



Weekly Briefing

Czech Republic economy briefing:
The Czech Economy amidst Crisis: The Darker & Brighter Sides
Ladislav Zemánek

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.
Szerkesztésért felelős személy: Chen Xin
Kiadásért felelős személy: Huang Ping

 1052 Budapest Petőfi Sándor utca 11.
 +36 1 5858 690
 office@china-cee.eu
 china-cee.eu

The Czech Economy amidst Crisis: The Darker & Brighter Sides

The national economy remained stabilised and maintained in a state of „an artificial hibernation“. Whereas an overall growth and low unemployment are expected in the months following termination of the lockdown, there are indications of risks and difficulties. In the analysis, I will focus on chosen problems related to recent economic development.

Irrespective of the overall interventionist policies and massive subvention programmes, approximately 15,500 companies ceased to exist last year, the figure being higher by 450 in comparison with 2019. To put it more concretely, it applied to 14,700 companies with limited liability and 800 joint-stock companies. At the same time, the number of newly established economic subjects was the lowest over the last 5 years. Generally, there are about 500,000 companies of both legal forms. It follows that the total number decreased by roughly 3 per cent in 2020. The reason is obvious – state restrictions, lockdown practices and partial transition towards artificial hibernation of social as well as economic processes as a result of political decisions. Negative effects have not been, however, distributed equally. While there have been industries exposed to fatal problems, the very existence of which being in danger, other branches have been booming. Any deep crisis has winners and losers and the present one is no exception. Among the most seriously afflicted, one can find accommodation, gastronomy, conference, tourism business and all others intertwined with them. The recently published statistics about Czech companies in 2020, nevertheless, do not reveal the gravity of the economic situation in our country because of a significant distortion incurred by state subsidies and extraordinary support.

The private sector to be at risk

The economic survival of a wide array of economic subjects is expensive, generating enormous state debt. Such generous state policies cannot last for a long time, therefore, deterioration may be expected in this regard. For instance, 1336 companies ceased to exist in January which is by 5 per cent more year-on-year. Simultaneously, 2413 new companies were registered, being by 11 per cent less than in January 2020. The first two months of this year was characterised by the continuation of a negative tendency consisting in decline in people's

interest in entrepreneurship, business stagnation and a rising number of bankruptcy, suspension or termination of business activities. Whereas a glimpse of the capital companies need not provoke alarmist sentiments, the situation is obviously more unfavourable from the point of view of the self-employed persons. In January, more than 25,500 self-employed persons (2.4 per cent from approximately 1.05 million altogether) suspended their business which is an unprecedented figure since 1989. The most hit branches were production, trade and services. According to the recent data, nearly 100,000 self-employed persons interrupted business, i.e. by 40 per cent more compared to the pre-crisis 2019.

The Czech Chamber of Commerce, the largest and most representative business association in our country and the only legal representative of Czech entrepreneurs, published results of a survey conducted among the self-employed persons and businesses operating in the most severely affected industries such as gastronomy, sports venues, retailing, laundries or the cleaner. The research shows that 20 per cent of these economic subjects will be forced to terminate their business in case the present lockdown continues more than a month, and the other 40 per cent thereof will declare bankrupt no later than in 3 months. The state subsidies cover less than a third of their wage and fixed expenses while the rest (including rental, leasing, power supplies or insurance) are frequently covered by loans or reserves. A frequent scenario is that these businesses contract debts in favour of their contractors. Regardless of the costly state support, about 10 per cent of entrepreneurs do not meet the requirements needed for obtaining subsidies, even though they are partially or fully subjected to the restrictions.

Unemployment maintained low

Several supportive programmes introduced by the Government are aimed not only at compensation for economic losses brought about by the restrictive regime but also at the maintenance of the high employment rate which has been typical of the Czech labour market for a long period. Irrespective of the tightening of the countermeasures in the course of February face to face with a negative epidemiologic situation, the unemployment rate remained at 4.3 per cent which was observed in the first month of the year. Unemployment raised by 1.3 per cent year-on-year. From the European perspective, the Czech Republic lost first place among the countries with the lowest unemployment rate, being replaced by adjacent Poland. From the official statistics of the Labour Office of the Czech Republic follows that there were 311,463 job applicants, by mere 2,604 persons more in comparison with January. At the same time, the number of job vacancies increased (330,735), being higher than the number of job applicants

in total. A characteristic feature of the present labour market is a sharp asymmetry of the crisis with regard to individual labour branches. While the restricted or completely closed businesses generate available labour force, there are industries suffering from a labour shortage, for instance, manufacturing, health care or social care.

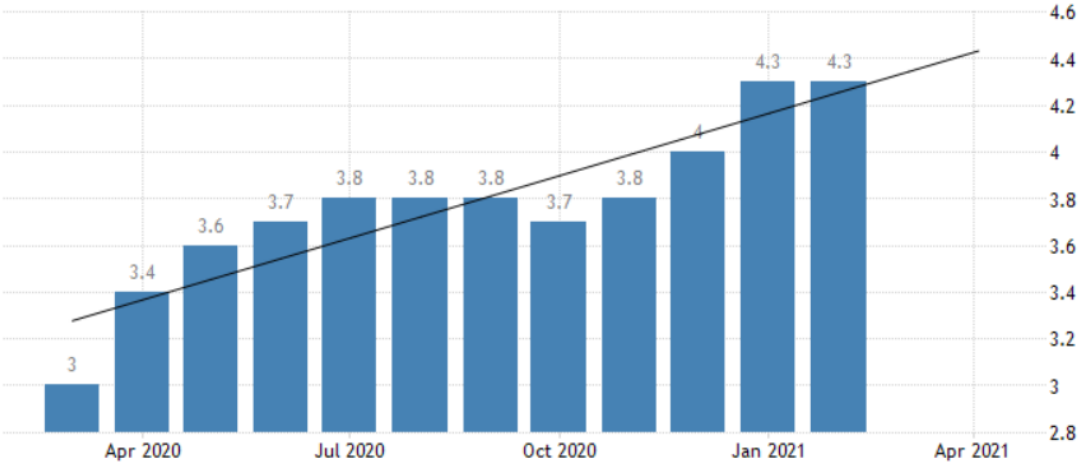


Table 1: The development of unemployment since March 2020 when the epidemic burst out in the Czech Republic. The trend is rising as shown by the black line.

Source: Ministry of Labour and Social Affairs, tradingeconomics.com

Beyond any doubt, these low figures are influenced substantially by the Government’s policies. Given the oncoming October parliamentary election, a change of the general direction and dominant paradigm towards a less interventionist one cannot be expected as it might have an impact on support of the leading ANO movement, the voters of which recruits predominantly from the old-age pensioners and employees, these groups being rather in favour of state interventionism, protectionism, paternalism, and restrictions as far as the epidemic is concerned. The unemployment hike is therefore utterly improbable in the months to follow. Moreover, seasonal work, which usually decreases the number of the unemployed, will push against a rise in the rate. Future development is highly dependent on the impacts of the restrictions, their shape, extent and duration. Taking the results of the survey carried out by the Czech Chamber of Commerce into consideration, insolvency and bankruptcy of businesses in the most afflicted industries could lead to an increase in unemployment. It follows that the crucial factors will be the state subsidies, management of the anti-crisis policies and the ability to cope with the epidemic no matter what method is used. The massive subvention policy, however, has depleted state financial reserves while the continuation of the lockdown,

mismanagement of the situation and obvious absence of both the overall strategy and tactics in the fight against the epidemic have exhausted the population, arousing mistrust, frustration and disobedience. Therefore, the question is to what extent such policy is sustainable and for how long. Costs are too high.

Rating to remain unchanged

Costs can be demonstrated on the balance of the state debt. Last year, it soared by 410 billion CZK (nearly 15.8 billion EUR) to an all-time high of 2.05 trillion CZK (78.85 billion EUR) in total. The state budget deficit was the highest in the modern history of our state. The state debt related to the GDP increased from 28.5 to 36.5 per cent. Even though the Czech Republic remains to be one of the less indebted countries in the European Union, it is not a piece of positive news, rather it proves the dismal economic reality of the present day. Hypothetically, each citizen including children owes about 191,000 CZK (7,346 EUR). The state debt is financed through state bonds, treasury bills and different types of loans. Albeit, the interests rates are propitious, financing of the state debt being cheap, such a situation can turn quickly, especially in case of the further steep rise in indebtedness. The international rating agencies might deteriorate the overall rating of the Czech Republic then which would bring about manifold negative consequences.

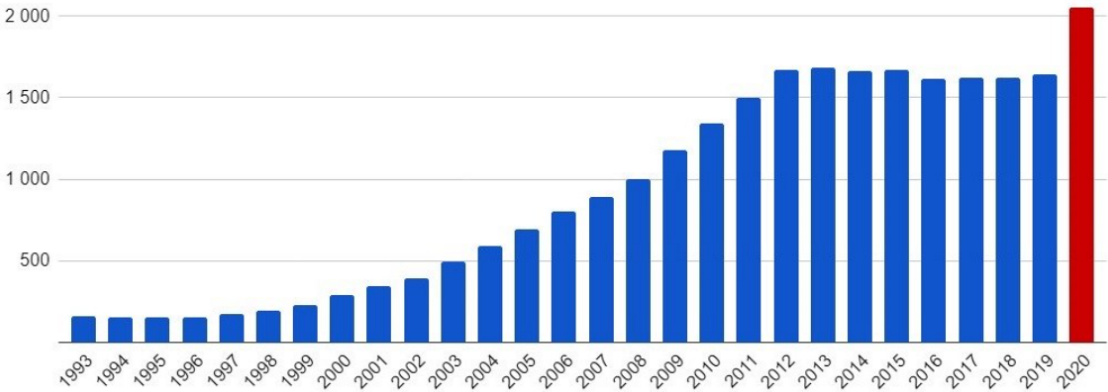


Table 2: The development of the Czech Republic's state debt since 1993 (figures on the left depict the debt in billion CZK).

Source: Ministry of Finance

In February, nevertheless, the Moody's Investors Service affirmed our country's debt ratings at Aa3, maintaining the stable outlook.¹ The main reasons are as follows: (1) strong both medium- and long-term economic resiliency despite the 2020 recession; (2) solid fiscal strength owing to the pre-crisis low debt level and strong debt affordability. The Moody's appreciated the stability and resilience of the Czech banking sector, predictability and transparency of the economic environment as well as a low level of political risks. According to the rating agency, the coronavirus epidemic will not cause lasting damages and the Czech GDP is expected to return to the pre-crisis figures no later than in 2022. The report emphasises the strong growth potential our economy has. Undoubtedly, such an assessment from abroad is positive, however, it should not cover serious structural problems and numerous risks. If the current crisis is mismanaged by the state authorities with the Government at the top, the Czech Republic's economy may be trapped.

¹ For greater detail see https://www.moodys.com/research/Moodys-affirms-the-Czech-Republics-Aa3-ratings-and-maintains-stable--PR_439412.