

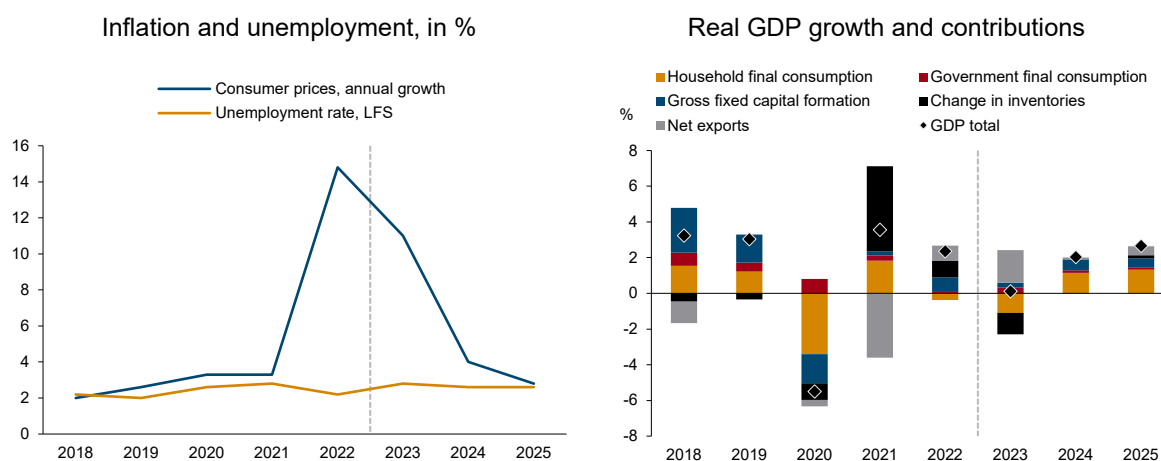


CZECHIA: In the slow lane

ZUZANA ZAVARSKÁ

There are not too many reasons to be optimistic about the economic performance of Czechia in 2023. The economy will remain stagnant (0.1%) and inflation high (11%). With prices rising steeply, household consumption is dragging growth downward, as are declining inventories. Following a period of surprising resilience, industry is also losing steam. The dim outlook for Germany is further weakening Czechia's prospects. A mild recovery can be expected in 2024, helped by inflation falling back.

Figure 6.6 / Czechia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Czech economy contracted slightly in Q2 2023 (-0.4%) year on year, the same as in the previous quarter. The factors driving and hindering growth also remained largely unchanged, as the economy is dealing with the same headwinds. On the positive side, net exports (+2.5pp), fixed investments (+0.8pp) and government consumption (+0.7pp) all contributed to growth. On the negative side, household consumption (-1.9pp) and inventory reduction (-2.5pp) proved a drag on growth. Quarter-on-quarter GDP growth was negligible (0.1%); however, the dynamics of household consumption turned positive for the first time since Q3 2021.

Following a period of surprising resilience in 2022 and early 2023, industry has been losing steam. Much of the resilience seen hitherto can be attributed to the automotive sector, which has been offsetting the otherwise weak industrial performance and propping up the country's export position. Combined with a sluggish growth of imports, the trade balance has witnessed a significant improvement since last year. Yet, with the backlog being fulfilled through the release of inventories and with new

orders consistently declining, recent data suggest that the worst is yet to come. Unfavourable global conditions, particularly the underperformance of Czechia's most important trading partner Germany, further add to the bleak prospects for the country's export-oriented industry.

Despite clear disinflationary trends over recent months, inflation still topped 10% in August²² – the nineteenth consecutive month of double-digit HICP growth for Czechia. Electricity, gas and other fuels are pushing up the inflation figures most strongly. On the other hand, food prices contracted slightly in monthly terms, reflecting the decline in agricultural producer prices. While the pace of growth in consumer prices will keep slowing (helped by the base effect), it will temporarily pick up at the end of the year, due to the absence of the energy price cap put in place by the government last August. The measure was adopted to shield consumers from the cost of energy last winter, but the cap was abolished for this year. Nevertheless, inflation is forecast to moderate significantly in 2024 (to 4%) and to reach the central bank's 2-3% target range by 2025 (2.8%), down from this year's 11.0%.

Inflation is eating into the incomes of Czech workers, as real wages declined (by 3.1%) for the seventh quarter in a row in Q2 2023. While wages grew relatively strongly in nominal terms, that was not yet sufficient to compensate for the high inflation. Hence, it is hardly surprising that consumption is acting as a major drag on growth, as households continue to put off purchasing big-ticket items until their financial situation improves. A study conducted by the Czech National Bank using 2022 national accounts data reveals that the steepest decline in real incomes was experienced by employees, whereas self-employed persons saw an improvement in their real incomes.²³ Pensioners witnessed only a slight fall in their income in real terms, despite facing higher inflation rates. In terms of income quintiles, the middle class was the worst hit.

There are no major developments on the labour market, with shortages of labour continuing to be the main issue. The employment rate has not seen much of a change this year. However, the average number of registered employees in industry has been on a declining trend in recent months, reflecting the deteriorating climate in the sector. The unemployment rate is expected to increase slightly to 2.8% this year and to stay at 2.6% in the coming years, which still represents a significantly lower rate than the EU overall.

As of September 2023, there were over 366,000 Ukrainian refugees registered under the temporary protection scheme in Czechia, a large proportion of them employed. However, qualification mismatches remain an issue for the integration of refugees onto the labour market. The humanitarian aid available to Ukrainian refugees has been markedly reduced since July of this year, following amendments to the Lex Ukraine law package, which came into force in March 2022 to support Ukrainian refugees.

The Czech National Bank (CNB) is expected to be more patient than other non-euro central banks in the region when it comes to monetary easing. As anticipated, the CNB again kept the policy rate unchanged in August at 7% and has voiced caution about lowering the rate prematurely. Considering the bank was a first mover – raising interest rates as early as 2021 – its firm commitment to tackling inflation is evident. Given its conservative stance, the bank will likely hold off cutting the policy rate until

²² Harmonised Index of Consumer Prices (HICP) values. The Czech Consumer Price Index and the HICP differ due to methodological differences related to imputed rents.

²³ Martin Kábrt, 'Nerovný dopad inflace na české domácnosti: poznatky z národních účtů', Czech National Bank, 10 May 2023, https://www.cnb.cz/cs/o_cnb/cnblog/Nerovny-dopad-inflace-na-ceske-domacnosti-poznatky-z-narodnich-uctu/

the end of 2023 (and then only with a modest reduction of around 0.25pp), after which it is expected to gradually reduce the policy rate to the natural rate of 3% by 2025.

The koruna was deliberately strengthened in order to combat imported inflation, but the CNB announced in August that it would be phasing out its foreign exchange interventions. As import prices have been declining steeply this year, the move does not really come as a surprise. Following the announcement, the koruna has depreciated, but it is still significantly stronger against the euro than its historical average.

The government is in the process of passing an austerity package, due to come into force in 2024. The fiscal balance turned negative in 2020 following a period of surplus years, and has remained in the red ever since. Following months of negotiations, the consolidation package is now in the final stages of approval by the cabinet. The package will consist primarily of tax reforms, introducing changes to excise duties, property taxes and value added tax, among others. A pension reform was introduced earlier this summer, which has also sparked heated public debate. With the incumbent government intent on improving the public finance situation through austerity measures, the fiscal balance and the public debt are forecast to shrink over the coming years.

All in all, there are not too many reasons to be optimistic about the prospects for Czechia in 2023: the economy will remain stagnant (0.1%) and inflation high (11%). With prices still rising steeply, household consumption will drag down growth, as will declining inventories. Net exports will be the main growth driver, helped by the so far resilient automotive industry and weak imports. Moderate growth of 2% in 2024 is expected to follow, as consumption and investment regain some of their dynamism. However, a high level of uncertainty surrounding future developments in industry is clouding the outlook for 2024 and 2025, with risks mainly on the downside.

Table 6.6 / Czechia: Selected economic indicators

	2020	2021	2022 ¹⁾	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average ²⁾	10,698	10,506	10,672	.	.	10,850	10,800	10,800
Gross domestic product, CZK bn, nom.	5,709	6,109	6,786	3,238	3,565	7,340	7,750	8,160
annual change in % (real)	-5.5	3.6	2.4	4.2	-0.6	0.1	2.0	2.7
GDP/capita (EUR at PPP)	28,050	29,710	31,950	.	.	.	.	.
Consumption of households, CZK bn, nom.	2,536	2,716	3,104	1,506	1,604	.	.	.
annual change in % (real)	-7.4	4.1	-0.8	3.7	-5.1	-2.4	2.5	2.9
Gross fixed capital form., CZK bn, nom.	1,516	1,589	1,817	839	891	.	.	.
annual change in % (real)	-6.0	0.8	3.0	5.4	-0.1	1.0	2.3	2.0
Gross industrial production								
annual change in % (real)	-7.2	6.9	2.5	1.0	0.6	0.3	2.0	3.3
Gross agricultural production								
annual change in % (real)	5.2	1.5	-1.3	.	.	.	.	.
Construction industry								
annual change in % (real)	-6.3	2.7	2.6	7.1	-2.7	.	.	.
Employed persons, LFS, th, average ³⁾	5,235	5,213	5,174	5,152	5,038	5,010	5,050	5,090
annual change in %	-1.3	-0.5	-0.8	-0.3	1.5	0.6	0.8	0.8
Unemployed persons, LFS, th, average ³⁾	137	151	118	118	134	140	130	140
Unemployment rate, LFS, in %, average ³⁾	2.6	2.8	2.2	2.3	2.6	2.8	2.6	2.6
Reg. unemployment rate, in %, eop	4.0	3.5	3.7	3.1	3.4	.	.	.
Average monthly gross wages, CZK	36,176	37,903	40,317	39,046	42,246	43,700	46,800	49,200
annual change in % (real, gross)	1.4	0.9	-7.6	-6.8	-4.8	-2.4	2.9	2.2
Consumer prices (HICP), % p.a.	3.3	3.3	14.8	12.6	15.2	11.0	4.0	2.8
Producer prices in industry, % p.a.	0.6	6.2	18.6	18.9	6.3	5.0	3.5	2.5
General governm. budget, EU def., % of GDP								
Revenues	41.5	41.4	41.0	.	.	42.2	42.8	42.3
Expenditures	47.2	46.5	44.7	.	.	46.4	44.7	43.3
Net lending (+) / net borrowing (-)	-5.8	-5.1	-3.6	.	.	-4.2	-1.9	-1.0
General gov. gross debt, EU def., % of GDP	37.7	42.0	44.2	.	.	45.0	44.3	43.0
Stock of loans of non-fin. private sector, % p.a.	4.1	8.4	4.5	8.1	5.4	.	.	.
Non-performing loans (NPL), in %, eop	2.8	2.4	1.9	2.1	1.8	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.25	3.75	7.00	7.00	7.00	6.75	4.50	3.00
Current account, EUR m	4,393	-6,639	-16,911	-4,239	-57	-3,800	-2,000	-200
Current account, % of GDP	2.0	-2.8	-6.1	-3.2	0.0	-1.2	-0.6	-0.1
Exports of goods, BOP, EUR m	128,226	148,552	174,999	85,818	94,424	183,400	190,700	200,200
annual change in %	-8.0	15.9	17.8	13.5	10.0	4.8	4.0	5.0
Imports of goods, BOP, EUR m	117,611	145,936	179,041	87,114	87,313	178,700	185,700	193,700
annual change in %	-9.6	24.1	22.7	23.5	0.2	-0.2	3.9	4.3
Exports of services, BOP, EUR m	22,842	25,275	31,985	14,725	17,121	34,500	37,000	39,600
annual change in %	-16.0	10.7	26.5	25.8	16.3	7.9	7.3	7.0
Imports of services, BOP, EUR m	18,912	21,180	28,333	12,477	15,217	30,900	33,100	35,400
annual change in %	-18.1	12.0	33.8	29.8	22.0	9.2	7.0	7.0
FDI liabilities, EUR m	7,367	10,953	10,045	4,362	5,746	10,000	.	.
FDI assets, EUR m	1,788	9,818	3,009	2,390	463	2,500	.	.
Gross reserves of CB excl. gold, EUR m	134,905	152,755	130,626	148,258	129,054	.	.	.
Gross external debt, EUR m	164,648	181,763	184,682	.	.	201,900	208,000	217,300
Gross external debt, % of GDP	76.3	76.3	66.9	.	.	66.0	65.5	65.5
Average exchange rate CZK/EUR	26.46	25.64	24.57	24.64	23.68	24.0	24.4	24.6

1) Preliminary. - 2) From 2022 including persons granted temporary protection. From 2021 according to census March 2021. - 3) From 2023 a new methodology in the LFS survey is applied. From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS), excluding persons on parental leave from employed persons. - 4) Two-week repo rate.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.