



Ministry of Finance CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast **Czech Republic**

October 2013

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

- recently, the Czech economy has been very volatile, QoQ decline in GDP of 1.3% in Q1 2013 was followed by an increase of 0.6% in Q2 2013
- 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 represents a positive risk
- the biggest negative domestic risk is the risk of political instability, although the economic sentiment is still low, the business cycle indicators show improvements in all areas

External Environment

The outlook for the global economy has worsened slightly

- economic growth in major economies fell behind expectations
- the U.S. economy is getting better, economic growth is driven mainly by the household consumption
- after a year and a half, the euro zone has recorded moderate QoQ growth, however, performance of the individual countries has been considerably differentiated
- growth in the emerging economies varies, China is striving to shift its economy toward self-sustaining growth based on domestic consumption, in other countries, however, the growth is hampered by structural problems

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

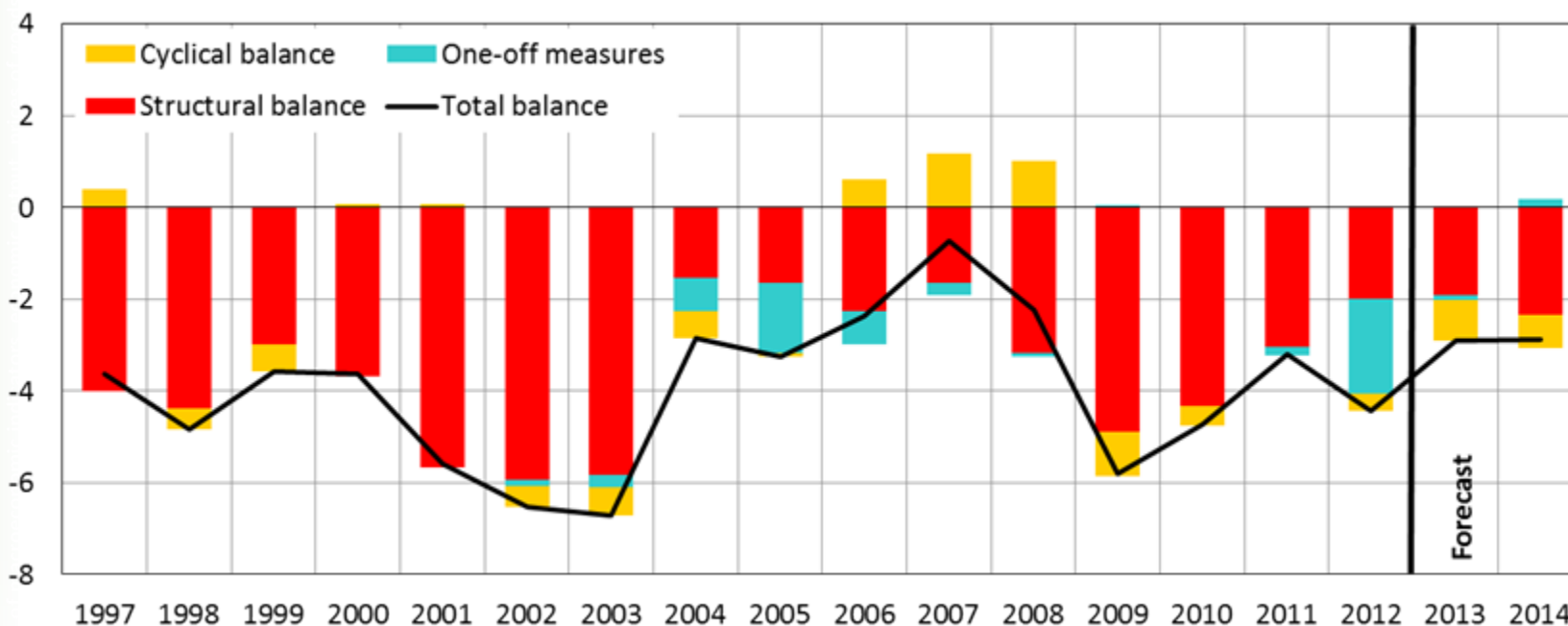
- in the euro zone periphery countries, the situation in government bond markets is relatively favourable, these states, however, are in recession and plagued by high unemployment

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



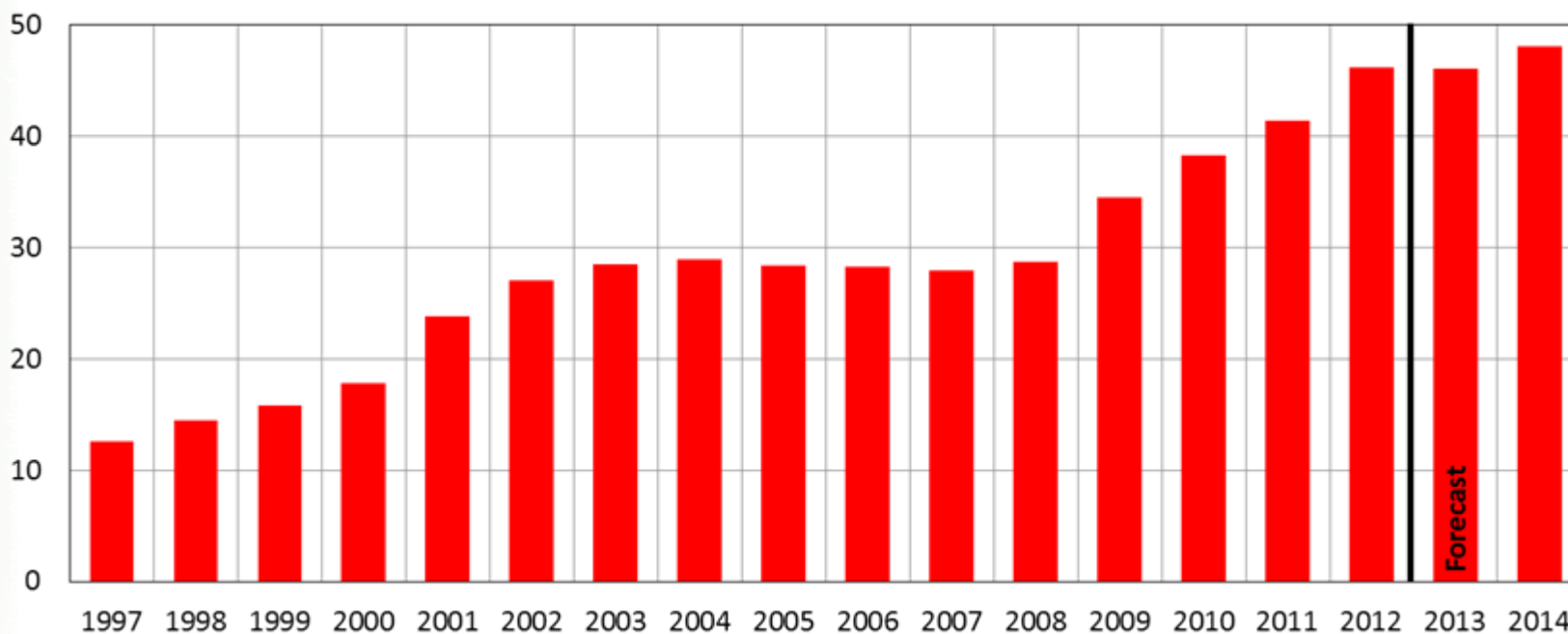
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- in 2012, the general government deficit reached 4.4% of GDP
- adjusted for one-off factors (financial compensation to churches and unreimbursed part of the EU resources), deficit was only 2.6% of GDP
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2012 and 2011) amounted to 1.0 p.p.
- at the end of 2012, the government debt reached 46.2% of GDP
- for both 2013 and 2014, we predict a government sector balance of -2.9% of GDP
- in 2013 and 2014, the government debt to GDP ratio should reach 46.1% and 47.9%, respectively

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%
- for both 2013 and 2014, we expect 3M PRIBOR of 0.5%
- long-term interest rates are low, yields to maturity of 10Y government bonds should reach about 2.1% in 2013 and 2.4% in the following year
- we estimate an average exchange rate at 25.8 CZK/EUR and 19.6 CZK/USD in 2013
- the nominal and real exchange rates should be below the previous long-term trend for the entire forecast horizon
- in October 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

- **Senate's Ordinance on the Change of Tax Laws in Connection with the Recodification of Private Substantive Law (the Senate approved on 10 October 2013)**
- **Senate's Ordinance on Immovable Property Acquisition Tax (the Senate approved on 9 October 2013)**
- **Amendment to the Act on Supported Energy Sources (came into effect on 2 October 2013)**
- **Amendment to the Act on Insurance and Financing of Exports with State Support (came into effect on 2 August 2013)**
- **Amendment to the Employment Act (came into effect on 1 August 2013)**

Macroeconomic Forecast

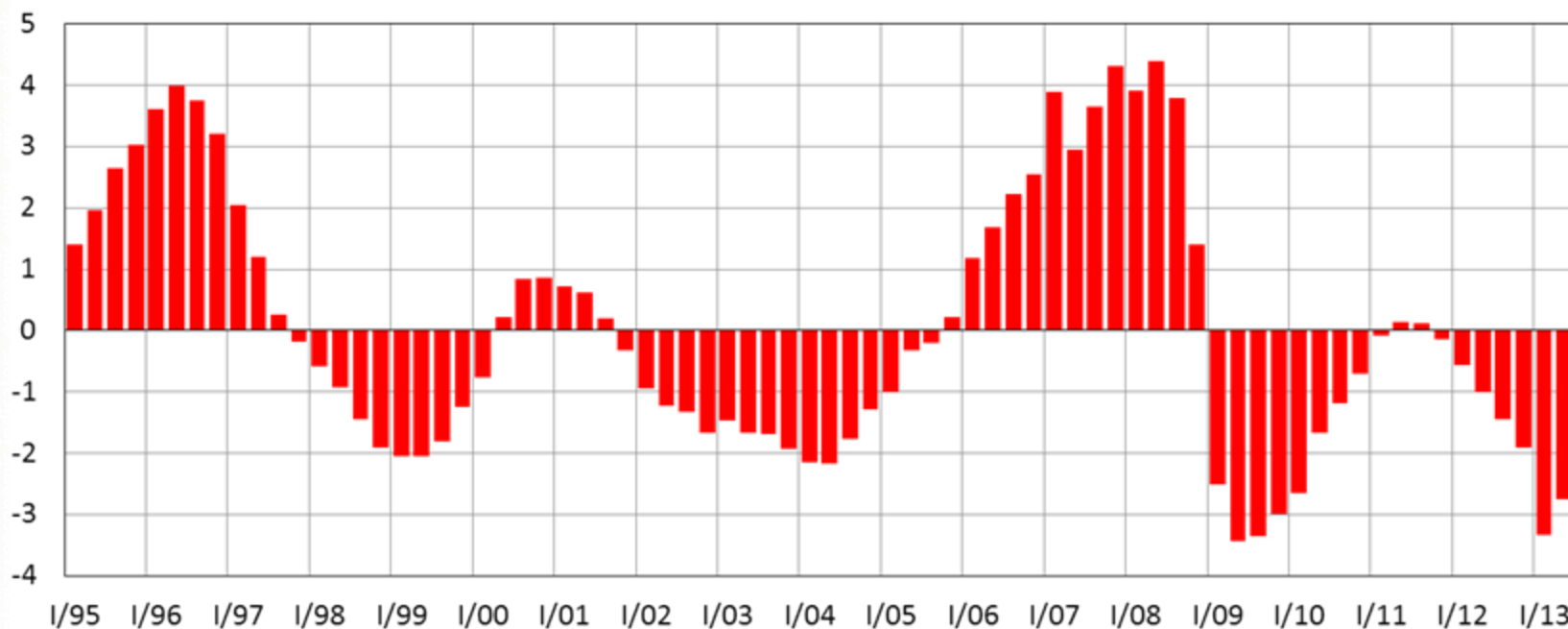
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



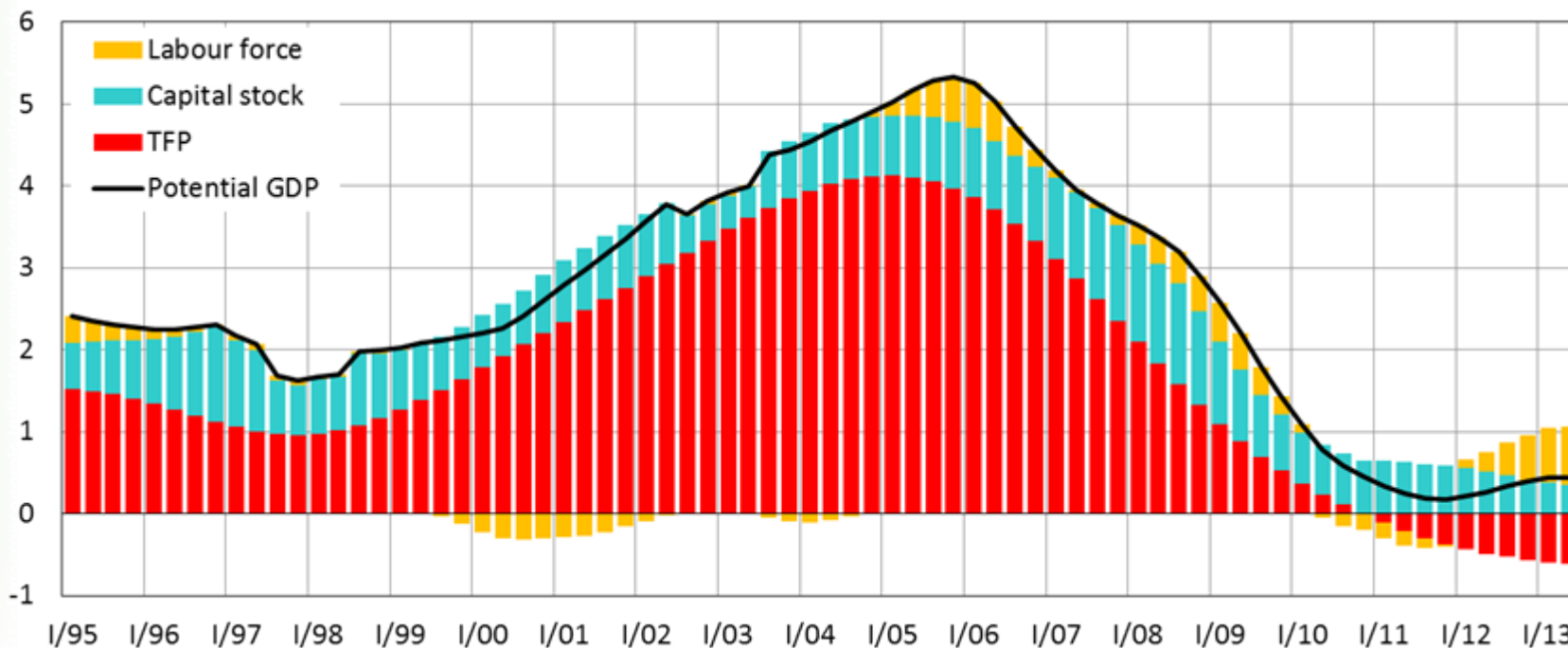
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- from Q4 2011, the Czech economy is in a negative output gap, which gradually deepens and reached -3.0% in H1 2013
- the component most seriously affected is total factor productivity, its contribution to the growth was negative and reached -0.6 p.p. in H1 2013
- deep fall in investment activity led to a gradual reduction of the contribution of the capital stock to 0.4 p.p. in H1 2013
- growth of labour supply exceeded the decline in working age population in H1 2013

Forecast of Macroeconomic Indicators

Macroeconomic Forecast

Main Macroeconomic Indicators

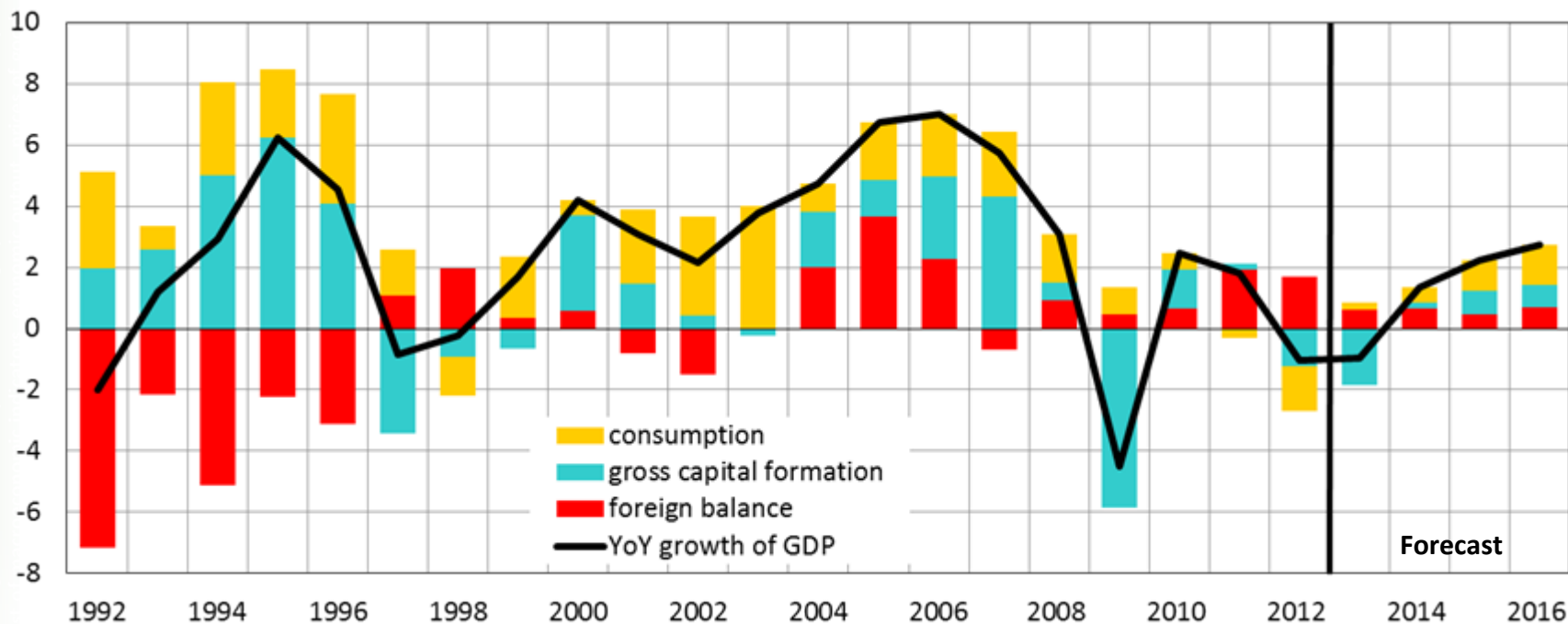
		2010	2011	2012	2013	2014
		<i>Current forecast</i>				
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	1,8	-1,0	-1,0	1,3
Consumption of households	<i>growth in %, const.pr.</i>	0,9	0,5	-2,1	0,2	0,9
Consumption of government	<i>growth in %, const.pr.</i>	0,2	-2,7	-1,9	0,8	0,2
Gross fixed capital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

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

- **real GDP increased by 0.6% QoQ in Q2 2013 and the Czech economy emerged from the 18-month recession**
- **GDP growth was driven by foreign trade and change in inventories and valuables**

Economic Performance

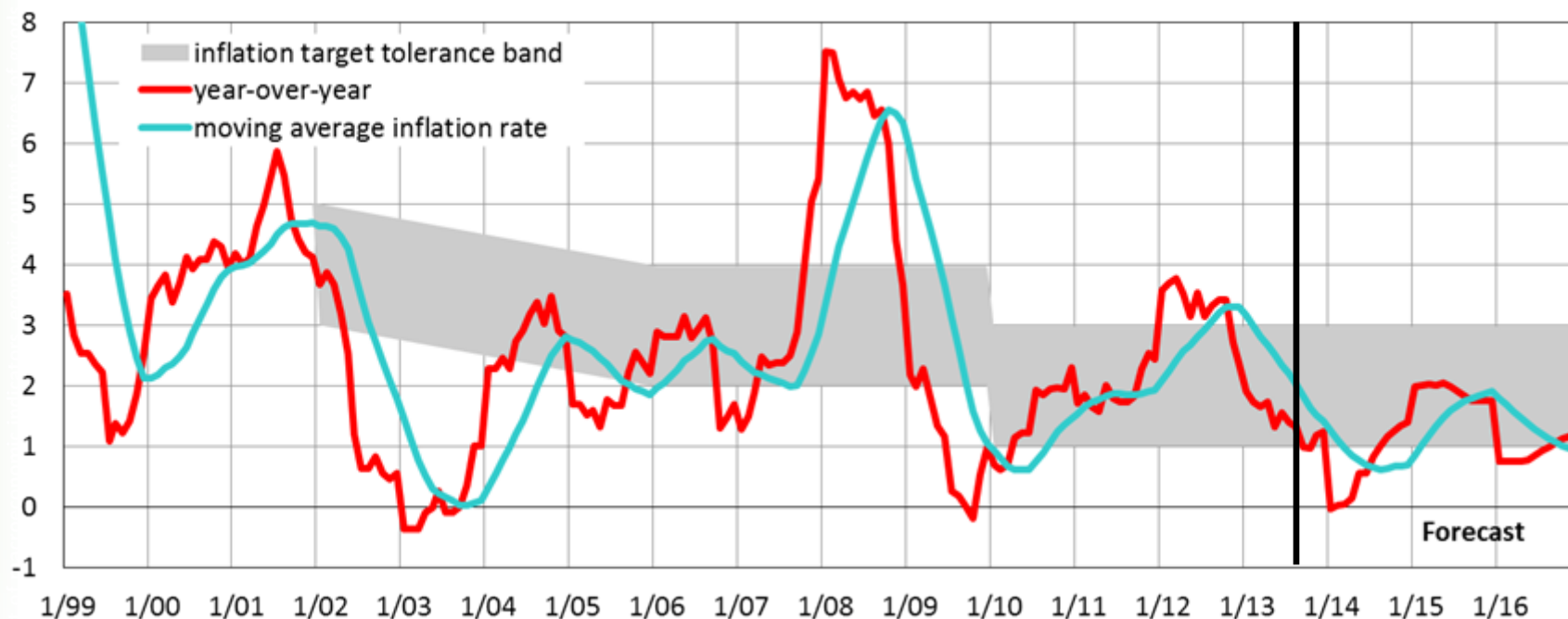
- **GDP should fall by 1.0% in 2013, for 2014 we expect rebound in economic growth of 1.3%**
- **expected increase in household consumption only by 0.2% in 2013 reflects adverse development in real disposable household income, for 2014 we expect to see a growth in household consumption by 0.9% in the context of economic recovery**
- **regarding real government consumption, we expect growth of 0.8% in 2013 and 0.2% in 2014**
- **due to the little company's needs to invest into physical capital, we anticipate a decrease of gross capital formation in 2013 and gradual recovery of the growth dynamic in the following years**
- **both in 2013 and 2014, the main driver of economic growth should be the foreign trade**

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

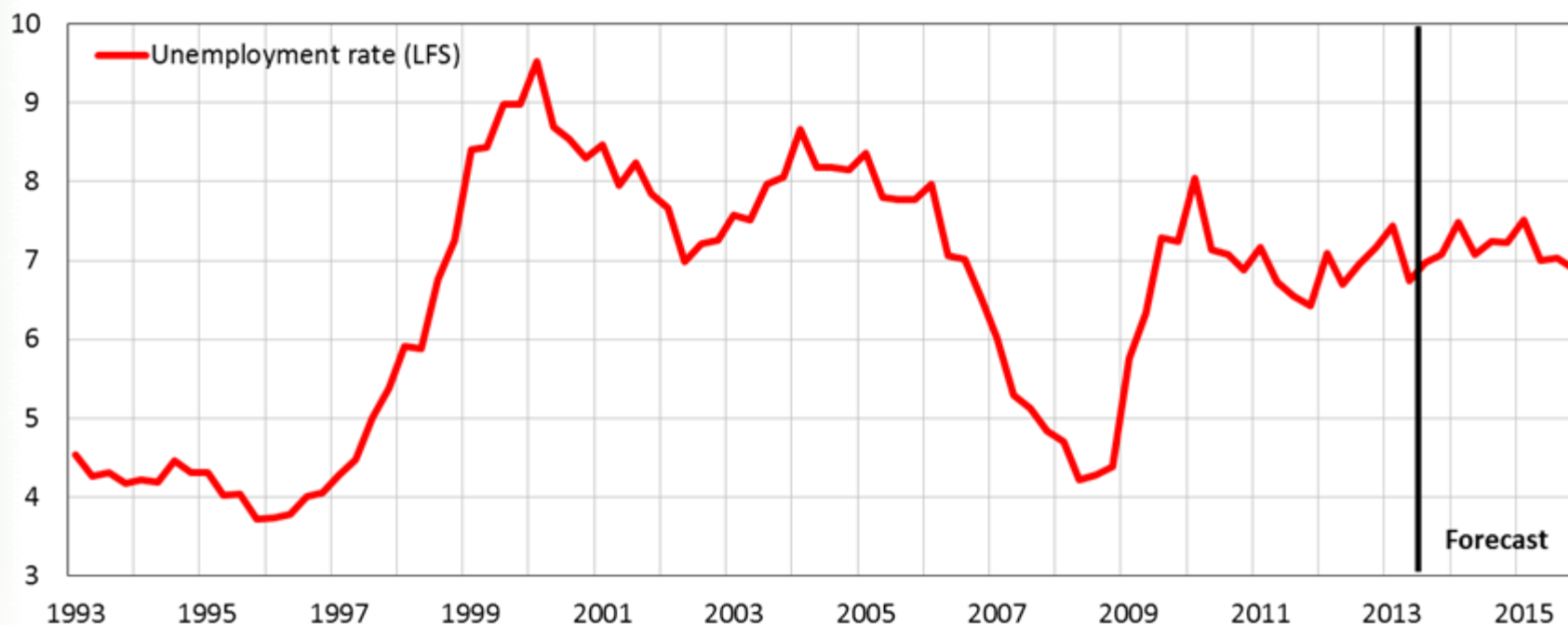
- in 2013, we expect modest growth in consumer prices of 1.4%, the main anti-inflationary factor is a deeply negative output gap
- we estimate 2014 average inflation rate at only 0.7%, mainly due to the decrease of electricity prices
- for 2016 we expect a slowdown in consumer prices growth to 0.9% according to the current legislative status the VAT rates should be harmonized at 17.5% as of 1 January 2016

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

Labour Market

- in the previous recession, the labour market behaved flexibly, even if not standard (the number of registered unemployed persons increased, however, at the same time employment grew due to the increase of casual work)
- in Q2 2013, the unemployment rate according to LFS decreased to 6.7% and employment increased by 0.5% QoQ
- future developments in the labour market is extremely uncertain, labour supply will probably remain high, labour demand will depend on the intensity of the economic recovery and the economic situation of the business sector
- we expect a growth in employment of 1.2% in 2013 and 0.4% in 2014
- the unemployment rate according to LFS should growth to 7.1% in 2013 and 7.3% in the following year, when it should reach its maximum

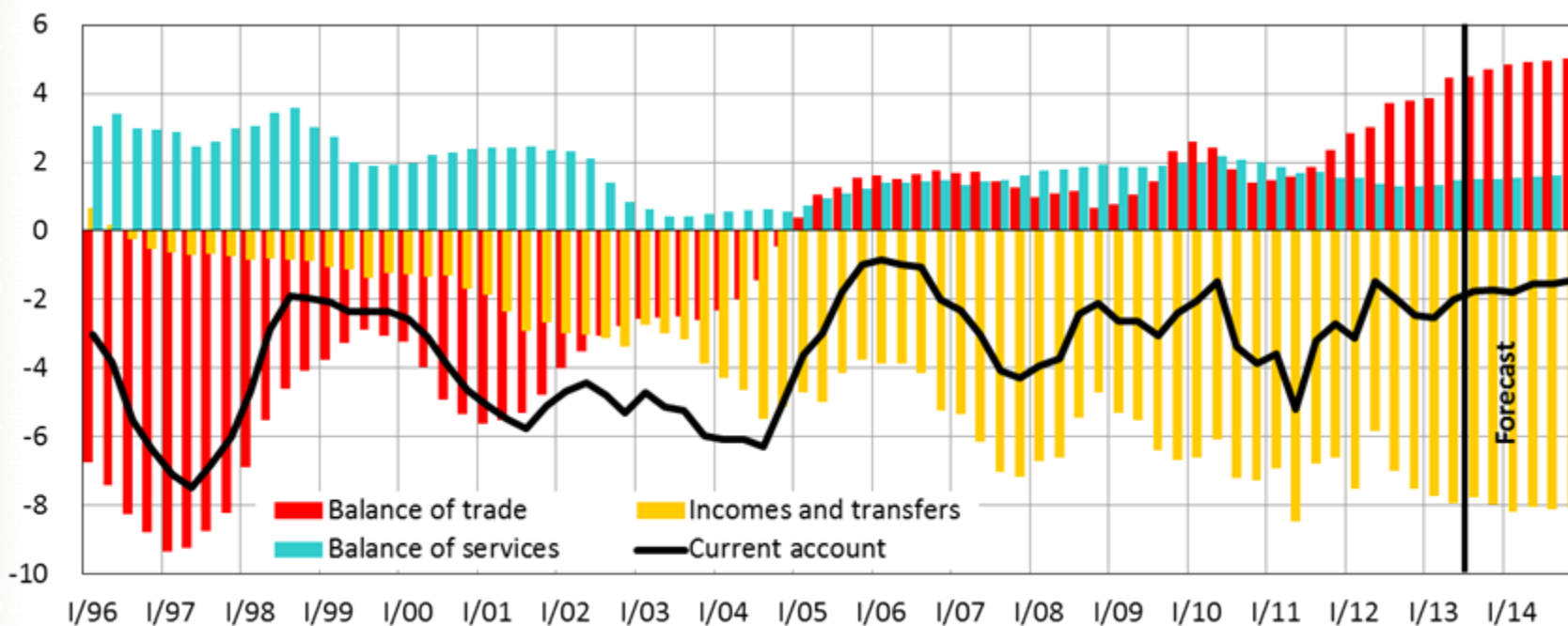
Labour Market

- in Q2 2013, the wage increase was no longer influenced by the legislative or administrative measures
- we expect overall wage bill to increase only by 0.8% in 2013 and by 2.5% in the following year
- for 2013 we anticipate the average wage increase of 0.9%, which should signify a real decline in the real average wage by 0.6%
- in 2014, due to estimated average inflation and expected growth of the average wage of 2.3%, the real wage should increase by around 1.5%

External Relations

Current Account

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



Sources: CNB and Ministry of Finance's own calculations

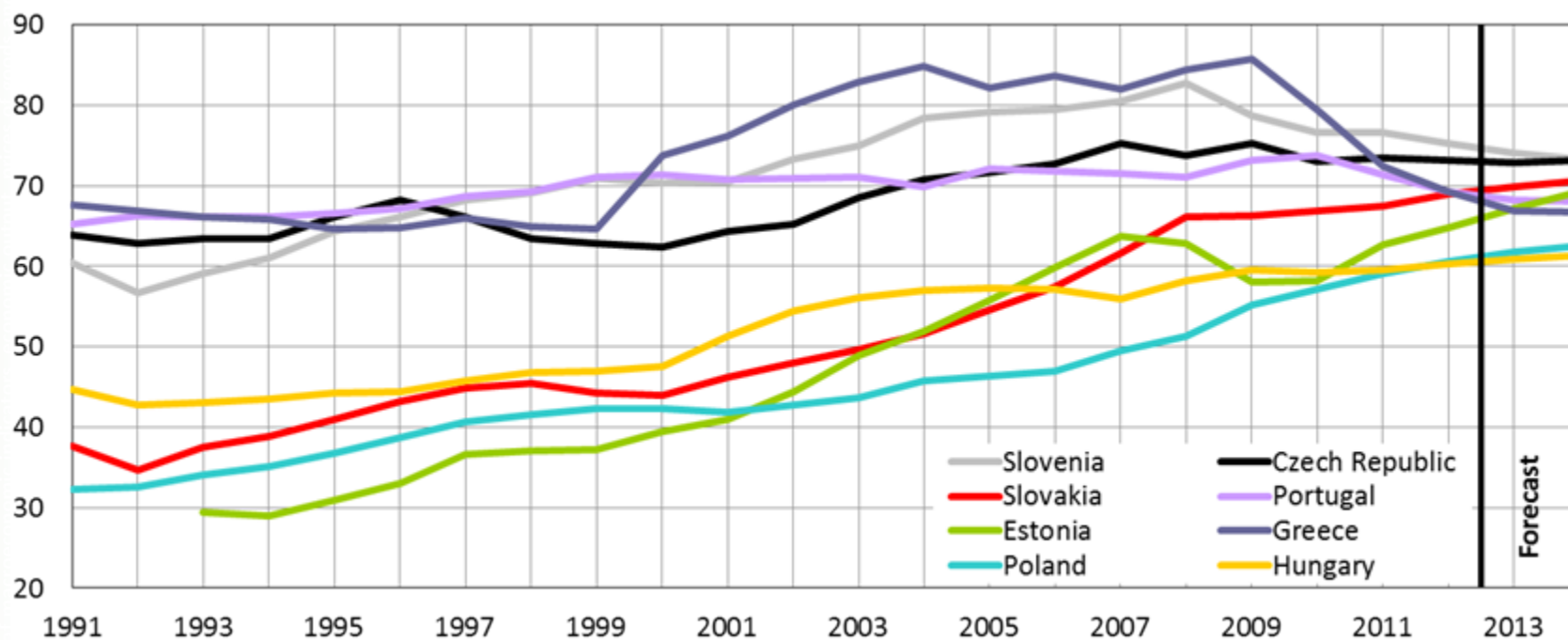
External Relations

- **worsening of the external environment together with a decline in domestic demand is reflected in a slowdown in the foreign trade growth, turn to gradual recovery of foreign trade and a return to growth in export markets is expected before the end of 2013**
- **given the expected improvement in the external environment and the gradual growth of domestic demand, the ratio of the trade balance to GDP should increase to 4.7% in 2013 and to 5.0% in 2014**
- **regarding the service balance, it should reach 1.5% of GDP in 2013 and 1.6% of GDP in the following year**
- **deficit in the balance of income has been showing a tendency to increase, it should raise to 8.1% of GDP in 2013, resp. 8.2% of GDP in 2014**
- **in 2013 and 2014, we expect the current account deficit of around 1.7% of GDP, resp. 1.4% of GDP, so 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

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
									<i>Prelim.</i>	<i>Forecast</i>	<i>Forecast</i>
Slovenia	<i>PPS</i>	19 700	20 700	22 100	22 700	20 300	20 500	21 000	20 900	20 700	21 000
	<i>EA12=100</i>	79	79	80	83	79	77	77	75	74	73
Czech Republic	<i>PPS</i>	17 800	18 900	20 700	20 200	19 400	19 500	20 100	20 300	20 400	21 000
	<i>EA12=100</i>	72	73	75	74	75	73	73	73	73	73
Slovakia	<i>PPS</i>	13 500	15 000	16 900	18 100	17 100	17 900	18 500	19 100	19 500	20 200
	<i>EA12=100</i>	55	57	62	66	66	67	67	69	70	71
Portugal	<i>PPS</i>	17 900	18 700	19 600	19 500	18 800	19 700	19 600	19 200	19 100	19 500
	<i>EA12=100</i>	72	72	72	71	73	74	71	69	68	68
Estonia	<i>PPS</i>	13 800	15 600	17 500	17 200	15 000	15 500	17 200	18 000	18 800	19 800
	<i>EA12=100</i>	56	60	64	63	58	58	63	65	67	69
Greece	<i>PPS</i>	20 400	21 800	22 500	23 100	22 100	21 200	19 900	19 200	18 700	19 100
	<i>EA12=100</i>	82	84	82	84	86	79	72	69	67	67
Poland	<i>PPS</i>	11 500	12 300	13 600	14 100	14 200	15 300	16 200	16 800	17 300	17 900
	<i>EA12=100</i>	46	47	49	51	55	57	59	61	62	63
Hungary	<i>PPS</i>	14 200	14 900	15 400	16 000	15 300	15 800	16 300	16 700	17 000	17 500
	<i>EA12=100</i>	57	57	56	58	60	59	60	60	61	61

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

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