E Looking back at 2013

The macroeconomic framework of the State Budget (SB) for 2013 was, rather exceptionally, based on the Macroeconomic Forecast from October 2012, since the original draft SB was returned by the Chamber of Deputies on 24 October 2012. On 21 November 2012, the government submitted a new draft SB which the Chamber of Deputies approved on 19 December 2012.

The following text compares the macroeconomic framework with the data for 2013 published before 1 April 2014. It should be pointed out that the data for 2013, which are specified below, cannot be considered final, as they will surely be revised. When assessing the forecast, the extent of revisions for 2010 and 2011 conducted by the CZSO from October 2012 to April 2014 should also be taken into account.

Comparison of the forecast with the actual data shows that the SB was based on a realistic macroeconomic framework. The deviation in the case of one of the main budgetary parameters, i.e. the level of GDP at current prices, amounted to only CZK 2 billion. Overall, the forecast accuracy was higher at current prices than at constant prices.

Table E.1: **The Macroeconomic Framework for the 2013 State Budget – Comparison with the Actual Data**

		2012 State Budget (July 2011)				Outcome (April 2013)				Difference (outcome – forecast)			
		2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
				Forecast									
Gross domestic product	*bill. CZK, curr.pr.*	3 775	3 808	3 820	3 882	3 791	3 823	3 846	3 884	16	15	26	2
Gross domestic product	*growth in %, const.pr.*	2.7	1.7	-1.0	0.7	2.5	1.8	-1.0	-0.9	-0.2	0.1	0.0	-1.6
Consumption of households	*growth in %, const.pr.*	0.6	-0.6	-3.0	-0.5	0.9	0.5	-2.1	0.1	0.3	1.1	0.9	0.6
Consumption of government	*growth in %, const.pr.*	0.6	-1.7	-1.1	-1.3	0.2	-2.7	-1.9	1.6	-0.4	-1.0	-0.8	2.9
Gross fixed capital formation	*growth in %, const.pr.*	0.1	-0.9	-0.6	0.3	1.0	0.4	-4.5	-3.5	0.9	1.3	-3.9	-3.8
Cont. of net exports to GDP growth	*p.p., const.pr.*	0.9	2.7	1.8	1.0	0.6	1.9	1.7	-0.3	-0.3	-0.8	-0.1	-1.3
GDP deflator	*growth in %*	-1.7	-0.8	1.3	0.9	-1.6	-0.9	1.6	1.9	0.1	-0.1	0.3	1.0
Average inflation rate	*%*	1.5	1.9	3.3	2.1	1.5	1.9	3.3	1.4	-	-	0.0	-0.7
Employment *(LFS)*	*growth in %*	-1.0	0.4	0.0	-0.2	-1.0	0.4	0.4	1.0	-	-	0.4	1.2
Unemployment rate *(LFS)*	*average in %*	7.3	6.7	6.9	7.3	7.3	6.7	7.0	7.0	-	-	0.1	-0.3
Wage bill *(domestic concept)*	*growth in %, curr.pr.*	-0.4	2.3	2.0	2.1	0.8	2.2	1.8	-0.9	1.2	-0.1	-0.2	-3.0
Current account / GDP	*%*	-3.9	-2.9	-1.3	-1.2	-3.9	-2.7	-1.3	-1.4	0.0	0.2	0.0	-0.2
Government sector balance	*% of GDP*	-4.8	-3.3	-3.2	-2.9	-4.7	-3.2	-4.2	-1.4	0.1	0.1	-1.0	1.5
Assumptions:													
Exchange rate CZK/EUR		25.3	24.6	25.1	24.9	25.3	24.6	25.1	26.0	-	-	0.0	1.1
Long-term interest rates	*% p.a.*	3.7	3.7	2.9	2.7	3.7	3.7	2.8	2.1	-	-	-0.1	-0.6
Crude oil Brent	*USD/barrel*	80	111	113	115	80	111	112	109	-	-	-1	-6
GDP in Eurozone (EA12)	*growth in %, const.pr.*	2.0	1.4	-0.5	0.3	1.9	1.6	-0.6	-0.4	-0.1	0.2	-0.1	-0.7

The macroeconomic framework of the SB was in line with other institutions' forecasts of that time, as is clear from the Table E.2.

At the time when the forecast was drawn up, the economy was in a shallow recession. According to the then available data, real GDP decreased by 0.2% OoQ in Q2 2012, which represented a YoY decrease of 1.7%. All components of domestic demand posted real YoY decline – household consumption went down by 3.5% (later changed to -2.3%), government consumption by 0.9% (now -2.5%) and gross capital formation by 6.5% (now -3.8%). On the contrary, the development of foreign trade had a positive impact.

Table E.2 **Comparison with other official forecasts**

	Date of forecast release	GDP *growth in %, const. pr.*	Inflation rate *in %, aop*
CNB	*November 2012*	0.2	2.3
EC	*November 2012*	0.8	-
IMF	*October 2012*	0.8	2.1
OECD	*November 2012*	0.8	2.0
Average		0.7	2.1
MoF	*October 2012*	0.7	2.1
Data	*April 2014*	-0.9	1.4

Neither the situation in the external environment of the Czech economy was favourable. The euro zone as a whole was also going through a recession and the development on its periphery (Greece, Cyprus, Portugal, Spain and Italy) was particularly alarming. Moreover, in mid-2012 there was an escalation of the debt crisis. Tensions were later reduced thanks to introducing the possibility of interventions by the ECB on the secondary government bonds market, the initiation of the ESM, and progress in resolving the problems of the Spanish banking sector. Yet the possibility of further escalation of the debt crisis was considered to be a significant downside risk.

Fortunately, this risk did not materialize. During 2013, market sentiment towards the euro zone periphery was gradually improving, and remained largely unaffected by, for example, complications related to negotiations on the bailout programme for Cyprus in March 2013. On the other hand, the economic performance of the euro area was weaker than assumed in the forecast. The recession lasted until Q1 2013 and the subsequent recovery during the year was only modest. Total economic output of the EA12 in 2013 was 0.7 pp below the forecast.

Development in individual euro area countries was very diverse; nevertheless, continuing uncertainty regarding future development, the impacts of fiscal consolidation, the labour market situation and related slow recovery of domestic demand, and the gradual stabilization of the financial markets combined with low credit activity, can all generally be identified as causes of a weaker than expected output growth. The unfavourable development of investment reflected the tight fiscal situation, mixed expectations of the private sector and low consumer confidence which only started improving slightly in H2 2013

The situation in the euro zone has been reflected in the development of the Czech economy. The forecast expected the recession in the Czech Republic to end at the turn of 2012 and 2013 and predicted subsequent slight but stable economic recovery. As in the euro area, the recession lasted one quarter longer. Moreover, the economic downturn in Q1 2013 was very deep – by 1.3% QoQ. Only slow economic recovery in the following two quarters led to GDP showing a decrease of 0.9% for the whole of 2013 instead of the expected growth of 0.7%. The extraordinarily strong QoQ GDP growth in Q4 2013 of 1.8% offered no assistance since it was largely caused by one-off factors, especially the effect of stockpiling cigarette tax stamps in reaction to an increase in the excise tax as of 1 January 2014.

The main domestic factors that contributed to a decrease in economic output in 2013 include political instability, hard to predict business environment and the low level of economic sentiment of consumers and of many segments of the business sector. These factors had a negative impact on the development of household consumption and investment.

Real (i.e. adjusted for changes in price level) economic activity did not develop fully in line with the original expectations. From the budgetary perspective, however, nominal quantities are more important. Within the rather accurately estimated level of nominal GDP, a higher than expected decrease in real GDP was offset by a higher than expected increase in the GDP deflator. As regards the individual components of real GDP use, the foreign trade balance, government consumption and household consumption developed more favourably compared to the assumptions. In contrast, gross capital formation recorded a deep decline.

A higher than expected increase in the trade balance surplus was definitely a result of a surprising improvement in the terms of trade of 1.4%, instead of the expected decrease of 1.0%. The faster growth of export prices and slower growth of import prices contributed to approximately the same extent. Conversely, growth rates of real goods and services exports more or less stagnated, while imports only slowed down slightly. The resulting contribution of foreign trade to real GDP growth even reached a negative value (–0.3 pp), instead of the originally expected 1.0 pp. An evaluation through the contribution to growth of real gross domestic income thus seem more economically justifiable, in the case of foreign trade including both volume and price components. In 2013, it reached 0.7 pp compared to the expected 0.2 pp.

Three factors influenced the recorded nominal level of household consumption. Instead of the decrease in household consumption expenditure in constant prices of 0.5%, growth of 0.1% was shown. The retroactive data revisions impacted in 2010 and 2011 in a similar direction, upwards by CZK 16 billion and CZK 36 billion, respectively. Lower than expected growth of consumer prices (see below) did not reverse the favourable result from the budget perspective.

Nominal and real investment was considerably lower compared to the forecast. Instead of expected growth of 0.3%, the volume of gross fixed capital formation decreased by 3.5%. We think that the main reasons for the decline in investment were significant uncertainty regarding future development and the private investors postponing new investment. The low utilization of production capacities in industry also has to be taken into account. However, unfavourable development has been identified also in government sector investment, the nominal decrease of which according to preliminary data reached CZK 15 billion in 2013 (when stagnation was expected). This decrease was almost exclusively caused by problems with drawing money from European funds.

Compared to the forecasted value, the average inflation rate in 2013 was 0.7 pp lower. Administrative measures (e.g. an unexpected decrease in natural gas prices) participated in this result by roughly two thirds, with market impacts responsible for the final third.

The response of the labour market to a decrease in economic output took an atypical course. In 2013, total employment increased by 1.0%, while the unemployment rate stagnated at 7.0%. The reduced creation of new "standard" jobs was outweighed by the so-called additional worker effect, whereby households reacted to their insecure prospects and deteriorated financial situation with an increase in labour supply in order to secure additional incomes. This is demonstrated by the record share of part-time jobs, and thus by a decrease in the number of worked hours per employee as well as the historically highest participation rate. However, the number of registered unemployed increased considerably in the course of 2013. The increasing divergence between these statistics and the Labour Force Survey (LFS) shows that employment growth could also be largely driven by informal extra incomes.

Based on the lower than expected economic growth (also due to higher employment and thus lower real labour productivity), the wage bill showed a decrease. One of the causes of the difference between the forecast and reality is the massive "tax optimization" as a result of introducing the solidarity surcharge for income tax from 2013, which affected employees whose annual income is more than 48 times higher than the average monthly wage. This resulted in the payment of extraordinary bonuses in early 2012 in the amount of approximately CZK 5 billion, with subsequent loss of the wage bill at the beginning of 2013.

Compared to expectations, the current account of the balance of payments showed CZK 7 billion (0.2% of GDP) higher deficit. As a whole it developed roughly in line with the forecast, though differences in individual balances were significant. Trade balance (goods) showed surplus higher by CZK 40 billion, and better results were achieved also in the balance of transfers (by CZK 16 billion) and the balance of services (by CZK 5 billion). In contrast, the income balance deficit was CZK 68 billion higher.

According to the CZSO's preliminary estimate, the government sector deficit reached 1.4% of GDP in 2013. Structural balance, i.e. the balance adjusted for the effects of business cycle and one-off or temporary measures, reached –0.3% of GDP due to fiscal effort (YoY change in the structural balance) amounting to 1.3 pp. Structural balance was therefore well below the level of the medium-term budgetary objective for the Czech Republic (structural balance of –1% of GDP). The better result was achieved mainly due to the impact of lower than expected investment activity (especially investment from national resources). Tax revenues fared also better than had been expected, especially in the case of indirect taxes, which was among other factors due to the relatively large stockpiling of tobacco products in reaction to an increase in the rate as of 1 January 2014. More favourable development was also seen in social allowances from the pension scheme system.