

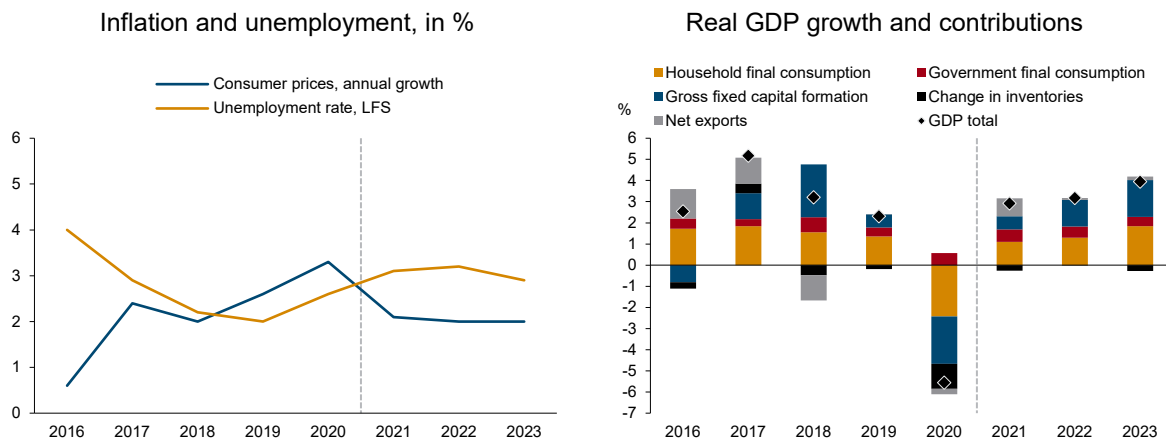


CZECHIA: Light at the end of the tunnel?

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GDP fell by 5.6% in 2020, a smaller decline than had been expected. Although the intensity of the recession was still evident in the fourth quarter of 2020, manufacturing is recovering. A moderate decline in employment is still under way. Czechia's economic fundamentals remain strong: the level of public debt is low, foreign-exchange reserves are very high and the trade balance is in surplus. Positive growth will return in 2021, although the rebound will not be particularly strong.

Figure 4.6 / Czechia: Main macroeconomic indicators



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

The authorities responded promptly to the initial outbreak of the pandemic. Although this came at a significant cost to economic activity, it was successful in restricting the spread of the virus. The lockdown was relaxed in May 2020, but this may have been a premature move. After a lull, the situation worsened again and the government was forced to impose a second lockdown in November. Essentially, this has been in place ever since.¹⁵ The prevailing assumption at present is that the stringency of the measures already introduced will gradually soften, paving the way for economic recovery, possibly towards the end of the second quarter of 2021.

GDP fell by 5.6% in 2020, although the decline was less steep than generally expected. All major GDP expenditure items, except public consumption, declined very strongly during the year: gross capital formation (-12.7%), fixed capital formation (-8.5%), household consumption (-5.2%), and exports and imports of goods and services (-5.9 % and -6.1 %, respectively).

¹⁵ See <https://bsg.ox.ac.uk/research/research-projects/covid-19-government-response-tracker>

The intensity of the recession was not much less pronounced in the fourth quarter. GDP fell by 5.1% (year on year), with household consumption plummeting by 9.3% and gross capital formation by 18.2% (gross fixed capital formation was down by 12.3%). However, exports posted fairly strong growth (4.7%), with imports more or less stagnating. Trade's contribution to GDP growth in the fourth quarter was positive, at about 3.3 percentage points (pp), compared with -0.3 pp for the full year. The surplus on trade in goods and services reached 8% of GDP. Public consumption grew by a remarkable 4.8% in the fourth quarter.

The recession in manufacturing is slowing down. In 2020 as a whole, gross value added (GVA) generated by manufacturing fell by close to 7%, whereas in the fourth quarter it contracted by only 0.9%. However, the recession in most other important sectors deepened in the fourth quarter. In the construction sector, GVA fell by more than 5% in the fourth quarter (compared with 3.5% for the full year); in transportation, trade, accommodation and catering (combined), the fourth quarter saw a 14% decline (compared with a fall of less than 12% in 2020 as a whole).

On the supply side, the overall recovery hinges on manufacturing, which is the major supplier of export goods. In 2020 manufacturing output fell by 7.2% in real terms. Sales of capital and intermediate goods experienced the heaviest losses. Manufacture of motor vehicles, which is of critical importance, declined by 12%. But the production figures for the fourth quarter indicate that a recovery in manufacturing is under way. It is quite obvious that industry's production potential is currently underutilised. That potential may be put into operation should the demand situation improve. Unfortunately, the most recent available data indicate that the volume of new orders (domestic as well as external) placed with manufacturing industry is not yet satisfactory. This situation may well change with an improvement in consumer sentiment at home and abroad.

A moderate decline in employment is still under way. However, a steep decline in hours worked (by more than 5%) is evident. Although average real wages grew quite strongly in the fourth quarter of 2020 (by close to 4%), the total wage bill continues to decline, even in nominal terms. Employees seem to prefer stable employment, even with a reduction in the number of hours worked (and hence a reduction in wages) to the risk of seeking new work opportunities. Certainly, the fact that government support to firms is conditional on the maintenance of employment is a factor in the slow pace of the rise in unemployment. The downward adjustments in employment will continue in 2021. However, as gradual disinflation is under way, inflation will become less of a drag on real wages, household incomes and private consumption.

The strong decline in household consumption in 2020 stemmed not only from the erosion of real incomes but also from an increased propensity to save¹⁶ – the latter most probably related to prevailing income uncertainties (but possibly also to the restrictions imposed on the purchases of various services and non-essential goods during the lockdown). Since May 2020 the monetary aggregates have been growing at speeds twice as high as had previously been the case: in January 2021 the stock of overnight deposits was 19% larger than in January 2020. At the same time, the stock of credit to residents increased by 3% and the stock of credit to the government rose by more than 60%. With attenuated income and employment uncertainties, voluntary household savings are likely to return to normal and demand for durables, apparel and various services may rise above normal levels, to make up for the

¹⁶ The Czech finance ministry's estimates suggest that households' saving propensity increased to 18% in 2020, from 12.5% in 2019. For 2021 the ministry expects a 17.4% saving propensity.

recent restrictions. The extent of the rebound in private consumption will determine the pace of recovery in 2021 and beyond. We expect a muted recovery in household consumption to take place, not earlier than the second half of 2021.

The fiscal deficit ballooned in 2020. At an estimated 6.1% of GDP, it may have raised the public debt/GDP ratio above 38%, still a very low level. The measures taken in response to the pandemic may have cost the public purse as much as 4.6% of GDP (2.2% in foregone tax revenue and 2.4% in additional expenditure). That 'cost' saved about 4% of GDP in 2020. Interestingly, public spending directly supporting households' (and firms') monetary incomes may prove less effective in softening the recession than other types of measures. As already indicated, the rising saving propensities pre-empt effective spending of direct monetary transfers to households.

The Czech National Bank lowered its policy rates quite aggressively, from 2.25% in February 2020 to 0.25% in May. This has pushed down interbank interest rates (and also yields on Treasury bonds) without preventing ongoing disinflation. Low interest rates, likely to prevail in 2021, may be important in promoting greater lending (or making the domestic public debt cheaper to service), and also because of their impact on the depreciated exchange rate of the koruna. The strong (temporary) devaluation during the first half of 2020 (from an average of CZK 25.6:EUR in the first half of 2020 to CZK 27 per EUR in the second) may be partly attributed to a somewhat indiscriminate treatment of 'peripheral' economies in the early stages of the pandemic. But Czechia's economic fundamentals are quite strong, foreign reserves are high and the trade balance is in surplus.

Table 4.6 / Czechia: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	10,594	10,630	10,672	10,700	10,720	10,740	10,760
Gross domestic product, CZK bn, nom.	5,111	5,410	5,749	5,651	5,920	6,230	6,610
annual change in % (real)	5.2	3.2	2.3	-5.6	2.9	3.2	3.9
GDP/capita (EUR at PPP)	26,670	27,900	28,890	27,750	.	.	.
Consumption of households, CZK bn, nom.	2,383	2,524	2,671	2,603	.	.	.
annual change in % (real)	3.9	3.3	2.9	-5.2	2.4	2.8	4.0
Gross fixed capital form., CZK bn, nom.	1,273	1,423	1,509	1,414	.	.	.
annual change in % (real)	4.9	10.0	2.3	-8.5	2.5	5.0	7.0
Gross industrial production							
annual change in % (real)	6.5	3.1	-0.3	-7.2	6.0	5.0	5.0
Gross agricultural production							
annual change in % (real)	-6.2	-0.9	2.1	4.0	.	.	.
Construction industry							
annual change in % (real)	3.3	9.2	2.7	-6.3	.	.	.
Employed persons, LFS, th, average	5,222	5,294	5,303	5,235	5,250	5,250	5,260
annual change in %	1.6	1.4	0.2	-1.3	0.2	0.0	0.1
Unemployed persons, LFS, th, average	155	122	109	137	170	170	160
Unemployment rate, LFS, in %, average	2.9	2.2	2.0	2.6	3.1	3.2	2.9
Reg. unemployment rate, in %, eop	3.8	3.1	2.9	4.0	.	.	.
Average monthly gross wages, CZK	29,638	32,051	34,111	35,611	36,900	38,300	39,800
annual change in % (real, gross)	4.1	5.9	3.5	1.2	1.5	1.8	2.0
Consumer prices (HICP), % p.a.	2.4	2.0	2.6	3.3	2.1	2.0	2.0
Producer prices in industry, % p.a.	0.7	0.7	1.7	0.6	0.8	1.0	1.1
General governm. budget, EU-def., % of GDP							
Revenues	40.5	41.5	41.6	41.4	40.3	40.0	40.0
Expenditures	39.0	40.6	41.3	47.5	46.8	45.6	44.5
Net lending (+) / net borrowing (-)	1.5	0.9	0.3	-6.1	-6.5	-5.6	-4.5
General gov.gross debt, EU def., % of GDP	34.2	32.1	30.2	38.4	43.3	46.7	48.4
Stock of loans of non-fin.private sector, % p.a.	6.5	6.8	5.2	4.1	.	.	.
Non-performing loans (NPL), in %, eop	4.0	3.3	2.5	2.7	.	.	.
Central bank policy rate, % p.a., eop ²⁾	0.50	1.75	2.00	0.25	0.50	0.75	0.75
Current account, EUR m	2,892	962	-660	6,900	5,000	6,700	6,200
Current account, % of GDP	1.5	0.5	-0.3	3.2	2.2	2.8	2.4
Exports of goods, BOP, EUR m	129,241	136,370	139,277	129,526	141,600	152,900	165,100
annual change in %	9.2	5.5	2.1	-7.0	9.3	8.0	8.0
Imports of goods, BOP, EUR m	119,448	128,516	130,082	118,460	129,100	139,300	151,600
annual change in %	9.8	7.6	1.2	-8.9	9.0	7.9	8.8
Exports of services, BOP, EUR m	24,206	25,942	27,120	21,800	23,500	24,900	27,000
annual change in %	9.9	7.2	4.5	-19.6	8.0	6.0	8.5
Imports of services, BOP, EUR m	19,468	21,262	23,054	17,801	19,000	20,800	22,300
annual change in %	7.7	9.2	8.4	-22.8	7.0	9.5	7.0
FDI liabilities, EUR m	9,997	7,129	8,314	5,825	.	.	.
FDI assets, EUR m	8,288	5,156	5,942	2,212	.	.	.
Gross reserves of CB excl. gold, EUR m	123,273	124,142	133,059	134,608	.	.	.
Gross external debt, EUR m	171,115	171,534	172,504	170,900	175,300	179,000	194,400
Gross external debt, % of GDP	88.1	81.3	77.0	80.0	77.0	74.0	75.0
Average exchange rate CZK/EUR	26.33	25.65	25.67	26.46	26.0	25.8	25.5

1) Preliminary and wiiw estimates. - 2) Two-week repo rate.

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