



Ministry of Finance

CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast

Czech Republic

January 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
- structural reforms

Economic Cycle

Forecast of Macroeconomic Indicators

- economic output
- inflation
- labour market
- external relations

Macroeconomic Forecast

Forecast Assumptions



Risks of the forecast

- we consider the risks of further development to be 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)
- on the other hand, 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
- the decision of the CNB to use the exchange rate as an additional monetary policy instrument has considerably increased the uncertainty of the forecasts

External Environment

The outlook for the global economy has improved slightly

- economic growth in the developed economies is stronger than expected and, moreover, there is a confidence that recovery will continue in 2014
- the U.S. economy is getting better, economic growth is driven mainly by the household consumption
- the euro zone has recorded QoQ growth, however, return to a growth trajectory will be gradual
- economic growth in developing economies slowed slightly, but it continues to retain its high dynamics

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

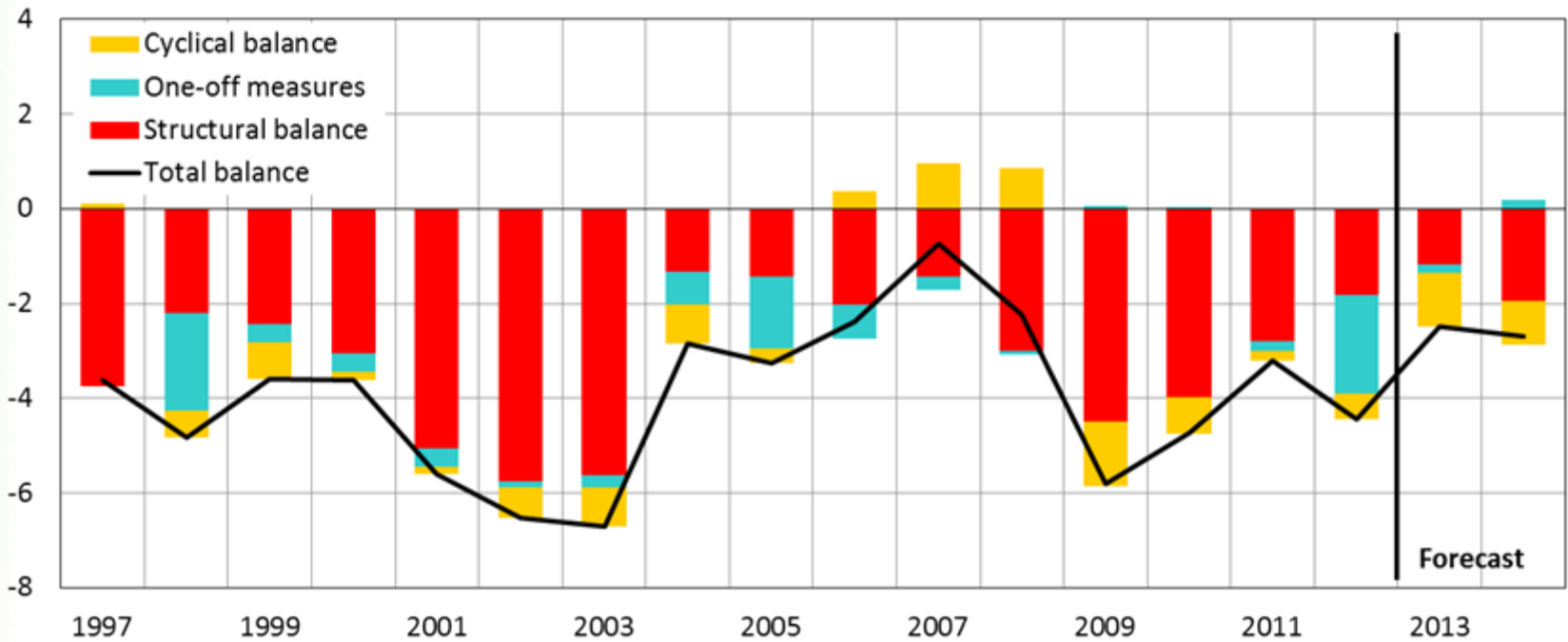
- economic recovery in the euro zone periphery states is very fragile and future developments remain clouded in considerable uncertainty

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



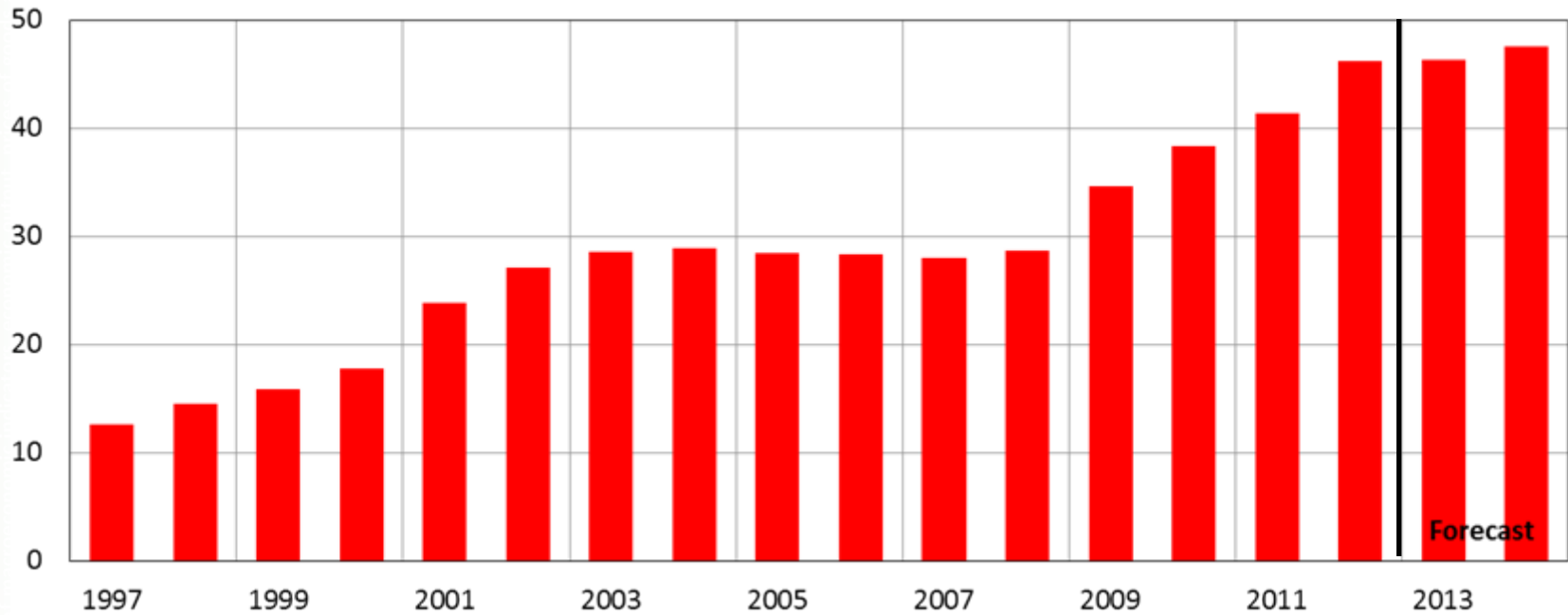
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- according to current Ministry of Finance estimates, the government sector balance ended with a deficit of 2.5% of GDP in 2013 (collection of value added tax is expected to have been higher because of the measures against tax evasion launched at the beginning of 2013)
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2013 and 2012) amounted to 0.7 p.p.
- at the end of 2013, the government debt reached 46.3% of GDP
- for 2014 we predict a government sector balance of -2.7% of GDP
- in 2014, the government debt to GDP ratio should reach 47.6%

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 2.5% in the following year
- we estimate an average exchange rate at 27.3 CZK/EUR and 20.2 CZK/USD in 2014
- in January 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+)

Structural reforms

Approval of major structural reforms

- **Act on Commercial Companies and Cooperatives (came into effect on 1 January 2014)**
- **Statutory Measure of the Senate Amending the Act on Public Procurement (came into effect on 1 January 2014)**
- **Statutory Measure of the Senate Amending Taxation Statutes in Connection with the Recodification of Private Law (came into effect on 1 January 2014)**
- **Statutory Measure of the Senate on Immovable Property Acquisition Tax (came into effect on 1 January 2014)**



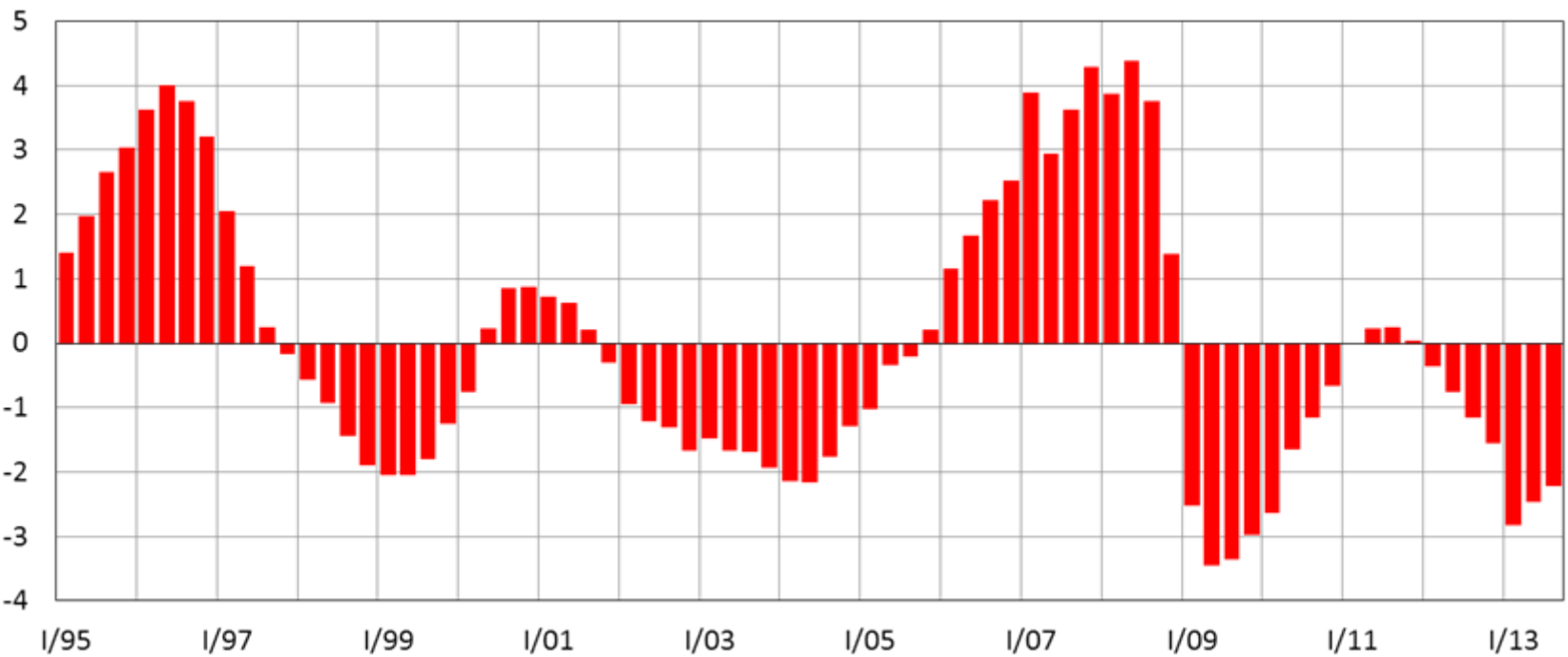
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



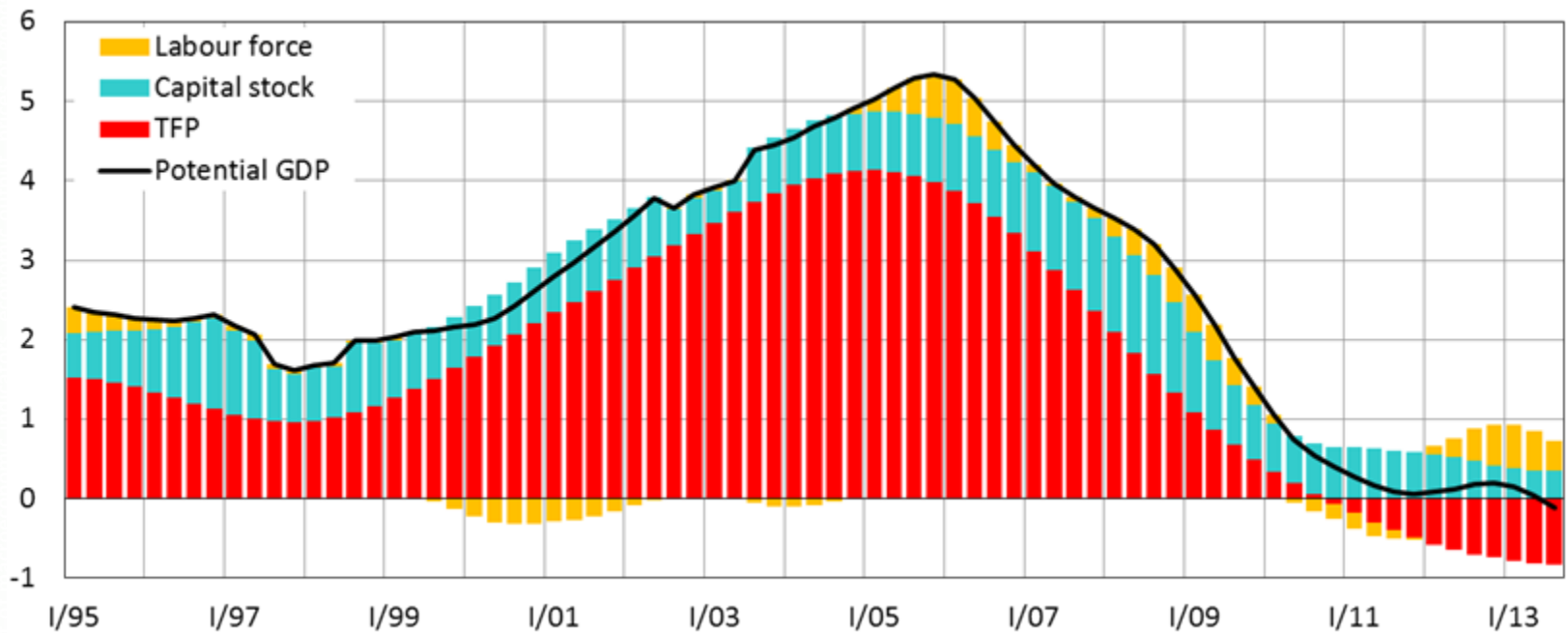
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- from Q4 2011, the Czech economy is in a negative output gap, which reached -2.5% in Q1-3 2013
- potential product has more or less come to a halt, however, these estimates in our opinion underestimate the reality
- the component most seriously affected is total factor productivity, its contribution to the growth was negative and reached -0.8 p.p. in Q1-3 2013
- deep fall in investment activity led to a gradual reduction of the contribution of the capital stock to 0.4 p.p. in Q1-3 2013
- growth of labour supply exceeded the decline in working age population in Q1-3 2013

Forecast of Macroeconomic Indicators



Macroeconomic Forecast

Main Macroeconomic Indicators

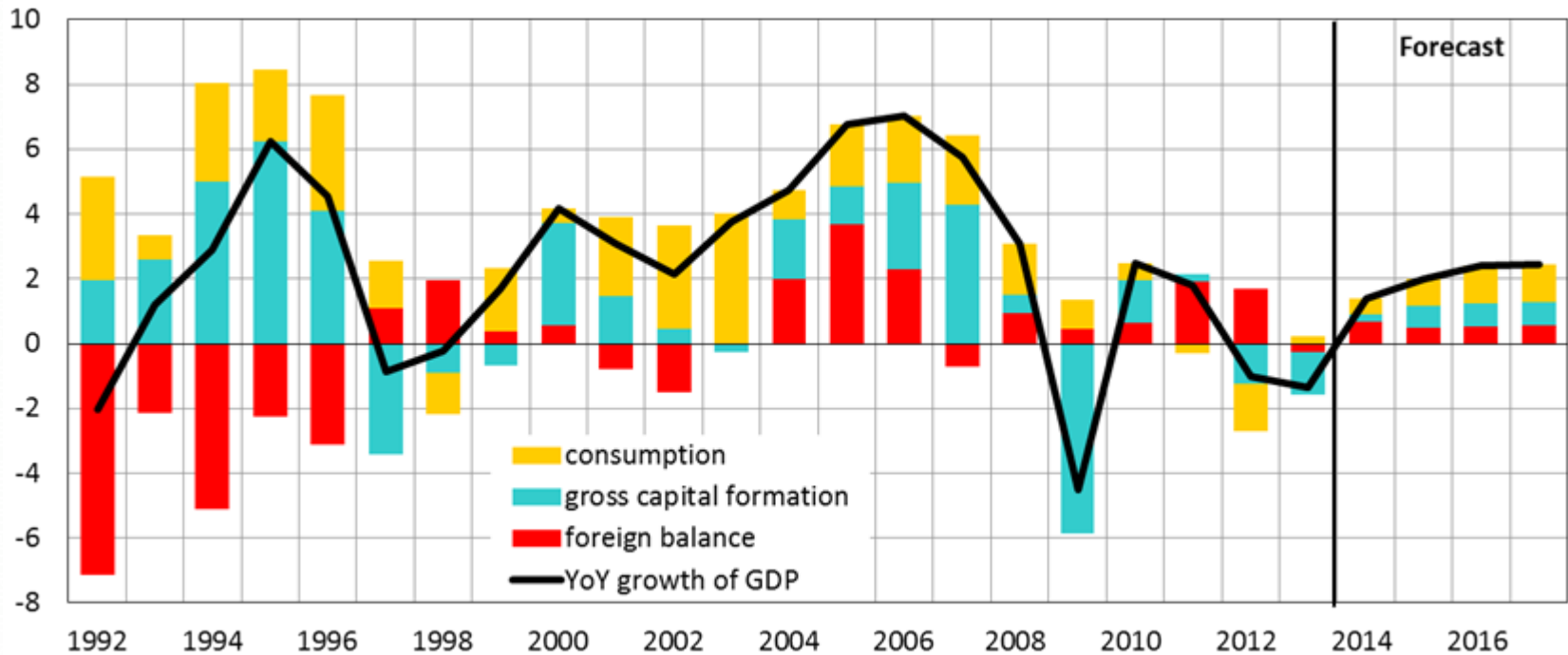
		2010	2011	2012	2013	2014	2015
		<i>Current forecast</i>					
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	1,8	-1,0	-1,4	1,4	2,0
Consumption of households	<i>growth in %, const.pr.</i>	0,9	0,5	-2,1	-0,2	0,6	1,5
Consumption of government	<i>growth in %, const.pr.</i>	0,2	-2,7	-1,9	1,6	1,0	0,4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

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

- **recovery is still very fragile and gradual, real GDP increased by 0.2% QoQ in Q3 2013**
- **the quarterly growth of GDP was predominantly driven by an increase in inventories and valuables and, to a lesser extent, government institution expenses for consumption; on the other hand, gross fixed capital formation continued its gradual decrease, now lasting for seven quarters on a quarterly basis**

Economic Performance

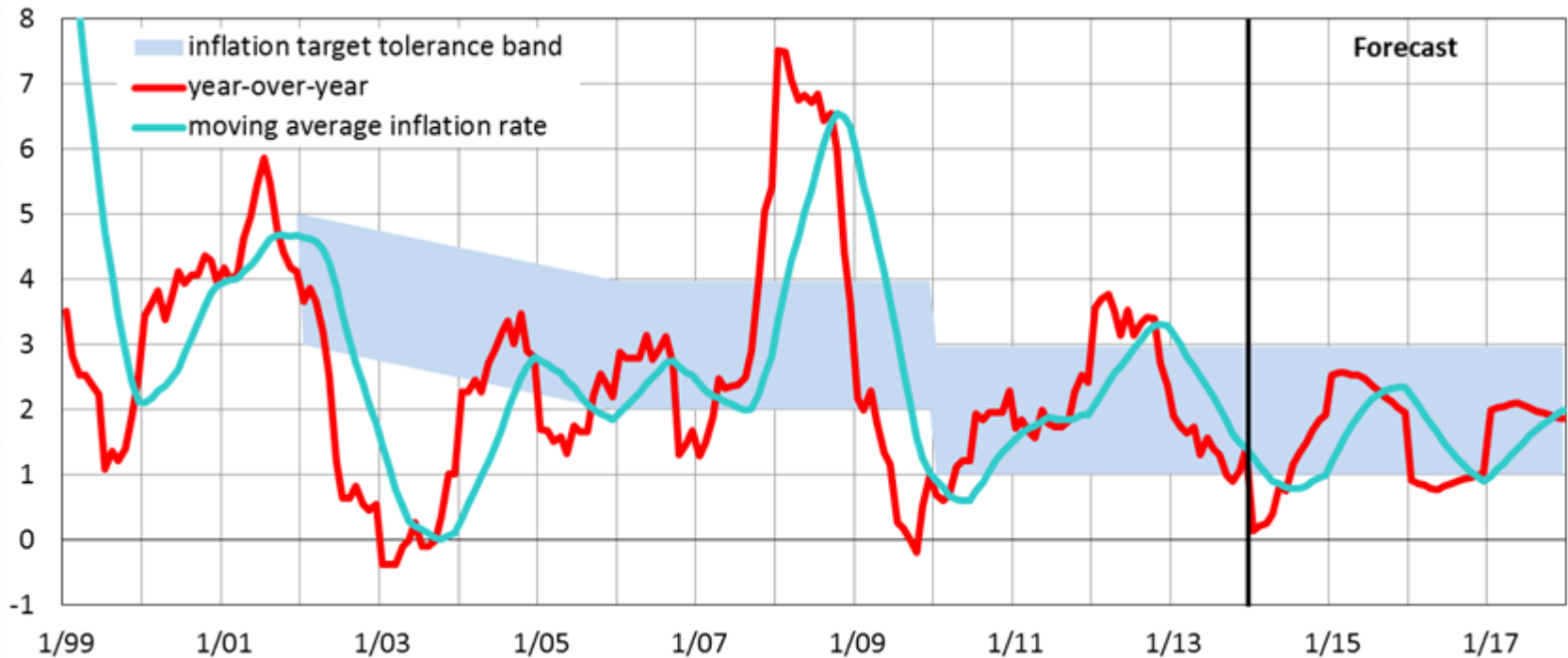
- we estimate that real GDP decreased by 1.4% in the whole of 2013
- real GDP should increase by 1.4% in 2014 and 2.0% in 2015
- expected increase in household consumption by 0.6% in 2014 reflects low growth of real disposable household income, for 2015 we expect to see a growth in household consumption by 1.5% in the context of economic recovery
- regarding real government consumption, we expect growth of 1.0% in 2014 and 0.4% in 2015
- due to low domestic and foreign demand and decrease in internal resources for financing, we anticipate a decrease of gross capital formation by 0.3 % in 2014 and gradual recovery of the growth dynamic in the following years
- in 2014, the main driver of economic growth should be the foreign trade, household consumption and investment should also contribute in 2015

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

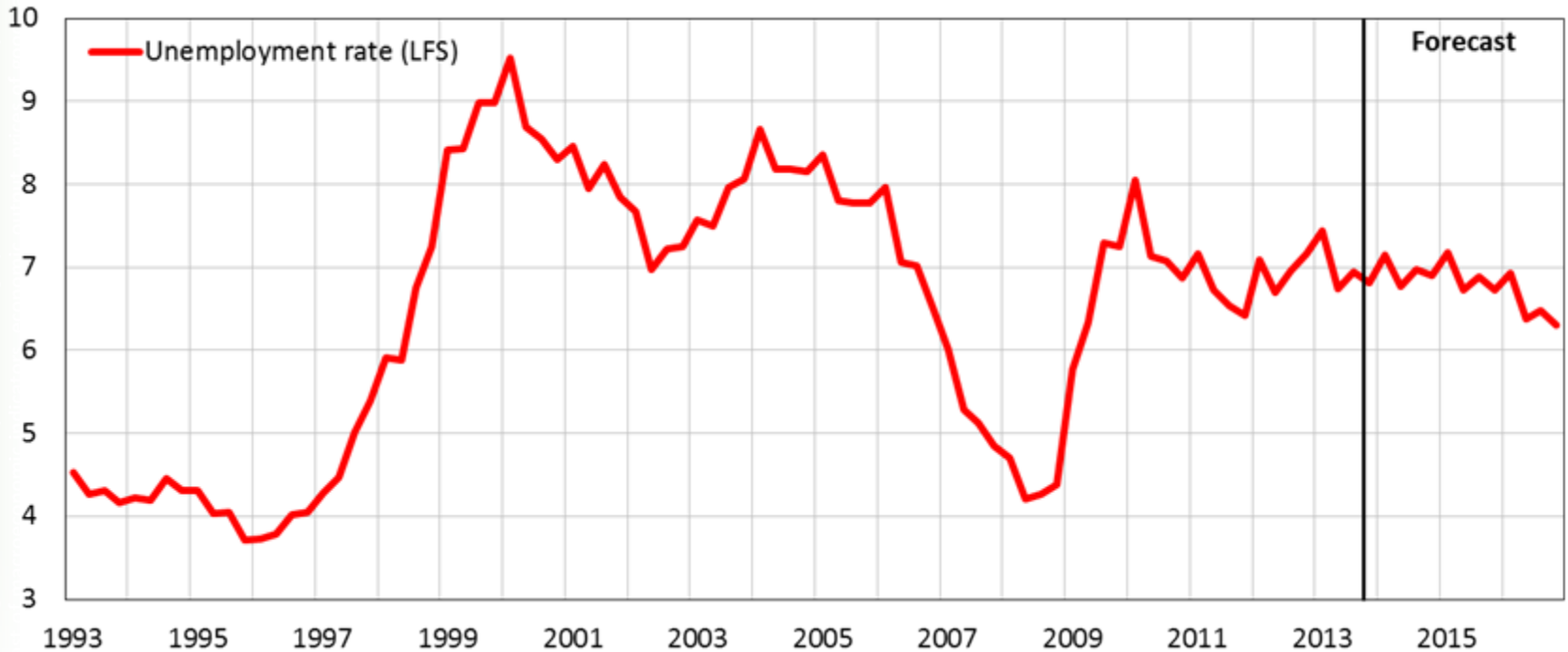
- the average inflation rate in 2013 amounted to 1.4%
- in spite of the weakening of the Czech koruna due to the CNB's foreign exchange interventions, 2014 should be characterized by very low inflation amounting to 1.0% (the main anti-inflationary factor is a decrease in the electricity price, a deeply negative output gap 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 2.4%,

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

Labour Market

- the behaviour of the labour market continued to be flexible, but somewhat non-standard from the macroeconomic perspective
- in Q3 2013, employment decreased by 0.2% QoQ and the unemployment rate according to LFS increased to 6.9% (the number of job applicants registered at labour offices in 2013 has reached its highest level in the Czech Republic's history)
- we expect further rationalization of the number of employees, which should be reflected in an increase in the number of worked hours per employee and by a slight increase in the unemployment rate
- for both 2014 and 2015, we expect a growth in employment of 0.1%
- the unemployment rate is expected to reach its peak of 7.0% in 2014, in the following year it should fall slightly to 6.9%

Labour Market

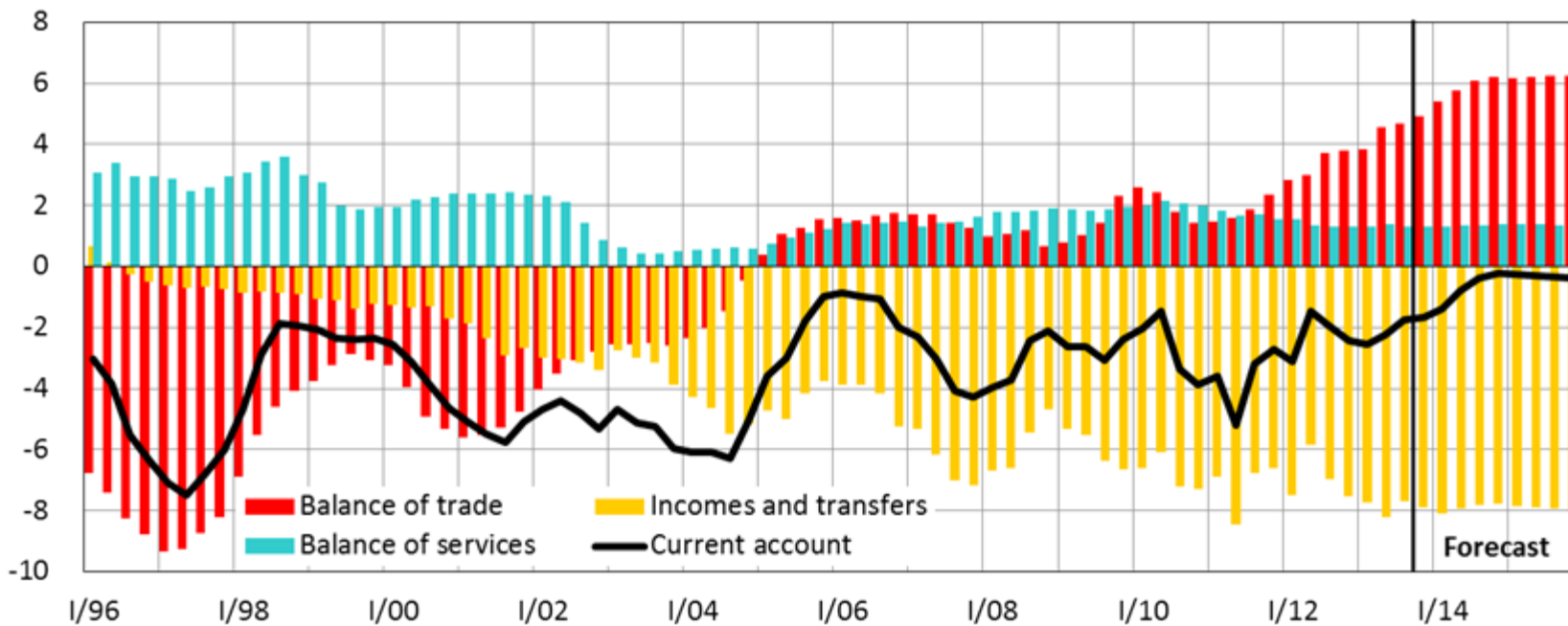
- in Q3 2013, the wage increase was no longer influenced by the legislative or administrative measures
- due to the efforts of the private sector to compensate for the relatively high increases of unit wage costs in recent years, we expect overall wage bill to increase by 2.2% in 2014 and by 4.3% in the following year
- for 2014, we anticipate the average wage increase of 2.5%; in real terms it should increase by 1.5%
- in 2015, due to estimated average inflation and expected growth of the average wage of 4.2%, the real wage should increase by around 1.8%

Macroeconomic Forecast

External Relations

Current Account

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



Sources: CNB and Ministry of Finance's own calculations

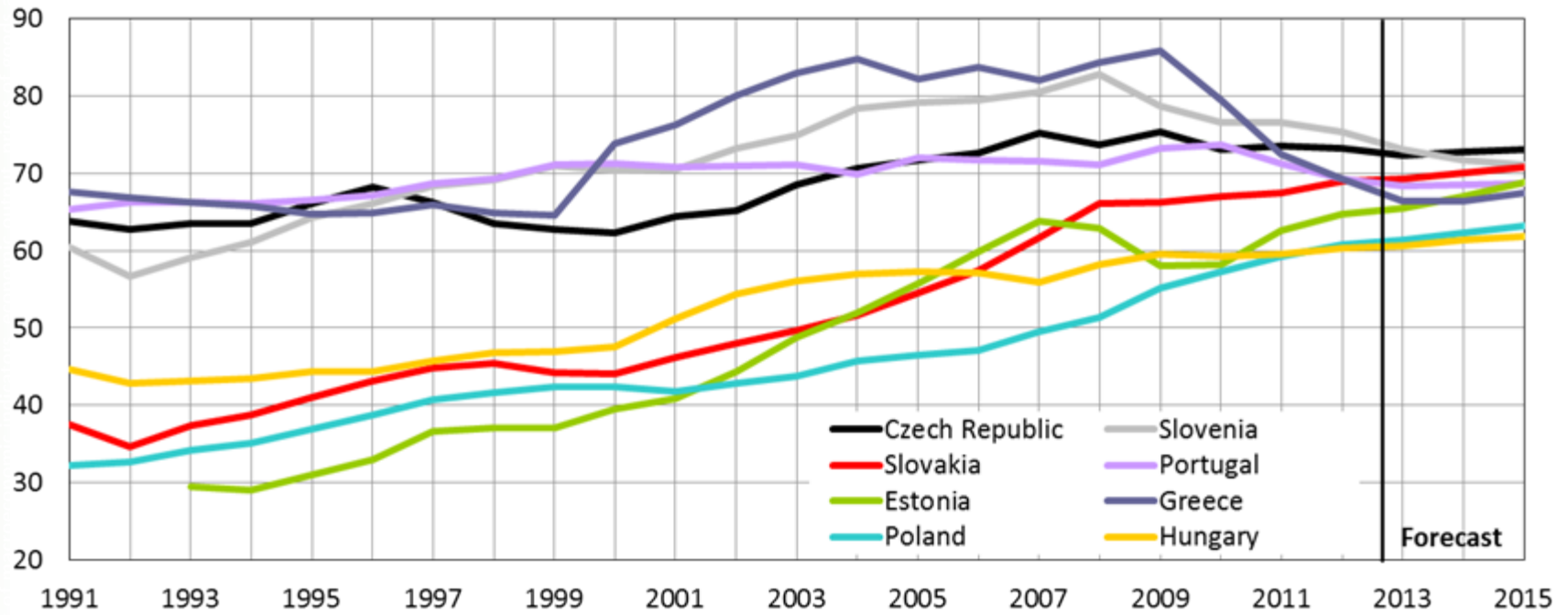
External Relations

- **export markets started rising again during H1 2013, however, we expect more dynamic growth of export markets in the following period due to the recovery in foreign trade**
- **given the expected improvement in the external environment, the gradual growth of domestic demand and weaker exchange rate of the Czech koruna, the ratio of the trade balance to GDP should reach 6.2% in both 2014 and 2015**
- **regarding the service balance, it should reach 1.4% of GDP in both 2014 and 2015**
- **deficit in the balance of income has been showing a tendency to increase in the long term, it should reach 7.9% of GDP in 2014 and 8.1% 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

Macroeconomic Forecast

International Comparison

GDP per capita – using current purchasing power parities

		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015		
											<i>Estimate</i>	<i>Forecast</i>	<i>Forecast</i>
Czech Republic	<i>PPS</i>	18 900	20 700	20 200	19 400	19 500	20 100	20 300	20 200	20 800	21 500		
	<i>EA12=100</i>	73	75	74	75	73	73	73	72	73	73		
Slovenia	<i>PPS</i>	20 700	22 100	22 700	20 300	20 500	21 000	20 900	20 400	20 500	20 900		
	<i>EA12=100</i>	79	80	83	79	77	77	75	73	72	71		
Slovakia	<i>PPS</i>	15 000	16 900	18 100	17 100	17 900	18 500	19 100	19 400	20 000	20 800		
	<i>EA12=100</i>	57	62	66	66	67	67	69	69	70	71		
Portugal	<i>PPS</i>	18 700	19 600	19 500	18 800	19 700	19 600	19 200	19 100	19 600	20 200		
	<i>EA12=100</i>	72	72	71	73	74	71	69	68	68	69		
Estonia	<i>PPS</i>	15 600	17 500	17 200	15 000	15 500	17 200	18 000	18 300	19 100	20 200		
	<i>EA12=100</i>	60	64	63	58	58	63	65	65	67	69		
Greece	<i>PPS</i>	21 800	22 500	23 100	22 100	21 200	19 900	19 200	18 600	19 000	19 800		
	<i>EA12=100</i>	84	82	84	86	79	72	69	66	66	67		
Poland	<i>PPS</i>	12 300	13 600	14 100	14 200	15 300	16 200	16 800	17 200	17 800	18 600		
	<i>EA12=100</i>	47	50	51	55	57	59	61	61	62	63		
Hungary	<i>PPS</i>	14 900	15 400	16 000	15 300	15 800	16 300	16 700	17 000	17 600	18 200		
	<i>EA12=100</i>	57	56	58	60	59	60	60	61	61	62		

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

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