



## **Weekly Briefing**

**Czech Republic social briefing:  
Inflation and Its Social Context: Towards a Vicious Circle?  
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# **Inflation and Its Social Context: Towards a Vicious Circle?**

## **Summary**

*Inflation is increasingly high in the Czech Republic and so are the basic interest rates set by the central bank. Whilst the real estate market is overheating from the point of view of the Czech National Bank, the increase in rates will probably not stop the considerable rise in prices of real estate. The overall inflation is, nevertheless, rather of domestic origin. It has been boosted by the state policies, including the expansionary fiscal policy and quantitative easing as their fundamental. Long-term inflation management cannot be effective without revising the social policy.*

## **Introduction**

The predictions formulated in the September economic briefing have been fulfilled.<sup>1</sup> The rapid rise of official inflation is going on which worries the Czech National Bank (CNB). The inflation rate amounted to 5.8 per cent in October, particularly due to an increase in prices of energy (electricity, gas) and expenses on housing. It is worth noticing that the inflation target set by the Czech National Bank is 2 per cent. It follows that inflation has gotten out of control. In response to that, the central bankers have repeatedly increased the basic rates.

## **Real estates and the housing question**

At the beginning of November, the two-week repo rate was increased by 1.25 per cent to 2.75 per cent while the discount rate to 1.75 per cent, and the Lombard rate – to 3.75 per cent. Such an increase was the biggest since 1997, having surprised an overwhelming majority of both economists and politicians.<sup>2</sup> Naturally, such a step will entail higher expenses on loans and mortgages for households as well as businesses, and strengthening of the national currency,

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<sup>1</sup> Zemánek, L., *High inflation: Recent Development & Central Bank's Response* (2021, November 02), china-cee.eu. Retrieved November 19, 2021, from <https://china-cee.eu/2021/11/02/czech-republic-economy-briefing-high-inflation-recent-development-central-banks-response/>.

<sup>2</sup> Hovorka, J., *Peníze dál rychle zdražují. ČNB prudce zvedá sazby* (2021, November 04), china-cee.eu. Retrieved November 15, 2021, from <https://www.penize.cz/urokove-sazby/429935-penize-dal-rychle-zdrazuji-cnb-prudce-zveda-sazby>.

hence lower real income for subjects operating abroad. The considerable increase in interest rates will probably lead to cooling down the mortgage market.<sup>3</sup>

Nevertheless, it does not necessarily mean that the real estate boom is over. Demand for mortgages may decrease but, still, there is and will be many people who have sufficient sources at their disposal, be they individuals (from the Czech Republic or abroad) or legal persons. So the intentional making mortgage more expensive will not likely to stop rising of prices, mitigate it at maximum only. One of the recent trends are acquisitions of real estate (especially flats) by investment funds. Of course, individuals cannot compete with these big financial actors. Interestingly, two years ago there was no institutional investor focusing on acquisitions of new flats. For property developers, in turn, is it easier to negotiate about a large-scale deal with a single investor than with dozens, hundreds or thousands of individuals. At least for this simple reason, one cannot expect a turn as far as the real estate property prices are concerned. It will result in an increase in the number of people renting a flat which will push the rent fee upwards.

In other words, the very Czech phenomenon of private homeownership might change gradually, since an overwhelming majority of people will not be sufficiently creditworthy to buy a flat. Nowadays, up to 79 per cent of people live in their own flat or house while merely 21 per cent have decided to rent one. From a comparative perspective, the average figure of homeownership throughout the EU amounts to 70 per cent. Interestingly, the highest numbers can be observed in the case of the post-socialist countries, including adjacent Slovakia or Poland. Big portfolios of rental flats have not existed apart from several exceptions, for

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<sup>3</sup> Whereas applicants could have been offered an interest rate of less than 1.8 per cent one year ago, in November people who wanted to get a mortgage must have been satisfied even with 4.0 per cent or more. In practical terms, if a client wants to buy a new flat of 65 square metres (which is an average flat in the Czech Republic) in Prague, the purchase price is around 8.9 million CZK (137.000 CZK per square metre). Let's suppose that the buyer has 20 per cent out of 8.9 million CZK in cash (the minimum amount to be paid by the client from his/her own means is 10 per cent but the former case is more usual because of more beneficial terms), then the mortgage equals 7.120.000 CZK. Under the current circumstances (4.0 per cent rate), clients are to pay 33.992 CZK per month with a 30-year maturity. One year ago, the monthly instalment was, however, 25.611 CZK. In other words, monthly instalments have been increasing by thousands of CZK which is not negligible at all, especially in relation to salaries. In the second quarter of 2021, the average *gross* salary reached 46.163 CZK in Prague (by 20.6 per cent more in comparison with the country's average figure). It follows that nowadays an average inhabitant of the capital spends virtually 75 per cent of the salary on the repayment of the mortgage for an average flat. It is obvious that accessibility of individual ownership of real estate becomes increasingly lower. Not by coincidence, this question was one of the most discussed within the parliamentary election campaign this year. See *Průměrná hrubá mzda v Praze dosáhla ve 2. čtvrtletí roku 2021 hodnoty 46 163 Kč, republikový průměr tak přesáhla o 20,6 %* (2021, September 03), kurzy.cz. Retrieved November 15, 2021, from <https://www.kurzy.cz/zpravy/608283-prumerna-hruba-mzda-v-praze-dosahla-ve-2-ctvrtleti-roku-2021-hodnoty-46-163-kc-republikovy-prumer/>. And also Moniová, E., *Hypotéka pod 4 % je vzácná skoro jako jednorožec. Splátky vyskočí o tisíce* (2021, November 13), seznamzpravy.cz. Retrieved November 15, 2021, from <https://www.seznamzpravy.cz/clanek/podivejte-se-kolik-kde-stoji-hypoteky-pod-4-procenta-se-dostanete-malokde-180310>.

instance, Heimstaden or CPI Byty companies. The rising demand for such a strategy indicates that big investors expect an expansion of rental housing in the next years and decades.<sup>4</sup>

### **Roots of the Czech inflation**

As far as the predictions of inflation development are concerned, the Czech National Bank has resigned from pressing inflation down to its target for now, estimating the rate to reach 7 per cent at the beginning of 2022, not falling below 5.6 per cent for the whole year. Considering inflation in the Czech Republic, an important point is that it has predominantly domestic roots. The not negligible role has been played by the rise of prices of energy or fuels on the global markets, problems with logistics or multiple hindrances within the global supply chains. However, if the high inflation was imported, the situation would be similar in other countries in the CEE region or the EU as such, which is not.<sup>5</sup> Domestic causes of inflation are related to the overall economic recovery after the lockdowns and severe restrictions that is accompanied by very strong demand, shortage of labour force, materials and individual economic subjects' inflation expectations. Face to face with the ubiquitous price increase, employees, trade unions as well as the Government itself press the employers (both in the state and private sector) to increase wages in order to at least compensate for the inflation to avoid the lowering of living standards. Nevertheless, such pressures further contribute to inflation, resulting in a vicious circle. Instead of the state authorities and political representatives would put emphasis on necessary budget cuts, austerity measures together with investment in innovations, disruptive models and progressive technologies, they have spent money for a massive increase in salaries, pensions and a wide array of compensatory allowances. The result is not only a considerable rise in state debt but also in people's savings and excess of cash.

This is not to say that increasing wages or pensions is bad. The problem is that such a rapid rise is not accompanied by a concurrent increase in labour productivity. Many people had higher real income during the pandemic than before, which enabled them to save more. The savings on the bank accounts have reached 3 trillion CZK (120 billion EUR). From April 2020 to March 2021, the Czechs accumulated 4.2 times more than was the annual average over the

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<sup>4</sup> Vejvodová, A., *Fondy ve velkém skupují nové byty, pořídít si vlastní bydlení tak bude pro Čechy těžší* (2021, October 29), ekonom.cz. Retrieved November 16, 2021, from <https://ekonom.cz/c1-66991900-fondy-ve-velkem-skupuji-nove-byty-poridit-si-vlastni-bydleni-tak-bude-pro-cechy-tezsi>.

<sup>5</sup> Tmejová, K., *Tuhle inflaci jsme upekli doma. Ceny nám porostou před očima, říká ekonomka Horská* (2021, November 14), forbes.cz. Retrieved November 17, 2021, from <https://forbes.cz/tuhle-inflaci-jsme-upekli-doma-ceny-nam-porostou-pred-ocima-rika-ekonomka-horska/>.

last two decades. All in all, the bank deposits increased by 11.5 per cent year-on-year.<sup>6</sup> These means, however, could be used much more effectively if the capital market is more developed. In case they are in the bank deposit products, the money does not generate yields, not contributing to allocate capital to effective companies and industries with huge potential.

## **Conclusion**

The long-term inflation is favourable for the states since the level of indebtedness is increasing. In this regard, inflation is one of the convenient tools for lowering state debt. Therefore, there is no reason for an activist state policy aimed against a „reasonably“ high inflation. Inflation has been boosted not only by the Government (through increasing salaries, pensions, subsidies or lowering the income tax for employees) but also – and perhaps more importantly – by the central bank. Over the last decade, the Czech National Bank resorted to the so-called quantitative easing, the substance of which lies in buying bonds as well as shares in order to pump money into the economy to expand the overall economic activity. Massive purchases of assets by the central banks lead to gradual, hidden nationalisation of the private sector, which calls into question the very existence of a capitalist economic system. At the same time, this process cannot but contribute to inflation. If the state authorities are serious about controlling and pressing down inflation, they ought to rethink the recent economic policies based on quantitative easing, massive interventions into market mechanisms, excessive regulation and last but not least the utterly expensive social policy.

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<sup>6</sup> Hovorková, K., *Češi mají rekordní úspory. Banky se o ně začínají prát, prošli jsme si jejich nabídky* (2021, July 07), *zpravy.aktualne.cz*. Retrieved November 17, 2021, from <https://zpravy.aktualne.cz/finance/cesi-maji-rekordni-uspory-nabidek-jak-je-v-bance-zhodnotit-a/r~9ad5e90ade4811eba1070cc47ab5f122/>.