



**Ministry of Finance**

**CZECH REPUBLIC**

Financial Policy Department

# **Macroeconomic Forecast**

**Czech Republic**

**January 2013**

## Macroeconomic Forecast

# Structure of the presentation

## Forecast Assumptions

- risks of the forecast
- external environment
- fiscal policy
- monetary policy, interest rates and exchange rates
- structural reforms

## Economic Cycle

## Forecast of Macroeconomic Indicators

- economic output
- inflation
- labour market
- external relations

# Forecast Assumptions



## Risks of the forecast

- compared to the last Macroeconomic Forecast, the short-term external risks have significantly decreased (calming of the financial markets) and medium-term external risks have slightly decreased (structural reforms, fiscal restraint and the gradual consolidation of the banking sector)
- from the long-term perspective, the situation in Greece seems to be unsustainable
- we consider a difficulty of predicting the business environment and very low level of confidence among consumers but also in many segments of the business sector as a significant internal risk in the Czech economy

# External Environment

## The global economic outlook is uncertain

- the euro zone economy continues to decline, however, performance of the individual countries has been considerably differentiated
- growth of the US economy gradually accelerates, uncertainty associated with the „fiscal-cliff“ was overcome
- economic growth in China slows, however, economy output is keeping to the plan

## The situation in the euro zone has calmed down

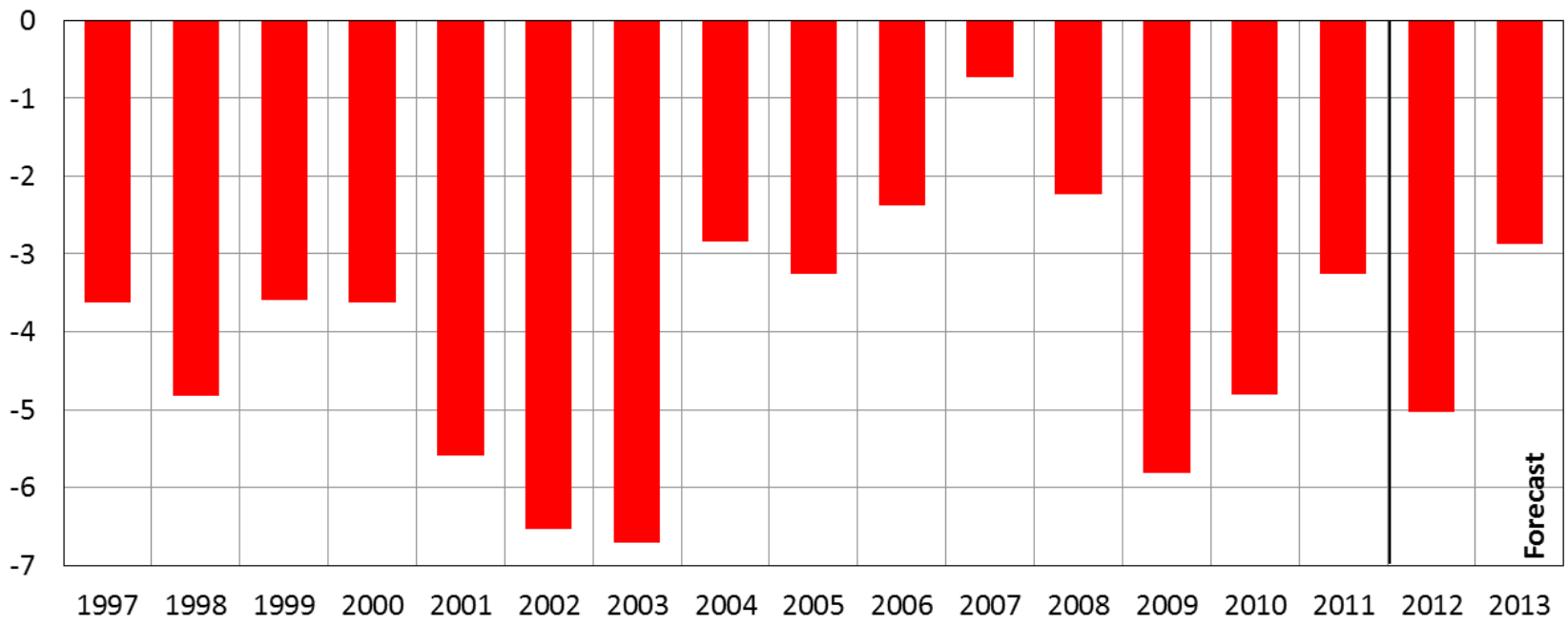
- the exchange of Greek government bonds ended up successfully and the first evaluation for meeting conditions of the second bailout programme for Greece was concluded
- the finance ministers of the EU have agreed to establish a Single Supervisory Mechanism for banks in the euro zone countries
- the restructuring of the Spanish banking sector continues

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# Fiscal Policy

## Net Lending/Borrowing

(in % of GDP)



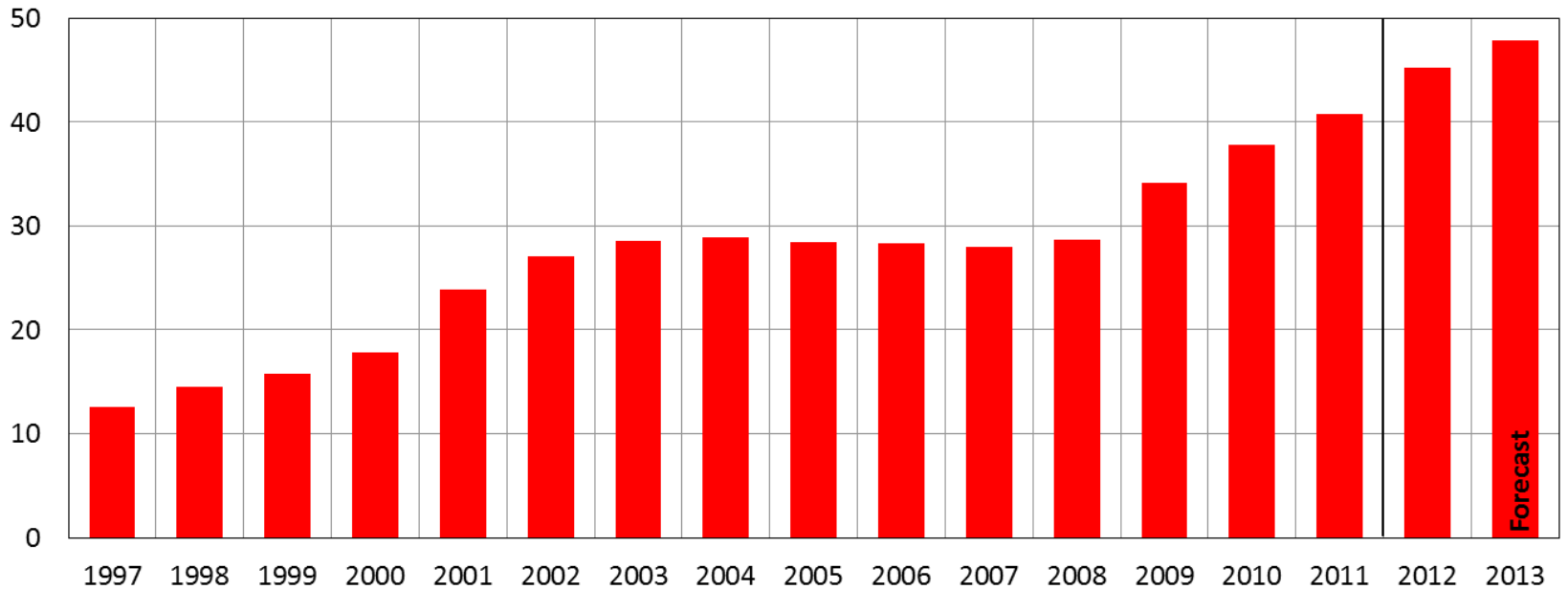
Source: Ministry of Finance.

## Macroeconomic Forecast

# Fiscal Policy

## Government Debt

(in % of GDP)



Source: Ministry of Finance.



## Fiscal Policy

- the current estimate of the general government deficit for 2012 is 5.0% of GDP, the deterioration is due to methodical adjustments in the accrual accounting system (financial compensation to churches and unreimbursed part of the EU resources)
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2012 and 2011) should amount to 1.0 p.p.
- we expect government debt at the end of 2012 at 45.2% of GDP
- for 2013, when the general government deficit should, in accordance with the excessive deficit procedure, be lower than 3% of GDP, we predict a balance of -2,9% of GDP



# Monetary Policy, Interest Rates and Exchange Rates

- effective from 2 November 2012, the Czech National Bank lowered the interest rate for 2W repo operations to 0.05%
- the 3M PRIBOR reached 1.0% in 2012, for the next two years we expect the average value of around 0.5% and 0.6% respectively
- long-term interest rates are low, yields to maturity of 10Y government bonds reached 2.8% in 2012, for the next two years are estimated yield of around 2.2% and 2.3% respectively
- an average exchange rate reached 25.1 CZK/EUR and 19.6 CZK/USD in 2012, for the entire forecast horizon the nominal and real exchange rates should be below the previous long-term trend
- in January 2013 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+)

# Structural reforms

## Approval of major structural reforms

- **Act on amendments to Tax, Insurance and Other Acts in Relation to Reducing Public Budget Deficit (came into effect on 1 January 2013)**
- **Amendment to the Act on Excise Taxes (came into effect on 1 January 2013)**
- **Act on the Conditions for Trading in Greenhouse Gas Emission Allowances (came into effect on 1 January 2013)**
- **Act on Supported Energy Sources (came into effect on 1 January 2013)**
- **Pension reform (came into effect on 1 January 2013)**
- **Amendment to the Act on Supplementary Pension Savings (came into effect on 1 January 2013)**

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# Economic Cycle

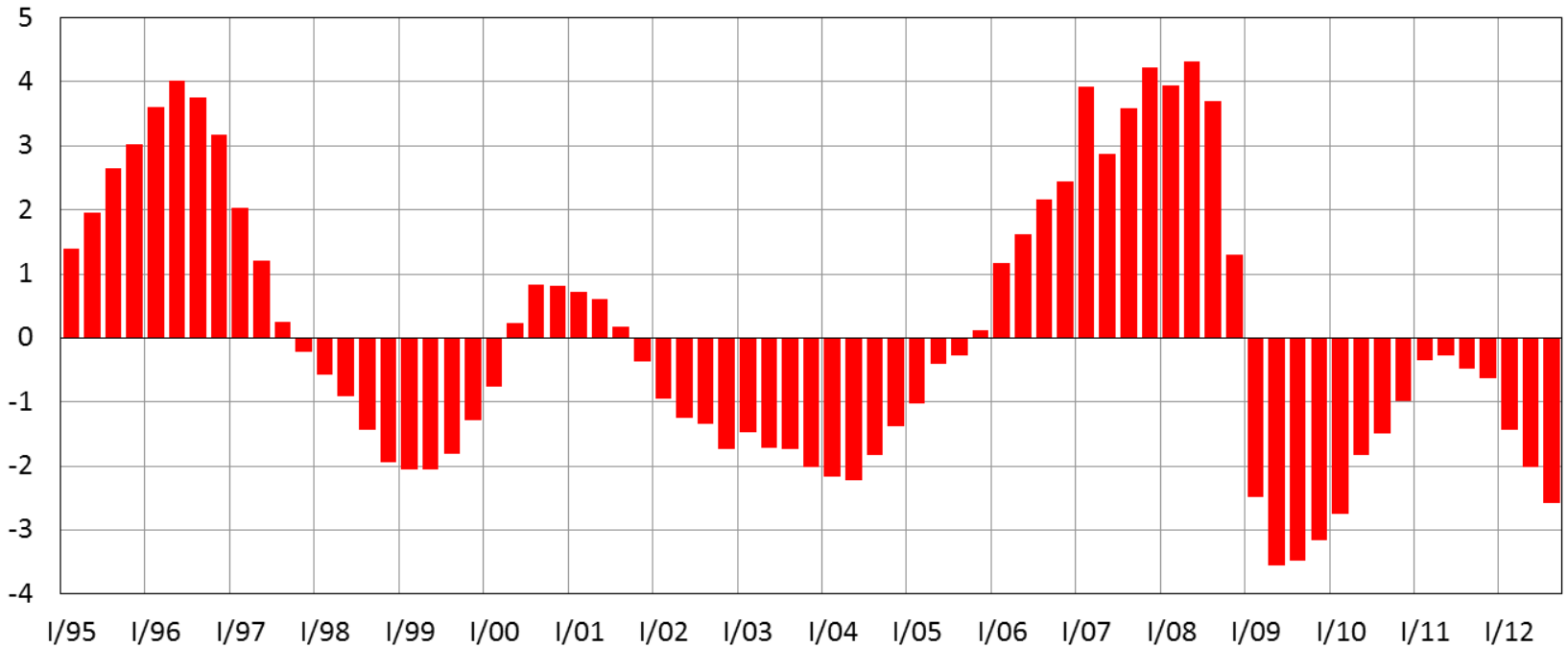


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# Economic cycle

## Output Gap

(in % of potential product)



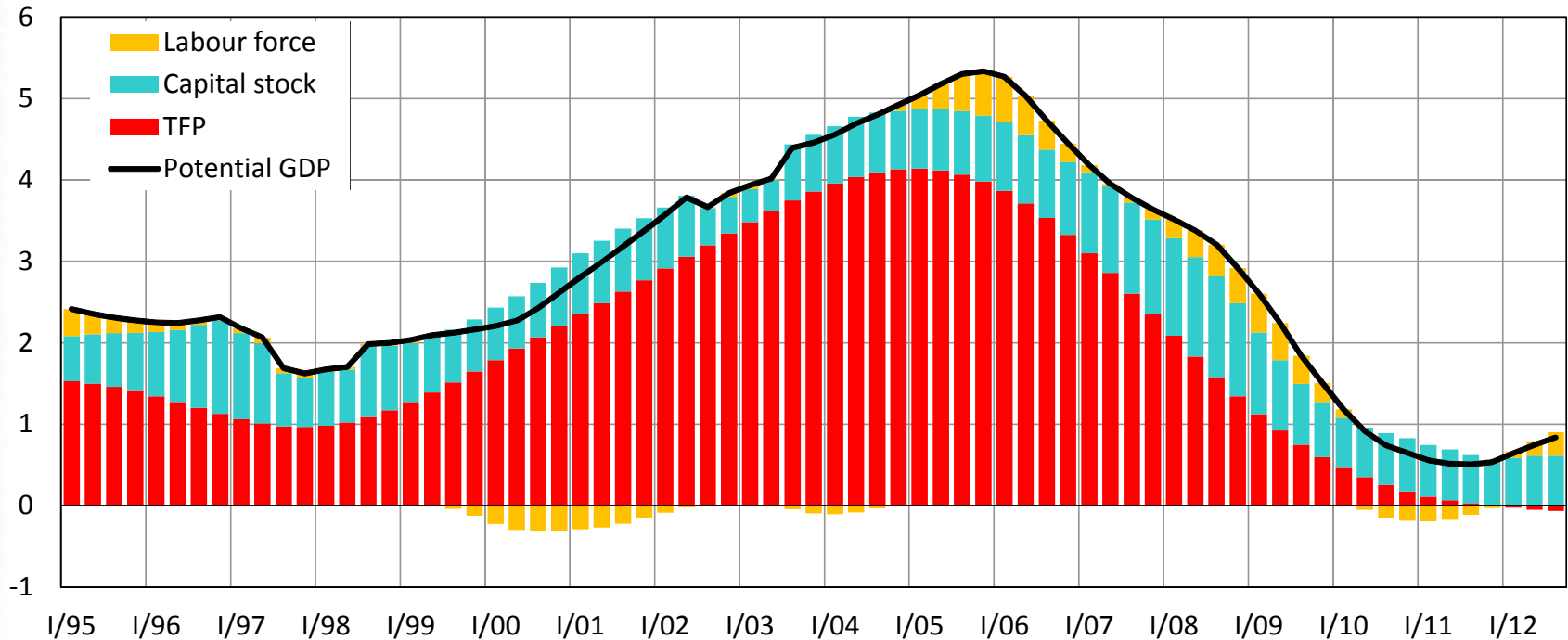
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

# Economic cycle

## Potential Product Growth

(in %, contributions in percentage points)



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

## Economic cycle

- since the recession at the turn of 2008 and 2009, the Czech economy has constantly shown a negative output gap, which gradually deepens from 3Q 2011 and reached -2,6% in 3Q 2012
- the component most seriously affected is total factor productivity, its contribution to the growth fell to only 0.0 p.p. in 1-3Q 2012
- deep fall in investment activity led to a reduction of the contribution of the capital stock, which remains relatively low
- growth of labour supply exceeded the decline in working age population in 1-3Q 2012



# Forecast of Macroeconomic Indicators



## Macroeconomic Forecast

## Main Macroeconomic Indicators

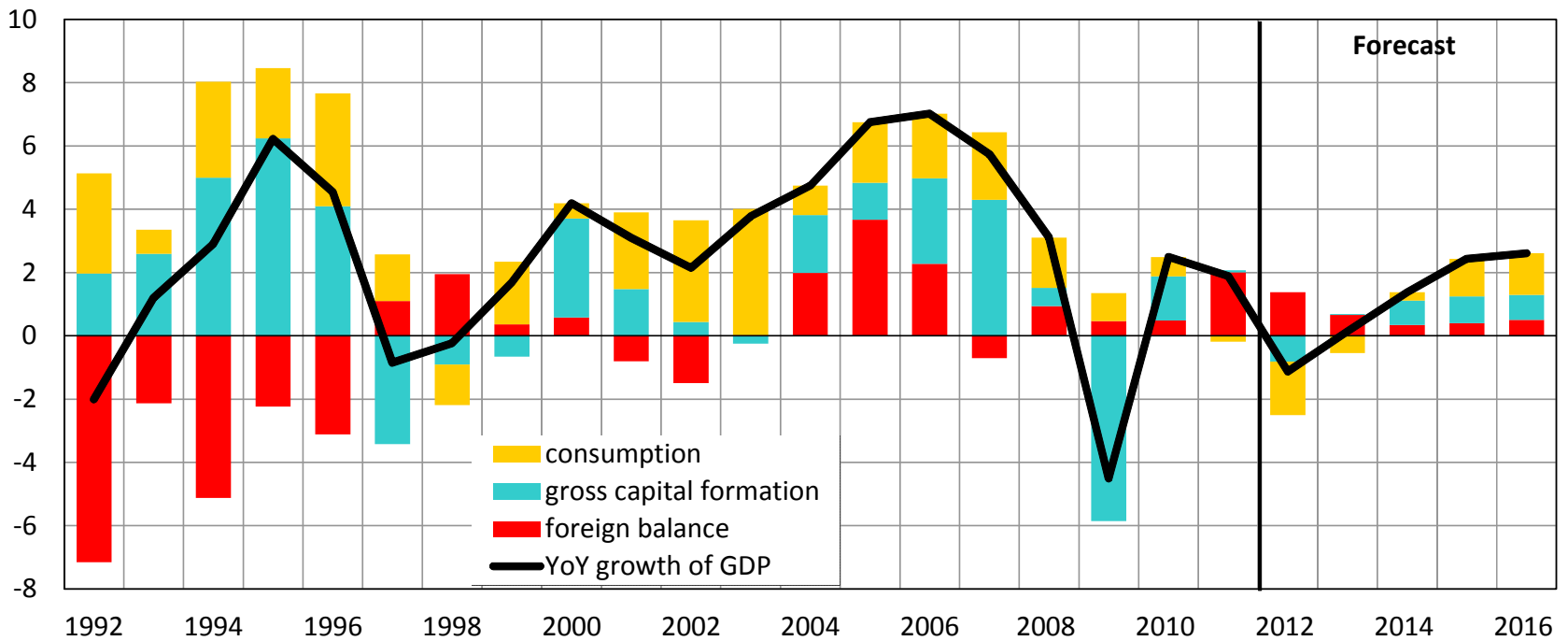
		2010	2011	2012	2013	2014
<b>Gross domestic product</b>	<i>growth in %, const.pr.</i>	2,5	1,9	-1,1	0,1	1,4
<b>Consumption of households</b>	<i>growth in %, const.pr.</i>	1,0	0,7	-3,0	-0,7	0,9
<b>Consumption of government</b>	<i>growth in %, const.pr.</i>	0,5	-2,5	-0,9	-1,0	-0,9
<b>Gross fixed capital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

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

# 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

- the Czech economy has been in a shallow recession, in 3Q 2012, the economic output declined QoQ for the third time in a row
- on a seasonally adjusted basis, the GDP fell by 0.3% QoQ in 3Q 2012 mainly due to the drop in household consumption and decline in inventories

## Economic Performance

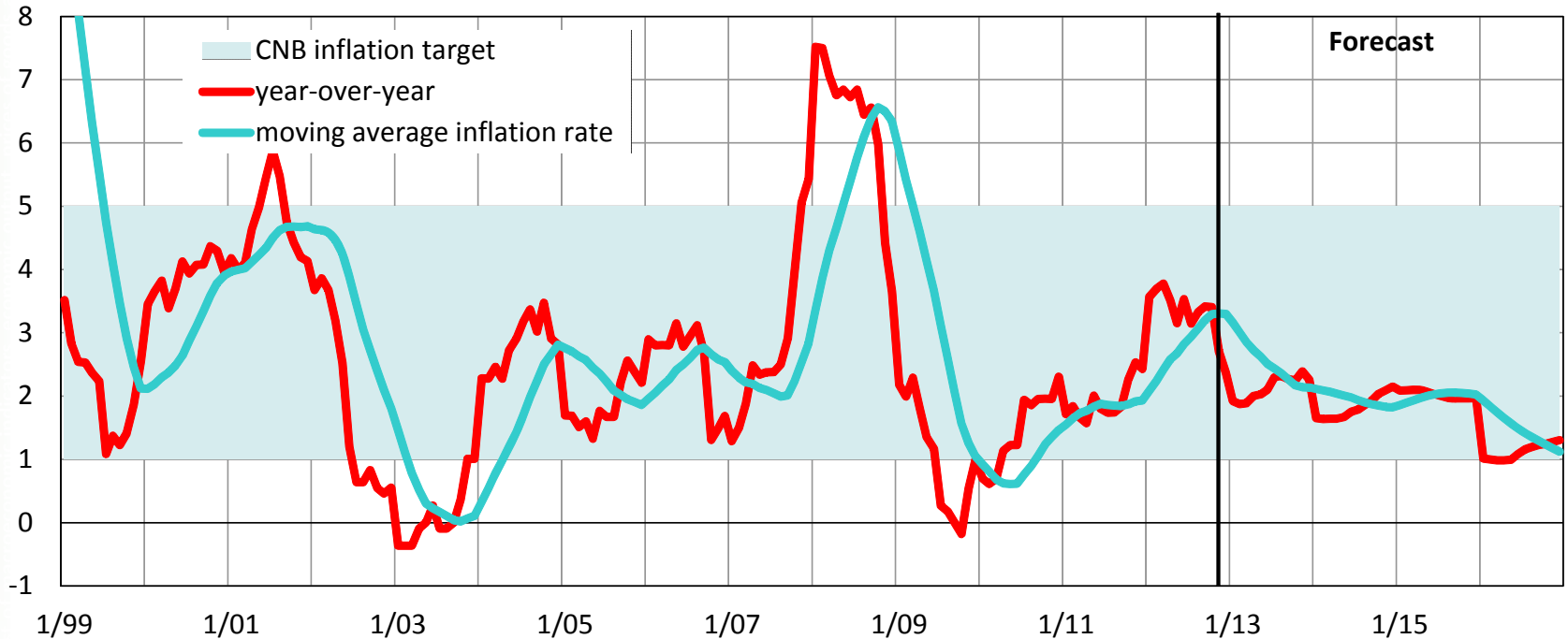
- **GDP should fall by 1.1% in 2012, in the following year it should stagnate or only slightly increase by 0.1% and for 2014 we expect rebound in economic growth of 1.4%**
- **drop in household consumption in 2012 reflects the decrease in real disposable household income, low savings rate and households' very low confidence in the economy, in 2013 the household consumption should decline only slightly and for 2014 we expect its growth**
- **decline in real government consumption in 2012 to 2014 reflects approved consolidation strategy**
- **due to the little company's needs to invest into physical capital, we anticipate a slight decrease of gross capital formation in 2012 and gradual recovery of the growth dynamic in the following years**
- **the main driver of economic growth in 2013 should be the foreign trade, in 2014 both the foreign trade and the household consumption**

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# Inflation

## Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations



# Inflation

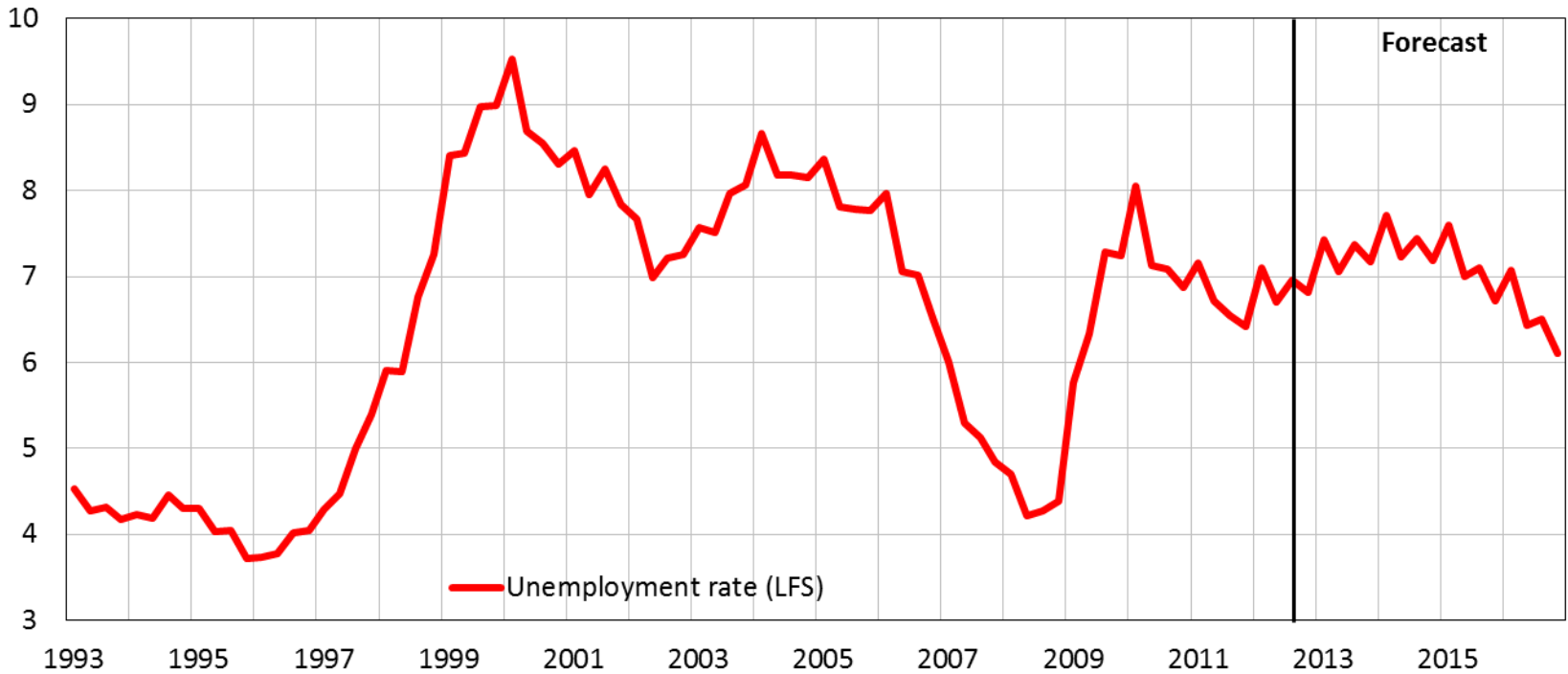
- the average inflation rate reached 3.3% in 2012
- we estimate 2013 average inflation rate at 2.1%, raising both VAT rates by 1 p.p. will contribute by 0.7 p.p.
- for 2014 we expect an average inflation rate of 1.8%

Macroeconomic Forecast

# Labour Market

## Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

## Labour Market

- **impacts of the current shallow recession have begun already affect the labour market, however, we do not expect significant deterioration**
- **in 2012, the employment should growth by 0.4% (viable firms struggle to retain quality employees and workers prefer to maintain at least minimum incomes, which is reflected by the decrease in the number of hours worked per employed person)**
- **the employment should stagnate in 2013 and 2014**
- **the unemployment rate according to LFS reached 7.0% in 3Q 2012, in the context of expected development of employment and economic situation, we expect its growth to 7.3% in 2013 and 7.4% in 2014**

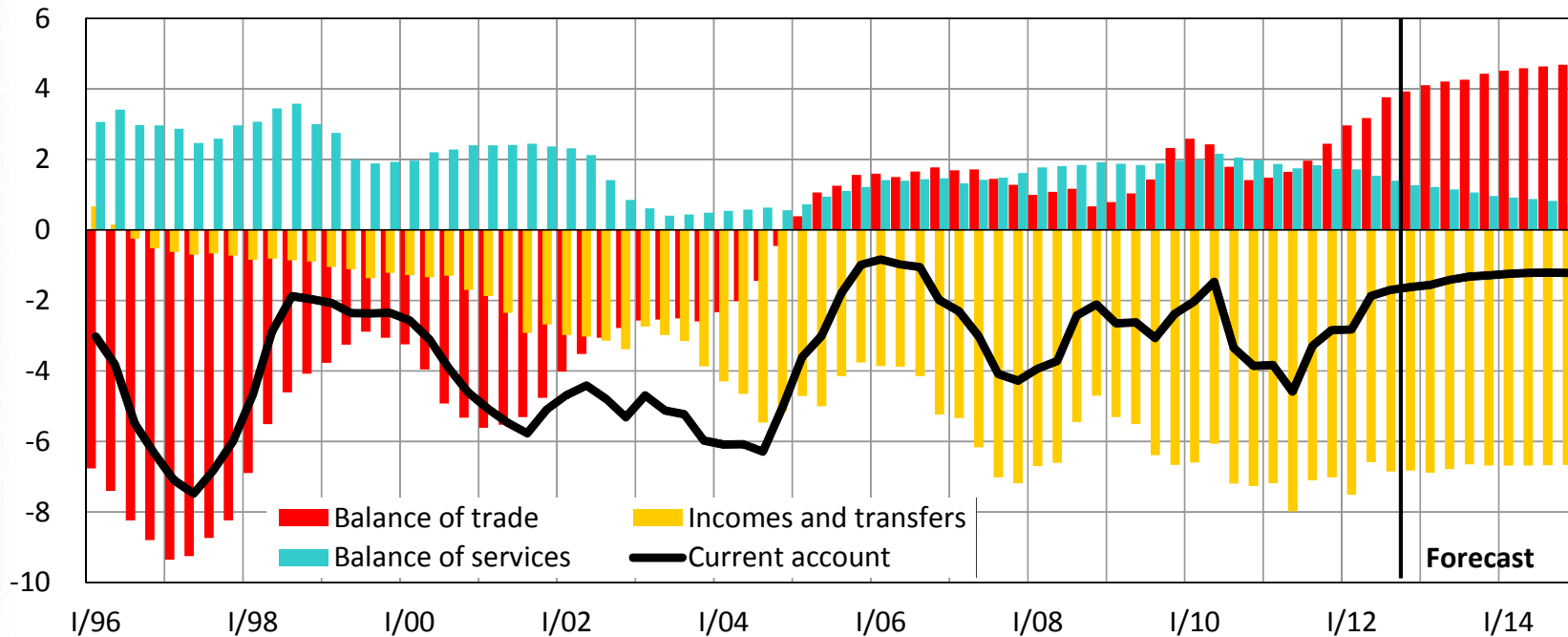
## Labour Market

- **the slowdown in wage bill growth and the average wage growth correspond basically to the situation of a longer economic recession and the shift of preferences of employers and employees to maintaining employment**
- **we expect overall wage bill to increase by 1.7% in 2012 and by 1.9% in the following year, because of lower economic performance**
- **for 2012 we anticipate the average wage increase of 2.2%, which should signify a real decline in the real average wage by 1.1%**
- **in 2013, due to estimated average inflation of 1.8% and expected growth of the average wage of 2.0%, the real wage should decrease by around 0.1%**

# 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

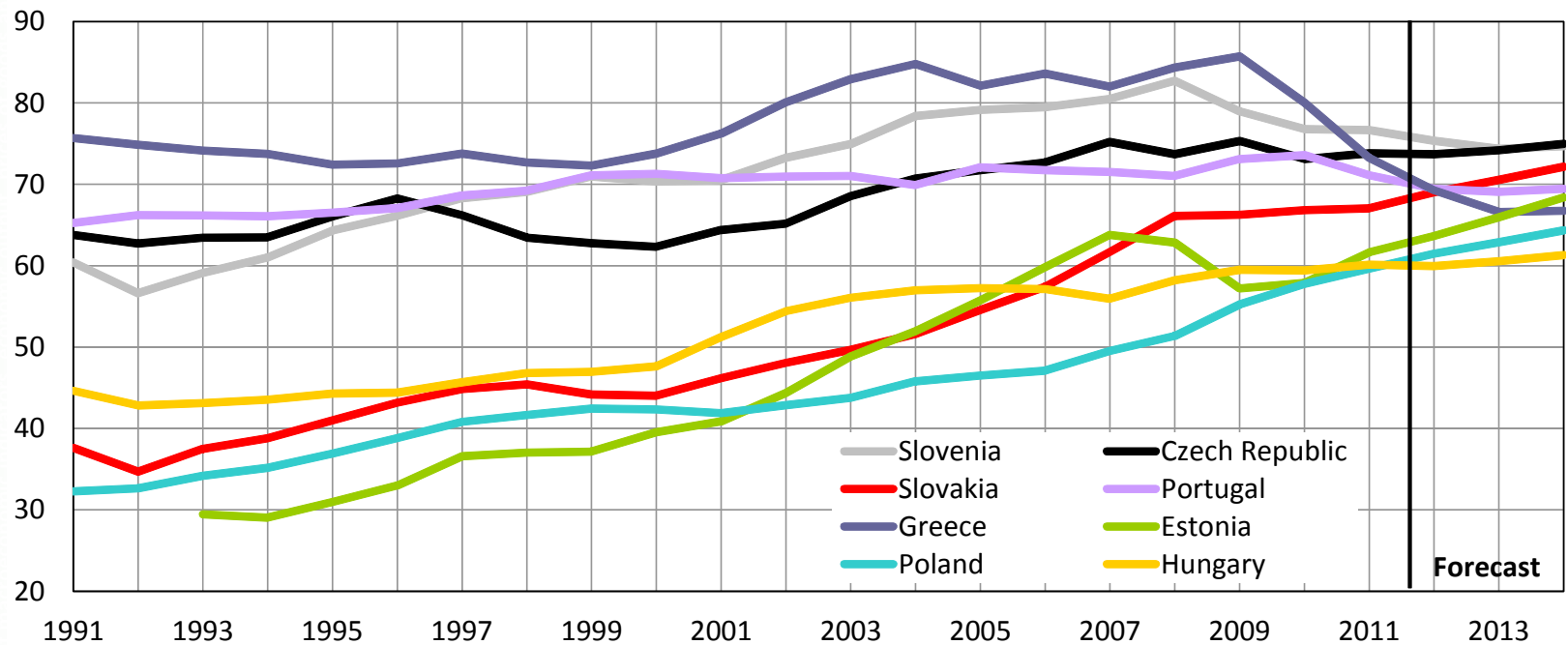
- we expect the current account deficit of around 1.5% GDP in the years 2012 to 2014
- dynamics of the world and also Czech trade growth is slowing, however decline in foreign demand will be compensated by reducing domestic demand and thus we expect exports exceed imports and balance of trade at 3.9% of GDP in 2012
- in 2013 and 2014, exports should slightly exceed imports and the ratio of the trade balance to GDP should increase to 4.4% and 4.7%
- due to the unfavourable outlook for the global economy, we expect decline in the service balance, it should gradually decrease from 1.3% of GDP in 2012 to 0.8% of GDP in 2014
- deficit in the balance of income has been showing a tendency to decrease, it should decline from 6.6% of GDP in 2012 to 6.9% of GDP in 2014



# International Comparison

## GDP per capita – using current purchasing power parities

(EA12 = 100)



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

## Macroeconomic Forecast

## International Comparison

## GDP per capita – using current purchasing power parities

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
		<i>Prelim. Forecast Forecast</i>									
<b>Slovenia</b>	<i>PPS</i>	<b>19 700</b>	<b>20 700</b>	<b>22 100</b>	<b>22 700</b>	<b>20 300</b>	<b>20 500</b>	<b>21 000</b>	<b>20 800</b>	<b>20 700</b>	<b>21 200</b>
	<i>EA12=100</i>	79	79	80	83	79	77	77	75	74	75
<b>Czech Republic</b>	<i>PPS</i>	<b>17 800</b>	<b>18 900</b>	<b>20 700</b>	<b>20 200</b>	<b>19 400</b>	<b>19 500</b>	<b>20 200</b>	<b>20 300</b>	<b>20 700</b>	<b>21 300</b>
	<i>EA12=100</i>	72	73	75	74	75	73	74	74	74	75
<b>Slovakia</b>	<i>PPS</i>	<b>13 500</b>	<b>15 000</b>	<b>16 900</b>	<b>18 100</b>	<b>17 100</b>	<b>17 900</b>	<b>18 400</b>	<b>19 000</b>	<b>19 600</b>	<b>20 500</b>
	<i>EA12=100</i>	55	57	62	66	66	67	67	69	71	72
<b>Portugal</b>	<i>PPS</i>	<b>17 900</b>	<b>18 700</b>	<b>19 600</b>	<b>19 500</b>	<b>18 800</b>	<b>19 700</b>	<b>19 500</b>	<b>19 100</b>	<b>19 200</b>	<b>19 700</b>
	<i>EA12=100</i>	72	72	72	71	73	74	71	69	69	69
<b>Greece</b>	<i>PPS</i>	<b>20 400</b>	<b>21 800</b>	<b>22 500</b>	<b>23 100</b>	<b>22 100</b>	<b>21 400</b>	<b>20 100</b>	<b>19 100</b>	<b>18 500</b>	<b>18 900</b>
	<i>EA12=100</i>	82	84	82	84	86	80	73	69	67	67
<b>Estonia</b>	<i>PPS</i>	<b>13 800</b>	<b>15 600</b>	<b>17 500</b>	<b>17 200</b>	<b>14 700</b>	<b>15 500</b>	<b>16 900</b>	<b>17 500</b>	<b>18 400</b>	<b>19 400</b>
	<i>EA12=100</i>	56	60	64	63	57	58	62	64	66	68
<b>Lithuania</b>	<i>PPS</i>	<b>11 900</b>	<b>13 100</b>	<b>14 800</b>	<b>15 400</b>	<b>12 900</b>	<b>14 100</b>	<b>16 600</b>	<b>17 400</b>	<b>18 300</b>	<b>19 400</b>
	<i>EA12=100</i>	48	50	54	56	50	53	60	63	66	68
<b>Poland</b>	<i>PPS</i>	<b>11 500</b>	<b>12 300</b>	<b>13 600</b>	<b>14 100</b>	<b>14 200</b>	<b>15 400</b>	<b>16 300</b>	<b>16 900</b>	<b>17 500</b>	<b>18 300</b>
	<i>EA12=100</i>	46	47	50	51	55	58	60	61	63	64
<b>Hungary</b>	<i>PPS</i>	<b>14 200</b>	<b>14 900</b>	<b>15 400</b>	<b>16 000</b>	<b>15 300</b>	<b>15 900</b>	<b>16 500</b>	<b>16 500</b>	<b>16 900</b>	<b>17 400</b>
	<i>EA12=100</i>	57	57	56	58	59	59	60	60	61	61

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

January 2013

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