



# Ministry of Finance CZECH REPUBLIC

Financial Policy Department

## **Macroeconomic Forecast** **Czech Republic**

**April 2013**

# Structure of the presentation

## Forecast Assumptions

- risks of the forecast
- external environment
- fiscal policy
- monetary policy, interest rates and exchange rates

## Economic Cycle

## Forecast of Macroeconomic Indicators

- economic output
- inflation
- labour market
- external relations

# Forecast Assumptions

## Risks of the forecast

- compared with the previous forecast, the prospects of the Czech economy for both this year and next year have slightly deteriorated, the main reason for the forecast deterioration is worsening economic outlook in the euro zone
- the most important economic risk related to the external environment is, in our view, the threat of the recession being experienced in the south of the euro zone spilling over to the countries of the Czech Republic's main trading partners
- Greece is in a deep depression, compared with 2007 Greek GDP will have cumulatively declined by about 24% this year
- we consider very low level of confidence among consumers but also in many segments of the business sector as a significant internal risk in the Czech economy

# External Environment

## The outlook for the world economy varies significantly

- the euro zone economy continues to decline for the fifth quarter in a row, however, performance of the individual countries has been considerably differentiated
- the U.S. economy is getting better, economic growth is driven mainly by household consumption
- emerging economies' growth is still stable, but these economies face weak external demand

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

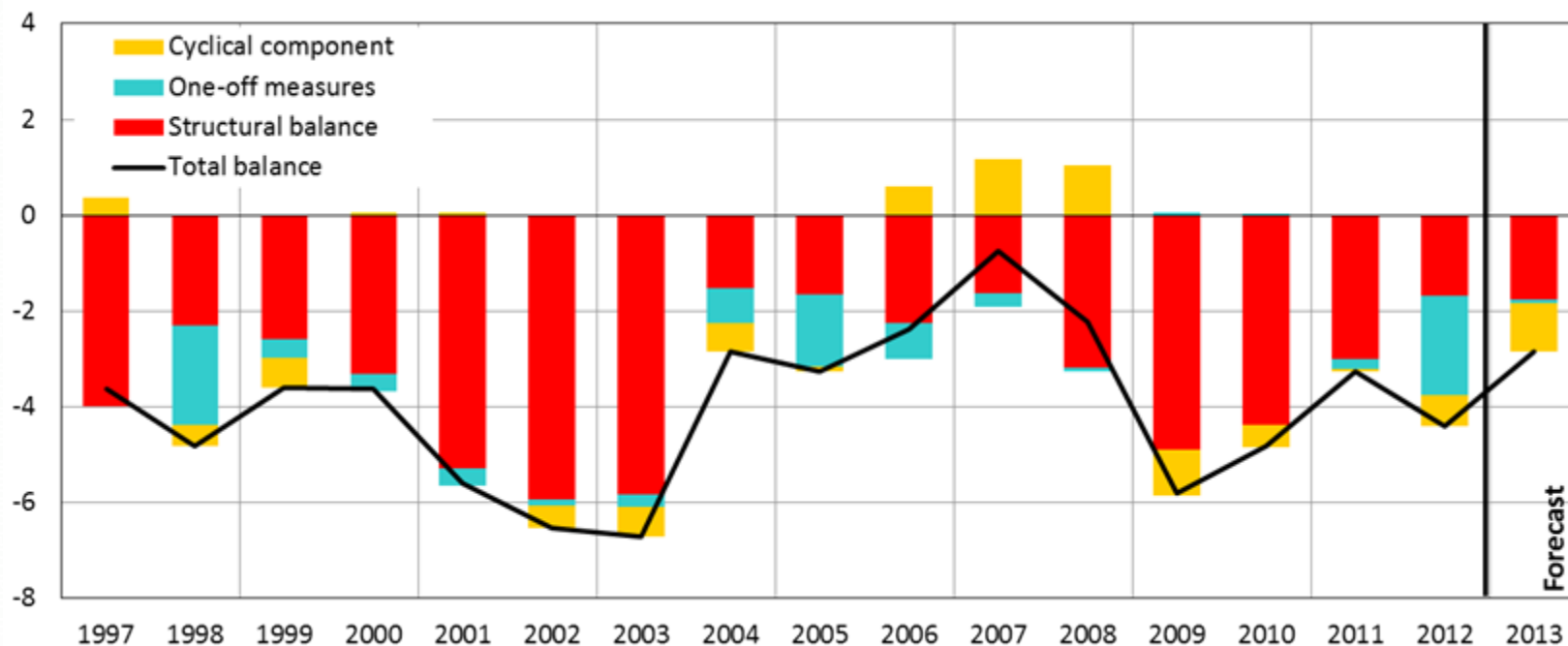
- Italy's parliamentary elections have ended in stalemate, with none of the political parties securing a majority in both houses of parliament
- the situation in Cyprus is deteriorating, problematic circumstances regarding negotiations on a bailout program

## Macroeconomic Forecast

# Fiscal Policy

## Net Lending/Borrowing

(in % of GDP)



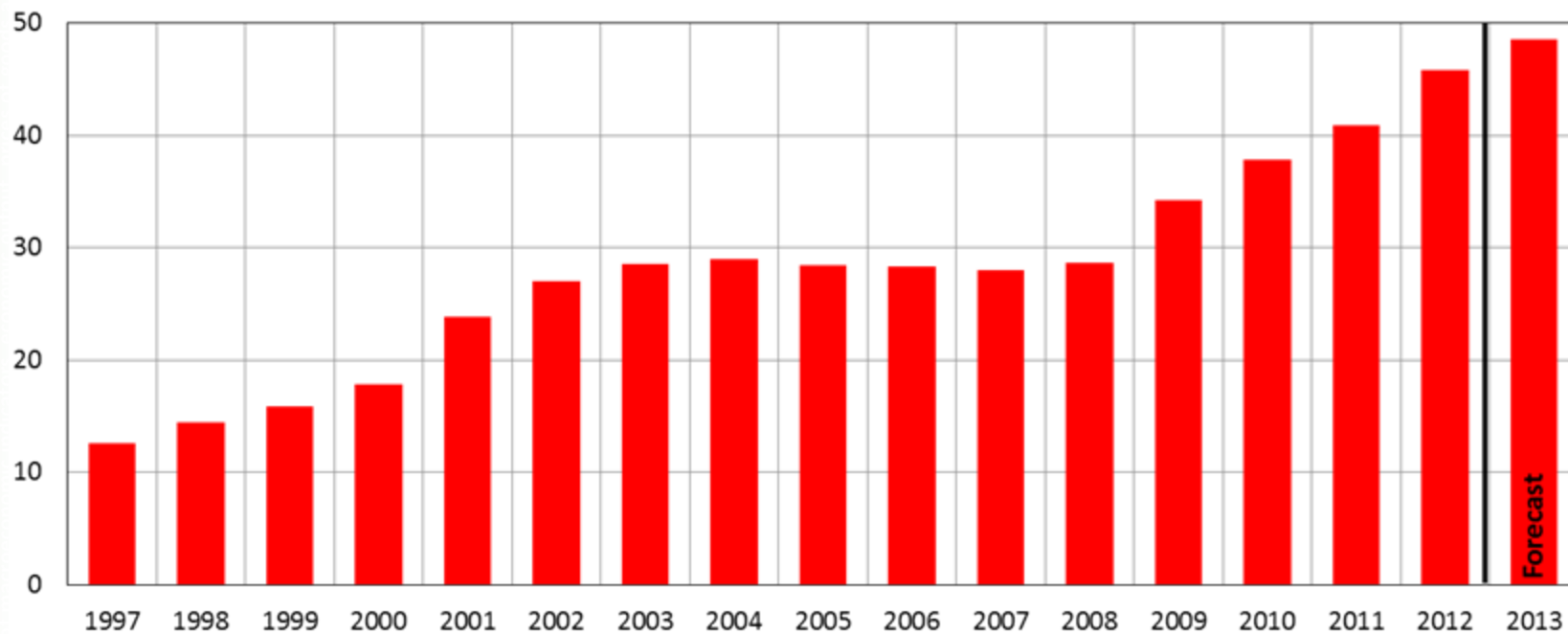
Source: Ministry of Finance.

## 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 4.4% of GDP, this estimate is of 0.6 p.p. better compared to the estimate of the Ministry of Finance from January 2013
- adjusted for one-off factors (financial compensation to churches and unreimbursed part of the EU resources), deficit is only 2.5% of GDP
- fiscal effort (year-on-year change of the cyclically adjusted balance between 2012 and 2011) amounted to 1.4 p.p.
- at the end of 2012, the government debt reached 45.2% of GDP
- for 2013, when the general government deficit should, in accordance with the excessive deficit procedure, be lower than 3% of GDP, we predict a balance of -2,8% of GDP



# 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 2013 and 2014, we expect 3M PRIBOR of 0.5% and 0.6% respectively
- long-term interest rates are low, yields to maturity of 10Y government bonds should reach about 2.2% in 2013 and 2.3% in the following year
- we estimate an average exchange rate at 25.4 CZK/EUR and 19.6 CZK/USD in 2013 and then the CZK should appreciate by 1.1% per year on average
- the nominal and real exchange rates should be below the previous long-term trend for the entire forecast horizon
- in March 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+)

## Macroeconomic Forecast

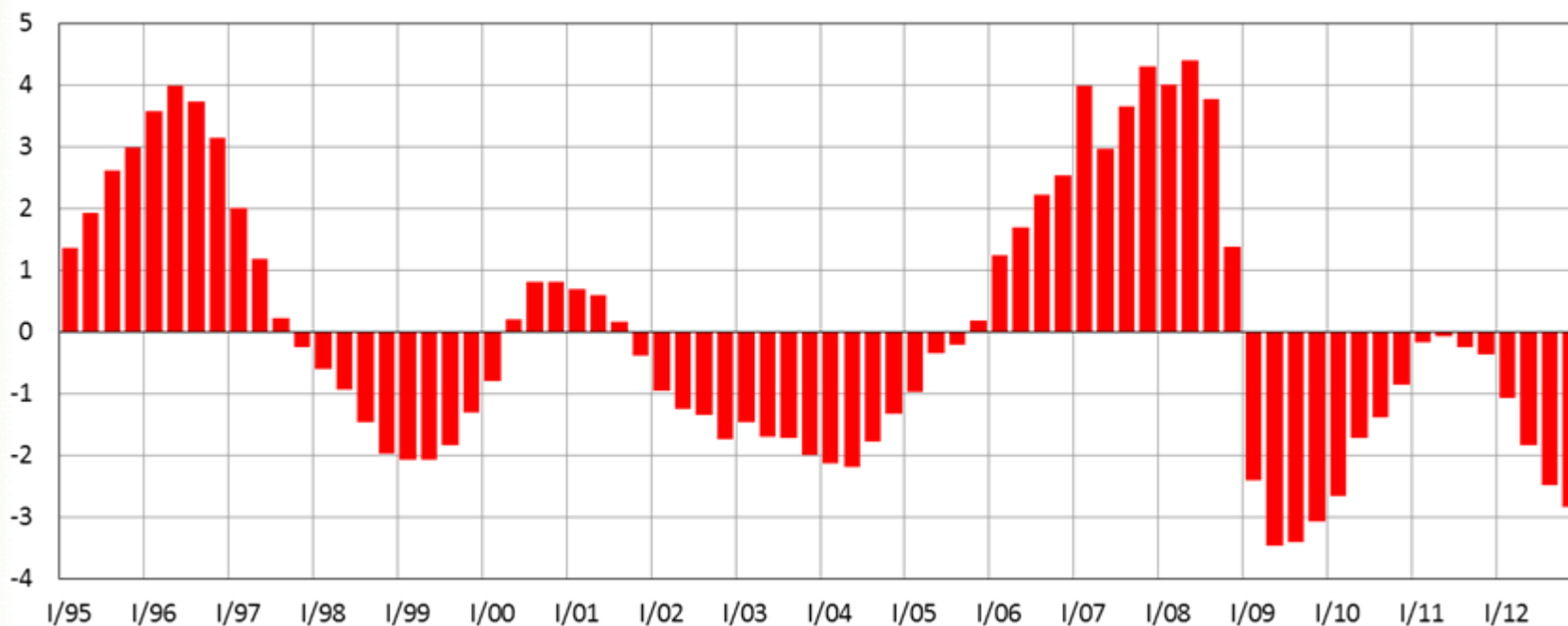
# Economic Cycle

## Macroeconomic Forecast

# Economic cycle

## Output Gap

(in % of potential product)

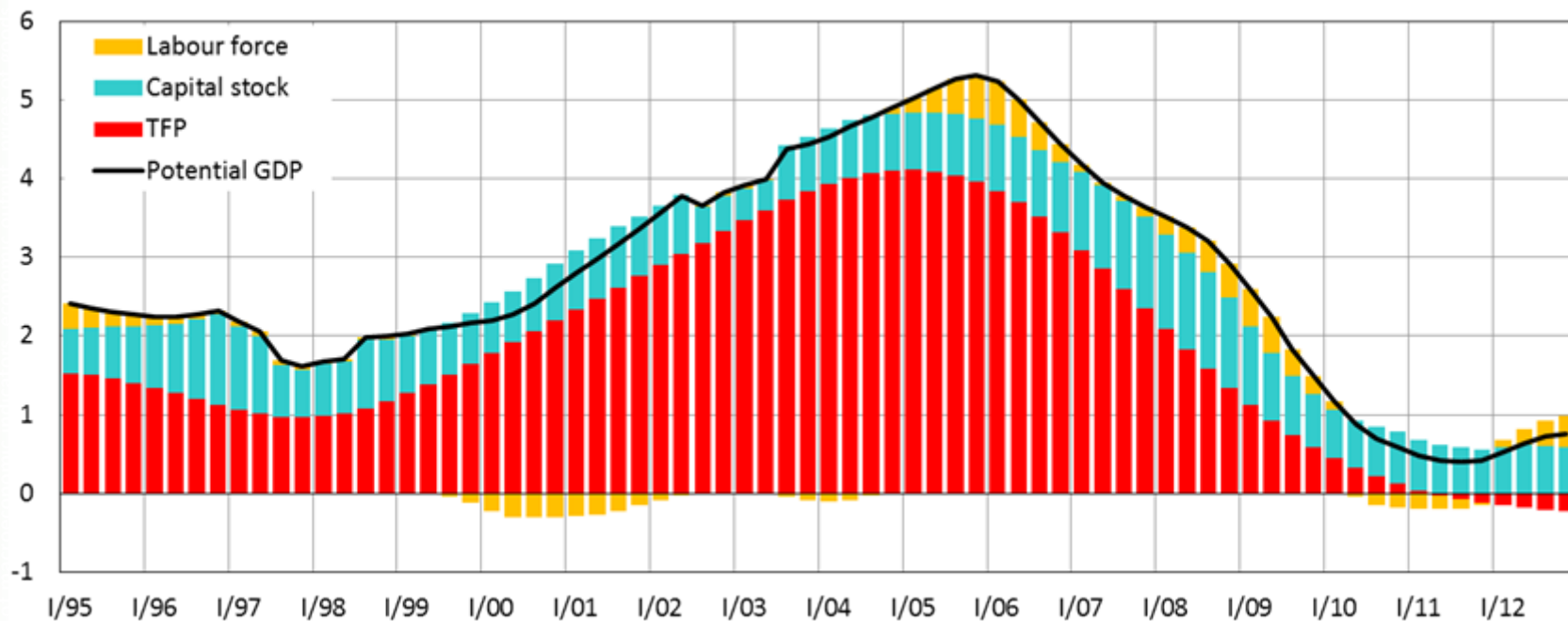


Sources: CZSO, CNB and Ministry of Finance's own calculations

# Economic cycle

## Potential Product Growth

(in %, contributions in percentage points)



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

## Economic cycle

- since the deep recession at the turn of 2008 and 2009, the Czech economy has been in a negative output gap, which gradually deepens from 3Q 2011 and reached -2,8% in 4Q 2012
- the component most seriously affected is total factor productivity, its contribution to the growth was negative and reached -0.2 p.p. in 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 exceeded the decline in working age population in 2012

# Forecast of Macroeconomic Indicators



## Macroeconomic Forecast

## Main Macroeconomic Indicators

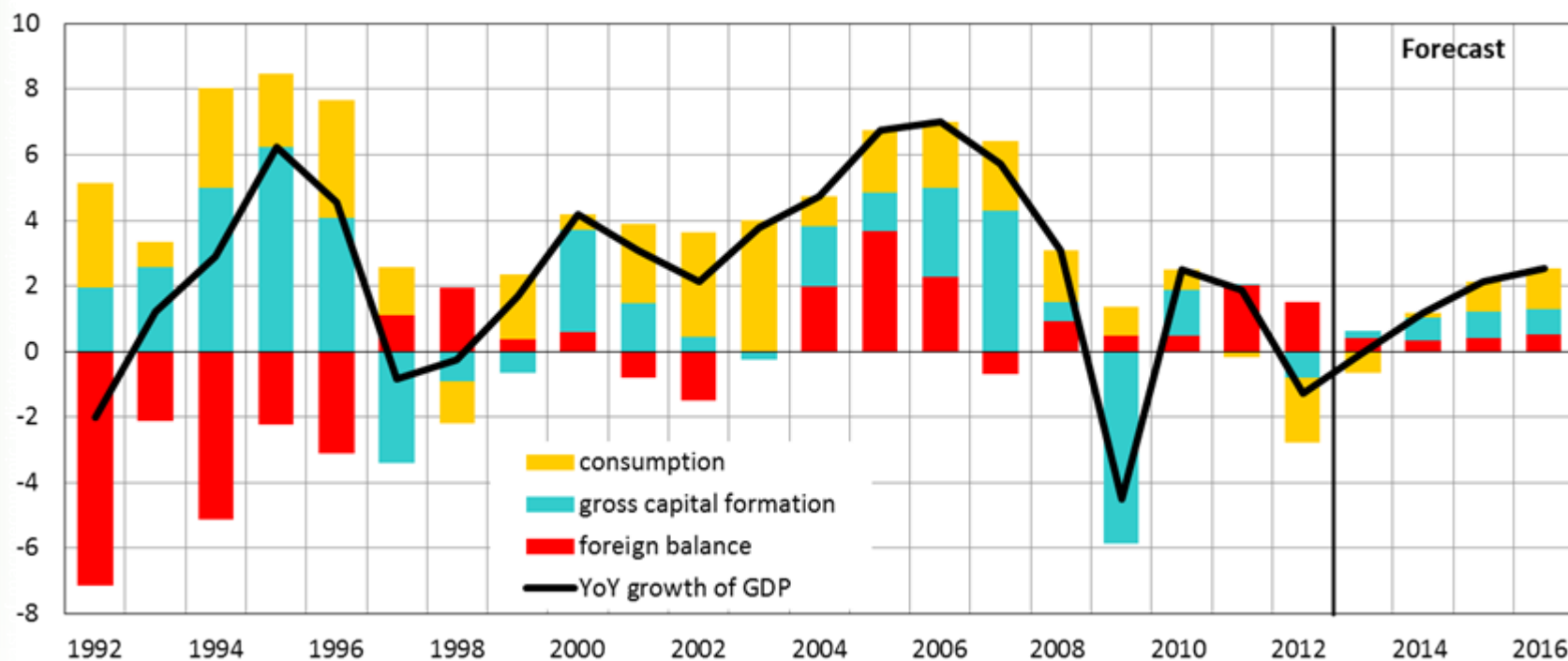
		2010	2011	2012	2013	2014
		<i>Current forecast</i>				
<b>Gross domestic product</b>	<i>growth in %, const.pr.</i>	<b>2,5</b>	<b>1,9</b>	<b>-1,3</b>	<b>0,0</b>	<b>1,2</b>
<b>Consumption of households</b>	<i>growth in %, const.pr.</i>	<b>1,0</b>	<b>0,7</b>	<b>-3,5</b>	<b>-1,2</b>	<b>1,0</b>
<b>Consumption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

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

- economic output fell by 0.2% in Q4 2012 QoQ, for the whole of 2012, GDP fell by 1.3% YoY
- the Czech economy has been in a recession throughout the 2012, however, the depth of QoQ declines started to decrease in H2 2012
- the decline in economic output is mainly due to the drop in household consumption and, to a lesser extent, decline in investments

## Economic Performance

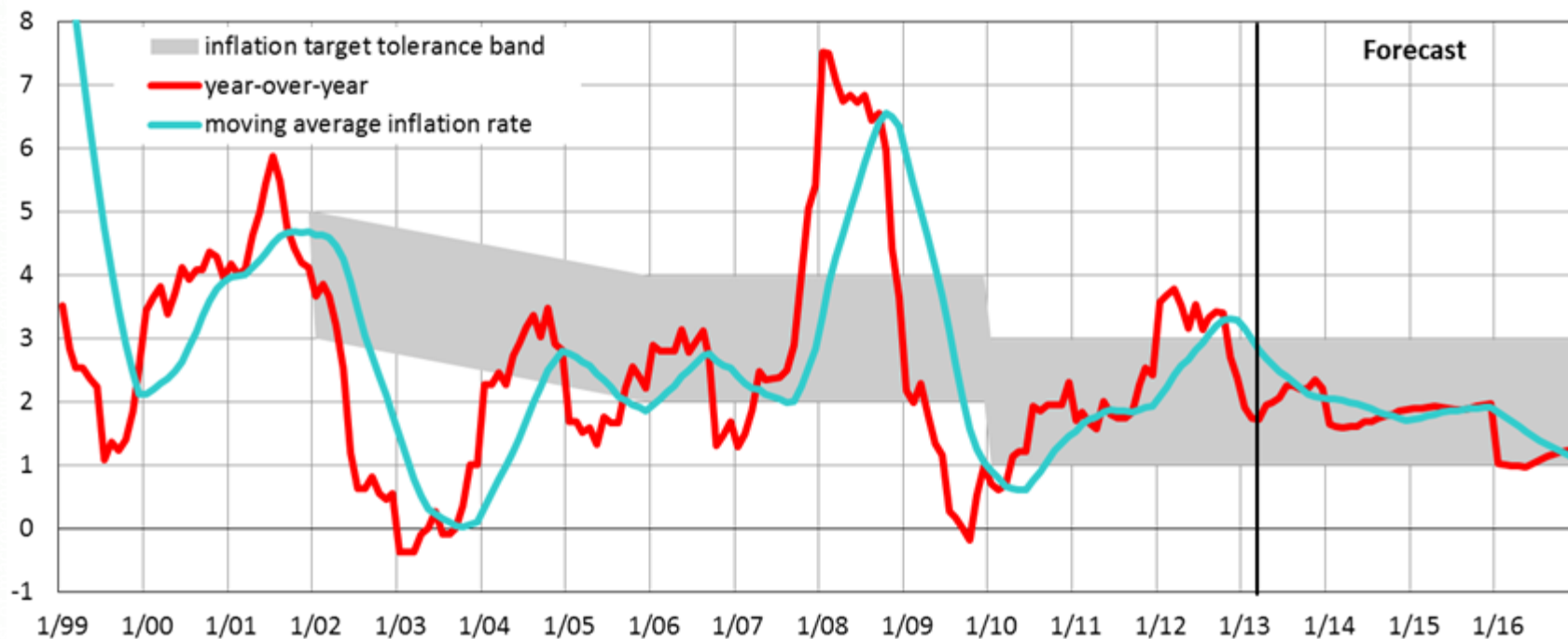
- GDP should stagnate in 2013 and for 2014 we expect rebound in economic growth of 1.2%
- expected drop in household consumption in 2013 reflects the decrease in real disposable household income, low savings rate and households' very low confidence in the economy, for 2014 we expect to see a growth in household consumption in the context of economic recovery
- decline in real government consumption in 2013 and 2014 reflects approved consolidation strategy
- due to the little company's needs to invest into physical capital, we anticipate a slight decrease of gross capital formation in 2013 and gradual recovery of the growth dynamic in the following years
- the main driver of economic growth in 2013 should be the foreign trade, in 2014 both the foreign trade and the household consumption

## Macroeconomic Forecast

# Inflation

## Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations



# Inflation

- **we estimate 2013 average inflation rate at 2.1%**
- **for 2014 we expect an average inflation rate of 1.7%**
- **for 2016 we expect a slowdown in consumer prices growth to 1.1%, according to the current legislative status the VAT rates should be harmonized at 17.5% as of 1 January 2016**

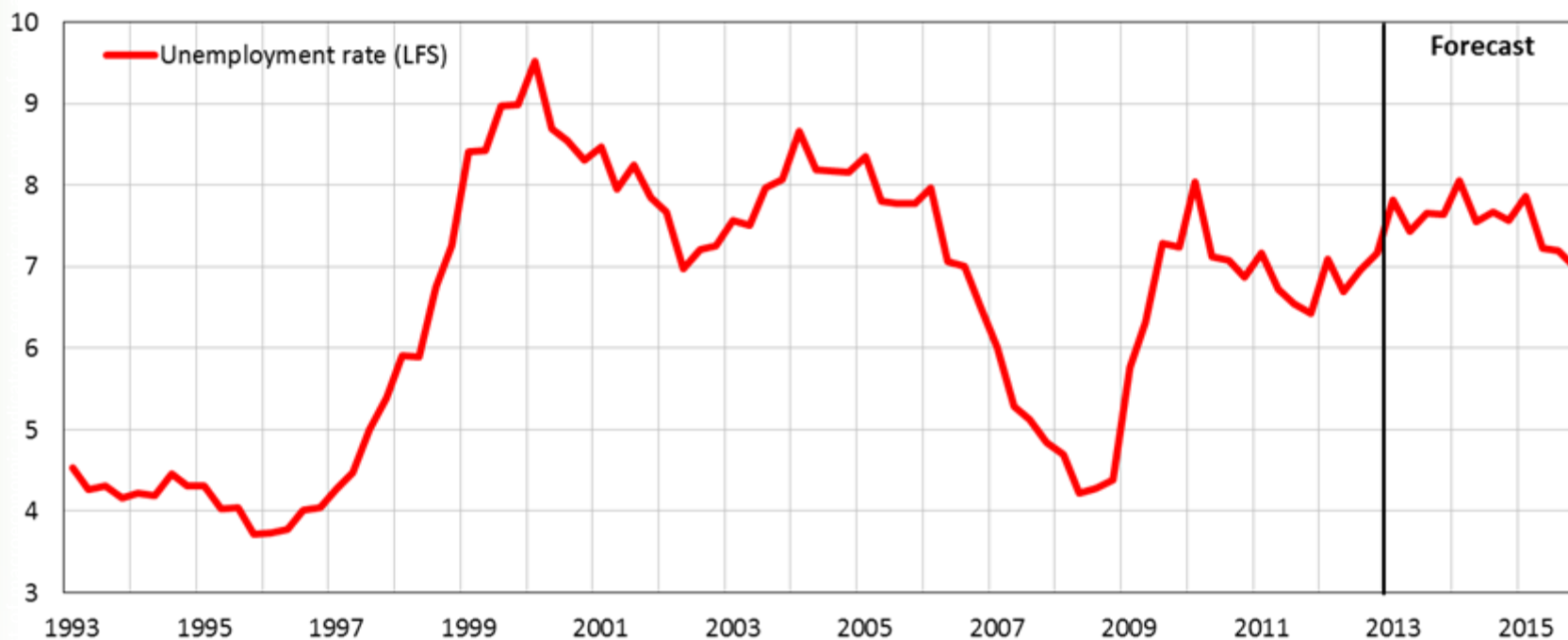


## Macroeconomic Forecast

# Labour Market

## Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

## Labour Market

- the lengthy recession already has a rather pronounced influence on the labour market, in 4Q 2012, the unemployment rate according to LFS increased to 7.2% and employment decreased by 0.1% QoQ
- the trend of an increased proportion of self-employed persons in employment at the expense of employees is also evident, something which is most likely leading to the extension of “false-self employment”
- the employment should decreased by 0.2% in 2013 (viable firms struggle to retain quality employees and workers prefer to maintain at least minimum incomes, which is reflected by the decrease in the number of hours worked per employed person), for 2014 we expect stagnation
- in the context of expected economic situation, the unemployment rate according to LFS should growth to 7.6% in 2013 and 7.7% in 2014

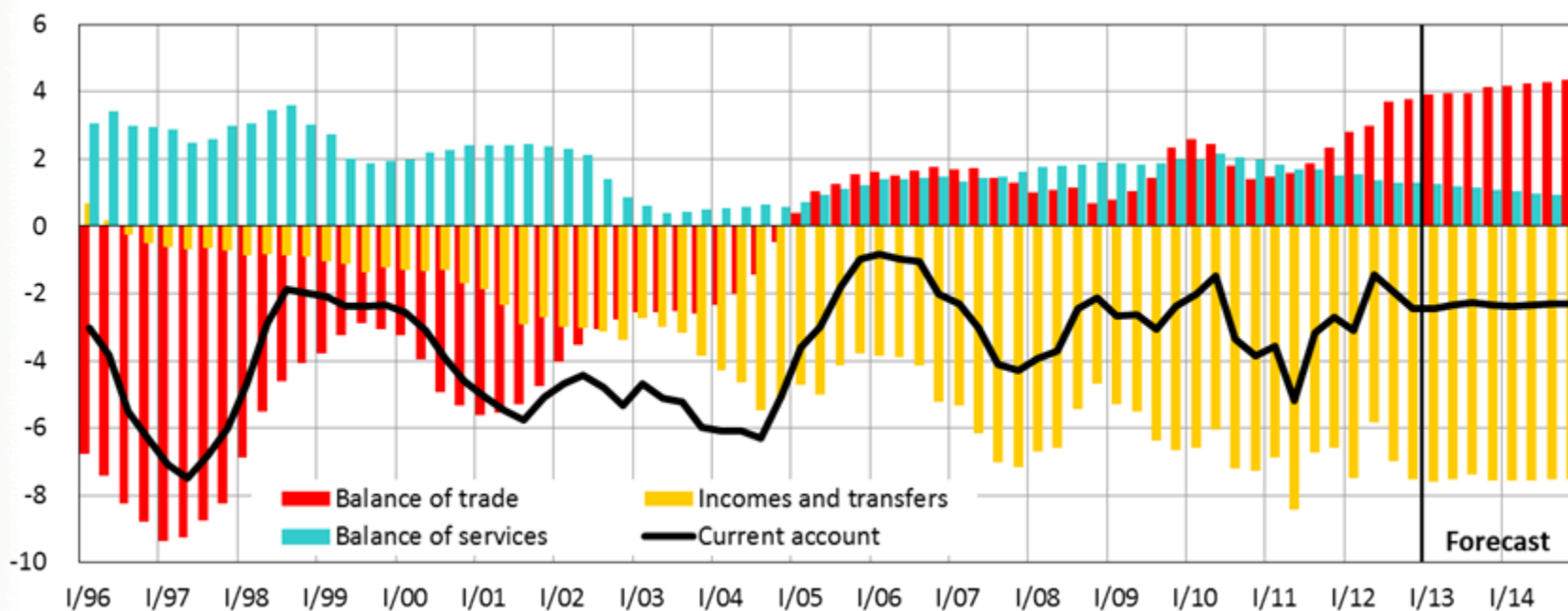
# Labour Market

- in Q4 2012, the wage bill and average wage were heavily influenced by the effort of high-income persons to avoid the newly introduced the so called solidarity tax
- given the above, we expect overall wage bill to increase only by 1.4% in 2013 and by 2.7% in the following year
- for 2013 we anticipate the average wage increase of 1.8%, which should signify a real decline in the real average wage by 0.2%
- in 2014, due to estimated average inflation and expected growth of the average wage of 2.8%, the real wage should increase by around 1.1%

# 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

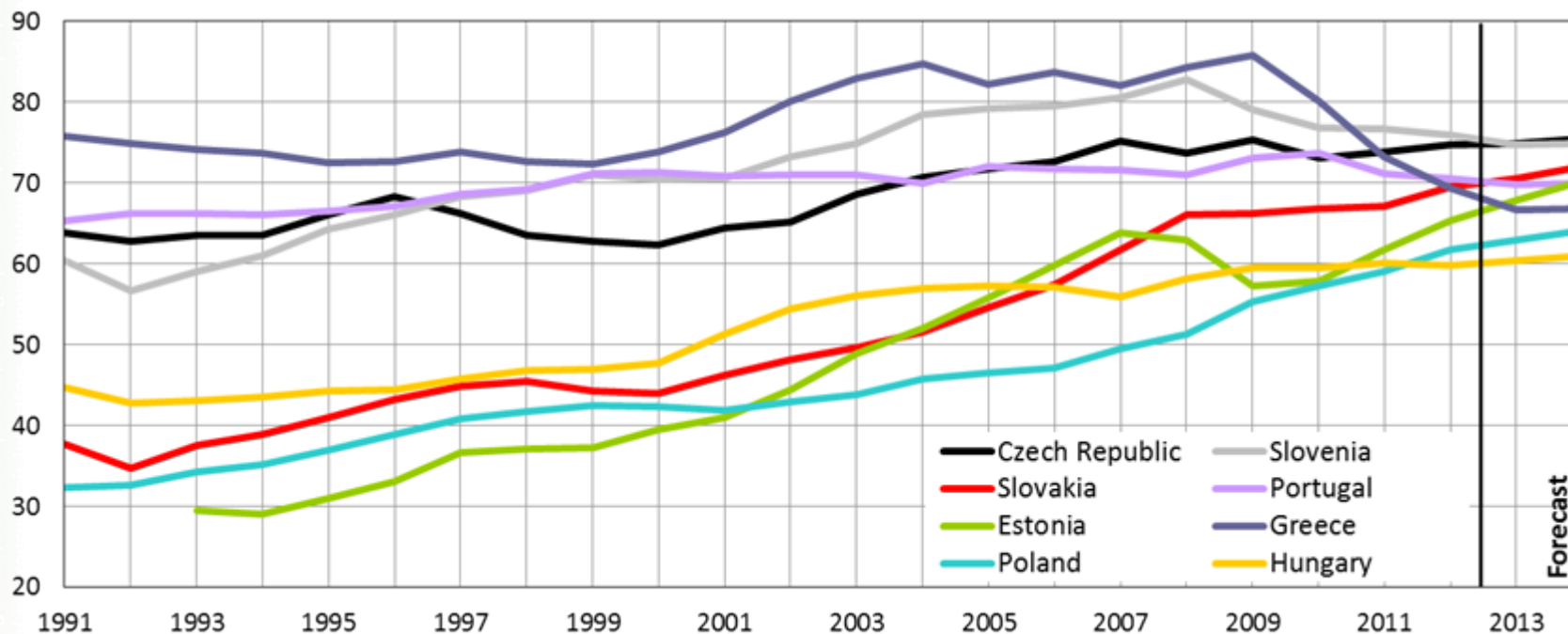
- **worsening of the external environment together with a decline in domestic demand is reflected in a slowdown in the foreign trade growth**
- **exports should slightly exceed imports and the ratio of the trade balance to GDP should increase to 4.1% in 2013 and to 4.3% in 2014**
- **due to the unfavourable outlook for the global economy, we expect decline in the service balance, it should gradually decrease to 1.1% of GDP in 2013 and 0.9.% of GDP in 2014**
- **deficit in the balance of income has been showing a tendency to increase, it should raise to 7.7% of GDP in 2013, resp. 7.8% of GDP in 2014**
- **we expect the current account deficit of around 2.3% GDP in 2013 and 2014, 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>
Czech Republic	<i>PPS</i>	17 800	18 900	20 700	20 200	19 400	19 500	20 200	20 500	20 800	21 400
	<i>EA12=100</i>	72	73	75	74	75	73	74	75	75	76
Slovenia	<i>PPS</i>	19 700	20 700	22 100	22 700	20 300	20 500	21 000	20 900	20 700	21 200
	<i>EA12=100</i>	79	79	80	83	79	77	77	76	75	75
Slovakia	<i>PPS</i>	13 500	15 000	16 900	18 100	17 100	17 900	18 400	19 100	19 600	20 400
	<i>EA12=100</i>	55	57	62	66	66	67	67	69	71	72
Portugal	<i>PPS</i>	17 900	18 700	19 600	19 500	18 800	19 700	19 500	19 400	19 300	19 800
	<i>EA12=100</i>	72	72	72	71	73	74	71	71	70	70
Lithuania	<i>PPS</i>	12 300	13 700	15 500	16 200	13 600	14 900	16 600	17 900	19 000	20 100
	<i>EA12=100</i>	50	52	57	59	53	56	60	65	68	71
Estonia	<i>PPS</i>	13 800	15 600	17 500	17 200	14 700	15 500	16 900	18 000	18 800	19 900
	<i>EA12=100</i>	56	60	64	63	57	58	62	65	68	70
Greece	<i>PPS</i>	20 400	21 800	22 500	23 100	22 100	21 400	20 100	19 100	18 500	18 900
	<i>EA12=100</i>	82	84	82	84	86	80	73	69	67	67
Poland	<i>PPS</i>	11 500	12 300	13 600	14 100	14 200	15 300	16 200	17 000	17 500	18 100
	<i>EA12=100</i>	46	47	50	51	55	57	59	62	63	64
Latvia	<i>PPS</i>	11 100	12 500	14 300	14 600	12 700	13 200	14 700	16 100	17 100	18 200
	<i>EA12=100</i>	45	48	52	53	49	49	54	59	62	65
Hungary	<i>PPS</i>	14 200	14 900	15 400	16 000	15 300	15 900	16 500	16 500	16 700	17 200
	<i>EA12=100</i>	57	57	56	58	60	59	60	60	60	61

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

April 2013

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