E The Year 2010 in Retrospect

In its efforts to increase the transparency of the work behind preparing its forecasts, the MoF has prepared a comparison of the macroeconomic framework of the state budget for 2010 and the published data for this year. We call attention to the fact that these data can in no way be deemed final for 2010, as the national accounts in particular will still surely be revised a number of times.

Sources of tables: Ministry of Finance's own calculations.

The macroeconomic framework of the national budget for 2010 was prepared on the basis of the June 2009 forecast. Let us remind ourselves of the situation in which the economy found itself at such time.

At the time, both the Czech economy and the **global economy** were going through the deepest slump. World trade was collapsing and the financial markets were experiencing a crisis caused by a number of busts and the very expensive cleanup of big banks. Just released macroeconomic data for the first quarter of 2009 showed a drop in QoQ GDP for the EA12 of 2.5% and for Germany of 3.8%.

The Czech Republic had also been in a **recession** since the fourth quarter of 2008. According to CZSO data at the time, the economic decline reached 3.4%, both QoQ and YoY, in the first quarter of 2009 (after seasonal and working day adjustments). The vast drop in world trade and domestic consumption in the Czech Republic led to a fall in the nominal value of export of approx. 20%, and investments decreased YoY by 5.4%. Inventories also decreased. Business cycle indicators of both domestic and foreign economies then only indicated a slowdown in the decline.

Low demand and falling prices of raw materials led to sharp **disinflation**, where the YoY increase in consumer prices slowed from 6.8% in July 2008 to 1.3% in May 2009. The labour market was also hit hard by the recession. Employment dropped sharply and the seasonally adjusted level of registered unemployed grew in less than a year from 5.4% in September 2008 to 8.1% in May 2009, and continued to rise steeply.

The CNB continued to lower its interest rate for two-week repo operations. In July 2009, the 2W repo rate reached 1.5%; nevertheless, the transmission mechanism of monetary policy was, thanks to a lack of confidence on the inter-bank market, weakened (wider spreads in interbank rates with respect to the 2W repo rate).

As part of **fiscal policy,** a National Emergency Plan was adopted by the Government in early 2009, whose fiscal stimulus in 2009 amounted to 2.2% of GDP. The majority of the measures should have been in force until the end of 2010.

The Fiscal Outlook from May 2009 stated that net lending/borrowing in the government sector should reach –5.1 % of GDP. This was a declared indicative target. A no-policy-change scenario would lead to net lending/borrowing at –6.9 % of GDP.

The situation on the government bond market of certain European countries, namely Latvia, Hungary, and Ukraine, significantly deteriorated during 2009. Yields on Czech government bonds began to register risk aversion and the relative inability of investors to differentiate between the various countries of Central and Eastern Europe. The rate was not fully based on reality and was largely influenced by psychological factors.

This development led to decision to radically shift from fiscal expansion to restriction. In September 2009, a package of measures aimed at stabilising public budgets was adopted. Its goal was to improve the net government balance to -5.3% of GDP in 2010. The main measures in the package included cancellation of crisis-related relief on social security contributions, increasing the VAT and excise tax rates, wage freezes in the government sector, and earmarking funds from the public budget chapters. We would like to point out that this package was proposed and approved only after the cut-off date for the macroeconomic framework of the budget for 2010.

In 2010, austere fiscal policy proved to be the right road to take when the development on the government bond market was dominated by the debt problems of certain Eurozone periphery countries. At moments of increased turbulence in May (Greece) and November (Ireland), the risk premiums on Czech bonds increased only marginally. In May 2010, the spread on 10Y German bonds was on average higher by 0.6 p.p. than in April of the same year; in November, the risk premium on Czech bonds did not even change.

Despite the unclear situation at the time that the June 2009 forecast came out and the fundamental change in the fiscal environment, the actual economic development in 2010 did not deviate to any great extent from the macroeconomic framework of the national budget.

Table E.1: **Comparison of the macroeconomic framework of the NB for 2010 with reality**

Summary of main indicators		2010 State Budget (July 2009 Forecast)			Outcome (April 2011)			Difference (Outcome–Forecast)		
		2008	2009	2010	2008	2009	2010	2008	2009	2010
Gross domestic product	*growth in %, const.pr.*	3.0	-4.3	0.3	2.5	-4.1	2.3	-0.5	0.2	2.0
Consumption of households	*growth in %, const.pr.*	2.7	1.1	0.7	3.6	-0.2	0.5	0.9	-1.3	-0.2
Consumption of government	*growth in %, const.pr.*	1.7	1.3	0.5	1.1	2.6	0.3	-0.6	1.3	-0.2
Gross fixed capital formation	*growth in %, const.pr.*	-0.1	-5.7	-1.5	-1.5	-7.9	-4.6	-1.4	-2.2	-3.1
Cont. of foreign trade to GDP growth	*p.p., const.pr.*	1.9	-1.8	0.2	1.3	-0.6	1.0	-0.6	1.2	0.8
GDP deflator	*growth in per cent*	1.6	2.8	1.0	1.8	2.5	-1.1	0.2	-0.3	-2.1
Average inflation rate	*per cent*	6.3	1.1	1.1	6.3	1.0	1.5	0.0	-0.1	0.4
Employment (LFS)	*growth in per cent*	1.6	-1.8	-2.1	1.6	-1.4	-1.0	0.0	0.4	1.1
Unemployment rate (LFS)	*average in per cent*	4.4	6.8	8.5	4.4	6.7	7.3	0.0	-0.1	-1.2
Wage bill (domestic concept)	*growth in %, curr.pr.*	10.8	1.0	1.0	8.7	0.0	0.1	-2.1	-1.0	-0.9
Current account / GDP	*per cent*	-3.1	-2.0	-0.9	-0.6	-3.2	-3.8	2.5	-1.2	-2.9
General government balance	*% GDP*	-1.5	-4.5	-5.1	-2.7	-5.8	-4.7	-1.2	-1.3	0.4
Assumptions										
Exchange rate CZK/EUR		24.9	26.8	25.5	24.9	26.4	25.3	0.0	-0.4	-0.2
Long-term interest rates	*% p.a.*	4.6	4.5	4.4	4.6	4.8	3.9	0.0	0.3	-0.5
Crude oil Brent	*USD/barrel*	98	62	79	98	62	80	0	0	1
GDP in Eurozone (EA-12)	*growth in %, const.pr.*	0.8	-4.3	-0.2	0.4	-4.1	1.7	-0.4	0.2	1.9

Note: Net government balance (net lending/borrowing) in ESA 95 according to the Fiscal Outlook from May 2009.

The global economic recovery in 2010 was greater than generally expected. Growth in the EA12 and other important economies thus strongly exceeded our forecast at the time. The accepted assumption about the development of the oil prices was spot on. Their marked increase at the end of the year to almost USD 100 per barrel did not affect annual results.

The extent to which final data for 2010 matched the macroeconomic framework of the budget was noteworthy in the case of **nominal values**, which are the most important for determining budgetary parameters. Nominal GDP reached CZK 3 670 bill. compared to the estimated CZK 3 678 bill. in connection with concurrent growth of 1.2%. At the same time, the difference in nominal consumption of households was minimal. Consumption amounted to CZK 1 869 bill. And grew by 1.8% compared to the budgetary framework of CZK 1 888 bill. CZK and growth of 1.6%. (The opposite direction of variances stems from revised data for 2009.)

Real GDP growth in the Czech Republic exceeded the forecast by 2.0 p.p. The economic growth of our business partners also increased the dynamic of Czech exports more than had been expected by the forecast. The largest contributors to the faster growth in the Czech Republic were foreign trade, with its contribution of 1.0 p.p. (instead of 0.2 p.p.) and increase in inventories with a contribution of 2.0 p.p. (instead of –0.1 p.p). Due to falling incomes, household consumption developed less favourably than anticipated by the forecast. Fixed capital formation was also falling faster than predicted.

A slightly higher **inflation rate** (by 0.4 p.p.) in contrast to the macroeconomic framework can be clearly attributed to the aforementioned additional tax measures, contributing 0.8 p.p. to price growth. The reduction in the CNB's inflationary target to 2% as of 1 January and lower growth of household consumption in a highly competitive environment were apparently helping to stabilise inflation.

Thanks to higher than expected economic growth, the **labour market** experienced less disruptions. The seasonally adjusted level of registered unemployment peaked during the first quarter of 2010 exactly as predicted, but on a slightly lower level (9.6 % versus 10.2%). The early cancellation of relief on social security contributions had only a short-term effect, which apparently delayed the peak by a number of months. In the same way, the decrease in the average employment level was substantially more moderate.

The results of the current account balance of payments cannot be evaluated due to the revision of the underlying data (for more information see Box C.4.1).

In 2010, the net government balance (net lending/borrowing) attained –4.7 of GDP according to April notifications. This result is by 0.6 p.p. better than the budget.