

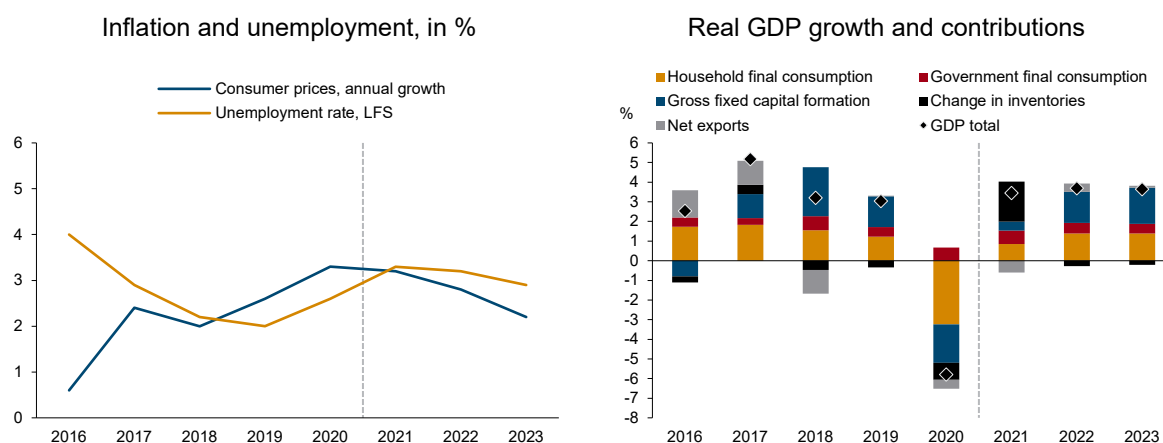


CZECHIA: Turnaround subdued by central bank activity

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Pandemic concerns have been fading. GDP has started to recover, and a rising wage bill is supporting a strong rise in consumption. Growth in gross fixed capital formation is still inadequate, but industrial production is performing very well. An upturn in inflation has led to a tightening of monetary policy. The interest rate hike may have negative consequences for growth, but fiscal policy will continue to be supportive. The prospects, though fairly good, remain unimpressive.

Figure 4.6 / Czechia: Main macroeconomic indicators



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

Pandemic concerns have been fading: no new measures that essentially restrict economic activity are to be expected, while the existing measures are likely to be gradually revoked. Businesses, public institutions and households are returning to 'normality', more or less.

After a decline of 2.7% in Q1 2021, we saw GDP recover and increase by 8.2% in Q2 2021. This turnaround was due primarily to household consumption, which, from a deep trough in Q1, expanded strongly in Q2 to contribute 3.4 percentage points (pp) to overall growth. Gross fixed capital formation shifted from deep recession to an (albeit less pronounced) recovery. However, its contribution to growth was still minuscule (0.4 pp). This contrasted with the huge contribution made by growing inventories (3.2 pp), partly due to an accumulation of work in progress (caused by problems with supply chains). There was a spectacular surge in both imports and exports in Q2, adding 0.5 pp to overall growth.

The wage bill rose by nearly 18% (nominally) in Q2 2021, and this has clearly supported the recovery in household spending. The number of employed persons has been increasing, but only slowly – and it is still 2% shy of the 2019 figure. The number of vacancies again exceeds the number of unemployed people: labour shortages may be on their way back. On the other hand, recent statistics indicate a very strong increase in total hours worked. This may explain the big rise in average real wages – 4.7% in the first half of the year.

The volume of residential construction work has surged in the second quarter of 2021. The recovery in gross fixed capital formation is also visible for other forms of capital investment, and especially transport equipment and productive machinery and installations. Investment in non-residential structures – which currently remains depressed – is likely to accelerate as the EU ‘recovery’ funds become available.

Gross value added (GVA) in manufacturing recorded a rise of 25%, contributing 5.4 pp to overall growth. The GVA of the trade, accommodation, transportation and catering sector rose by close to 9% (having declined by nearly 14% in Q1). The other main sectors, which mostly stagnated or declined in Q1 (including construction), also reported a positive – albeit much less spectacular – growth in GVA.

Industrial production is performing very well. The automotive branch – the backbone of the country’s manufacturing – outperformed all the other branches its output rose in real terms by close to 30% in the first half of 2021 – double the figure for manufacturing as a whole. This trend is likely to continue, though less vigorously. Manufacturing faces large and rising volumes of new orders – domestic, as well as external. But the actual rate of growth in industrial output in the second half of the year may be limited by the emerging shortage of some imported production inputs (e.g. microchips).

An upturn in inflation has already led to a tightening of monetary policy. Currently, the key Czech National Bank (CNB) interest rate is 1.5%. But the mood at the CNB is definitely hawkish, referring to rapidly rising property prices, etc. And so, 2021 may well end with an even higher rate. The irony of the situation is that the current inflation is fuelled by the high cost of imported energy and by rising indirect taxes. These two factors are projected to be important in 2022, as well (inflation next year will be bolstered further by hikes in administered prices). Core inflation – free of such extraneous factors – is not far off 2% now and should not be higher than (an otherwise acceptable) 2.5% in 2022, even allowing for some temporary hikes in food prices.

The factors responsible for the current inflation are plainly insensitive to the actions of the CNB.

It is quite clear that the more restrictive monetary policy is intended to pre-empt extravagant wage settlements and runaway credit expansion that could fuel excessive demand for consumer goods at some point. But this preventive policy carries a high risk of actually depressing consumption and investment ahead of a possible boom. A strong rise in wages and consumption seems desirable to compensate for the losses of 2020 and Q1 2021. Moreover, the concerns about an undue expansion of credit are not entirely valid: the stock of credit extended to the business sector is actually declining, while the stock of credit extended to households is more or less stagnant (only the volume of credit to finance households’ housing needs is increasing fairly rapidly). At the same time, both firms and households are increasing their bank deposit holdings.

The interest rate hike may have negative consequences for the exchange rate. A strengthening koruna (CZK) could alleviate domestic cost and price pressures. But it is unlikely to improve foreign trade and thus real activity. All in all, the CNB's recent activity is likely to limit the scope and size of the real economy, without actually helping to influence the progress of inflation. Inflation will subside on its own, if the exogenous factors permit.

Fiscal policy will continue to be supportive. The fiscal (general government) deficit ballooned in 2020. At an estimated 6.1% of GDP, it raised the public debt/GDP ratio to above 38%, still a very low level. In 2021, the fiscal deficit is likely to be even larger, contributing some 0.6% to GDP growth (via additional measures supporting private consumption and public investment). It is assumed that the deficits will decline steadily in 2022 and 2023, as the extraordinary measures to support household income are phased out.

Prospects are fairly good, but unimpressive. Despite promising signals from the manufacturing sector, the recovery in gross fixed investment is still inadequate. Although fiscal policy remains supportive for the time being, monetary policy – overreacting to inflation, which is largely insensitive to policy interest rates – is likely to subdue real growth, which may hover at around 3.5% in 2021-2023.

Table 4.6 / Czechia: Selected economic indicators

	2018	2019	2020 ¹⁾	2020 January-June	2021	2021 January-June	2021 Forecast	2022 Forecast	2023
Population, th pers., average	10,630	10,672	10,698	10,696	10,698		10,710	10,730	10,750
Gross domestic product, CZK bn, nom.	5,410	5,790	5,695	2,720	2,915		6,070	6,420	6,790
annual change in % (real)	3.2	3.0	-5.8	-6.1	3.0		3.4	3.7	3.6
GDP/capita (EUR at PPP)	27,900	29,100	28,090	.	.		.	.	.
Consumption of households, CZK bn, nom.	2,524	2,663	2,543	1,248	1,275		.	.	.
annual change in % (real)	3.3	2.6	-7.1	-6.4	0.4		1.9	3.1	3.1
Gross fixed capital form., CZK bn, nom.	1,423	1,568	1,495	690	710		.	.	.
annual change in % (real)	10.0	5.9	-7.2	-3.8	0.9		1.7	6.0	7.0
Gross industrial production									
annual change in % (real)	3.1	-0.3	-7.2	-13.2	15.2		10.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	-0.9	2.1	3.9	.	.		.	.	.
Construction industry									
annual change in % (real)	9.2	2.7	-6.3	-2.4	-0.3		.	.	.
Employed persons, LFS, th, average ²⁾	5,294	5,303	5,235	5,245	5,168		5,250	5,260	5,270
annual change in %	1.4	0.2	-1.3	-1.1	.		0.2	0.1	0.1
Unemployed persons, LFS, th, average ²⁾	122	109	137	116	169		180	170	160
Unemployment rate, LFS, in %, average ²⁾	2.2	2.0	2.6	2.2	3.2		3.3	3.2	2.9
Reg. unemployment rate, in %, eop	3.1	2.9	4.0	3.7	3.7		.	.	.
Average monthly gross wages, CZK	32,051	34,578	35,662	34,290	36,802		38,300	40,600	42,500
annual change in % (real, gross)	5.9	5.0	-0.1	-1.0	4.7		4.0	3.0	2.5
Consumer prices (HICP), % p.a.	2.0	2.6	3.3	3.5	2.5		3.2	2.8	2.2
Producer prices in industry, % p.a.	0.7	1.7	0.6	0.5	2.8		5.0	2.5	1.5
General governm. budget, EU-def., % of GDP									
Revenues	41.5	41.4	41.0	.	.		40.3	40.0	40.0
Expenditures	40.6	41.1	47.1	.	.		46.8	45.6	44.5
Net lending (+) / net borrowing (-)	0.9	0.3	-6.1	.	.		-6.5	-5.6	-4.5
General gov.gross debt, EU def., % of GDP	32.1	30.0	37.8	.	.		43.3	46.7	48.4
Stock of loans of non-fin.private sector, % p.a.	6.8	5.2	4.1	5.6	4.2		.	.	.
Non-performing loans (NPL), in %, eop	3.3	2.5	2.7	2.4	2.7		.	.	.
Central bank policy rate, % p.a., eop ³⁾	1.75	2.00	0.25	0.25	0.50		1.50	1.75	1.50
Current account, EUR m	962	747	7,772	3,900	3,820		5,800	6,100	6,600
Current account, % of GDP	0.5	0.3	3.6	3.2	3.8		2.5	2.4	2.5
Exports of goods, BOP, EUR m	136,370	139,428	130,017	60,395	75,192		152,100	167,500	182,600
annual change in %	5.5	2.2	-6.7	-14.7	24.5		17.0	10.1	9.0
Imports of goods, BOP, EUR m	128,516	130,088	119,217	56,712	69,788		140,700	152,300	166,000
annual change in %	7.6	1.2	-8.4	-12.6	23.1		18.0	8.3	9.0
Exports of services, BOP, EUR m	25,942	27,204	22,878	11,626	11,651		24,700	26,200	28,400
annual change in %	7.2	4.9	-15.9	-11.2	0.2		8.0	6.0	8.5
Imports of services, BOP, EUR m	21,262	23,078	18,905	9,165	9,504		20,800	22,800	24,600
annual change in %	9.2	8.5	-18.1	-10.9	3.7		10.0	9.5	8.0
FDI liabilities, EUR m	7,129	9,582	5,539	1,763	2,415		7,000	.	.
FDI assets, EUR m	5,156	4,243	2,831	749	2,421		4,500	.	.
Gross reserves of CB excl. gold, EUR m	124,142	133,059	134,899	134,745	140,057		.	.	.
Gross external debt, EUR m	171,534	172,544	163,883	163,544	164,168		165,800	172,000	175,700
Gross external debt, % of GDP	81.3	76.5	76.1	76.0	70.3		71.0	69.0	66.0
Average exchange rate CZK/EUR	25.65	25.67	26.46	26.34	25.86		26.0	25.8	25.5

1) Preliminary. - 2) From 2021 a methodological change in the economic status of persons on parental leave. -3) Two-week repo rate.

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