



Ministry of Finance

CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast of the Czech Republic in a Nutshell

April 2014

Macroeconomic Forecast

Structure of the presentation

Forecast Assumptions

- risks of the forecast
- external environment
- fiscal policy
- monetary policy, the financial sector and foreign exchange rates
- policy statement of the government - priorities

Economic Cycle

Forecast of Macroeconomic Indicators

- economic output
- inflation
- labour market
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Forecast Assumptions

Risks of the forecast

- the risks of the scenario are considered to be more or less balanced
- the most important negative economic risk related to the external environment is, in our view, the still unresolved crisis in the euro zone (although the situation has become calmer in a short time, the risk of a possible escalation of the crisis can not be entirely ruled out)
- the possibility of a stronger recovery in Germany and some other main trading partners of the Czech Republic represents a positive risk
- the biggest negative risk within the Czech economy is the fact that it is „frozen“ after a 5-year period of alternating recession and stagnation
- real gross fixed capital formation is at the bottom of the investment cycle after a very deep fall lasting for more than 5 years
- the decision of the CNB to use the exchange rate as an additional monetary policy instrument has considerably changed the economic policy setting

External Environment

The outlook for the global economy remains relatively favourable

- the outlook for global economic growth is relatively positive, the global economic growth could be driven by the recovery in developed economies in the years of the outlook
- the economic growth in U. S. slowed due to the impact of consolidation measures in 2013, the private consumption and investment should be the main drivers of growth in the following year
- the economic activity in the euro zone is recovering, however, return to a growth trajectory will be gradual
- economic growth in developing economies has slowed slightly, but it continues to retain its high dynamics; however, the revision of growth models will be needed

Escalation of the debt crisis in the euro zone cannot be fully ruled out

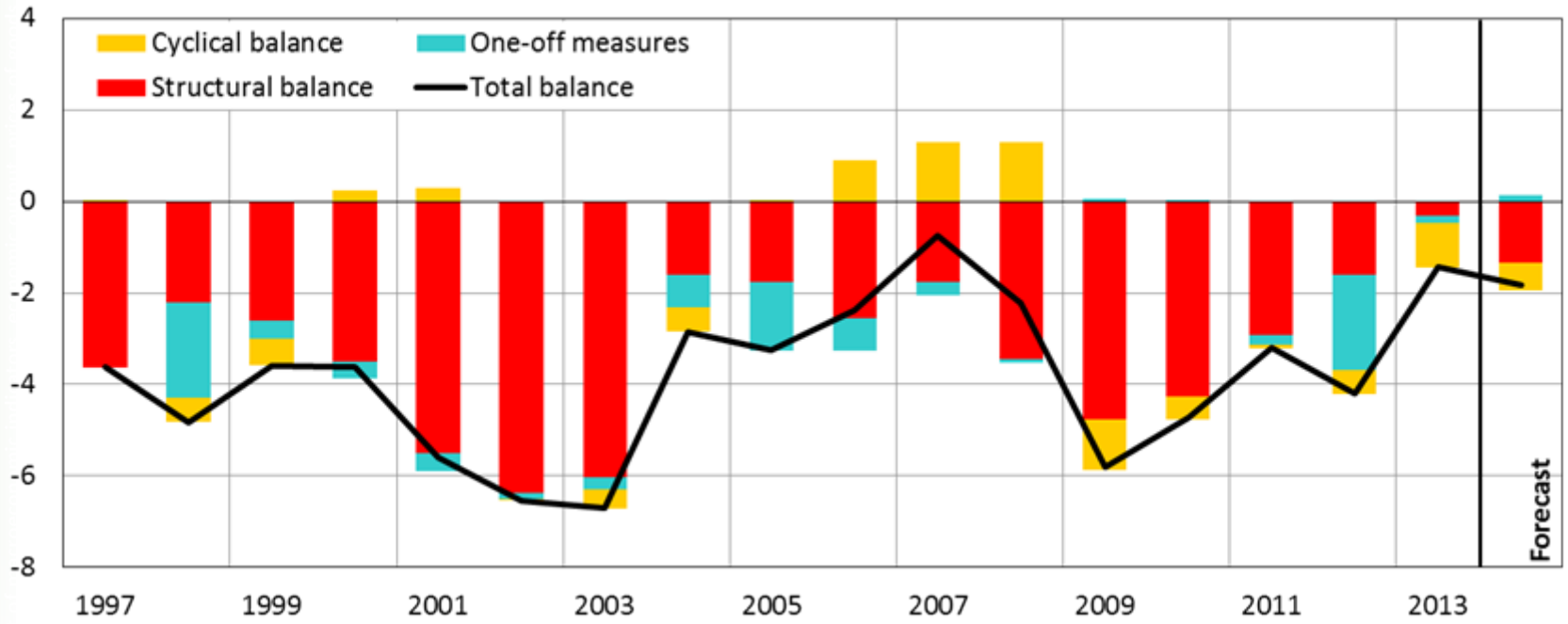
- economic recovery in the euro zone periphery states is very fragile, the risk regarding the quality of bank assets still remains

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



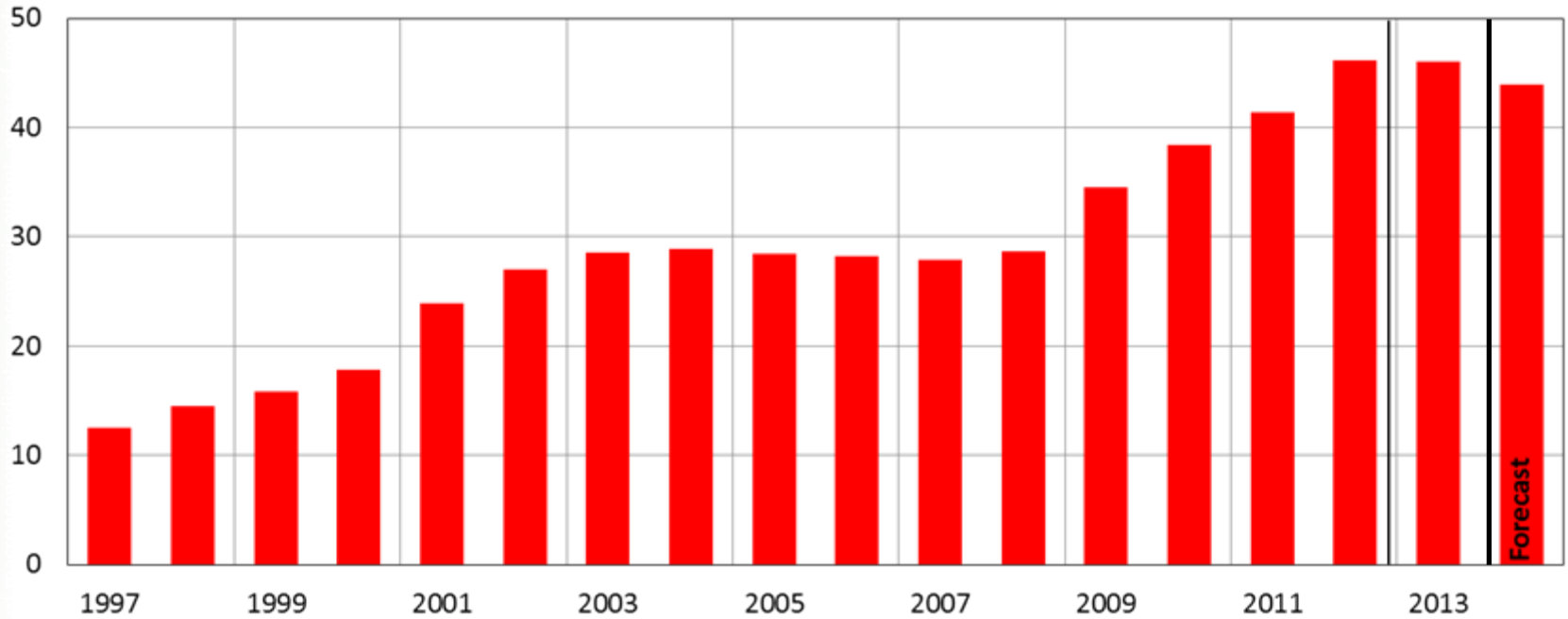
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- according to the CZSO's preliminary estimates, the government sector balance ended with a deficit of 1.4% of GDP in 2013
- compared to the assumption, the estimate improved by 1.1 pp due to higher tax revenues, lower government investment and better development of social security contributions
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2013 and 2012) amounted to 1.3 pp
- at the end of 2013, the government debt reached 46.0% of GDP
- for 2014 we predict a government sector balance of -1.8% of GDP
- in 2014, we expect the government debt to GDP ratio should decrease by 2 pp to 44.0%

Monetary Policy, the Financial Sector and Foreign Exchange Rates

- effective from 2 November 2012, the Czech National Bank lowered the interest rate for 2W repo operations to 0.05%
- on 7 November 2013, the CNB has initiated foreign exchange interventions against the Czech koruna aimed at keeping the CZK/EUR exchange rate close to 27 CZK/EUR
- for both 2014 and 2015, we expect 3M PRIBOR of 0.4%
- long-term interest rates are low, yields to maturity of 10Y government bonds should reach about 2.4% in 2014 and 2.6% in the following year
- we estimate an average exchange rate at 27.3 CZK/EUR and 20.1 CZK/USD in 2014
- in April 2014, the Czech Republic's rating was stable at a good level of investment, mainly due to macroeconomic stability and a credible fiscal policy (Standard & Poor's AA-, Moody's A1, Fitch A+)

Policy statement of the government - priorities

- development of conditions for free enterprises, kick-starting of sustainable economic growth, increasing competitiveness, job creation
- effective utilization of EU funds
- stocktaking and reconstruction of the state, rationalization of state's economic management
- fight against corruption, serious economic crime and usury
- development of public services in education, health, social system, transport and security
- development of civil society
- active membership of the EU and NATO
- adoption of civil service law
- effective use of information and communication technologies in public administration
- strengthening of parliamentary control of the Czech Republic's intelligence service

Macroeconomic Forecast

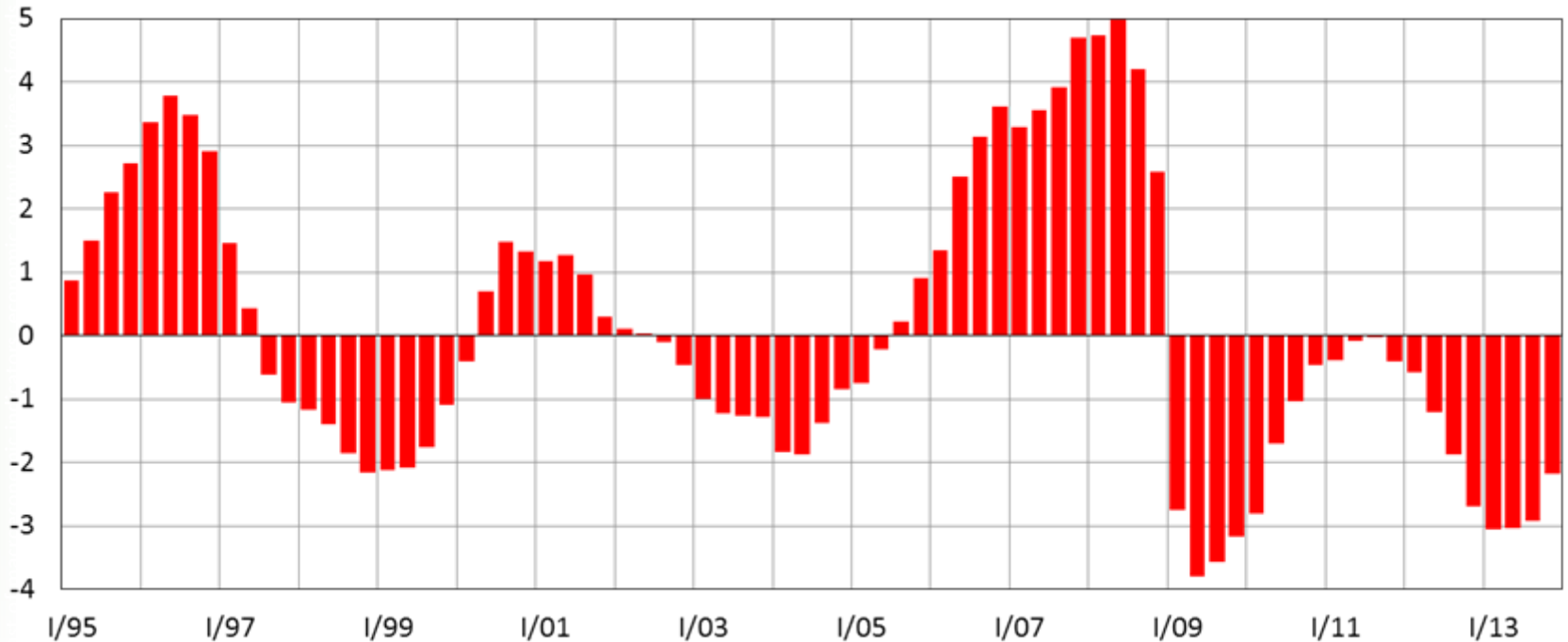
Economic Cycle



Economic cycle

Output Gap

(in % of potential product)

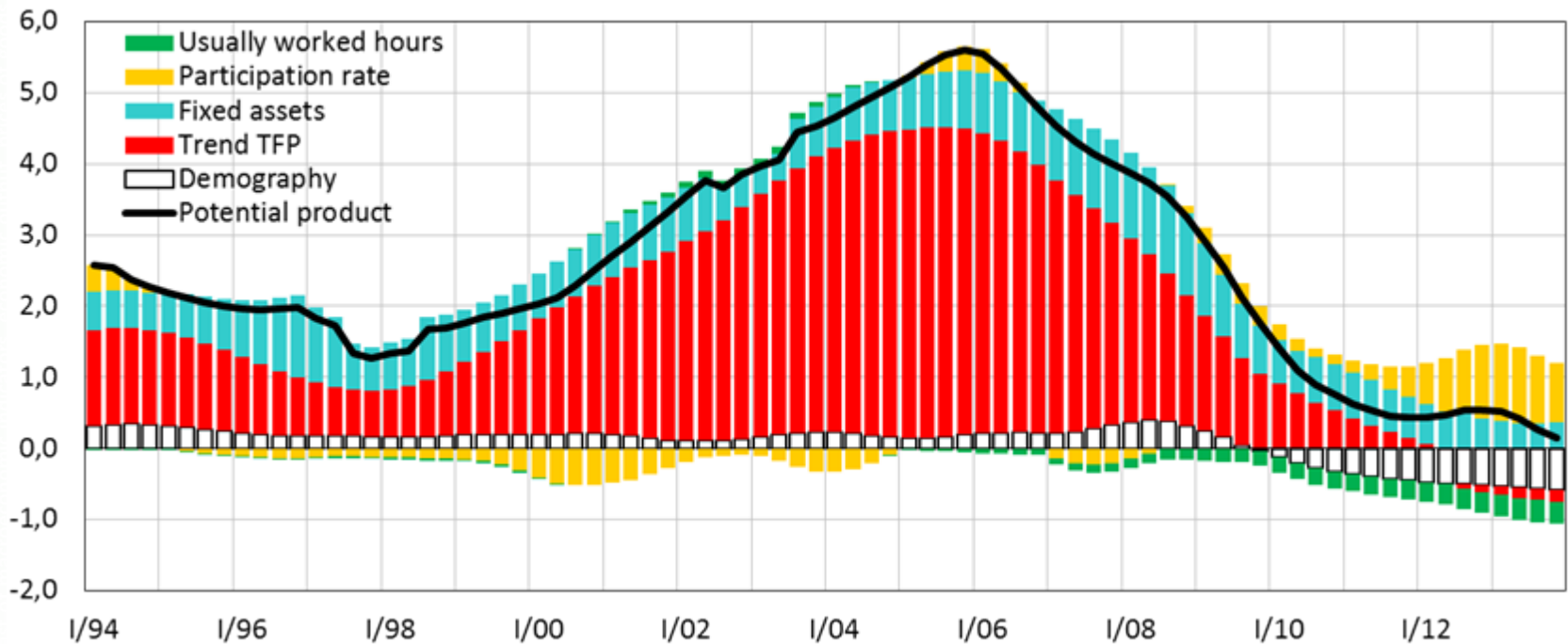


Sources: CZSO, CNB and Ministry of Finance's own calculations

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



Sources: CZSO, CNB and Ministry of Finance's own calculations

Economic cycle

- from Q4 2011, the Czech economy is in a negative output gap, which reached -2.8% in 2013
- due to long periods of recession or sluggish economic growth, growth of potential product slowed considerably, down to approximately 0.3% in 2013
- the component most seriously affected is total factor productivity, it has been more or less stagnant since 2011
- deep fall in investment activity led to a gradual reduction of the contribution of the capital stock
- the participation rate has become the most important factor of potential product growth from 2012
- demographic development and the number of usually hours worked slowed potential product growth

Forecast of Macroeconomic Indicators



Macroeconomic Forecast

Main Macroeconomic Indicators

		2010	2011	2012	2013	2014	2015
		<i>Current forecast</i>					
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	1,8	-1,0	-0,9	1,7	2,0
Consumption of households	<i>growth in %, const.pr.</i>	0,9	0,5	-2,1	0,1	0,6	1,5
Consumption of government	<i>growth in %, const.pr.</i>	0,2	-2,7	-1,9	1,6	0,8	0,7
Gross fixed capital formation	<i>growth in %, const.pr.</i>	1,0	0,4	-4,5	-3,5	2,7	2,0
Contr. of foreign trade to GDP growth	<i>p.p., const.pr.</i>	0,6	1,9	1,7	-0,3	0,5	0,6
Contr. of increase in stocks to GDP growth	<i>p.p., const.pr.</i>	1,0	0,1	-0,1	-0,2	0,2	0,1
GDP deflator	<i>growth in %</i>	-1,6	-0,9	1,6	1,9	1,8	1,7
Average inflation rate	<i>%</i>	1,5	1,9	3,3	1,4	1,0	2,3
Employment (LFS)	<i>growth in %</i>	-1,0	0,4	0,4	1,0	0,2	0,2
Unemployment rate (LFS)	<i>average in %</i>	7,3	6,7	7,0	7,0	6,8	6,6
Wage bill (domestic concept)	<i>growth in %, curr.pr.</i>	0,8	2,2	1,8	-0,9	1,8	3,5
Current account / GDP	<i>%</i>	-3,9	-2,7	-1,3	-1,4	-0,4	-0,3

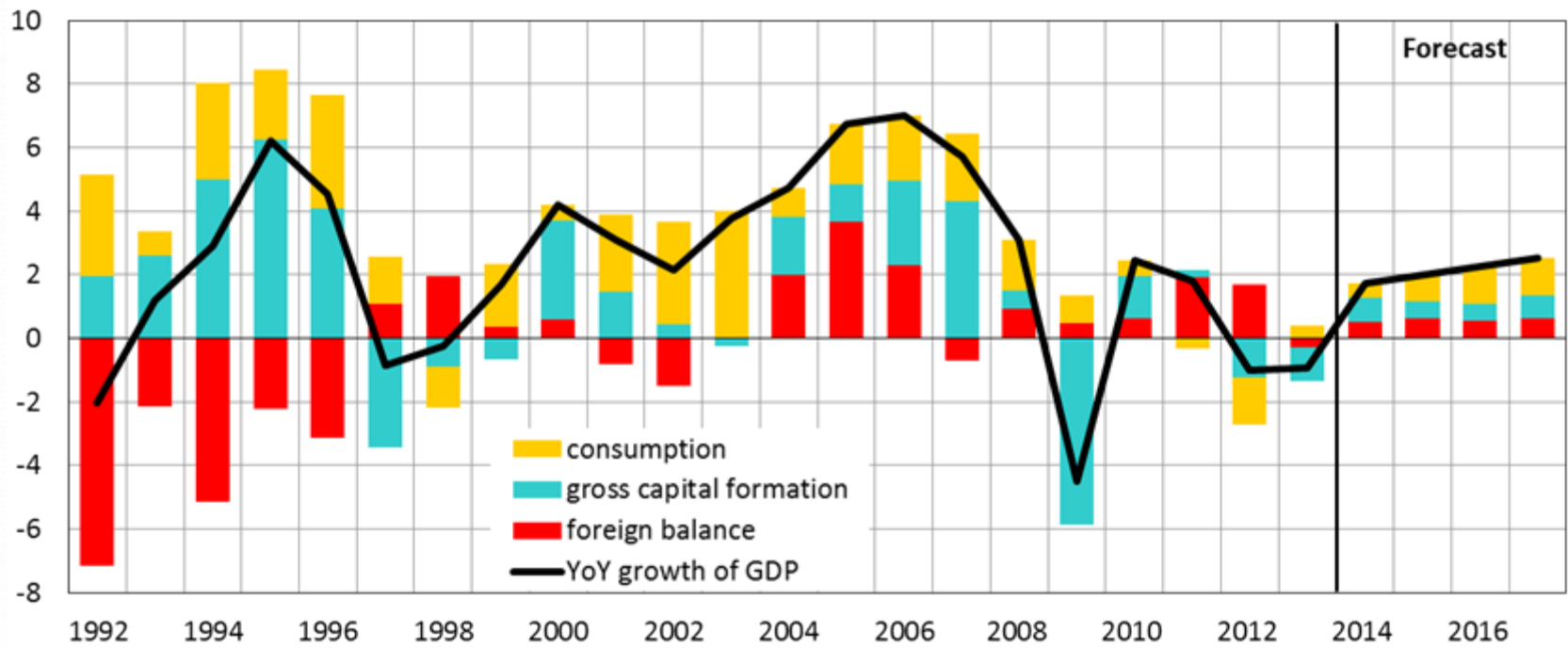
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic Performance

Gross Domestic Product (real)

(in constant prices, decomposition of the YoY growth, in percentage points)



Sources: CZSO and Ministry of Finance's own calculations

Economic Performance

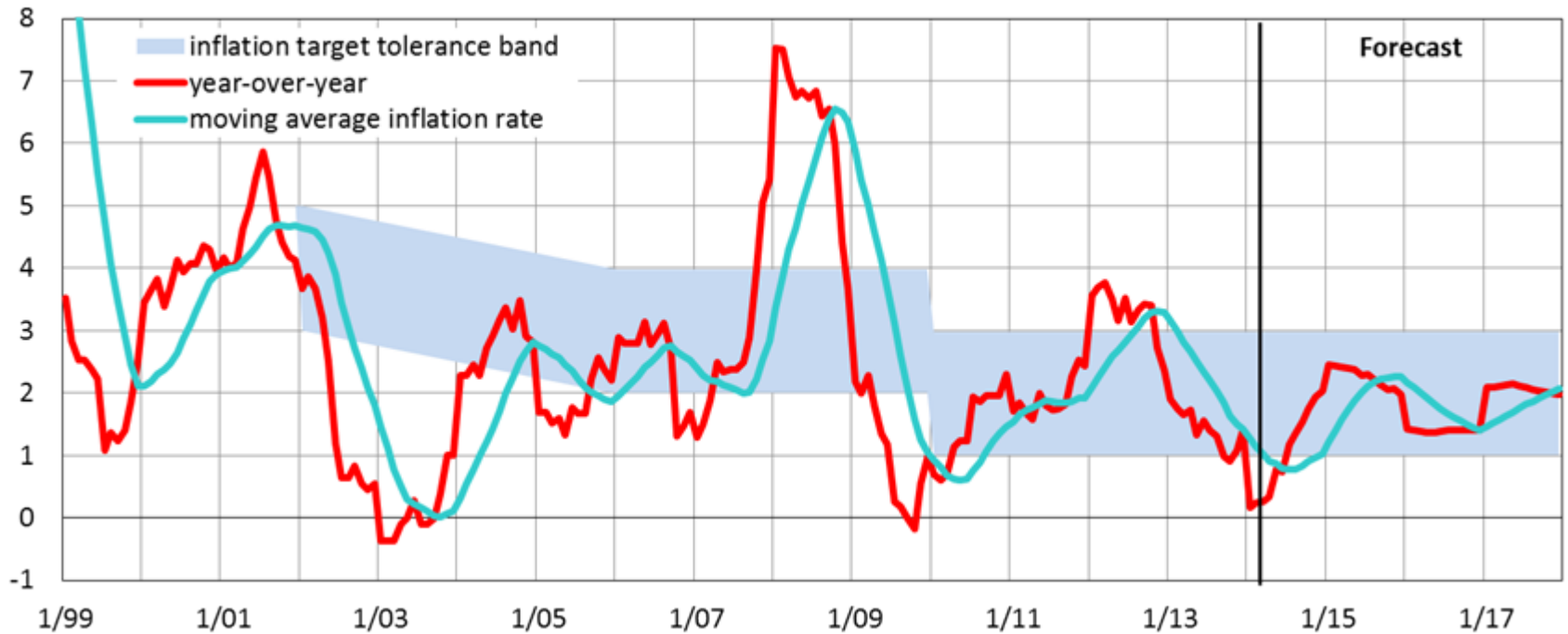
- real GDP decreased by 0.9% in 2013
- the strong QoQ growth of 1.8% in Q4 2013 was largely a product of one-off factors (the real gross value added increased by 0.8% QoQ), however, slow economic recovery should continue
- real GDP should increase by 1.7% in 2014 and by 2.0% in 2015
- expected increase in household consumption by 0.6% in 2014 reflects low growth of real disposable household income, for 2015 we expect to see a growth in household consumption by 1.5% in the context of economic recovery
- regarding real government consumption, we expect growth of 0.8% in 2014 and 0.7% in 2015
- due to the necessity to draw down maximum possible resources from EU funds from the 2007–2013 financial perspective until the end of 2015, we expect restoration of investment growth dynamics
- in 2014 and 2015, foreign trade will have a pro-growth impact

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

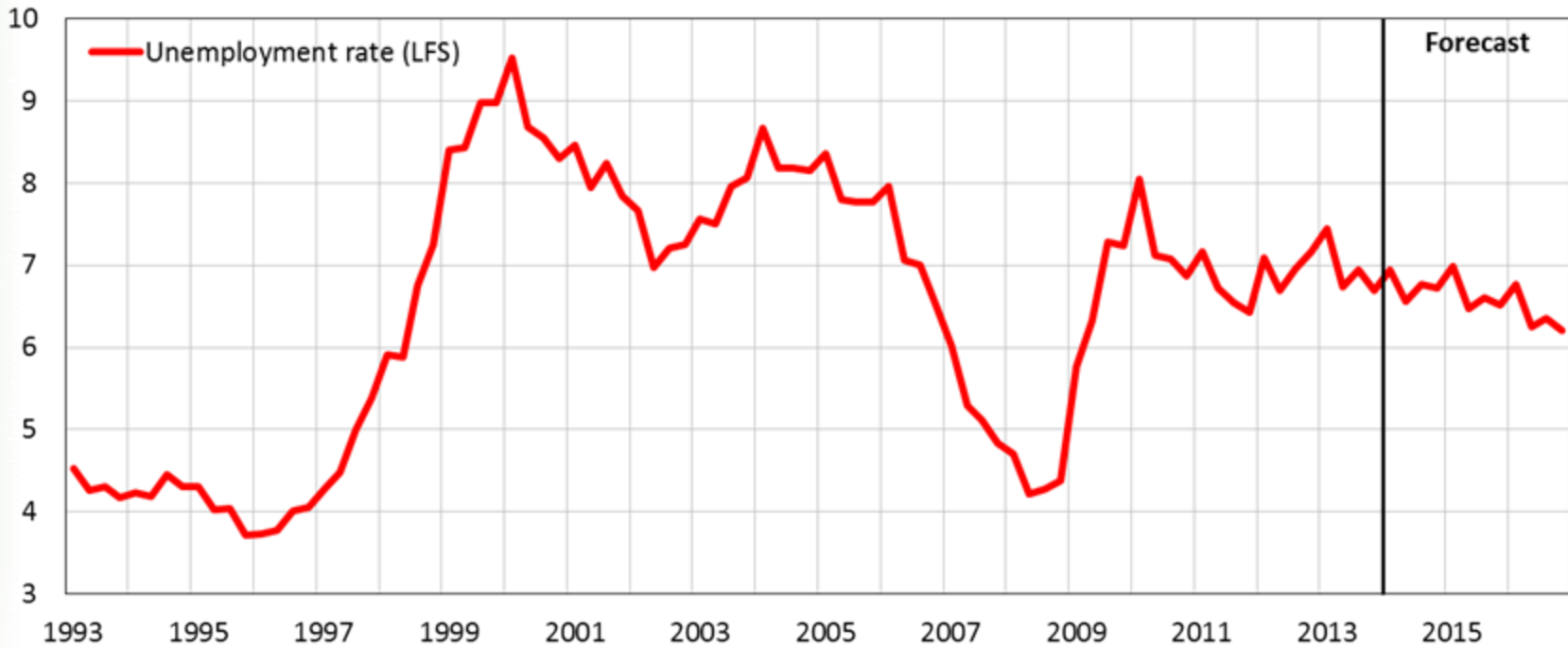
- in spite of the weakening of the Czech koruna due to the CNB's foreign exchange interventions, 2014 should be characterized by very low inflation amounting to 1.0% (the main anti-inflationary factor is a decrease in the electricity price, a deeply negative output gap and development of unit labour costs will contribute in a lower extent)
- due to the expected economic growth and the related closing of the output gap, we estimate 2015 average inflation rate at 2.3%

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

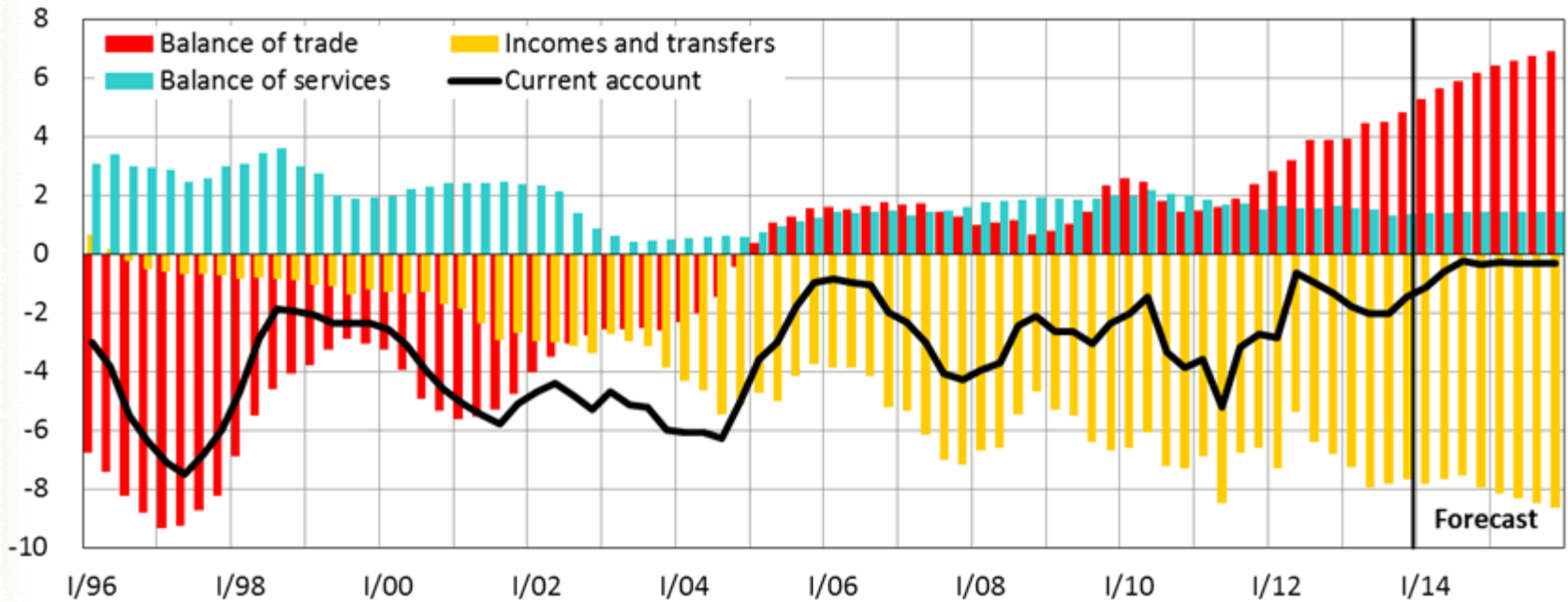
Labour Market

- in Q4 2013, employment grew by 0.2% QoQ and the unemployment rate according to LFS decreased to 6.7%; the development was significantly affected by a YoY increase in the share of part-time jobs
- for both 2014 and 2015, we expect a growth in employment of 0.2%
- the unemployment rate according to LFS is expected to reach its peak in Q1 2014, then it should gradually decline to 6.8% in 2014 and to 6.6% in 2015
- surprisingly large decline in the wage bill by 2.7% in the average wage by 1.8% in Q4 2013 can be only partially attributed to the extent of managerial bonuses shifted to Q4 2012
- due to the efforts of the private sector to compensate for the relatively high increases of unit wage costs in recent years, we expect overall wage bill to increase by 1.7% in 2014 and by 3.6% in the following year

External Relations

Current Account

(moving sums of the latest 4 quarters, in % of GDP)



Sources: CNB and Ministry of Finance's own calculations

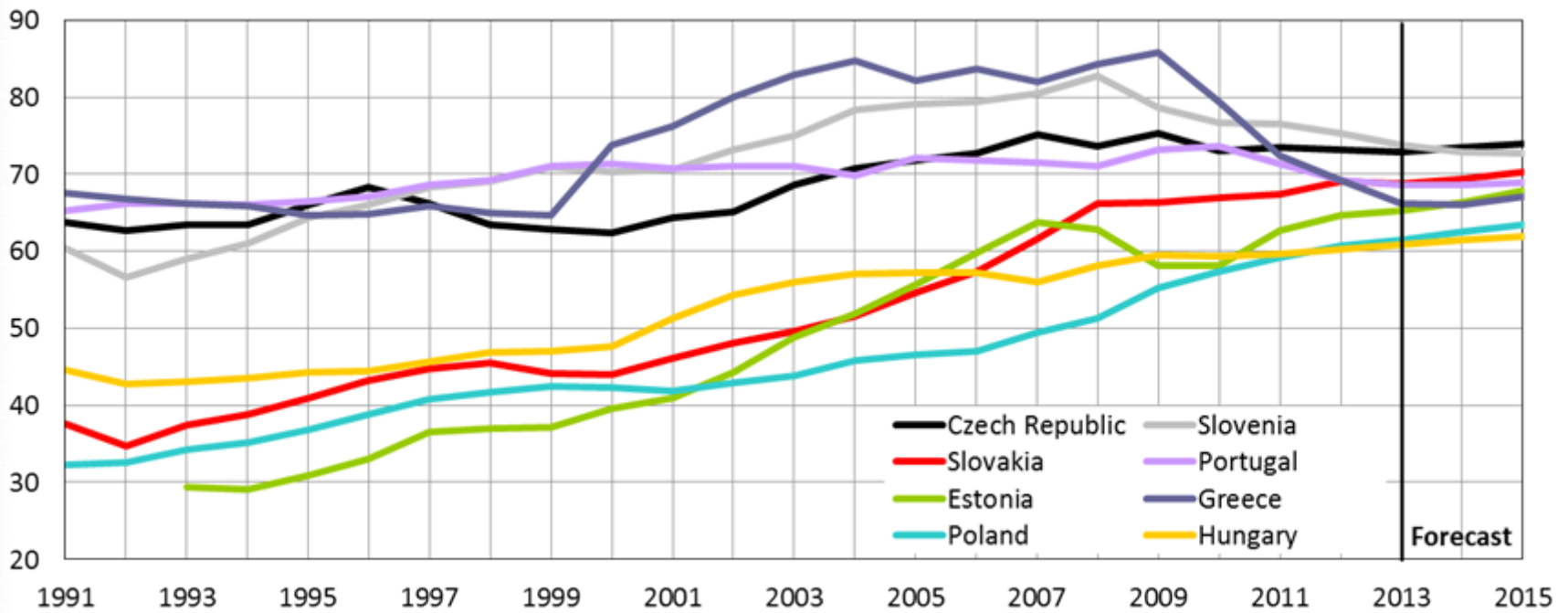
External Relations

- export markets started rising again during 2013, however, we expect more dynamic growth of export markets in the following period due to the recovery in foreign trade
- thanks to the continuing positive impact of the terms of trade, the ratio of the trade balance to GDP could increase to 6.1% of GDP in 2014 and to 6.9% in the following year
- we expect the surplus in the balance of services to reach 1.4% of GDP in 2014 and 2015
- deficit in the balance of income has been showing a tendency to increase in the long term, it should reach 8.2% of GDP in 2014 and 8.8% of GDP in 2015
- in both 2014 and 2015, the current account of the balance of payments should be nearly balanced

International Comparison

GDP per capita – using current purchasing power parities

(EA12 = 100)



Sources: Eurostat, OECD, IMF and Ministry of Finance's own calculations

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