



Ministry of Finance CZECH REPUBLIC

Financial Policy Department

Macroeconomic Forecast **Czech Republic**

July 2013

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

- compared with the previous forecast, the prospects of the Czech economy for both this year and next year have deteriorated, the main cause of the deterioration is decline of GDP by 1.3% in Q1 2013 QoQ
- scenario is burdened by downward risks
- 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 area spilling over to the countries of the Czech Republic's main trading partners (however, the short-term risks related to the debt crisis in the euro area should not be too serious)
- we consider very low level of confidence among consumers and business sector as a main internal risk in the Czech economy

External Environment

The outlook for the global economy remains diverse

- the euro zone economy continues to decline for the sixth 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, partially also by foreign investment
- growth in the emerging economies varies, China is maintaining its high growth rates, in other countries, however, the growth is hampered by structural problems

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

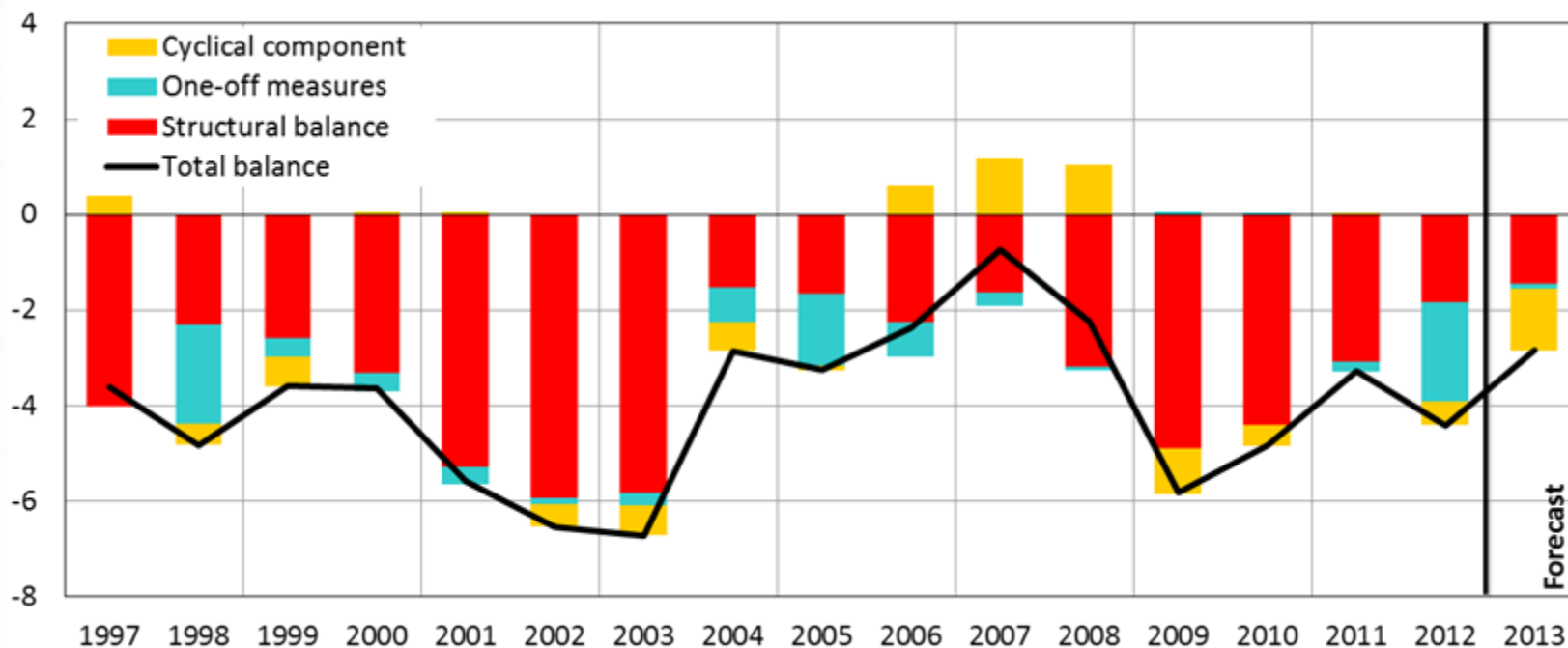
- in the euro zone periphery countries, the situation in government bond markets is relatively favourable, these states, however, are in recession and plagued by high unemployment

Macroeconomic Forecast

Fiscal Policy

Net Lending/Borrowing

(in % of GDP)



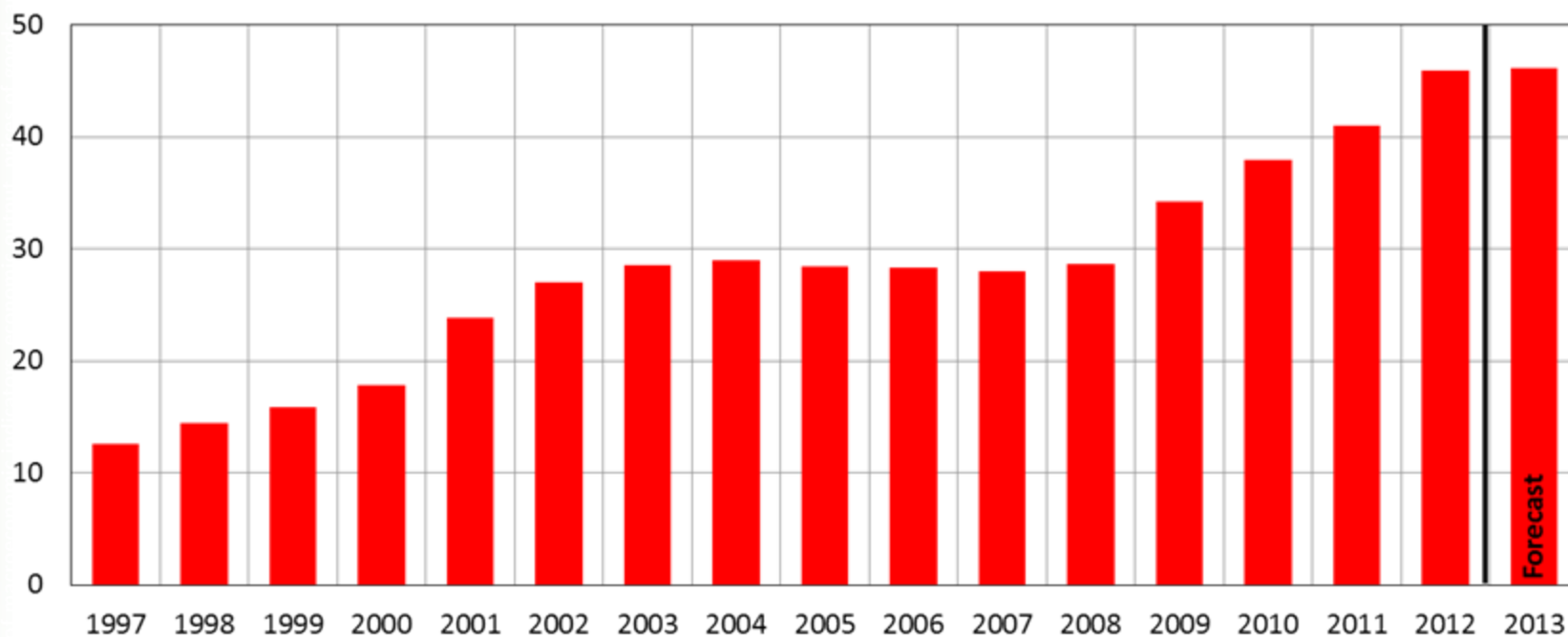
Source: Ministry of Finance.

Macroeconomic Forecast

Fiscal Policy

Government Debt

(in % of GDP)



Source: Ministry of Finance.

Fiscal Policy

- in 2012, the general government deficit reached 4.4% of GDP
- 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 1.3 p.p.
- at the end of 2012, the government debt reached 45.9% 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%
- long-term interest rates are low, yields to maturity of 10Y government bonds should reach about 2.0% in 2013 and 2.2% in the following year
- we estimate an average exchange rate at 25.8 CZK/EUR and 19.7 CZK/USD in 2013
- 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+)

Structural reforms

Approval of major structural reforms

- **Act on the Change of Tax Laws in Connection with the Recodification of Private Substantive Law (the Government approved on 17 April 2013)**
- **Act on Immovable Property Acquisition Tax (the Government approved on 17 April 2013)**
- **Act on Improving Transparency of Joint-Stock Companies (came into effect on 30 June 2013)**
- **Amendment to the Commercial Code (came into effect on 1 July 2013)**
- **Amendment to the Act on Insurance and Financing of Exports with State Support (the Senate approved on 21 June 2013)**

Macroeconomic Forecast

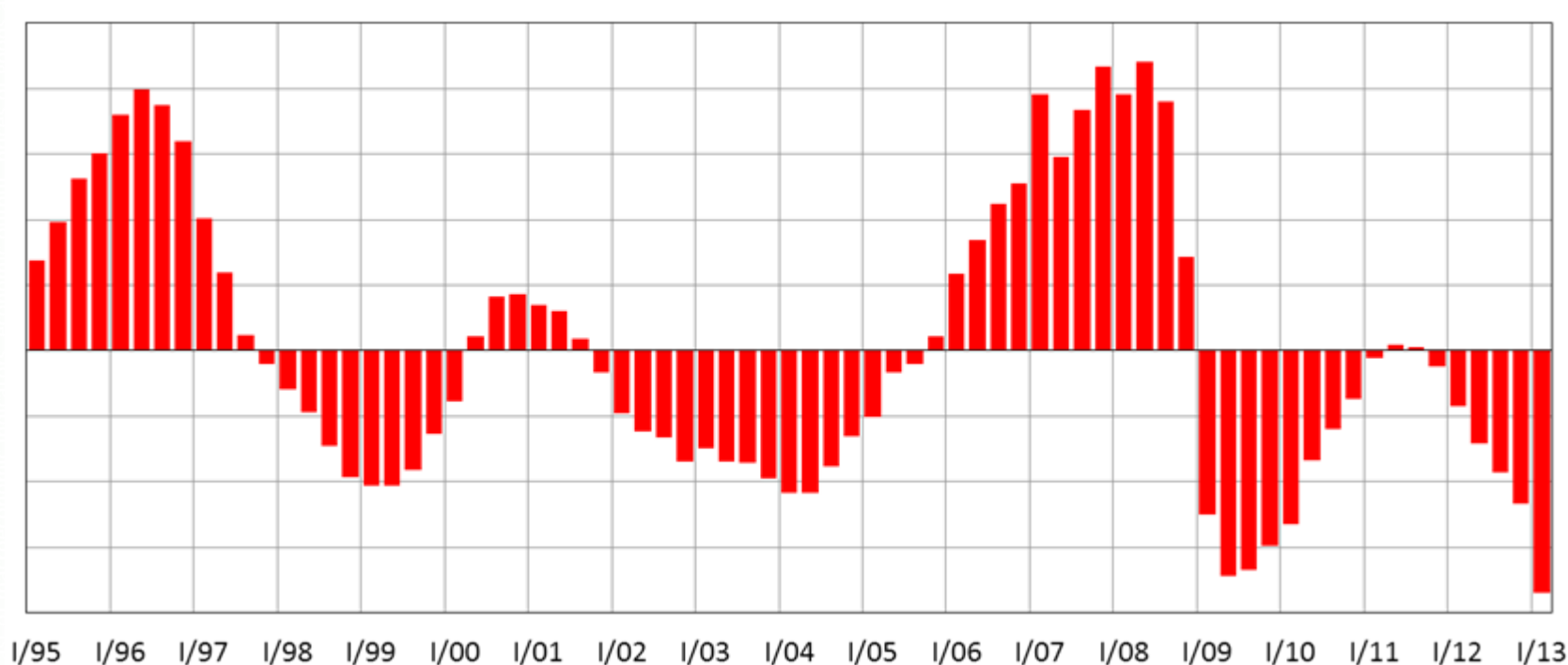
Economic Cycle

Macroeconomic Forecast

Economic cycle

Output Gap

(in % of potential product)



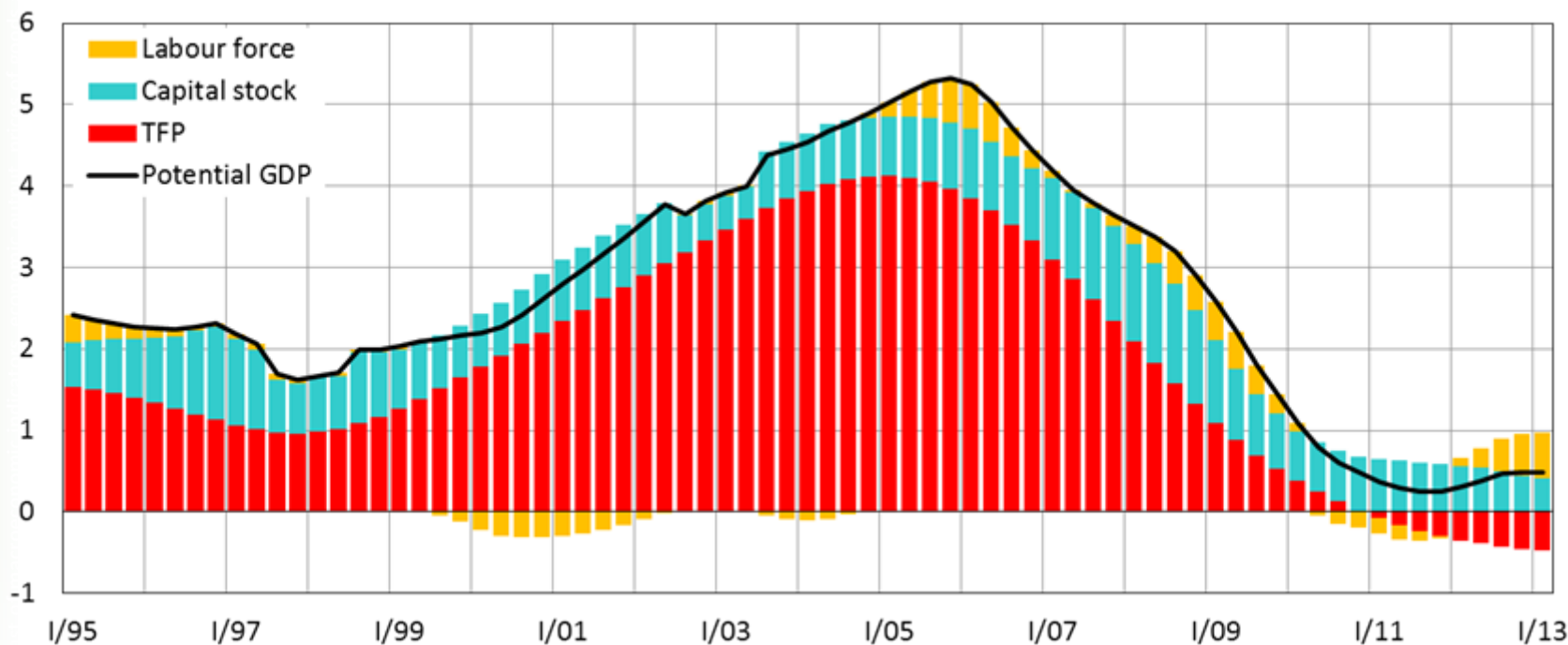
Sources: CZSO, CNB and Ministry of Finance's own calculations

Macroeconomic Forecast

Economic cycle

Potential Product Growth

(in %, contributions in percentage points)



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

Economic cycle

- from 4Q 2011, the Czech economy is in a negative output gap, which gradually deepens and reached -3,7% in Q1 2013
- the component most seriously affected is total factor productivity, its contribution to the growth was negative and reached -0.5 p.p. in Q1 2013
- deep fall in investment activity led to a gradual reduction of the contribution of the capital stock to 0.4 p.p. in Q1 2013
- growth of labour supply exceeded the decline in working age population in 1Q 2013

Forecast of Macroeconomic Indicators

Macroeconomic Forecast

Main Macroeconomic Indicators

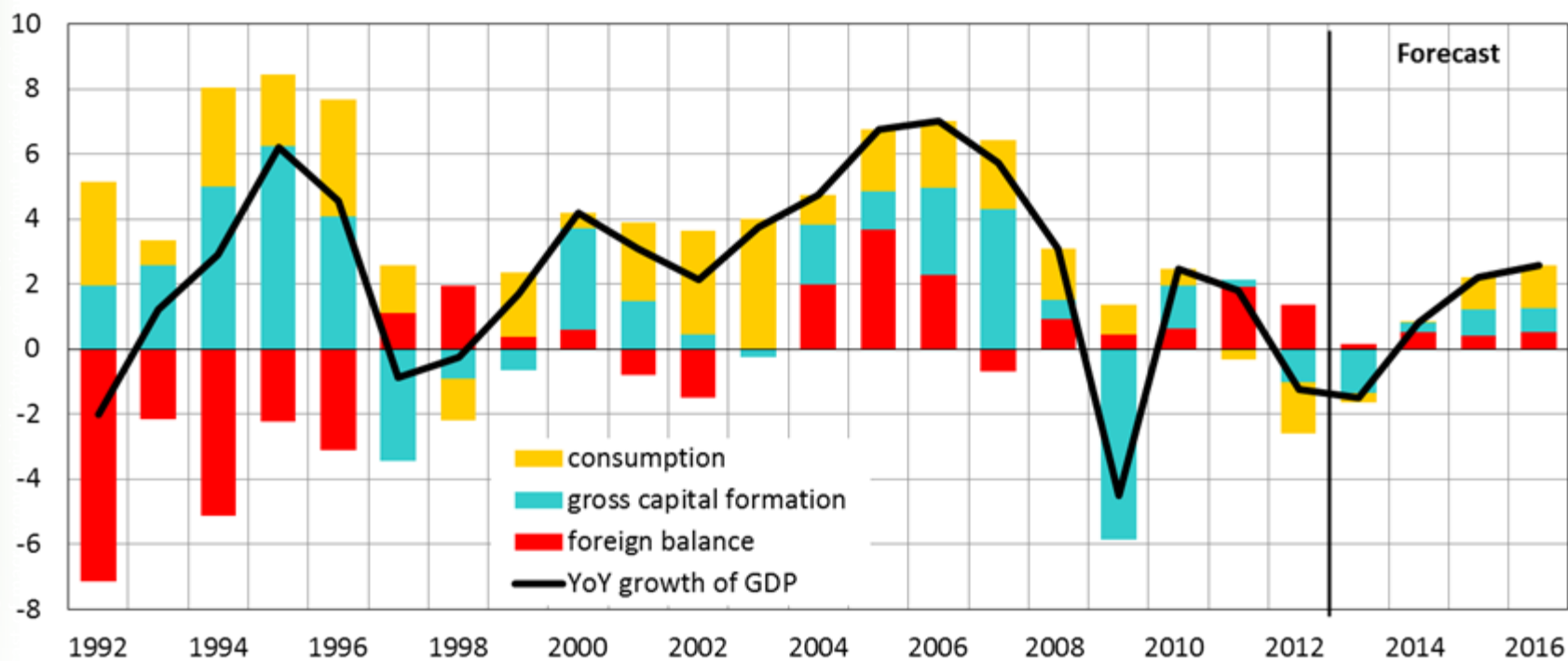
		2010	2011	2012	2013	2014
		<i>Current forecast</i>				
Gross domestic product	<i>growth in %, const.pr.</i>	2,5	1,8	-1,2	-1,5	0,8
Consumption of households	<i>growth in %, const.pr.</i>	0,9	0,5	-2,7	-0,8	0,4
Consumption of government	<i>growth in %, const.pr.</i>	0,2	-2,7	-1,2	0,5	-0,9
Gross fixed capital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

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

- **economic output fell by 1.3% in Q1 2013 QoQ, the Czech economy has been in recession for six consecutive quarters**
- **the decline in economic output is due to the drop in household consumption, gross capital formation and foreign trade**

Economic Performance

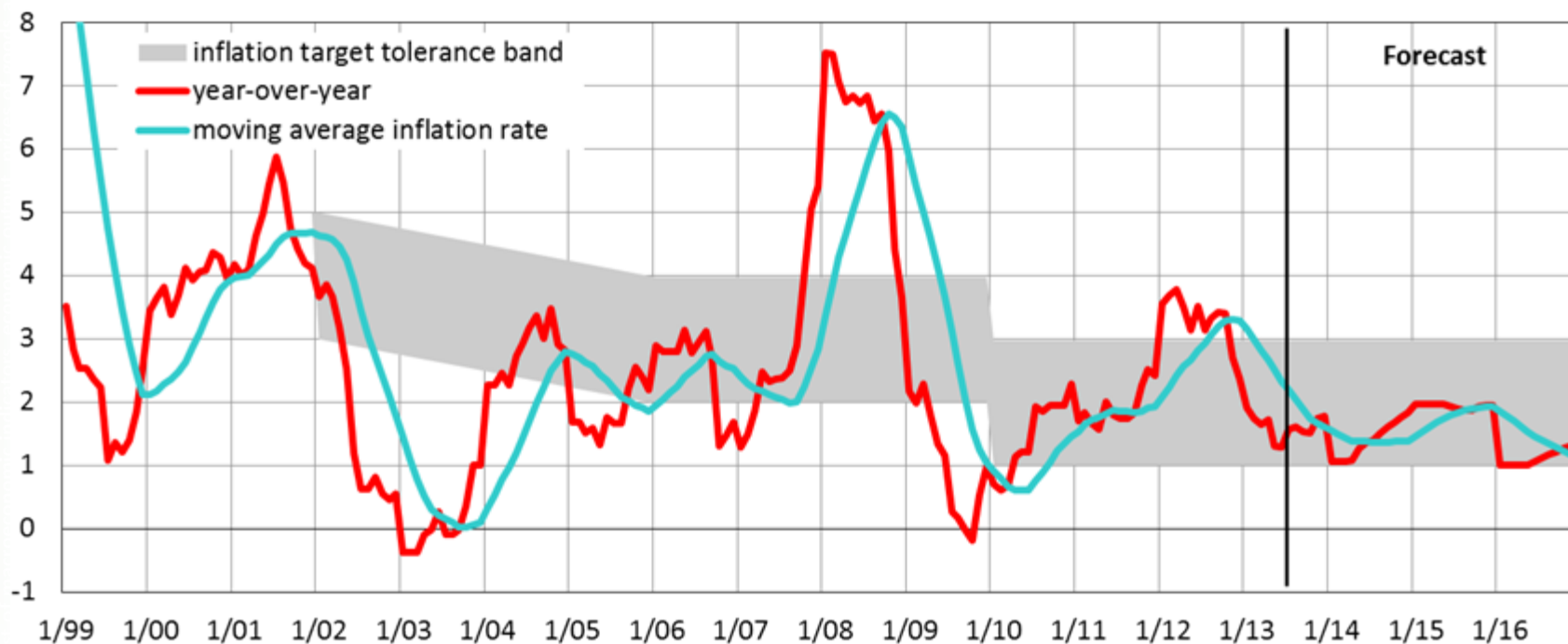
- GDP should fall by 1.5% in 2013 and for 2014 we expect rebound in economic growth of 0.8%
- expected drop in household consumption by 0.8% in 2013 reflects the decrease in real disposable household income, low savings rate and households' very low confidence in the economy, for 2014 we expect to see a growth in household consumption in the context of economic recovery
- regarding real government consumption, we expect growth of 0.5% in 2013 and decline of 0.9% in 2014
- due to the little company's needs to invest into physical capital, we anticipate a decrease of gross capital formation in 2013 and gradual recovery of the growth dynamic in the following years
- the main driver of economic growth both in 2013 and 2014 should be the foreign trade

Macroeconomic Forecast

Inflation

Consumer Prices

(YoY growth rate, in %)



Sources: CZSO and Ministry of Finance's own calculations

Inflation

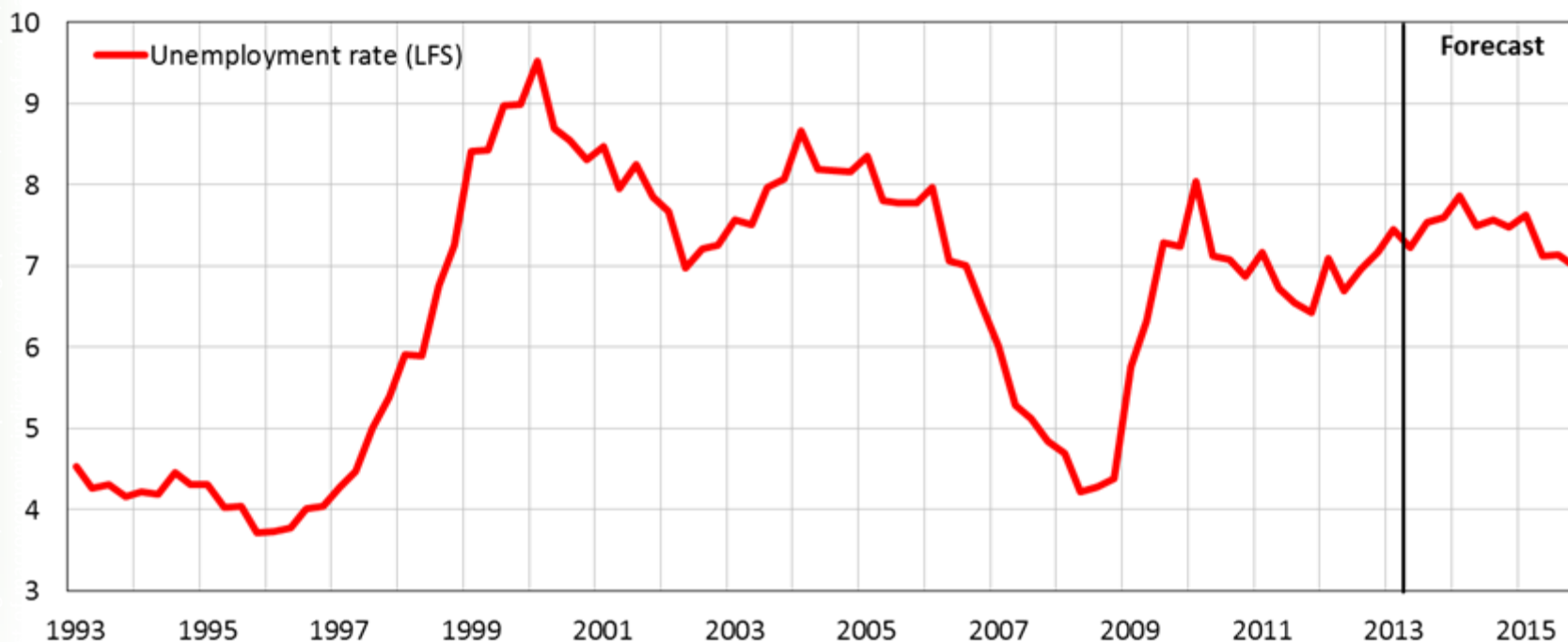
- in 2013, we expect modest growth in consumer prices of 1.6%, the main anti-inflationary factor is a deeply negative output gap
- we estimate 2014 average inflation rate at 1.4%, growth of consumer prices should be influenced by administrative measures in less extent
- for 2016 we expect a slowdown 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 has a somewhat unusual course in the labour market
- in Q1 2013, the unemployment rate according to LFS raised to 7.4%, but at the same time employment increased by 0.3% (increase in employment was due to the decline in hours worked per worker and growth of the share of part-time jobs)
- due to the delayed impact of the recession and development in Q1 2013, for 2013 we expect an increase in employment of 0.5% and in the following year a slight decrease of 0.2%
- in the context of expected economic situation, the unemployment rate according to LFS should growth to 7.5% in 2013 and 7.6% in 2014

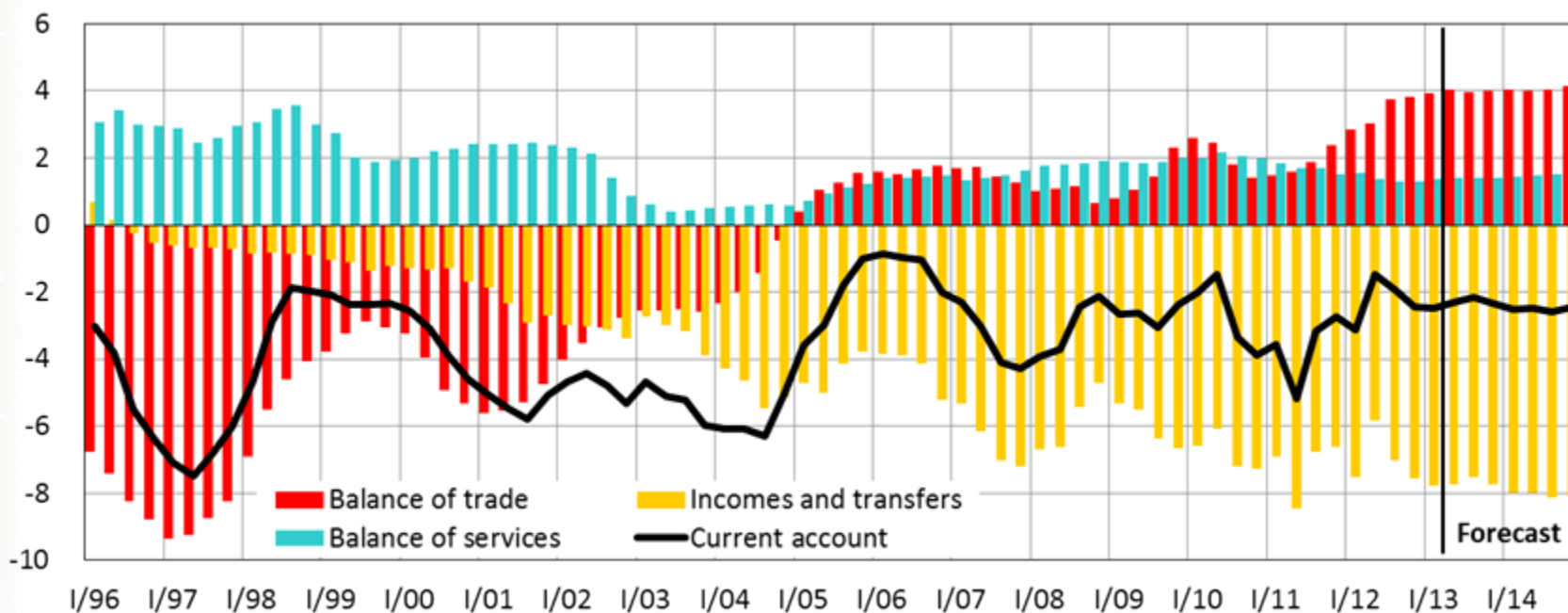
Labour Market

- in Q1 2013, 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 0.7% in 2013 and by 2.1% in the following year
- for 2013 we anticipate the average wage increase of 0.8%, which should signify a real decline in the real average wage by 0.8%
- in 2014, due to estimated average inflation and expected growth of the average wage of 2.3%, the real wage should increase by around 0.9%

External Relations

Current Account

(moving sums of the latest 4 quarters, in % of GDP)



Sources: CNB and Ministry of Finance's own calculations

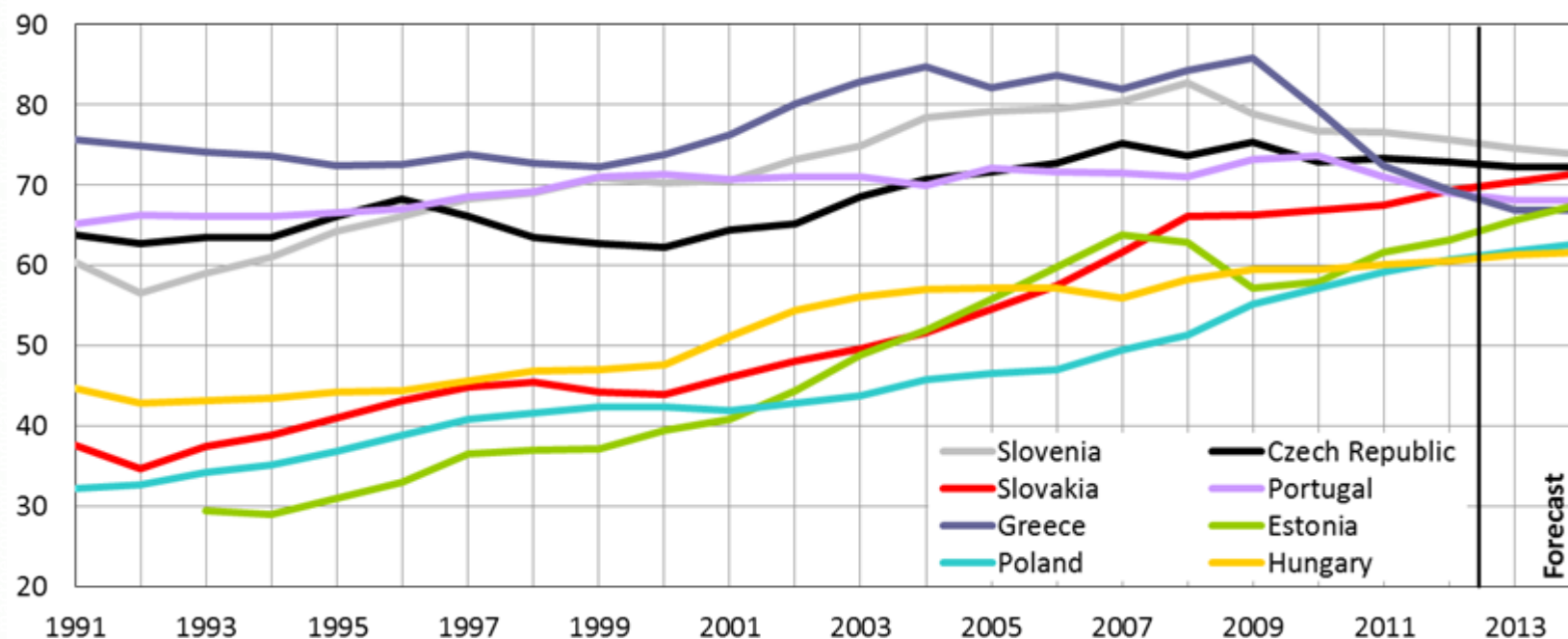
External Relations

- **worsening of the external environment together with a decline in domestic demand is reflected in a slowdown in the foreign trade growth, turn to gradual recovery of foreign trade and a return to growth in export markets is expected before the end of 2013**
- **exports should slightly exceed imports and the ratio of the trade balance to GDP should increase to 4.0% in 2013 and to 4.1% in 2014**
- **regarding the service balance, it should stagnate at 1.4% of GDP in 2013 and then slightly increased to 1.5% of GDP in the following year**
- **deficit in the balance of income has been showing a tendency to increase, it should raise to 8.2% of GDP in 2013, resp. 8.3% of GDP in 2014**
- **in 2013 and 2014, we expect the current account deficit of around 2.3% of GDP, resp. 2.4% of GDP, 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
		Prelim. Forecast Forecast									
Slovenia	PPS	19 700	20 700	22 100	22 700	20 300	20 500	21 000	21 000	20 800	21 100
	EA12=100	79	79	80	83	79	77	77	76	75	74
Czech Republic	PPS	17 800	18 900	20 700	20 200	19 400	19 500	20 100	20 200	20 200	20 700
	EA12=100	72	73	75	74	75	73	73	73	72	72
Slovakia	PPS	13 500	15 000	16 900	18 100	17 100	17 900	18 500	19 200	19 700	20 400
	EA12=100	55	57	62	66	66	67	68	69	70	71
Portugal	PPS	17 900	18 700	19 600	19 500	18 800	19 700	19 500	19 200	19 000	19 500
	EA12=100	72	72	72	71	73	74	71	69	68	68
Lithuania	PPS	12 300	13 600	15 500	16 100	13 600	14 900	16 600	17 800	18 800	19 800
	EA12=100	49	52	56	59	53	56	60	64	67	69
Greece	PPS	20 400	21 800	22 500	23 100	22 100	21 200	19 900	19 200	18 700	19 100
	EA12=100	82	84	82	84	86	79	72	69	67	67
Estonia	PPS	13 800	15 600	17 500	17 200	14 700	15 500	16 900	17 500	18 300	19 400
	EA12=100	56	60	64	63	57	58	62	63	66	68
Poland	PPS	11 500	12 300	13 600	14 100	14 200	15 300	16 200	16 800	17 300	17 900
	EA12=100	46	47	50	51	55	57	59	61	62	63
Hungary	PPS	14 200	14 900	15 400	16 000	15 300	15 900	16 500	16 800	17 100	17 600
	EA12=100	57	57	56	58	59	59	60	61	61	62
Latvia	PPS	11 100	12 500	14 300	14 600	12 700	13 200	14 700	15 900	16 900	17 900
	EA12=100	45	48	52	53	49	49	54	57	60	63

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

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