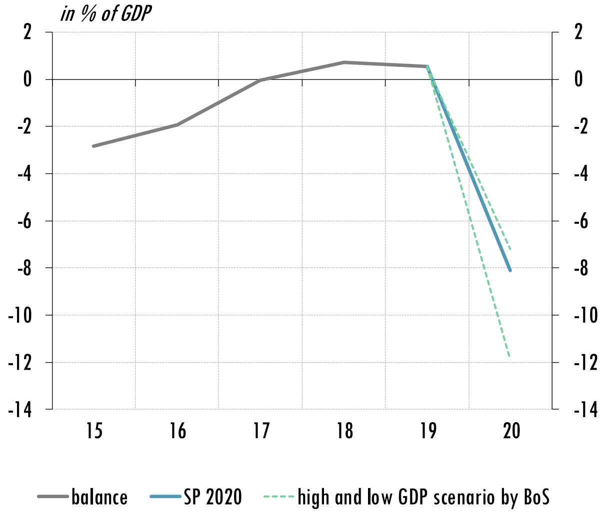
Macroeconomic and fiscal effects of measures adopted to mitigate the consequences of the COVID-19 epidemic

The measures adopted to contain the COVID-19 epidemic will result in a substantial drop of economic activity, while the measures adopted to mitigate these consequences will strongly affect the fiscal situation. When adopting and in particular when implementing the measures, the most important aspect is transparency, which is essential for establishing credibility of measures both among domestic economic agents and on international financial markets; the amount and the price of financial means available in the future will greatly depend on this credibility, as well as the assessment, once the epidemic is over, of the effectiveness of individual measures.

This is an assessment of the macroeconomic and fiscal effects of measures adopted up to now, while in accordance with recommendations of international organisations (OECD, IMF), we have put in place the real-time monitoring of their fiscal effects that will be constantly updated. The Fiscal Council will use this assessment of fiscal effects as input for a review of fiscal sustainability in future budget documents.

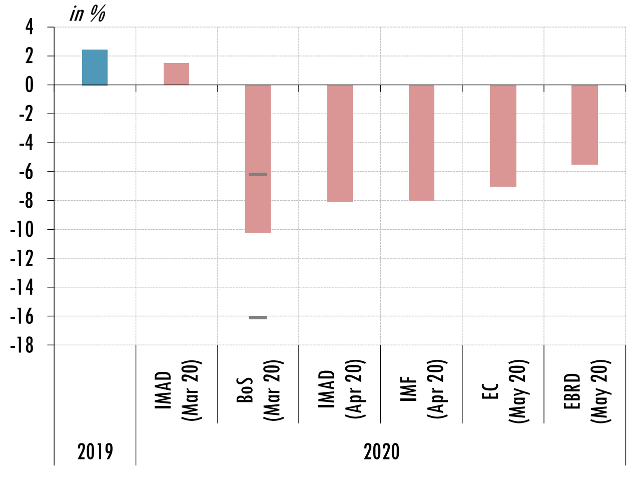
The result of uncertainty is a considerable range of forecasts concerning economic activity in the current year, which shows a 5–16% drop in GDP. The Institute of Macroeconomic Analysis and Development (IMAD) baseline scenario (COVID-19 scenario), which was the basis for the preparation of the 2020 Stability Programme (SP2020), predicts a 8.1% decline in GDP; while the Ministry of Finance in its baseline scenario PS2020 expects the general government deficit at 8.1% of GDP.

Figure 1: General government balane in the case of materialisation of marginal scenarios of economic activity



Sources: SORS, SP 2020 (Apr 20), shock definition according to estimates of Bank of Slovenia. Estimates: FC.

Figure 2: Real GDP growth in 2019 and forecasts for 2020



Sources: SORS, IMAD, SP 2020 (Apr 20), IMF, BoS, Consensus Economics, EC, EBRD.

The estimate of the effects of measures may not be done with any certainty, as they are subject to a number of assumptions. When adopting the first coronavirus stimulus package the government estimated that the direct effect of measures on public finances would be about EUR 3 billion, that is 6.7% of GDP forecast for the current year. In the Stability Programme, this estimate was lowered by about one third, to almost EUR 2 billon, that is 4.4% of GDP. In its assessment of the Stability Programme, the

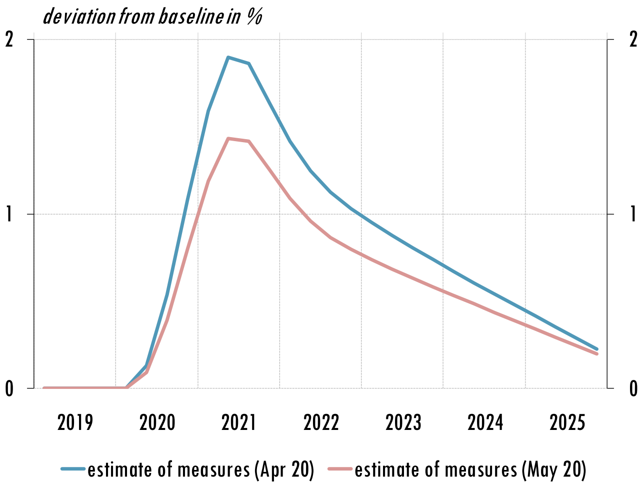
Fiscal Council estimated the value of measures at approximately EUR 1.7 billion, that is 3.8% of GDP. The currently available data on the actual number of persons included in individual measures indicate that the latter estimate could be lower by one quarter.

However, the available government documents contain no estimate of the impact of the adopted COVID-19 mitigation measures on macroeconomic aggregates. It should be noted that the IMAD COVID-19 scenario takes into consideration these measures, but a concrete estimate of their impact is missing. Due to the uncertainty mentioned earlier, such estimates are difficult to prepare; yet they provide a useful insight in how the mechanisms of these measures operate, and are particularly useful in helping reduce uncertainty and increase support for measures of local economic agents, as well as the assessment of risk and the preservation of and reinforcing the confidence of financial markets. The effects of measures may be analysed on the basis of the estimate of static multipliers; however, due to feedback links between public finances and macroeconomic aggregates, a dynamic estimate is also of interest. Coefficients based on estimates of links between past macroeconomic aggregates are used, which, however, do not necessarily reflect the functioning of economic agents in the current conditions. Consequently, the results of these simulations must be handled with considerable caution and only as an indication of possible reactions of the economy to policy measures.

Shocks were defined in relation to the estimated direct effects of measures adopted so far on public finance. Effects are broken down into social transfers, wages in the public sector and other government sector expenses (mostly subsidies). All these variables were temporarily increased in one quarter (second quarter of 2020) and returned to the level of the baseline scenario afterwards. Thus, the simulations show only the impact of the measures; they do not contain the estimate of the decrease of general government revenue due to the drop of economic activity that is already included in the baseline scenario.

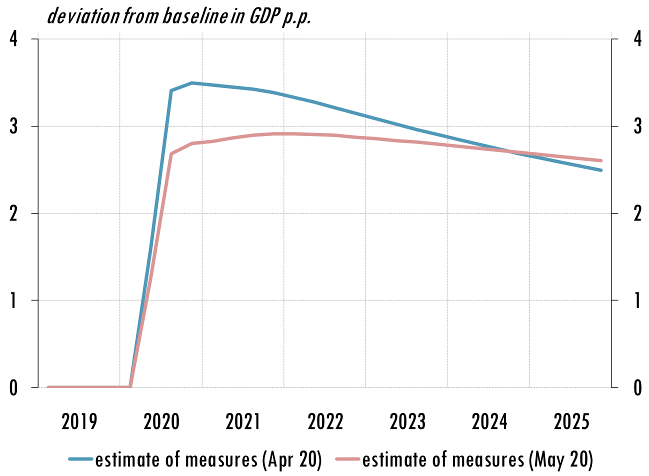
The simulations of the impact of fiscal measures show that in 2020, measures would provide a 1.5–2% support to economic activity in comparison to economic activity in the scenario without government action. The drop in economic activity in relation to the baseline scenario is thus mitigated by about one quarter; this is similar to the model evaluation of the impact of measures in the EU prepared by the

Figure 3: The effects of measures on GDP level



Source: FC. Note: The estimate of measures (Apr 20) is based on the estimate from FC Assessment (28 April 20), while the estimate of measures (May 20) is based on estimate of measures with data available in early May 20.

Figure 4: The effects of measures on general government



Source: FC. Note: The estimate of measures (Apr 20) is based on the estimate from FC Assessment (28 April 20), while the estimate of measures (May 20) is based on estimate of measures with data available in early May 20.

European Commission[1]. Simulations also suggest that the multiplicative effects of adopted measures are relatively small. This was to be expected as measures were primarily intended to prevent a significant economic decline and excessive increase of unemployment.

The positive macroeconomic impact of these measures could result in the deterioration of public finance aggregates. This is without considering the fact that due to the economic crisis the fiscal balance is already strongly worsened in the baseline scenario and also without considering the option that if there were no economic policy action there is a great likelihood that public finance aggregates would additionally deteriorate. Simulations show that as the result of these measures the general government deficit would increase in the first year by about 3–3.5 pps of GDP, in the following years it is expected to align with the deficit level estimated in the baseline scenario. At the same time, in the year of adoption of measures the government debt would increase by about 3–3,5 pps. of GDP, and five years later it would be about 2.5 pps of GDP higher than the one estimated in the baseline scenario.

[1] See EC Spring Forecast 2020, pp. 65-72.