



Ministry of Finance

CZECH REPUBLIC

Department for Financial Policies

Macroeconomic Forecast of the Czech Republic

April 2012

Macroeconomic Forecast

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)
- we consider a very low level of consumer confidence in the future economic development 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

Economic performance of the U.S. economy is gradually improving

Concerns about the euro zone's debt crisis are easing

- restructuring of the Greek debt and the release of the second bailout package
- the European Central Bank has initiated a second long term refinancing operation
- Greece's rating has been upgraded in solving the debt crisis, while ratings of Spain, Italy and Portugal have been further downgraded

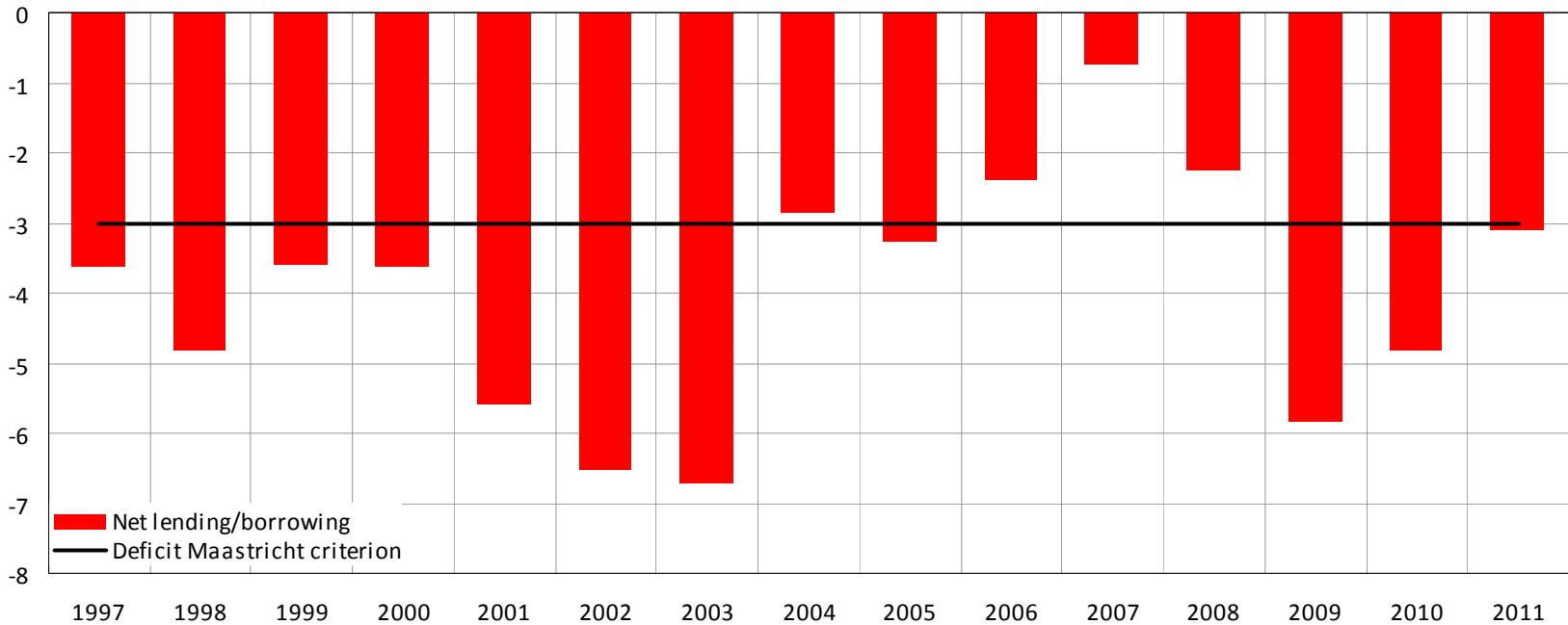
Slowdown of the economic growth in China and other large developing economies

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



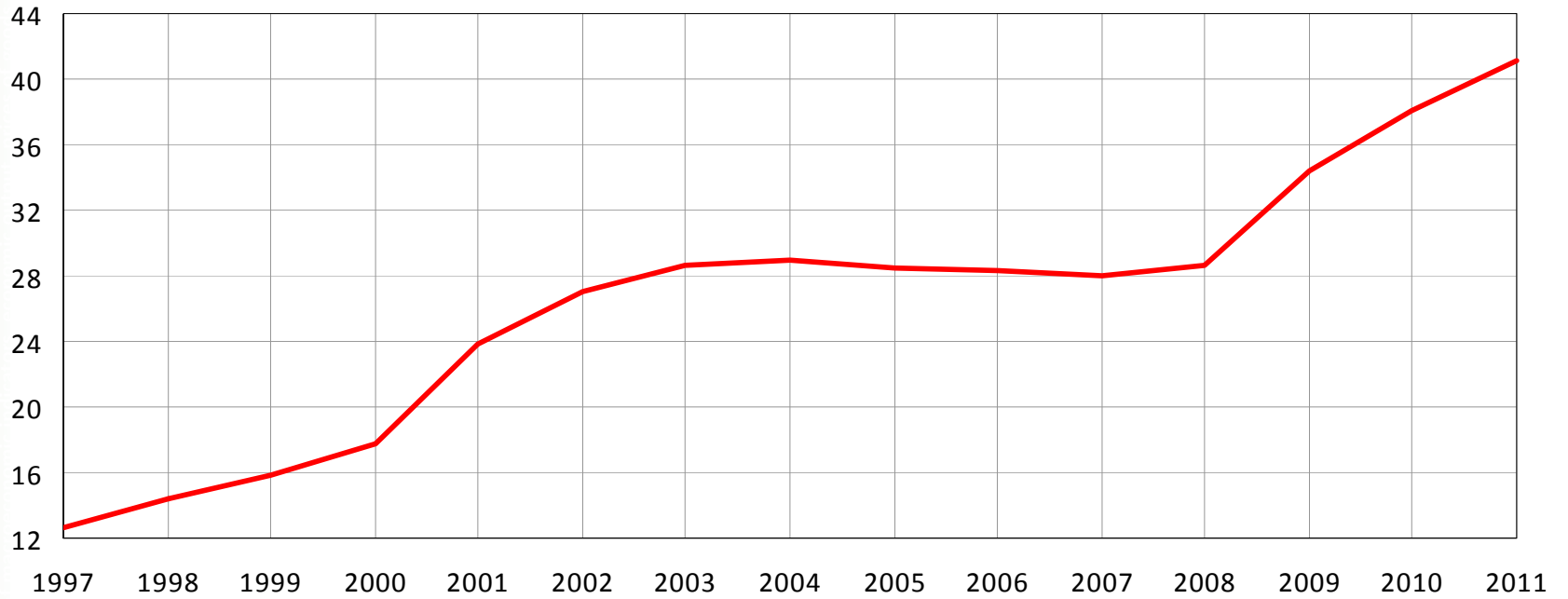
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

- according to the preliminary estimates, the general government deficit reached 3.1% of GDP in 2011
- fiscal effort (year-on-year change of the cyclically adjusted balance) amounted to 1.6 p.p. reflecting approved austerity measures
- government debt at the end of 2011 is estimated at 41.2% of GDP

Fiscal Aim

- achieve balance in the general government sector 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 only at 0.75% in the first quarter of 2012**
- **the average value for 3M PRIBOR stagnated in the first quarter of 2012 at 1.2% and we expect the same value for 2012 and 2013**
- **after a significant weakening of the Czech crown in the fourth quarter of 2011, the situation in the financial markets has improved and the Czech crown has started to appreciate**
- **we expect an average exchange rate of 25.0 CZK/EUR and 19.2 CZK/USD in 2012**
- **In April 2012 the Czech Republic's rating was stable at a good level of investment (Standard & Poor's AA-, Moody's and Fitch Ratings - A1)**

Structural reforms

Approval of major structural reforms

- **Act on Commercial Companies and Cooperatives (President signed on 20 February 2012)**
- **Amendment of the Public Procurement Act (came into effect on 1 April 2012)**
- **Amendment of the Investment Incentives Act (the Chamber of Deputies approved on 21 March 2012)**
- **Second phase of healthcare reform (came into effect on 1 April 2012)**

Macroeconomic Forecast

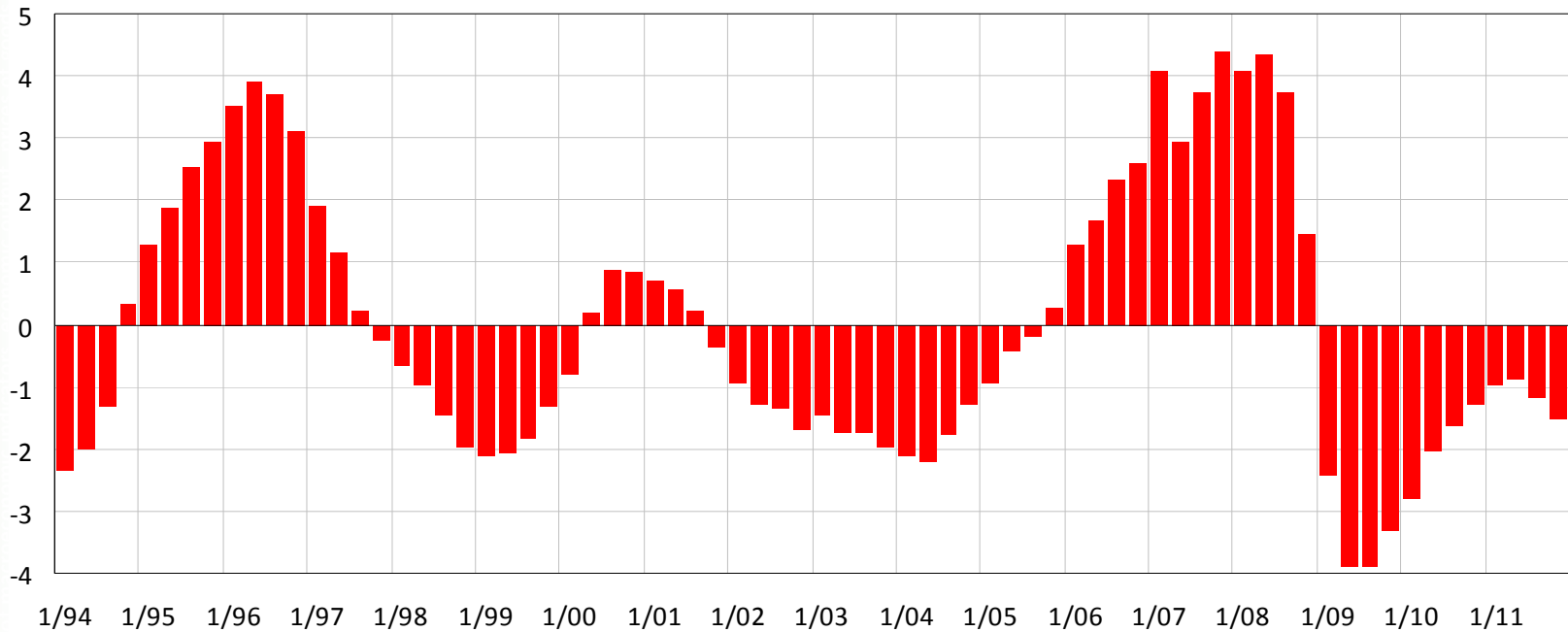
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)

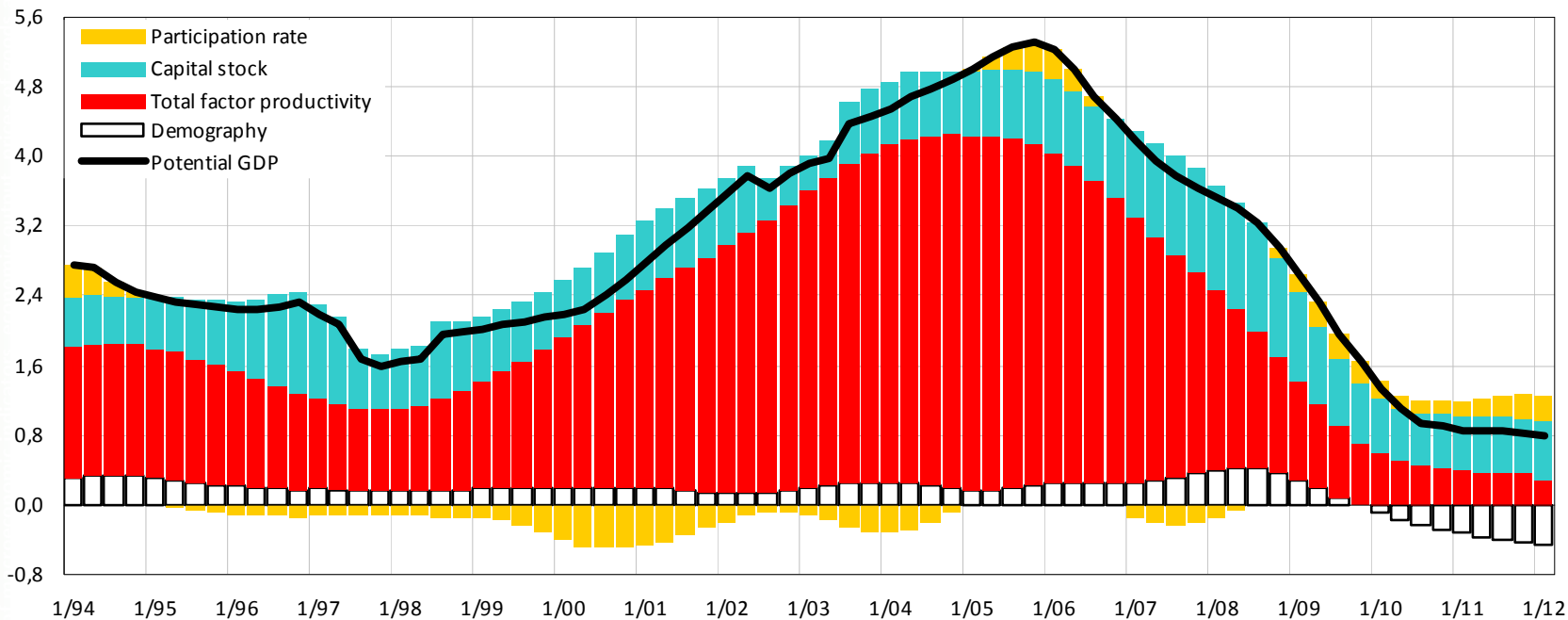


Sources: CZSO, CNB and Ministry of Finance's own calculations

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 2010 and 2011 gradually decreased to 1%
- the output gap gradually decreased after the recession, but stagnation of the GDP led to its deepening to -1.6% at the end of 2011
- the component most seriously affected is total factor productivity, its contribution to the growth fell to only 0.4 p.p. in 2011
- deep fall in investment activity led to a reduction of the contribution of the capital stock, which remains relatively low
- modest growth of labour supply partly compensates the decline in working age population
- according to our calculations, the total level of potential output loss due to recession and slow recovery is about 9.2% so far

Forecast of Macroeconomic Indicators



Macroeconomic Forecast

Main Macroeconomic Indicators

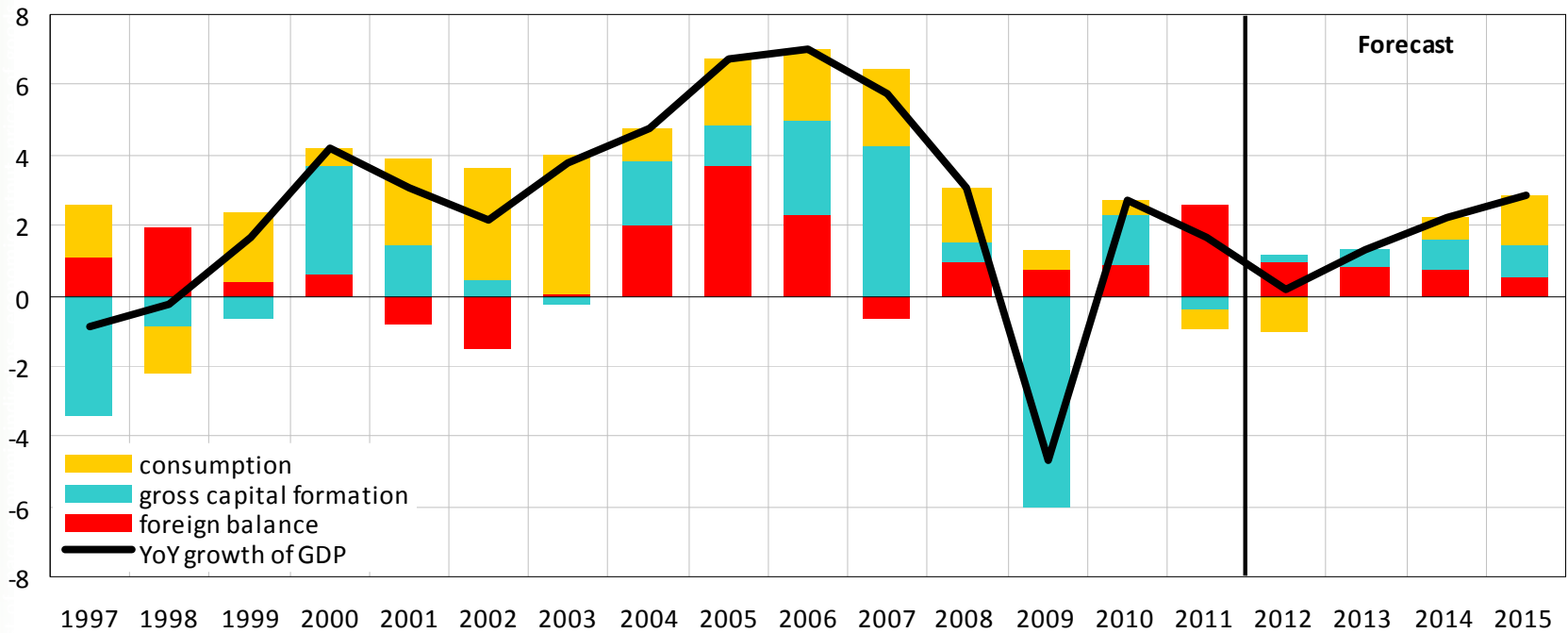
		2009	2010	2011	2012	2013
					Forecast	
Gross domestic product	<i>growth in %, const.pr.</i>	-4,7	2,7	1,7	0,2	1,3
Consumption of households	<i>growth in %, const.pr.</i>	-0,4	0,6	-0,5	-0,4	0,2
Consumption of government	<i>growth in %, const.pr.</i>	3,8	0,6	-1,4	-3,7	-0,5
Gross fixed capital formation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

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

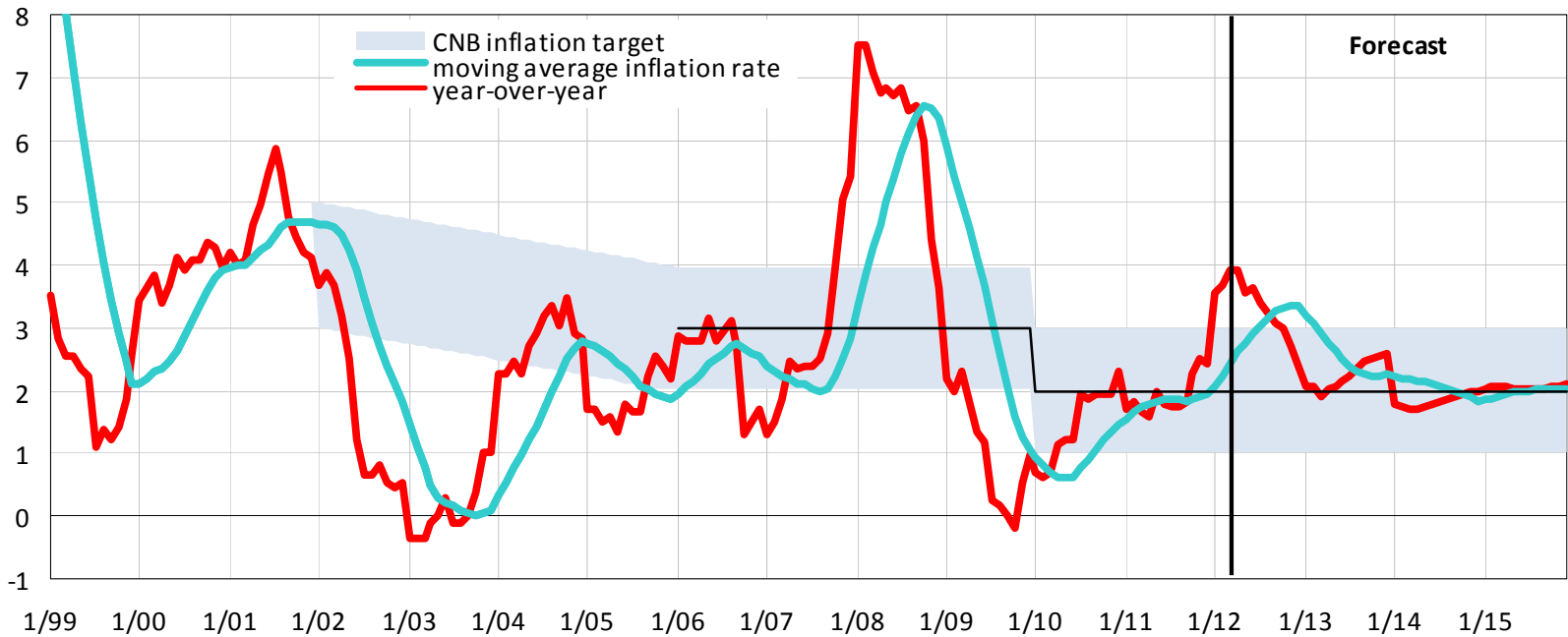
- we expect stagnation and real GDP growth of just 0.2% in 2012, economic growth should recover to 1.3% in the following year
- decline in household consumption in 2012 is primarily due to unfavourable income situation of the households and higher inflation, household consumption could be stabilized in 2013
- decline in real government consumption in 2012 and 2013 reflects adopted stabilization measures and 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

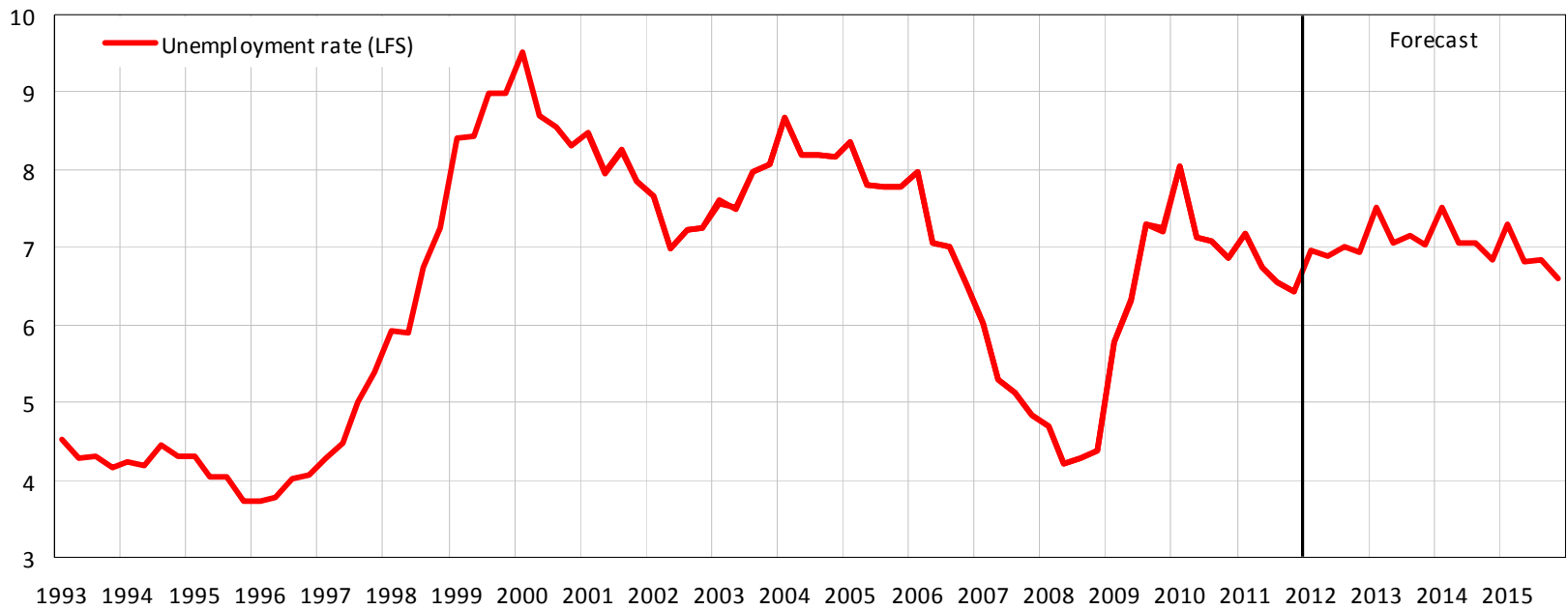
Inflation

- **we estimate 2012 average inflation rate at 3.3%, this rise is mainly due to approved administrative measures (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 2.3 % (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

- the employment should fall by 0.5% in 2012 due to the expected delayed impact of the GDP stagnation and announced further job cuts in the state sector; in response to the expected improvement of the economic situation, we estimate employment growth of 0.1% in 2013
- the unemployment rate according to LFS reached 6.4% in the fourth quarter of 2011, 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

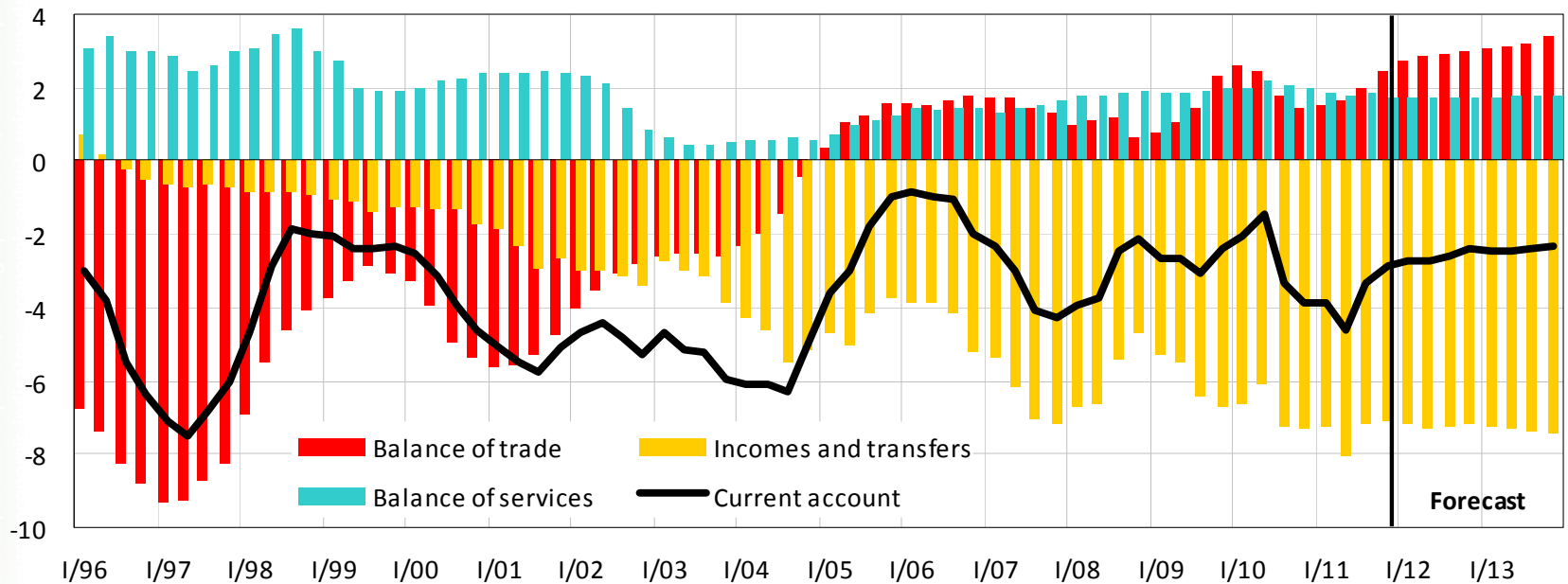
- **we expect overall wage bill to increase only by 1.5 % in 2012, because of lower economic performance, decline in employment and further budget savings measures; in the following year the wage bill should raise at 2.6 %**
- **in 2012, we expect the average wage increase of only 2.0% (assuming inflation rate of 3.3%, we estimate the real average wage will decrease by 1.3%)**
- **due to expected improvement of the economic situation average wage should increased by 2.6% in 2013**

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

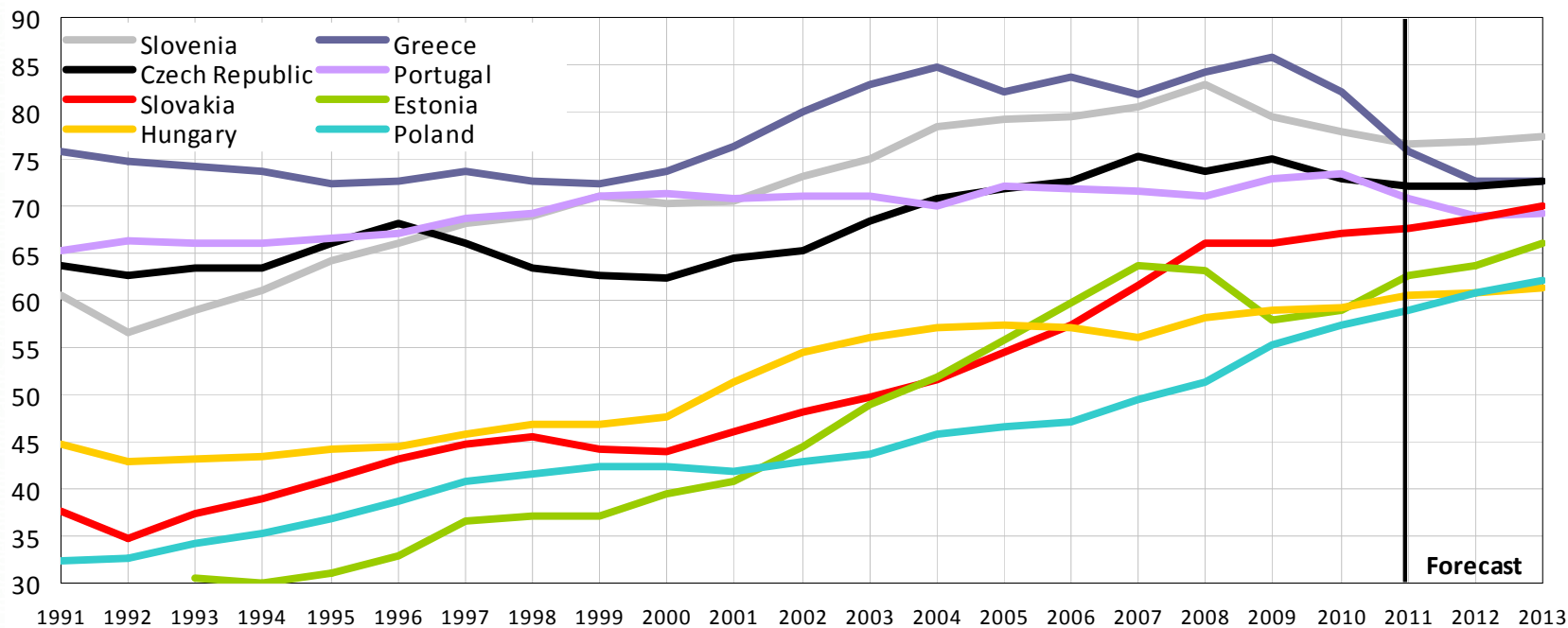
External Relations

- 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 3.0% of GDP in 2012 and at 3.4% of GDP in 2013
- 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 due to the outflow of investment revenues within foreign direct investment, it should reach about 7.2% of GDP in 2012 and 7.5% of GDP in 2013
- we estimate the ratio of the current account to GDP at -2.4% in 2012 and -2.3% 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	20 900	21 200	21 800
	<i>EA12=100</i>	78	79	79	80	83	79	78	77	77	77
Greece	<i>PPS</i>	20 300	20 400	21 800	22 500	23 100	22 100	21 900	20 700	20 100	20 500
	<i>EA12=100</i>	85	82	84	82	84	86	82	76	73	73
Czech Republic	<i>PPS</i>	16 900	17 800	18 900	20 700	20 200	19 300	19 400	19 700	20 000	20 500
	<i>EA12=100</i>	71	72	73	75	74	75	73	72	72	73
Portugal	<i>PPS</i>	16 700	17 900	18 700	19 600	19 500	18 800	19 600	19 400	19 000	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	18 500	19 000	19 800
	<i>EA12=100</i>	52	55	57	62	66	66	67	68	69	70
Estonia	<i>PPS</i>	12 400	13 800	15 600	17 500	17 300	14 900	15 700	17 100	17 600	18 600
	<i>EA12=100</i>	52	56	60	64	63	58	59	63	64	66
Hungary	<i>PPS</i>	13 600	14 200	14 900	15 400	16 000	15 200	15 800	16 500	16 800	17 300
	<i>EA12=100</i>	57	57	57	56	58	59	59	61	61	61
Poland	<i>PPS</i>	11 000	11 500	12 300	13 600	14 100	14 300	15 300	16 100	16 800	17 600
	<i>EA12=100</i>	46	46	47	50	51	55	57	59	61	62

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

April 2012

Ministry of Finance of the Czech Republic
Financial Policy Department
Letenská 15
118 10 Prague 1

<http://www.mfcr.cz>

