

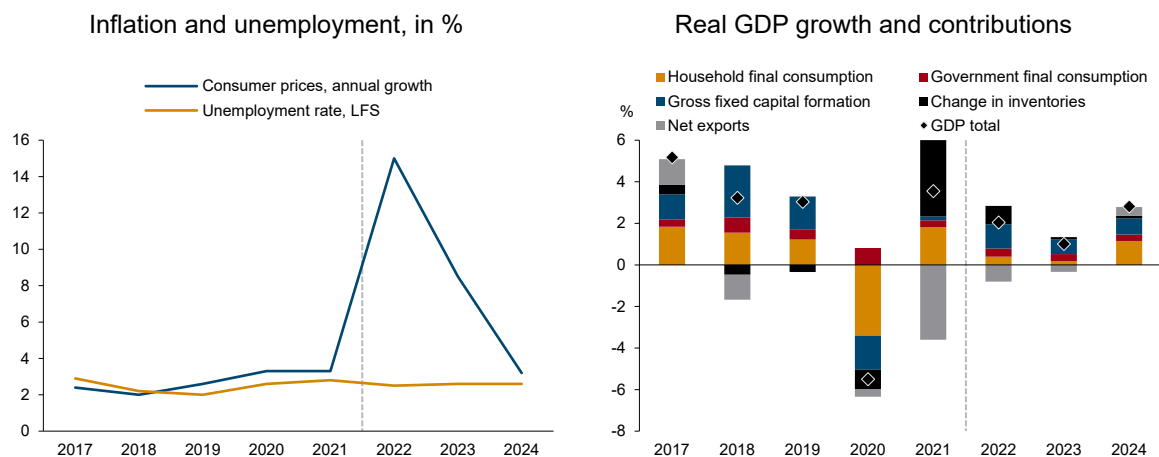


CZECHIA: Outlook lukewarm at best

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The resilience of the Czech economy is fading, and it is anticipated that the coming months will bring recessionary pressures. The reasons for pessimism are piling up: inflation will remain high, real wages will continue to decline, and industry will struggle with supply-chain issues. As a result, after 2% in 2022, growth will slow to a modest 1% in 2023.

Figure 6.6 / Czechia: Main macroeconomic indicators



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

Czechia continued to deal relatively well with the mounting geo-economic challenges in the first half of 2022, although Q2 already started to reveal some signs of weakening momentum. GDP expanded by 0.5% quarterly and 3.7% annually in Q2 2022 – a performance that places the Czech economy at the lower end of the EU spectrum. Gross capital formation was the main growth driver, linked primarily to inventory accumulation (contributing +2.2 percentage points (pp) to year-on-year growth), but also supported by fixed investment (+1.6 pp). Private consumption stagnated in annual terms (0 pp) and shrank against the previous quarter, as households struggled with the ever-increasing cost of living. The consumption of durables fell particularly markedly, suggesting that consumers had previously stocked up on those items, in order to shield themselves from further price rises. Net exports continued to place a damper on growth (-0.6 pp) amidst persistent supply-chain issues that hampered the export of manufactured goods.

The growth prospects going into winter are bleak. A mild recession in the second half of the year is anticipated, moderating the solid growth witnessed so far. The full cost of the Russian war against Ukraine will become apparent in early 2023 and will affect nearly all the demand components of GDP. Gross fixed capital formation will continue to contribute most strongly to an unimpressive real GDP

growth of 1% projected for next year. While the appetite is low for private investment in conditions of high uncertainty and rising borrowing costs, the anticipated disbursement of EU funds is expected to provide a boost to public-sector investments.

Real wages will inevitably be hit in the coming months, and will only begin to recover in 2024, once the inflationary pressures subside. In Q2 2022, real wages took a hit of 9.8%, significantly reducing the purchasing power of the Czech people. Overall, we expect real wages to shrink by 6% in 2022, followed by a further decrease of 1.2% in the coming year. As a result, consumers will increasingly be faced with the choice of dipping into their savings or tightening their belts. As more households become inclined to opt for the latter, domestic consumption will likely be anaemic in 2023, before picking up again towards the end of the forecast period.

The unsupportive environment for industrial production will continue to hurt exporters, resulting in a negative contribution of net exports to growth over the next two years. Industrial performance has been unimpressive and sluggish; but as energy shortages become more acute going into winter, and as supply-chain bottlenecks continue to bite, industrial production is expected to shrink year on year in 2022. In the automotive industry, declining new orders suggest an imminent deterioration in Czechia's most prominent sector. For several reporting periods in a row now, the adverse operating conditions in industrial value chains have been a sore point for the heavily export-oriented Czech economy. Consequently, the current account deficit as a share of GDP is expected to widen to a 15-year high of 4% in 2023, cushioned somewhat by the strong performance of services. While it is anticipated that the downward trend will be reversed in 2024, once the economy begins to regain its dynamism, a current account deficit will be maintained over the whole forecast horizon.

Soaring prices are troubling the Czech economy, with core inflation the highest in the EU. It is expected that inflation will prove finally to have peaked in Q3 2022, at slightly below 20%. However, the spectacle of prices rising at well above the central bank's target of 2% is far from over: next year will still see high single-digit growth in consumer prices, driven predominantly by the developments on global commodity markets. An analysis of the different inflation channels also points to the presence of factors that are not just imported, but are a result of domestic forces. This makes the Czech situation somewhat unique. Here, imputed rents are the major driver, though other items also play a role.

Still, the prevailing sentiment is that monetary policy has now done all it can to tame the price pressures. The Czech National Bank was among the first in the region to sharply raise its policy rates, engaging in nine interest rate hikes since mid-2021. With the nominal two-week repo rate presently at 7%, the policy rate remains in negative territory in real terms. However, as inflation figures are expected to return to much more moderate levels towards the end of next year, further major hikes in interest rates are deemed unlikely.

By contrast, the government has moved far more slowly in putting forward a policy response to the soaring energy prices. Only in September – and following public pressure to lend a helping hand to struggling households and firms – did the government finally introduce support packages. Under the proposed plan, a price cap will be placed on electricity and gas for all retail consumers, including households and small firms. Large firms are to be offered a separate subsidy programme worth an estimated CZK 30bn. The plan proposes financing these packages from the increased government revenues that Czechia has enjoyed thanks to its position as a net exporter of electricity. Nevertheless,

this wide-ranging, untargeted support, combined with the lack of demand reduction incentives, is likely to result in a mild deterioration in the budget deficit.

Despite the headwinds blowing from several directions, the labour market continues to remain stretched. The issue of labour shortages has proved strikingly persistent, weathering all the recent storms. The influx of Ukrainian refugees has slightly alleviated the pressure: as of August 2022, the Czech labour ministry reported that roughly 100,000 Ukrainian refugees had joined the labour market¹⁴ (about a quarter of the influx of refugees into Czechia estimated by UNHCR), with official labour bureau statistics showing a 12% increase in Ukrainian employees in Czechia since February, driven entirely by women. All in all, compared to our previous forecasts, only a marginal deterioration (-0.1 pp) in the unemployment rate is anticipated in 2023, despite a much more significant downward revision of the country's economic growth prospects (-1.9 pp).

¹⁴ <https://www.ceskenoviny.cz/zpravy/praci-ma-107-000-uprchliku-s-vizem-k-ochrane-jurecka-to-oznacil-za-uspech/2246440>

Table 6.6 / Czechia: Selected economic indicators

	2019	2020	2021 ¹⁾	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average	10,672	10,698	10,506	.	.	10,600	10,650	10,690
Gross domestic product, CZK bn, nom.	5,791	5,709	6,108	2,921	3,238	7,170	7,860	8,340
annual change in % (real)	3.0	-5.5	3.5	3.5	4.2	2.0	1.0	2.8
GDP/capita (EUR at PPP)	29,160	27,870	29,500	.	.	.	.	.
Consumption of households, CZK bn, nom.	2,663	2,536	2,715	1,280	1,521	.	.	.
annual change in % (real)	2.6	-7.4	4.1	1.4	4.1	0.9	0.4	2.6
Gross fixed capital form., CZK bn, nom.	1,568	1,516	1,586	721	843	.	.	.
annual change in % (real)	5.9	-6.0	0.7	0.4	8.4	4.5	2.7	3.0
Gross industrial production								
annual change in % (real)	-0.3	-7.2	6.9	15.7	0.2	-0.7	2.5	4.0
Gross agricultural production								
annual change in % (real)	2.0	5.1	-1.0	.	.	.	.	.
Construction industry								
annual change in % (real)	2.7	-6.3	2.7	0.9	5.8	.	.	.
Employed persons, LFS, th, average ²⁾	5,303	5,235	5,213	5,168	5,150	5,200	5,170	5,170
annual change in %	0.2	-1.3	-0.5	-1.4	-0.3	-0.2	-0.5	0.0
Unemployed persons, LFS, th, average ²⁾	109	137	151	169	128	130	140	140
Unemployment rate, LFS, in %, average ²⁾	2.0	2.6	2.8	3.2	2.5	2.5	2.6	2.6
Reg. unemployment rate, in %, eop	2.9	4.0	3.5	3.7	3.1	.	.	.
Average monthly gross wages, CZK	34,578	36,176	37,903	36,893	39,008	41,000	44,000	46,200
annual change in % (real, gross)	4.9	1.4	0.9	3.3	-6.9	-6.0	-1.2	1.8
Consumer prices (HICP), % p.a.	2.6	3.3	3.3	2.5	12.6	15.0	8.5	3.2
Producer prices in industry, % p.a.	1.7	0.6	6.2	2.8	18.9	25.8	16.0	5.5
General governm. budget, EU def., % of GDP								
Revenues	41.3	41.5	40.6	.	.	40.8	41.5	41.5
Expenditures	41.1	47.2	46.5	.	.	45.5	45.2	43.4
Net lending (+) / net borrowing (-)	0.3	-5.8	-5.9	.	.	-4.7	-3.7	-1.9
General gov. gross debt, EU def., % of GDP	30.0	37.6	42.0	.	.	43.0	43.8	44.2
Stock of loans of non-fin. private sector, % p.a.	5.2	4.1	8.4	4.2	8.1	.	.	.
Non-performing loans (NPL), in %, eop	2.5	2.8	2.4	2.7	2.1	.	.	.
Central bank policy rate, % p.a., eop ³⁾	2.00	0.25	3.75	0.50	7.00	7.00	4.00	3.00
Current account, EUR m	747	4,393	-2,074	3,331	-3,488	-7,500	-12,750	-10,750
Current account, % of GDP	0.3	2.0	-0.9	2.9	-2.7	-2.6	-4.0	-3.1
Exports of goods, BOP, EUR m	139,428	128,226	148,002	75,295	85,141	170,900	181,200	189,200
annual change in %	2.2	-8.0	15.4	26.6	13.1	15.5	6.0	4.4
Imports of goods, BOP, EUR m	130,088	117,611	145,221	70,173	86,317	176,000	187,300	194,200
annual change in %	1.2	-9.6	23.5	25.6	23.0	21.2	6.4	3.7
Exports of services, BOP, EUR m	27,204	22,842	25,116	11,594	14,326	30,900	33,600	36,500
annual change in %	4.9	-16.0	10.0	0.1	23.6	23.0	8.8	8.6
Imports of services, BOP, EUR m	23,078	18,912	20,819	9,458	12,136	26,100	29,100	32,000
annual change in %	8.5	-18.1	10.1	3.1	28.3	25.5	11.5	10.0
FDI liabilities, EUR m	9,582	7,367	6,491	2,370	5,409	7,000	.	.
FDI assets, EUR m	4,243	1,788	6,280	2,434	2,589	4,500	.	.
Gross reserves of CB excl. gold, EUR m	133,059	134,905	152,755	140,064	148,258	.	.	.
Gross external debt, EUR m	172,544	164,648	179,866	165,938	184,595	219,600	244,800	259,800
Gross external debt, % of GDP	76.5	76.3	75.5	69.7	63.0	75.5	76.0	76.0
Average exchange rate CZK/EUR	25.67	26.46	25.64	25.86	24.64	24.7	24.4	24.4

1) Preliminary. - 2) From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS), excluding persons on parental leave from employed persons. - 3) Two-week repo rate.

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