



Ministry of Finance

CZECH REPUBLIC

Department for Financial Policies

Macroeconomic Forecast of the Czech Republic

April 2011

Macroeconomic Forecast

Structure of the presentation

Forecast Assumptions

- external environment
- fiscal policy
- monetary policy, interest rates and exchange rates

Economic Cycle

Forecast of Macroeconomic Indicators

- economic output
- inflation
- labour market
- external relations

Macroeconomic Forecast

Forecast Assumptions

External Environment

The main world economies continue to recover

- economic growth rate in world economy is uneven, particularly China and India record rapid growth
- real GDP is expected to increase, on YoY basis, by 3.0% in USA and 1.8% in EU27 in 2011 and 3.1 % in USA and 2.1 % EU27 in 2012

Risks to the future development

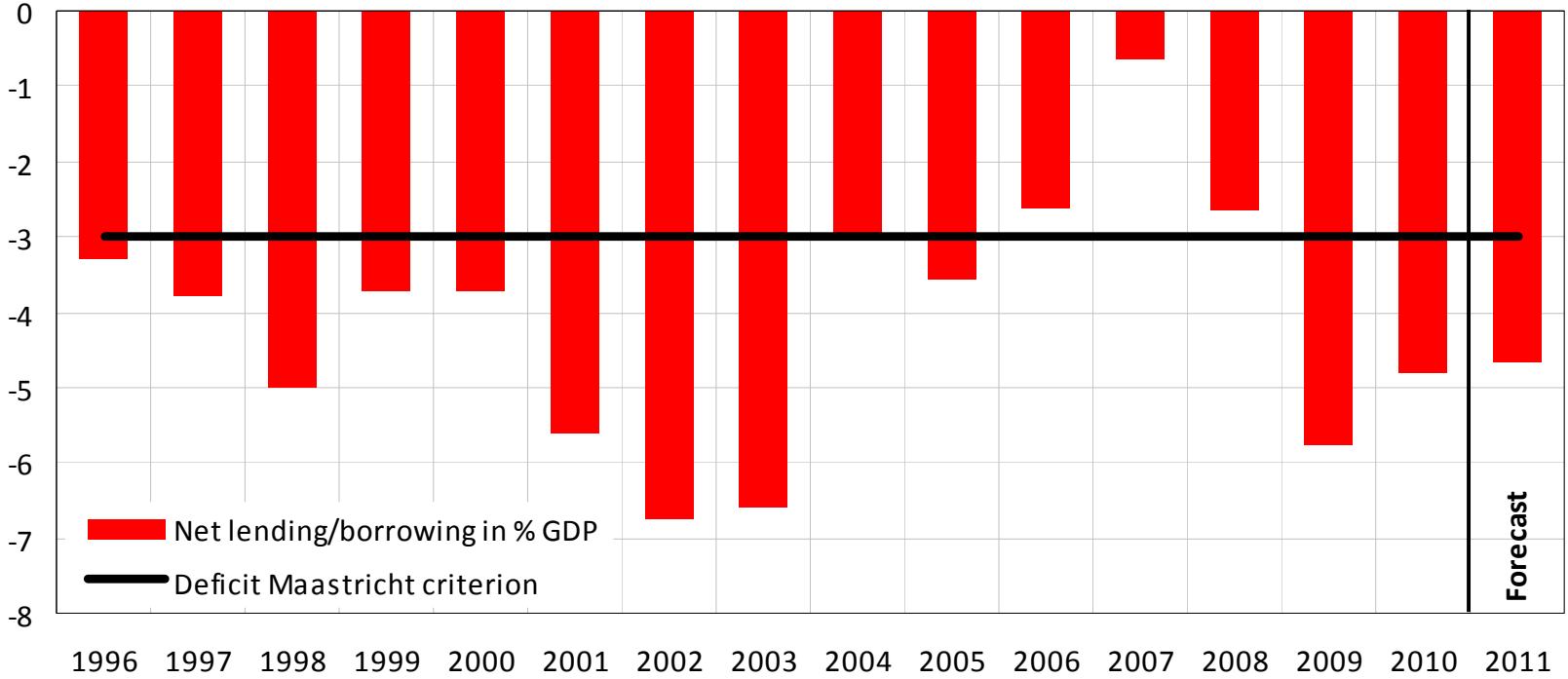
- persistent problems in the financial sector
- high public debts in most EU countries and subsequent impacts of budgetary consolidation
- unequal speeds of development in the euro area
- unrest in the Arab world

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



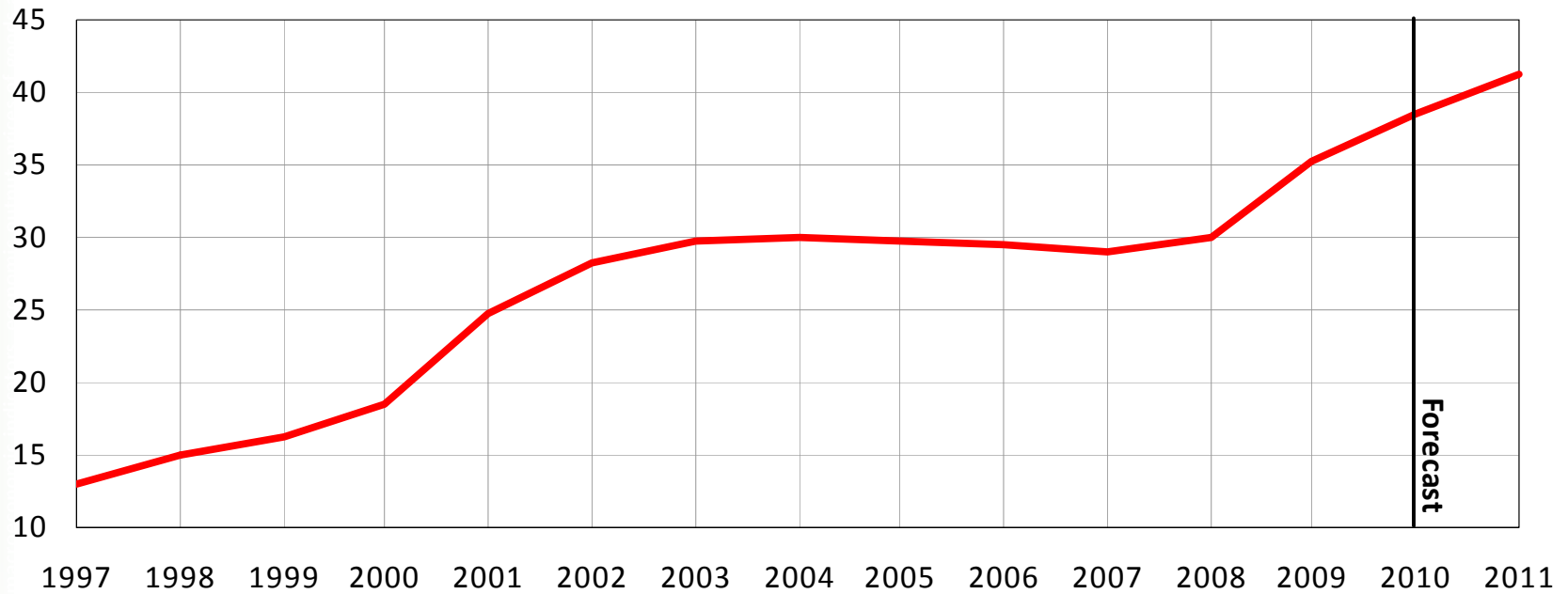
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

- in 2010, according to the preliminary estimates, the general government deficit has reached 4.7% of GDP
- the deficit is expected to be reduced to 4.2% of GDP in 2011 due to faster growth of certain tax revenues and cuts in spending
- government debt at the end of 2011 is estimated at 41.4% of GDP

Fiscal Aims

- fulfilment of Maastricht fiscal criterion in 2013
- balanced public budgets 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 at 0.75% in the first quarter of 2011**
- **the average value for 3M PRIBOR declined in the first quarter of 2011 to 1.2% and a moderate increase is expected in the second half of 2011**
- **the CZK/EUR exchange rate has gradually appreciated since mid 2010 in accordance with the long-term trend, we are expecting an average exchange rate of 24.1 CZK/EUR in 2011**
- **the Czech Republic's rating in March 2011: Moody's - A1, Standard & Poor's - A, Fitch Ratings - A1**



Economic Cycle

Economic Situation in the Czech Republic

Impacts of the Economic Recession

- the recession lasted from the fourth quarter of 2008 to the second quarter of 2009
- the recession was “imported”, the most important transmission channel was foreign trade
- recession hit the industry at first and then spilled over to services and retail trade
- the real GDP fell by about 5% during the recession
- the banking sector was not significantly affected by financial crisis
- the labour market was affected with a delay, the unemployment rate reached its peak in the first quarter of 2010

Economic Situation in the Czech Republic

Economic Recovery

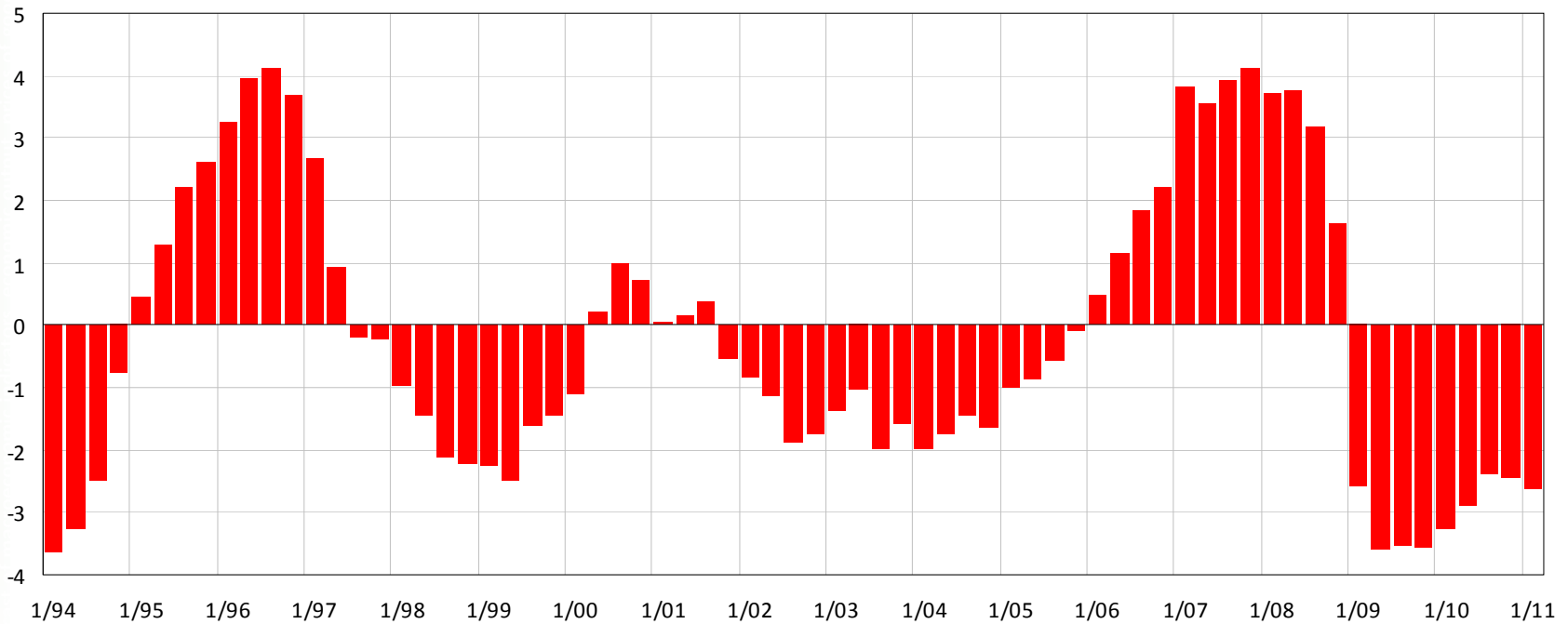
- the Czech economy stepped out of the recession in the third quarter of 2009, however, the recovery is relatively slow
- the recovery was driven by domestic demand in 2010, whereas the main factor contributing to the economic growth in 2011 should be foreign demand
- the economic dynamic is partly constrained by fiscal consolidation measures, which affect mainly the domestic demand
- the situation in the labour market is improving from the second quarter of 2010, but the improvement is very slow

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



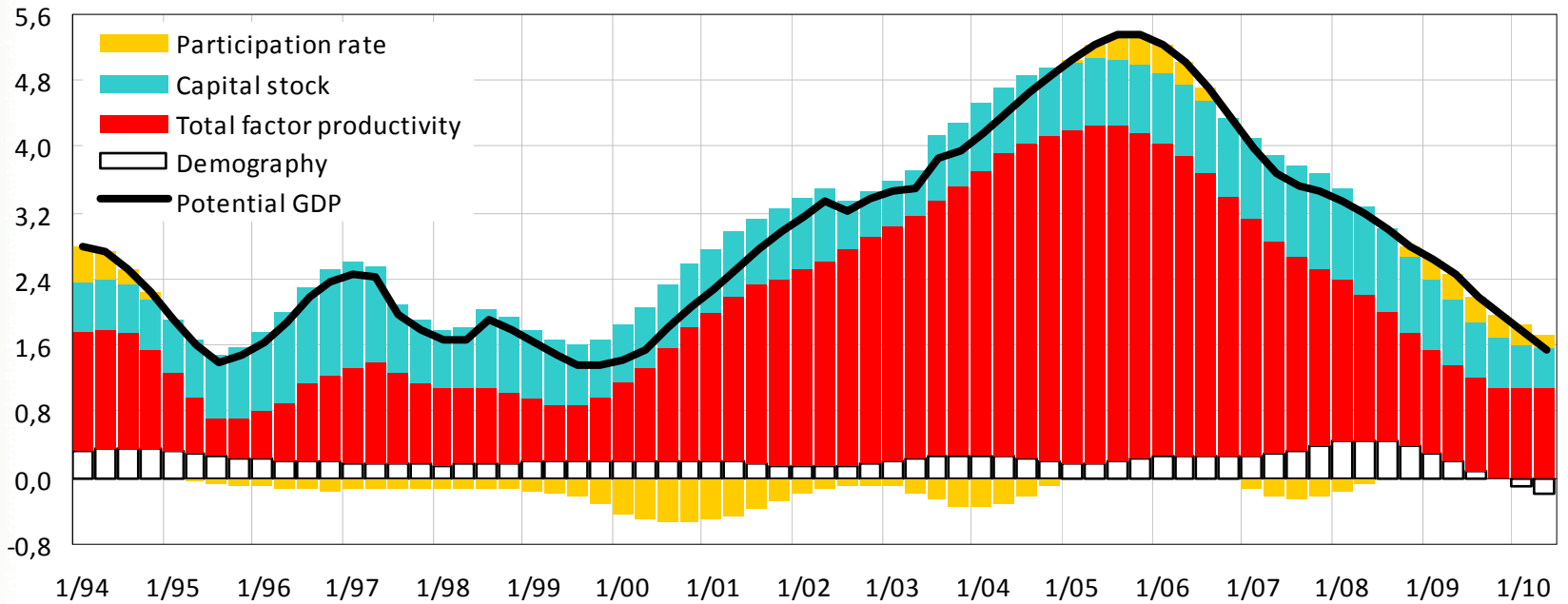
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- economic recession gave rise to a deeply negative output gap
- potential product growth, on YoY basis, fell from 5.2% in 2005 probably to 1.6 % in 2010
- in 2010, the component most seriously affected was total factor productivity, however, total factor productivity's trend growth already showed signs of stabilising
- the labour supply accelerated its growth during the recession and thus compensated the moderate decline in working age population

Forecast of Macroeconomic Indicators



Macroeconomic Forecast

Main Macroeconomic Indicators

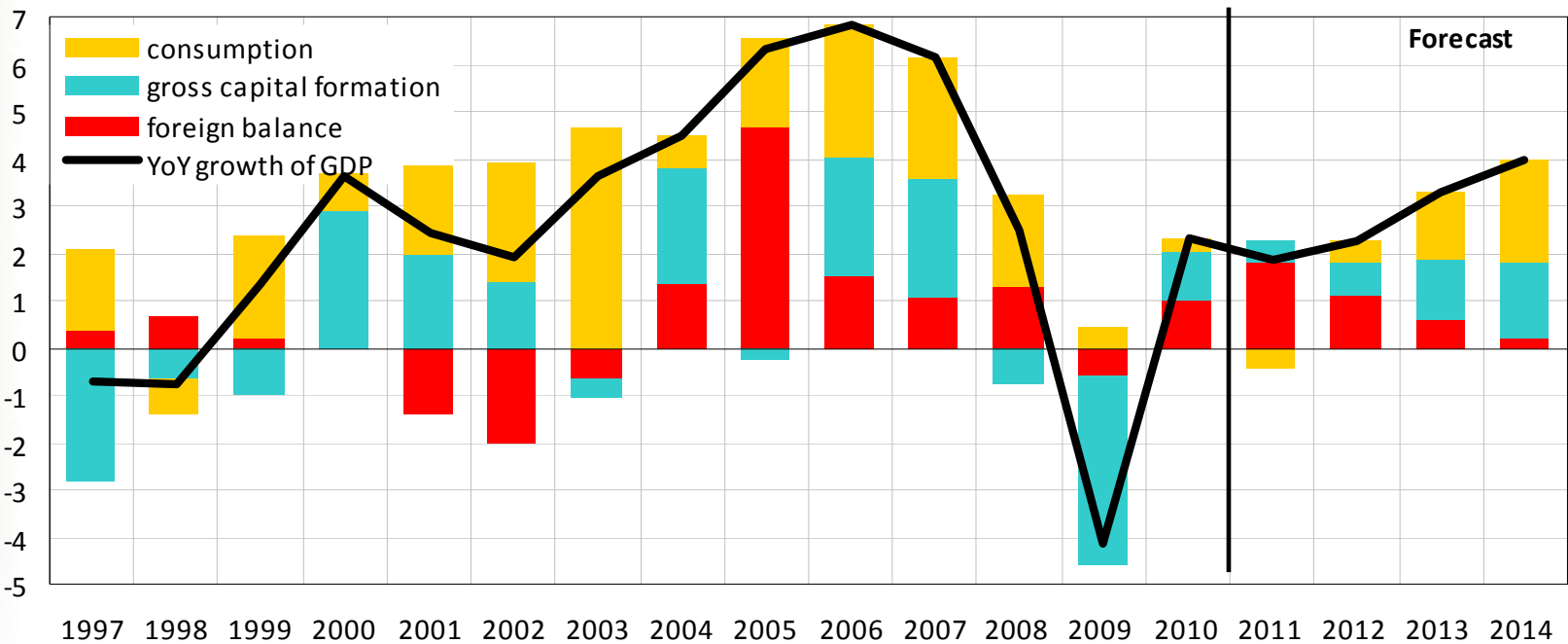
		2008	2009	2010	2011	2012
					<i>Forecast</i>	
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	-4,1	2,3	1,9	2,3
Consumption of households	<i>growth in %, const.pr.</i>	3,6	-0,2	0,5	0,7	1,9
Consumption of government	<i>growth in %, const.pr.</i>	1,1	2,6	0,3	-3,4	-2,5
Gross fixed capital formation	<i>growth in %, const.pr.</i>	-1,5	-7,9	-4,6	0,7	3,2
Cont. of foreign trade to GDP growth	<i>p.p., const.pr.</i>	1,3	-0,6	1,0	1,8	1,1
GDP deflator	<i>growth in per cent</i>	1,8	2,5	-1,1	-0,5	2,7
Average inflation rate	<i>per cent</i>	6,3	1,0	1,5	2,1	3,2
Employment (LFS)	<i>growth in per cent</i>	1,6	-1,4	-1,0	0,2	0,5
Unemployment rate (LFS)	<i>average in per cent</i>	4,4	6,7	7,3	6,9	6,5
Wage bill (domestic concept)	<i>growth in %, curr.pr.</i>	8,7	0,0	0,1	2,1	4,4
Current account / GDP	<i>per cent</i>	-0,6	-3,2	-3,8	-4,0	-3,4

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

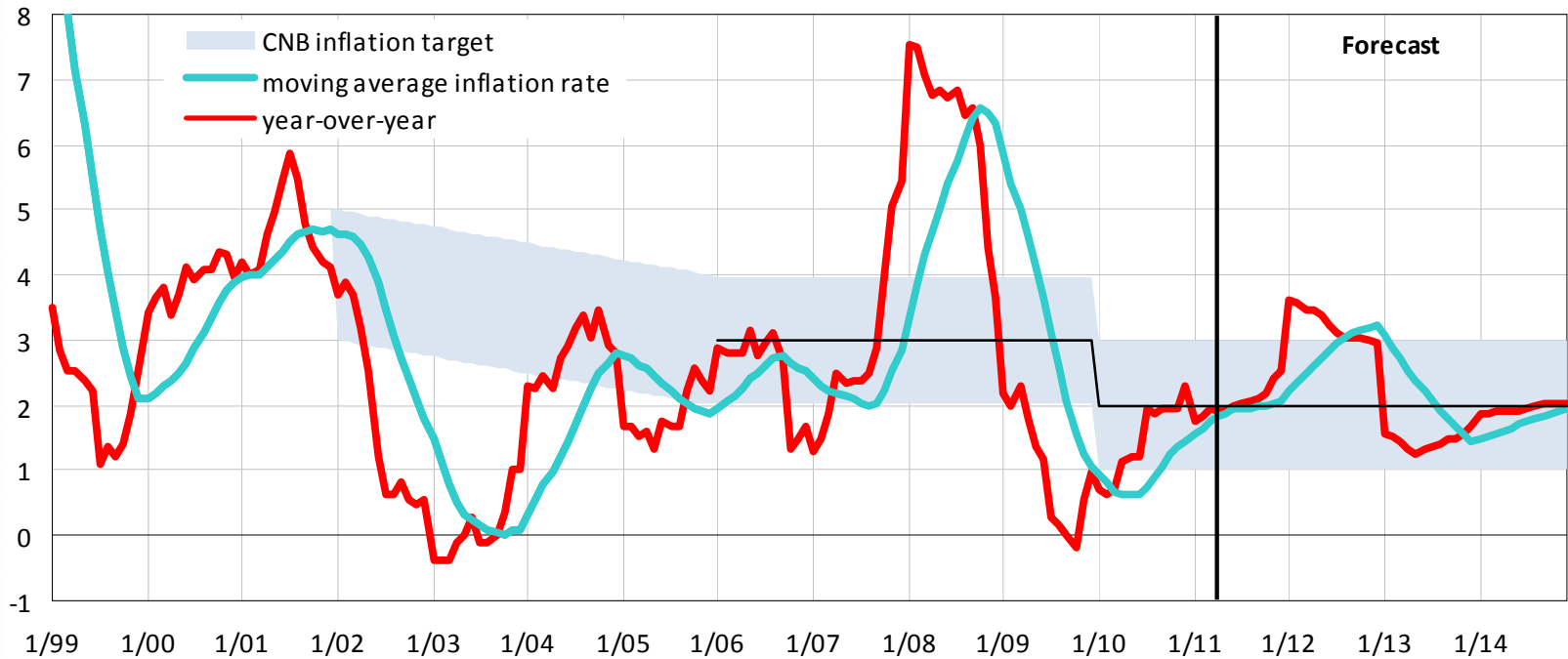
- **real GDP increased by 2.3% over 2010 and it will slow to 1.9% in the next period due to the influence of fiscal measures**
- **in 2011, the economic growth will be driven mainly by foreign trade, we expect the foreign trade's contribution to be 1.8 p.p.**
- **due to the fiscal consolidation domestic demand will increase only by 0.1% in 2011**
- **decline in real government consumption, which began in mid 2010, will last until 2013 (decrease in wages in part of the public sector and the reduction of purchases of goods and services)**
- **investment growth should be restored in 2011 and it should accelerate in the forthcoming years**

Macroeconomic Forecast

Inflation

Consumer Prices

(decomposition of the YoY increase in consumer prices, in percentage points)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

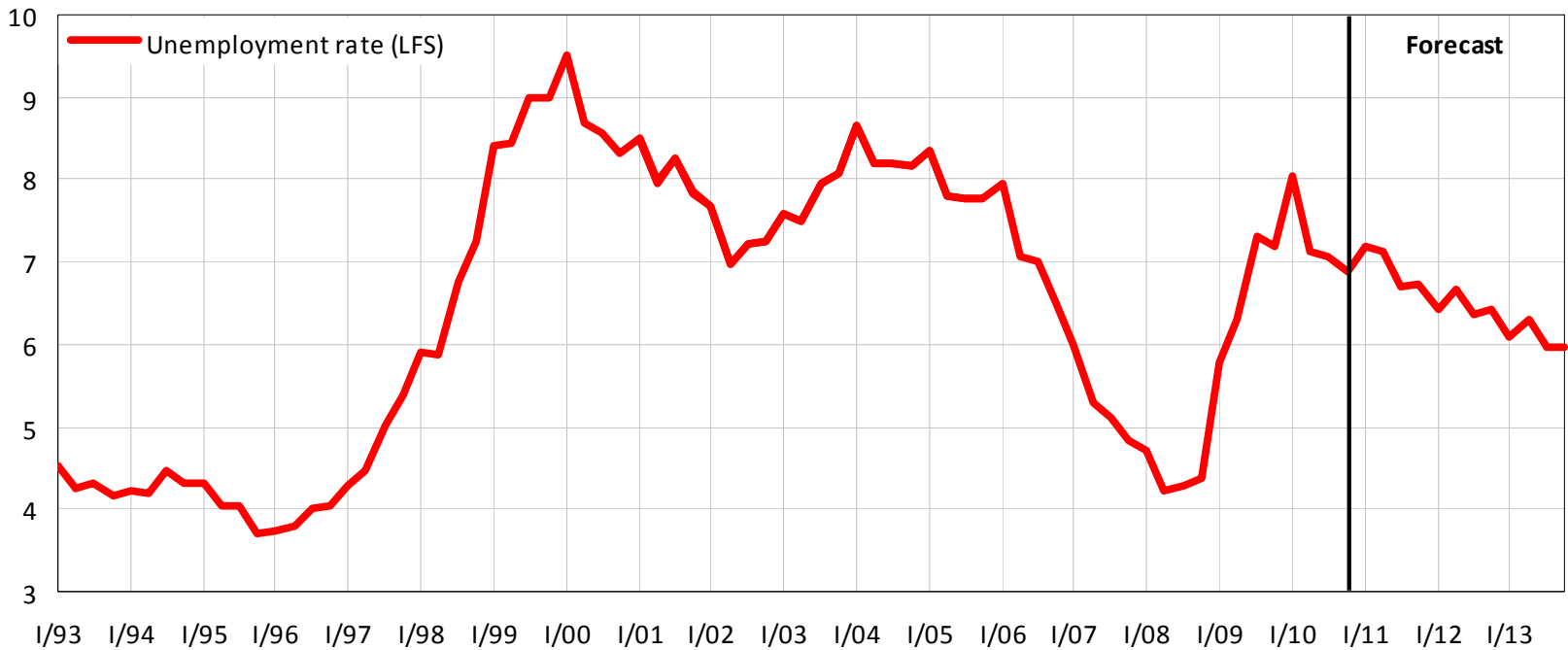
- although there was an increase in indirect taxes in 2010 (VAT and consumer taxes), the average inflation rate was only 1.5% that year
- we expect the average inflation rate in 2011 to reach 2.1% (inflation is evaluated as cost-push inflation, inflation impulses should be mitigated by the persistent cyclical position of the Czech economy in the negative output gap)
- we estimate 2012 average inflation rate at 3.2% (an increase of reduced VAT rate from 10% to 14% will contribute by 1.2 p.p.)

Macroeconomic Forecast

Labour Market

Unemployment Rate

(Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

Labour Market

- labour market reflected economic recovery with some delay
- the employment fell by 1.0% in 2010 and it should finally increase by 0.2% in 2011
- there continued to be intensive YoY increase in the number of self-employed from the first quarter of 2009
- for 2011 and 2012 we are expecting acceleration of employment growth, but it will remain far below 1%
- the unemployment rate according to LFS reached its peak in 2010, when it grew from 4.2% in the second quarter of 2008 to 8.0% in the first quarter of 2010
- we are expecting a fall of unemployment rate to 6.9% in 2011 and slight decrease afterwards

Labour Market

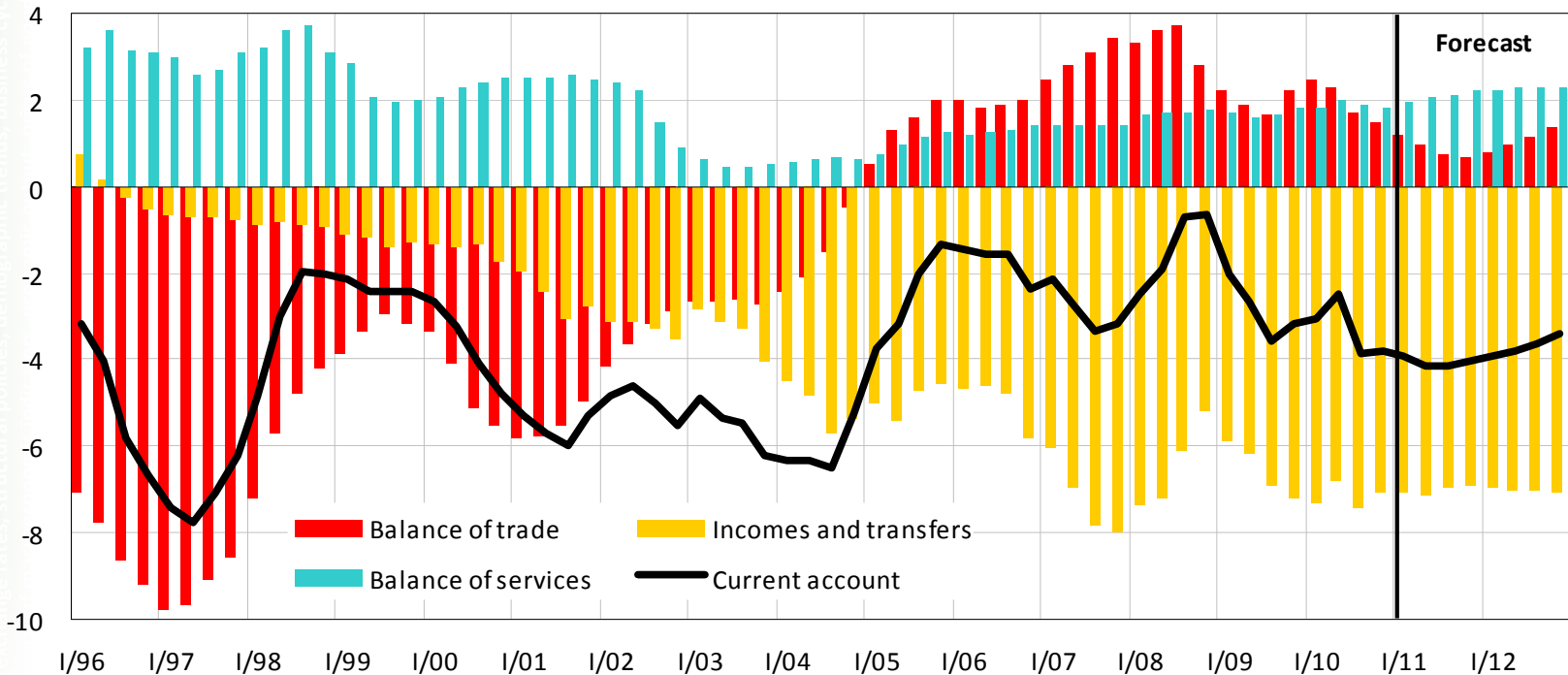
- we are expecting the wage bill to increase by only 2.1% in 2011, the growth will be driven by the business sector due to cost-saving measures in government sector (decrease in employment and wages in part of the public sector)
- growth of wage bill will accelerate in forthcoming years in accordance with nominal GDP growth
- in 2010, YoY growth of average wage was the lowest in the last ten years, it reached only 2.0%
- we are expecting slower growth by 2.6% for 2011 and then growth by 4.1% in 2012, this growth continuing to be pulled by the business sector

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

- in March 2011, the methodology used to report data on foreign trade in goods and services changed, in the first phase, data from 2009 and 2010 were revised
- ratio of the current account to GDP attained -3.8% in 2010 and we are expecting slight worsening to -4.0% in 2011 as a consequence of deterioration in mineral fuels balance
- world trade continues to recover, we estimate the balance of trade at 0.7% of GDP in 2011 and 1.4% of GDP in 2012
- service balance surplus is continuously slightly increasing
- due to growing outflow of dividends from direct foreign investments, deficit in the balance of income will rise
- we do not regard the risk of macroeconomic imbalance as significant

Macroeconomic Forecast

International Comparison

GDP per capita – using current purchasing power parities

		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
									<i>Předb.</i>	<i>Predikce</i>	<i>Predikce</i>
Slovensko	<i>PPS</i>	17 300	18 700	19 700	20 700	22 100	22 800	20 700	21 500	22 200	23 000
	<i>EA 12 = 100</i>	75	78	79	79	80	83	80	82	82	83
Řecko	<i>PPS</i>	19 200	20 300	20 600	22 100	22 900	23 500	22 100	21 500	21 000	21 000
	<i>EA 12 = 100</i>	83	85	83	85	83	86	86	81	78	76
Česká republika	<i>PPS</i>	15 200	16 300	17 100	18 200	19 900	20 200	19 200	20 000	20 600	21 300
	<i>EA 12 = 100</i>	66	68	69	70	73	74	75	76	76	77
Portugalsko	<i>PPS</i>	16 400	16 700	17 800	18 600	19 600	19 500	18 800	19 700	20 000	20 300
	<i>EA 12 = 100</i>	71	70	72	71	71	71	73	74	74	73
Slovensko	<i>PPS</i>	11 500	12 300	13 500	15 000	17 000	18 100	17 200	18 300	19 100	20 100
	<i>EA 12 = 100</i>	50	52	54	57	62	66	67	69	70	72
Estonsko	<i>PPS</i>	11 300	12 400	13 800	15 600	17 300	17 000	15 000	16 100	16 900	18 200
	<i>EA 12 = 100</i>	49	52	56	60	63	62	58	61	63	66
Maďarsko	<i>PPS</i>	13 000	13 700	14 200	14 900	15 600	16 200	15 300	15 900	16 300	16 800
	<i>EA 12 = 100</i>	56	57	57	57	57	59	59	60	60	61
Polsko	<i>PPS</i>	10 100	11 000	11 500	12 300	13 600	14 100	14 300	15 100	15 900	16 800
	<i>EA 12 = 100</i>	44	46	46	47	49	51	55	57	59	60
Litva	<i>PPS</i>	10 200	10 900	11 900	13 100	14 700	15 300	12 900	13 500	14 100	14 900
	<i>EA 12 = 100</i>	44	46	48	50	54	56	50	51	52	54

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

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