



Ministry of Finance CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast **Czech Republic**

October 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 (the scenario anticipates no escalation of the euro zone's debt crisis during the forecast horizon, on the other hand, neither does it expect any fundamental positive breakthrough in resolving these problems)
- in comparison with the previous forecast, the short-term risks have diminished, from a medium-term perspective, however, the situation is much more serious

Risks of the forecast

- we consider a political instability, difficulty of predicting the business environment and very low level of confidence among consumers but also in certain segments of the business sector as a significant internal risk in the Czech economy
- the forecast is based on the assumption of 1 p.p. increase in both VAT rates and implementation of pension reform
- scenario is burdened by a significant downward risks

External Environment

The global economic outlook is uncertain

- the euro zone economy showed a QoQ decline, however, performance of the individual countries have been considerably differentiated
- growth of the US economy is slowing down, the so-called „fiscal-cliff“ represents a great uncertainty and the possibility of a sharp drop in the economic growth in 2013
- economic growth in China and other large developing economies is slowing down

The situation in the euro zone has temporarily calmed down

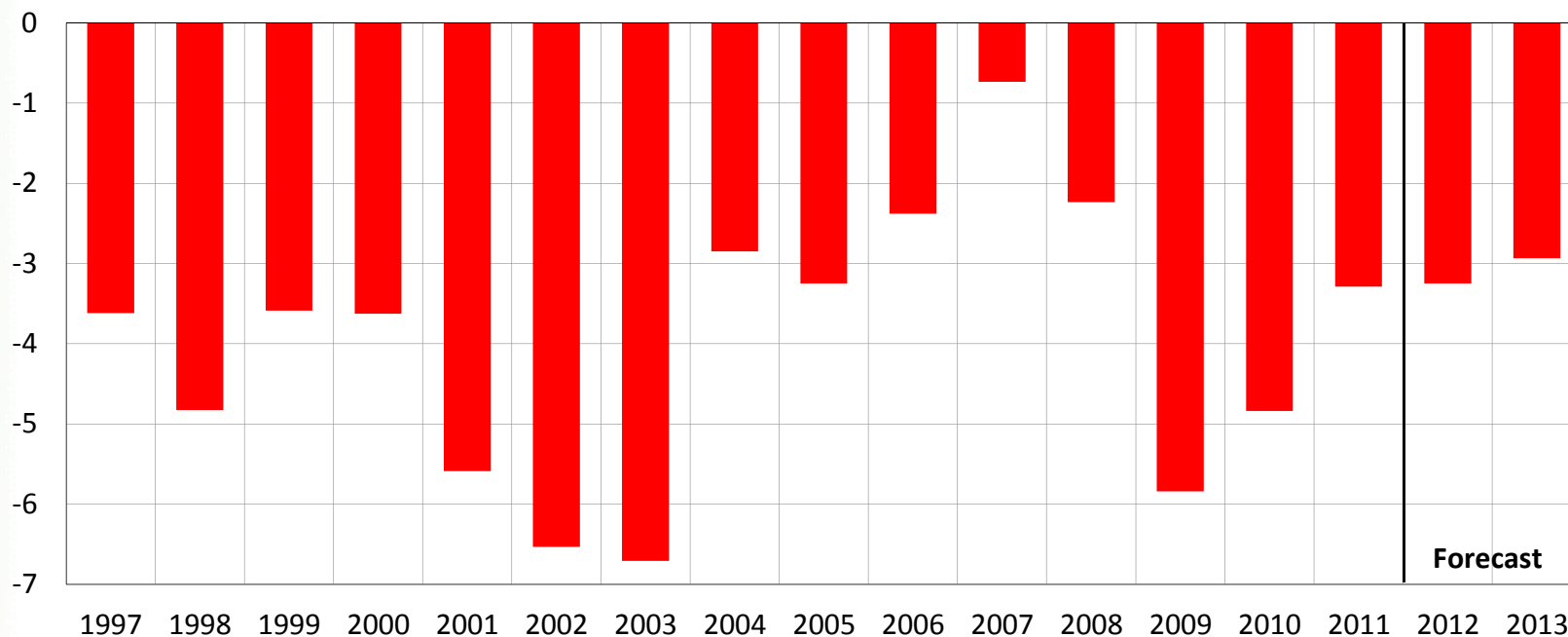
- on 6 September 2012, the ECB approved a new programme for purchasing government bonds on the secondary markets
- on 8 October 2012, the long-term bailout fund, the ESM, was launched
- the EC presented its plan for the creation of a banking union

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



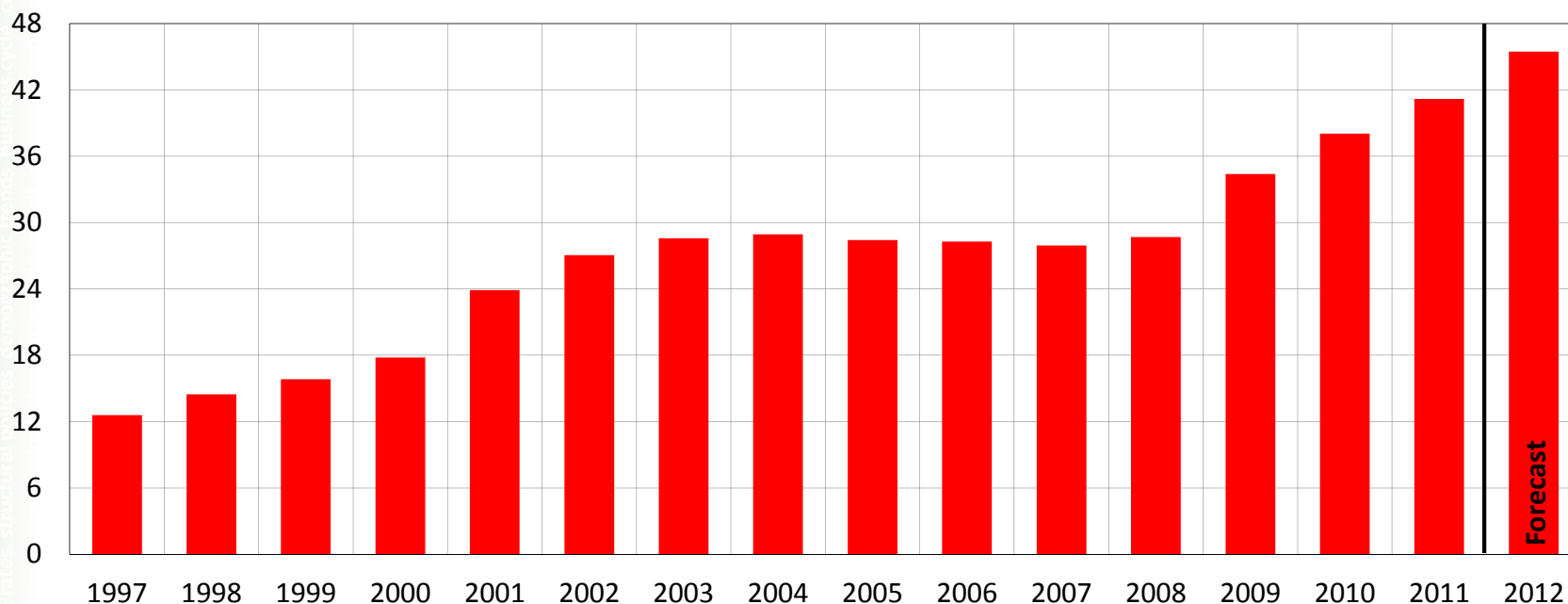
Source: Ministry of Finance.

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 0.8 p.p.
- we expect government debt at the end of 2012 at 45.5% 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 -2,9% of GDP

Monetary Policy, Interest Rates and Exchange Rates

- effective from 1 October 2012, the Czech National Bank lowered the interest rate for 2W repo operations to 0.25%
- the 3M PRIBOR averaged 1.0% in Q3 2012 and we anticipate it will reach an average value of 1.0% in 2012 and 0.5% in the following year
- long-term interest rates are low, yields to maturity of 10Y government bonds should reach 2.9% in 2012 and 2.7% in 2013
- for 2012, we expect an average exchange rate of 25.1 CZK/EUR and 19.5 CZK/USD
- the nominal and real exchange rates should be below the previous long-term trend for the entire forecast horizon
- in October 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 re-approved on 6 September 2012)**
- **Amendment to the Commercial Code (the Government approved on 25 July 2012)**
- **Amendment to the Consumer Credit Act (the Government approved on 22 August 2012)**
- **Act on the Conditions for Trading in Greenhouse Gas Emission Allowances (the Chamber of Deputies approved on 26 September 2012)**
- **Amendment to the Act on Supplementary Pension Savings (the Chamber of Deputies approved on 26 September 2012)**

Macroeconomic Forecast

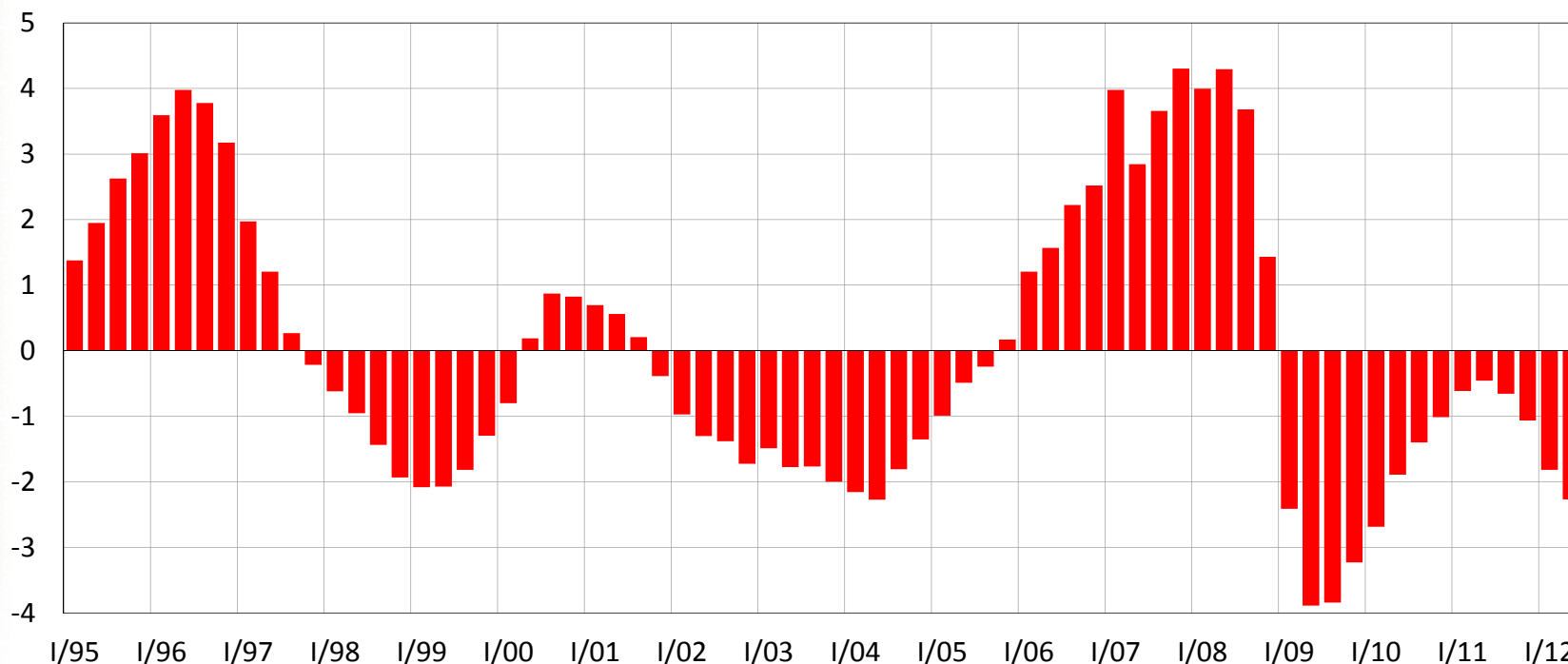
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



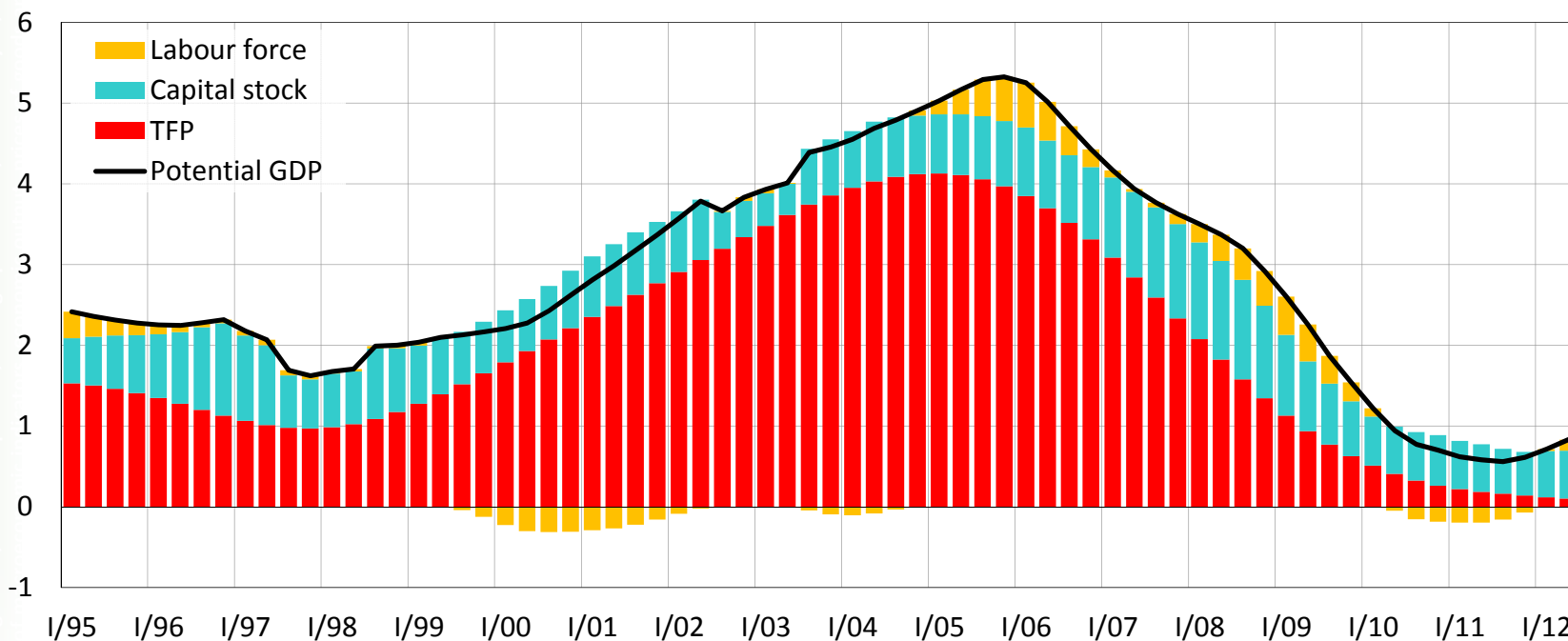
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- since the recession at the turn of 2008 and 2009, the Czech economy has constantly shown a negative output gap, which gradually deepens from 3Q 2011 and reached -2,0% in 1H 2012
- the component most seriously affected is total factor productivity, its contribution to the growth fell to only 0.1 p.p. in 1H 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 1H 2012

Forecast of Macroeconomic Indicators

Macroeconomic Forecast

Main Macroeconomic Indicators

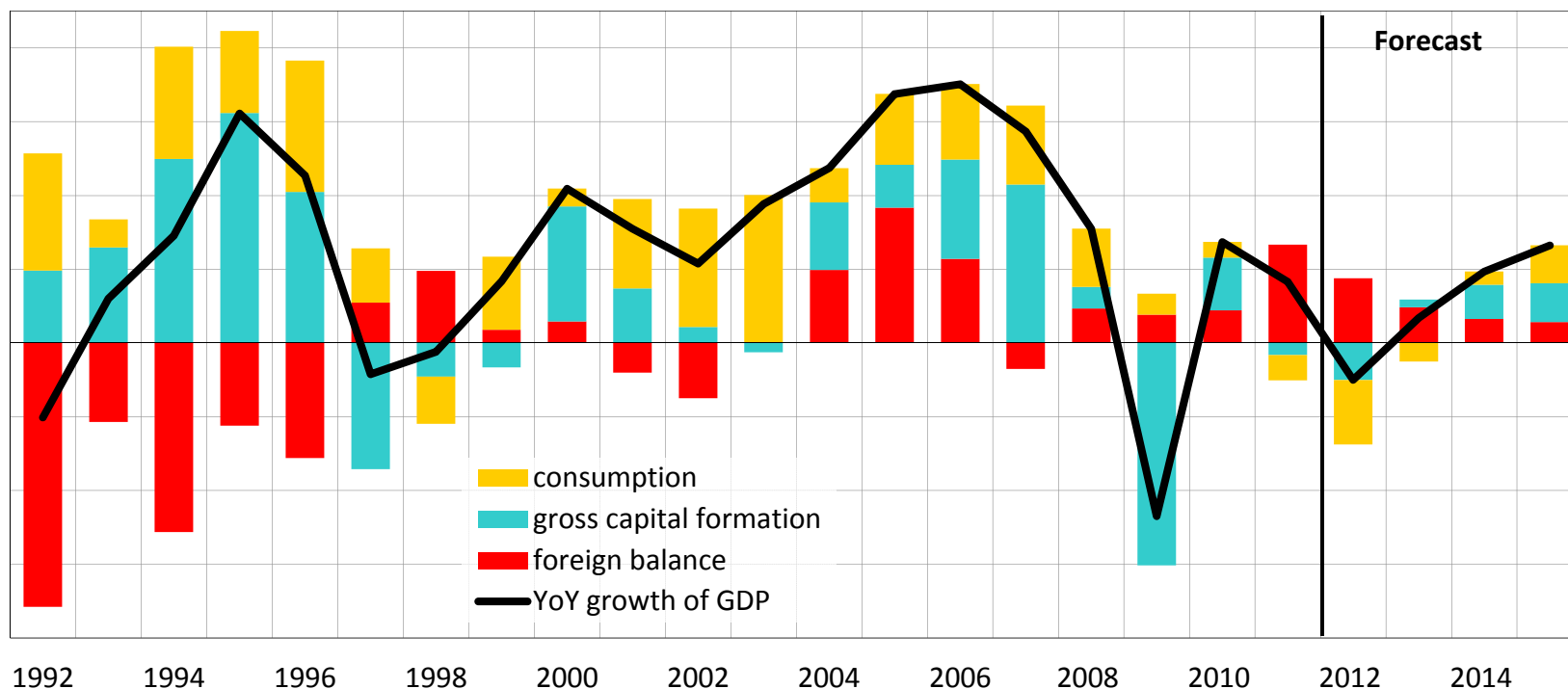
		2009	2010	2011	2012	2013
		<i>Current forecast</i>				
Gross domestic product	<i>growth in %, const.pr.</i>	-4,7	2,7	1,7	-1,0	0,7
Consumption of households	<i>growth in %, const.pr.</i>	-0,4	0,6	-0,6	-3,0	-0,5
Consumption of government	<i>growth in %, const.pr.</i>	3,8	0,6	-1,7	-1,1	-1,3
Gross fixed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

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

- the Czech economy has been in a shallow recession, in 2Q 2012 economic output declined QoQ for the fourth time in a row
- on a seasonally adjusted basis, the GDP fell by 0.2% QoQ in 2Q 2012 mainly due to the drop in household consumption

Economic Performance

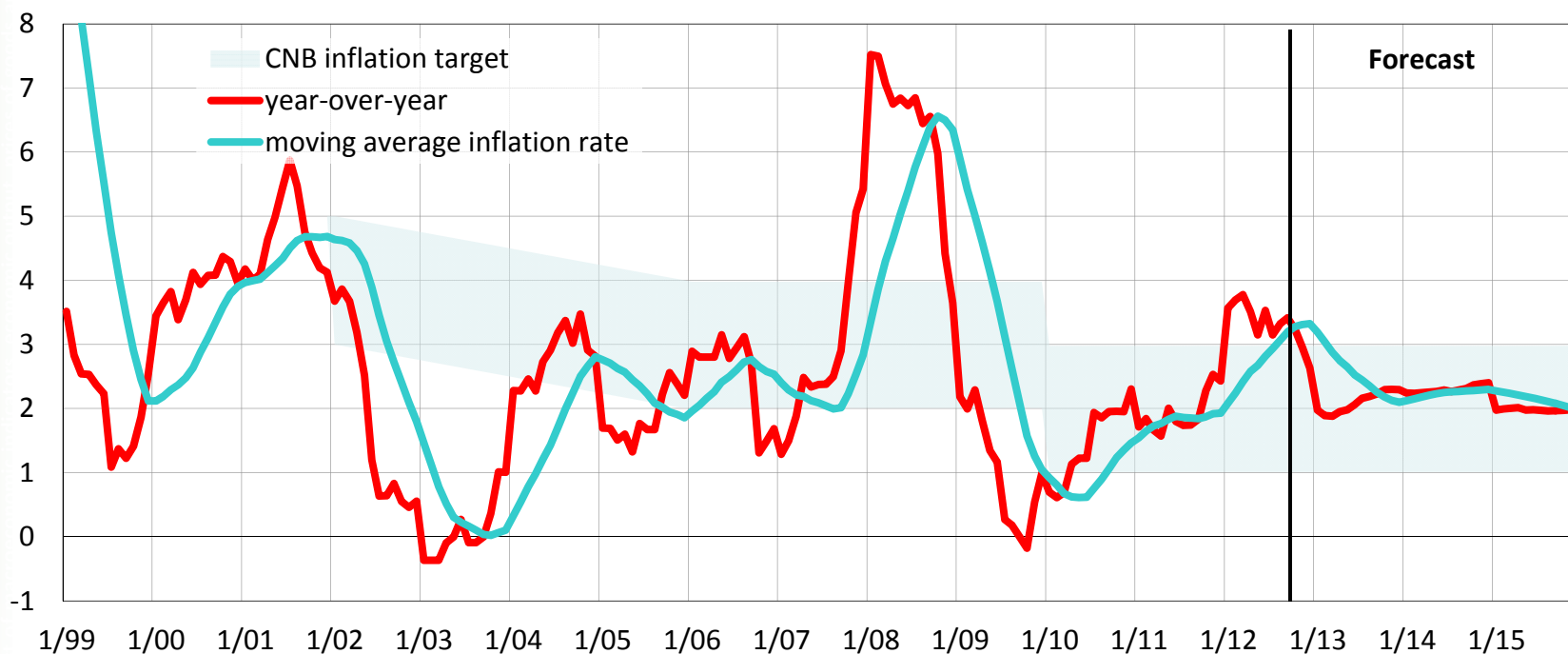
- GDP should fall by 1.0% in 2012, in the following year economic growth should recover to 0.7%
- drop in household consumption in 2012 reflects both the decrease in real disposable household income and households' very low confidence in the economy, in the following year the household consumption should decline only slightly
- decline in real government consumption in 2012 and 2013 reflects approved consolidation strategy
- due to the little company's needs to invest into physical capital, we expect a slight decrease of gross capital formation 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

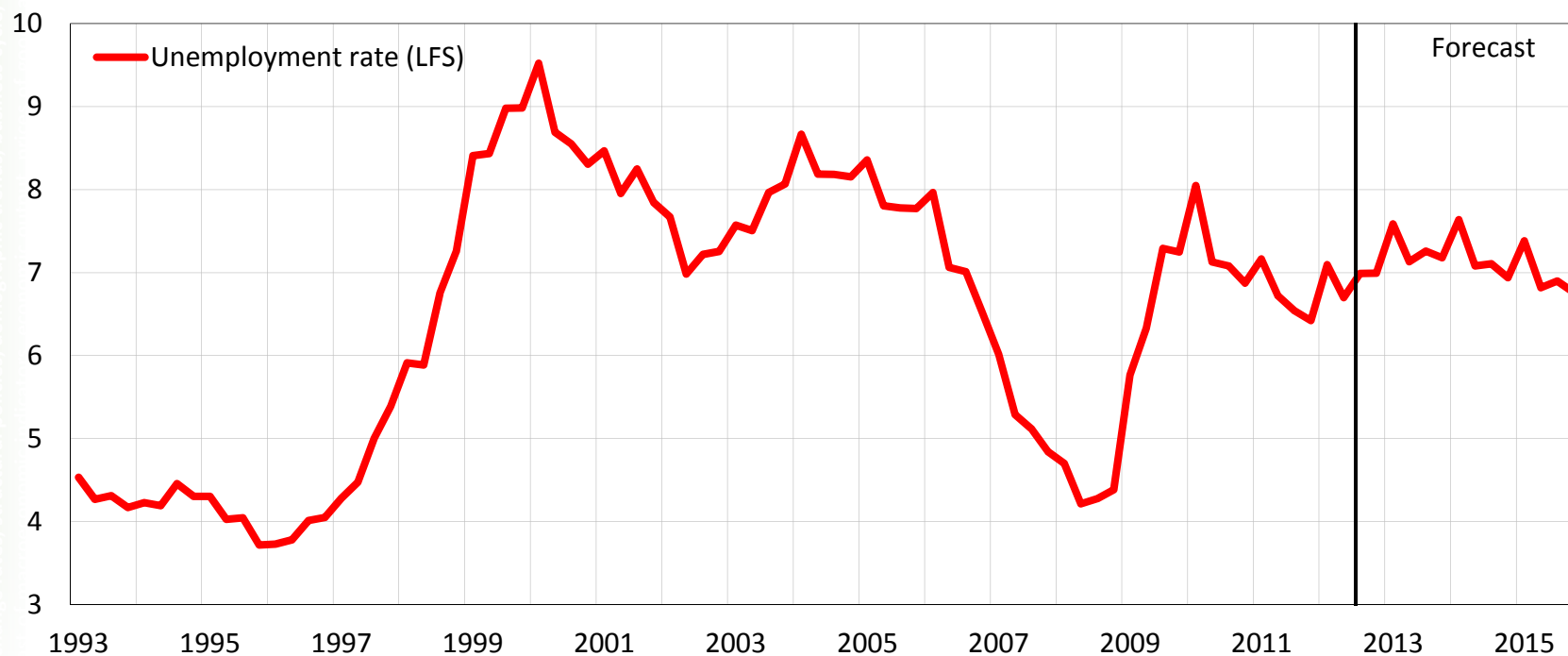
- we estimate 2012 average inflation rate at 3.3%, administrative measures will make up around three-quarters of the inflation rate (an increase of reduced VAT rate from 10% to 14% will contribute by 1.1 p.p.)
- for 2013 we expect an average inflation rate of 2.1% (raising both VAT rates by 1 p.p. will 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

- **impacts of the current shallow recession have begun already affect the labour market, however, we do not expect significant deterioration**
- **the employment should stagnate in 2012 and fall by 0.2% in 2013**
- **the unemployment rate according to LFS reached 6.7% in 2Q 2012, in the context of expected development of employment and economic situation, we expect its growth to 6.9% in 2012 and 7.3% in 2013**

Labour Market

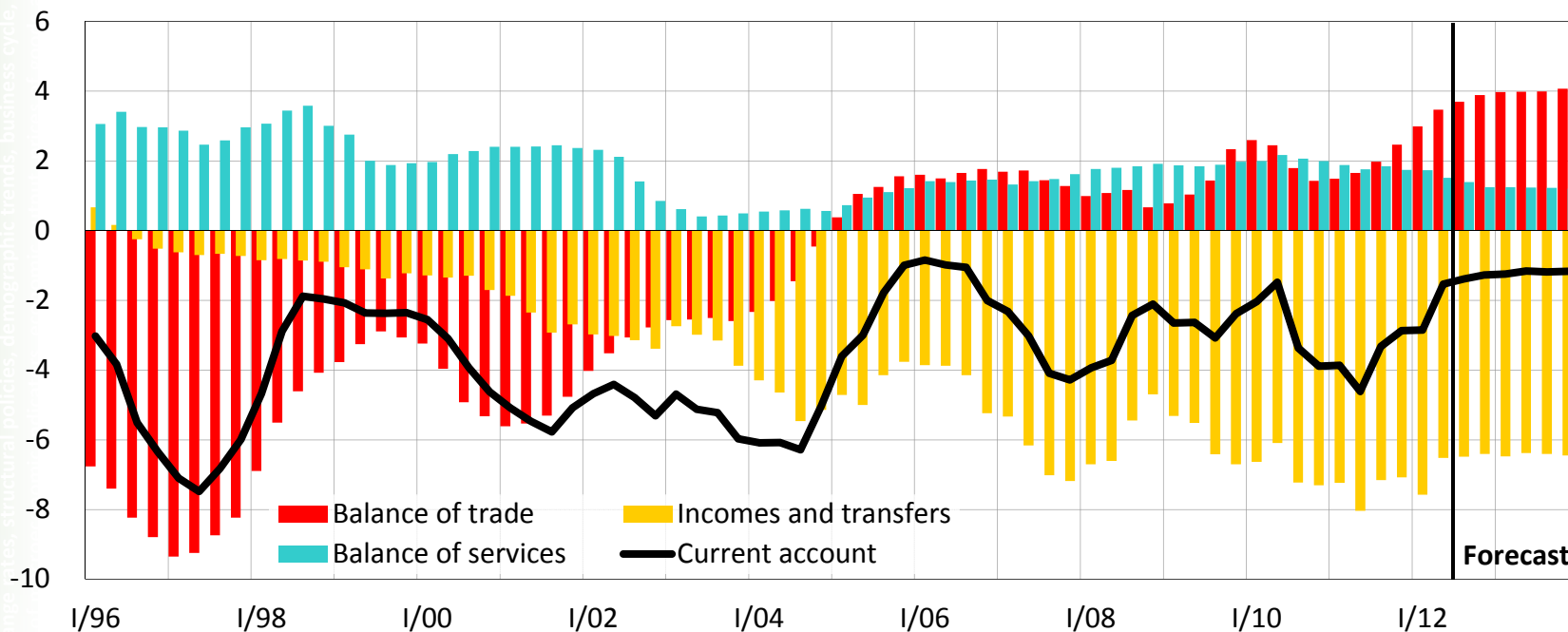
- **growth in the wage bill and average wage in 2Q 2012 was surprising in the context of the economy's performance, however, we do not anticipate continuation of this high growth**
- **we expect overall wage bill to increase by 2.0% in 2012 and by 2.1% in the following year, because of lower economic performance**
- **in 2012, we anticipate the average wage increase of 2.4%, which should signify a real decline in the real average wage by 0.9%**
- **due to the lower inflation, expected growth of the average wage of 2.5% in 2013 should mean the increase in the real average wage by 0.4%**

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

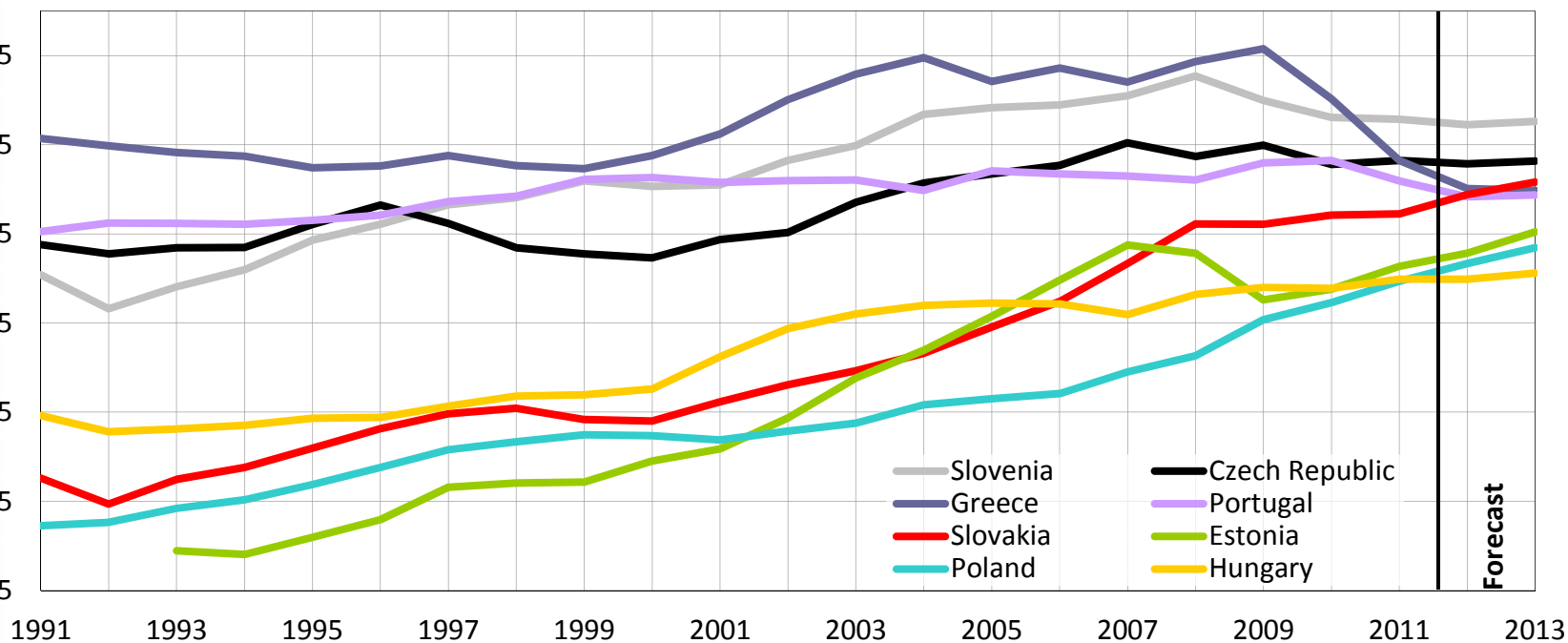
- we expect a significant reduction in the current account deficit in 2012 and 2013, the ratio of the current account to GDP should reach -1.3% in 2012 and -1.2% in 2013
- dynamics of the world and also Czech trade growth is slowing, however decline in foreign demand will be compensated by reducing domestic demand and thus we expect exports exceed imports and balance of trade at 3.9% 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 4.1%
- due to the unfavourable outlook for the global economy we expect decline in the service balance, it should reach about 1.2% of GDP in 2012 and 2013
- deficit in the balance of income has been showing an improving tendency since mid-2011, it should reach about 6.4% of GDP in 2012 and 6.5% of GDP in 2013

Macroeconomic Forecast

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	20 600	20 800	21 300	21 300	21 800
	<i>EA12=100</i>	78	79	79	80	83	80	78	78	77	78
Czech Republic	<i>PPS</i>	16 900	17 800	18 900	20 700	20 200	19 300	19 400	20 100	20 100	20 500
	<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	21 400	20 100	19 400	19 600
	<i>EA12=100</i>	85	82	84	82	84	86	80	73	70	70
Slovakia	<i>PPS</i>	12 300	13 500	15 000	16 900	18 100	17 000	17 900	18 400	19 200	19 900
	<i>EA12=100</i>	52	55	57	62	66	66	67	67	69	71
Portugal	<i>PPS</i>	16 700	17 900	18 700	19 600	19 500	18 800	19 500	19 400	19 100	19 500
	<i>EA12=100</i>	70	72	72	72	71	73	73	71	69	69
Estonia	<i>PPS</i>	12 400	13 800	15 600	17 500	17 200	14 800	15 700	16 800	17 400	18 300
	<i>EA12=100</i>	52	56	60	64	63	58	59	61	63	65
Poland	<i>PPS</i>	11 000	11 500	12 300	13 600	14 100	14 300	15 300	16 400	17 000	17 800
	<i>EA12=100</i>	46	46	47	50	51	55	57	60	62	63
Hungary	<i>PPS</i>	13 600	14 200	14 900	15 400	16 000	15 200	15 700	16 400	16 600	17 000
	<i>EA12=100</i>	57	57	57	56	58	59	59	60	60	61

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

October 2012

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

<http://www.mfcr.cz>

