



Weekly Briefing

**Czech Republic economy briefing:
2023: An Economic Outlook
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2023: An Economic Outlook

Summary

The prospects of the Czech Republic are far from positive. In 2023 the economy will be exposed to ongoing pressures. However, the long-term tendencies are of much higher importance, and these are more worrying. The analysis shows that GDP is expected to be below zero, inflation will be decreasing, remaining, at the same time, around 10 per cent. Government's fiscal expansionism will deepen the state's indebtedness, especially if the coalition cabinet is not willing to introduce substantial austerity measures. The central bank will not change the restrictive monetary policy with the aim to dampen consumption and the expansion of money in the national economy.

Introduction

The economic development in 2023 will be strongly affected by high inflation connected with the energy crisis. The national economy as a whole is expected to be in a recession which, nevertheless, will not entail a substantial increase in unemployment. The latter is among the lowest in the EU for a long period. The problem to be addressed frequently will be the declining standard of living resulting in the rise of poverty. The question is which policies will be adopted by the ruling cabinet to mitigate the negative results of the ongoing multiple crises and, at the same time, to secure sustainable development in a long-term perspective.

Overheat is over

The rising prices pose a risk for a wide array of economic subjects starting from households and ending with SMEs and large enterprises. The rapid increase in costs has already had an impact on individual consumption. Households could save up substantial financial reserves over the last years, partly due to the pandemic and state subsidies. These reserves are diminishing as a consequence of the galloping inflation which especially applies to poorer households. The high degree of uncertainty and volatility have made economic subjects postpone investment and expenses while creating additional reserves. This behaviour will contribute considerably to the overall economic recession. Some sectors have been overheated so far, for instance, the real estate market which was enabled by the low interest rates and

expansion of money circulation. This phase is over. The basic interest rates are much higher compared to the eurozone, making both consumer and corporate loans much less accessible.

Not by coincidence, the mortgage market slumped by 60 per cent in 2022 in comparison with 2021. Banks provided 217 billion CZK (more than 9 billion EUR) compared to 537 billion CZK (more than 22 billion EUR) a year before, thus dropping to the level of 2014/2015.¹ This situation will hardly change in 2023 despite the stagnation of the prices of real estate, accompanied by a decrease in the case of less attractive locations and old properties. The demand will be low not only because of the deteriorating economic situation of households but also due to high interest rates. By January 2023 the average interest rate of mortgages amounted to 6.34 per cent while the figure was 4.14 per cent in January 2022, and 1.94 per cent at the beginning of 2021. Further dynamics will be dependent on the changes in the basic interest rates set by the Czech National Bank, and these, in turn, will be adjusted in relation to inflation and inflation expectations.

Interest rates

The basic interest rates have been stable since June 2022 when the two-week repo rate was increased to 7.00 per cent, the discount rate to 6.00 per cent, and the Lombard rate to 8.00 per cent. These rates are the highest since the beginning of this century and probably will not be decreased in 2023. Central bank's Governor declares that the rates were too low in the last decade which stimulated excessive consumption and indebtedness. The CNB has the ambition to make people save and invest, thus restoring conservative and moderate economic behaviour.² Governor Aleš Michl expects that the monetary policy will be more restrictive, and thus interest rates will be higher over the next six years than in the past decade in order to decrease the expanding indebtedness and controlling inflation. The inflation target is set at 2 per cent but it has not been fulfilled since 2018.³ Even though inflation will likely decrease below 10 per cent by the end of 2023, the basic interest rates will be kept high.

¹ Sovová, E., Zámečnicková, J. (2023, January 10). *Sazby hypoték zamrzly, nemovitostní trh stagnuje. Co čekat v roce 2023.* iDNES.cz. https://www.idnes.cz/finance/hypoteky-a-pujcky/hypoteka-ceny-nemovitost-hypindex-urokove-sazby.A230109_091329_pujcky_sov

² Michl, A. (2023, January 5). *Začneme spořit. A to hned!* ČNB. <https://www.cnb.cz/cs/verejnost/servis-pro-media/autorske-clanky-rozhovory-s-predstaviteli-cnb/Zacneme-sporit.-A-to-hned/>

³ Michl, A. (2023, January 5). *Pět Rašínových myšlenek, které pomohou i dnes.* ČNB. <https://www.cnb.cz/cs/verejnost/servis-pro-media/autorske-clanky-rozhovory-s-predstaviteli-cnb/Pet-Rasinovych-myslenek-ktere-pomohou-i-dnes/>

These expectations are confirmed by the CNB's prognosis, according to which the 3M PRIBOR rate (that is, the average rate at which commercial banks are willing to lend liquidity on the Czech interbank money market) will decrease only slightly to 5.3 per cent in 2024 compared to 7.0 per cent in 2023. The figures indicate that the mortgage interest rates will be still oscillating around 6 per cent by the end of the next year which will deepen the housing crisis unless the prices of real estate drop on a large scale. The relatively high level of interest rates collide with CNB's prediction of inflation, for the central bank expects that the rate will get close to the target in the second quarter of 2024 when it could descend to 2.1 per cent.⁴ In December 2022 year-on-year inflation amounted to 15.8 per cent, and the average inflation thus equalled record 15.1 per cent throughout the last year.⁵

Economic decline

The economic growth will be negative in 2023 so the Czech economy will suffer from recession as a result of the deteriorating financial situation of both households and businesses, lower external demand, persisting problems in global trade chains as well as energy shock and overall negative expectations on the side of economic subjects. The slump in real wages will be mitigated by rising nominal wages, state subsidies in the field of energy, and last but not least pensions and social benefits. Even though the central bankers want to motivate households and enterprises to make investments, the very high level of financial uncertainty and concerns push them to save instead and postpone their investment plans.

In terms of the gross national product, the Czech National Bank expects an absolute decrease of -0.7 per cent. In 2022, the figures should be slightly above 2.0 per cent and in 2024 the economy could return to the growth of some 2.5 per cent. Other prognoses are more sceptical, expecting a decrease of -1.1 per cent this year in which the most significant part shall be played by the fall of households' consumption (-3.0 per cent) and gross capital formation (-3.1 per cent). The recent analysis carried out by Deloitte warns that the real convergence of the Czech Republic towards more developed countries has stopped. In 2022, GDP at purchasing power parity per capita in the Czech Republic in relation to the EU decreased from 93 to 91 per

⁴ *Prognóza ČNB – podzim 2022* (2022, November 11). ČNB. <https://www.cnb.cz/cs/menova-politika/prognoza/>

⁵ Průměrná míra inflace v roce 2022 byla 15,1 % (2023, January 11). Český statistický úřad. <https://www.czso.cz/csu/czso/cri/indexy-spotrebitelskych-cen-inflace-prosinec-2022>

cent. Such a fluctuation need not be only temporary unless the qualitative economic transformation accompanied by GDP growth occurs.⁶

	2020	2021	2022	2023	2020-23
<i>GDP (in %)</i>	-5.5	3.5	2.2*	-0.7*	-0.5
<i>Inflation (in %)</i>	3.2	3.8	15.1	9.1*	7.8
<i>Average wage growth (in %)</i>	4.4	6.1	6.3*	7.7*	6.1
<i>Government debt to GDP (in %)</i>	37.0	42.2	43.4*	45.0*	41.9
<i>3M PRIBOR p.a. (in %)</i>	0.86	1.13	6.28	7.00*	3.8
<i>Unemployment (in %)</i>	3.6	3.8	3.4	3.2*	3.5

Sources: Czech National Bank, Czech Statistical Office, Eurostat, Ministry of Finance

The table summarises some basic indicators of the national economic development between 2020 and 2023 (the asterisk stands for estimation). Several important conclusions can be drawn based on these data. Since the outburst of the pandemic, the economy has contended with problems, being unable to fully recover. The GDP performance will be below zero in this period. The recession is accompanied by high inflation which devalues financial reserves and contributes to a bad environment both in the economy and society. Inflation exceeds the rapid rise of wages in state, public and private sectors resulting in a fall in real wages, and thus a decline in standards of living. Wages will decrease by almost 2 per cent in 2020-2023. Moreover, the steep rise in nominal wages is not correlated with improving labour performance which is rather stagnating and is largely enabled by massive state expenditures on salaries (in state and public sectors) and state subsidies. Fiscal expansionism has a twofold effect: it increases the state debt, and sustains loss-making businesses, thereby maintaining a very low level of unemployment and hindering the progressive development of the national economy. The state debt will continue to grow. Even though the debt to GDP is not extremely high in comparison with other Western countries, the tendency is disturbing. In 2019 the figure was only 29 per cent.

⁶ Marek, D., Franče, V., Pastucha, F. (2023, January). *Výhled české ekonomiky na rok 2023*. Deloitte. <https://www2.deloitte.com/content/dam/Deloitte/cz/Documents/about-deloitte/vyhled-ceske-ekonomiky-na-2023-Deloitte.pdf>

Conclusion

The current economic model is hardly sustainable for a long period. Both experts and some politicians, therefore, attempt to design appropriate reforms. At the end of 2022, the National Economic Council (NERV) presented a strategy addressing the problem of overall economic stagnation, financial instability and possible loss of trust towards the country on financial markets. The experts put forward measures in a predominantly neoliberal way focusing on privatisation, restriction of social transfers and redistribution, reduction of the welfare state, cutback in both state agenda and bureaucracy, imposition of a charge on university education as well as increase in some taxes.⁷ It seems that such unpopular policies are necessary within the liberal democratic framework. Distinct paths are possible only beyond the borders of the present model.

⁷ *Návrhy NERV na snížení výdajů a zvýšení příjmů veřejných rozpočtů v ČR* (2022, November 3). Vláda České republiky. <https://www.vlada.cz/assets/media-centrum/aktualne/Navrhy-NERV-na-snizeni-vydaju-a-zvyseni-prijmu.pdf>