

# Fiscal consolidation and reduction of borrowing needs in the pipeline for the Czech Republic

Fiscal policy is showing the first signs of improvement, but consolidation will not take place until next year. This year's supply of Czech government bonds is under control and the significant reduction in borrowing requirements for next year will soon come into the spotlight. FX issuance is no longer a topic thanks to EU money



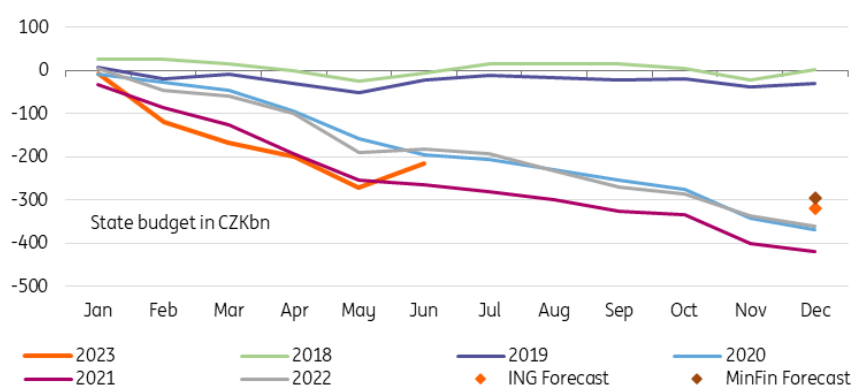
## Fiscal policy: Improvement but still a mixed picture

The June state budget result showed a reversal of the negative trend for the first time this year. The improvement is higher than we expected, but still this year's budget will be a risk both ways for Czech government bond (CZGB) issuance. The story remains the same from the beginning of the year. While spending is on track for the Ministry of Finance (MinFin), tax revenues are lagging. In detail, we see that personal and corporate income tax is in line with the plan or even slightly

higher. On the other hand, indirect taxes such as VAT and consumption tax are lagging behind the plan, confirming the slump in domestic demand in recent quarters.

Looking ahead, we can expect the deficit to deteriorate again in July and then improve in August and September due to the incoming historically record dividend from the state-owned energy company and the windfall tax. So the picture will be mixed for the rest of this year. We leave our deficit forecast for this year unchanged at CZK320bn, versus the MinFin's plan of CZK295bn. This, together with the surplus of other sectors of the public finances, should result in a public deficit of 3.8% of GDP. However, we may still see some changes here from the government, which wants to assess this year's state budget during the summer and perhaps introduce some savings measures for this year.

## State budget development and 2023 forecast (CZKbn)



Source: MinFin, ING estimates

For next year, the government recently approved a CZK235bn state budget deficit and is targeting a public deficit of 1.8% of GDP, which includes the approval of a savings package. This is starting to be discussed in parliament, however, we expect this to be an issue in the autumn months. Given that the government has a majority in both houses of parliament, we expect the key parameters to be approved.

Since the beginning of the year, the MinFin has covered about 54% of this year's CZGBs issuance, according to our calculations, assuming the higher state budget deficit we forecast vs the MinFin plan. This is less than CEE peers Poland and Romania but still fully under control and well positioned for the second half of the year when we can expect lower CZGB yields. For the rest of the year, we expect the monthly supply of CZGBs to be about the same or only slightly lower than the first half average. This is confirmed by the indication for July of CZK19bn, with the MinFin traditionally trying to avoid lower summer liquidity.

**54%** Issued CZGBs vs ING estimate for this year

Elsewhere on the supply side for this year, we no longer expect any euro-denominated bond issuance, as we assumed in [our CZGBs outlook](#) at the beginning of the year. The MinFin is currently in discussions with the European Commission to extend the Recovery and Resilience Facility plan and we expect this year's FX needs to be covered fully by European Union money. On the other hand, we do not expect EU money to be involved in covering CZK needs this year.

## Financing needs for 2023 (CZKbn)

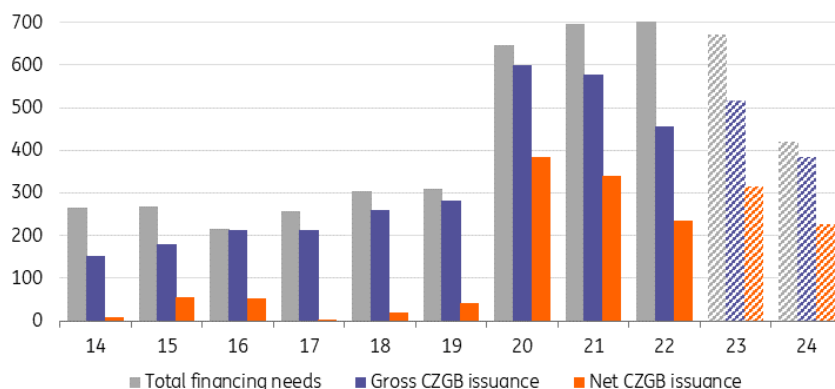
	MinFin	ING
State budget deficit	295.0	320.0
Transfers and other operations of state financial assets	1.4	1.4
T-Bonds denominated in local currency redemptions	200.2	200.2
T-Bonds denominated in foreign currency redemptions	0.0	0.0
Redemptions and early redemptions on retail bonds	1.0	0.4
Money market instruments redemptions	145.2	145.2
Redemption of T-bills		0.0
Redemption of other money market instruments		145.2
Repayments on credits and loans	3.0	3.0
<b>Total financing needs</b>	<b>645.7</b>	<b>670.2</b>
Money market instruments		10.0
T-bills		10.0
Other money market instruments		0.0
Gross issuance of CZK-denominated T-bonds on domestic market	Min 400-500	516.4
Gross issuance of EUR-denominated T-bonds on domestic market		0.0
Gross issuance of T-bonds on foreign market		0.0
Gross issuance of savings government bonds		0.0
Received credits and loans		145.2
Financial asset and liquidity management		-1.4
<b>Total financing sources</b>		<b>670.2</b>
<b>Gross borrowing requirement</b>		<b>671.6</b>
<b>Net CZGB issuance</b>		<b>316.2</b>

Source: MinFin, ING estimates

## Significant drop in borrowing needs next year

The MinFin recently published an updated funding strategy that didn't bring much new for this year. However, the figures for next year confirmed our earlier calculations of a drop in borrowing needs next year to around 60% of this year's level. This is due to the year-on-year decline in the state budget deficit, but also to low redemptions next year. This should translate into a significant drop in the supply of CZGBs next year. Moreover, the government may involve more money from the EU and supranational institutions, which may further reduce the supply of CZGBs next year.

## Total financing needs and CZGBs issuance (CZKbn)

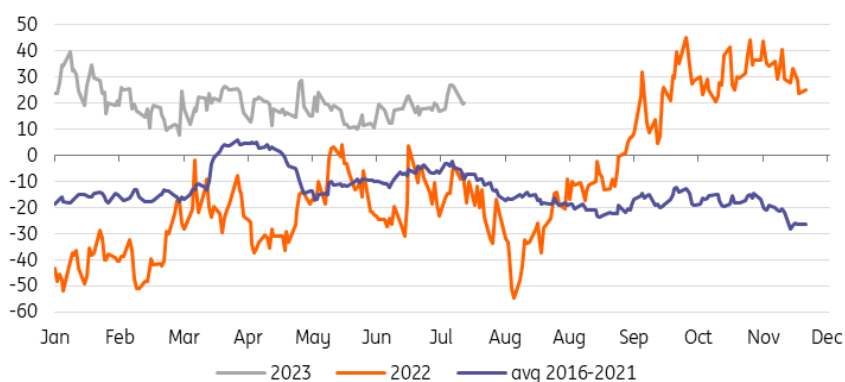


Source: MinFin, ING estimates

## ASW tightening for the rest of the year

Given CZGBs supply dynamics, which are trending towards pre-Covid levels, and fiscal consolidation, which is a positive outlier among CEE peers, we expect the asset swap spread (ASW) to return to negative territory, a historically usual level for the spread vs the interest rate swap (IRS) curve. On the CZGBs side, we expect the government's consolidation package to take the main spotlight in late summer/early fall and later the MinFin to start focusing on CZGBs supply for next year, which should be positive for bonds. Moreover, on the IRS side, the market is already pricing in a near return of the Czech National Bank rate to the equilibrium level of 3% at this point, which should limit the further decline of the long-end in the IRS curve. Overall, we are positive on CZGBs and see a case for significant ASW tightening in the second half of the year.

## 10y CZGBs ASW (bp)



Source: Refinitiv, ING

## Author

**Frantisek Taborsky**  
 EMEA FX & FI Strategist  
[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.