

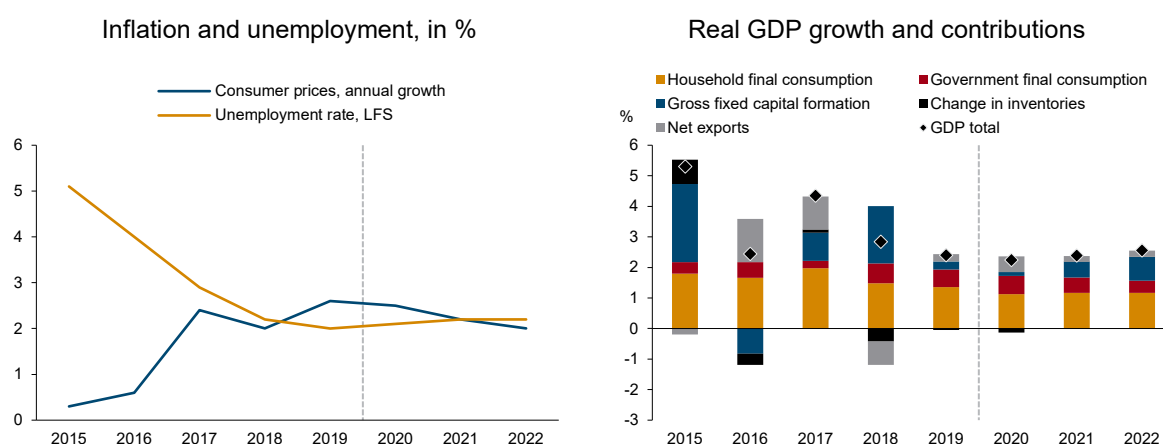


CZECH REPUBLIC: Weak growth at nearly full employment

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GDP growth has gradually been losing momentum, as productive investment starts to decline. Labour resources are nearing depletion, but labour shortages are failing to spark intensified capital formation. Interest rates on loans are no longer as low as they used to be, and the exchange rate is becoming less stable. The recessionary tendencies in Germany are spilling over into Czech manufacturing. Consumption remains the backbone of a subdued growth in output.

Figure 6.6 / Czech Republic: Main macroeconomic indicators



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

GDP growth has been slowing on account of weak capital formation. Faltering investment spending is the main demand-side factor responsible for the weakening output growth. Having increased strongly throughout 2018, gross fixed capital formation rose by only 3% in the first quarter of 2019, before stagnating (it amounted to 1.6% for the first three quarters of 2019).

Productive (business sector) investment is particularly affected. The volumes of investment in the form of machinery, equipment and means of transportation declined in the first three quarters of 2019. In contrast, investment in dwellings and in other buildings and structures (the latter category is primarily related to the realisation of infrastructure projects) kept rising (by 4.7% and 1.4%, respectively). Over the year, growth in public investment slowed considerably (turning slightly negative in the third quarter of 2019). This development correlates with an ongoing deceleration in the growth of investment co-financed from EU funds.

Labour reserves may be nearing depletion. The fairly high participation and employment rates leave room for only slightly higher employment. All the same, in terms of hours worked, total employment increased by 1.2% during the first three quarters of 2019. The scope for productive internal reallocation of labour – from lower-productivity sectors (such as agriculture) to higher-productivity sectors – appears rather limited. Agriculture (which employs slightly more than 3% of the active labour force) is still shedding employment quite vigorously – but without any perceptible easing of the employment bottlenecks in industry and trade. For various reasons (including cultural barriers), net migration is low (20,000-30,000 people a year), while the natural population increase will turn negative in the coming years. Demography is not going to be conducive to high employment dynamics, as the working-age population is expected to continue to decline (whereas the population aged 64 and over is projected to keep expanding quite strongly). Given the constraints on the supply of labour, it is vital that its productivity should increase.

The labour shortages have not intensified fixed capital formation. With labour shortages and rising labour costs, one might have expected greater investment in labour-saving technologies. But this does not seem to hold true in the Czech case. In fact, Czech labour productivity growth has been rather unimpressive. The attractiveness of investing in the Czech economy may have dwindled because the shortage of skilled labour is likely to persist in the future, partly on account of the adverse demographic trends. The cost/wage concerns may additionally discourage capital formation (in favour of alternative locations, such as Romania or Poland).³⁶

Interest rates on loans are no longer as low as they used to be. Despite its 'dovish' reputation, the Czech National Bank has responded to higher inflation by gradually raising the policy interest rate. In real terms, interest rates on loans to the household sector are only moderately positive. Growth of lending to the household sector has slowed somewhat, but remains pretty strong all the same. Despite the rather low interest rates available on business loans, lending to the corporate sector slowed dramatically throughout 2019, mirroring that sector's stagnant output and investment. On the whole, it is not quite clear how higher interest rates will counteract inflation, as lending to the private sector has anyway been contracting.

The exchange rate is becoming less stable. Despite the growing interest-rate differentials vis-à-vis the euro area, for a long time the CZK failed to appreciate in nominal terms against the euro. The absence of pronounced nominal appreciation kept real appreciation at bay and was beneficial for foreign trade. On the other hand, this configuration proved conducive to a growing volume of domestic lending denominated in foreign currencies – something that may prove risky, should there be a stronger devaluation. The abrupt nominal appreciation of the CZK at the beginning of 2020 may represent a long-overdue response to the interest-rate disparities with the euro area. If sustained, the appreciation may have some cooling effect on inflation – but it could also negatively affect the trade balance.

The recessionary tendencies coming to the fore in the German car industry (the key branch of the German economy) may be spilling over into Czech manufacturing, which is tightly integrated with German industry. Brexit and the tensions disrupting global trade will also affect the Czech economy. The depressed export sales are already having repercussions for current production and employment.

³⁶ The average rate of growth of labour productivity (real GDP per employed person) was 2.1% in the Czech Republic (2014-2018), compared to 2.8% in Poland and 4.3% in Romania.

More ominously, the foreign recessionary tendencies are likely to discourage investment, especially in the key automotive branch.

Sound fiscal policy is continuing, but the size of public sector surpluses is set to gradually diminish over the medium term. Thus fiscal policy is generating a (very) modest pro-growth impulse that is likely to compensate, at least partly, for the effects of diminished private investment spending.

Consumption remains the backbone of the subdued output growth. Driven by a strong rise in wages and pensions, household consumption remains the main demand-side source of output growth. But consumption growth is not excessive as (with some delay) inflation is following the rising unit labour costs. Inflation (also in administered prices) is thus eroding real disposable incomes. Moreover, the expanding disposable household incomes are partly absorbed by rising investment in housing, and also go to fuel the household demand for financial assets. Together, these two components of household saving are on the rise – not only because of short-term worries (increased levels of economic uncertainty), but also on account of long-term concerns (e.g. the ageing of Czech society).

The longer-term prospects remain uncertain. A strong (though structurally skewed) manufacturing base will permit balanced (both externally and internally) but unimpressive overall growth for a few more years. Once the German economy strengthens, Czech GDP growth will speed up as well. However, dwindling labour resources do not bode particularly well in the longer run. The Czech economy may need a structural change, with an aggressive technological reorientation. Whether such a move is compatible with the heavy reliance on foreign direct investment that is characteristic of the Czech economy remains an open question.

Table 6.6 / Czech Republic: Selected economic indicators

	2015	2016	2017	2018	2019 ¹⁾	2020 Forecast	2021 Forecast	2022
Population, th pers., average	10,546	10,566	10,594	10,630	10,670	10,675	10,680	10,690
Gross domestic product, CZK bn, nom.	4,596	4,768	5,047	5,324	5,620	5,900	6,170	6,460
annual change in % (real)	5.3	2.5	4.4	2.8	2.4	2.2	2.4	2.6
GDP/capita (EUR at PPP)	25,300	25,600	26,800	28,000	29,000	.	.	.
Consumption of households, CZK bn, nom.	2,125	2,213	2,361	2,491	2,640	.	.	.
annual change in % (real)	3.8	3.6	4.2	3.2	2.9	2.4	2.5	2.5
Gross fixed capital form., CZK bn, nom.	1,216	1,189	1,250	1,364	1,420	.	.	.
annual change in % (real)	10.2	-3.1	3.7	7.6	1.0	0.5	2.0	3.0
Gross industrial production								
annual change in % (real)	4.3	3.4	6.5	3.1	-0.4	1.5	2.0	2.0
Gross agricultural production								
annual change in % (real)	-4.8	7.0	-6.2	-1.1	1.3	.	.	.
Construction industry								
annual change in % (real)	6.8	-5.6	3.3	9.2	2.3	.	.	.
Employed persons, LFS, th, average	5,042	5,139	5,222	5,294	5,303	5,320	5,330	5,330
annual change in %	1.4	1.9	1.6	1.4	0.2	0.3	0.2	0.0
Unemployed persons, LFS, th, average	268	211	155	122	109	110	120	120
Unemployment rate, LFS, in %, average	5.1	4.0	2.9	2.2	2.0	2.1	2.2	2.2
Reg. unemployment rate, in %, eop	6.2	5.2	3.8	3.1	2.9	.	.	.
Average monthly gross wages, CZK	26,591	27,764	29,638	31,868	34,100	36,100	38,000	39,900
annual change in % (real, gross)	2.9	3.7	4.1	5.3	4.3	3.3	3.0	3.0
Consumer prices (HICP), % p.a.	0.3	0.6	2.4	2.0	2.6	2.5	2.2	2.0
Producer prices in industry, % p.a.	-2.4	-3.2	0.7	0.7	1.7	1.5	1.5	1.0
General governm. budget, EU-def., % of GDP								
Revenues	41.1	40.2	40.5	41.8	39.8	40.0	40.5	40.0
Expenditures	41.7	39.5	38.9	40.7	39.2	39.7	40.5	40.3
Net lending (+) / net borrowing (-)	-0.6	0.7	1.6	1.1	0.6	0.3	0.0	-0.3
General gov.gross debt, EU def., % of GDP	40.0	36.8	34.7	32.6	30.3	28.5	27.3	26.4
Stock of loans of non-fin.private sector, % p.a.	6.6	6.7	6.5	6.8	5.2	.	.	.
Non-performing loans (NPL), in %, eop	5.8	4.8	4.0	3.3	2.5	.	.	.
Central bank policy rate, % p.a., eop ²⁾	0.05	0.05	0.50	1.75	2.00	2.25	2.00	2.00
Current account, EUR mn	368	2,744	3,058	628	-133	700	700	900
Current account, % of GDP	0.2	1.6	1.6	0.3	-0.1	0.3	0.3	0.4
Exports of goods, BOP, EUR mn	115,573	118,033	129,242	137,024	138,815	147,000	154,400	162,100
annual change in %	4.7	2.1	9.5	6.0	1.3	5.9	5.0	5.0
Imports of goods, BOP, EUR mn	108,701	108,946	119,458	128,533	129,700	137,500	144,100	151,000
annual change in %	6.1	0.2	9.6	7.6	0.9	6.0	4.8	4.8
Exports of services, BOP, EUR mn	20,603	21,923	24,161	25,776	26,446	27,800	29,500	31,300
annual change in %	8.9	6.4	10.2	6.7	2.6	5.0	6.0	6.0
Imports of services, BOP, EUR mn	17,742	17,942	19,308	21,069	21,790	23,100	24,500	26,000
annual change in %	5.0	1.1	7.6	9.1	3.4	6.0	6.0	6.0
FDI liabilities, EUR mn	1,521	9,809	9,997	7,272	8,175	6,000	.	.
FDI assets, EUR mn	3,357	2,909	8,288	3,730	5,498	4,500	.	.
Gross reserves of NB excl. gold, EUR mn	58,903	80,999	123,273	124,142	132,933	.	.	.
Gross external debt, EUR mn	115,396	129,448	171,115	169,308	175,100	181,200	184,600	188,200
Gross external debt, % of GDP	68.5	73.4	89.3	81.6	80.0	78.0	76.0	74.0
Average exchange rate CZK/EUR	27.28	27.03	26.33	25.65	25.67	25.4	25.4	25.4

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

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