Czech Republic: Stricter Covid restrictions force GDP rethink

The Czech government introduced a new set of measures yesterday due to the surge of Covid-19 infections. Measures are focused mainly on limiting gatherings of people, impacting restaurants, culture events, sports and related services. We revise our 2020 GDP forecast to -7.5% from -6.5%

Economy will decline in the last quarter again

According to our estimates, new tightened government measures against the spread of the coronavirus will lead to a quarter-on-quarter decline of about 1.5% in the last quarter of this year. Before the arrival of the second wave of the pandemic, we had expected growth of 2.5%.

Revision of 2020 GDP decline by 1 percentage point

We are thus revising our full-year growth estimate for the domestic economy from the current -6.5% to -7.5%. However, this is still a milder decline than the Czech National Bank expected in its latest August forecast (-8.3% year-on-year). Our assumption is based on relatively swift economic growth in 3Q of around 4.5% (after a 9% fall in 2Q), a figure which will be published by the statistical office at the end of October. However, the consensus in the market is hovering around

4% growth. In the case of weaker growth, the full-year economic decline would move closer to 8%.

Despite the new restrictions, however, the domestic economy should, for the time being, avoid a double-digit decline this year, which was assumed by some earlier estimates at the start of the Covid outbreak.

-7.5%

2020 GDP (YoY)

revised from -6.5% due to new restrictions

Spontaneous shutdown of industry would be more harmful

However, the risk to our forecast is a partial or full shutdown of some large industrial companies, which happened during the spring wave, due to the further spread of Covid cases, or further strengthening of government restrictions if the spread of the coronavirus is not sufficiently reduced in the next two weeks.

500bn budget not worsening in our view

Despite further economic restrictions and associated measures to support the economy, we believe that the government deficit will not exceed the planned CZK 500bn this year.

Until the beginning of the second wave, the numbers were signalling a lower-than-expected deficit of around CZK 380bn for the whole of 2020. As such, there should be enough room for fiscal support in months ahead.

The cost of the main support measures until the end of September was in the range of tens of billions of Czech koruna, with furlough costs of CZK 18bn, nursing allowances of CZK 11bn, and the remission of social security contributions costing CZK 13bn. At the same time, the current restrictions are not as broad and therefore will be less expensive compared to the spring. As such, the approved CZK 500bn budget still has room to further support the economy in the last quarter.

So far, no more easing by the CNB

If the situation does not worsen further than the above-mentioned outlook, we are still betting on stable CNB rates. Inflation is still above the upper limit of the tolerance band, and further easing of monetary conditions would bring a weaker koruna. However, according to the development of market rates, market bets on further CNB rate cuts are mounting.