The Czech Fiscal Council

Office of the Czech Fiscal Council

CZECH FISCAL COUNCIL

O P I N I O N

of the Czech Fiscal Council

number 2/2023

of 8 June 2023

on general government finances and fiscal and budgetary policy

Pursuant to the Section 21(2)(a) of Act No. 23/2017 Coll., on the Rules of Budgetary Responsibility, as amended, the Czech Fiscal Council (CFC) monitors general government finances. As part of that work, it also strives to identify risks and threats that may have an adverse impact on public budget stability in the short, medium and long term. The Czech Fiscal Council has informed the public about its conclusions every quarter since September 2018

Initial economic situation

The Czech economy stagnated quarter-on-quarter in the first quarter of 2023 and recorded a 0.4% year-on-year decline. This was the first year-on-year decline since Q1 2021. Economic performance thus remains relatively weak and lags behind most countries in the European Union. The balance of foreign trade in goods and services ended the first quarter with a surplus of CZK 93.7 billion. In the first quarter, the trade balance in goods was in surplus by CZK 39.6 billion. This is a significant difference from the deficit of CZK 12 billion in the same period of the previous year. Foreign trade in goods is positively influenced mainly by exports of motor vehicles, while lower world prices are not pushing the balance of foreign trade into previous deficits. The extent of the external imbalance in the economy has thus decreased substantially.

On the contrary, strong internal imbalances persist, manifested both in continued high inflation (12.7% year-on-year in April) and in persistent tensions in an overheated labour market. Employment grew by 1.4% in Q1 compared with the same quarter last year and rose by 0.4% quarter-on-quarter. The general adjusted unemployment rate was 2.8% in April. Real wages recorded a 6.7% year-on-year decline in the first quarter due to high inflation.

General government financesand fiscal policy settings for the coming years

The economy's internal imbalances continued to be reflected in the performance of public finances. At the end of May, the state budget deficit amounted to CZK 271.4 billion (CZK 263.7 billion after adjusting for revenues and expenditures related to EU projects) and thus approached the approved balance for the whole year 2023 (CZK –295 billion). This negative development is due to several factors: 1) a significantly negative balance of interventions on the energy market, where revenues from levies on electricity producers are still significantly lower than the compensation paid, and other expenditure programmes related to the energy crisis (subsidies to the heating sector or transmission system operators), 2) the absence of revenues from the Modernisation Fund, 3) a slower pace of collection of indirect taxes, which is related to the decline in real household consumption.

It will be clearer in July, when corporate income tax surcharges will be collected from large entities, and it will also be possible to make a qualified estimate of the windfall tax yield from the filed tax returns. In the autumn, the revenue side should be boosted by this year's record dividend from CEZ. On the other hand, however, pensions increased as part of the extraordinary indexation, which was not foreseen in the original budget, will start to be paid from June.

However, it is already clear that the achievement of the planned deficit is fundamentally at risk, or it is extremely unlikely that the planned deficit could be achieved at all. The main risks are the uncertainty about the use of the Modernisation Fund for current expenditure and the likely negative balance of energy market interventions. The scope for offsetting these negative trends with savings in the current budget is limited, as a rapid change in legislation would be required for mandated expenditure, and many investment as well as operational expenditures have already been contracted.

From the point of view of the further development of public finances, it is essential to what extent and in what final form the government will succeed in pushing through the so-called Consolidation package presented by the government in May. However, it is crucial that the implementation of the Consolidation package is not accompanied by the adoption of additional measures that will have negative effects on the structural balance.

In the case of the Consolidation package, the CFC appreciates that the government is coming up with concrete proposals to reduce public spending and increase public revenues. This is fully in line with the CFC's past positions, which pointed to the long-term unsustainability of the current level of the structural deficit. In line with its previous statements, the CFC considers the proposed scope of consolidation to be acceptable; its size should not jeopardise the economic recovery and it has the potential to set positive budgetary trends for the future, provided that the package is actually implemented and the consolidation trajectory is maintained.

In this context, however, the CFC draws attention to the following:

1. The consolidation package will only take its real form when the 2024 state budget law is drawn up and approved, and only when the parameters of the budget will determine the government's consolidation efforts in the area of public finances. At the same time, this pace will eventually be deducted not from the expected 2023 reality, which was the content of this year's budget proposal, but from its actual implementation, which will almost certainly be worse than the approved state budget law (see above).

   The CFC therefore reiterates its call for compliance with the rules of sound budgeting and good budgetary practice, so that the figures in the 2024 budget reflect as faithfully as possible all known facts when the budget is prepared and, on the contrary, are not based on uncertain or improbable facts.

2. For this reason, it is also highly problematic from a fiscal point of view that at the moment the overall framework of public budget expenditures for 2024 and the years 2025 and 2026 has not yet been set, i.e. the so-called Budgetary Strategy, which according to the law should be available from the end of April this year. It is therefore not possible to determine with reasonable certainty the point from which consolidation will start. It is only after the delayed approval of the Budgetary Strategy by the Government that the Government's consolidation efforts will be given a concrete quantitative outline. It is clear that these contours will still be the subject of substantial political negotiations.

   In addition, this overall framework may also include the possible acceptance of a loan from the so-called National Recovery Plan, which is currently being discussed by the political representation. Its possible adoption will affect public sector deficits and debt at the Budgetary Strategy horizon and beyond.

3. The CFC will be therefore ready to assess the realism of the consolidation trajectory only after the above conditions have been met, but in any case, in accordance with Act No 23/2017 Coll., on the Rules of Budgetary Responsibility, as amended, it will issue its opinion on the Budgetary Strategy, which will be the basic guideline for the entire trajectory and will also form its boundaries.

In addition to measures aimed at reducing structural imbalance, the government also presented upcoming changes to the pension system. The CFC believes that most of them are in the right direction and are necessary to increase the financial sustainability of the system. Again, the CFC considers the issue of the so-called "demanding occupations" as systemic risks, which may reduce the fairness and financial sustainability of the pension system if this issue disrupts unsustainably.