



Ministry of Finance CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast **Czech Republic**

July 2012

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

- the forecast is based on a „no-event“ scenario because of the huge uncertainties concerning the future development (in the forecast horizon an escalation of the euro zone's debt crisis and other geopolitical events with significant economic impact will not occur, on the other hand, the euro zone's problems will not be solved)
- we consider a very low level of confidence in further economic development, especially among consumers but also in certain segments of the business sector as a significant internal risk in the Czech economy, which leads to more cautious microeconomic decisions
- scenario is burdened by a significant downward risks

External Environment

The global economic outlook is uncertain

- the euro zone economy is stagnating, unemployment is increasing and restrictive fiscal policy reduces household consumption
- growth of the US economy is not strong enough to create sufficient numbers of new jobs
- economic growth in China and other large developing economies is slowing down

Concerns about the euro zone's debt crisis increased again

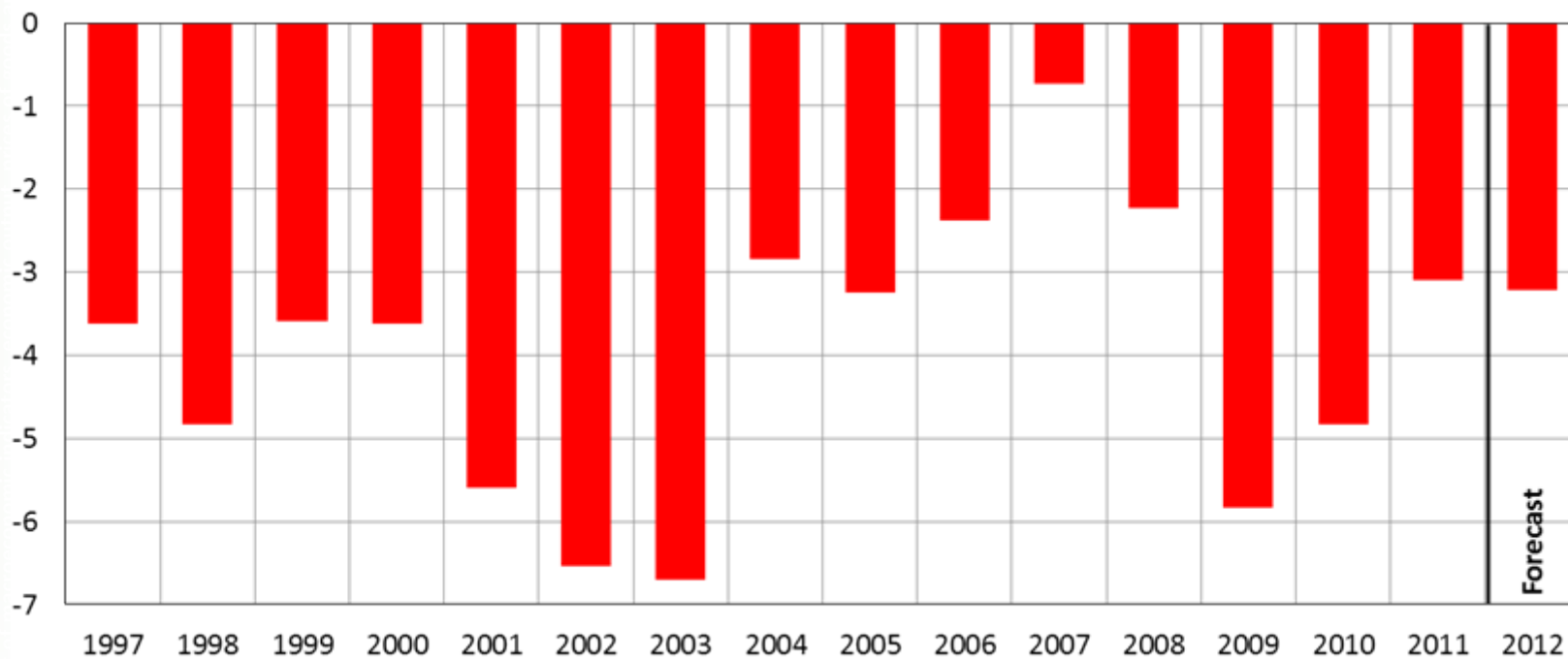
- political uncertainty about the future direction of Greece, or its staying in the euro zone, has increased
- conditions and prospects of the Spanish banking sector are unfavourable
- on 25th June 2012, Cyprus has asked for financial assistance

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



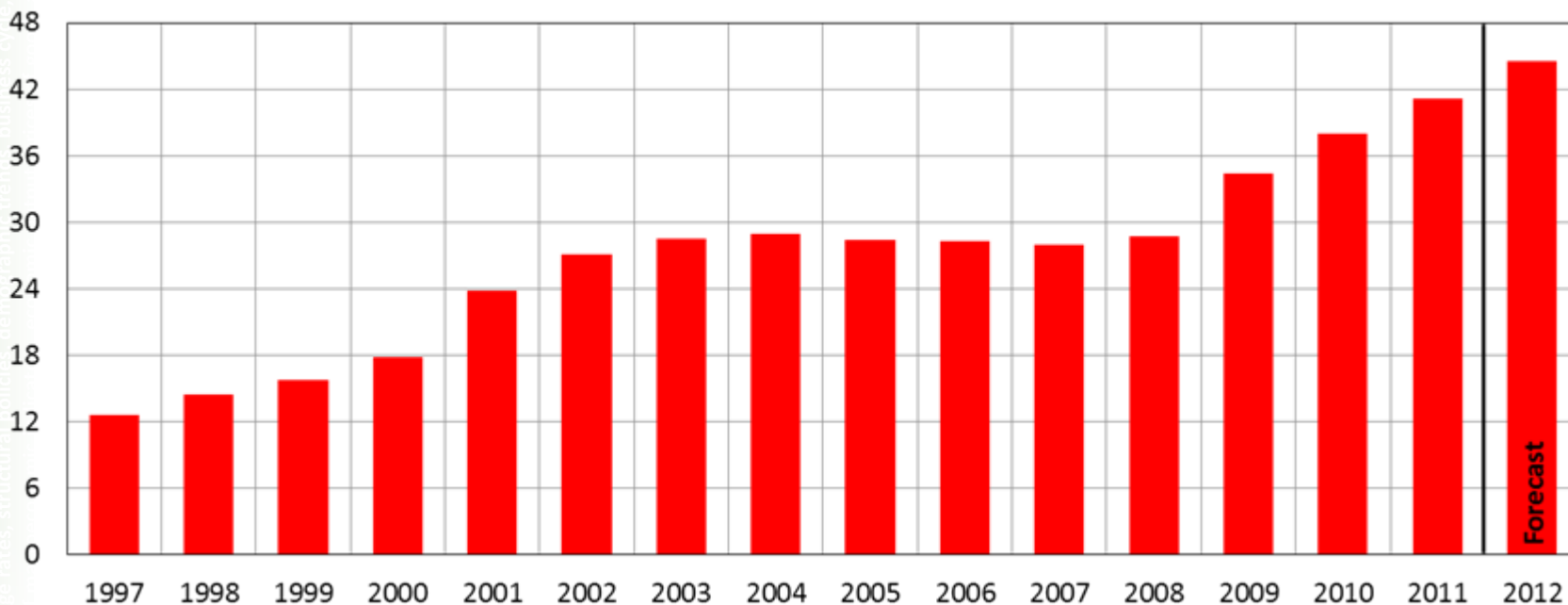
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- the current estimate of the general government deficit for 2012 is 3.2% of GDP
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2012 and 2011) should amount to 0.6 p.p.
- we expect government debt at the end of 2012 at 44.6% of GDP

Monetary Policy, Interest Rates and Exchange Rates

- on 28th June 2012, the Czech National Bank lowered the interest rate for 2W repo operations by 0.25 p.p. to 0.50%
- the average value for 3M PRIBOR stagnated in the second quarter of 2012 at 1.2% and we expect the same value for 2012 and 2013
- stress tests published by the Czech National Bank in June 2012 confirmed banks' sufficient resilience to external shocks
- precarious situation in the euro zone has contributed to the increase in the risk aversion, which showed the weakening of the Czech crown and increased exchange rate volatility in the second quarter of 2012
- we expect an average exchange rate of 25.3 CZK/EUR and 19.9 CZK/USD in 2012
- in June 2012 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 (the Government approved on 23 May 2012)**
- **Amendment of the Investment Incentives Act (came into effect on 12 July 2012)**
- **Act on Improving Transparency of Joint-Stock Companies (the Government approved on 30 May 2012)**
- **Act on Supported Energy Sources (the Chamber of Deputies approved on 9 May 2012)**

Macroeconomic Forecast

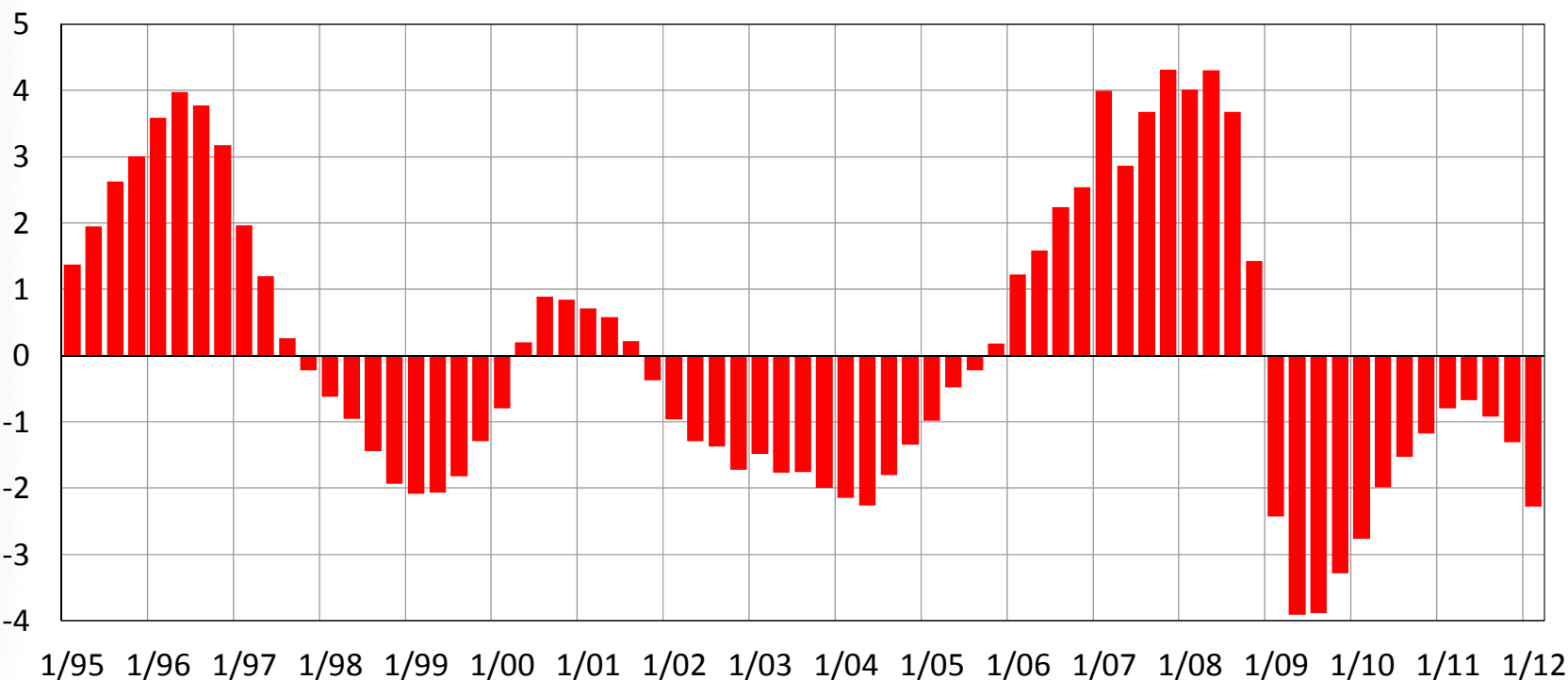
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



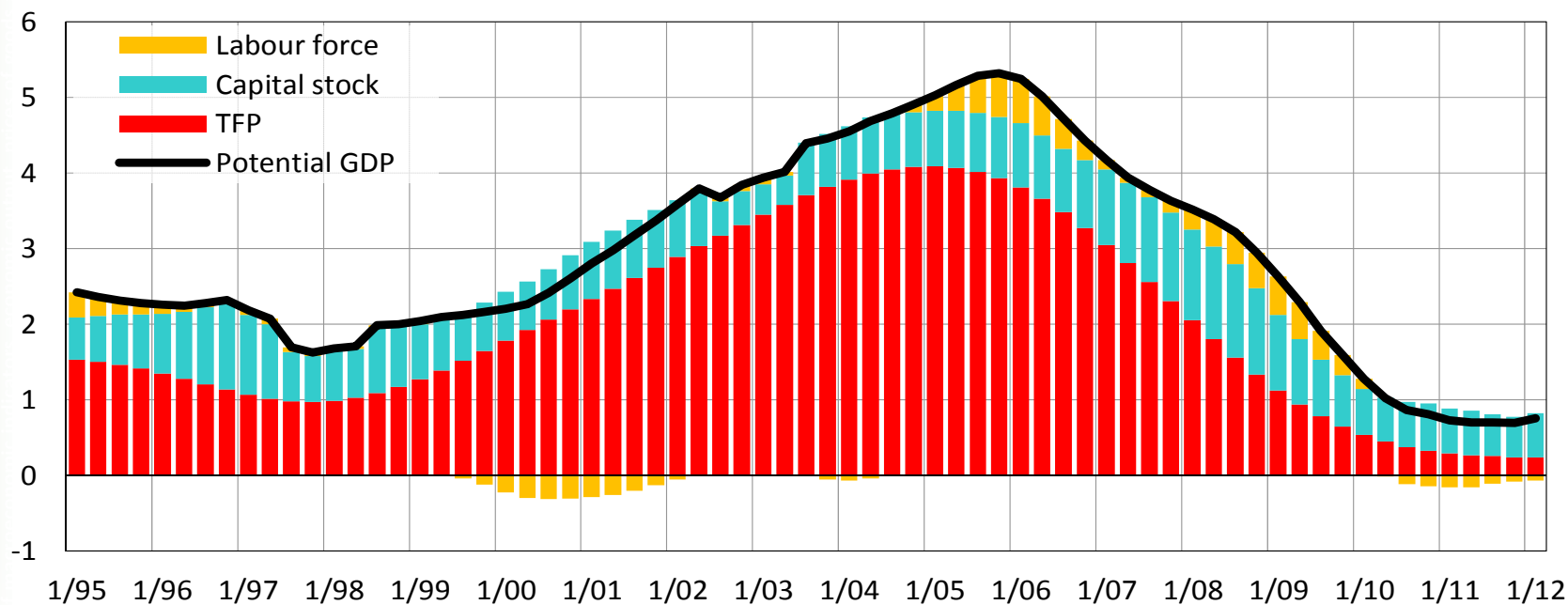
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- YoY growth of potential product in 2011 gradually decreased to 0.7%, however, our estimate is probably undervalued
- stagnation of the GDP caused the output gap to deepen to -2.3% in the first quarter of 2012 (however, these data are not entirely representative due to deformation of the real GDP time series caused by the non-standard development of taxes on products)
- the component most seriously affected is total factor productivity, its contribution to the growth fell to only 0.2 p.p. in the first quarter of 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 partly compensates the decline in working age population

Forecast of Macroeconomic Indicators

Macroeconomic Forecast

Main Macroeconomic Indicators

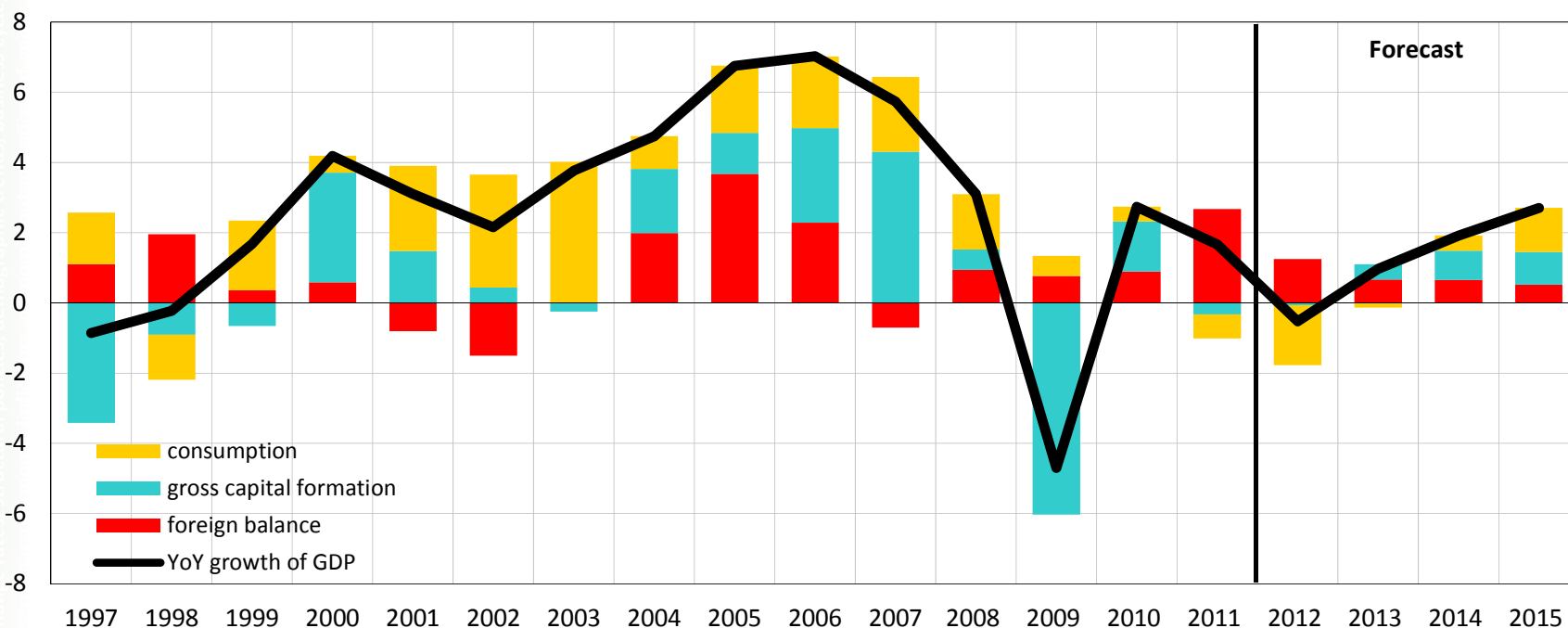
		2009	2010	2011	2012	2013
					<i>Forecast</i>	
Gross domestic product	<i>growth in %, const.pr.</i>	-4,7	2,7	1,7	-0,5	1,0
Consumption of households	<i>growth in %, const.pr.</i>	-0,4	0,6	-0,6	-2,2	0,1
Consumption of government	<i>growth in %, const.pr.</i>	3,8	0,6	-1,7	-2,8	-0,8
Gross fixed capital formation	<i>growth in %, const.pr.</i>	-11,5	0,1	-0,9	-1,0	2,0
Cont. of foreign trade to GDP growth	<i>p.p., const.pr.</i>	0,8	0,9	2,7	1,2	0,7
GDP deflator	<i>growth in %</i>	1,9	-1,7	-0,8	1,5	1,1
Average inflation rate	<i>%</i>	1,0	1,5	1,9	3,2	2,2
Employment (LFS)	<i>growth in %</i>	-1,4	-1,0	0,4	-0,3	-0,2
Unemployment rate (LFS)	<i>average in %</i>	6,7	7,3	6,7	7,0	7,2
Wage bill (domestic concept)	<i>growth in %, curr.pr.</i>	-2,1	-0,4	2,3	1,9	2,5
Current account / GDP	<i>%</i>	-2,4	-3,9	-2,9	-2,2	-2,6

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

- on a seasonally adjusted basis, the GDP fell by 0.2% QoQ in the fourth quarter of 2011 and further by 0.8% QoQ in the first quarter of 2012
- causes of decline in the first quarter of 2012 are rather due to issues of accounting methodology – increasing the excise taxes on cigarettes with effect from the start of 2012 led to stockpiling in the fourth quarter of 2011 (the contribution of indirect taxes to GDP development was -0.8 p.p.)
- seasonally adjusted gross value added grew by 0.2% in the first quarter of 2012, so the Czech economy probably did not fall back into recession

Economic Performance

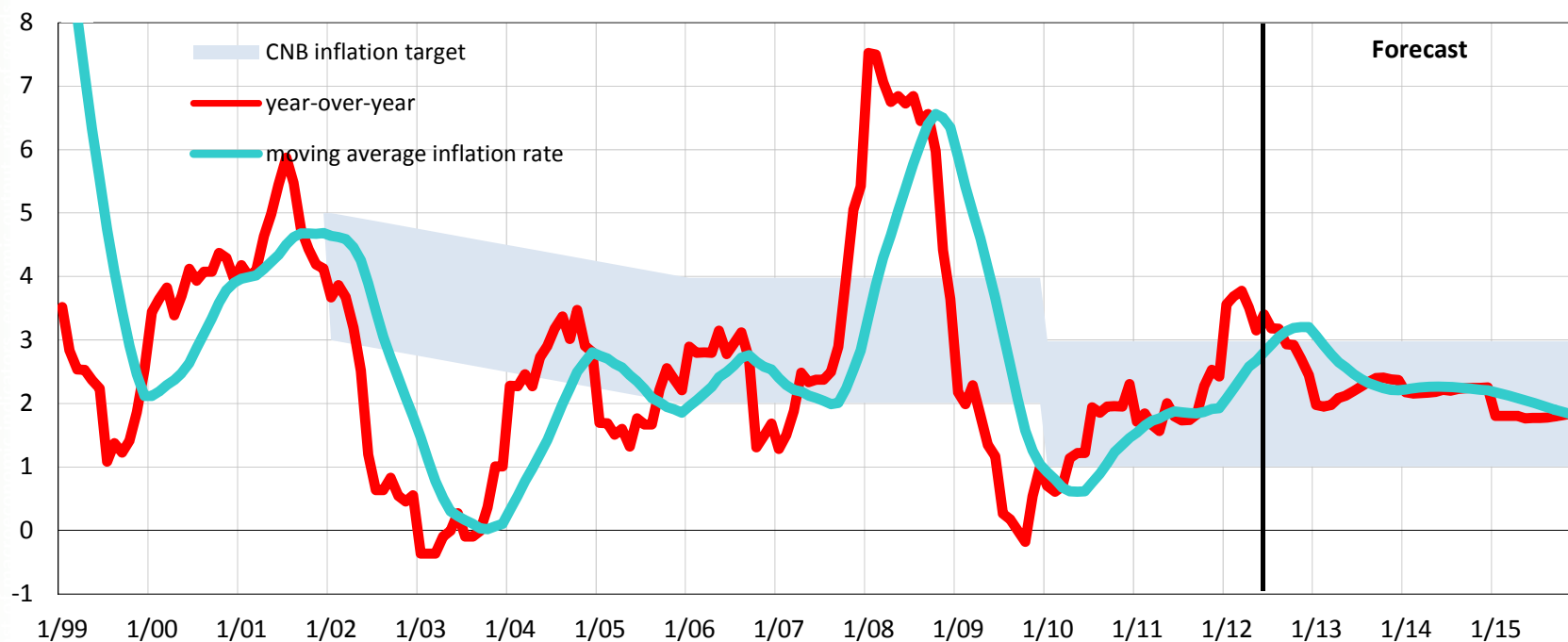
- GDP should fall by 0.5% in 2012, in the following year economic growth should recover to 1.0%
- decline in household consumption in 2012 is primarily due to expected decline in real wages and rise in the price level, in 2013 household consumption could be stabilized
- decline in real government consumption in 2012 and 2013 reflects approved consolidation strategy
- development of the investment is highly uncertain, we expect a slight decrease in 2012 and recovery of the growth dynamic in 2013
- the foreign trade will probably continue to be a main driver of the economic growth

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

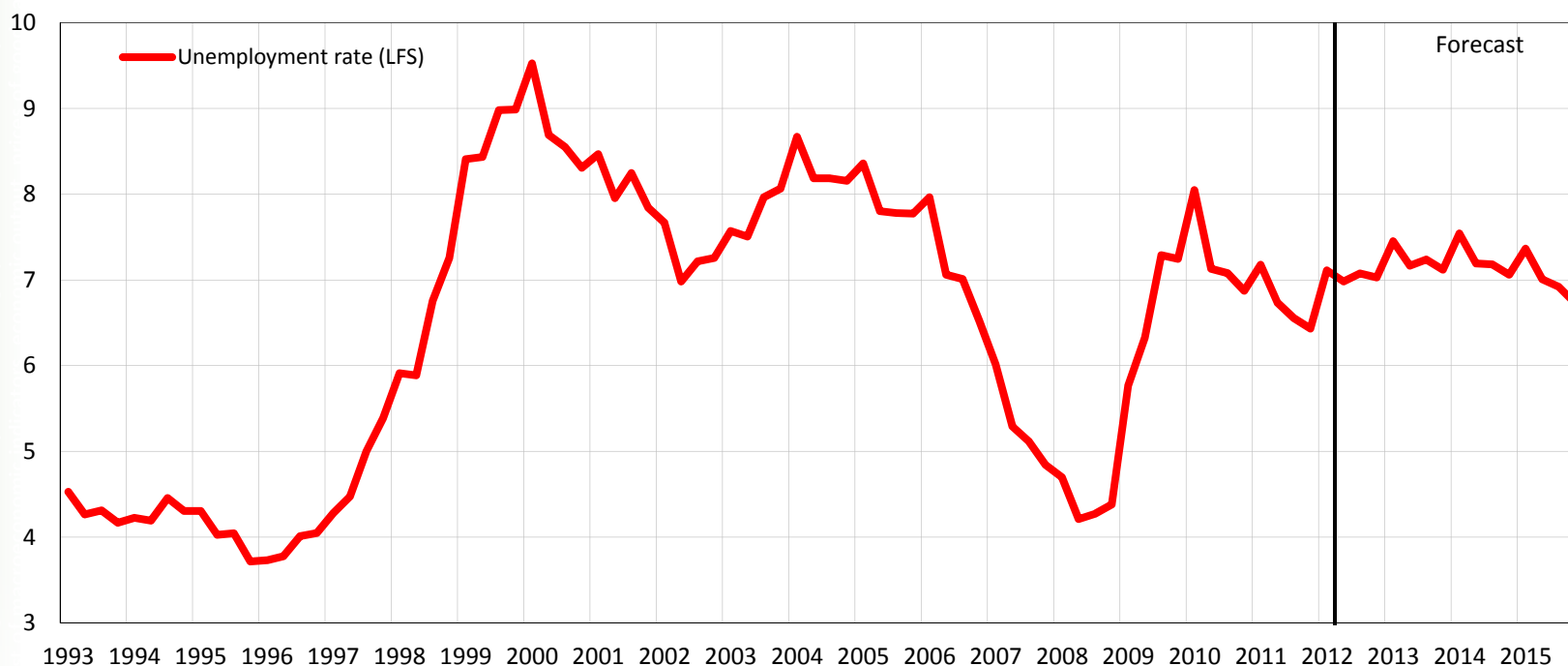
- we estimate 2012 average inflation rate at 3.2%, administrative measures will make up around three-quarters of the inflation rate (an increase of reduced VAT rate from 10% to 14% will contribute by 1.1 p.p.)
- for 2013 we expect an average inflation rate of 2.2% (raising both VAT rates by 1 p.p. will contribute by 0.7 p.p.)

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

Labour Market

- with respect to the stagnation, the situation in the labour market is so far so good
- we do not expect significant deterioration in the labour market, the employment should fall by 0.3% in 2012 and by 0.2% in 2013
- the unemployment rate according to LFS reached 7.2% in the first quarter of 2012, in the context of current and expected development of employment and economic situation, we expect its growth to 7.0% in 2012 and 7.2% in 2013

Labour Market

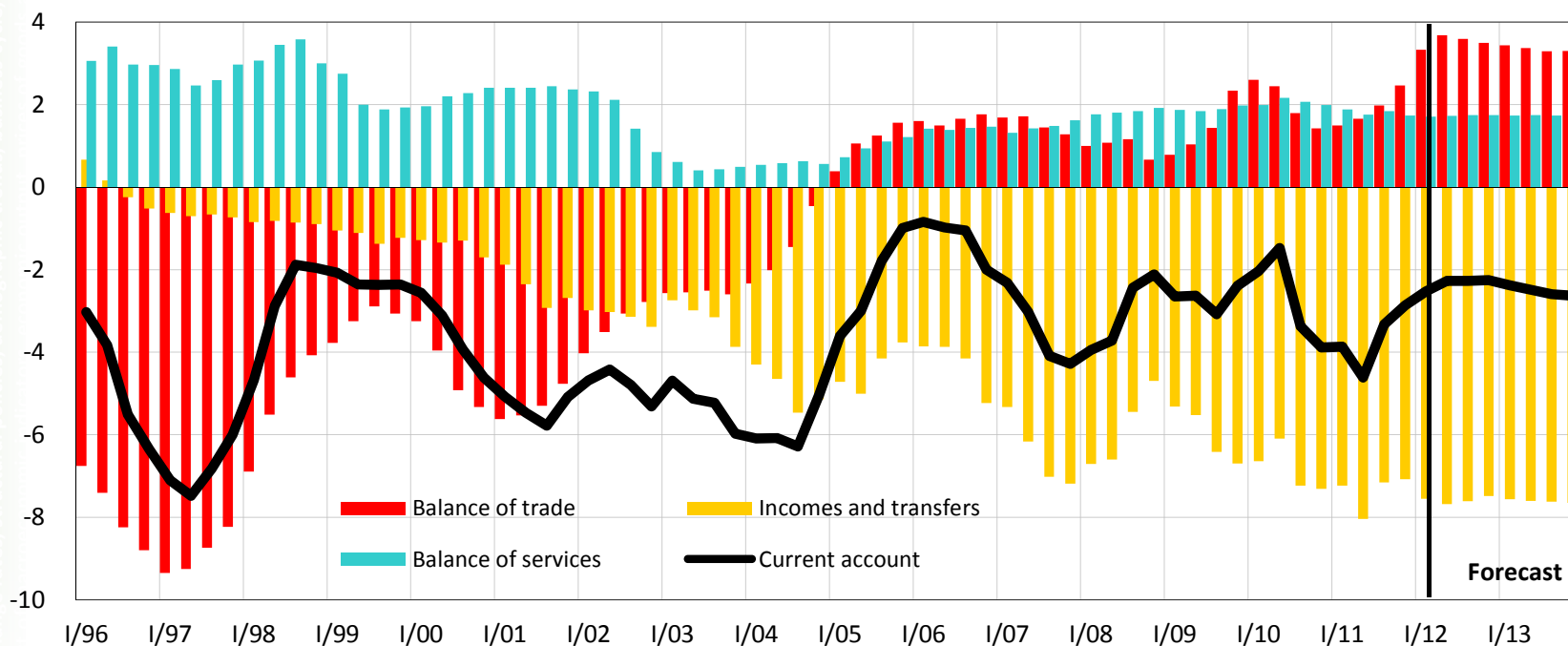
- growth in the wage bill and average wage in the first quarter of 2012 was surprising in the context of the economy's performance
- we expect overall wage bill to increase by 1.9% in 2012, because of lower economic performance, decline in employment and further budget savings measures; in the following year the wage bill should raise at 2.5%
- in 2012, we anticipate the average wage increase of 2.4%, which should signify a real decline in the real average wage by 0.7%
- due to the lower inflation, growth in 2013 of 2.4% should mean the increase in the real average wage by 0.2%

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

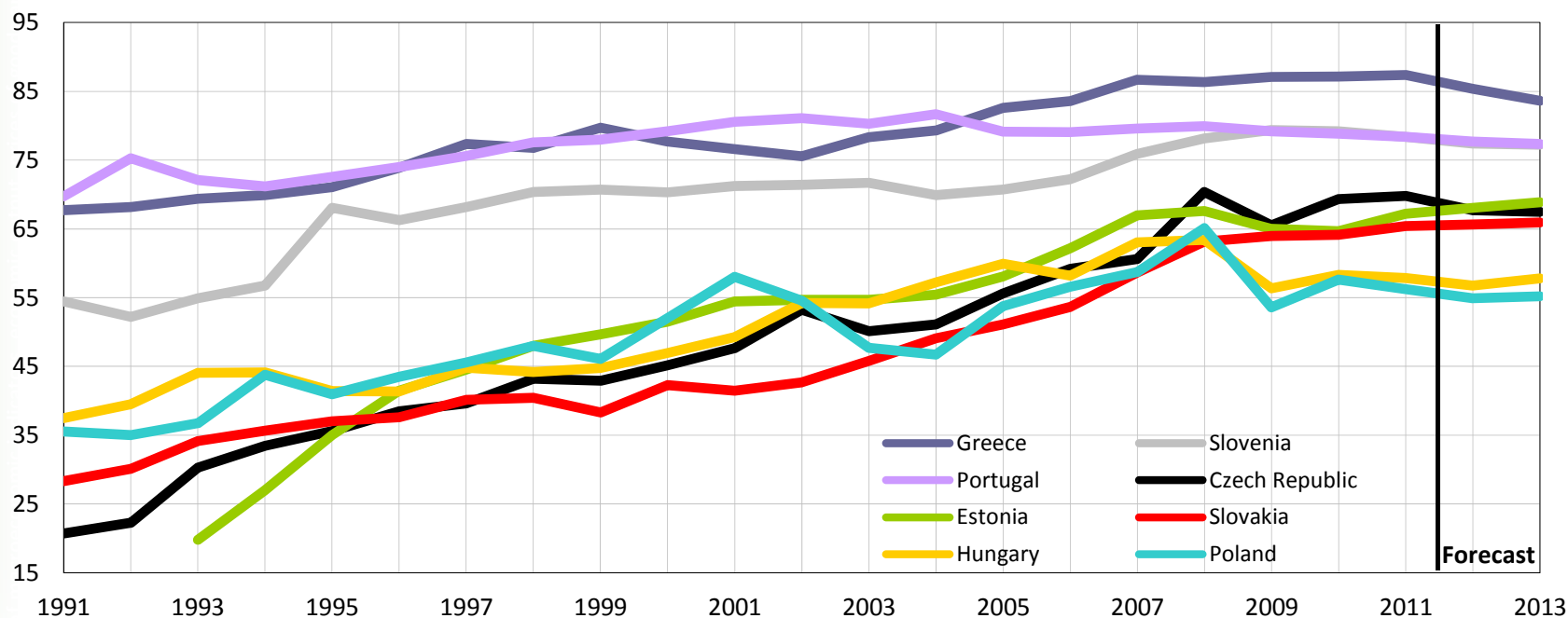
External Relations

- 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 3.5% of GDP in 2012
- in 2013, in addition to the recovery of the trade, the slump in domestic demand should come to the end and the ratio of the trade balance to GDP should reach 3.2%
- due to the unfavourable outlook for the global economy we expect stagnation of the service balance, it should reach about 1.7% of GDP in 2012 and 2013
- deficit in the balance of income is steadily growing, it should reach about 7.5% of GDP in 2012 and 7.6% of GDP in 2013
- we estimate the ratio of the current account to GDP at -2.2% in 2012 and -2.6% in 2013
- we do not regard the risk of macroeconomic imbalance as significant

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

		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
									<i>Prelim.</i>	<i>Forecast</i>	<i>Forecast</i>
Slovenia	<i>PPS</i>	18 800	19 600	20 700	22 100	22 700	20 500	20 700	21 000	21 000	21 500
	<i>EA12=100</i>	78	79	79	80	83	79	78	77	76	76
Czech Republic	<i>PPS</i>	16 900	17 800	18 900	20 700	20 200	19 300	19 400	20 000	20 100	20 600
	<i>EA12=100</i>	71	72	73	75	74	75	73	73	73	73
Greece	<i>PPS</i>	20 300	20 400	21 800	22 500	23 100	22 100	21 900	20 700	19 900	20 200
	<i>EA12=100</i>	85	82	84	82	84	86	82	76	72	72
Portugal	<i>PPS</i>	16 700	17 900	18 700	19 600	19 500	18 800	19 600	19 400	19 100	19 500
	<i>EA12=100</i>	70	72	72	71	71	73	73	71	69	69
Slovakia	<i>PPS</i>	12 300	13 500	15 000	16 900	18 100	17 000	17 900	18 400	19 100	19 900
	<i>EA12=100</i>	52	55	57	62	66	66	67	67	69	71
Estonia	<i>PPS</i>	12 400	13 800	15 600	17 500	17 300	14 900	15 700	16 800	17 400	18 300
	<i>EA12=100</i>	52	56	60	64	63	58	59	62	63	65
Poland	<i>PPS</i>	11 000	11 500	12 300	13 600	14 100	14 300	15 300	16 400	17 100	17 900
	<i>EA12=100</i>	46	46	47	50	51	55	57	60	62	64
Hungary	<i>PPS</i>	13 600	14 200	14 900	15 400	16 000	15 200	15 800	16 500	16 600	17 100
	<i>EA12=100</i>	57	57	57	56	58	59	59	61	60	61

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

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