Czech Republic

The Czech Fiscal Council

Country note, January 2019

Key messages:

- **The Czech economy is above its potential output and the labour market remains overheated.**
- **General government surplus is expected to reach 1,6 % of GDP and debt 33,0 % of GDP in 2018.**
- **The national fiscal rules were applied for the first time in 2018 and were fulfilled.**

Macroeconomic outlook

The Czech economy is above its potential output, however its rate of growth is currently slowing down to 2,4 % y-o-y in the third quarter of 2018. Current main drivers of the growth remain household consumption and investment while net exports contribute to growth negatively. Due to positive output gap, the labour market remains overheated with unemployment rate on record low levels and wage growth surpassing 8 % y-o-y in nominal terms and 6 % in real terms. Monetary policy has responded by further increases of monetary policy rate to 1,75 %. Increase in interest rate differential vis-à-vis the eurozone and expected appreciation of the koruna is an incentive for foreign investors to further purchases of the government bonds. This could potentially become a source of macroeconomic vulnerability. Another source of potential vulnerability is the domestic overheated property market, which led to tightening of the macroprudential policy on credit markets by the Czech National Bank. The November forecast of economic growth by Ministry of Finance for the next year is reduced down to 2,9 % for 2019 compared to 3,3 % in spring forecast.

Short-term fiscal outlook

General government surplus is expected to reach 1,6 % of GDP in 2018. The surplus is mainly due to local governments while the state budget is running a deficit. A packet of discretionary expenditure programs (e.g. reduction of fares for students and pensioners) amounts to approximately 0,2 % of GDP. The proposed state budget for 2019 is in deficit about 0,8 % of GDP while the total general government should run a surplus of 1,0 % of GDP (but structural balance only 0,5 % of GDP). Therefore, the fiscal impulse is expected to be positive in 2019. The independent Committee for Budgetary Forecasts assessed the latest macroeconomic forecast by Ministry of Finance, on which the proposed state budget is based, as a realistic one.

Medium-term fiscal outlook

Fiscal policy remains procyclical the estimated change in primary structural balance in 2019 is negative and approximately zero in 2020 and 2021. On the one hand, the balance of the general government is expected to be positive in next three years and the debt of general government should therefore decline down to 30,0 % by 2021. On the other hand, rising monetary policy rates will gradually lead to higher expenditures on debt service.

## Fiscal framework and national fiscal rules

The national fiscal rules were applied for the first time in 2018 and were fulfilled. Neither the size of the debt of general government nor the structural balance breached their limits set by the law in 2018 and we do not expect that the limits will be breached in the next three years. However, according to the first report on long-term sustainability of public finance made by Czech Fiscal Council, there are potential risks arising mainly from ageing of the population, which, if not solved in near future, could threaten macroeconomic stability in forthcoming decades.
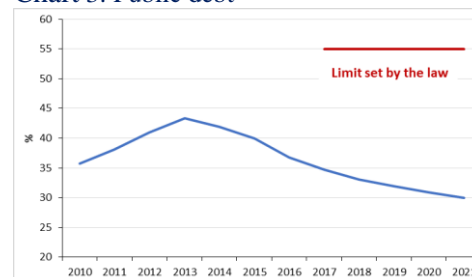

Chart 1: Okun law (2007–2020)

$y = -0,0865x + 0,0148$
$R^2 = 0,368$
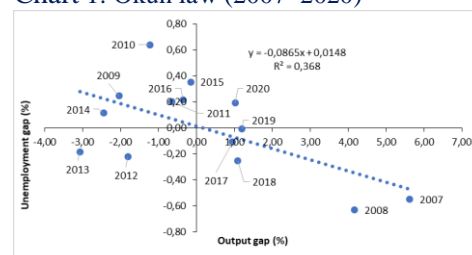
Source: AMECO, forecast: 2018–2020

Chart 2: Structural balance

Limit set by the law
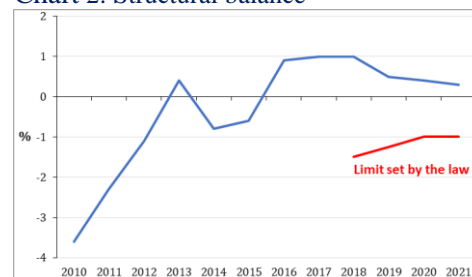
Source: Ministry of Finance (MoF), forecast: 2018–2021

Chart 3: Public debt

Limit set by the law

Source: MoF, forecast: 2018–2021

Key indicator forecast

		2015	2016	2017	2018f	2019f	2020f	2021f	Source
Real GDP growth rate	[% y-to-y]	5,3	2,5	4,3	3,0	2,9	2,7	2,5	1
Output gap	[%]	0,1	0,5	1,4	2,1	2,5	2,4	2,2	2,3,4
GG balance	[% of GDP]	-0,6	0,7	1,6	1,6	1,0	0,9	0,8	1
GG debt	[% of GDP]	40,0	36,8	34,7	33,0	31,9	30,9	30,0	1
Cyclical budgetary component	[% of GDP]	0,1	-0,1	0,5	0,5	0,6	0,6	0,5	1
Cyclically-adjusted balance	[% of GDP]	-0,7	0,8	1,0	1,0	0,5	0,4	0,3	1
Cyclically-adjusted primary balance	[% of GDP]	0,4	1,7	1,8	1,7	1,2	1,1	1,1	1
Structural balance	[% of GDP]	-0,6	0,9	1,0	1,1	0,5	0,4	0,3	1