21. CZECHIA

Czechia was hit hard by the second wave of the pandemic. As the situation improves, containment measures are expected to be slowly lifted, leading to a recovery driven by both domestic and foreign demand. Inflation is projected to moderate substantially. The government budget deficit is forecast to stay elevated, due to both temporary fiscal support measures combating the effects of the pandemic and permanent tax cuts. The government debt-to-GDP ratio remains low but is increasing at a brisk pace.

Economic activity to start recovering

According to a preliminary flash estimate, GDP declined by 0.3% in quarter-on-quarter terms in the first quarter of 2021. As the public health situation improves and containment measures are gradually relaxed, a rebound in economic activity should follow. Real GDP is forecast to grow by 3.4% in 2021, driven by both domestic and foreign demand as well as a rebuilding of inventories. In 2022, GDP is forecast to accelerate further to around 4.4%, mainly supported by a rebound in private consumption and investment.

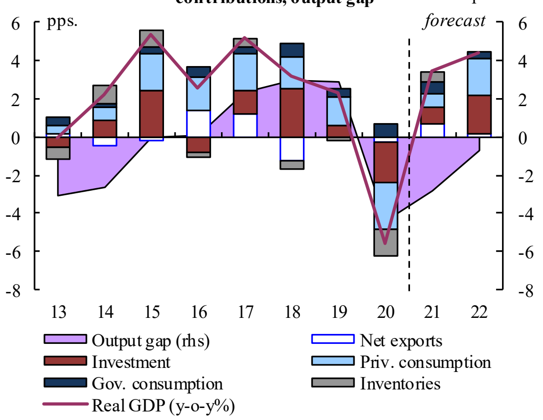
Domestic demand, which has suffered since the reintroduction of social-distancing measures in January 2021, is projected to pick up from the second quarter of the year as the pandemic situation improves, restrictions are eased and uncertainty fades. After an expected increase of around 1.5% in 2021, private consumption should recover further in 2022 when households should also reduce their savings more markedly.

Government consumption is forecast to grow by 2.8% in 2021, fuelled by pandemic-related spending and, to a lesser extent, an increase in public sector employment. In 2022, the rise in government consumption is forecast to slow to around 1.4% due to the unwinding of temporary support measures.

Investment is expected to expand by about 3.6 in 2021, stimulated by external demand, favourable financing conditions and high capacity utilisation rates in industry. Private investment growth is forecast to increase to almost 8% in 2022.

Net exports are forecast to be slightly positive in 2021. The dynamics of exports following the economic recovery of Czechia's key trading partners should just offset the effect of import-intensive investment demand. Increased imports for household consumption are expected to support import growth and slightly worsen the performance of net trade in 2022.

Graph II.21.1: **Czechia - Real GDP growth and contributions, output gap**



Labour market to remain solid

The unemployment rate is expected to remain low. With its tight labour market and a low share of temporary contracts, Czechia's labour market had been in a good position to absorb the impact of the crisis. The unemployment rate is forecast to increase to 3.8% in 2021. The strengthening of economic growth is expected to improve labour market conditions in 2022, with the unemployment rate decreasing to 3.5%.

Wages are expected remain stable in 2021 but to grow again in 2022. With aggregate household income remaining relatively stable and consumption limited by restrictions, the gross household saving rate increased in 2020 and is expected to remain above its pre-pandemic level over the forecast horizon, contributed mainly by higher income households .

Inflation expected to slow substantially

HICP inflation is forecast to ease to 2.4% in 2021. Higher oil and food prices are expected to be the only inflationary drivers in 2021. In 2022, no significant inflationary pressures are expected, except for recovering domestic demand. Inflation is thus expected to decline further to 2.2%, closer to the central bank's target of 2%.

Public finances remain supportive for the economic recovery in 2021

Czechia deployed extensive fiscal stimulus to cushion the downturn in 2020 and to support the recovery in 2021. The general government balance ended 2020 with a deficit of 6.2% of GDP, driven both by declining revenues and increasing expenses. On the revenue side, the main impact came from declining corporate income tax and VAT collection linked to the decrease in private consumption. Expenditures were higher due to several government support programmes. Short-time work schemes like the 'Antivirus' programme and the 'Compensation bonus for self-employed' have proved successful in preserving employment. Several subsidy and guarantee schemes have been put in place to support companies. Social benefits and compensation of government employees also increased, reflecting both temporary COVID-19 expenses but also some permanent increases.

For 2021, the government deficit is set to deepen further to 8.5% of GDP. With a delayed economic recovery, most of the support programmes are likely to be extended. New support programmes for companies affected by the lockdown have been introduced ('COVID-2021' and 'COVID-Uncovered costs'). A cut in personal income tax will permanently increase the budget deficit by almost 2% of GDP. The cut in income tax and higher social benefits are also the reasons for a deficit forecast of 5.4% of GDP in 2022, despite the recovery in other tax revenues and the phasing-out of support programmes.

The economic recovery in 2021 and 2022 is expected to be further supported by the use of grants from the RRF in combination with ESIF funds. The forecast includes RRF-financed expenditures (primarily investments) of 0.4% of GDP in 2021 and 0.7% in 2022.

While public debt is low compared to other Member States, the pace of its growth in 2020-2022 is above the average. The public debt-to-GDP ratio, which stood at 38.1% in 2020, is forecast to rise to 44.3% in 2021 and 47.1% in 2022, driven by developments in the headline balance, partly offset by nominal GDP growth.

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		5748.8	100.0	2.7	5.2	3.2	2.3	**-5.6**	**3.4**	**4.4**
Private Consumption		2720.4	47.3	2.4	4.0	3.5	3.0	**-5.2**	**1.5**	**4.3**
Public Consumption		1133.5	19.7	1.5	1.8	3.8	2.2	**3.5**	**2.8**	**1.4**
Gross fixed capital formation		1509.1	26.2	2.2	4.9	10.0	2.3	**-8.1**	**3.6**	**7.9**
of which: equipment		605.8	10.5	3.3	1.1	8.9	1.4	**-15.0**	**3.2**	**7.2**
Exports (goods and services)		4276.6	74.4	8.1	7.2	3.7	1.3	**-5.9**	**8.5**	**6.2**
Imports (goods and services)		3930.5	68.4	7.5	6.3	5.8	1.4	**-6.1**	**8.4**	**6.6**
GNI (GDP deflator)		5402.2	94.0	2.4	6.4	3.4	1.7	**-5.5**	**3.0**	**4.5**
Contribution to GDP growth:	Domestic demand			2.1	3.5	4.9	2.5	**-3.9**	**2.2**	**4.3**
	Inventories			0.1	0.5	-0.5	-0.2	**-1.5**	**0.5**	**0.0**
	Net exports			0.5	1.2	-1.2	0.0	**-0.3**	**0.7**	**0.1**
Employment				0.5	1.6	1.3	0.3	**-1.5**	**-1.5**	**0.3**
Unemployment rate (a)				6.6	2.9	2.2	2.0	**2.6**	**3.8**	**3.5**
Compensation of employees / head				4.3	7.2	8.1	6.3	**2.9**	**0.9**	**2.8**
Unit labour costs whole economy				2.1	3.5	6.1	4.2	**7.4**	**-3.8**	**-1.3**
Real unit labour cost				0.4	2.1	3.5	0.3	**3.1**	**-5.7**	**-3.3**
Saving rate of households (b)				11.9	11.8	12.2	12.4	**18.8**	**18.2**	**15.6**
GDP deflator				1.7	1.3	2.6	3.9	**4.2**	**2.0**	**2.1**
Harmonised index of consumer prices				2.0	2.4	2.0	2.6	**3.3**	**2.4**	**2.2**
Terms of trade goods				0.1	-1.3	-0.2	0.3	**1.7**	**-0.7**	**-0.5**
Trade balance (goods) (c)				0.4	5.1	3.7	4.2	**5.0**	**4.8**	**4.2**
Current-account balance (c)				-3.5	0.8	-0.6	-0.9	**0.1**	**-0.3**	**-0.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.4	1.4	0.2	-0.3	**0.8**	**0.3**	**-0.2**
General government balance (c)				-3.0	1.5	0.9	0.3	**-6.2**	**-8.5**	**-5.4**
Cyclically-adjusted budget balance (d)				-3.2	0.6	-0.3	-0.8	**-4.4**	**-7.4**	**-5.1**
Structural budget balance (d)				-0.2	0.6	-0.3	-0.8	**-4.4**	**-7.5**	**-5.1**
General government gross debt (c)				33.3	34.2	32.1	30.3	**38.1**	**44.3**	**47.1**

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