Czech Republic

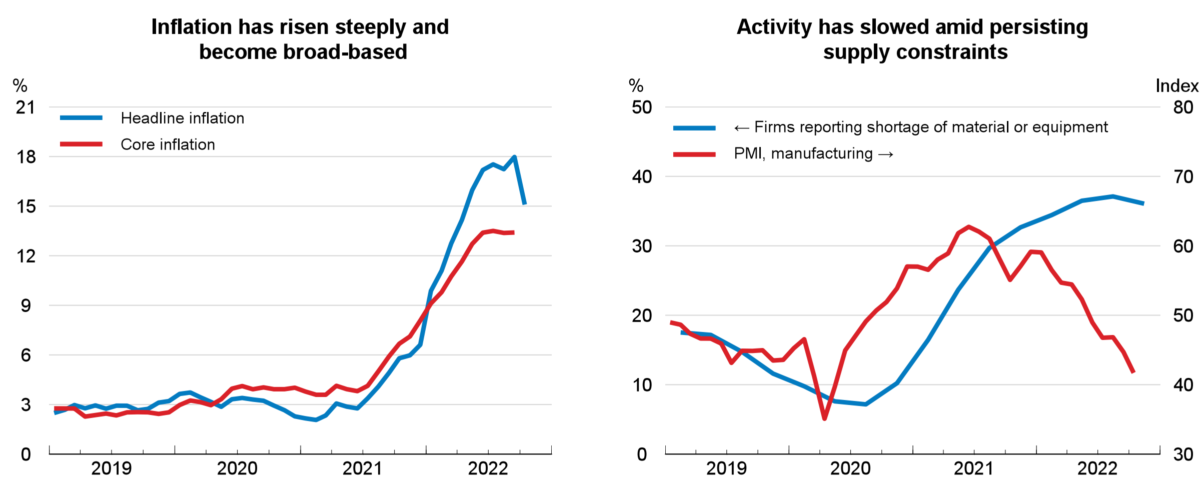
GDP growth will slow from 2.4% in 2022 to -0.1% in 2023, before picking up to 2.4% in 2024. Higher energy and commodity prices and supply disruptions to gas and oil imports from Russia have triggered steep rises in the cost of living and a risk of energy shortages. Lower global growth, persistent constraints in global supply chains and tight financing conditions will hold back activity in 2023. Inflation will start subsiding in 2023 but will remain well above the 2% target. The unemployment rate will remain low, at under 3%.

Macroeconomic policy needs to maintain a tight and well-coordinated stance until inflation expectations are firmly under control. Steady consolidation of the structural fiscal balance should be started, which will also serve to rebuild fiscal buffers. Measures to counter high energy prices should be well-targeted and temporary while preserving incentives for energy savings. Strengthening labour supply and accelerating the green transition would support growth and make it more sustainable.

The economy has slowed markedly

According to the preliminary estimate, GDP fell by 0.4% in the third quarter of 2022. Russia's war of aggression against Ukraine has exacerbated problems in global supply chains and increased pressures on energy and commodity prices. Exports and activity, notably in manufacturing and construction, are constrained by disruptions in the supply of important raw materials and components. Growth in trading partners is slowing significantly. Inflation has risen to very high levels – 15.1% in October 2022 – and become broad-based, squeezing real household incomes. High uncertainty and the looming energy crisis have resulted in large falls in consumer and business sentiment, lowering domestic demand. The labour market remains tight and the unemployment rate low, at 2.2% in the third quarter of 2022. However real wages have fallen sharply.

Czech Republic



Source: Czech Statistical Office; Czech National Bank; and S&P Global.

StatLink https://stat.link/cdu5lp

Czech Republic: Demand, output and prices

Czech Republic	2019	2020	2021	2022	2023	2024
	Current prices CZK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	5 793.9	-5.5	3.5	2.4	-0.1	2.4
Private consumption	2 712.0	-7.2	4.0	0.5	-0.5	2.4
Government consumption	1 134.5	4.2	1.5	0.2	1.0	1.4
Gross fixed capital formation	1 568.2	-6.0	0.6	4.9	-0.9	2.8
Final domestic demand	5 414.7	-4.5	2.5	1.7	-0.3	2.3
Stockbuilding[1]	29.8	-0.9	4.8	1.5	0.0	0.0
Total domestic demand	5 444.5	-5.4	7.6	3.1	-0.2	2.2
Exports of goods and services	4 284.6	-8.1	6.8	3.1	1.6	3.9
Imports of goods and services	3 935.2	-8.2	13.2	4.1	1.4	3.6
Net exports[1]	349.4	-0.4	-3.6	-0.6	0.1	0.2
Memorandum items						
GDP deflator	_	4.3	3.3	8.7	8.8	4.2
Consumer price index	_	3.2	3.8	15.2	9.9	4.1
Core inflation index[2]	_	3.6	5.0	12.4	10.0	4.1
Unemployment rate (% of labour force)	_	2.5	2.8	2.3	2.6	2.8
Household saving ratio, net (% of disposable income)	_	16.8	15.6	8.6	7.6	8.5
General government financial balance (% of GDP)	_	-5.8	-5.1	-4.5	-4.1	-2.4
General government gross debt (% of GDP)	_	47.0	48.5	51.7	54.5	55.7
General government debt, Maastricht definition[3] (% of GDP)	_	37.6	42.0	45.2	48.0	49.3
Current account balance (% of GDP)	_	2.0	-0.8	-4.0	-2.9	-3.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 112 database.

StatLink https://stat.link/9wrfgn

The Czech economy relied heavily on energy imports from Russia prior to the war, with virtually all gas originating from Russia. Efforts have continued to fill gas storage capacity sufficiently and find alternative sources. With usual winter temperatures the current supply should suffice for the 2022-23 winter, and the projections assume no major supply issues over the 2023-24 winter. The government has introduced measures to cushion the impact of high energy prices, including income support to households and SMEs, price caps on energy, and temporary cuts in excise taxes on fuels, partly financed by a newly introduced tax on excess profits of energy producers, traders and banks. The Czech Republic has witnessed a large inflow of Ukrainian refugees. According to the United Nations High Commission for Refugees, at end-October, around 455 000 refugees were recorded in the country, which is the highest ratio of all receiving countries and equivalent to 4.3% of the total population. Provision of basic services and cash transfers add to fiscal costs. At the same time, about a third of refugees of working age were employed as of late August 2022, easing slightly the tightness of the labour market and reducing reliance on government aid.

A tight macroeconomic policy stance is warranted

The central bank has tightened monetary policy significantly to counter rapid increases in core inflation and rising inflation expectations. Between June 2021 and June 2022, it raised the policy interest rate from 0.25% to 7%, after which it paused its tightening cycle. It also intervened more actively on the foreign exchange market to reduce exchange rate volatility and stave off depreciation pressures on the koruna.

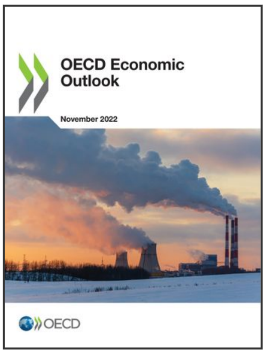
The projections assume that the policy interest rate rises further to 7.75% in the fourth quarter of 2022. A gradual easing cycle is projected to start in the fourth quarter of 2023. Fiscal policy has been providing stimulus over recent years to support the economy during the pandemic, but too many measures have been untargeted and with a permanent impact on the government structural balance. The fiscal situation has deteriorated, fiscal rules have been loosened and a credible fiscal consolidation plan has yet to be presented. Recently introduced measures to cushion the impact of high energy prices are assumed to stay in place over the projection horizon, contingent on the evolution of market prices. The general government deficit will be at 4.1% of GDP in 2023 and fall to 2.4% in 2024, while public debt will continue rising.

High uncertainty will continue to weigh on growth

Activity will be held back in 2023 by high energy prices and continued high uncertainty. Private consumption will remain subdued due to rising prices and depleted household savings. Uncertainty and tighter financing conditions will hold down private investment, but public investment will be boosted by EU financing. With eased global supply disruptions, growth will pick up in 2024 as international trade growth strengthens. Inflation will start falling from currently very high levels, as tightened financing conditions dampen domestic demand. Unemployment will rise slightly, but the labour market will remain tight over the projection horizon. Risks include rises in commodity and energy prices, a strong depreciation of the koruna and de-anchored inflation expectations, each of which would further fuel inflation and make it more persistent. A breakdown of trust among social partners would likely result in a destabilising wage-price spiral. On the other hand, a deeper recession and lower confidence would lower inflation more quickly.

Strengthening labour supply and accelerating the green transition would support growth

The central bank has appropriately tightened monetary policy, and interest rates will have to remain elevated until inflationary pressures are well controlled. Fiscal policy should avoid stimulating aggregate demand in order not to undermine monetary policy. Fiscal support measures to cushion rising energy prices should be better targeted and maintain incentives for energy savings. Boosting domestic labour supply (through increased employment of mothers and older workers), better matching skills provision with skills needs and using immigration policy more effectively would help attract and retain skilled labour. Investment into renewable energy and electric vehicle mobility would reduce reliance on the gas and oil markets and help the recovery. Incentives to boost energy efficiency, including for heating and insulation in the residential sector, should be strengthened to reduce reliance on coal.



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