

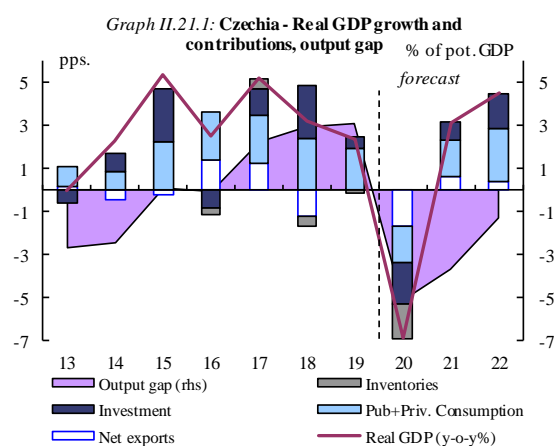
21. CZECHIA

Following a partial recovery from its COVID-19 induced recession over the summer, a resurgence of infections accompanied by renewed containment measures is set to disrupt economic activity once again. Real GDP is forecast to decline by almost 7% in 2020 and return to 2019 levels only by the end of 2022. Inflation is projected to remain elevated this year but should moderate substantially over the forecast period towards targeted levels. Public finances are forecast to deteriorate significantly.

Economic activity to fall but recover over the forecast period

The COVID-19 pandemic and related containment measures are expected to hit Czechia's economy hard in 2020. While the third quarter of 2020 is expected to show GDP growth of around 5% in quarter-on-quarter terms, new containment measures following a major surge in new infections and decreased confidence look set to bring this recovery to a temporary halt in the last quarter of 2020. Real GDP is forecast to contract by almost 7% in 2020, followed by an increase of 3% in 2021 and 4½% in 2022. Nonetheless, the magnitude of the recovery will largely depend on the evolution of the pandemic, the effectiveness of government measures to support the economy and how quickly global demand rebounds.

The reintroduction of social distancing measures will negatively impact domestic demand, which is projected to remain sluggish until early 2021 before picking up afterwards. Private consumption, which was the main driver of growth in recent years, is expected to drop by 5% in 2020, reflecting continued uncertainty and ongoing restrictions. While it is expected to recover in 2021 and 2022, its full return to the previous growth trajectory will depend on the impact of the crisis on employment and wage growth.



Investment to contract strongly in 2020 and recover only partially

Investment is expected to contract by 7½% in 2020, owing to supply chain disruptions, high uncertainty and restrictions affecting workforce availability during the lockdown period. The fall in construction investment may be however softened by the sector's existing order book and its reliance on local supply chains. Investment is expected to recover in 2021 and in 2022. Public investment growth is expected to be weak in 2020 but to rebound significantly in 2021 and 2022.

Trade will be impacted strongly due to the structure of Czechia's exports. The highly procyclical nature of some sectors (such as the automotive sector) is set to decrease the trade balance of goods in 2020. However, provided that supply chains remain functional, despite the structural challenges affecting the automotive sector, manufacturing and exports should continue to recover in 2021 and 2022. At the same time, the trade balance of services is expected to continue to contribute positively over the forecast horizon.

Unemployment is expected to be impacted as well, although its increase should be cushioned by measures taken by the government. Czechia's previously tight labour market and low share of temporary contracts should blunt the impact of the crisis. The unemployment rate is forecast to increase to 2.7% in 2020 and 3.4% in 2021. Strengthening economic growth is expected to improve labour market conditions in 2022, with the unemployment rate decreasing to 3.2%. Real wages are expected to decrease slightly in 2020, but to grow again in 2021 and 2022.

Inflation expected to decrease substantially

Headline HICP inflation is forecast to increase to 3.4% in 2020 and to decline to 2.3% in 2021 and 2% in 2022. The decrease in demand pressures in 2020 is set to be accompanied by temporarily elevated growth in corporate costs related to

COVID-19 and thus have only a limited effect on inflation in 2020. Core inflation is unlikely to fall significantly until early next year. While energy prices are set to remain low, food prices are forecast to stay at elevated levels. Service price inflation is expected to slow over the forecast horizon as the recession weighs on wage growth.

Public finances to improve gradually but risks remain

The general government balance is expected to end 2020 in a deficit of 6¼%, reflecting both lower tax revenues due to declining economic activity and government measures supporting the economy. On the revenue side, the biggest loss is likely to come from a decline in corporate income tax revenue followed by a drop in indirect taxes revenue due to lower domestic consumption. Government support programs add up to over 4% of GDP. While a framework arrangement of more than 5% of GDP has been put in place for state guarantees for company loans, the actual take-up has so far amounted to less than 1% of GDP, which means that risks from the scheme are limited, at present.

With a partial economic recovery, and therefore an increase in tax revenues, the deficit is forecast to decline to 4¾% in 2021, of which 0.2 pps. are investments expected to be eventually financed by the Recovery and Resilience Facility grants. However, risks remain in 2021, related to the eventual prolongation of state support programmes. Personal income tax reforms currently under discussion could have a further negative impact on the budget deficit next year but have not been included in the forecast because they are still uncertain. Under a no-policy-change assumption, the deficit is expected to improve further to 3¾% of GDP in 2022 as the economic recovery accelerates, improving tax revenues and offsetting expenditure growth.

Public debt is likely to increase significantly to 38% of GDP by the end of 2020 and further to 40½% in 2021 and 42¼% in 2022, reflecting primarily the evolution of the headline balance and nominal GDP. At this level it would still remain among the lowest in the EU.

Table II.21.1:

Main features of country forecast - CZECHIA

	2019			Annual percentage change						
	bn CZK	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		5748.7	100.0	2.7	5.2	3.2	2.3	-6.9	3.1	4.5
Private Consumption		2720.2	47.3	2.4	4.0	3.5	3.1	-5.0	2.3	4.3
Public Consumption		1134.7	19.7	1.5	1.8	3.8	2.3	3.5	2.6	1.9
Gross fixed capital formation		1506.9	26.2	2.2	4.9	10.0	2.2	-7.5	3.3	6.3
of which: equipment		606.1	10.5	3.3	1.1	8.9	1.4	-15.2	3.3	7.0
Exports (goods and services)		4276.5	74.4	8.1	7.2	3.7	1.3	-11.0	7.3	5.5
Imports (goods and services)		3930.1	68.4	7.5	6.3	5.8	1.4	-9.5	6.9	5.4
GNI (GDP deflator)		5395.3	93.9	2.4	6.4	3.2	1.8	-7.3	3.2	4.7
Contribution to GDP growth:		Domestic demand		2.1	3.5	4.9	2.5	-3.6	2.5	4.1
		Inventories		0.1	0.5	-0.5	-0.2	-1.6	0.0	0.0
		Net exports		0.5	1.2	-1.2	0.0	-1.7	0.6	0.4
Employment				0.5	1.6	1.3	0.2	-1.1	-0.5	1.5
Unemployment rate (a)				6.6	2.9	2.2	2.0	2.7	3.3	3.2
Compensation of employees / head				4.3	7.2	8.1	6.3	0.3	0.9	1.2
Unit labour costs whole economy				2.1	3.5	6.2	4.1	6.6	-2.7	-1.8
Real unit labour cost				0.4	2.1	3.5	0.3	3.0	-4.1	-3.6
Saving rate of households (b)				11.9	11.8	12.1	12.3	16.2	13.0	9.6
GDP deflator				1.7	1.3	2.6	3.9	3.4	1.4	1.9
Harmonised index of consumer prices				2.0	2.4	2.0	2.6	3.4	2.3	2.0
Terms of trade goods				0.1	-1.3	-0.2	0.3	0.8	-0.2	0.4
Trade balance (goods) (c)				0.4	5.1	3.7	4.2	3.4	3.6	3.7
Current-account balance (c)				-3.5	0.8	-0.8	-1.0	-2.3	-2.0	-1.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.4	1.4	0.1	-0.4	-1.4	-0.9	-0.3
General government balance (c)				-3.0	1.5	0.9	0.3	-6.2	-4.7	-3.7
Cyclically-adjusted budget balance (d)				-3.2	0.6	-0.2	-1.0	-4.2	-3.3	-3.3
Structural budget balance (d)				-	0.6	-0.2	-1.0	-4.2	-3.3	-3.2
General government gross debt (c)				33.3	34.2	32.1	30.2	37.9	40.6	42.2

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.