Czech Republic

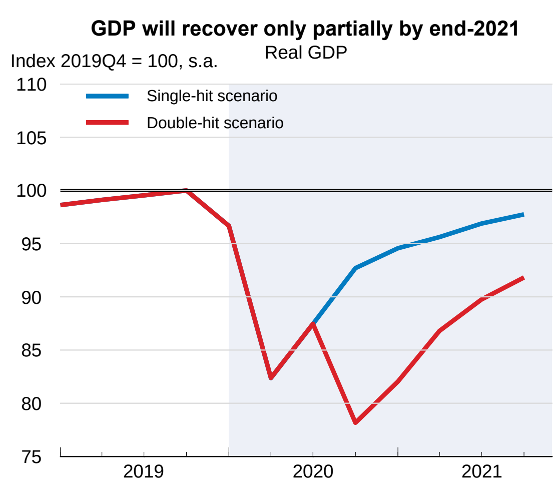
The spread of the COVID-19 pandemic has been contained effectively and the government has started to lift containment measures gradually. Nevertheless, the lockdown and disrupted supply chains have had a deep adverse economic impact. If a further virus outbreak returns before the end of the year, GDP is projected to decrease by 13.2% in 2020. If, on the other hand, the virus outbreak subsides in the coming months, GDP may fall by 9.6%. The economy is projected to recover only partially by end-2021. Bold policy support will help the economy recover from the crisis, but unemployment will rise significantly from low levels.

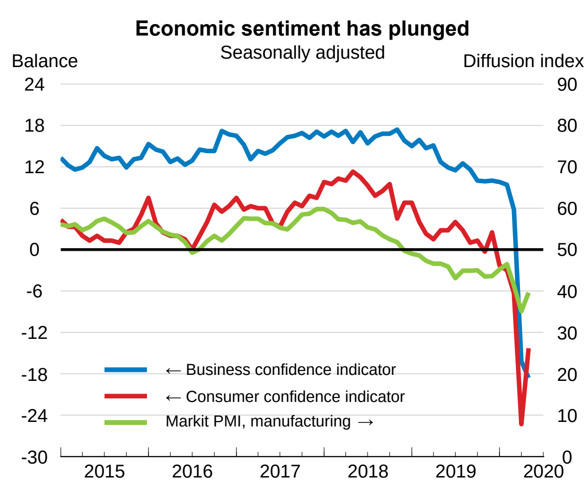
Considerable policy space permits continued support of the economy, although at 0.25%, the Czech National Bank now has limited room to reduce policy interest rates. It could further lower the counter-cyclical capital buffer, as well as introduce quantitative easing, if needed. Fiscal space is available to continue supporting the economy and alleviating hardship while the crisis continues. In a longer-term perspective, boosting R&D investment and strengthening lifelong learning would help future growth. Reducing the time needed to obtain construction permits would boost investment and help restart the economy.

The authorities took early and bold steps to contain the spread of the virus

The Czech health system was relatively well equipped to respond to the crisis, with the number of doctors and acute hospital beds above the OECD average. As the threat of the pandemic rose, additional resources were channelled to the health sector and adjustments were made to raise capacity to treat COVID-19 patients.

Czech Republic





Source: OECD Economic Outlook 107 database; Czech Statistical Office; Markit.

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Czech Republic: Demand, output and prices (double-hit scenario)

Czech Republic: double-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices CZK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 765.8	4.5	2.8	2.5	-13.2	1.7
Private consumption	2 242.1	4.4	3.2	3.0	-11.1	6.3
Government consumption	918.7	1.3	3.4	2.6	6.9	2.5
Gross fixed capital formation	1 188.1	4.0	7.5	2.7	-28.6	-8.4
Final domestic demand	4 348.9	3.6	4.4	2.8	-11.8	2.0
Stockbuilding[1]	49.9	0.1	-0.4	0.2	-0.7	0.0
Total domestic demand	4 398.8	3.7	3.9	3.0	-12.6	2.0
Exports of goods and services	3 789.8	7.1	4.4	1.0	-14.0	3.0
Imports of goods and services	3 422.8	6.3	5.9	1.5	-13.2	3.6
Net exports[1]	367.0	1.1	-0.8	-0.3	-1.4	-0.3
Memorandum items						
GDP deflator	_	1.4	2.6	3.5	3.3	2.2
Consumer price index	_	2.5	2.1	2.8	2.9	1.4
Core inflation index[2]	_	2.0	2.4	2.5	3.1	1.5
Unemployment rate (% of labour force)	_	2.9	2.2	2.0	3.8	5.0
General government financial balance (% of GDP)	_	1.5	0.9	0.3	-8.3	-5.1
General government gross debt (% of GDP)	_	43.9	40.4	38.5	47.9	52.3
General government debt, Maastricht definition (% of GDP)	_	34.6	32.5	30.7	40.2	44.6
Current account balance (% of GDP)	_	1.7	0.4	-0.4	1.7	0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934137599

The pandemic started gathering pace after 9 March, when the first infection of a person without travel history was confirmed. A state of emergency was proclaimed on 12 March. Internal travel and gathering in groups were restricted and international travel banned. Restaurants, hotels and most stores were closed. In the first half of April, the number of people with confirmed COVID-19 infections started to fall. Signs of a rapid containment of the pandemic allowed the government to commence a gradual lifting of restrictions on society and the economy in mid-April.

The stoppage of car production is weighing on the economy

The lockdown had an immediate strong negative impact on economic activity. In March, retail sales fell 9% year-on-year. Similarly, industrial output fell by 11%. Notably, the automobile industry was forced to stop production for almost a month due to international supply chain disruptions and a drop in demand, with repercussions for many domestic SMEs. The purchasing managers index (PMI) indicates a significant drop in manufacturing, and economic sentiment has plunged. The Prague Stock Exchange PX index lost close to 40% of its value from the beginning of the year to mid-March, but recovered about half of it by end-May. The koruna depreciated close to 6% against the euro in the first five months of the year. The unemployment rate started to rise from very low levels. In April, the survey-based unemployment rate rose to 2.3% and the registered unemployment rate rose to 3.4%. According to official estimates, short-time work schemes helped maintain more than 500 thousand jobs by mid-May, with more than 55 thousand applications for support, reflecting mounting slack in the labour market.

Czech Republic: Demand, output and prices (single-hit scenario)

Czech Republic: single-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices CZK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 765.8	4.5	2.8	2.5	-9.6	7.1
Private consumption	2 242.1	4.4	3.2	3.0	-6.9	9.9
Government consumption	918.7	1.3	3.4	2.6	6.9	2.0
Gross fixed capital formation	1 188.1	4.0	7.5	2.7	-22.0	14.0
Final domestic demand	4 348.9	3.6	4.4	2.8	-8.0	8.7
Stockbuilding[1]	49.9	0.1	-0.4	0.2	-0.8	0.0
Total domestic demand	4 398.8	3.7	3.9	3.0	-8.8	8.7
Exports of goods and services	3 789.8	7.1	4.4	1.0	-9.8	11.7
Imports of goods and services	3 422.8	6.3	5.9	1.5	-8.8	14.3
Net exports[1]	367.0	1.1	-0.8	-0.3	-1.3	-1.1
Memorandum items						
GDP deflator	_	1.4	2.6	3.5	3.3	2.3
Consumer price index	_	2.5	2.1	2.8	3.0	1.9
Core inflation index[2]	_	2.0	2.4	2.5	3.1	1.9
Unemployment rate (% of labour force)	_	2.9	2.2	2.0	3.5	3.8
General government financial balance (% of GDP)	_	1.5	0.9	0.3	-6.5	-2.2
General government gross debt (% of GDP)	_	43.9	40.4	38.5	45.7	46.4
General government debt, Maastricht definition (% of GDP)	_	34.6	32.5	30.7	37.9	38.7
Current account balance (% of GDP)	_	1.7	0.4	-0.4	1.5	-1.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

StatLink https://doi.org/10.1787/888934137618

Considerable policy space permitted bold policy support

At the onset of the crisis, policy interest rates were relatively high and public debt was low. Short-time work schemes, benefit payments to the self-employed, income support to workers caring for children, and tax-deferrals have been introduced. Moreover, a COVID loan and guarantee programme has been launched to boost firm liquidity, notably for SMEs. Further support has been offered through deferrals of rent and loan repayments. The Ministry of Finance estimates the size of the support at CZK 1.13 trillion (20.4% of GDP), of which one-quarter is direct budget support and deferred taxes, and the rest is liquidity support and guarantees. In the period from March to May, the Czech National Bank (CNB) cut policy rates three times, from 2.25% to 0.25%, and communicated that it stood ready to do more, including koruna support and quantitative easing. To help banks extend credit, the CNB also lowered the counter-cyclical capital buffer (from 1.75% to 1%).

The economy will not recover fully by the end of 2021

The projections assume a lockdown limited to 6 weeks in the first half of 2020, with a gradual lifting of measures thereafter. Moreover, the double-hit scenario assumes another virus outbreak later in the year with a renewed – more limited - lockdown, but also additional policy support. GDP will contract sharply, and recovery will be only gradual due to prolonged uncertainty. The unemployment rate will rise significantly, and inflation will subside from current levels outside the tolerance band. In the single hit-scenario, recovery will be faster and policy support will help prevent lasting damage to capacity, including by limiting the rise in unemployment. Nevertheless, GDP will not reach its pre-crisis level by the end of the projection period. Both scenarios result in a substantial rise in government budget deficits and public debt. Uncertainty about the outlook is unusually high. Bringing back on stream numerous companies and fully restoring the international automobile supply chain may take longer than expected and additional setbacks could again force shutdowns.

The policy stance should continue to be supportive if needed

After a cumulative cut of 200 basis points between March and May, the Czech National Bank now only has limited room to reduce interest rates further. It could however reduce the counter-cyclical capital buffer further, if needed. It could also launch quantitative easing to counter a potential increase in interest rates at longer maturities. Bank credit quality should be monitored closely to anticipate and address a potential surge in bad loans. Further fiscal stimulus through temporary and well-targeted programmes may be required in event of a second outbreak or continued strains in the economy. Support to R&D investment and enhanced skills building through training and lifelong learning, notably for low-skilled workers, could help productivity growth over the medium term as well as labour reallocation where needed. Shortening the lengthy procedures for obtaining construction permits could importantly boost investment and help restart the economy.

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