



Ministry of Finance

CZECH REPUBLIC

Department for Financial Policies

Macroeconomic Forecast of the Czech Republic

July 2011

Macroeconomic Forecast

Structure of the presentation

Forecast Assumptions

- 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



External Environment

The main world economies continue to recover

- economic growth rate in world economy is uneven, particularly China and India record rapid growth (however, there are already signs of overheating), while growth rate in developed countries is still rather weak
- real GDP is expected to increase, on YoY basis, by 2.8% in USA and 2.0% in EU27 in 2011 and 3.1 % in USA and 2.1 % EU27 in 2012

Risks to the future development

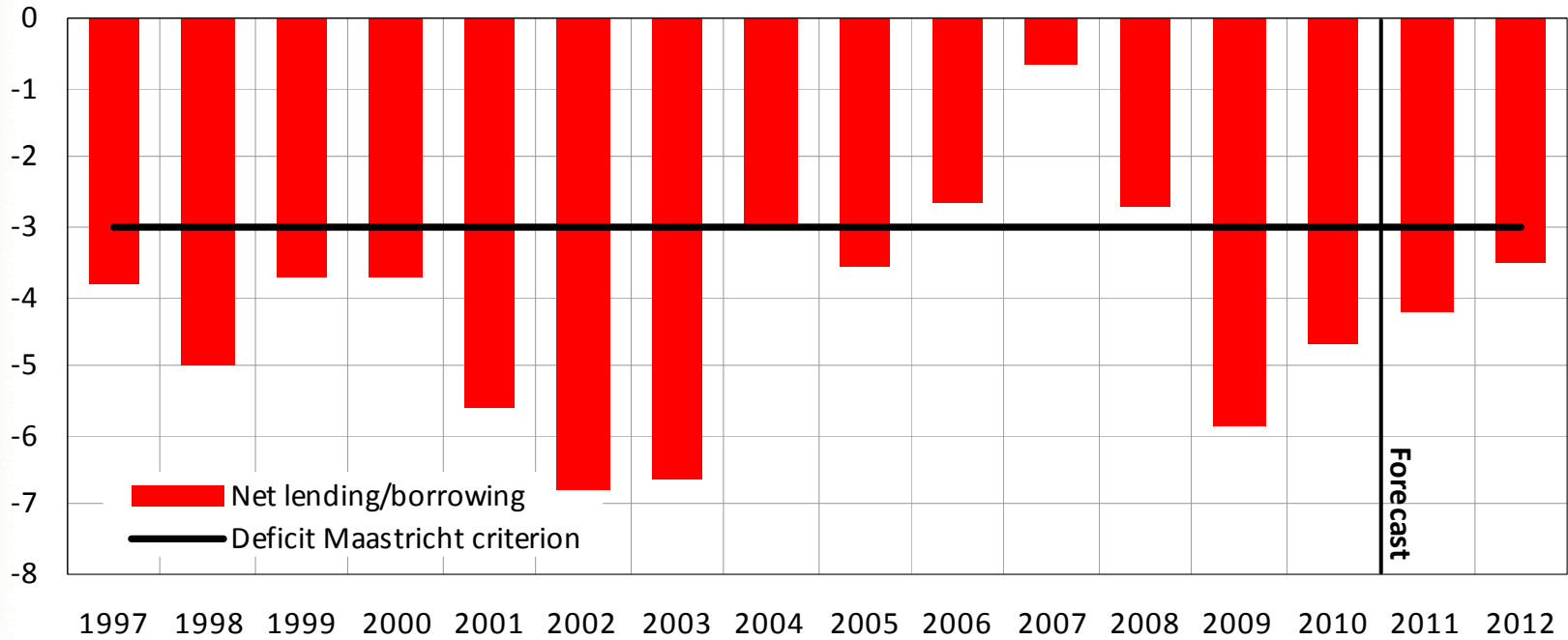
- debt crisis in Greece and the deepening crisis in other euro area countries (Portugal, Spain, Ireland)
- high commodity prices

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



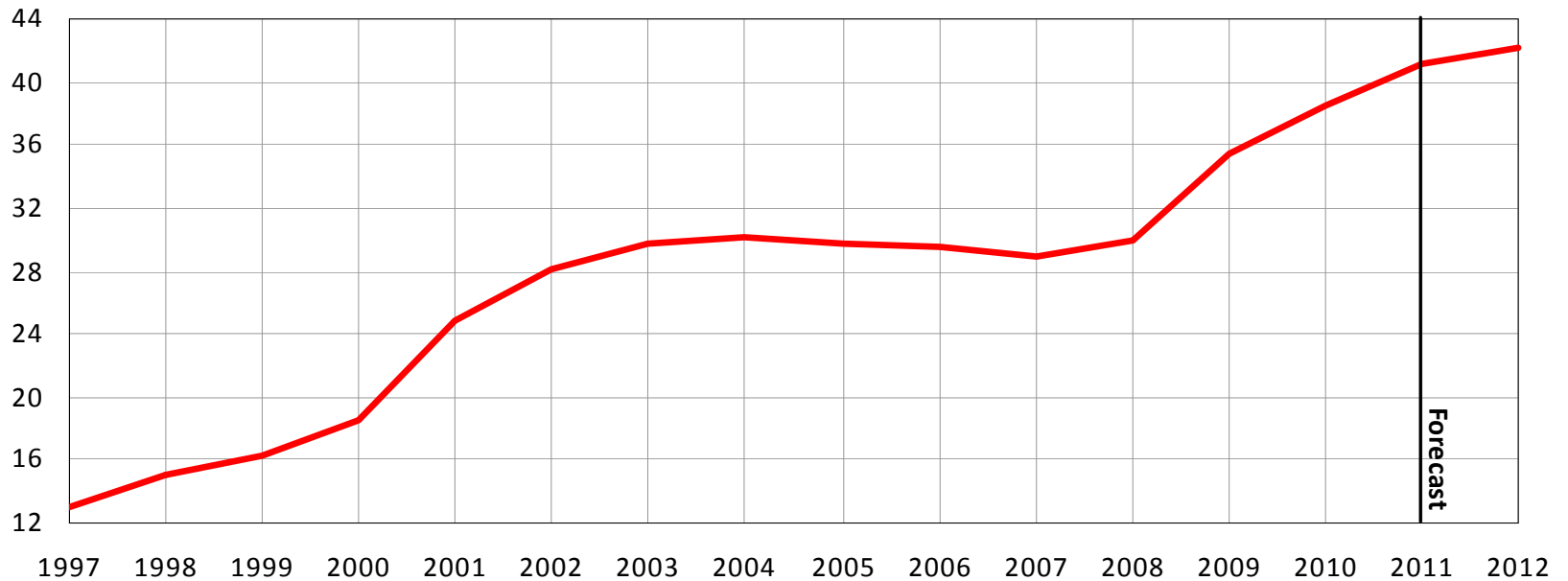
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- in 2010, according to the preliminary estimates, the general government deficit has reached 4.7% of GDP
- the deficit is expected to be reduced to 4.2% of GDP in 2011 due to faster growth of certain tax revenues and cuts in expenditures
- government debt at the end of 2011 is estimated at 41.2% of GDP

Fiscal Aims

- fulfilment of Maastricht fiscal criterion in 2013
- balanced public budgets in 2016

Monetary Policy, Interest Rates and Exchange Rates

- **CNB's inflation target as annual consumer price index growth of 2% with a tolerance band of $\pm 1\%$, effective from January 2010**
- **interest rate for 2W repo operations stood at 0.75% in the second quarter of 2011**
- **the average value for 3M PRIBOR stagnated in the second quarter of 2011 at 1.2% and a moderate increase is expected in the second half of 2011**
- **the CZK/EUR exchange rate has gradually appreciated since mid 2010 in accordance with the long-term trend, we are expecting an average exchange rate of 24.2 CZK/EUR and 17.4 CZK/USD in 2011**
- **the Czech Republic's rating in June 2011: Moody's - A1, Standard & Poor's - A, Fitch Ratings - A1**

Structural reforms

Approval of major structural reforms

- **pension reform (the Government approved on 29 June 2011)**
- **social reform I (the Government approved on 18 May 2011)**
- **first phase of healthcare reform (the Chamber of Deputies approved on 21 June 2011)**
- **amendment to the Labour Code (the Government approved on 29 June 2011)**
- **law on Commercial Companies and Cooperatives (the Government approved on 18 May 2011)**
- **amendment to the Public Procurement Act (the Government approved on 18 May 2011)**

Macroeconomic Forecast



July 2011

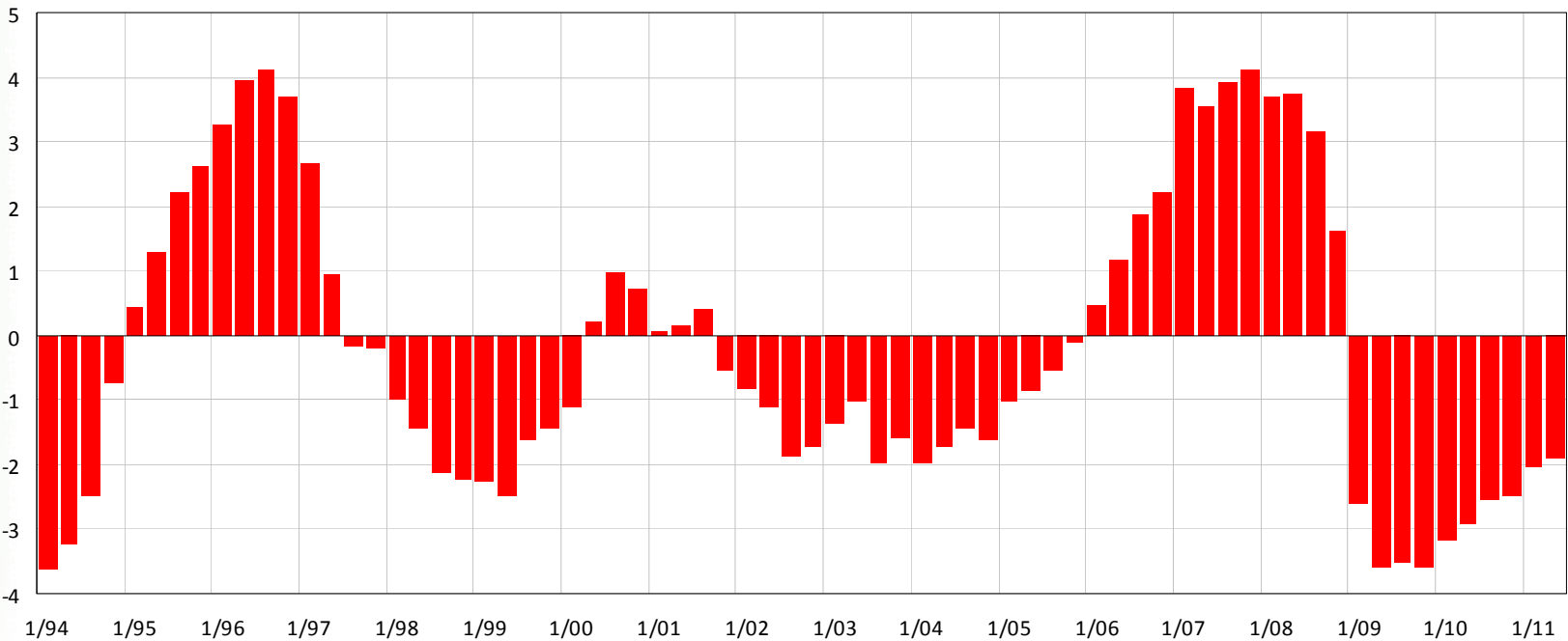
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



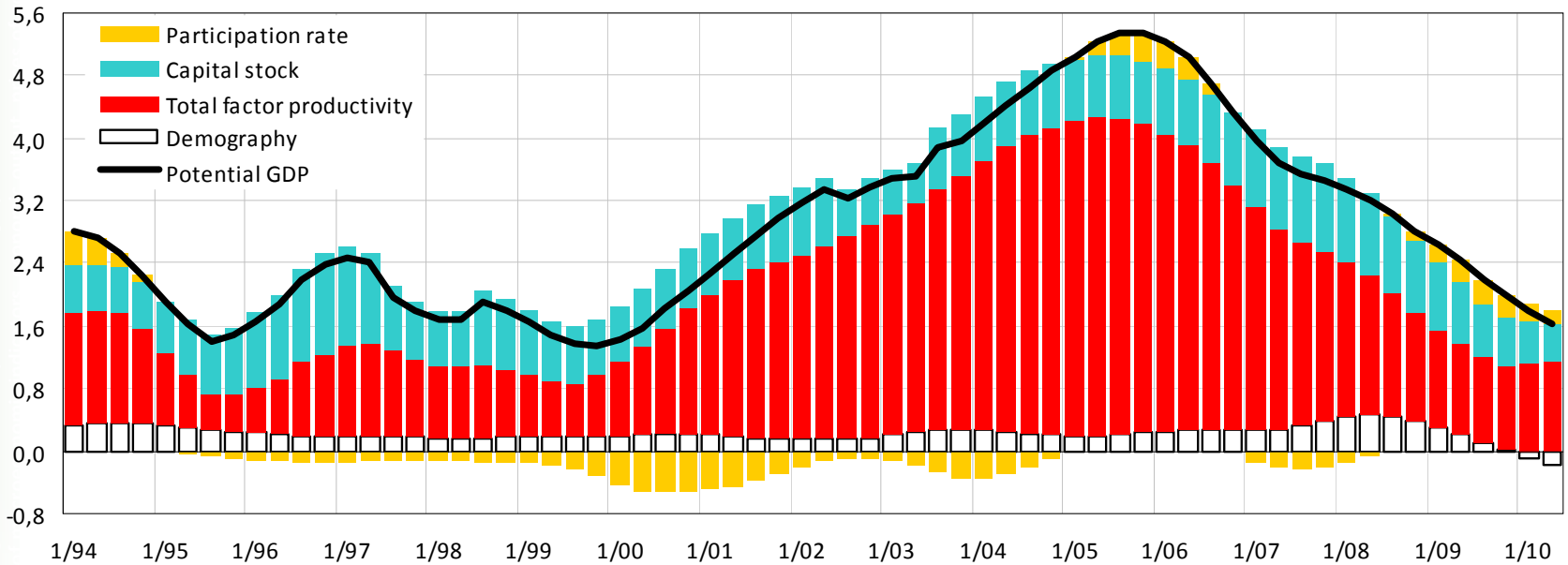
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- **economic recession gave rise to a deeply negative output gap, potential product growth, according to our calculations, fell to 1.6% in 2010**
- **in 2010, the component most seriously affected was total factor productivity, however, total factor productivity's trend growth already showed signs of stabilising**
- **deep fall in investment activity led to a reduction of the contribution of the capital stock, which remains relatively low**
- **the labour supply accelerated its growth during the recession and thus partly compensated the moderate decline in working age population**

Forecast of Macroeconomic Indicators



Macroeconomic Forecast

Main Macroeconomic Indicators

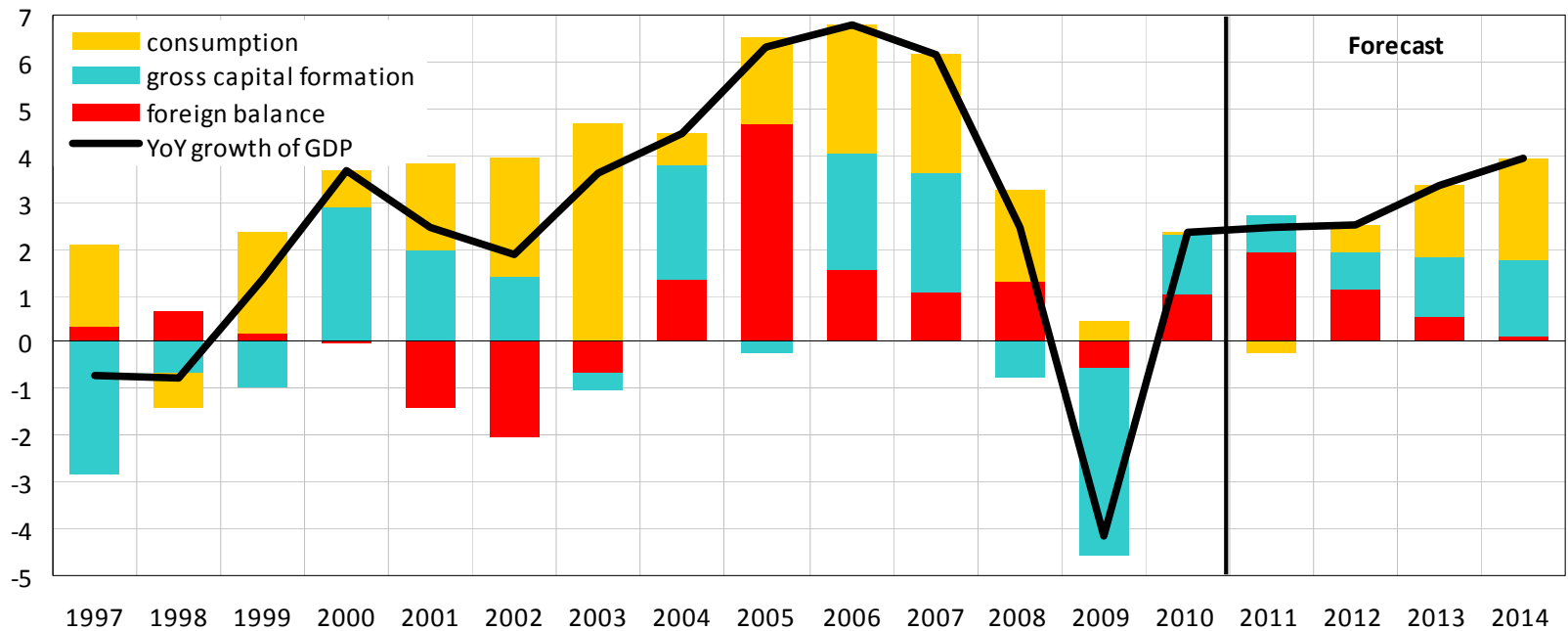
		2008	2009	2010	2011	2012
					<i>Forecast</i>	
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	-4,1	2,3	2,5	2,5
Consumption of households	<i>growth in %, const.pr.</i>	3,6	-0,2	0,2	0,5	2,0
Consumption of government	<i>growth in %, const.pr.</i>	1,1	2,6	-0,1	-2,4	-2,1
Gross fixed capital formation	<i>growth in %, const.pr.</i>	-1,5	-7,9	-3,1	1,9	3,2
Cont. of foreign trade to GDP growth	<i>p.p., const.pr.</i>	1,3	-0,6	1,0	1,9	1,1
GDP deflator	<i>growth in %</i>	1,8	2,5	-1,2	-0,8	2,6
Average inflation rate	<i>%</i>	6,3	1,0	1,5	2,3	3,5
Employment (LFS)	<i>growth in %</i>	1,6	-1,4	-1,0	0,2	0,4
Unemployment rate (LFS)	<i>average in %</i>	4,4	6,7	7,3	6,7	6,4
Wage bill (domestic concept)	<i>growth in %, curr.pr.</i>	8,7	0,0	1,2	2,3	4,4
Current account / GDP	<i>%</i>	-0,6	-3,2	-3,8	-3,9	-3,6

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

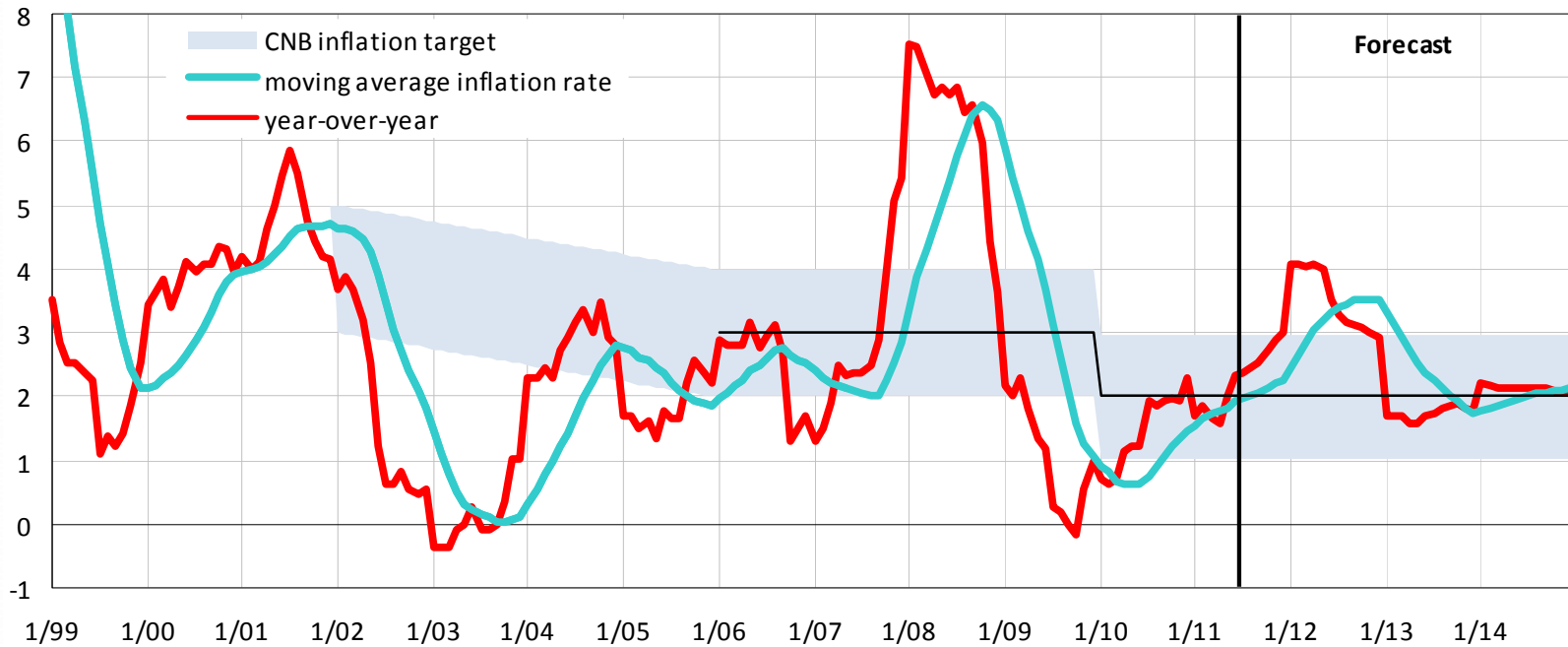
- **recovery of the Czech economy continues (real GDP increased by 2.3% in 2010 and we expect economic growth of 2.5% in 2011 and 2012, which will be driven by foreign trade)**
- **domestic demand will increase only by 0.5% in 2011 due to continuing unfavourable income situation of households**
- **decline in real government consumption, which began in mid 2010, will last until 2013 (decrease in employment in the public sector and the reduction of purchases of goods and services)**
- **investment growth should be restored in 2011 and it should accelerate in the forthcoming years**
- **contribution of the foreign trade will gradually decrease in coming years due to deceleration of the growth in export volumes**

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

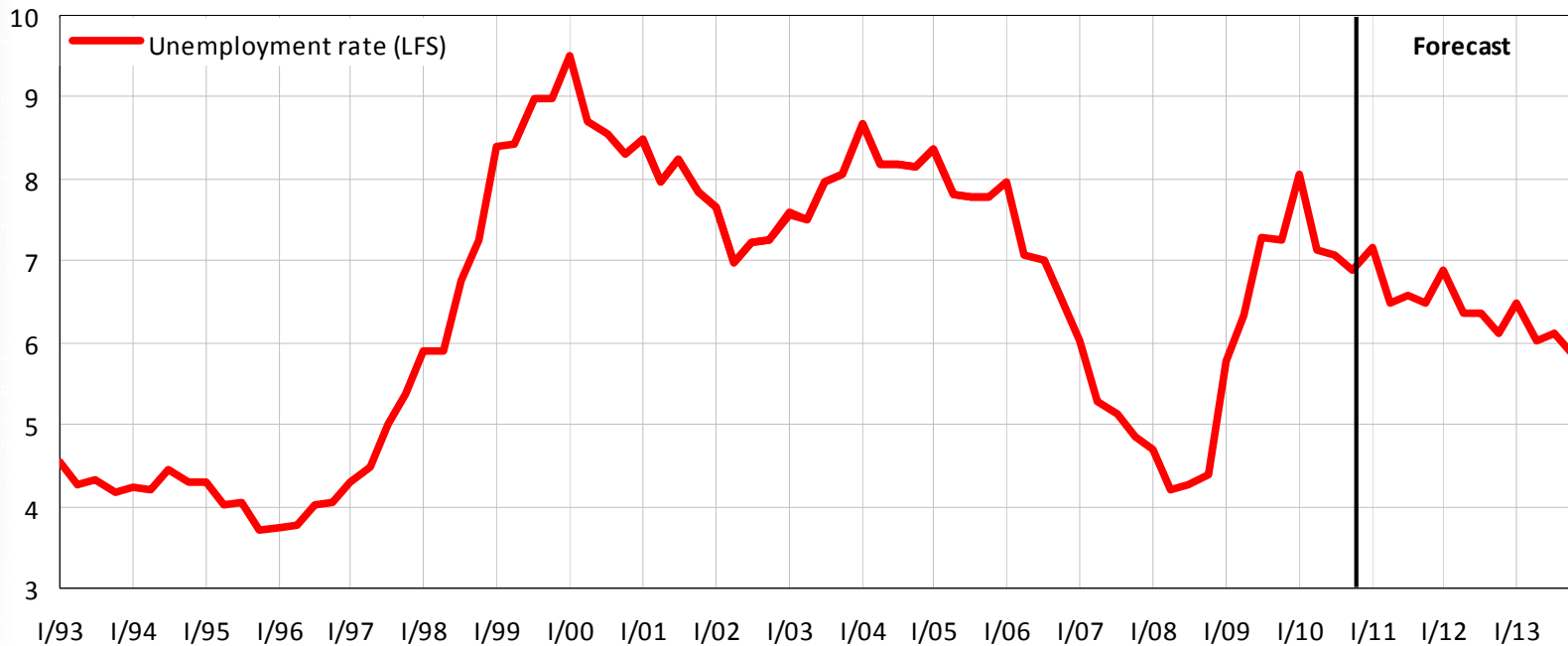
- we expect the average inflation rate in 2011 to reach 2.3%
- inflation is evaluated as cost-push inflation, external inflation impulses should be mitigated by the persistent cyclical position of the Czech economy in the negative output gap, gradual improvement in the labour market and moderate wage increases
- we estimate 2012 average inflation rate at 3.5% (an increase of reduced VAT rate from 10% to 14% will contribute by 1.1 p.p.)

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

Labour Market

- labour market reflects economic recovery
- the employment should increase by 0.2% in 2011 and by 0.4% next year (low growth corresponds to a rational personnel policy, the involvement of free capacities and restrictive policy in the state sector)
- the unemployment rate according to LFS, after a steep increase at the end of 2010, is already decreasing
- we are expecting a fall of unemployment rate to 6.7% in 2011 and to 6.4 % in 2012 (economic recovery, improving structural characteristics of the labour market and new regulation legislation will contribute to the decline)

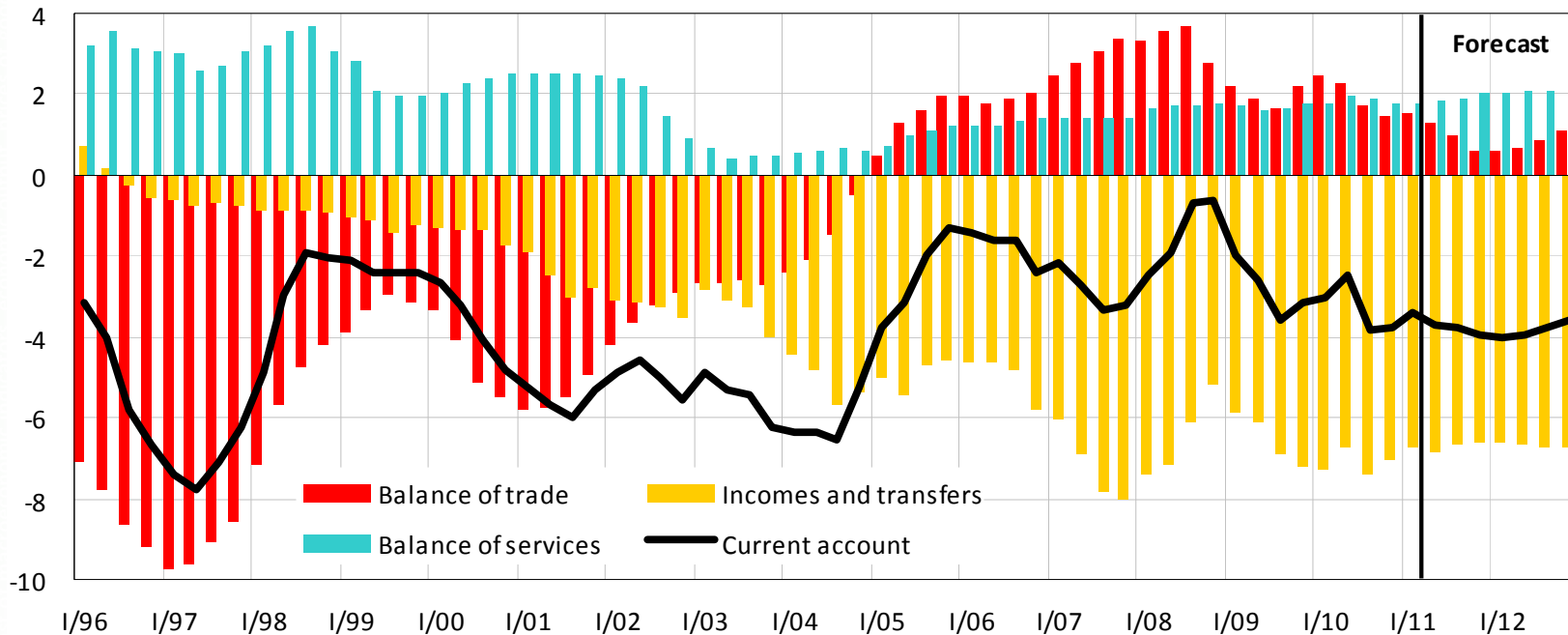
Labour Market

- we expect the wage bill to increase by only 2.3% in 2011, due to cost-saving measures in government sector (decrease in employment and wages in large part of the public sector) the growth will be driven mainly by the business sector
- on the assumption of wage growth in government sector in 2012, we expect overall wage bill to increase by 4.4% that year
- we estimate a slight increase of average wage by 2.3% in 2011 and then growth by 4.0% in 2012, the growth will be pulled by the business sector

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

- **world trade continues to growth, we estimate the balance of trade at 0.6% of GDP in 2011 and 1.1% of GDP in 2012**
- **service balance surplus is continuously slightly increasing, which should continue also in the forthcoming years**
- **deficit in the balance of income should be slightly lower in 2011, but it should deepen again in the following year**
- **we expect slight worsening of the ratio of the current account to GDP to -3.9% in 2011 and to -3,6% next year**
- **we do not regard the risk of macroeconomic imbalance as significant**

Macroeconomic Forecast

International Comparison

GDP per capita – using current purchasing power parities

		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
									<i>Prelim.</i>	<i>Forecast</i>	<i>Forecast</i>
Slovenia	<i>PPS</i>	17 300	18 700	19 700	20 700	22 100	22 800	2 0700	21 300	22 000	22 700
	<i>EA12=100</i>	75	78	79	79	80	83	81	80	80	81
Greece	<i>PPS</i>	19 200	20 300	20 600	22 100	22 900	23 500	2 2100	21 700	21 300	21 300
	<i>EA12=100</i>	83	85	83	85	83	86	86	82	78	76
Czech Republic	<i>PPS</i>	15 200	16 300	17 000	18 200	19 900	20 200	1 9200	19 500	20 200	20 900
	<i>EA12=100</i>	66	68	69	70	73	74	75	73	74	75
Portugal	<i>PPS</i>	16 400	16 700	17 800	18 600	19 600	19 500	1 8900	19 800	20 100	20 400
	<i>EA12=100</i>	71	70	72	71	72	71	73	74	73	73
Slovakia	<i>PPS</i>	11 500	12 300	13 500	15 000	17 000	18 100	1 7200	18 100	18 800	19 800
	<i>EA12=100</i>	50	52	54	57	62	66	67	68	69	71
Estonia	<i>PPS</i>	11 300	12 400	13 800	15 600	17 300	17 000	1 5000	15 900	16 700	18 000
	<i>EA12=100</i>	49	52	56	60	63	62	58	60	61	64
Hungary	<i>PPS</i>	13 000	13 700	14 200	14 900	15 600	16 100	1 5300	15 700	16 100	16 600
	<i>EA12=100</i>	56	57	57	57	57	59	59	59	59	59
Poland	<i>PPS</i>	10 100	11 000	11 500	12 300	13 600	14 100	1 4300	15 200	16 000	16 900
	<i>EA12=100</i>	44	46	46	47	50	51	55	57	59	60
Lithuania	<i>PPS</i>	10 200	10 900	11 900	13 100	14 700	15 300	1 2900	14 200	14 800	15 600
	<i>EA12=100</i>	44	46	48	50	54	56	50	53	54	56

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

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