



**Ministry of Finance**

**CZECH REPUBLIC**

Department for Financial Policies

# **Macroeconomic Forecast of the Czech Republic**

**January 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 (a dramatic escalation of the debt crisis will not occur, but the politicians will not overcome the current situation in a credible way)
- scenario is burdened by a significant downward risks (the risk events include controlled and uncontrolled default of some euro area country, the need to accept assistance of some major euro area country, endangering the stability of the euro area banking sector, deeper recession in Germany, leaving of one or more countries from the euro area)
- the impacts of negative external shocks on the Czech economy is highly probable due to its high openness

# External Environment

**Economic performance of the U.S. economy is quite encouraging**

**The uncertainty associated with the debt crisis in the euro area is growing**

- the economic growth is slowing down (Germany) or stagnating (France, Italy, Spain), some economies are in recession (Greece and Portugal)
- on 13 January 2012, S&P lowered ratings of most euro area countries (on Italy, Cyprus, Portugal and Spain by two notches and on Austria, France, Malta, Slovakia and Slovenia by one notch)
- customer and investment optimism is decreasing
- uncertainty in the financial markets is transmitting to the real economy

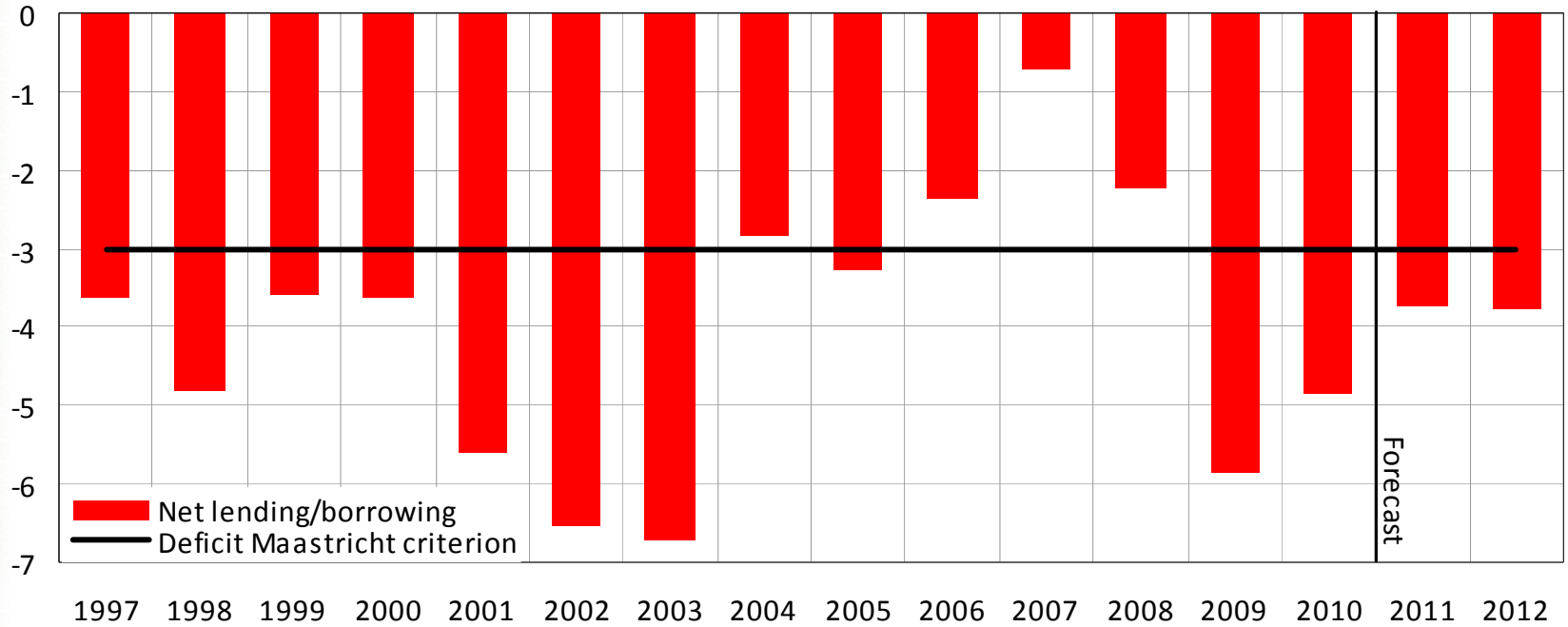
**Possible slowdown of the economic growth in China**

Macroeconomic Forecast

# Fiscal Policy

## Net Lending/Borrowing

(autonomous projection, in % of GDP)



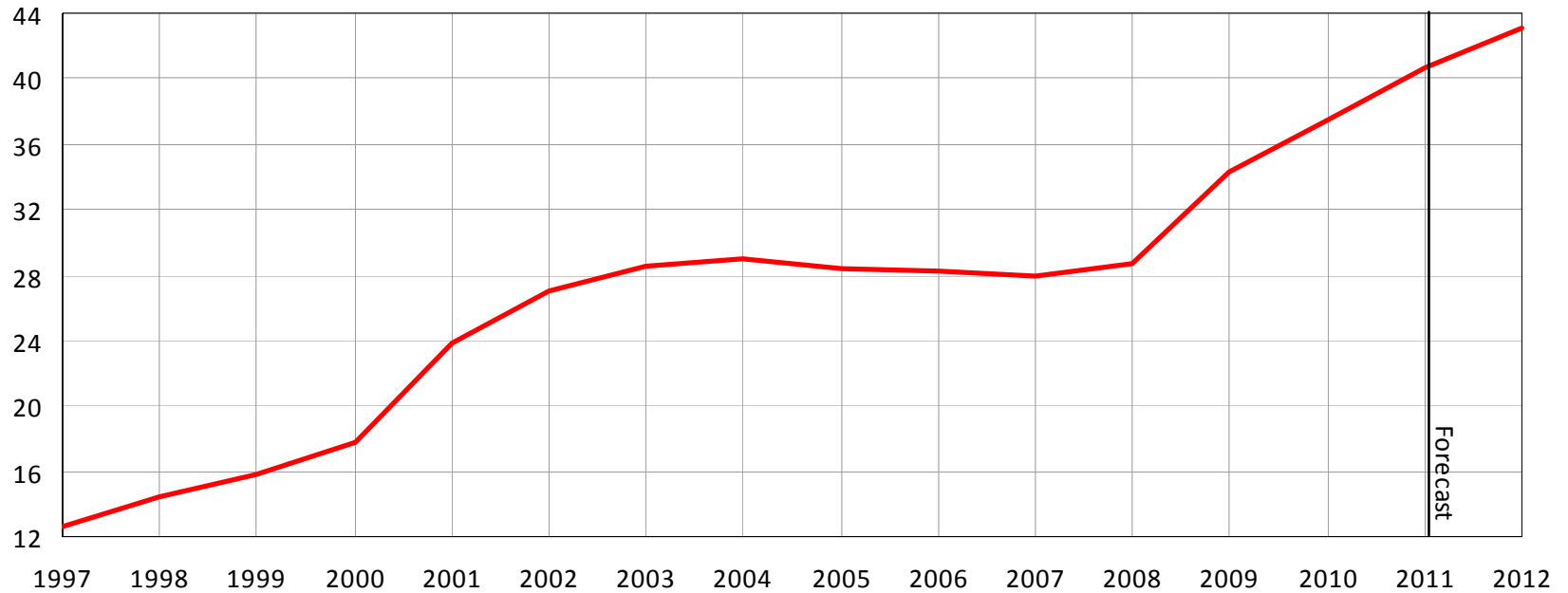
Source: Ministry of Finance.

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# Fiscal Policy

## Government Debt

(autonomous projection, in % of GDP)



Source: Ministry of Finance.



## Macroeconomic Forecast

# Fiscal Policy

- according to the preliminary estimates, the general government deficit reached 3.7% of GDP in 2011, where fiscal effort (year-on-year change of the cyclically adjusted balance) amounted to 0.9 p.p.
- government debt at the end of 2011 is estimated at 40.7% of GDP
- government deficit may increase to 3.8% of GDP in 2012 (it is an effect of the new macroeconomic outlook, the impact of which is a decrease in tax revenues as well as an increase in some expenditures), therefore the government will have to adopt some consolidation measures

## Fiscal Aims

- 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 end of 2011**
- **the average value for 3M PRIBOR stagnated in the fourth quarter of 2011 at 1.2% and a moderate decrease to 1.1% is expected in 2012**
- **tense situation in the financial markets and increasing risk aversion led to a significant weakening of the exchange rate in the fourth quarter of 2011, in December 2011 the average value was 25.51 CZK/EUR**
- **due to the deepening debt crisis, we expect an average exchange rate of 25.6 CZK/EUR and 19.7 CZK/USD in 2012**
- **in January 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 (the Chamber of Deputies approved on 16 December 2011)**
- **Amendment to the Public Procurement Act (the Chamber of Deputies approved on 4 November 2011)**
- **Act on Criminal Liability of Legal Entities (came into effect on 1 January 2012)**
- **3rd pillar of tax reform (President signed on 27 December 2011)**
- **Amendment to the Employment Act (came into effect on 1 January 2012)**
- **Amendment to the Labour Code (came into effect on 1 January 2012)**
- **First phase of healthcare reform (came into effect on 1 December 2011)**
- **Second phase of healthcare reform (President signed on 22 November 2011)**

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# Economic Cycle

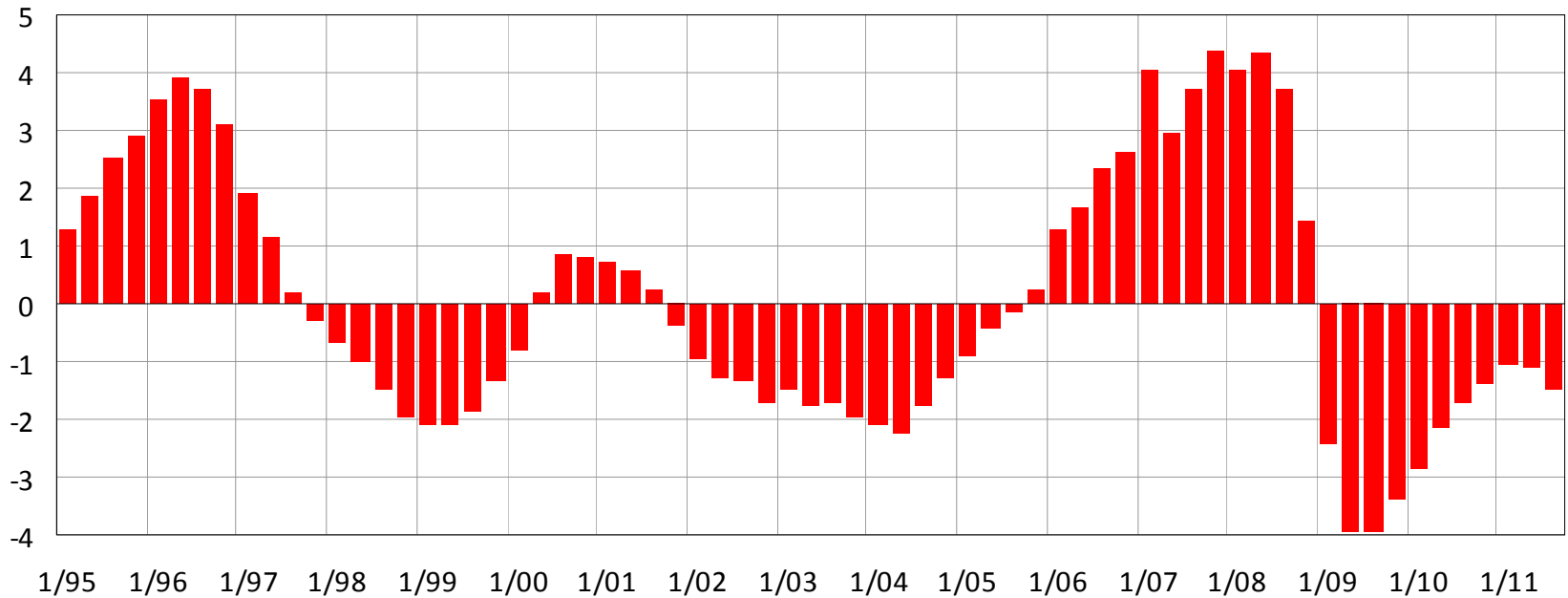


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# Economic cycle

## Output Gap

(in % of potential product)

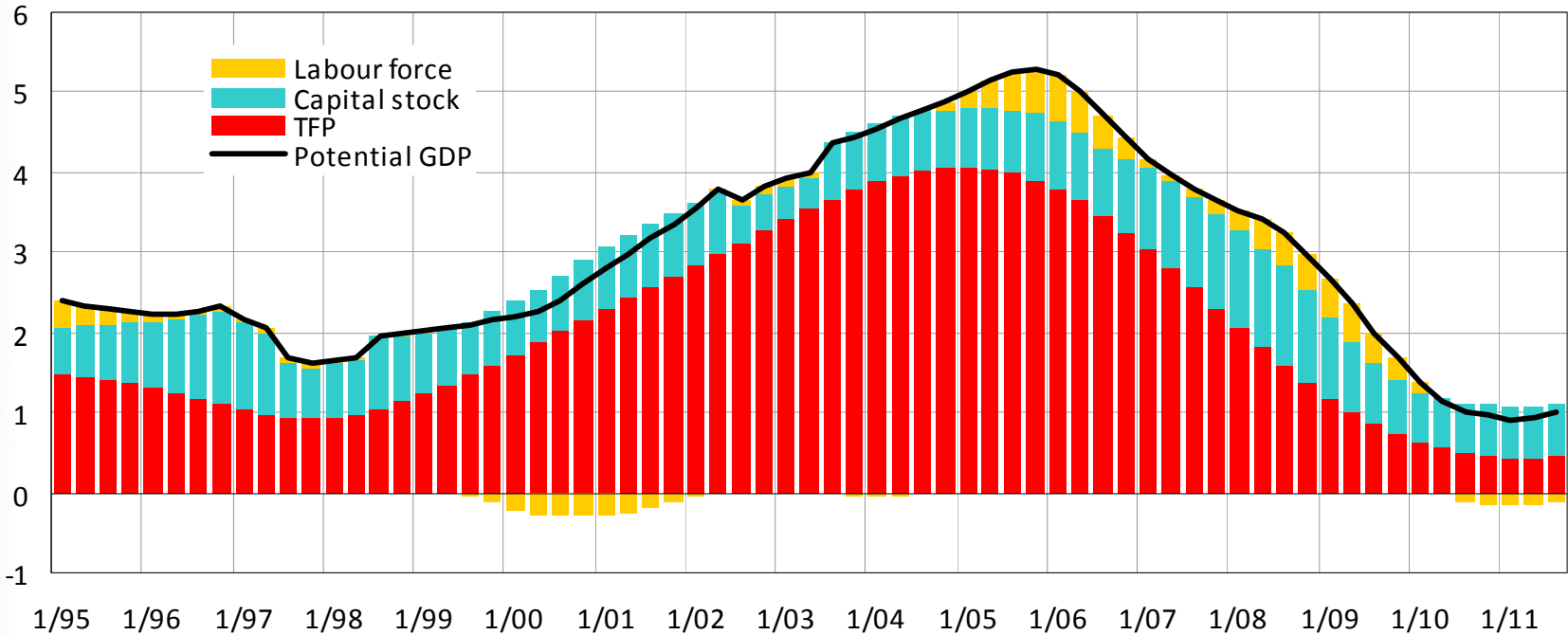


Sources: CZSO, CNB and Ministry of Finance's own calculations

# Economic cycle

## Potential Product Growth

(in %, contributions in percentage points)



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

## Economic cycle

- economic recession in late 2008 and 2009 gave rise to a deeply negative output gap
- YoY growth of potential product gradually decreased to 1% and, according to our calculations, the total level of potential output loss due to recession and slow recovery is about 8.2% so far
- the component most seriously affected is total factor productivity, its contribution to the growth fell to only 0.4 p.p. in the first three quarters of 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



# Forecast of Macroeconomic Indicators



## Macroeconomic Forecast

## Main Macroeconomic Indicators

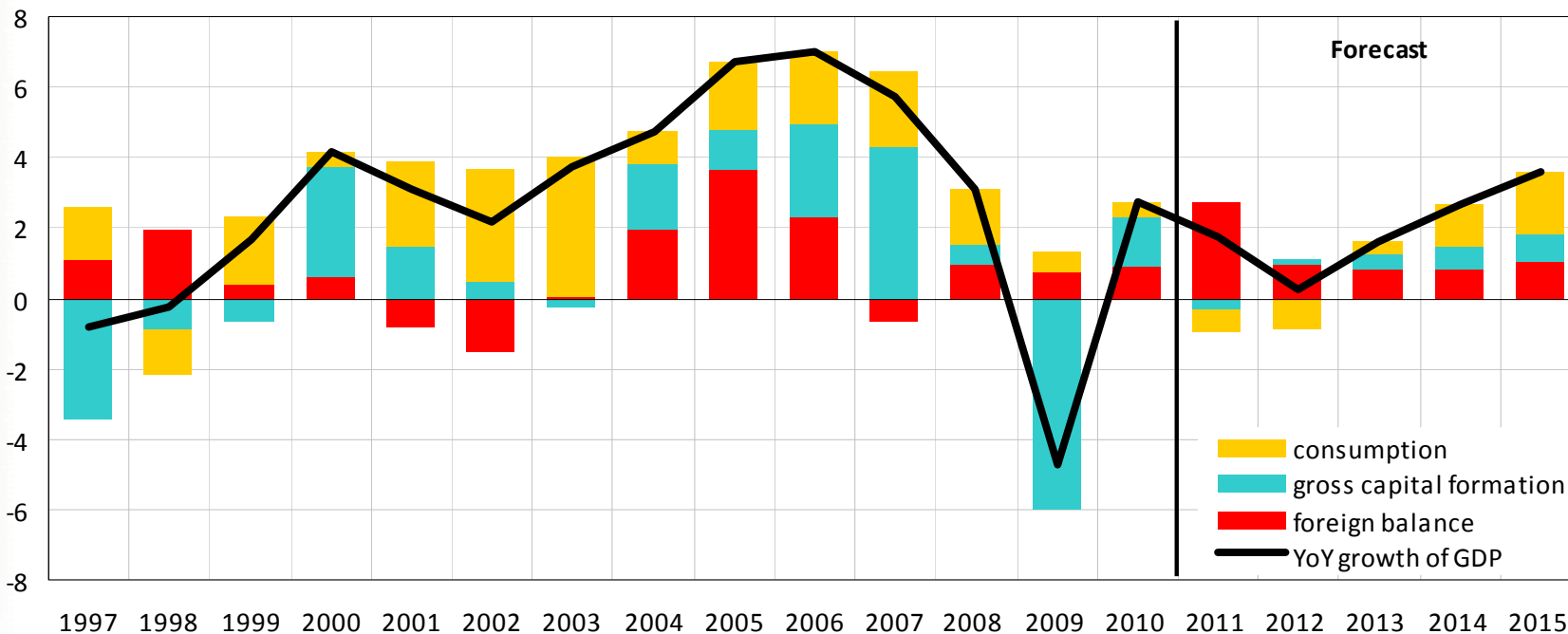
		2009	2010	2011	2012	2013
		<i>Forecast</i>				
<b>Gross domestic product</b>	<i>growth in %, const.pr.</i>	<b>-4,7</b>	<b>2,7</b>	<b>1,8</b>	<b>0,2</b>	<b>1,6</b>
<b>Consumption of households</b>	<i>growth in %, const.pr.</i>	<b>-0,4</b>	<b>0,6</b>	<b>-0,4</b>	<b>-0,7</b>	<b>0,7</b>
<b>Consumption of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

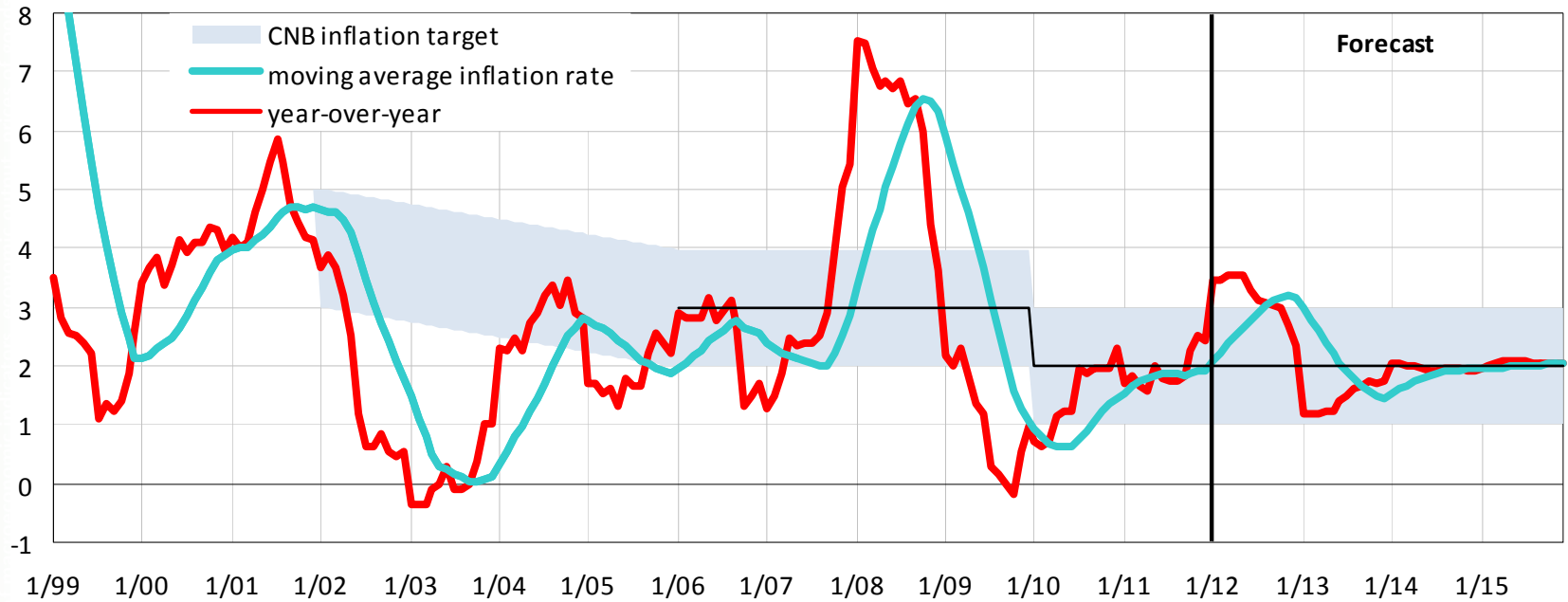
- for 2011 we estimate real GDP growth of 1.8% and for 2012 we expect stagnation and growth of just 0.2% (future development is highly uncertain, growth will be probably suppressed by pessimism, loss of confidence and concerns about the impacts of the euro area debt crisis)
- decline in household consumption in 2011 and 2012 is primarily due to consumer concerns about the debt crisis and unfavourable income situation of the households (decrease of salaries in the public sector, higher inflation in 2012)
- decline in real government consumption in 2011 and 2012 reflects adopted stabilization measures and approved consolidation strategy (decrease in employment in the public sector and the reduction of purchases of goods and services)
- investment growth decreased slightly in 2011 and we expect stagnation in 2012 (future development is highly uncertain)
- the foreign trade was the main driver of the economic growth in 2011 and this trend will probably continue in the next two years

Macroeconomic Forecast

# Inflation

## Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

# Inflation

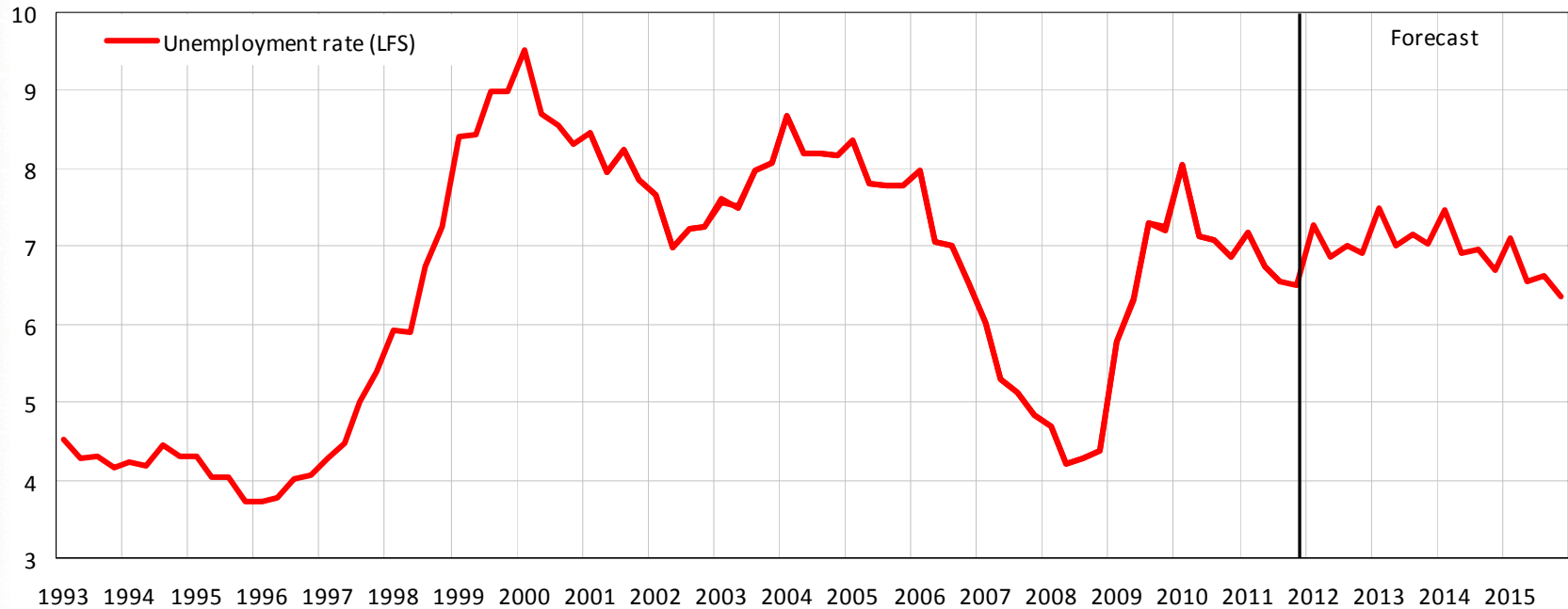
- the average inflation rate in 2011 reached 1.9%
- we estimate 2012 average inflation rate at 3.2%, this rise is mainly due to approved administrative measures (an increase of reduced VAT rate from 10% to 14% will contribute by 1.1 p.p.)



Macroeconomic Forecast

# Labour Market

## Unemployment Rate (Labour Force Survey, in %)



Sources: CZSO and Ministry of Finance's own calculations

## Labour Market

- **the employment should increase by 0.4% in 2011, however, we expect the decrease of 0.3% in 2012 due to the expected delayed impact of the GDP stagnation and announced further job cuts in the state sector**
- **the unemployment rate according to LFS reached 6.6% in the third 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

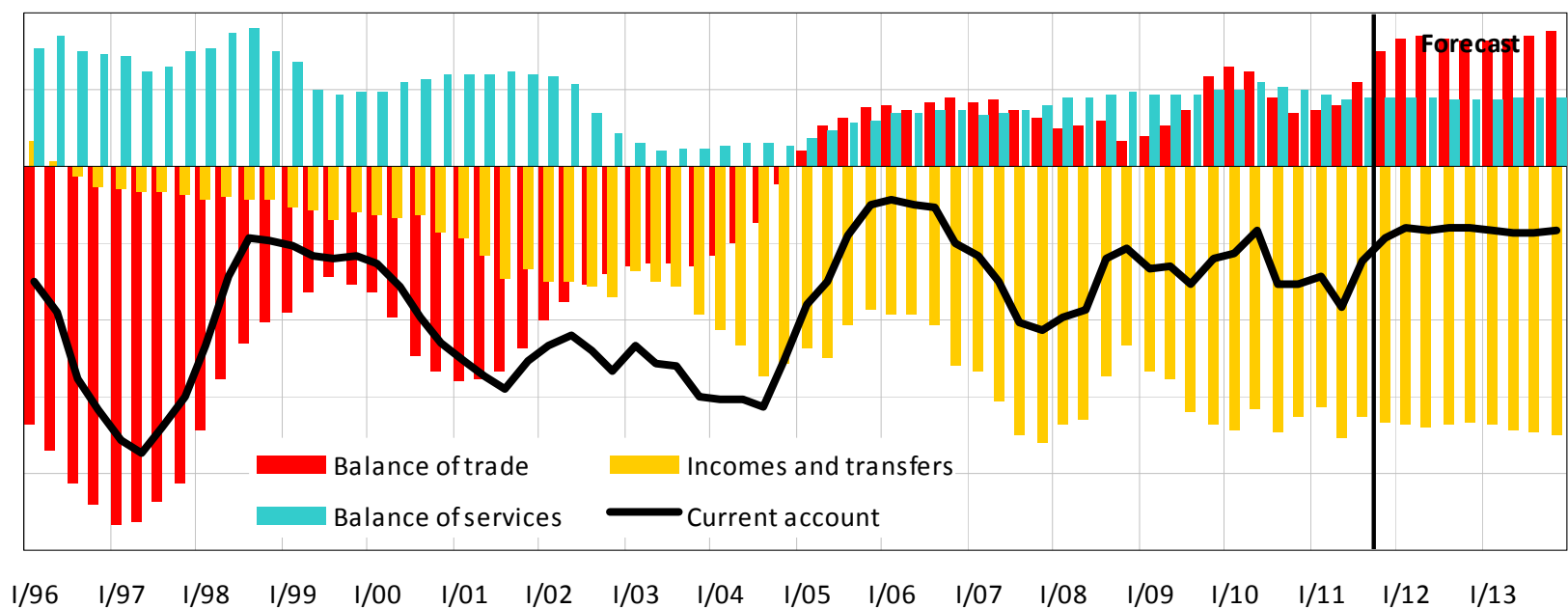
- the wage bill increased by about 1.7% in 2011, due to the cost-saving measures in government sector (decrease in employment and wages in large part of the public sector) the growth was driven mainly by the business sector
- in 2012, we expect overall wage bill to increase only by 2.0 % because of lower economic performance, decline in employment and further budget savings measures
- based on signals from the business sector and the known intentions regarding salaries in the public sector, average wage slightly increased by 2.2% in 2011
- in 2012, we expect the average wage increase of only 2.0% (assuming inflation rate of 3.2%, we estimate the real average wage will decrease by 1.1%)

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

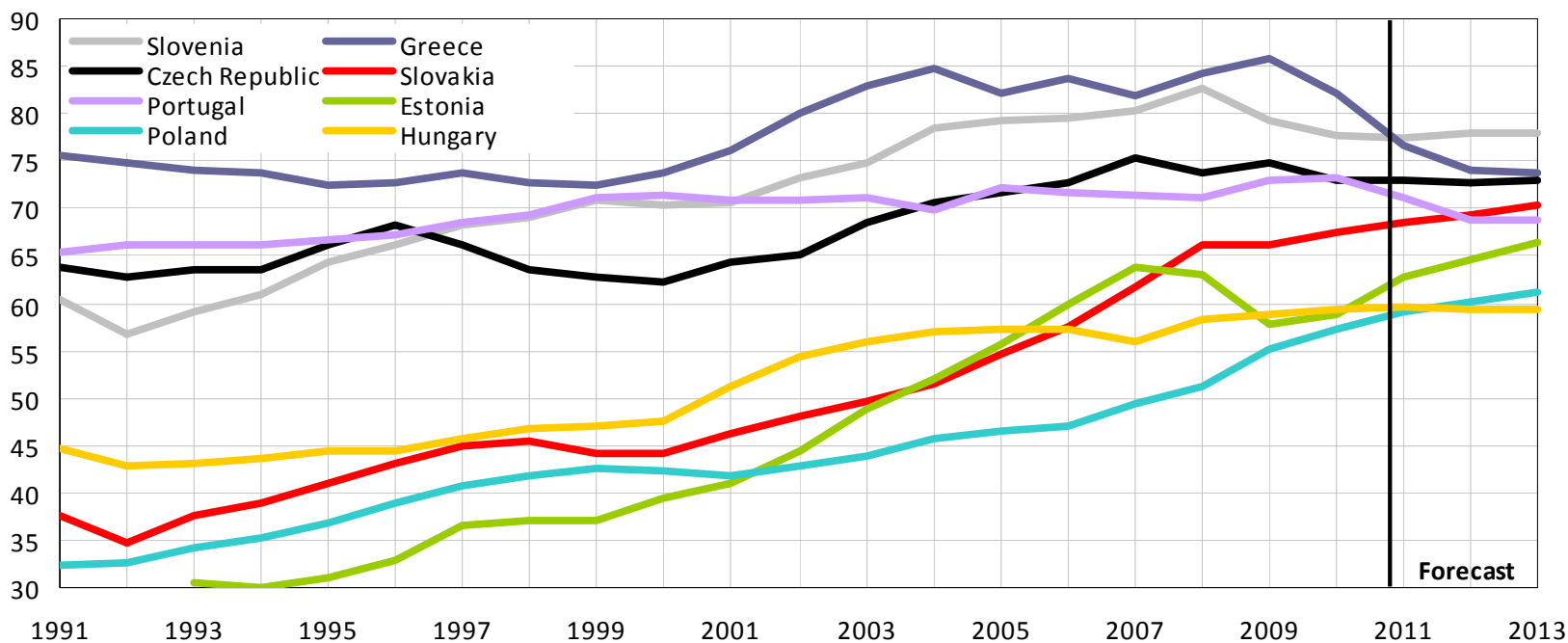
- we estimate the balance of trade at 3.0% of GDP in 2011
- dynamics of the world and also Czech trade growth is slowing, however decline in foreign demand will be compensated by reducing domestic demand and thus we expect exports exceed imports and balance of trade at 3.3% of GDP in 2012 and at 3.5% of GDP in 2013
- due to the unfavourable outlook for the global economy we expect stagnation or slight decline in the service balance surplus, it should reach about 1.8% of GDP in 2011 and 1.7% of GDP in 2012
- deficit in the balance of income is steadily growing due to the outflow of investment revenues within foreign direct investment, it should reach about 6.7% of GDP in 2011 and 6.9% of GDP in 2012
- we estimate the ratio of the current account to GDP at -1.9% in 2011 and -1.6% and -1.7% next two years
- 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	21 200	21 700	22 300
	<i>EA12=100</i>	78	79	79	80	83	79	78	78	78	78
Greece	<i>PPS</i>	20 300	20 400	21 800	22 500	23 100	22 100	21 900	20 900	20 600	21 000
	<i>EA12=100</i>	85	82	84	82	84	86	82	77	74	74
Czech Republic	<i>PPS</i>	16 900	17 800	18 900	20 700	20 200	19 300	19 400	19 900	20 200	20 800
	<i>EA12=100</i>	71	72	73	75	74	75	73	73	73	73
Slovakia	<i>PPS</i>	12 300	13 500	15 000	16 900	18 200	17 000	18 000	18 700	19 300	20 100
	<i>EA12=100</i>	52	55	57	62	66	66	67	69	69	70
Portugal	<i>PPS</i>	16 700	17 900	18 700	19 600	19 500	18 800	19 500	19 400	19 100	19 600
	<i>EA12=100</i>	70	72	72	71	71	73	73	71	69	69
Estonia	<i>PPS</i>	12 400	13 800	15 600	17 500	17 300	14 900	15 700	17 100	18 000	19 000
	<i>EA12=100</i>	52	56	60	64	63	58	59	63	65	66
Poland	<i>PPS</i>	11 000	11 500	12 300	13 600	14 100	14 300	15 300	16 100	16 700	17 500
	<i>EA12=100</i>	46	46	47	50	51	55	57	59	60	61
Hungary	<i>PPS</i>	13 600	14 200	14 900	15 400	16 000	15 200	15 800	16 300	16 500	17 000
	<i>EA12=100</i>	57	57	57	56	58	59	59	60	59	59
Lithuania	<i>PPS</i>	11 000	11 900	13 100	14 800	15 400	12 800	14 000	15 400	16 300	17 300
	<i>EA12=100</i>	46	48	50	54	56	50	53	56	59	60

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

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