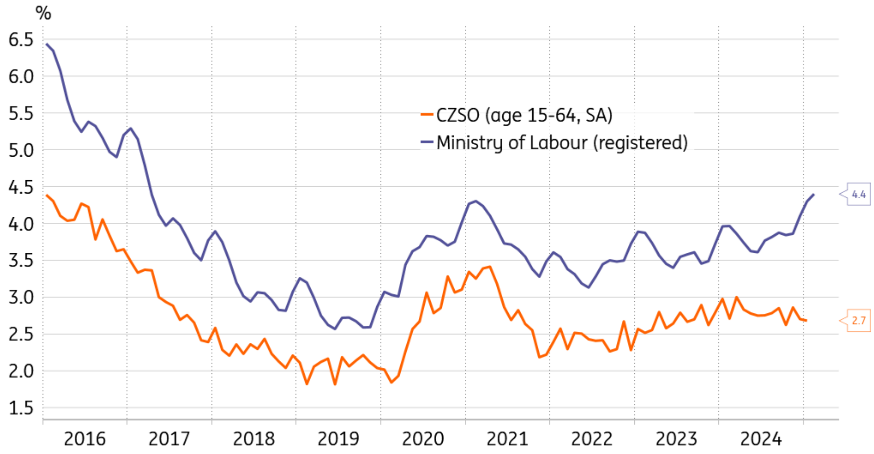
Czech unemployment ticks higher but wage growth remains solid

The labour market tightness softened somewhat while both nominal and real wage growth remained robust. Industry is key to further labour market developments, and it seems that it can gain some solid ground in the coming quarters. More defence spending is an upward risk to Czechia's economic performance

Labour market tightness gradually eases

The registered unemployment rate increased to 4.4% in February, according to statistics from the Ministry of Labour. This is seasonally unadjusted data, so it is a bit tricky to gauge the underlying development. The registered unemployment rate usually jumps in January, when work related to tourism and construction is at a low point. The February change in this statistic can go both ways, so we draw the conclusion that the marginal increase suggests some easing in the labour market. Moreover, surveys show that layoffs in the beleaguered industrial sector continued at the beginning of the year.

Registered unemployment rate picked up



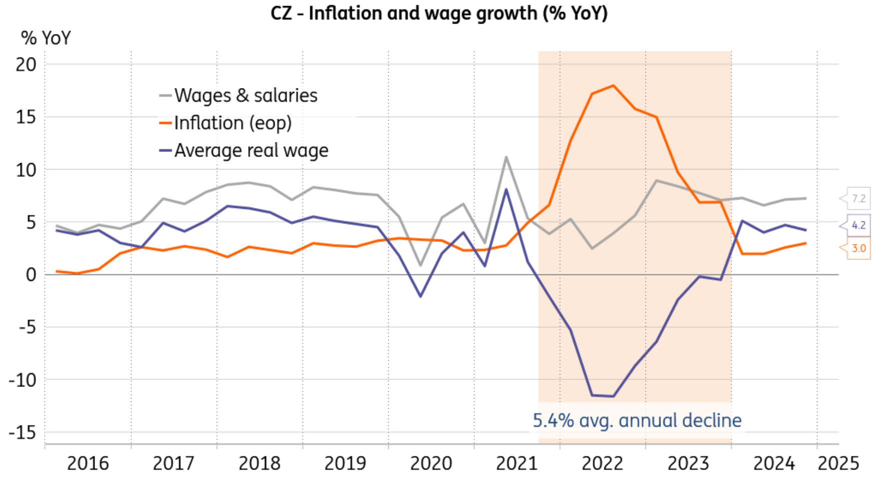
Source: Ministry of Labour, CZSO, Macrobond

That said, we see a more intense divergence between the registered unemployment rate as measured at the labour offices, and the unemployment rate as measured by the Czech Statistical Office survey. We expect the shedding of staff in the manufacturing sector to become more visible in later statistics from upcoming observations, though the expanding construction segment is absorbing some of the job seekers.

Wage pressures did not abate

The labour market remained relatively tight in a historical context over the year-end, which contributed to continued lofty wage growth in the final quarter of the year. Nominal wages added 7.2% from a year earlier in 4Q24, coming in somewhat stronger than the latest Czech National Bank forecast of 7.0%. When adjusted for inflation, wages increased by 4.2% annually in the same period, coming in higher than markets expected. This is still robust real wage growth which has relaxed household budget constraints and opened the door for further spending.

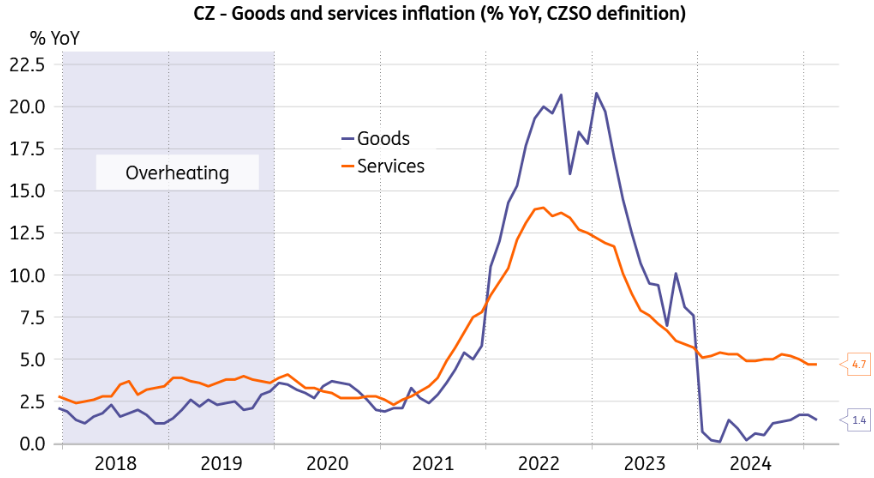
Wage growth beats expectations



Source: CZSO, Macrobond

Such appetite for consumption will have repercussions for consumer price pressures. Indeed, the price dynamics in the service sector remained elevated and unchanged at 4.7% in February, as defined by the Statistical Office, according to the preliminary CPI estimate. We expect the disinflation process in the service segment to carry on, yet it is not certain at this point. That said, it is still too potent and above the rates of 2019 when the Czech economy was overheating. Currently, the economy is somewhat subdued compared to those times.

Price stickiness in services is still tangible



Source: CZSO, Macrobond

The Czech economy is gradually stabilising with two pistons of consumption and construction firing plausibly, while industry still can't find solid ground. However, we believe that there are initial signs that Czech manufacturing has left the worst behind it and will gradually improve in terms of output over the coming quarters. Whether this is the case has yet to be seen, and this will also be key for developments in the labour market.

If the industrial base experiences a resurgence, labour scarcity could become even more pronounced. We anticipate the Czech economy will regain momentum, particularly in terms of real growth and real wages, positioning it to outpace its eurozone peers once again. Such a setup should keep inflation above the target for the rest of the year and likely beyond.

Export performance back in the game

The recent trade statistics point to a revival in exports, which is crucial for the Czech economic performance. According to preliminary data, the balance of foreign trade in goods at current prices ended January with a surplus of CZK 20.0bn, which is CZK 12.9bn higher than in the preceding year. The overall balance of foreign trade in goods was favourably influenced in particular by a higher surplus on trade in motor vehicles from a year earlier. The trade deficit in computers, electronic, and optical equipment narrowed, and the balance in machinery and equipment also increased.

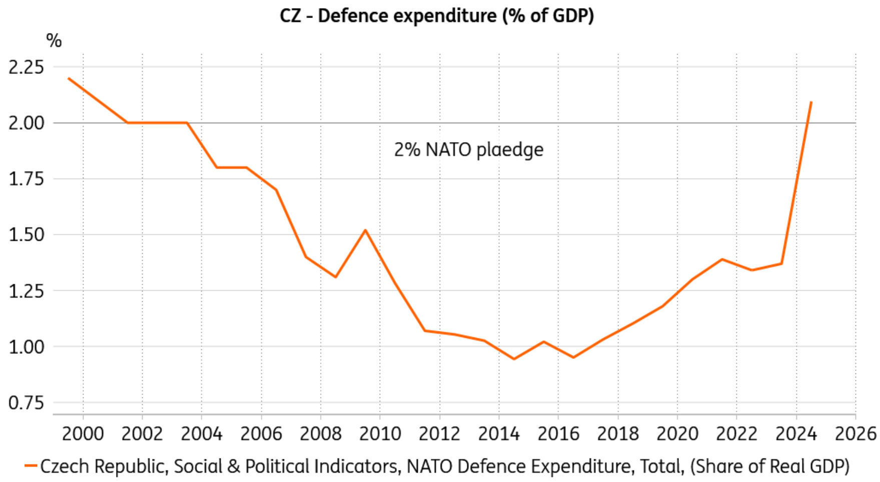
Exports gained 12.2% year-on-year, and imports increased by 8.7% YoY in January. There was an annual increase in exports in most commodity groups in January. On a seasonally adjusted basis, January's exports added 1.6% and imports 3.3% from the previous month.

For the labour market, it will be critical to see whether industry has already hit bottom and will be able to recover. We have seen quite substantial layoffs in manufacturing over recent quarters, as the malaise in the sector has dragged on. However, things are starting to turn for the better, and surveys show that firms are becoming less pessimistic about the outlook.

Military spending set to drive Czech industry

There is also an impulse in the pipeline from the likely increase in military spending and more general support for the arms industry, with Czechia being traditionally a frontrunner in this segment. When looking back, Czechia was the iron and industrial heart of the Austrian empire, and it still has a lot to offer. There is currently a discussion about Czechia being capable of increasing defence spending from 2% of GDP to 3%, i.e., by at least CZK 80 billion a year, as stated by Prime Minister Petr Fiala.

Defence spending is set to increase



Source: Macrobond

In the public debate, economists mostly agree that it may be possible to increase taxes, such as excise taxes, while cutting some other spending. In order to strengthen the country's security, some of them believe that it could now be justified to increase the country's debt. The suggested EU funding to boost defence and security would be utilised, however, the details and final approval have yet to be seen. It seems like Czechia is willing to increase its military spending anyway and use the EU money once available. This poses an upward risk to economic performance, with more robust industrial output, elevated demand for the workforce and potentially inflation in the future.

Author

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Disclaimer