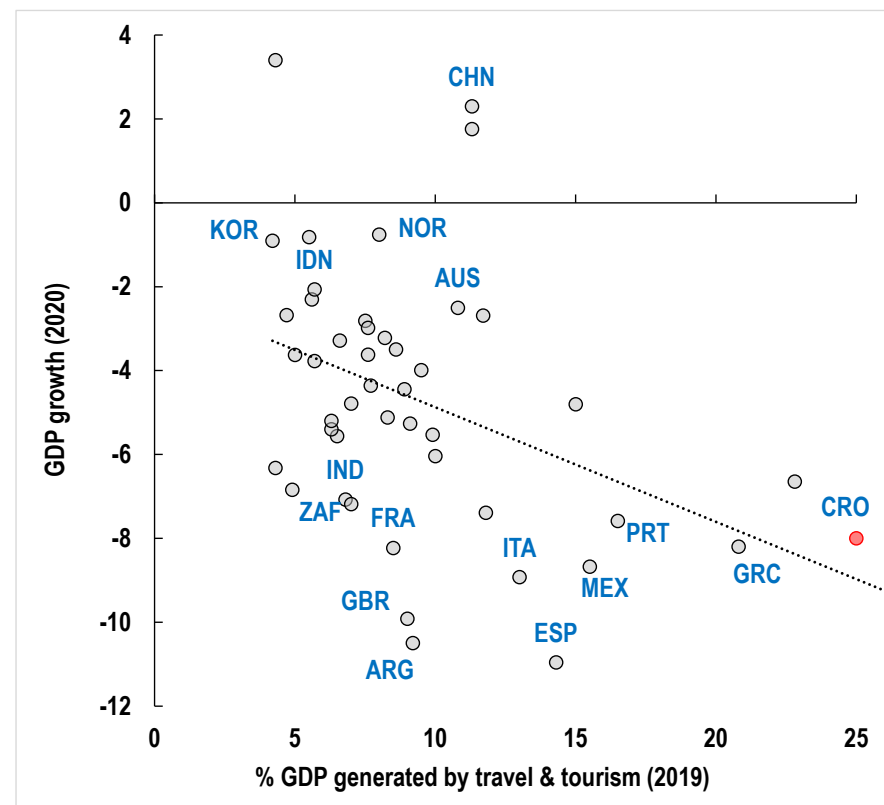
## □ within countries

- high-contact sectors heavily affected

## □ across countries

- path of the pandemic and curbs to mobility
- differences in economic structures
- magnitude and effectiveness of fiscal and monetary support
- adaptation of economy to the pandemic

### Tourism and GDP



Note: This chart is downloaded from OECD Interim Economic Outlook presentation from March 2021. Data includes 45 countries, Croatian data were added to the chart.

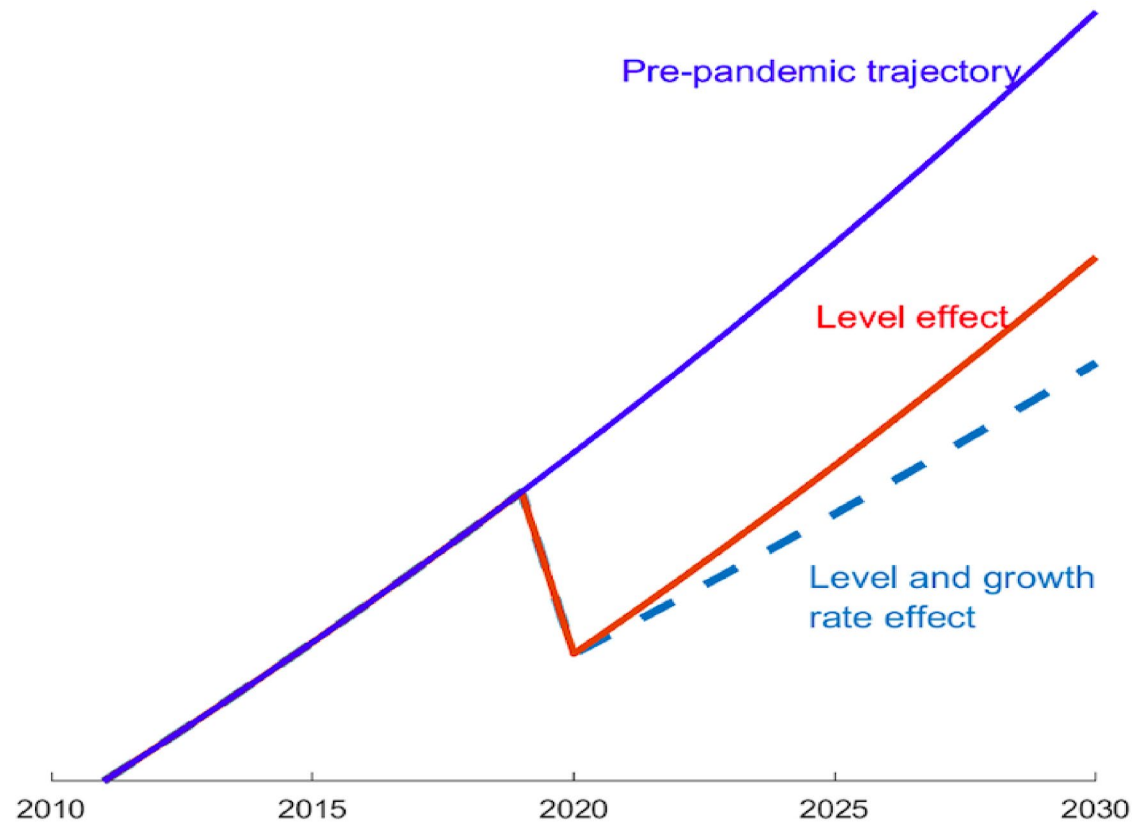
Sources: OECD (data and calculations), WTTC and DZS (for Croatia).

# Transmission channels of COVID-19 to potential output

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- **hysteresis in the labor market** (younger and lower skilled workers, older workers)
- channel of transmission to capital is reflected through significantly **lower investments** due to high uncertainty and accelerator effect
- **effect of pandemic shock to TFP growth is unclear, there are negative effects:**
  - disruptions in distribution chains, erosion of human capital, declining quality of education
  - financial distress in the corporate sector – corporate defaults and job destruction related to exits
- **but there are also silver linings**
  - higher investment in R&D
  - accelerated digitalization
  - reallocation of jobs from low-skilled services to potentially more productive sectors

# Stylised representation of possible scarring to potential output following COVID-19

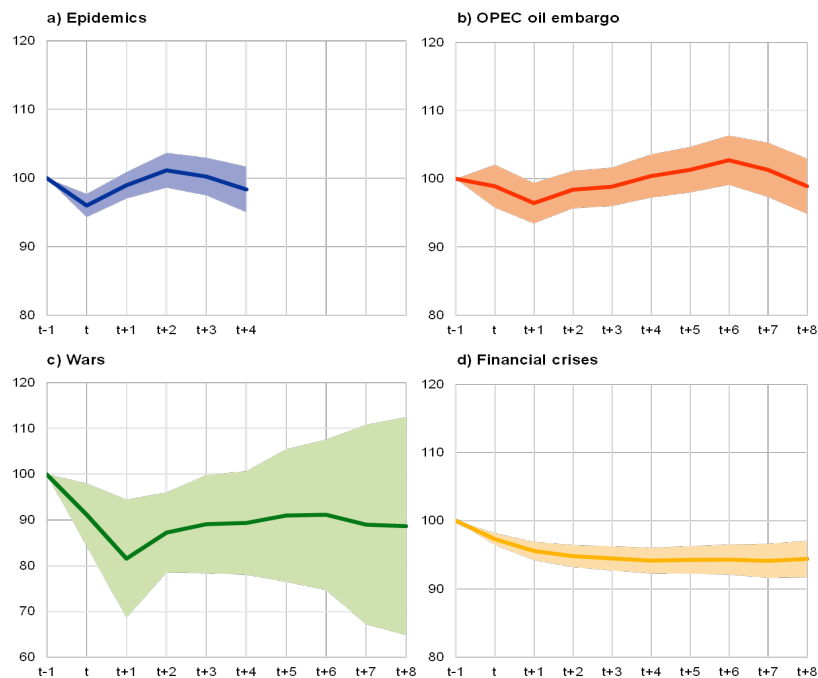


- the level of potential output is likely to be subdued post-COVID relative to its pre-pandemic estimates
- pandemic shock can affect the potential output of the economy through the initial impact on the level of economic output, but also by affecting future growth rates (scarring)

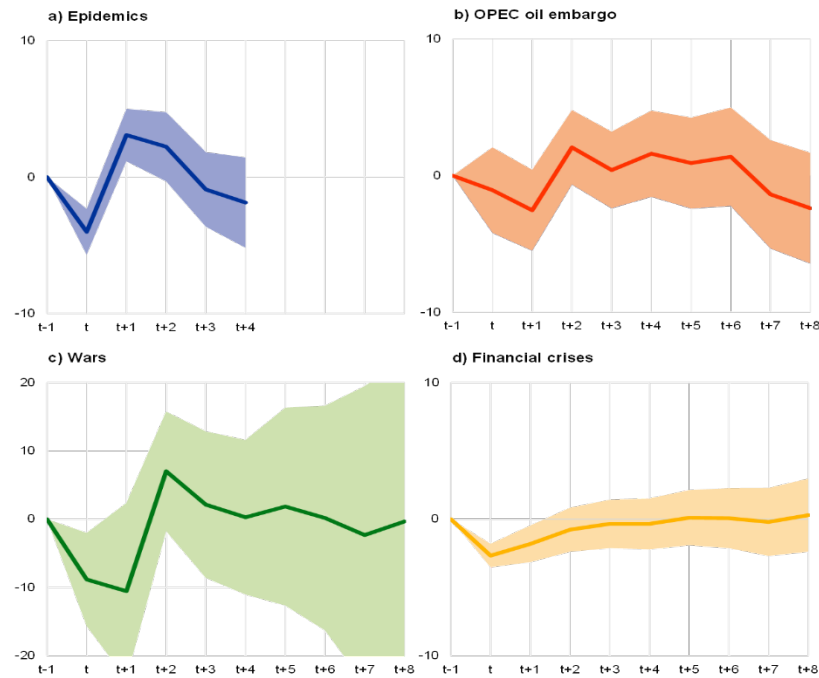
Source: Fernald, J., & Li, H. (2021, February). The Impact of COVID on Potential Output. Federal Reserve Bank of San Francisco.

# Scarring effects of past epidemics and other crises

## Potential output level



## Potential output growth



Note: The continuous lines indicate the impact of the respective event in year  $t$  on the level of potential output up to the period  $t+8$ , i.e. eight years after the end of the event, and the shaded areas depict the 95% confidence interval. The impact on potential output is estimated with a local projections approach, based on a global panel that includes all events simultaneously, four lags of potential output growth to control for endogeneity, and country-fixed effects. As most of the epidemics considered in the analysis are relatively recent, the sample only allows their impact to be calculated until four years after the end of the epidemic. Potential output is defined as the level of output that is consistent with the productive capacity of an economy.

Source: ECB. (2020). The scarring effects of past crises on the global economy. Frankfurt: ECB Economic Bulletin, Issue 8/2020. European Central Bank.

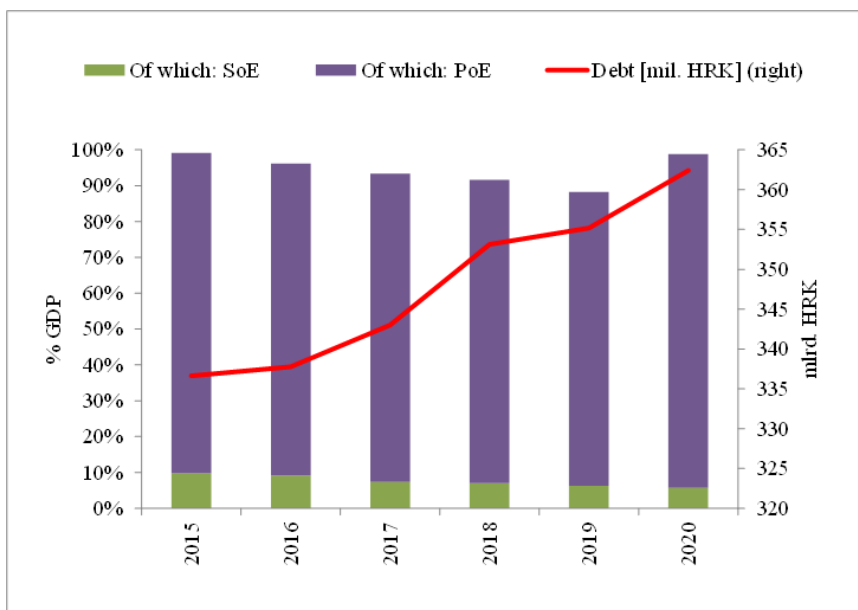
# Corporate sector - the knife-edge problem

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- ❑ lockdowns, costs of containment measures, collapse in demand, supply-chain disruptions and general uncertainty hit companies hard (IMF, Ebeke et al., 2021)
- ❑ ample fiscal support kept companies afloat
  - corporate bankruptcies went down
- ❑ too early withdrawal of support would destroy many viable companies and depress potential growth
- ❑ excessive support may hinder corporate restructuring
  - “zombies” capture resources (labor, capital), crowd out healthy companies and impede the long term growth
  
- ❑ how to target support and time the withdrawal?

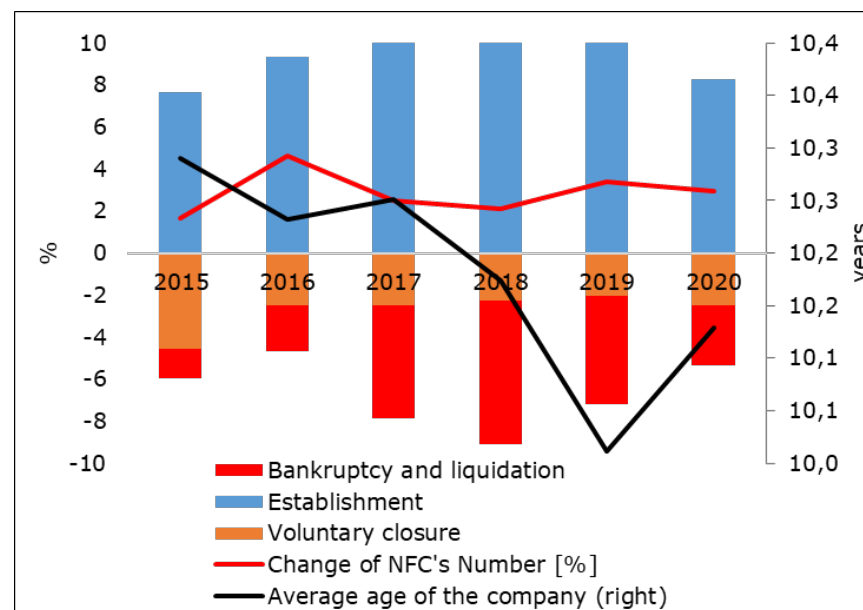
# The case of Croatia – higher debt and slower exit from the market

## Indebtedness growth driven by debt and GDP dynamics



Source: HNB, FINA

## Average age of a company increased in 2020



Source: Court Registry

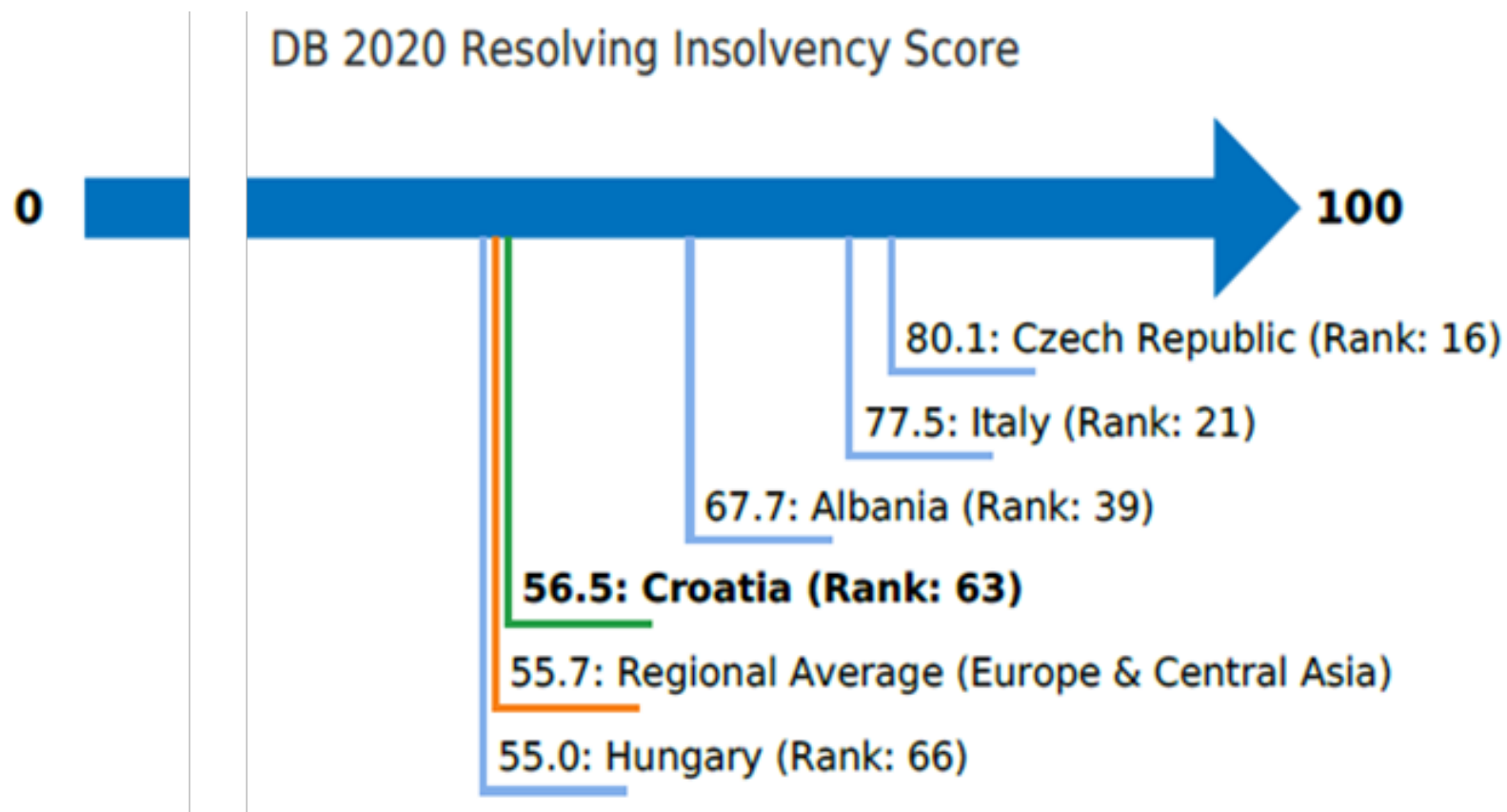
## How to deal with the “zombies”?

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- a series of market failures
- Internal measures
  - encourage companies to collect more equity ("more skin in the game").
  - ease the conversion of debt into equity.
  - connect investment decisions and performance while reducing moral hazard.  
However, they require developed capital markets and investment culture.
- External measures
  - strengthen the insolvency framework / improve the efficiency of debt restructuring and
  - better targeting of fiscal support.
  - policies not necessarily aligned (e.g., in Croatia banks could not write off a loan if they did not use all available legal instruments to collect, which essentially corresponds to pushing an enterprise into a bankruptcy).



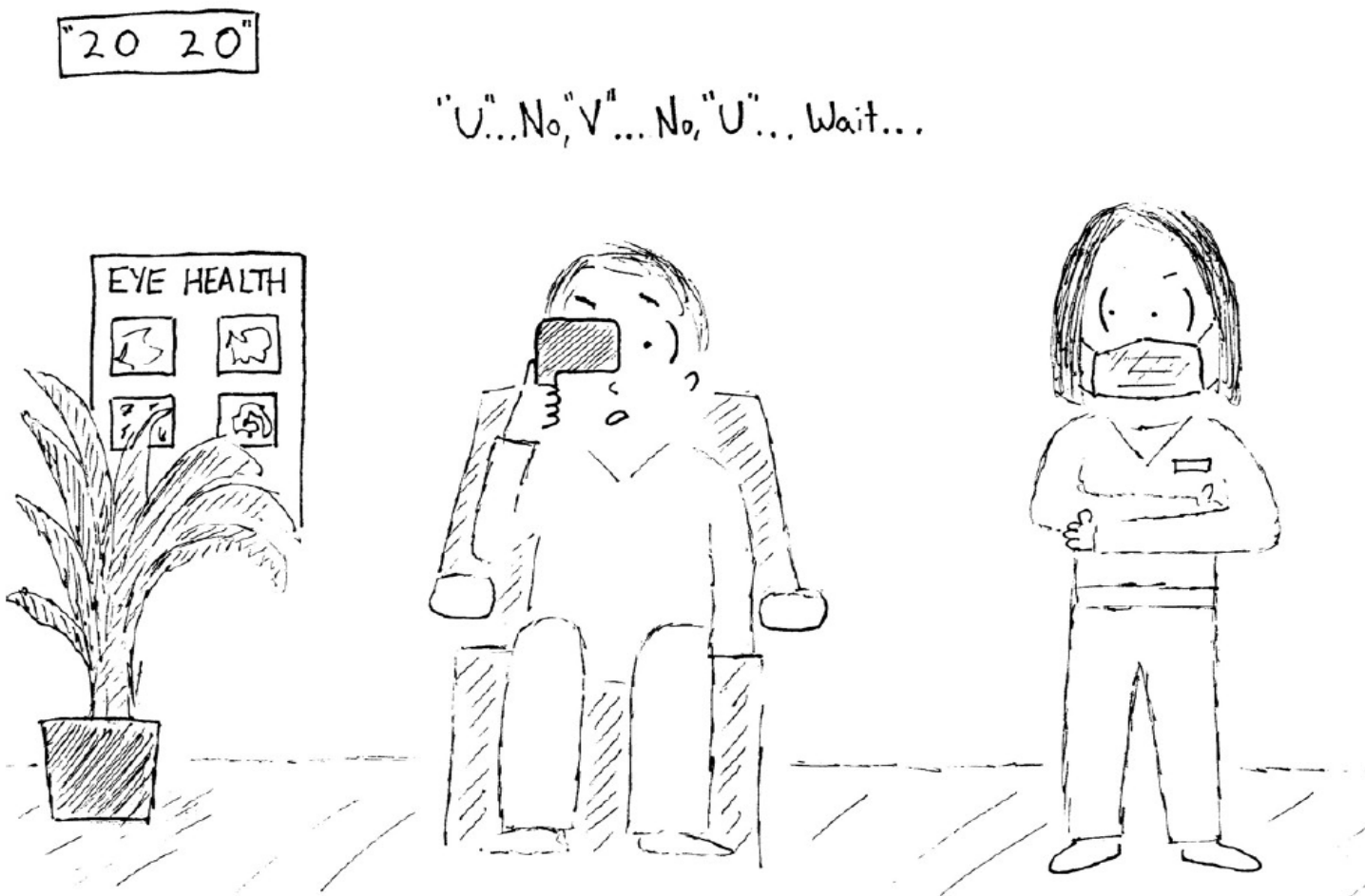
## Resolving insolvency – a good place to start



Note: Ranking of economies on the ease of resolving insolvency is determined by sorting their scores for resolving insolvency. These scores are the simple average of the scores for the recovery rate and the strength of insolvency framework.

Source: World Bank

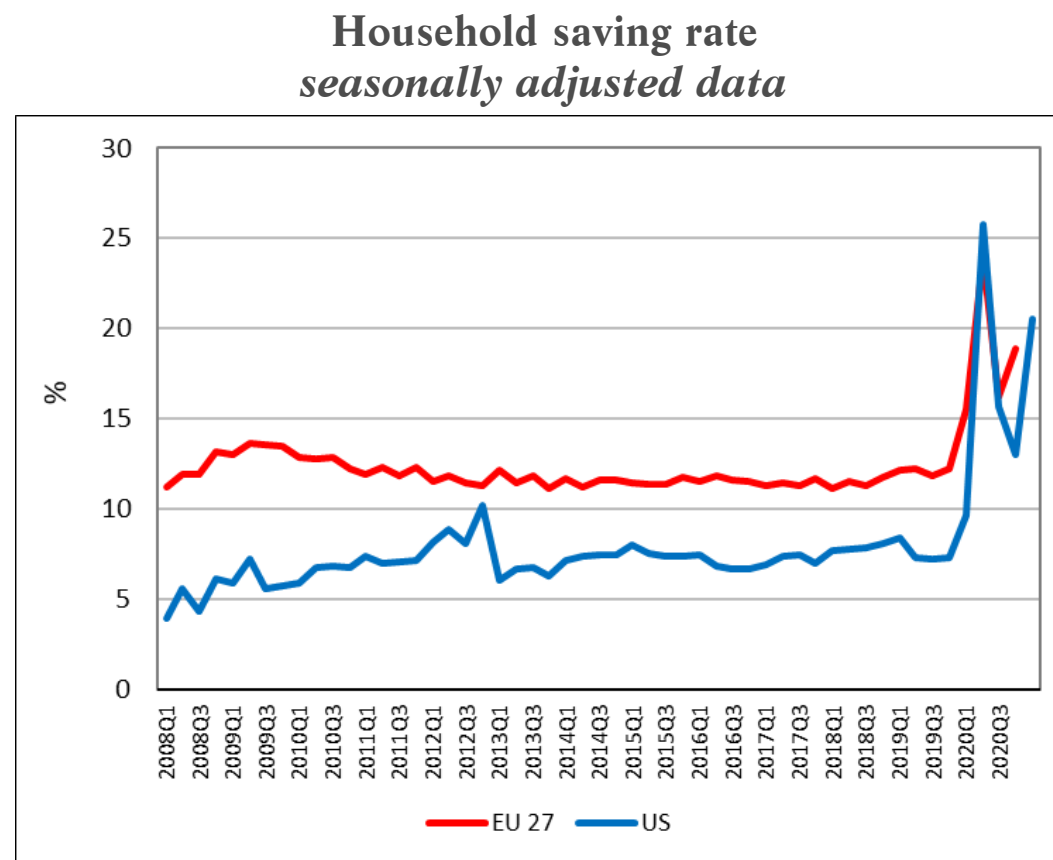
# More immediate concerns – the demand side of the equation



- collapse of consumption and higher savings
  - accumulated savings could boost pent-up demand and fuel the recovery
- stretched asset prices increase risks for financial stability
  - residential real estate are particularly worrisome

## Household savings have shoot-up

- the COVID-19 pandemic and the associated virus containment measures have **constrained private consumption**.
  - at the same time, **fiscal support compensated** much of income losses.
  - also, high level of uncertainty regarding financial and economic situation, has **lowered propensity to consume**.
- ➔** all above has led to an unprecedented accumulation of both **'forced'** and **'precautionary'** savings.



Source: Eurostat, FED

## Will accumulated savings support the recovery?

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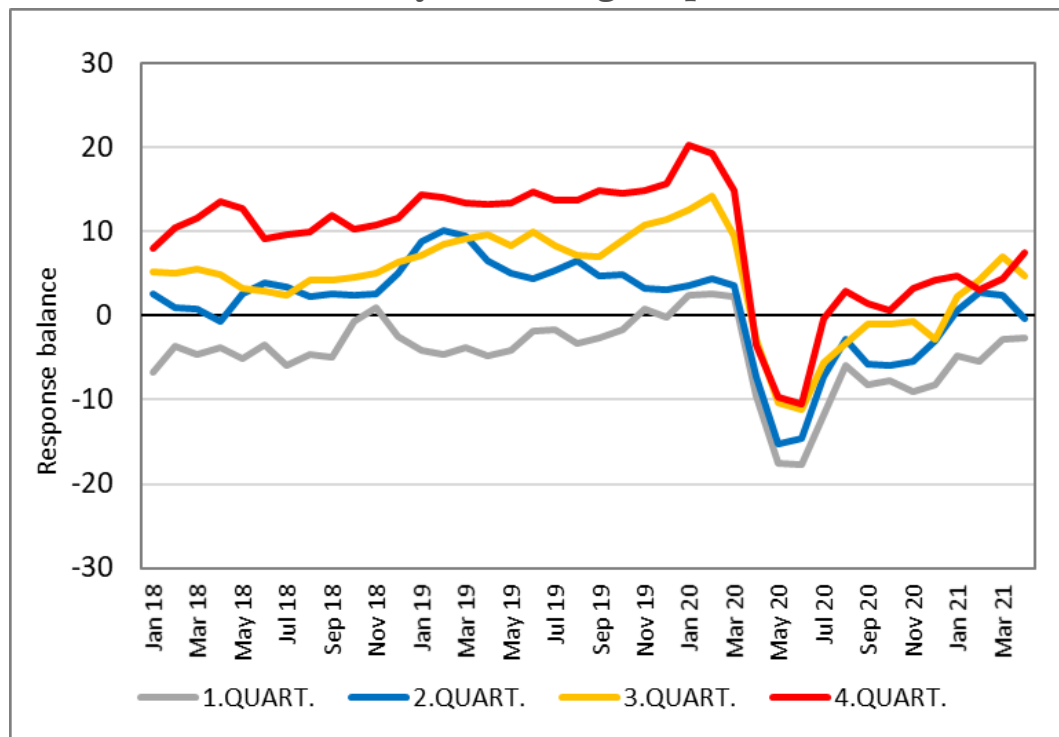
- **How long will it take the savings rate to return to its long-term average?**
  - *What will happen with the excess savings?*

*Looking ahead, the strength of the recovery in consumption and output will crucially depend on the speed at which accumulated savings are unwound. This in turn will depend on how consumers perceive their current and expected financial situation, the distribution of the savings across socio-economic groups of the population, such as income and age (high-skilled workers and the elderly have higher saving rate), and the level of prevailing uncertainty regarding the economic outlook. (Friz and Morice, 2021)*

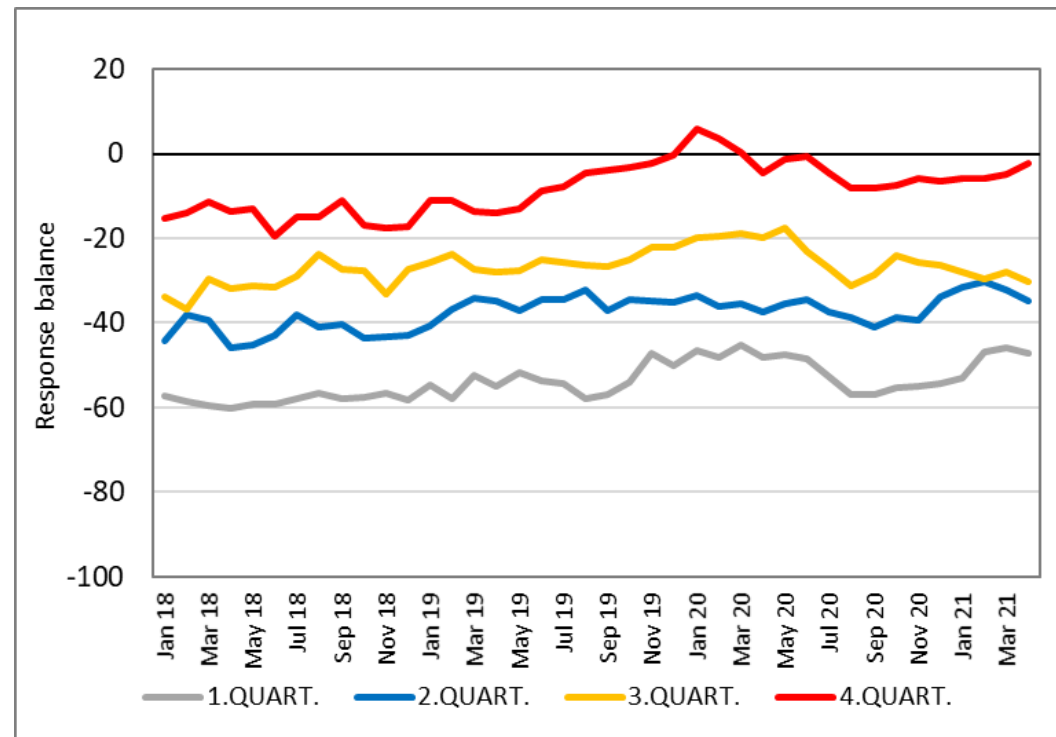
- Higher-income households tend to spend a smaller fraction of their income, both on average and in response to a positive shock to their finances.

# While sentiment in Croatia improved across all income groups, expectations of additional savings remain elevated only for the highest quartile

Expectations on how will financial position of household change over the next 12 months, by income group



Likelihood of increasing savings in the next 12 months, by income group

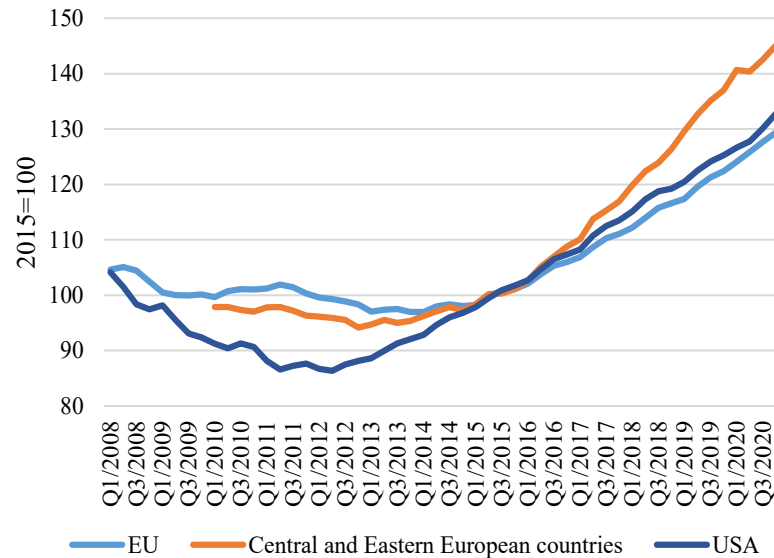


Note: In March 2021, 1.quartile referred to income group up to 4500 kunas, 2. quartile from 2500 to 6000 kunas, 3. quartile from 6000 to 8275 kunas, and 4. quartile more than 8275 kunas. Seasonal adjustment is calculated as a 3-month moving average. Last available data refers to April 2021.

Source: IPSOS, CNB

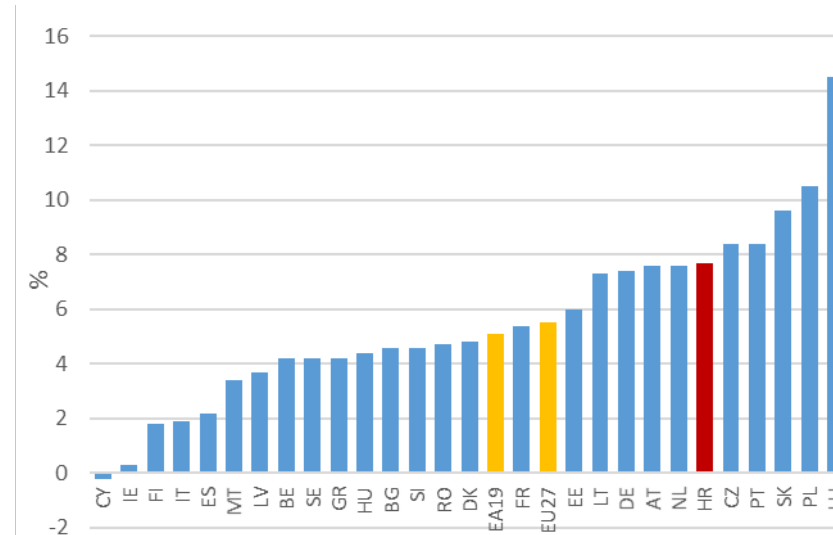
# Residential real estate remained resilient throughout the current crisis

### House price indices



Source: Eurostat, FRED

### Annual growth rates of residential property prices in year 2020

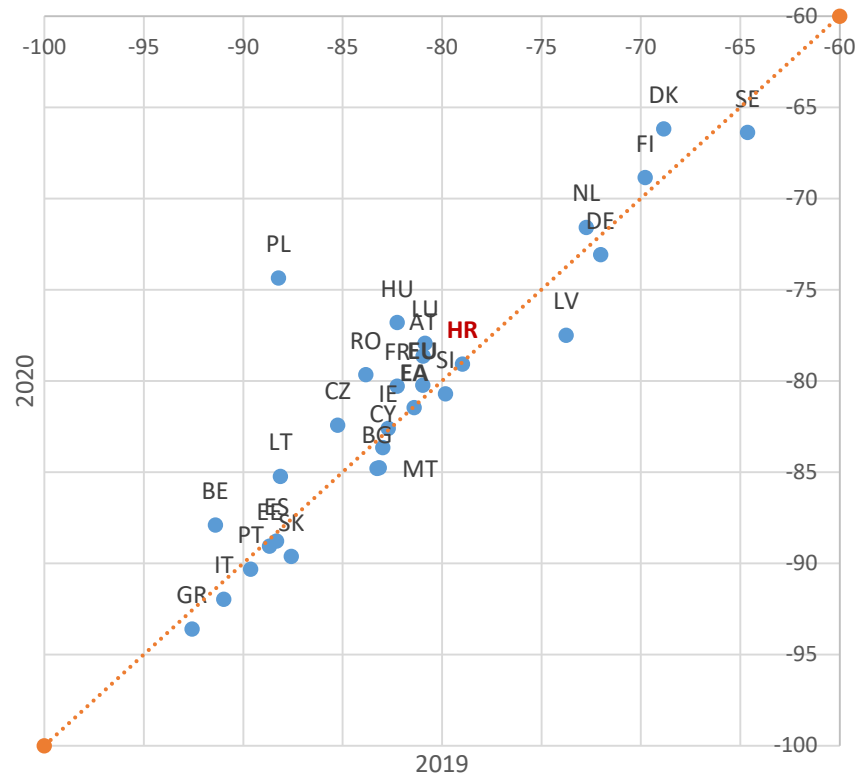


Source: Eurostat; ECB

- ❑ residential property prices continued to rise throughout 2020 reaching record highs in most of EU member states
- ❑ aggregate house prices in EU increased by 5.5% on a yearly level, however growth rates differed substantially across countries

# Consumers confidence remained stable

## Consumers confidence in the housing market



Note: Data represents survey answers on planning a purchase or building a home within the next 12 months. Countries above the dotted line experienced a rise in consumer confidence in year 2020.

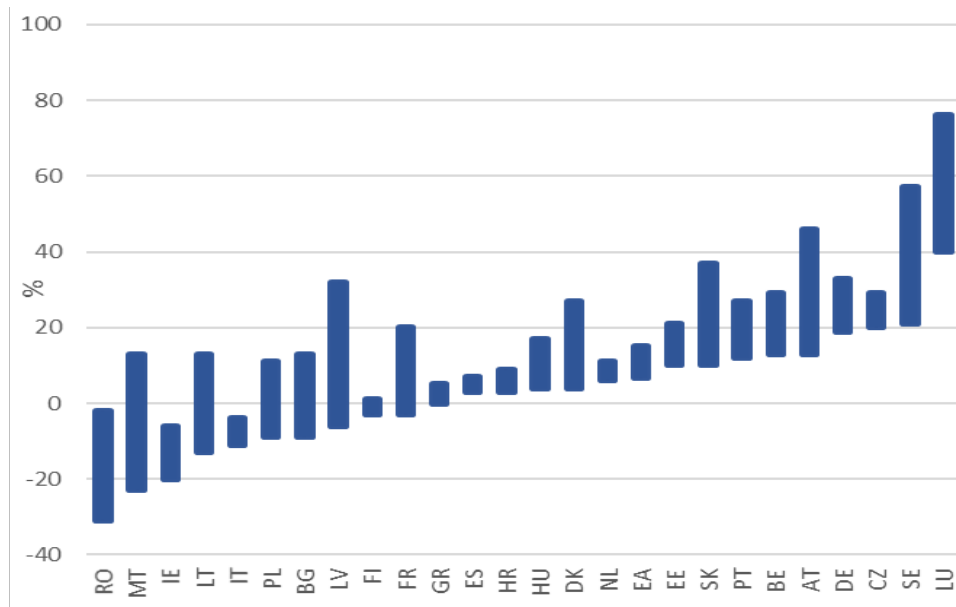
Source: EC

- price growth was fuelled by low interest rate environment and supporting policy measures – payment moratoria, job protection schemes
- fiscal support backed consumer confidence which has increased in most of EU member states
- housing demand was also supported by allocation of additional savings

# Overstretched residential real estate prices

## Valuation of residential property prices – range of estimates (2020Q4)

(assessment of deviations of certain indicators from equilibrium levels)



Note: Estimates are based on four different valuation methods: price-to-rent ratio, price-to-income ratio, asset pricing approach and a Bayesian estimated inverted demand model. For each country, the blue bars represent the range of estimates across the four valuation methods. Estimates are up to Q3 2020 for CY and SI, and up to Q4 2020 for all the other countries.

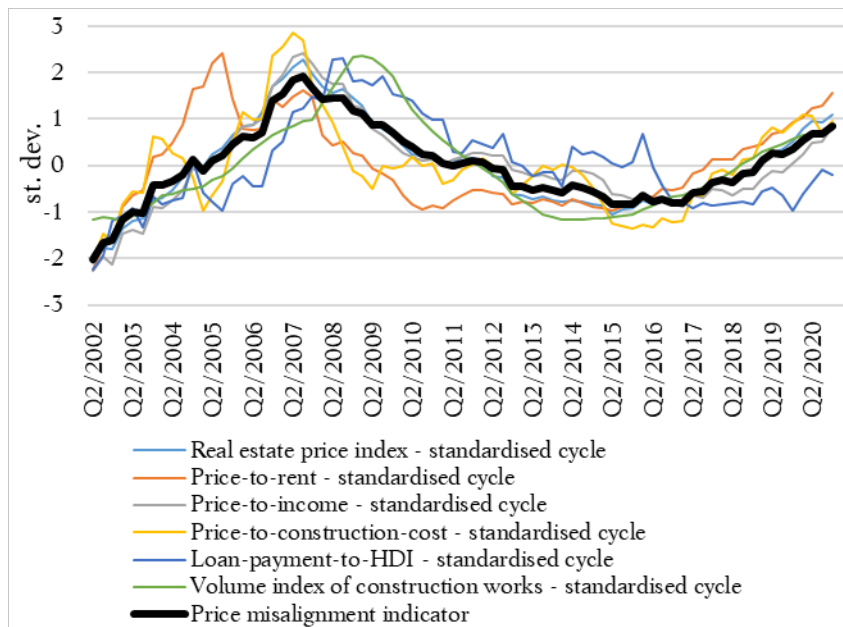
Source: ECB calculations

- future developments in the housing market will be determined by the duration of the ongoing crisis and subsequent economic recovery
- ending of support may harm ability to service housing debt
- Primarily risks for financial stability
  - low market liquidity and decreased collateral values would materialize



# Residential real estate in Croatia

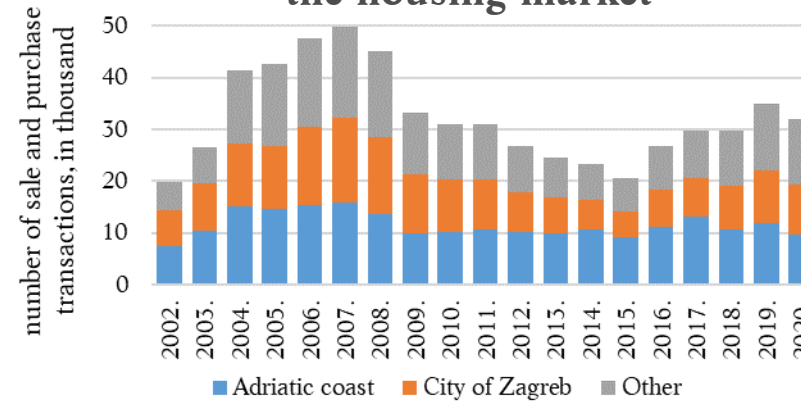
## Price overvaluation indicator for Croatia



Note: The composite misalignment indicator is calculated as a first principal component of the cycles in the six subindicators and captures their common dynamics.

Source: CBS, CNB calculations

## Number of sale and purchase transactions in the housing market

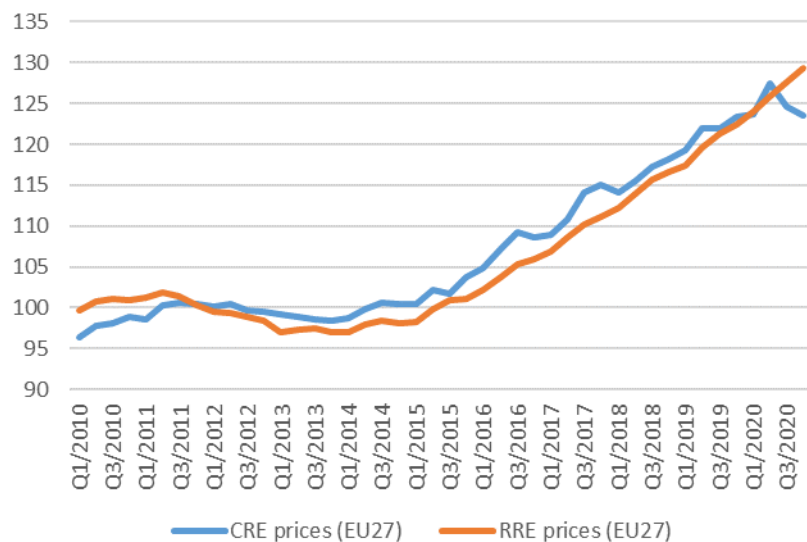


Source: Tax Administration

- last year house prices increased by 7,7% and the number of transactions fell by 8,6%
- high demand for housing in Croatia was supported by stable demand from foreign citizens and government housing loans subsidies introduced in 2017

# Commercial real estate market diverging from residential

CRE and RRE price indices in EU



Source: ECB, Eurostat

- new trends related to the pandemic and uncertainty about its duration, such as working from home and online shopping, led to a price decline in CRE market
- further developments in CRE market are uncertain and will be affected by the new preferences shaped due to the pandemic and the ability of the market participants to adapt

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**Thank you for your attention!**