

21. CZECHIA

While recovering from the 2020 recession, the negative impact of supply-chain disruptions pose headwinds for the Czech economy in 2021. Economic activity is forecast to accelerate in early 2022, driven by both domestic and foreign demand, including public investment supported by the Recovery and Resilience Facility. Inflation is projected to rise in 2021 and 2022 due to the combination of rising energy prices, supply-side bottlenecks and robust demand, but to slow thereafter. While the government budget deficit is set to start decreasing in 2022, permanent measures are expected to keep the deficit above pre-pandemic levels. The government debt-to-GDP ratio remains low but is expected to increase.

After the 1% quarter-on-quarter rebound in real GDP amid easing pandemic-related restrictions in the second quarter of 2021, economic growth in Czechia is expected to moderate in the remainder of this year. While domestic demand is forecast to remain strong accompanied by surging imports, supply chain disruptions are set to weigh on production and exports, bringing annual GDP growth to 3% in 2021. Economic growth is projected to increase to 4.4% in 2022, before returning close to average growth at 3.2% in 2023. Therewith, the Czech economy is set to reach its pre-pandemic output level in 2022-Q3.

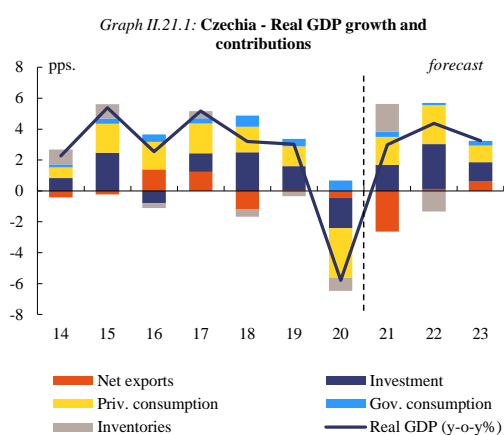
Supported by increasing real disposable income, private consumption bounced back sharply in 2021-Q2 and is expected to remain one of the main growth drivers also for the rest of the year. While the savings rate is set to remain high in 2021, it is projected to start declining in 2022, given stable economic conditions and more spending opportunities. Private investment also rebounded significantly and is expected to remain strong over the forecast horizon, stimulated by external demand and favourable financing conditions.

A boost to public investment by the EU funds is forecast from 2022 onwards. Government consumption is projected to grow at a sustained pace in 2021, fuelled by pandemic-related spending and an increase in the public sector employment bill. In 2022, the growth of government consumption is set to slow as pandemic-related expenditure is phased-out.

Trade impacted by supply-chain challenges

Net exports are forecast to contribute negatively to growth in 2021 due to the intensifying supply chain disruptions. With this factor expected to diminish in the course of 2022, net exports are expected to restart its contribution to economic growth in 2023. After being initially depleted

during the pandemic, inventories are also projected to contribute significantly to GDP growth in 2021.



Labour market to remain robust

The unemployment rate is expected to remain low. With its tight labour market and a low share of temporary contracts, Czechia's labour market was in a good position to absorb the impact of the crisis. The unemployment rate is set to increase only slightly this year, to 2.7%. The accelerating economic growth is expected to improve labour market conditions over the forecast horizon, with the unemployment rate decreasing to 2.6% in 2022 and 2.4% in 2023.

Inflation expected to rise

Inflationary pressures have intensified recently, driven by rising production input prices and increased consumer demand. Annual HICP growth is thus expected to increase to 3.3% in 2021. In response to mounting risks of above target inflation the Czech National Bank recently raised the policy rates. As regulated energy prices are set to be raised at the beginning of 2022, inflation is expected to peak at 3.4% in 2022. Well-anchored inflation expectations are projected to prevent temporary price pressures from becoming

permanent, allowing inflation to slow to 2.3% in 2023.

Fiscal consolidation to start in 2022

The budget deficit is set to widen further in 2021 to 7.0% of GDP, compared to 5.6% in 2020. This is driven by higher expenditure triggered by the extensive fiscal stimulus including the support measures to counter the COVID-19 pandemic, a reduction in personal income taxes, and further increases in pensions and public wages. The expected recovery of private consumption and the higher growth in salaries in 2021 leads to increases in indirect taxes and social security contributions, which are, however, not fully offsetting higher government expenses.

The government deficit is set to decline to 4.3% of GDP in 2022. The COVID-19 support measures started to be withdrawn in the second half of 2021 and are not expected to impact public finances in 2022 anymore. However, some permanent measures taken during the pandemic (e.g. the cut in personal income taxes) will continue to affect budget revenues. Accelerating inflation and higher salaries will also put pressure on government

expenses (pension indexation linked to salaries and inflation, higher intermediate consumption or compensation of state employees), but will also support growth of revenues. This trend is set to continue in 2023 when revenues growth is forecast only slightly higher than the growth in expenditures. The headline general budget deficit is expected to decrease further to 3.9%, but still staying well above the levels before the start of the pandemic. The composition of expenditures is projected to shift towards investments. With the support from the Recovery and Resilience Facility (RRF) and other EU funds, public fixed capital formation is set to surpass 5% of GDP for the first time in the last 10 years. The forecast also incorporates expenditures financed by RRF grants, for a cumulative amount of 1.7% of 2019 GDP over the forecast horizon.

While public debt is still low compared to other EU Member States, the expected pace of its growth in 2020-2023 is above the EU average. The public debt-to-GDP ratio, which stood at 37.7% in 2020, is forecast to rise to 44.3% in 2022 and 46.3% in 2023, driven by the negative headline balance, being only partly offset by nominal GDP growth.

Table II.21.1:

Main features of country forecast - CZECHIA

	2020			Annual percentage change						
	bn CZK	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		5694.6	100.0	2.8	3.2	3.0	-5.8	3.0	4.4	3.2
Private Consumption		2595.7	45.6	2.5	3.5	2.7	-6.8	4.0	5.5	2.3
Public Consumption		1232.4	21.6	1.5	3.8	2.5	3.4	1.5	0.7	1.5
Gross fixed capital formation		1494.6	26.2	2.2	10.0	5.9	-7.2	6.4	10.7	4.3
of which: equipment		545.5	9.6	2.9	8.9	2.6	-13.7	8.5	12.5	0.0
Exports (goods and services)		4042.5	71.0	7.9	3.7	1.5	-6.9	8.4	4.5	5.9
Imports (goods and services)		3653.5	64.2	7.2	5.8	1.5	-6.9	13.4	4.6	5.4
GNI (GDP deflator)		5496.1	96.5	2.6	3.4	2.4	-3.2	2.2	3.7	3.2
Contribution to GDP growth:										
		Domestic demand		2.1	4.9	3.3	-4.5	3.8	5.6	2.6
		Inventories		0.1	-0.5	-0.3	-0.9	1.8	-1.3	0.0
		Net exports		0.7	-1.2	0.0	-0.5	-2.6	0.1	0.6
Employment				0.6	1.3	0.2	-1.7	0.5	0.5	0.4
Unemployment rate (a)				6.3	2.2	2.0	2.6	2.7	2.6	2.4
Compensation of employees / head				4.3	8.1	7.2	3.2	6.0	6.9	4.9
Unit labour costs whole economy				2.0	6.1	4.3	7.7	3.4	2.9	2.0
Real unit labour cost				0.5	3.5	0.4	3.2	-0.5	-0.1	-0.4
Saving rate of households (b)				11.9	12.2	13.1	21.0	20.1	16.8	16.8
GDP deflator				1.5	2.6	3.9	4.4	3.9	3.1	2.5
Harmonised index of consumer prices				1.8	2.0	2.6	3.3	3.3	3.4	2.3
Terms of trade goods				-0.1	-0.2	0.4	2.0	0.5	-0.8	0.6
Trade balance (goods) (c)				1.2	3.7	4.1	5.0	2.5	1.4	2.1
Current-account balance (c)				-3.1	-0.6	-0.9	2.2	-1.2	-2.5	-1.7
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.1	0.2	-0.4	3.5	0.0	-0.4	0.4
General government balance (c)				-2.6	0.9	0.3	-5.6	-7.0	-4.3	-3.9
Cyclically-adjusted budget balance (d)				-2.8	0.0	-0.8	-3.8	-5.7	-3.8	-3.8
Structural budget balance (d)				0.1	0.0	-0.8	-3.8	-5.7	-3.8	-3.8
General government gross debt (c)				34.0	32.1	30.0	37.7	42.4	44.3	46.3

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.