INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/35

CZECH REPUBLIC

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

February 2025

In the context of the 2024 Article IV Consultation, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on November 26, 2024, with the officials of the Czech Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 7, 2025.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

*Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR25/020

IMF Executive Board Concludes 2024 Article IV Consultation with the Czech Republic

FOR IMMEDIATE RELEASE

Washington, DC – February 4, 2025: On January 24, 2025, the Executive Board of the International Monetary Fund (IMF) concluded the 2024 Article IV consultation [1] with Czech Republic and endorsed the staff appraisal on a lapse-of-time basis without a meeting.

After a period of stagnation, growth has picked up since late 2023, but the recovery has been slow and uneven. Consumer spending has strengthened, sustained by a rebound in real wages and early signs of a decline in the household saving rate. In contrast, investment remains weak, hampered by uncertainty about global trade, the effects of tight domestic policies and a slow absorption of EU funds. Despite subdued economic activity and a decline in job vacancies, the Czech labor market continues to suffer from structural job shortages, particularly among skilled workers, and labor hoarding.

Led by lower commodity prices, restrictive monetary policy, and economic slack, headline inflation has reached the CNB’s 2 percent target and remained close to it over the past summer. It has drifted to 2.8 percent by October 2024, mainly reflecting volatile food prices and administered prices base effects. Core inflation stood at 2.4 percent, as lower goods price growth, was offset by sticky services price growth and recovery in real wages.

Driven by higher real disposable income, growth is expected to have extended its recovery in the second half of the year, but the currently restrictive policy mix and a weak external environment likely dampened near-term outcomes. In 2025, fiscal policy is set to turn neutral, while the need for monetary policy restriction will decrease as inflationary pressures ease. As the policy mix becomes more supportive of economic activity and external demand gradually strengthens, growth should gain further momentum. Wage moderation also supports competitiveness of Czech manufacturers in export markets. As a result, growth is expected to accelerate to 2.4 percent in 2025 from a projected 1 percent a year earlier.

Executive Board Assessment[2]

The Czech economy is slowly recovering after an unprecedented combination of shocks but faces structural headwinds. Following a period of stagnation, growth is picking up, as the policy mix becomes more supportive of economic activity and external demand gradually strengthens. Staff assesses the external position to be moderately stronger than the level implied by fundamentals and desirable policy settings in 2024 (Annex IV). Despite the cyclical upswing, however, weak productivity growth and structural labor shortages are set to weigh down medium-term potential growth, which is now estimated at around 2 percent.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

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Inflation has moderated and, after drifting higher on volatile food prices in the near term, is expected to converge back to target.

Risks to growth are on the downside while risks to inflation appear balanced. Further geoeconomic fragmentation and a weaker than anticipated recovery among key European trading partners, especially Germany, point to downside risks to growth and inflation. On the other hand, stronger wage growth and stickier than expected services inflation, along with protracted increases in commodity prices, could exert upward pressure on inflation.

Staff sees ground for continuing to lower the policy rate. With inflation expectations broadly anchored and output below potential, there is room for additional rate cuts to achieve by mid-2025 a neutral policy rate, which staff estimates at around 3 percent, albeit subject to large uncertainty. Further easing should be pursued in a gradual, data-dependent manner. Once uncertainty recedes and inflation stabilizes more closely to target, the CNB could consider placing more weight on forecast-based inflation targeting.

Consideration should be given to reducing the size of the central bank's balance sheet over time. Profitability has been considerably improved through various ad hoc cost rationalization measures and diversification towards higher yielding assets. But focus should shift from profit maximization to balance sheet reduction. Aiming to gradually reduce the size of the balance sheet would help limit risks to the CNB's financial position. To minimize any impact on the exchange rate, this could be done through a transparent and predictable mechanism of small, regular FX sales above and beyond the existing program.

A broadly neutral fiscal stance this year is appropriate, but additional measures will be needed over the medium term to counter spending pressures. Staff recommends a further adjustment of ½ percentage points of GDP annually over 2027–28 to reach a structural deficit of less than 1 percent of GDP by 2028. Productivity-enhancing spending should be safeguarded, and automatic stabilizers should operate freely.

Policy actions should be considered both on the revenue and the spending side. Staff encourages the authorities to reassess the composition of tax revenue. On the spending side, the reform of the Czech pension system is welcome, but further adjustments may be required in the future. Containing the expansion of the public sector workforce, including in fragmented local administrations, and improving targeting of social benefit can limit costs, while efficient absorption of EU funds could boost productivity.

Financial stability risks are contained and broadly unchanged since the last Article IV Consultation but warrant vigilance. Real estate risks should continue to be monitored closely. Given the relatively low risk weights on mortgage loans, supervisors should continue to review bank exposures and ensure that credit risks are accurately reflected in banks' risk weights. The authorities should also continue to regularly evaluate the effect of mark-to-market losses on banks' securities portfolios and the impact of exchange rate fluctuations on their corporate exposures. Finally, continued efforts are needed to reduce the transnational aspects of corruption and to safeguard the financial and real-estate sectors from money laundering risks and cross-border illicit financial flows.

Staff assesses the current macroprudential stance as appropriate. Caution should be exerted in considering additional easing. A further release of the CCyB would be advisable only in response to clear materialization of financial risks. Conversely, an increase in the CCyB rate should be considered in case of rapid credit growth and rising asset prices.

Swift action is needed to support the ongoing economic transformation. Building on the newly adopted Economic Strategy, the authorities are urged to undertake concrete policy measures. Structural policies should focus on facilitating the allocation of labor towards higher value-added sectors and firms, addressing the gender pay gap to boost labor participation, reducing administrative burden and red tape, accelerating digitalization, and promoting a more ambitious green transition.

Czech Republic: Selected Economic Indicators, 2023–2025			
	2023	2024	2025
		Projections	
NATIONAL ACCOUNTS			
Real GDP (expenditure)	-0.1	1.0	2.4
Domestic demand	-2.6	0.3	2.3
Output gap (percent of potential output)	-1.0	-1.4	-0.6
LABOR MARKET			
Employment	1.5	0.7	0.1
Unemployment rate (average, in percent)	2.6	2.8	2.5
PRICES			
Consumer prices (average)	10.7	2.5	2.4
Consumer prices (end-of-period)	6.9	3.0	2.1
MACRO-FINANCIAL			
Broad money (M3)	8.1	5.3	5.0
Private sector credit	6.5	4.0	3.5
Ten-year government bond	4.4	4.0	3.6
Exchange rate			
Nominal effective exchange rate (index, 2005=100)	112.6	...	...
Real effective exchange rate (index, CPI-based; 2005=100)	125.4	...	...
PUBLIC FINANCE (percent of GDP)			
General government revenue	40.1	40.5	40.5
General government expenditure	43.9	43.3	43.0
Net lending / Overall balance	-3.8	-2.9	-2.5
Primary balance	-3.2	-1.6	-1.3
Structural balance (percent of potential GDP)	-2.6	-2.2	-2.2
General government debt	42.4	43.5	44.5
BALANCE OF PAYMENTS (percent of GDP)			
Trade balance (goods and services)	5.0	6.4	4.4
Current account balance	0.3	1.6	0.3
Gross international reserves (billions of euros)	134.3	143.3	152.3
(in months of imports of goods and services)	7.9	8.2	8.0
(in percent of short-term debt, remaining maturity)	119.1	121.9	123.3

Sources: Czech National Bank; Czech Statistical Office; Ministry of Finance; Haver Analytics, and IMF staff estimates and projections.
Structural balances are net of temporary fluctuations in some revenues and one-offs. COVID and energy price-related one-offs are

CZECH REPUBLIC

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

January 7, 2025

KEY ISSUES

Context. The Czech Republic is evolving from a heavily manufacturing-based, export-oriented hub to a more mature and diversified economy. Non-auto manufacturing, energy, and construction, once important Czech engines of growth, have run out of steam, hampered by decelerating productivity growth, higher energy costs, and sluggish demand. The auto industry has shown resilience so far, but the required transition to electric vehicles and exposure to foreign competition are set to exert significant pressures in the coming years. Higher value-added sectors, including ICT services, are constrained by lack of skilled labor and limited access to capital, undermining their ability to compete in global markets.

Outlook and risks. After stagnating in 2022-23, the Czech economy is slowly recovering, as consumer spending is sustained by a rebound in real wages. Growth is poised to gain momentum as the policy mix becomes more supportive of economic activity and external demand gradually strengthens. Despite the cyclical upswing, however, weak productivity growth and structural labor shortages are set to weigh down potential growth. Inflation has moderated and, after drifting higher on volatile food prices in the near term, is expected to converge back to target. Risks to growth are on the downside, while risks to inflation appear balanced.

Policy recommendations. The policy mix has delivered prudent demand management and served the Czech Republic well, allowing a return towards price stability, while preserving fiscal and financial buffers. However, the country would benefit from more effective supply-side policies to support the ongoing transition. More specifically:

- **Monetary policy.** With inflation expectations broadly anchored and output below potential, there is room for additional rate cuts to achieve by mid-2025 a neutral policy rate. Consideration should be given to reducing the size of the central bank's balance sheet over time to help limit risks to the CNB's financial position.

- **Fiscal policy.** Fiscal consolidation efforts in 2024 have been commendable. A broadly neutral fiscal stance this year is appropriate, but additional measures will be needed over the medium term to counter spending pressures.

- **Financial policies.** Financial stability risks are contained and broadly unchanged since the last Article IV Consultation but warrant vigilance. The current macroprudential stance is appropriate and caution should be exerted in considering additional easing.

- **Structural policies.** Concrete actions should focus on facilitating the allocation of labor towards higher value-added sectors and firms, addressing the gender pay gap to boost labor participation, reducing administrative burden and red tape, accelerating digitalization, and promoting a more ambitious green transition.

Approved By
Oya Celasun (EUR) and Fabian Valencia (SPR)

Discussions were held in Prague during November 13-26, 2024. The team comprised Vincenzo Guzzo (head), Lukas Boer, Moataz El Said, Keyra Primus, and Guillermo Tolosa (all EUR). Hana Hejlová (OED) also participated in the mission. Mr. Alasal and Ms. Mitchell (all EUR) assisted with the mission and the preparation of the staff report. The mission met with the Governor of the Czech National Bank (CNB) Aleš Michl, CNB Deputy Governors Jan Frait and Eva Zamrazilová, and CNB Board Members Karina Kubelková and Jan Kubíček, CNB Executive Directors Libor Holub, Petr Král, and Jan Schmidt; Deputy Minister of Finance Marek Mora, Director General of Economic Strategies and Policies David Prušvic; other senior officials, and representatives from the private sector.

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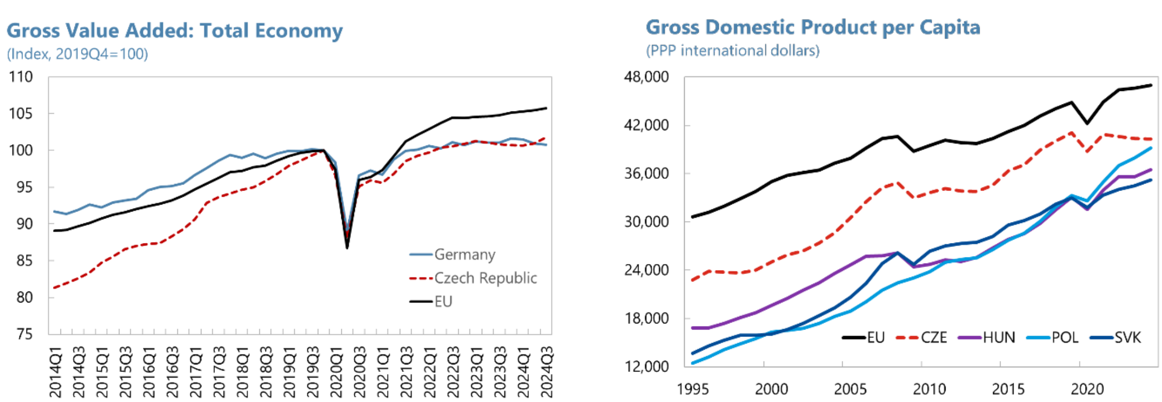
CONTEXT

1. **Over the past two decades, the Czech Republic converged steadily towards the living standards of more advanced EU economies.** This progress was underpinned by successful market-oriented policies, monetary and fiscal discipline, a sound financial system, and solid institutions.

2. **However, in recent years growth has lost momentum.** After 2016, non-auto manufacturing, energy, and construction, until then important engines of growth, started running out of steam, hampered by decelerating productivity growth, high energy costs, and sluggish demand (Box 2). Higher value-added sectors, including ICT services, were constrained by lack of skilled labor and limited access to capital, undermining their ability to compete on global markets. For a while, strong household consumption sustained activity in domestic services and, along with a boom in tourism, allowed the Czech economy to grow despite the downturn in industry. This phase, however, came to a sudden halt with the recent shocks. After rebounding from the pandemic, the economy stagnated in 2022-23, as large increases in commodity prices, a jump in the household saving rate, and a fall in real wages dampened consumption.

3. **The economy faces structural headwinds.** Significant integration in global value chains, concentration in terms of trading partners, products, and suppliers, and high energy intensity make the Czech economy vulnerable to geoeconomic fragmentation and much needed decarbonization efforts and prone to more frequent structural shocks. The Czech auto industry has shown resilience so far, but, absent adequate supporting infrastructure, the required transition to electric vehicles and foreign competition are set to exert significant pressures in the coming years, despite the recent reduction in unit labor costs (see Box 1 and Selected Issues Paper). Adverse demographics add to downward pressures on potential growth. Implementation of past IMF advice has been mixed (Annex VII).

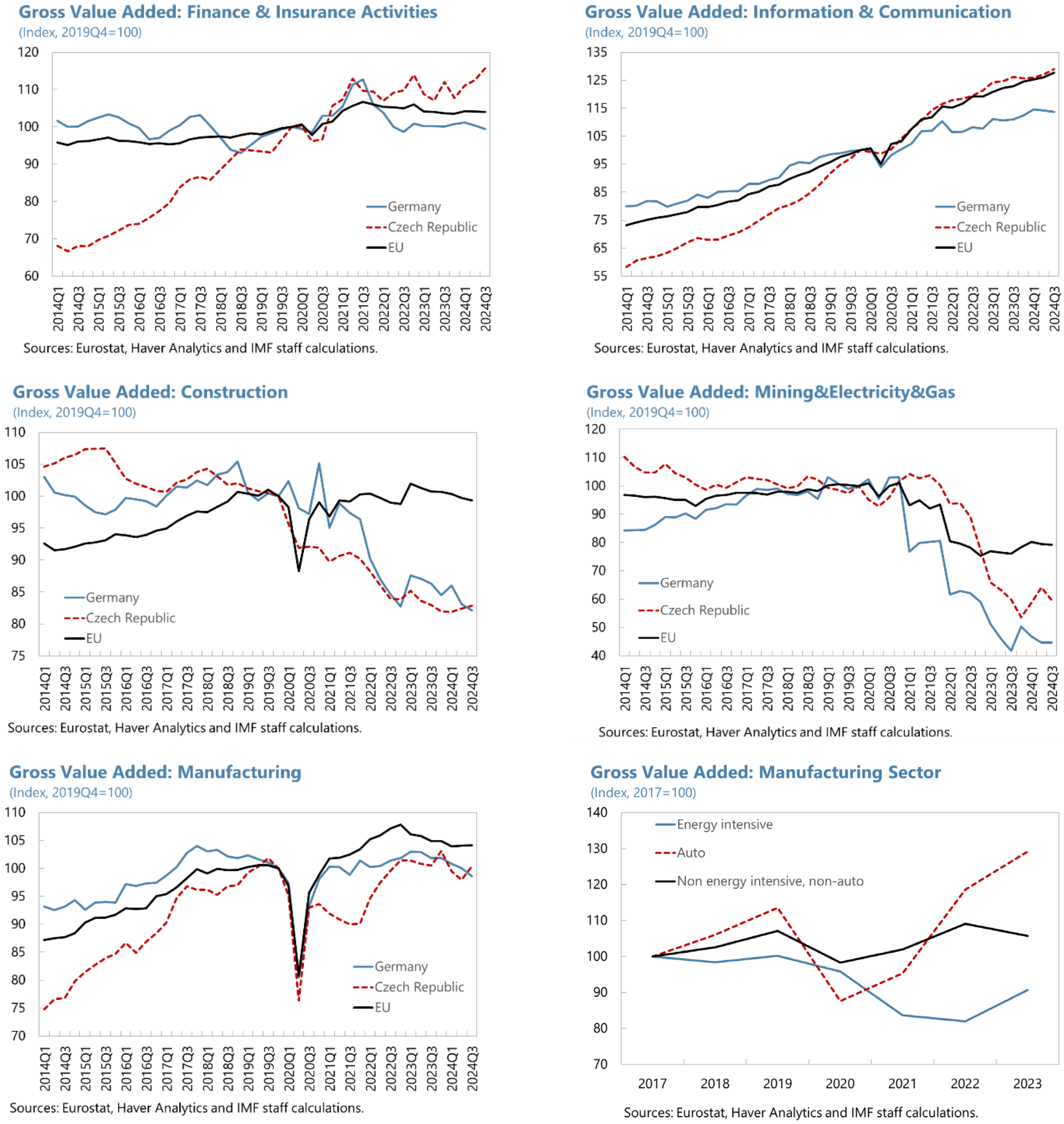
Text Figure 1. GDP Per Capita and Productivity



Sources: Eurostat; Haver Analytics and IMF staff calculations.

Source: Haver Analytics.

Figure 1. Sectoral Growth Developments



Box 1. Key Challenges to Sustained Productivity Growth

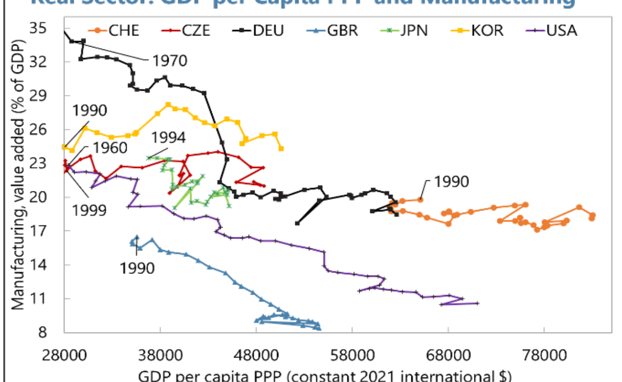
Contrary to conventional wisdom, the recent underperformance only partly reflects exposure to specific markets or a specific economic structure. Since the onset of the pandemic, the Czech economy has significantly lagged peers. This outcome is often attributed to its links to specific slow-growing trading partners (especially Germany) and to its energy-intensive economic structure. However, exports have performed broadly in line with EU exports, as Czech manufacturers have successfully offset weak demand in the German market with expansion in other fast-growing markets. Also, staff's counterfactual analysis, assuming the Czech economy had the same structure of an average EU country, reveals that only a third of the output loss relative to the pre-pandemic trend can be attributed to its economic structure.

Recent shocks have exposed preexisting vulnerabilities. In 2022-23, labor productivity in the Czech Republic has fallen considerably more than in the EU. To some extent, this reflects labor hoarding, which has likely been greater than in other countries, given the tight labor market and the sharper fall in real wages compared to peers. But several structural factors are also at play, some of which had already started unfolding in the years leading up to the recent shocks.

First, productivity growth has been on a declining trend. While post-GFC Czech Republic's productivity growth was still above that of Germany and other EU countries, it had already decelerated significantly. This reflected lower capital deepening, a natural development for a country entering a more advanced stage in the convergence process, but also a notable deceleration in total factor productivity (TFP) which never recovered to pre-GFC growth rates.

Second, specific sectors have been a drag on both growth and productivity. The construction sector—where output has shrunk by nearly 25 percent over the last ten years—has significantly underperformed compared to most other EU countries (in terms of both value added and productivity), hampered by shortages of skilled workers and administrative burdens. The energy sector has also contracted significantly, reflecting falling demand, phasing out of coal production, and limited investment in renewables. Staff's analysis of the distance to the EU TFP frontier (see Selected Issues Paper) shows large and widening TFP gaps for the Czech energy and construction sectors from EU top performers. Finally, the non-auto manufacturing sector has been stagnant for almost a decade. This is common to many countries experiencing slower industrialization as they converge to higher income levels.

Real Sector: GDP per Capita PPP and Manufacturing



Sources: Haver Analytics and World Bank.

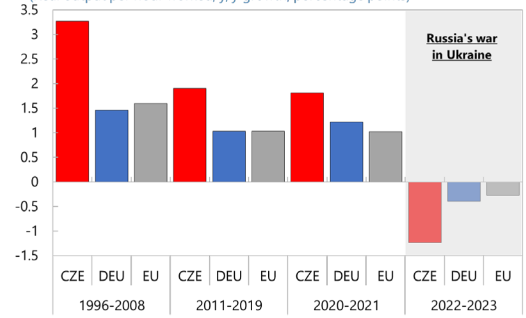
Third, inefficient allocation of labor and capital across sectors has also weighed down productivity. While productivity growth within sectors has been broadly in line with EU average (though reflecting diverging sectoral trends), the decline in productivity observed in the Czech Republic in the post-pandemic period can be attributed to allocative inefficiency. Analysis shows that relatively high-productivity sectors, including manufacturing and financial services, have steadily reduced their workforce while low-productivity public administration has expanded considerably. Similarly, capital has not been allocated efficiently with strong growth for bank credit extended to low-productivity sectors, including the public administration, and declining credit (along with lower FDI inflows) towards manufacturing.

Stronger productivity would hinge on decisive policy action to address each of these dimensions. System-wide, faster digitalization would boost TFP. Enhanced use of existing tax credits for R&D would also support innovation and raise TFP growth. At the sector level, expediting processes, especially at the local administration level, would be critical to address bottlenecks in the construction sector and scale up renewable investments in the energy sector. Finally, steps should be taken to favor better allocation of resources. More targeted active labor market policies could channel labor towards higher-productivity sectors, while availability of venture capital and equity financing could support better availability of funding.

Box 1. Figure 1. Productivity Developments

Labor Productivity per Hour Worked

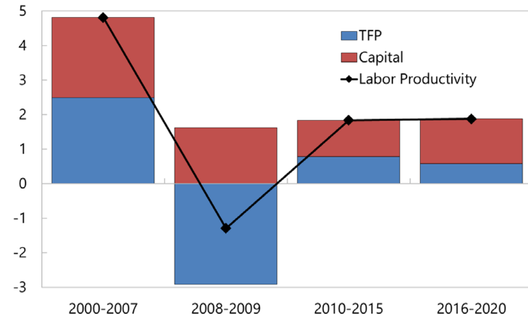
(Real output per hour worked, y/y growth, percentage points)



Sources: Haver Analytics and IMF staff calculations.

Decomposition of Labor Productivity Growth

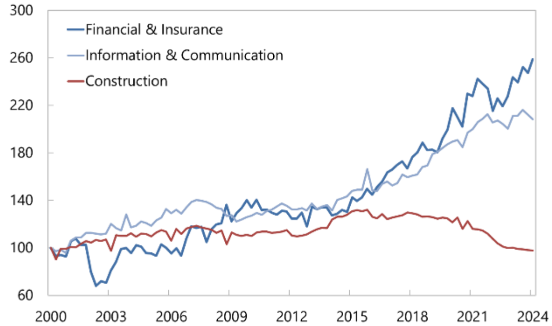
(Percent; annual average)



Sources: EU KLEMS; and IMF staff calculations.

Labor Productivity

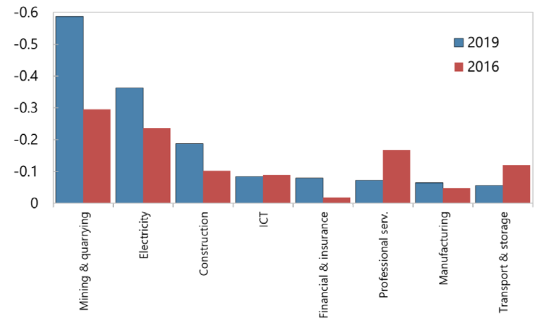
(2000Q1 = 100)



Source: Haver Analytics.

Distance to EU TFP Frontier, 2016 vs. 2019

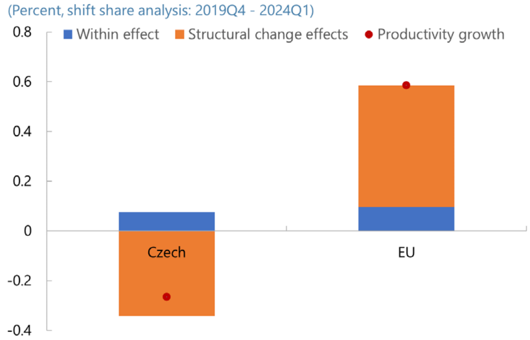
(Log differenced deviation from frontier; based on index, 2015=100)



Sources: EUKLEMS and IMF staff calculations.

Productivity Growth Decomposition

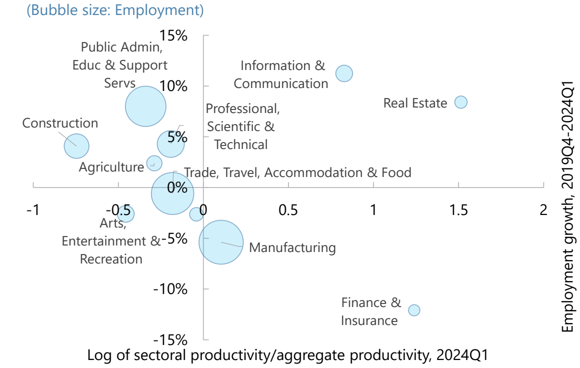
(Percent, shift share analysis: 2019Q4 - 2024Q1)



Source: IMF staff calculations on the basis of Rodrik et al.

Employment Growth and Productivity

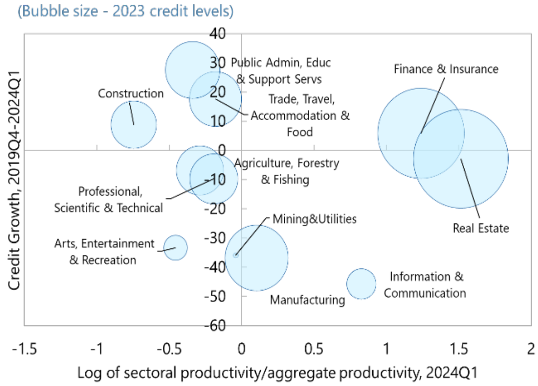
(Bubble size: Employment)



Sources: National Statistical Office; Haver Analytics; and IMF staff calculations.

Credit Growth and Productivity

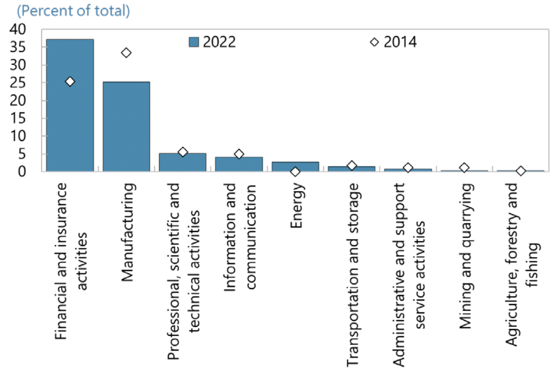
(Bubble size - 2023 credit levels)



Sources: National Statistical Office; Haver Analytics; and IMF staff calculations.

Inward FDI Stocks by Sector

(Percent of total)



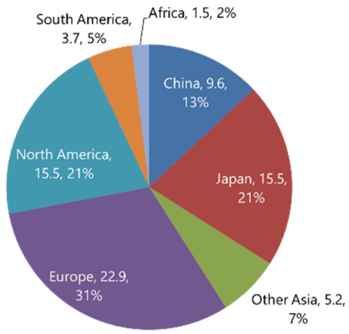
Source: OECD.

Box 2. The Czech Republic's Auto Industry: Recent Developments and the Road Ahead

The automotive industry plays a key role in the Czech Republic's economy, contributing to 10 percent of the country's value added, and large shares of employment and exports. The strong links of the auto industry with both domestic production and international trade, further magnifies its role in the economy.

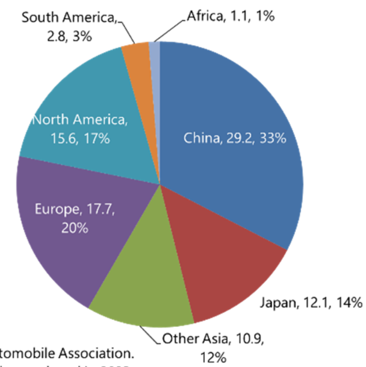
In recent years, the Czech Republic's automotive industry, like most European auto producers, has faced several challenges, including, supply chain disruptions, shifting consumer preferences, and increased competition, as China and India ramped up capacity and captured a significant market share, offering more affordable vehicles. In addition, the industry has faced more stringent European regulatory requirements and higher labor costs, which impacted its competitiveness.

Global Vehicle Production (2007)[1]
(Millions)



Source: Czechia Automobile Association.
1/ 73.0 million vehicles produced in 2007

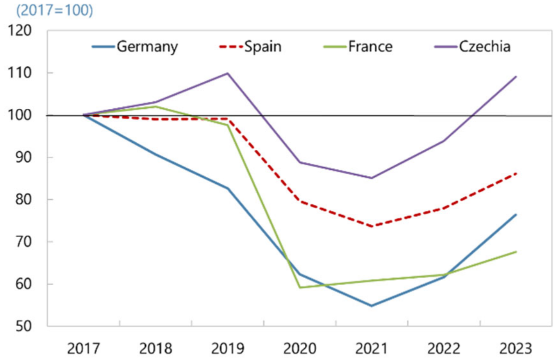
Global Vehicle Production (2023)[1]
(Millions)



Source: Czechia Automobile Association.
1/ 89.5 million vehicles produced in 2023

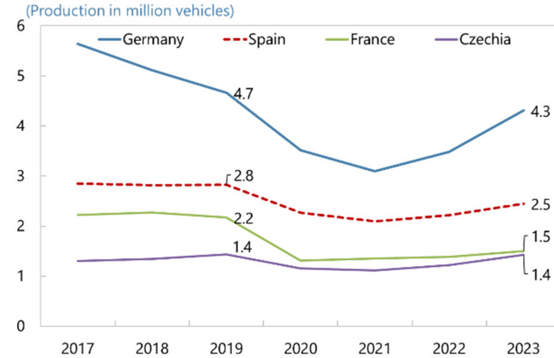
Nevertheless, in an increasingly competitive global landscape, the Czech Republic's automotive industry managed to recover from the 2020-21 dip and production is now back to pre-pandemic levels. This reflects an optimal production mix between combustion engine vehicles and electric vehicles (EVs) in line with market demand, combined with expansion in some fast-growing European markets (e.g., Poland), and a flexible production cost structure compared to other top European producers.

Europe Top Four Auto Producers
(2017=100)



Source: International Organization of Motor Vehicle Manufacturers (OICA).

Europe Top Four Auto Producers
(Production in million vehicles)



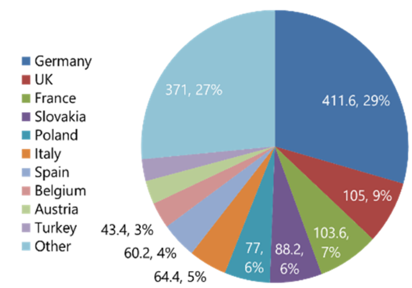
Source: International Organization of Motor Vehicle Manufacturers (OICA).

However, several challenges lie ahead. In addition to relying almost exclusively on European export markets, the Czech auto industry faces the dual challenge of: (i) adapting to European regulation driving the transition towards EVs, and (ii) competing with other manufacturers, mainly from China, which have already established a dominant position in the EV market.

Box 2. The Czech Republic's Auto Industry: Recent Developments and the Road Ahead (Concluded)

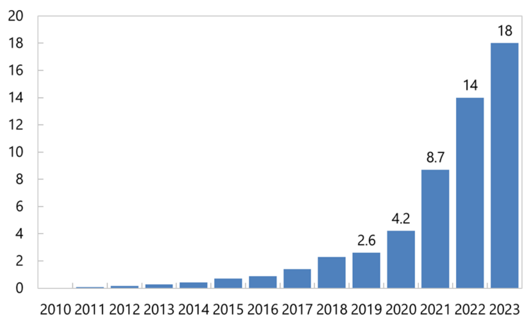
This transition requires significant investments in new technologies, production facilities, and the retraining of a skilled workforce, and will likely put financial strain on the Czech Republic's auto producers. Furthermore, EV supply chains face challenges in securing raw materials like lithium and cobalt for batteries, which are globally in high demand. While this shift presents long-term environmental benefits, it complicates the immediate outlook for Europe's (and the Czech Republic's) auto industry as it navigates technological, financial, and geopolitical hurdles.

Auto Export Markets
(in thousands and percent, 2023)



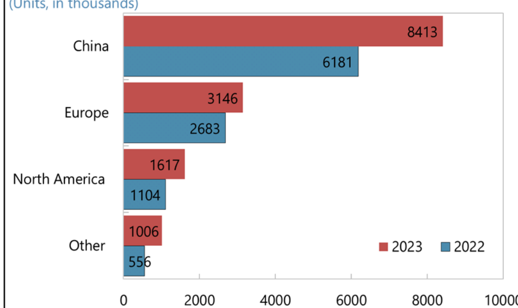
Source: Czechia Automobile Association.

Global Market Share of EVs
(Percent of total vheicle sales)



Source: Statista.

Battery Electric Vheicle (BEV) + Plug-in Hybrid Electric Vheicle Sales (PHEV)
(Units, in thousands)



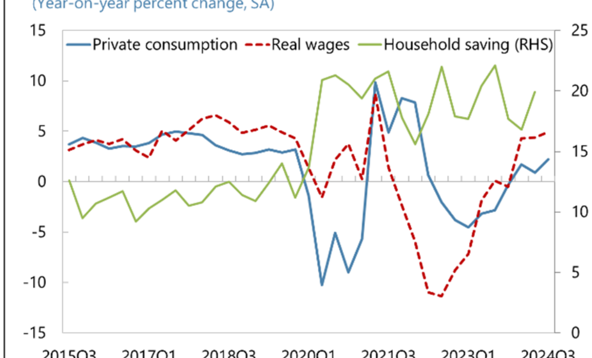
Source: EV volumes.

Several measures should be considered to alleviate the potential economic impact and enhance the resilience of the Czech Republic's automotive industry. These include incentivizing innovation, supporting workforce retraining and development, expanding infrastructure, including an adequate charging network, and calibrating consumer incentives.

RECENT DEVELOPMENTS

4. **The Czech economy is slowly recovering.** After a period of stagnation, growth has picked up since late 2023 with GDP expanding in the first half of 2024 by an average 1.2 percent on a sequential annualized basis, but the recovery has been uneven. Consumer spending has strengthened, fueled by a rebound in real wages and early signs of a decline in the household saving rate. In contrast, investment remains weak, hampered by uncertainty about global trade, the effects of tight domestic policies and a slow absorption of EU funds.

Consumption, Wages and Savings
(Year-on-year percent change, SA)

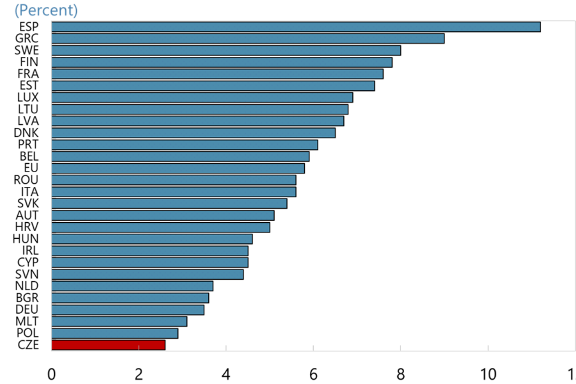


Source: Haver Analytics.

De-stocking of previously accumulated inventories is also weighing down on investment but supporting exports.

5. The labor market remains tight. Despite subdued economic activity and a decline in job vacancies, the Czech labor market continues to suffer from structural job shortages, particularly among skilled workers, and labor hoarding. The unemployment rate has increased, only modestly and, at 2.6 percent in 24Q3, it is the lowest in the EU. Hampered by adverse demographics, the labor force has been on a downward trend, interrupted only by temporary, large migration inflows of successfully integrated Ukrainian refugees over the last two years.

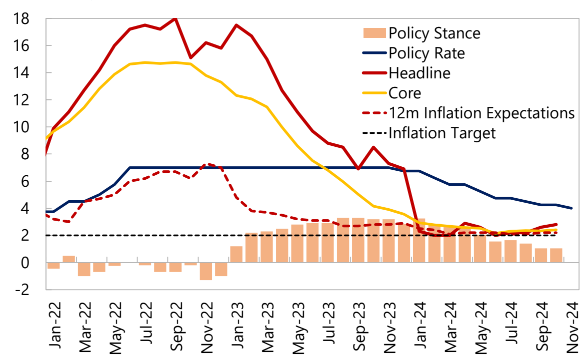
Unemployment Rate, Q3-2024
(Percent)



Source: Haver Analytics.

6. Inflation has moderated. Led by lower commodity prices, restrictive monetary policy and economic slack, headline inflation has reached the Czech National Bank (CNB) 2 percent target in February 2024 (from a peak of 18 percent in September 2022) and remained close to it over the summer. It has drifted to 2.8 percent by November 2024, mainly reflecting volatile food prices and administered prices base effects. Core inflation stood at 2.3 percent, as lower goods price growth, was offset by sticky services price growth and recovery in real wages. Market-based 12- and 36-month ahead inflation expectations are broadly anchored.

Inflation Rate and Monetary Policy
(Percentage)



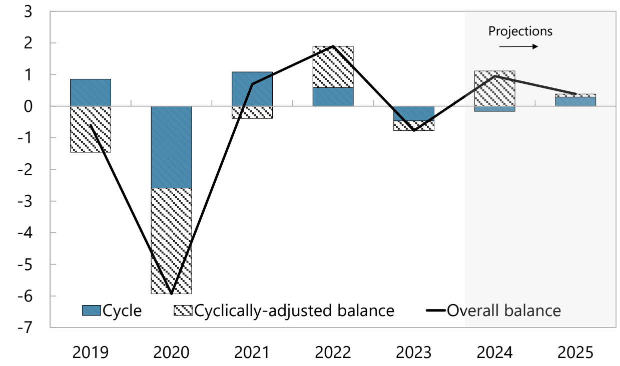
Sources: IMF Staff Calculations, CNB and Haver Analytics.

7. Monetary policy is still restrictive despite sizable rate cuts. Against the backdrop of easing inflationary pressures and subdued economic activity, starting in December 2023, the CNB has lowered the policy rate by a cumulative 300 basis points to 4 percent currently. With inflation expectations broadly anchored and a negative output gap, a simple Taylor rule suggests that monetary policy is still tight.[1]

[1] Alternatively, the monetary policy stance can be calculated as the difference between the real policy rate—based on 12-months ahead financial market inflation expectations—and the natural rate which is set at 1 percent over the plotted horizon. Taylor rules are shown in Figure 4.

8. **Fiscal policy turned tighter in 2024, though less than initially anticipated.** The budget deficit is estimated to have stayed below 3 percent of GDP, despite the slow economic recovery and the additional spending to deal with the recent floods. This entails a fiscal tightening—measured as change in the cyclically adjusted balance—of about 1.1 percent of GDP[2]. The projected public debt ratio remains relatively low, at 43.1 percent of GDP, although some 14 percentage points above pre-pandemic levels.

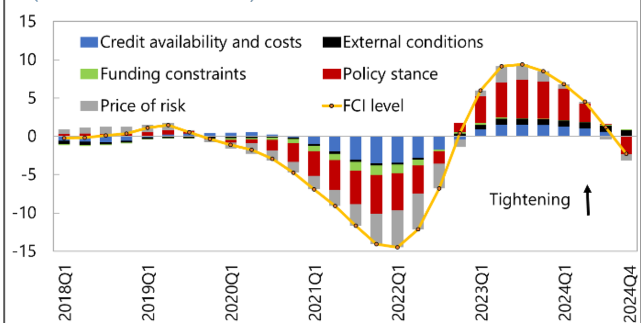
Change in Fiscal Balance
(Percent of GDP)



Source: Ministry of Finance and IMF Staff Calculations.

9. **Mortgage activity is picking up, as financial conditions ease.** As the lower CNB policy rate passes through bank lending rates and household incomes increase, the mortgage market is gradually regaining ground. Flows of new mortgage loans year-to-date exceed again 2014-20 levels, even though the number of loans remains well below long-term averages. Activity likely intensified before new regulation penalizing mortgage pre-payments entered into force in September 2024. After contracting during most of last year, residential and commercial property prices bottomed out in late 2023 and posted a moderate rebound in recent months, adding to long-standing affordability concerns, especially for the Prague metropolitan area.

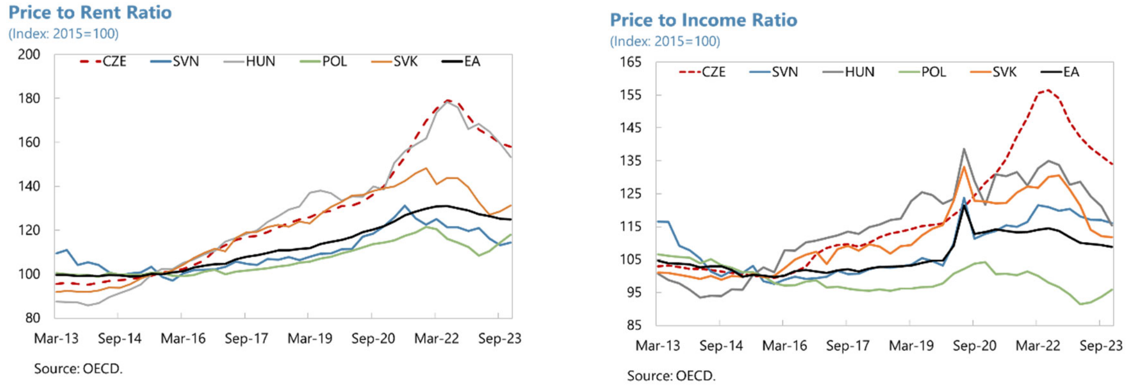
Financial Conditions Index (FCI)
(Contribution to unscaled FCI)



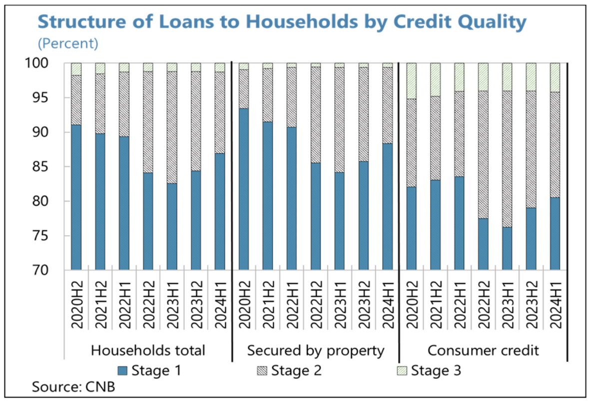
Source: Borraccia et al., 2023, IMF Working Papaer 23/209.
Note: For implementing Partial Least Square, we divide the sample into distinct time periods, each with its regression. The indices are then chained together. It's essential to note that the absolute FCI levels may not be entirely comparable to the early 2000s, given variations in available financial indicators. The final index chain covers most of the 2015-2023 period. 2024Q3 and 2024Q4 are forecasts.

[2] A significant part of the adjustment reflects unwinding of one-off measures related to energy subsidies and support to Ukrainian refugees. A structural balance, which excludes these measures as well as the one-off flood-related spending, would imply a smaller tightening of around 0.4 percent of GDP.

Text Figure 2. House Price Developments

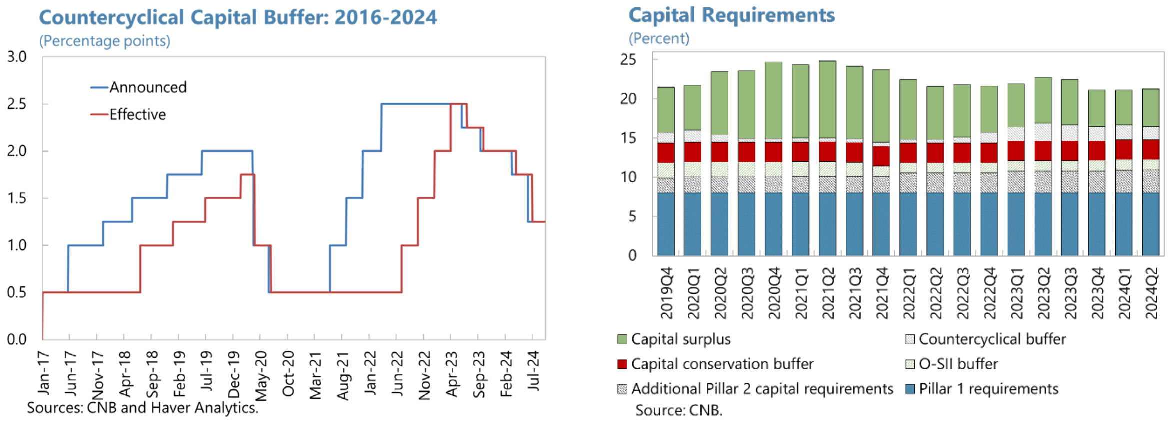


10. The financial sector remains generally sound. Banks are profitable, well-capitalized, and liquid. The aggregate capital ratio stood at 22.6 percent of risk-weighted assets at mid-2024, with voluntary buffers at more than 6 percentage points. That said, all five systemic banks rely on internal ratings-based approaches, with risk weights on mortgage loans averaging around 18 percent (against 35 percent under the standardized approach). NPL are very low, at 1.8 percent of total loans, while stage 2 loans stand at around 12 percent, reflecting a now reverting precautionary increase in the share of stage 2 household loans in recent years. CNB's bank solvency stress tests point to large increase in loan defaults, forcing release of capital buffers, only in an adverse scenario (GDP contracting by a cumulative 10 percent over two years). Investment funds continue to grow rapidly, having more than doubled their assets in the last three years to around 18 percent of GDP.



11. The macroprudential framework was recalibrated in response to evolving financial risks. In June 2024, the CNB lowered the countercyclical capital buffer (CCyB) by 50 basis points to 1.25 percent as cyclical financial risks were seen subsiding, while introducing a general systemic risk buffer (SyRB), at 0.5 percent effective from January 2025, in response to rising structural risks. The LTV ratio limit is set at 80 percent (and 90 percent for applicants under 36 years), while limits on debt-service-to-income (DSTI) and debt-to-income (DTI) remain deactivated. Buffers and limits were left unchanged during the rest of the year.

Text Figure 3. Countercyclical Capital Buffers and Capital Requirements



12. The external position is moderately stronger than the level implied by fundamentals and desirable policies (Annex IV). The current account continued widening from a surplus of 0.4 percent of GDP in 2023 to 1.4 percent at end-September 2024. This increase mainly reflects a wider trade surplus resulting from weaker investment over the cycle along with sustained aggregate savings. External debt remains moderate. The nominal exchange rate vis-à-vis the euro depreciated by around 2.5 percent in 2024, driven primarily by domestic monetary policy easing and higher global risk perception (Annex II).

OUTLOOK AND RISKS

13. The recovery is poised to continue. Driven by higher real disposable income, growth is expected to have extended its recovery in the second half of the year, but the currently restrictive policy mix and a weak external environment likely dampened near-term outcomes. In 2025, fiscal policy is set to turn neutral, while the need for monetary policy restriction will decrease as inflationary pressures ease. As the policy mix becomes more supportive of economic activity and external demand gradually strengthens, growth should gain further momentum. Wage moderation also supports competitiveness of Czech manufacturers in export markets. As a result, growth is expected to accelerate to 2.4 percent in 2025 from a projected 1 percent a year earlier. Despite the cyclical upswing, however, weak productivity growth and structural labor shortages are set to weigh down on medium-term potential growth, which is now estimated at around 2 percent (from 2.5 percent previously, Annex I).

14. Inflation is expected to converge back to target again. After a further increase above 3 percent in the near term on food price base effects, inflation is projected to converge back towards 2 percent by 2025H2, aided by the lagged effect of tight monetary policy and macroeconomic slack. Recent fiscal consolidation efforts should also support disinflation, while inflation expectations remain anchored.

15. Risks to growth are on the downside while risks to inflation appear balanced (Annex III). Further geoeconomic fragmentation, a weaker than anticipated recovery among key European trading partners, especially Germany, and stronger than expected effects of past monetary policy tightening point to downside growth risks. These factors would also weigh down on inflation. On the other hand, stronger wage growth and stickier than expected services inflation, along with protracted increases in commodity prices, could exert upward pressure on inflation. Narrowing policy rate differentials vis-à-vis major central banks could weaken the koruna and add to inflationary pressures.

Authorities' Views

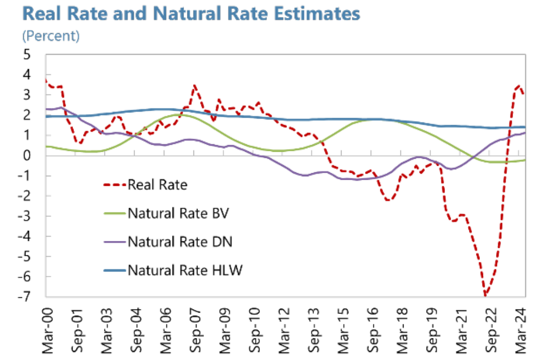
16. The authorities agreed with IMF staff on the growth outlook but expect inflation to converge to target later. Like IMF staff, they expect growth to gradually accelerate in 2025, supported by stronger household consumption, in turn led by solid real wage growth, along with better prospects for investment and revived external demand. Reflecting slower productivity growth, CNB staff recently revised down their estimate of medium-term potential growth to 2.5 percent. After a temporary increase to slightly above 3 percent at the end of the year, they expect inflation to decline in early 2025 on lower growth in administered prices. However, under their baseline, inflation only stabilizes close to the 2 percent target in 2026. While recognizing downside risks to growth from a more pronounced downturn in the German economy, they assess risks to inflation as still modestly tilted to the upside, on possible higher-than-expected inertia in services prices, lower-than-expected decrease in profit margins, and increased wage demands.

POLICY DISCUSSIONS

A. Monetary Policy—Managing Inflation Risks as Restrictive Stance Is Gradually Removed

17. Staff sees ground for continuing to lower the policy rate. Monetary policy has been appropriately eased. However, with inflation expectations broadly anchored and output below potential, the current stance remains tight. This leaves room for additional rate cuts to achieve by mid-2025 a neutral policy rate, which staff estimates at around 3 percent, albeit subject to large uncertainty (Box 3). Further easing should be pursued in a gradual, data-dependent manner, carefully weighing risks of core inflation remaining elevated due to second round effects against the possibility of inflation undershooting the 2 percent target. Sustained wage growth above productivity growth or protracted commodity price increases would call for a more gradual decline in the policy rate, whereas signs that inflation might undershoot the target would call for the policy rate to be lowered to a neutral level before mid-2025.

Box 3. The Czech Republic's Natural Rate of Interest



Sources: BV is Bulir and Vlcek (2024), DN is Del Negro et al. (2017), HLW is adjusted Holsten, Laubach and Willliams (2017), Bloomberg, Consensus Forecast, Haver Analtytics, IMF Staff Estimates.

The real natural or neutral interest rate r* is used to gauge the monetary policy stance. It is typically defined as the level of the real short-term interest rate that would keep output at potential and inflation at target.[1] Thus, the policy stance is accommodative if r<r* and restrictive if r>r*. Accordingly, central banks aim to set the real rate close to the natural rate. If inflation is off target, a neutral monetary policy stance is assumed to return the economy to balance over a horizon of up to 18-24 months.

The Czech Republic's natural rate is currently estimated at around 1 percent, albeit subject to significant uncertainty. In line with international interest rates and decreasing domestic potential growth, the natural rate of the Czech Republic has been declining, albeit marginally, since the 2000s. The natural rate is currently estimated at around 1 percent. This results from an approximate average of three different approaches that are each subject to considerable uncertainty and provide a range from 0 to 1.5 percent.[2]

A range of time-varying factors could push the natural rate of the Czech Republic up or down going forward. The natural rate is driven by both structural and policy factors affecting savings and investment. The applied empirical approaches link r* mainly to potential growth while considering international linkages to some extent. Over the next years, r* could be negatively affected by lower growth due to supply-chain reshoring and decarbonization, while related higher public investment, including for defense, could push r* upwards. Higher global uncertainty could also decrease r* via increased demand for savings, while faster AI-led technological growth and higher public debt would raise it.

Staff's estimate implies a terminal rate of 3 percent and an increase in public debt service expenditures. With inflation expectations at around 2 percent, a neutral real rate of around 1 percent implies a terminal policy rate of 3 percent. It also implies that the current policy stance is still tight and leaves further room for rate cuts. For fiscal policy, real rates of around 1 percent imply considerably larger debt payments than observed during 2016-23 when ex-post real yields on government bonds were negative.

[1] 'Neutral' and 'natural' interest rate are often used interchangeably. However, the neutral interest rate is the non-inflationary rate of interest while the natural interest rate is the long-run flexible-price equilibrium rate of the real interest rate, in other words the steady state level of the neutral rate (Obstfeld, 2023).

[2] The natural rate is estimated with: i) the semi-structural model of Holsten, Laubach and Williams (2017) that includes an IS curve and a Philips curve and links the natural rate to potential growth and an unspecified residual component that is altered to focus on the trend component in r* ii) Bulir and Vlcek's (2024) open-economy extension of this model that takes into account that some of the higher potential growth of converging economies can be reflected by an appreciating exchange rate and thereby entail a lower natural interest rate, and iii) Del Negro et al.'s (2017) more flexible factor model that places less structural restrictions on the data.

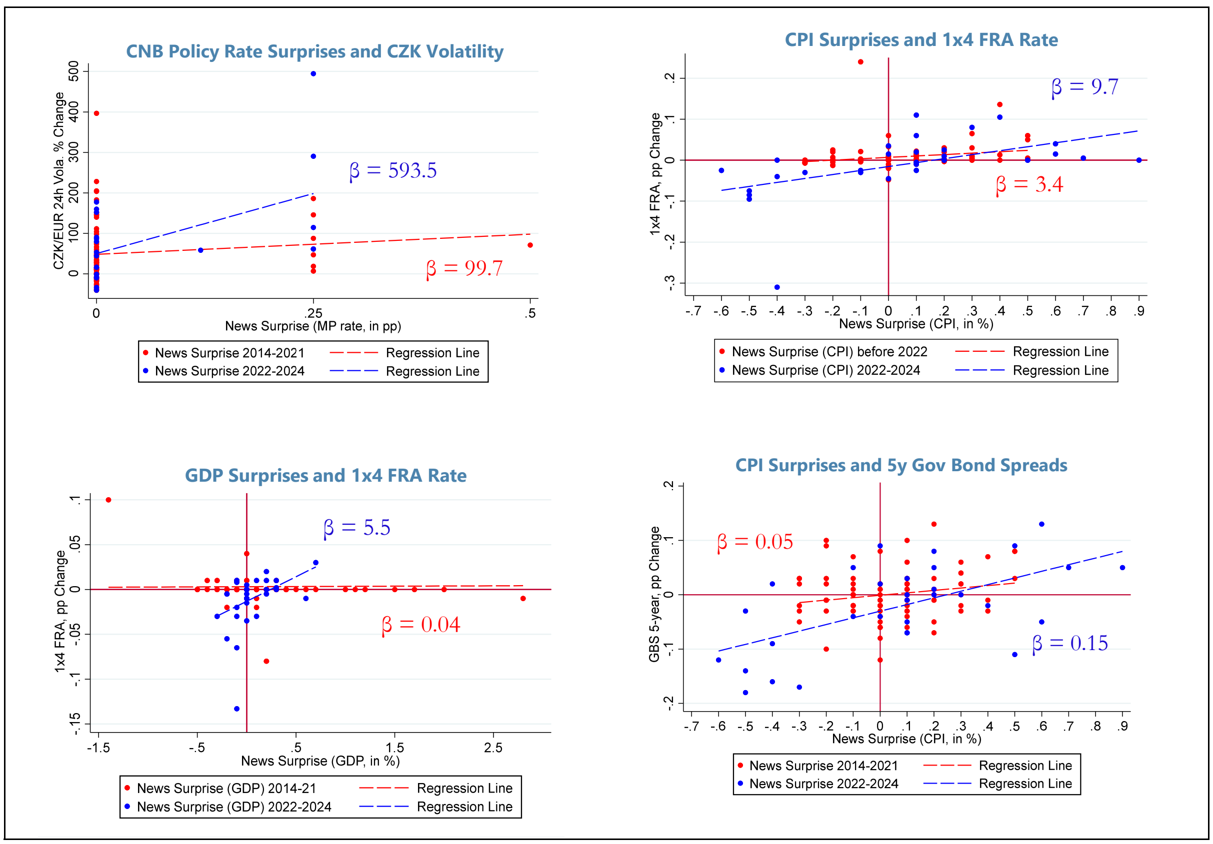
18. **The current risk management approach could give way to a gradual return to forecast-based inflation targeting.** In a high-uncertainty environment, a data-dependent approach makes greater use of information related to recent inflation developments, but it may also result in larger market volatility (Box 4). Once uncertainty recedes and inflation stabilizes more closely to target, the CNB could consider placing more weight on forecast-based inflation targeting, assessing costs and benefits relative to a data-dependent, meeting-by-meeting approach. Throughout this transition, clear and transparent communication, including strong commitment to bringing inflation back to

target will remain critical to keep expectations firmly anchored. Relatedly, an external review of the CNB's monetary policy analytical and modeling framework has just been completed.[3]

Box 4. Is There a Cost for More Data-Dependent Monetary Policy?

A stronger focus on data-dependent monetary policy has potentially changed how markets react to macroeconomic news. During recent periods of high inflation and elevated volatility, forecast-based inflation targeting has become less effective. In response, the CNB, like many other central banks, has moved towards a more data-dependent, meeting-by-meeting approach (see e.g., Michl, 2023 for the CNB or ECB, 2024 for the ECB[1]). This means giving less weight to baseline projections and more to the observed inflation dynamics and the strength of monetary transmission. Adapting monetary policy frameworks to navigate new challenges, however, can lead to a potential change in the response of asset prices to macroeconomic data and policy news, both in terms of higher volatility and absolute size.

Staff's analysis suggests that CNB policy rate decisions have led to higher exchange rate volatility post-2022. An event-study approach analyzing financial market responses in daily windows shows that CNB rate decisions deviating from expectations have raised EUR/CZK volatility post-2021 three times as much as before. Surprise tightenings of domestic monetary policy have led to larger Czech Koruna appreciation than pre-2022. Conversely, CPI and GDP news different from expectations have not led to higher exchange rate volatility post-2021.



Domestic GDP and CPI news and foreign monetary policy surprises have had larger effects on domestic market interest rates post-2021. Post-2021, both positive CPI and GDP news have produced relatively larger increases in short-term interest rates (1x4 Forward Rate Agreements), a proxy for stronger short-term monetary policy reaction. Moreover, the response of government bond spreads (e.g., 5-year

[3] See https://www.cnb.cz/en/cnb-news/press-releases/CNB-publishes-the-results-of-the-external-review-of-its-monetary-policy-analytical-and-modelling-framework/.

Box 4. Is There a Cost for More Data-Dependent Monetary Policy? (Concluded)

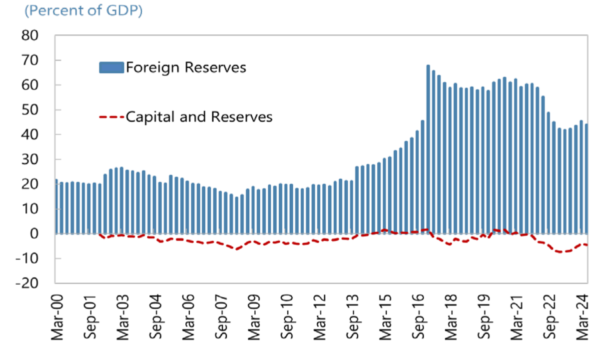
Czech yields over German yields) changed significantly, indicating a different risk assessment by markets; positive CPI news produced larger increases and positive GDP news larger decreases in spreads post-2021. Finally, foreign monetary policy surprises entailed significantly larger volatility in domestic market interest rates since 2022.

Central banks face a potential trade-off. These results suggest a trade-off between i) pursuing a more data-dependent approach, responding to realized data that may provide stronger informative signals about future inflation but facing greater financial market volatility; or ii) returning to a more forecast-based policy rule and potentially reducing volatility but facing the risk of greater deviation from target. As uncertainty recedes and inflation becomes more closely aligned to target, the cost of higher volatility is more likely to outweigh the benefit of attaching a large weight on recent data when setting policy rates.

[1]Speech from October 17, 2023, by CNB Governor Michl (https://www.bis.org/review/r231019a.htm); ECB Press Release from September 12, 2024 (https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.mp240912~67cb23badb.en.html).

19. Consideration should be given to reducing the size of the central bank's balance sheet over time. The CNB balance sheet carries foreign currency reserve assets of more than 40 percent of GDP, a legacy of the FX floor in place during 2013-17. In 2023, with the aim of slowing down the growth of its balance sheet, the central bank resumed a program of FX sales (limited to part of the income generated by the reserves). After reaching a negative equity of more than 7 percent of GDP, in 2023, profitability (and the capital position) was considerably improved through various ad hoc cost rationalization measures and diversification towards higher yielding assets, including gold and equities. Recently, the rate of unremunerated minimum reserve requirement was also raised by 2 percentage points to 4 percent. Focus should shift from profit maximization to balance sheet reduction. Aiming to gradually reduce the size of the balance sheet would help limit risks to the CNB's financial position. To minimize any impact on the exchange rate, this could be done through a transparent and predictable mechanism of small, regular FX sales above and beyond the existing program.

Central Bank FX Reserves and Capital
(Percent of GDP)



Sources: CNB and Haver Analytics.

Authorities' Views

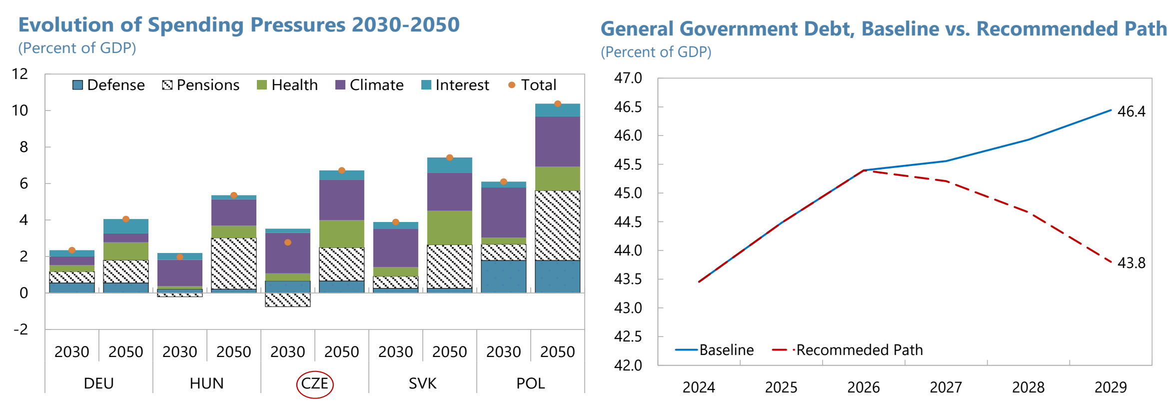
20. The CNB sees reasons for maintaining a restrictive monetary policy stance. They noted that a tight stance would still be required to ensure that inflation stabilizes close to the 2 percent target over the monetary policy horizon, emphasizing risks that a protracted period of significant increase in food prices could lead to second round effects. They also warned about the recent rebound in real estate demand leading to accelerating property prices and renewed mortgage lending activity. The need for restrictive monetary policy will only decrease as inflation pressures ease. The CNB agreed with IMF staff that after the effects of past shocks recede, more weight could be placed on forecast-based inflation targeting. At the moment, the CNB does not consider shrinking its balance sheet actively through sales of FX reserves beyond its existing program. The CNB notes that in the current geopolitical environment, ample reserves may provide a buffer to guard against the risk of pressures on capital flows and the exchange rate.

B. Fiscal Policy—Preserving Buffers while Supporting Transformation

21. The 2025 budget commits to a broadly neutral fiscal policy but is subject to some risks. Fiscal consolidation efforts in 2024 have been commendable. A broadly neutral fiscal stance in 2025 is appropriate, considering the narrowing (but still negative) output gap and the still tight monetary stance. The state budget prioritizes spending in education, research and development, infrastructure, and defense through additional revenue generated by a 2-percentage point increase in the corporate income tax rate and a 60 percent surcharge on excess profits of energy firms and banks. The wage bill is expected to grow by 7 percent. Overall, the budget entails a general government deficit of 2.3 percent of GDP. However, under staff's baseline, possible cost overruns and revenue shortfalls are estimated to leave the deficit around ¼ percentage points above the authorities' projection.

22. Additional measures will be required over the medium term to keep the deficit at prudent levels. Under staff's baseline, the structural deficit improves by only ½ percentage point over 2024-28 to a deficit of around 2 percent of GDP. Fiscal space is assessed to be substantial and the overall risk of sovereign stress low (Annex V), but the debt ratio does not stabilize over the forecast horizon and significant long-term pressures related to pension, healthcare, defense, and energy security spending could further erode buffers over time. Preserving fiscal policy space would help absorb these spending pressures. Accordingly, staff's recommended path, broadly aligned with the national fiscal rule, entails a further adjustment of about ½ percentage points of GDP a year over 2027–28 to reach a structural deficit of less than 1 percent of GDP by 2028. Productivity-enhancing spending should be safeguarded, and automatic stabilizers should operate freely. However, absent a severe downside shock, discretionary stimulus should be avoided, as it could ignite price and wage pressures, given the tight labor market, and hurt competitiveness.

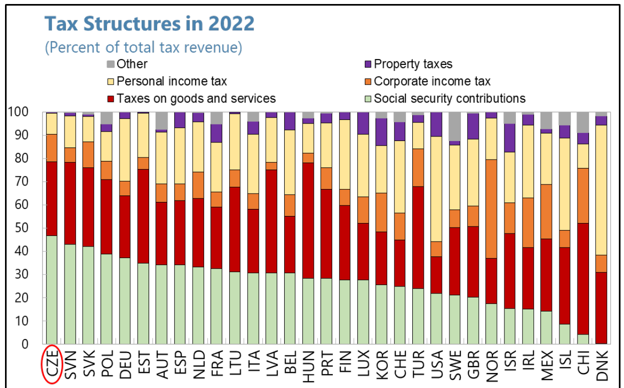
Text Figure 4. Spending Pressures



Sources: EC, EIB, WEO, and IMF staff estimates and projections.

Source: IMF Staff Projections.

23. Tax revenue composition could be improved sustaining consolidation efforts. Against the backdrop of a restrained fiscal environment, it is vital for taxation and spending to be aligned with the strategic objective of delivering inclusive and sustainable growth. Social security contributions account for nearly half of the revenue collected, while revenue from property, environmental and consumption taxes is well below the EU average. Staff encourages the authorities to revisit over time the composition of tax revenue. In addition to reversing the large changes enacted in 2021, the structure of the personal income tax should also be reassessed against the intended degree of progressivity. Further, gradually transitioning the property tax from the current system based on property size to market values, and regularly update these values, would result in increased revenue and enhance both the efficiency and fairness of the tax system. A property value-based tax would also increase over time the cost of unoccupied properties and encourage supply, alleviating house price pressures. Ongoing efforts to modernize the Czech tax administration are set to strengthen revenue resilience.



Source: OECD.

24. The adjustment should also be accompanied by measures on the expenditure side. The important actions taken to improve the sustainability of the Czech pension system are welcome but limiting the annual increase in the retirement age to one month reduces the intended effects of the reform and may require further adjustments in the future. To limit costs and mitigate economy-wide labor shortages, the sustained expansion of the public sector workforce should be contained going forward, especially in fragmented local administrations and locally provided services. Enhancing collaboration between municipalities would lead to more efficient delivery of public services and investments, including for the education system. In addition, a more neutral tax-sharing formula between the state and smaller municipalities could raise incentives for such collaboration. Spending on social benefits could be better targeted. Efficient and better targeted absorption of EU Cohesion funds along with faster progress towards unlocking Recovery and Resilience Facility (RRF) funds could support productivity-enhancing capital spending.

Authorities' Views

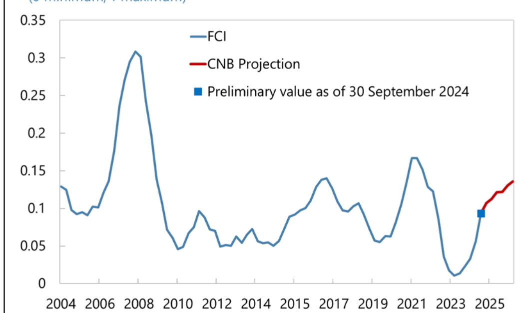
25. The authorities agreed on the need of additional fiscal consolidation over the medium term. They assessed risks to the 2025 budget to be limited but agreed with IMF staff on the importance of preserving fiscal policy space to help absorb aging- and security-related spending. While seeing merits in revisiting over time the composition of tax revenue, they stressed the need for policy action primarily on the spending side. Containing the expansion of the public sector workforce, especially among local administrations, was seen as a priority. There was broad agreement that local governments' spending efficiency could be significantly improved.

C. Financial Sector Policies—Calibrating Frameworks with Evolving Risks

26. While remaining contained and broadly unchanged, financial stability risks warrant vigilance. Residential property prices have staged a moderate rebound in recent months, adding to long-standing affordability concerns, especially for the Prague metropolitan area. Recent initiatives to offer affordable rental housing may provide some relief. Real estate funds are not systemic institutions, but their role in the domestic commercial real estate market has grown significantly. Close monitoring of risks stemming from loans secured by commercial property collateral should be pursued further. Given the relatively low risk weights on mortgage loans, supervisors should continue to review bank exposures and ensure that credit risks are accurately reflected in banks' risk weights. Additionally, considering banks' high exposure to Czech sovereign debt and to euro loans to non-financial corporations, the authorities should continue to regularly evaluate the effect of mark-to-market losses on securities portfolios and the impact of exchange rate fluctuations on corporate exposures.

27. The current macroprudential stance is broadly appropriate. While the Czech Republic is the only EU country to have lowered the countercyclical capital buffer (CCyB) rate since 2020, the rate had been tightened comparatively more (up to 2.5 percent) during the upward phase of the financial cycle. Staff assesses the current 1.25 percent CCyB rate as appropriate and urges the authorities to exert caution in considering additional easing. A further release of the CCyB would be advisable only in response to clear materialization of financial risks. Conversely, an increase in the CCyB rate should be considered in case of rapid credit growth and rising asset prices. The introduction of a general systemic risk buffer is welcome, given the structural headwinds facing the economy. Mortgage activity should be monitored closely to identify potential early triggers for the reactivation of DSTI and DTI limits.

CNB: Financial Cycle Indicator
(0 minimum, 1 maximum)



Source: CNB.

28. Continued efforts are needed to safeguard the financial and real-estate sectors from money laundering risks and cross-border illicit financial flows. The CNB, in its capacity of AML/CFT supervisor, uses cross-border financial flows data obtained from banks to conduct entity-level ML/TF risk assessments, a critical tool in prioritizing AML supervisory engagements. They should continue to deepen such analysis and investigate the potential impact of such flows on the real estate sector. Sectoral analysis focused on cross border risks could also—in addition to the continued focus on domestic risks from financial crimes—be incorporated into the National Risk Assessment and the National AML/CFT Strategy, whose updates are scheduled in 2025. Obtaining timely and accurate information on beneficial ownership of Czech real estate transactions is crucial to prevent misuse by criminals. While the latest amendments of the AML Act in 2024 are welcome, the authorities should continue to address any remaining gaps through legislative and regulatory reforms. It is also important to increase suspicion reporting by real estate intermediaries. Efforts to reduce the transnational aspects of corruption need to continue from both the supply side and the facilitation side.

Authorities' Views

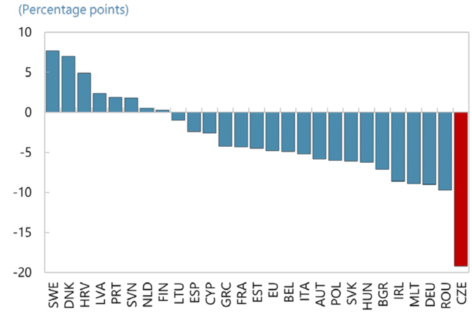
29. The CNB assessed the Czech financial sector to be sound and resilient to potential adverse shocks. While recognizing that the mortgage market is gradually picking up and property prices are rising again, they noted that from a financial stability perspective the risk of excessive growth in mortgage loans remains low for now. Accordingly, they deemed appropriate to leave all macroprudential rates unchanged and DSTI and DTI ratios deactivated. However, the CNB would be ready to increase the CCyB rate again, should the financial cycle continue to move into a new expansion phase. On AML/CFT, the authorities indicated that they would continue their efforts to reduce the transnational aspects of corruption and to safeguard the financial and real estate sectors from money laundering risks and cross-border illicit financial flows.

D. Structural Policies—Accelerating Sustainable and Inclusive Growth

30. Decisive action is needed to support economic transformation. The newly adopted Economic Strategy usefully identifies key focus areas to achieve long-term, sustainable growth. Building on this diagnosis, the authorities are urged to undertake concrete policy actions.

31. More targeted active labor market policies would facilitate labor reallocation and enhance participation. The proposed amendments to the Labor Code promote greater flexibility in the labor market and should be adopted swiftly. Use of existing data on job mismatches could inform modernized vocational training and targeted upskilling and reskilling measures, facilitating labor reallocation. Aligning education programs with labor market needs could further address skill shortages. Recent migration flows have been successfully absorbed by the Czech labor market. Policies should continue to focus on integrating migrants in the most productivity-enhancing way possible. Addressing the gender pay gap and increasing the availability of affordable and high-quality childcare and eldercare facilities could encourage more women to enter the workforce and boost labor participation.

Employment Gap After Childbirth, 2023
(Percentage points)



Source: Eurostat.

32. Efforts to ease restrictions, reduce administrative burden and accelerate digitalization would attract capital and support growth prospects. Deepening the EU single market would allow the Czech Republic, like other EU members, to better leverage economies of scale, foster competition, lower costs, and enhance resilience. Domestic structural policies should accompany this progress, supporting business climate and making the Czech Republic a more attractive destination for foreign capital. Priority should be given to reducing administrative burden and red tape, especially among local municipalities, expediting spatial planning and construction permit processes, and enhancing adoption of digital technologies. Harmonizing IT systems in the public administration, upgrading online government services to businesses, and expanding digital infrastructures, including broadband, would also be critical. Encouraging use of existing tax credits for research and development would support innovation. Expanding availability of venture capital and equity financing would boost opportunities for startups and allow young firms to scale up.

33. The commitment to climate neutrality should be met by more ambitious steps. The authorities are planning to expand nuclear power capacity, building on Czech established know-how in this area, to reduce emissions and achieve greater energy security in the long run. However, the Czech energy mix currently remains dominated by fossil fuels, which still represented two thirds of gross available energy in 2023. The authorities have committed to phasing out dependence on coal by 2033 and have aligned with the EU's goal of achieving net-zero greenhouse gas emissions by 2050. At current policies, however, this target is likely out of reach. Investment in renewables remains low by international standards and could be scaled up, including through recently identified acceleration zones, while boosting energy efficiency. Adaptation policies have reduced the potential damage from recent floods, making infrastructure more resilient to climate change impacts. Staff encourages the government to continue investing in adaptation to climate change.

Authorities' Views

34. The authorities agreed on the need to support economic transformation and boost productivity growth. Labor hoarding was seen as one contributing factor behind inefficient allocation of resources lately but there was broad agreement on the structural nature of the Czech productivity slowdown. While emphasizing ongoing progress with active labor market policies, the authorities saw merits in IMF staff's recommendations to improve targeting of available schemes through the existing dataset. They also acknowledged the importance of increasing the share of university graduates in scientific and technical fields. IMF staff's diagnosis that boosting productivity would require reducing administrative burden, upgrading digital infrastructures, and expediting processes, especially among fragmented local governments, was widely shared. On energy, while recognizing the merits of investments in renewables, the authorities stressed the instrumental role of nuclear power in reducing emissions and achieving greater security and laid out their strategy to expand capacity through construction of new reactors.

STAFF APPRAISAL

35. The Czech economy is slowly recovering after an unprecedented combination of shocks but faces structural headwinds. Following a period of stagnation, growth is picking up, as the policy mix becomes more supportive of economic activity and external demand gradually strengthens. Staff assesses the external position to be moderately stronger than the level implied by fundamentals and desirable policy settings in 2024 (Annex IV). Despite the cyclical upswing, however, weak productivity growth and structural labor shortages are set to weigh down medium-term potential growth, which is now estimated at around 2 percent. Inflation has moderated and, after drifting higher on volatile food prices in the near term, is expected to converge back to target.

36. Risks to growth are on the downside while risks to inflation appear balanced. Further geoeconomic fragmentation and a weaker than anticipated recovery among key European trading partners, especially Germany, point to downside risks to growth and inflation. On the other hand, stronger wage growth and stickier than expected services inflation, along with protracted increases in commodity prices, could exert upward pressure on inflation.

37. Staff sees ground for continuing to lower the policy rate. With inflation expectations broadly anchored and output below potential, there is room for additional rate cuts to achieve by mid-2025 a neutral policy rate, which staff estimates at around 3 percent, albeit subject to large uncertainty. Further easing should be pursued in a gradual, data-dependent manner. Once uncertainty recedes and inflation stabilizes more closely to target, the CNB could consider placing more weight on forecast-based inflation targeting.

38. Consideration should be given to reducing the size of the central bank's balance sheet over time. Profitability has been considerably improved through various ad hoc cost rationalization measures and diversification towards higher yielding assets. But focus should shift from profit maximization to balance sheet reduction. Aiming to gradually reduce the size of the balance sheet would help limit risks to the CNB's financial position. To minimize any impact on the exchange rate, this could be done through a transparent and predictable mechanism of small, regular FX sales above and beyond the existing program.

39. A broadly neutral fiscal stance this year is appropriate, but additional measures will be needed over the medium term to counter spending pressures. Staff recommends a further adjustment of ½ percentage points of GDP annually over 2027–28 to reach a structural deficit of less than 1 percent of GDP by 2028. Productivity-enhancing spending should be safeguarded, and automatic stabilizers should operate freely.

40. Policy actions should be considered both on the revenue and the spending side. Staff encourages the authorities to reassess the composition of tax revenue. On the spending side, the reform of the Czech pension system is welcome, but further adjustments may be required in the future. Containing the expansion of the public sector workforce, including in fragmented local administrations, and improving targeting of social benefit can limit costs, while efficient absorption of EU funds could boost productivity.

41. Financial stability risks are contained and broadly unchanged since the last Article IV Consultation but warrant vigilance. Real estate risks should continue to be monitored closely. Given the relatively low risk weights on mortgage loans, supervisors should continue to review bank exposures and ensure that credit risks are accurately reflected in banks' risk weights. The authorities should also continue to regularly evaluate the effect of mark-to-market losses on banks' securities portfolios and the impact of exchange rate fluctuations on their corporate exposures. Finally, continued efforts are needed to reduce the transnational aspects of corruption and to safeguard the financial and real-estate sectors from money laundering risks and cross-border illicit financial flows.

42. Staff assesses the current macroprudential stance as appropriate. Caution should be exerted in considering additional easing. A further release of the CCyB would be advisable only in response to clear materialization of financial risks. Conversely, an increase in the CCyB rate should be considered in case of rapid credit growth and rising asset prices.

43. Swift action is needed to support the ongoing economic transformation. Building on the newly adopted Economic Strategy, the authorities are urged to undertake concrete policy measures. Structural policies should focus on facilitating the allocation of labor towards higher value-added sectors and firms, addressing the gender pay gap to boost labor participation, reducing administrative burden and red tape, accelerating digitalization, and promoting a more ambitious green transition.

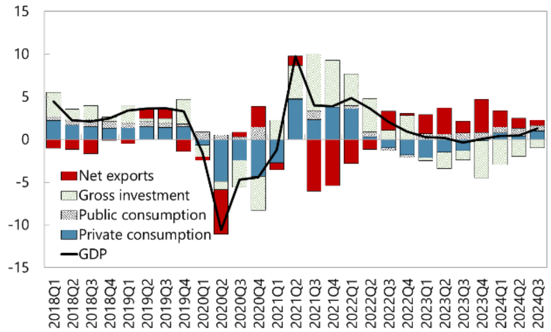
44. It is recommended that the next Article IV consultation be completed on the standard 12-month cycle.

Figure 2. Growth Developments

Growth slowed in 2023 due to a significant decline in private consumption…

Contribution to Real Expenditure GDP

(Seasonally adjusted, Y-on-Y percent change; Contributions in percentage points)

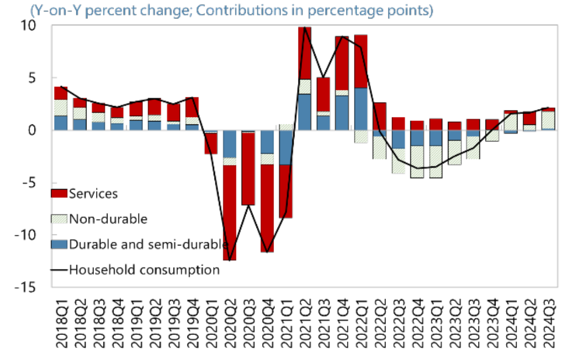


Sources: Czech Statistical Office and Haver Analytics.

… as falling real wages and a higher saving rate weighed on durable and non-durable consumption…

Contribution to Household Consumption Growth

(Y-on-Y percent change; Contributions in percentage points)

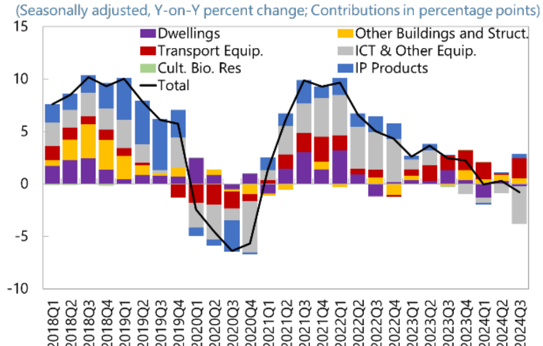


Source: Eurostat.

… and investment was a drag on growth on a tight policy mix.

Changes in GFCF

(Seasonally adjusted, Y-on-Y percent change; Contributions in percentage points)

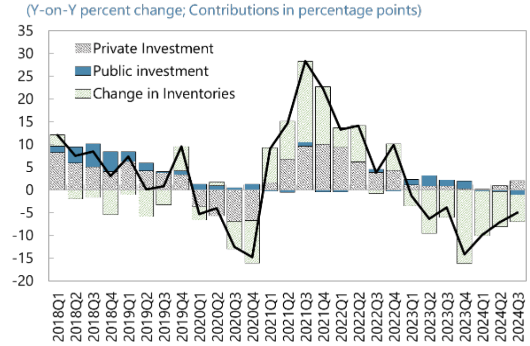


Sources: Czech Statistics Office and IMF staff calculations.

Gross capital formation has been driven primarily by a fall in inventories as bottlenecks in gross value chains eased.

Gross Capital Formation

(Y-on-Y percent change; Contributions in percentage points)



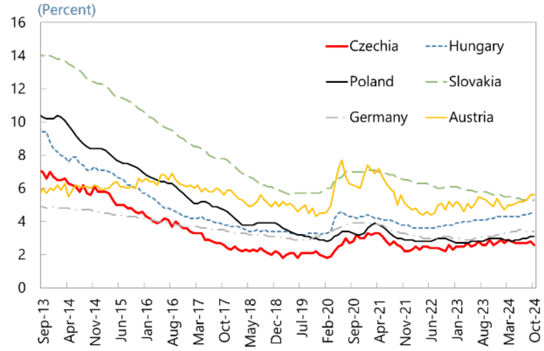
Source: Czech National Bank.

Figure 3. Labor Market Developments

The unemployment rate increased modestly as the economy stagnated but remains among the lowest in Europe…

Unemployment Rate

(Percent)

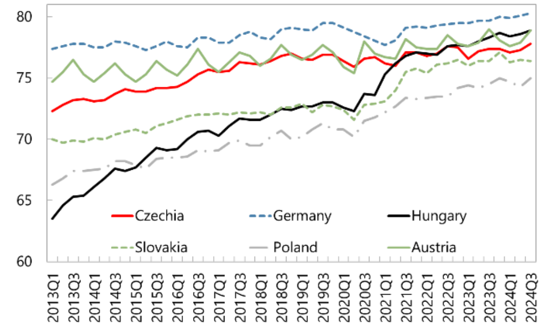


Sources: Czech Statistical Office and Haver Analytics.

… while labor force participation has been broadly stable after the pandemic.

Labor Force Participation Rate

(Percent of population, 15-64)

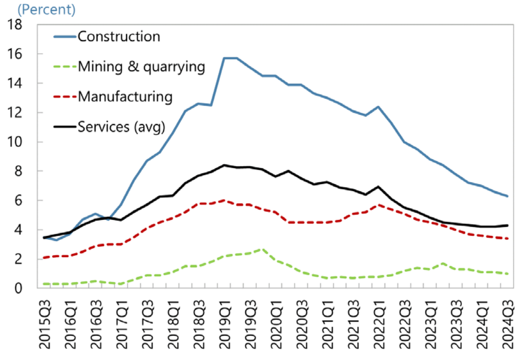


Sources: Czech Statistical Office and Haver Analytics

Vacancy rates have declined gradually since 2019…

Vacancy Rates Across Sectors

(Percent)

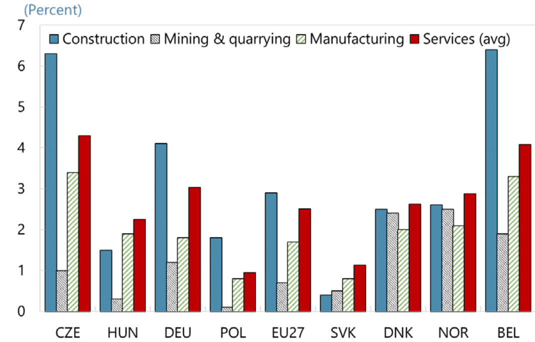


Sources: Czech Statistical Office and Haver Analytics

… although in most sectors they remain relatively high compared to other European countries.

Job Vacancy Rate, Q3-2024

(Percent)

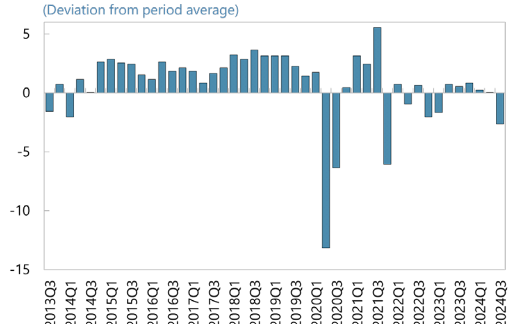


Sources: Czech Statistical Office and Haver Analytics.

While fluctuating, capacity utilization has converged towards average …

Capacity Utilization

(Deviation from period average)

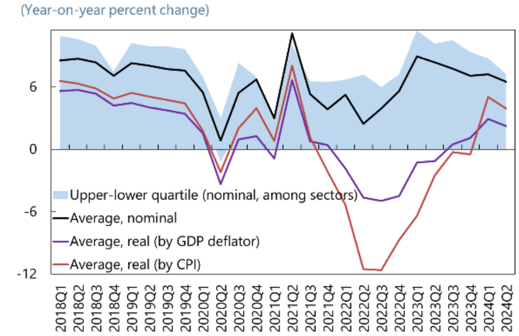


Sources: Czech Statistical Office and Haver Analytics.

…and the growth of unit labor costs is below pre-pandemic rates.

Wage Growth Rate

(Year-on-year percent change)



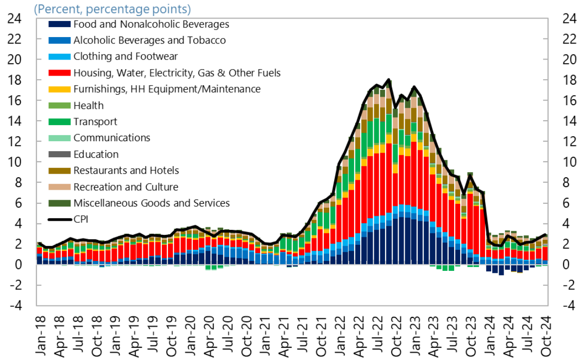
Sources: Haver Analytics and IMF staff calculations.

Figure 4. Inflation Developments

CPI inflation dropped to 2 percent in early 2024 on a sizable fall in the housing and energy components…

CPI, Contributions

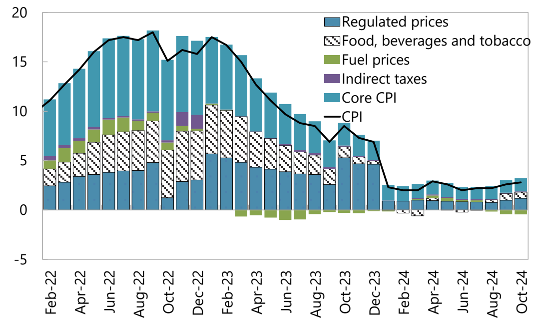
(Percent, percentage points)



… while food prices have added to disinflationary pressures, but rebounded lately.

CPI, Contributions

(Y-on-Y percent change; Contributions in pecentage points)

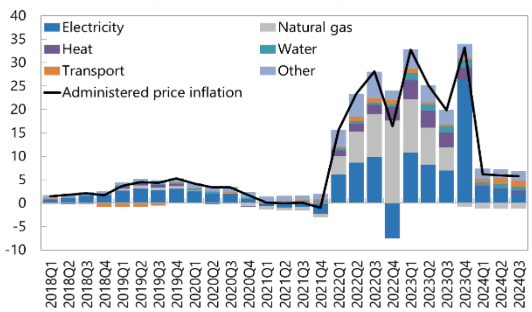


Sources: Haver Analytics and CNB.

Regulated prices inflation remains elevated driven by electricity prices.

Contribution to Administered Price Inflation

(Y-on-Y percent change; Contributions in pecentage points)

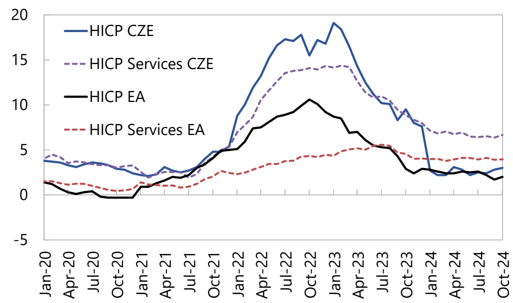


Source: CNB.

HICP inflation has come down to the euro area average while services inflation remains more elevated.

HICP

(Y-on-Y percent change)

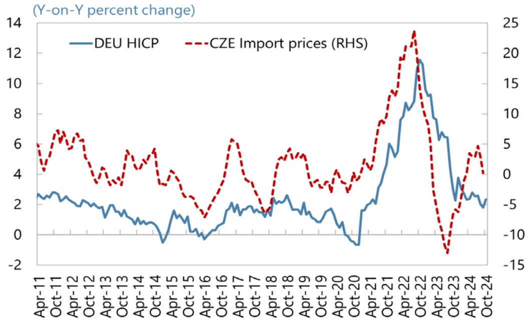


Sources: Haver Analytics

Import price growth picked up again in 2024…

Import Prices

(Y-on-Y percent change)

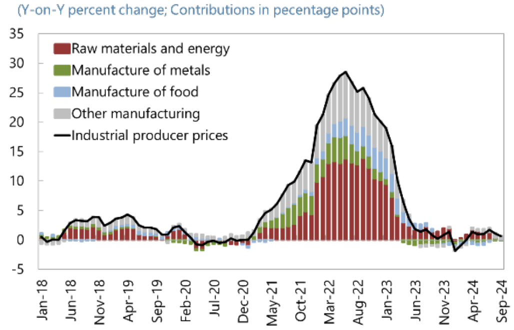


Sources: Czech Statistical Office and Haver Analytics.

… while food and metal prices exerted downward pressure on producer price inflation.

Industrial Producer Prices

(Y-on-Y percent change; Contributions in pecentage points)



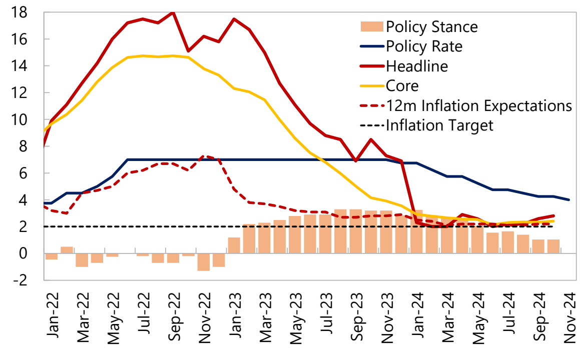
Sources: CNB.

Figure 5. Monetary Policy

Policy rates have been gradually lowered since December 2023, gradually easing the policy stance…

Inflation Rate and Monetary Policy

(Percentage)

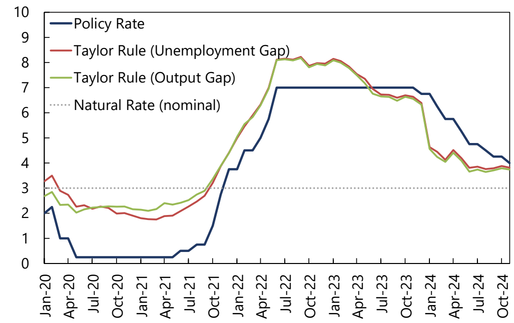


Sources: IMF Staff Calculations, CNB and Haver Analytics.

… which, however, remains somewhat tight according to simple Taylor rules…

Policy Rates

(percent)

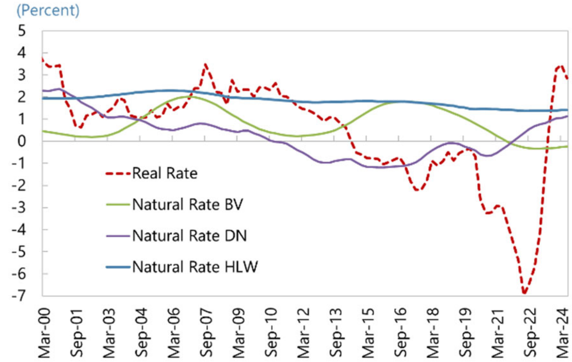


Source: Haver Analytics and IMF staff calculations.

… as well as according to a natural rate estimate of around 1 percent.

Real Rate and Natural Rate Estimates

(Percent)

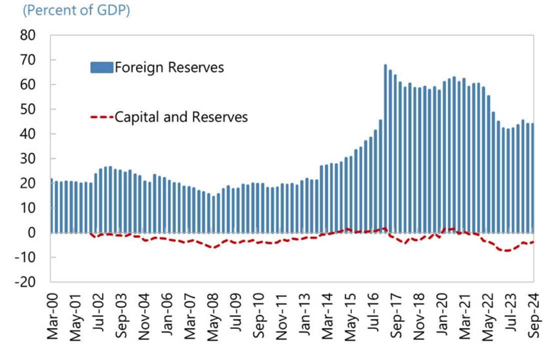


Sources: BV is Bulir and Vlcek (2024), DN is Del Negro et al. (2017), HLW is adjusted Holsten, Laubach and Willliams (2017), Bloomberg, Consensus Forecast, Haver Analtytics, IMF Staff Estimates.

CNB FX reserves have remained at elevated levels since 2017 exerting negative pressure on CNB equity.

Central Bank FX Reserves and Capital

(Percent of GDP)

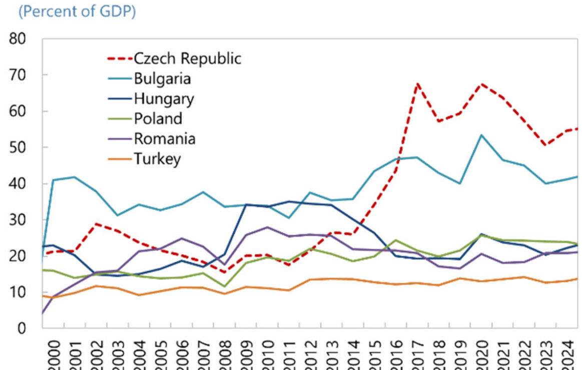


Sources: CNB and Haver Analytics.

Compared to peers, total reserve assets are very high at over 50 percent of GDP…

Total Reserve Assets

(Percent of GDP)

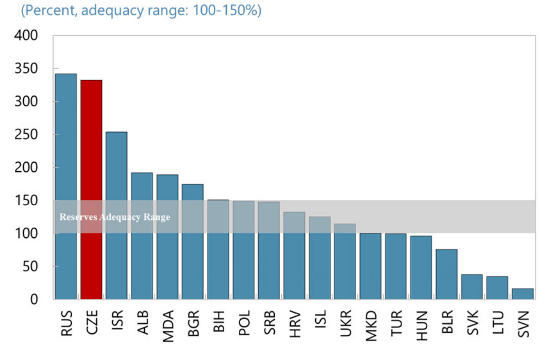


Source: IMF staff estimates.

… and stand at more than 300 percent of the ARA metric.

Reserves / Metric

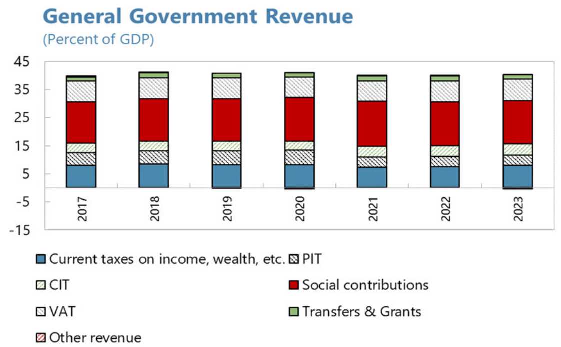
(Percent, adequacy range: 100-150%)



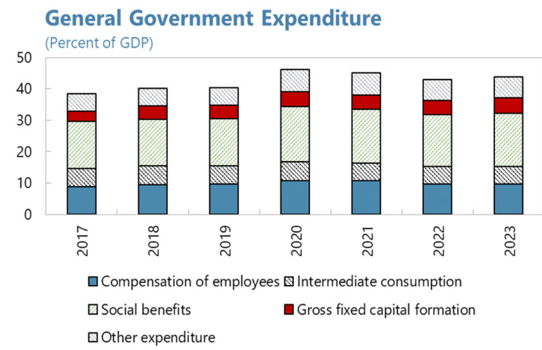
Source: IMF staff estimates.

Figure 6. Fiscal Sector

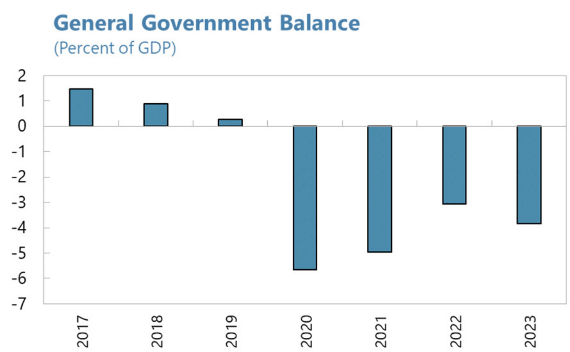
In recent years, revenue dropped after the change in the PIT regime...



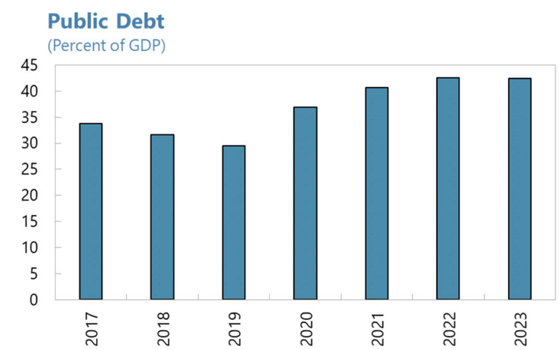
... while spending increased, reflecting policy measures in response to the pandemic...



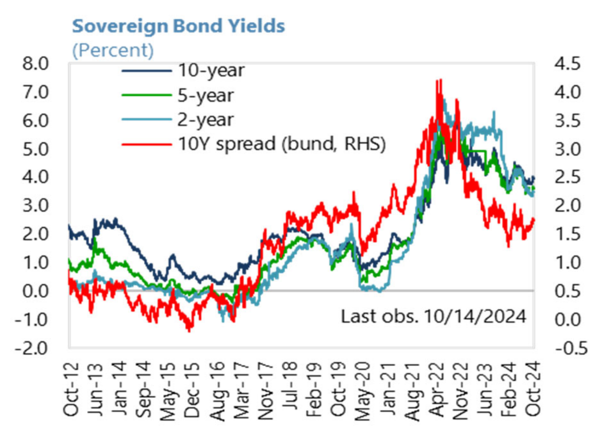
...turning the fiscal surplus into a deficit...



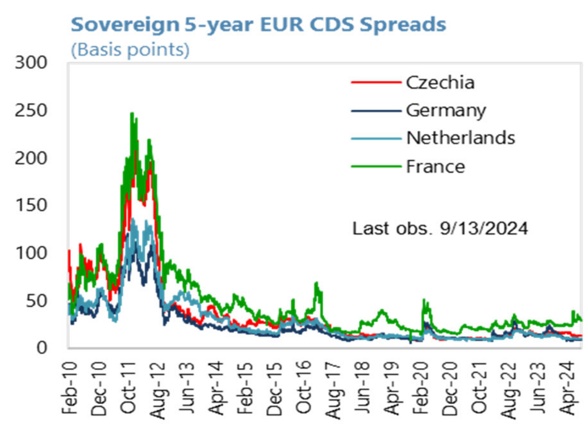
...and increasing public debt.



Bond yields decreased and spreads tightened as the CNB eased monetary policy ...



...while CDS spreads continued to be tight.



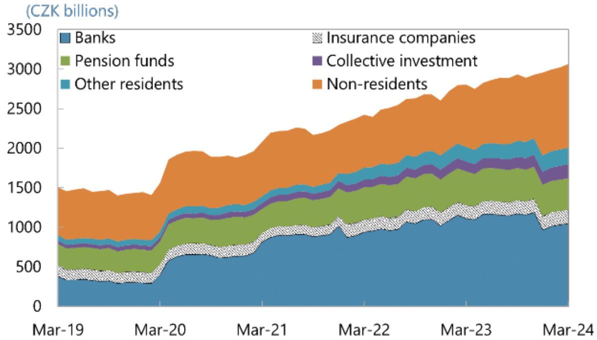
Sources: Czech Republic Ministry of Finance; Bloomberg; and IMF staff calculations.

Figure 7. Financial Sector

Around one third of Czech government securities are held by foreign residents and another third by banks…

Holdings of Koruna-denominated Czech Government Securities

(CZK billions)

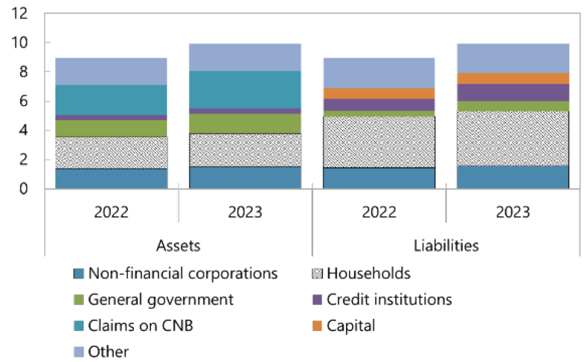


Source: Czech National Bank.

… for which government securities and claims on the CNB have increased as a share of asset from 2022 to 2023.

Selected Items of Domestic Banking Sector's Balance Sheet

(CZK trillions)

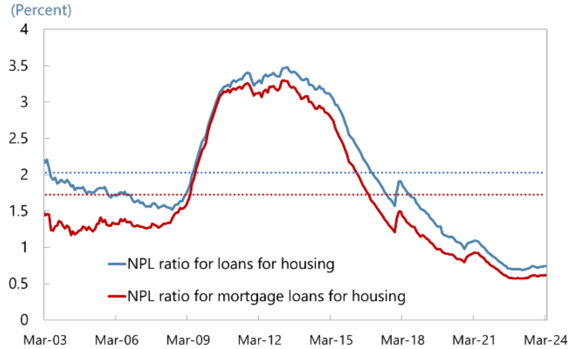


Source: Czech National Bank.

Non-performing loan ratios for the housing segment remain historically low…

NPL Ratio for Loans for Housing

(Percent)



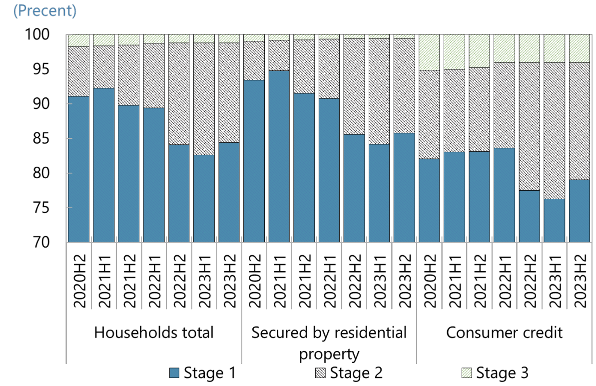
Source: Czech National Bank.

Note: The dashed lines indicate the long-term average (2002–2023) of each variable.

… while the share of stage 2 loans increased in 2023.

Household Loans by Credit Segment

(Precent)

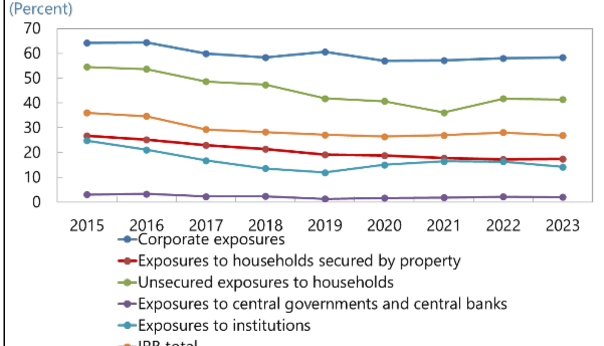


Source: CNB

Banks' risk weights have decreased with mortgage risk weights at around 20 percent under the IRB approach.

Average Risk Weights of The Main Categories of Exposures Under The IRB Approach

(Percent)

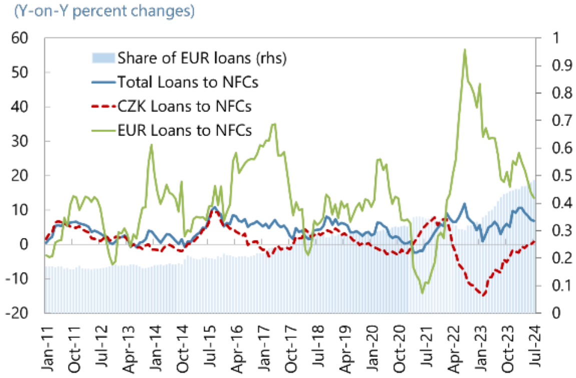


Source: Czech National Bank.

The share of euro loans to NFCs has increased strongly over 2023 and stands at around 50 percent.

Loans to NFCs

(Y-on-Y percent changes)

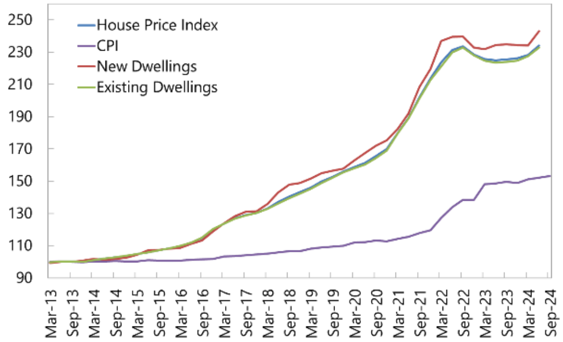


Source: Haver Analytics.

Figure 8. Housing Loans and Property Prices

After a period of stagnation at elevated levels, house prices have started rising again since 2024Q2…

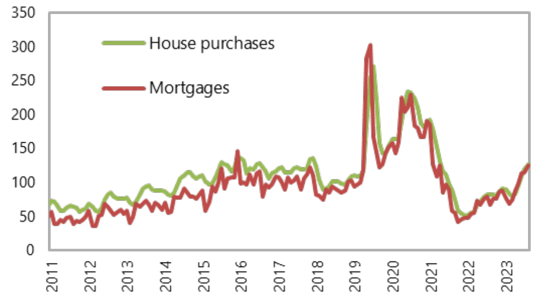
House and Consumer Prices
(2013=100)



Sources: Czech Statistical Office and Haver Analytics.

… along with the real value of housing loans.

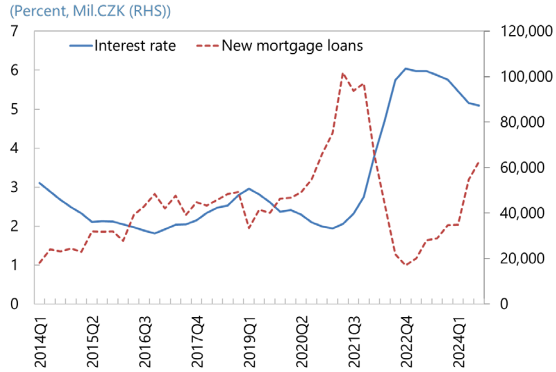
Real Value of New Loans: 2011-2024 (July)
(3-month moving averages, 2019=100)



Source: Czech National Bank.

With decreasing mortgage rates, mortgage loan activity is picking up…

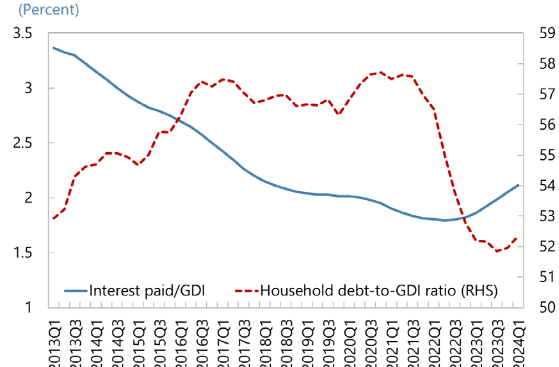
New Mortgage Loans and Rate
(Percent, Mil.CZK (RHS))



Source: CNB.

… but the household debt to income ratio remains lower than in recent years.

Debt Ratio and Interest Paid by Households
(Percent)

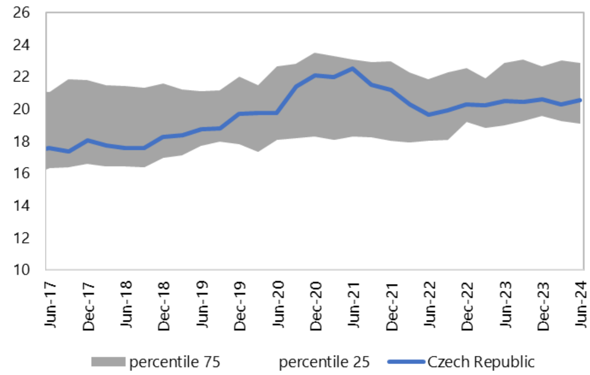


Source: Czech National Bank.

Figure 9. Financial Sector Indicators Relative to European Peers[1]

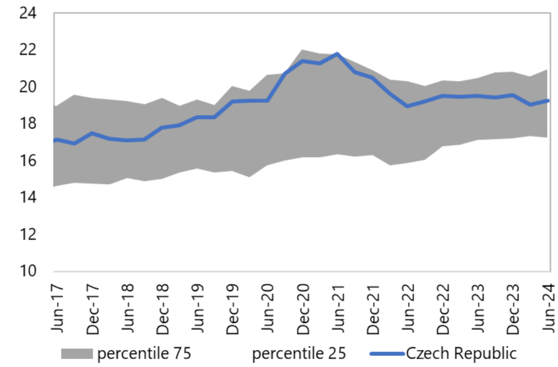
Banks remain adequately capitalized…

Regulatory Capital to Risk-weighted Assets
(EOP, %)



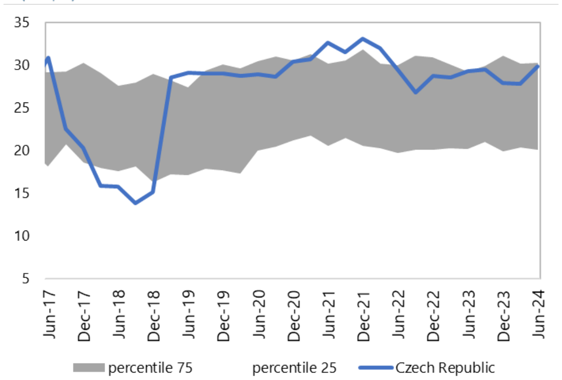
… especially with respect to Tier 1 capital.

Tier 1 Capital to Risk-weighted Assets
(EOP, %)



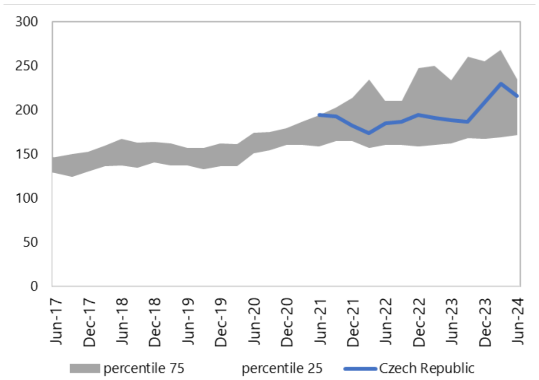
Liquidity is ample….

Liquid Assets to Total Assets
(EOP, %)



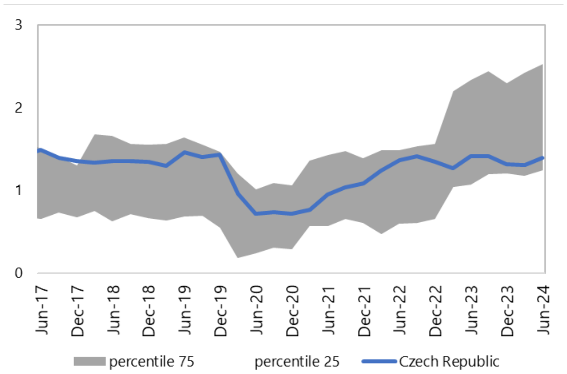
… with a relatively high liquidity coverage ratio.

Liquidity Coverage Ratio
(EOP, %)



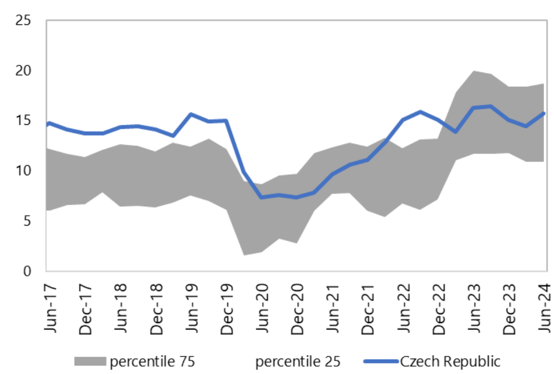
The system is profitable, but less so with respect to peers in the last year…

Return on Assets
(EOP, %)



… and so is the return on equity relatively to an average position.

Return on Equity
(EOP, %)

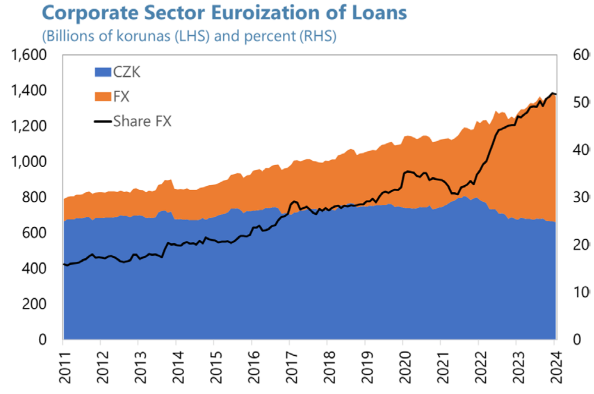


Sources: IMF, Haver Analytics, and IMF staff calculations.

1/ The shaded areas correspond to the two center quartiles of the distribution of the corresponding indicators across countries in Europe for which the data is available for each observation.

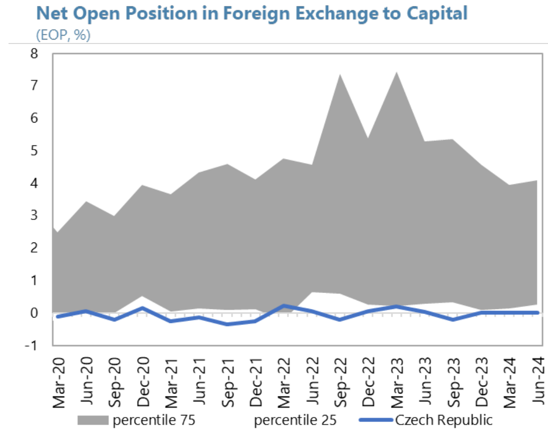
Figure 10. Euroization of Corporate Loans

The share of foreign currency denominated corporate loans has increased strongly to around 50 percent…

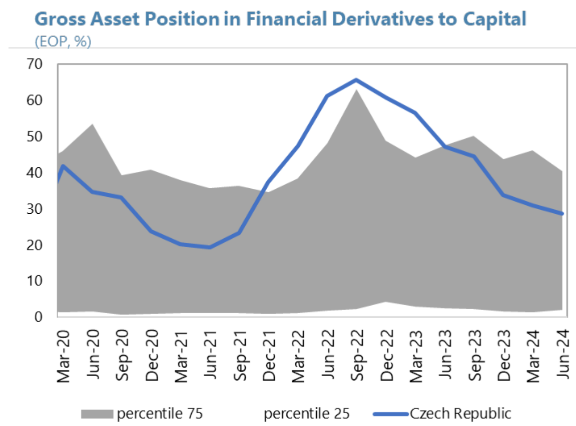


Source: CNB.

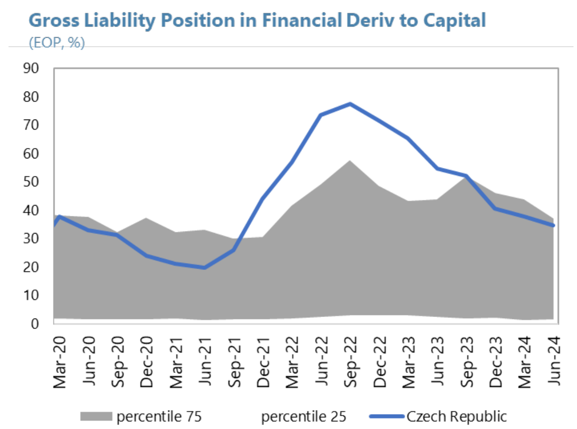
…but net FX exposure has remained at zero implying limited corporate risk from FX denominated loans.



In comparison to peers, the gross asset position in financial derivates has moderated…



…as has the gross liability position.



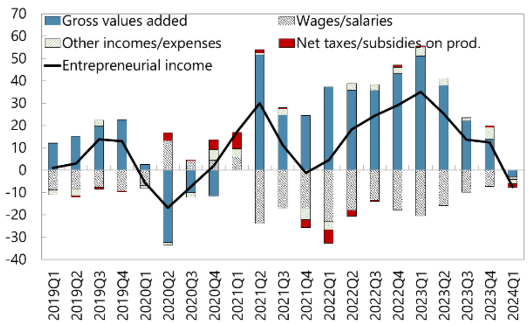
Sources: CNB, IMF's Financial Soundness Indicators Database, and Haver Analytics. For Czech net open foreign exchange positions, data provided by CNB on bank US dollar and euro exposures.

Figure 11. Non-financial Corporations

Gross profitability has fallen in 2024 for the first time since 2020…

Change in Gross Profits

(Y-on-Y percent change; Contributions in pecentage points)

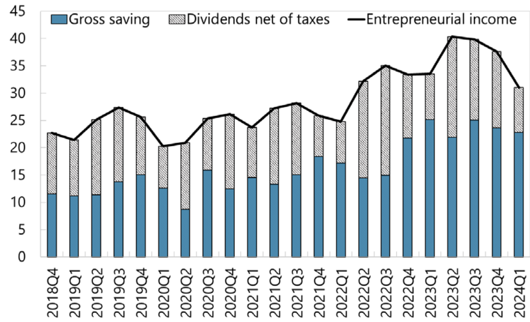


Source: CNB.

… driving down dividend payments as gross savings remained largely unchanged.

From Profits to Savings (Levels)

(Percent of 2019Q4 GDP)

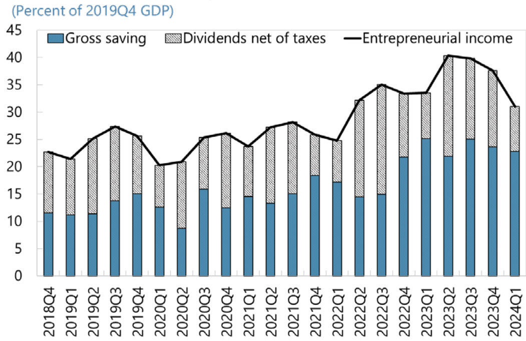


Source: CNB.

NFCs gross savings rate remains historically high and is used almost completely for investment.

From Profits to Savings (Levels)

(Percent of 2019Q4 GDP)

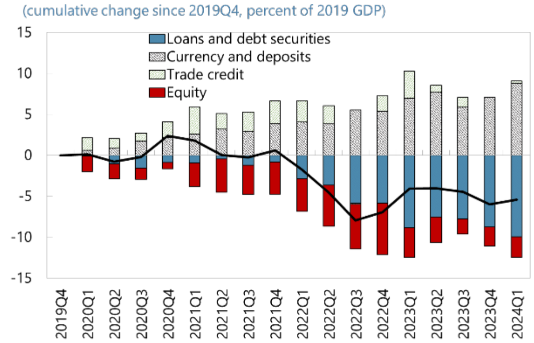


Source: CNB.

Leverage has increased in recent years.

Net Financial Transactions by Instrument

(cumulative change since 2019Q4, percent of 2019 GDP)

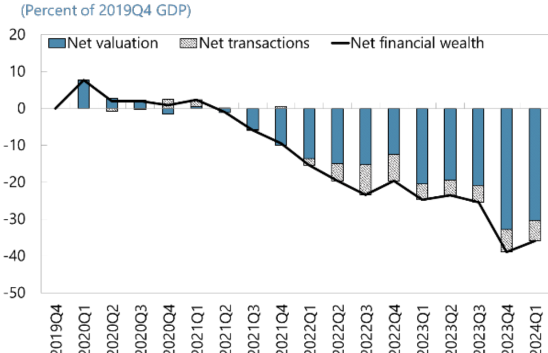


Source: CNB.

NFCs net financial wealth has decreased significantly since 2021…

Change in Net Financial Wealth Relative to 2019Q4

(Percent of 2019Q4 GDP)

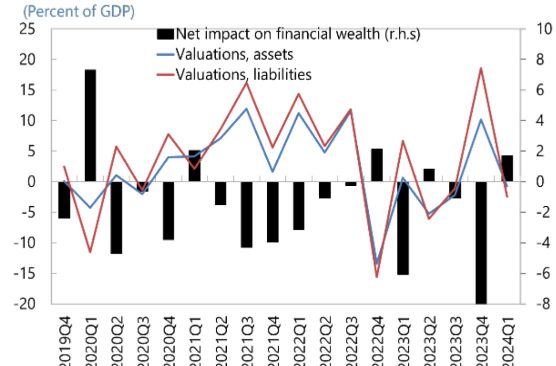


Source: CNB.

…as valuation effects have disproportionately affected liabilities.

Valuation Effects

(Percent of GDP)

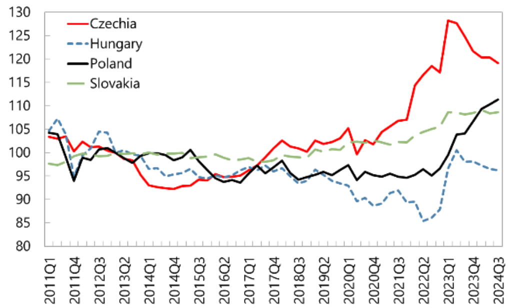


Source: CNB.

Figure 12. External Position and Competitiveness

The REER depreciation came to a halt in early 2024 at a still elevated level compared to others...

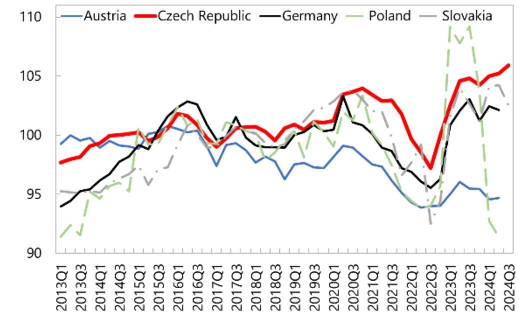
Real Effective Exchange Rate: CPI Based
(Index: 2013Q1 = 100)



Sources: Czech Statistical Office, Haver Analytics and IMF staff calculations.

...while the terms of trade improved above pre-energy shock levels.

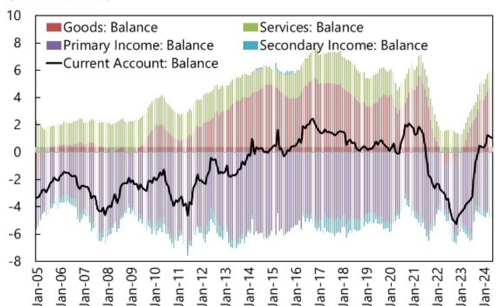
Terms of Trade
(Index: 2015 = 100)



Sources: Czech Statistical Office and Haver Analytics.

The current account has bounced back to a surplus driven by goods exports...

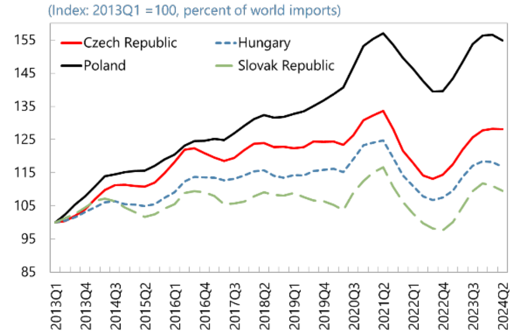
Current Account Balance
(Percent of GDP)



Sources: Haver Analytics and IMF staff calculations.

... with the exports share recovering back to pre-pandemic levels, in line with peers.

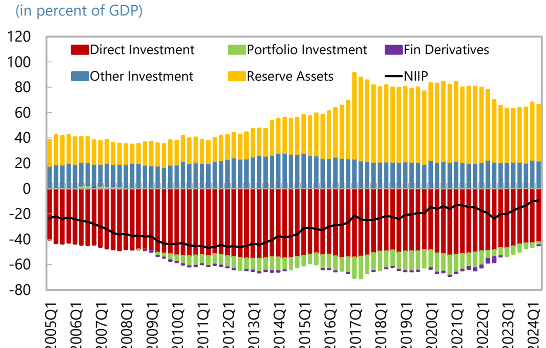
Exports Share of World Imports
(Index: 2013Q1 =100, percent of world imports)



Source: Direction of Trade Statistics.

The NIIP has improved gradually...

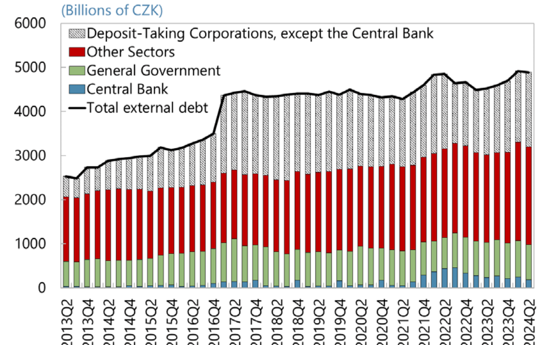
Net International Investment Position
(in percent of GDP)



Sources: Czech Statistical Office and Haver Analytics.

... while external debt has picked up slightly.

External Debt Composition by Sector
(Billions of CZK)



Source: Czech National Bank.

Table 1. Czech Republic: Selected Economic Indicators, 2020–29
(Annual percent change, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Staff projections					
NATIONAL ACCOUNTS										
Real GDP (expenditure)	-5.3	4.0	2.8	-0.1	1.0	2.4	2.2	2.1	2.0	2.0
Domestic demand	-5.0	7.3	3.3	-2.6	0.3	2.3	2.1	2.3	2.4	2.4
Consumption	-3.4	3.3	0.5	-0.8	2.1	2.0	1.8	2.0	2.2	2.2
Public	4.1	1.5	0.4	3.5	3.3	1.3	1.1	1.2	1.2	1.2
Private	-6.4	4.2	0.5	-2.8	1.6	2.3	2.1	2.5	2.7	2.7
Investment	-9.3	18.5	10.2	-6.5	-3.8	3.0	3.0	3.0	3.0	3.0
Exports	-8.5	8.2	5.1	2.7	2.2	5.6	4.5	4.4	4.4	4.4
Imports	-8.4	13.7	5.9	-0.9	1.6	5.9	4.6	4.8	5.1	5.1
Contribution to GDP										
Domestic demand	-4.7	6.9	3.2	-2.7	0.4	2.3	2.0	2.2	2.3	2.3
Net exports	-0.6	-2.8	-0.3	2.6	0.6	0.2	0.2	-0.1	-0.3	-0.3
Investment (percent of GDP)	25.5	26.2	27.7	27.3	26.9	25.8	25.8	26.0	26.2	26.4
Gross domestic investments (percent of GDP)	24.7	28.1	31.0	28.0	26.4	26.0	26.0	26.2	26.4	26.6
Gross national savings (percent of GDP)	26.5	26.1	26.3	28.3	28.0	26.2	26.4	26.7	26.9	27.1
Output gap (percent of potential output)	-4.0	-1.3	0.3	-1.0	-1.4	-0.6	-0.1	0.0	0.0	0.0
Potential growth	1.4	1.2	1.2	1.2	1.4	1.5	1.7	2.0	2.0	2.0
LABOR MARKET										
Employment	-1.4	0.3	-1.6	1.5	0.7	0.1	0.4	0.3	0.0	0.0
Total labor compensation	1.7	7.2	7.8	7.7	5.3	5.2	4.6	4.4	4.0	4.0
Unemployment rate (average, in percent)	2.5	2.7	2.2	2.6	2.8	2.5	2.4	2.4	2.4	2.4
PRICES										
Consumer prices (average)	3.2	3.8	15.1	10.7	2.5	2.4	2.0	2.0	2.0	2.0
Consumer prices (end-of-period)	2.3	6.6	15.8	6.9	3.0	2.1	2.0	2.0	2.0	2.0
Producer price index (average)	0.1	7.2	24.3	5.0	...	...	...	...	...	...
GDP deflator (average)	4.5	4.0	8.7	8.2	4.2	2.6	2.0	2.0	2.0	2.0
MACRO-FINANCIAL										
Money and credit (end of year, percent change)										
Broad money (M3)	10.0	6.8	6.1	8.1	5.3	5.0	4.2	4.1	4.0	4.0
Private sector credit	3.6	8.9	5.7	6.5	4.0	3.5	3.5	3.5	3.5	3.5
Interest rates (in percent, year average)										
Three-month interbank rate	0.9	1.1	6.3	7.1	...	...	...	...	...	...
Ten-year government bond	1.1	1.9	4.3	4.4	4.0	3.6	3.2	2.8	2.4	2.0
Exchange rate										
Nominal effective exchange rate (index, 2005=100)	99.8	103.7	107.4	112.6	...	...	...	...	...	...
Real effective exchange rate (index, CPI-based; 2005=100)	100.2	104.9	115.1	125.4	...	...	...	...	...	...
PUBLIC FINANCE (percent of GDP)										
General government revenue	40.6	40.1	39.9	40.1	40.5	40.5	40.4	39.4	39.2	39.0
General government expenditure	46.3	45.0	43.0	43.9	43.3	43.0	42.2	41.2	41.2	41.2
Net lending / Overall balance	-5.6	-5.0	-3.1	-3.8	-2.9	-2.5	-1.9	-1.8	-2.0	-2.1
Primary balance	-5.1	-4.4	-2.6	-3.2	-1.6	-1.3	-0.6	-0.5	-0.7	-0.9
Structural balance (percent of potential GDP)	-3.9	-4.4	-3.2	-2.6	-2.2	-2.2	-1.8	-1.8	-2.0	-2.1
Cyclically adjusted balance (percent of potential GDP)	-3.9	-4.4	-3.2	-3.4	-2.3	-2.3	-1.8	-1.8	-2.0	-2.1
General government debt	36.9	40.7	42.5	42.4	43.5	44.5	45.4	45.6	45.9	46.4
BALANCE OF PAYMENTS (percent of GDP)										
Trade balance (goods and services)	6.7	3.7	1.1	5.0	6.4	4.4	4.3	4.0	3.8	3.6
Current account balance	1.8	-2.1	-4.7	0.3	1.6	0.3	0.4	0.5	0.5	0.5
Gross international reserves (billions of euros)	135.4	153.3	131.3	134.3	143.3	152.3	160.3	166.3	170.9	171.9
(in months of imports of goods and services)	12.1	11.2	7.7	7.9	8.2	8.0	8.0	7.9	7.6	7.2
(in percent of short term debt, remaining maturity)	142.8	136.7	118.6	119.1	121.9	123.3	125.0	126.2	126.8	126.5
MEMORANDUM ITEMS										
Nominal GDP (USD billions)	251.1	291.0	301.8	343.2	346.1	355.3	369.0	383.2	397.9	414.1
Population (millions)	10.7	10.5	10.8	10.9	10.9	10.9	10.9	10.8	10.8	10.8
Real GDP per capita	-5.4	5.9	-0.1	-0.3	0.3	2.6	2.5	2.4	2.3	2.3
GDP per capita (USD thousands)	23.46	27.67	27.88	31.63	31.65	32.58	33.94	35.36	36.84	38.45

Sources: Czech National Bank; Czech Statistical Office; Ministry of Finance; Haver Analytics, and IMF staff estimates and projections.
Structural balances are net of temporary fluctuations in some revenues and one-offs. COVID-related one-offs are however included.

Table 2. Czech Republic: Balance of Payments, 2020–29
(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Staff Projections					
Current account balance	1.8	-2.1	-4.7	0.3	1.6	0.3	0.4	0.5	0.5	0.5
Trade balance	4.8	1.7	-0.3	3.8	5.1	3.0	2.9	2.7	2.6	2.5
Exports	57.2	60.0	61.2	57.4	59.7	60.5	60.8	61.8	62.9	64.3
Imports	52.4	58.2	61.5	53.6	54.6	57.5	57.9	59.1	60.4	61.8
Nonfactor services	1.9	1.9	1.4	1.2	1.3	1.4	1.4	1.3	1.2	1.2
Receipts	10.5	10.5	11.5	11.6	12.1	12.2	12.4	12.5	12.7	12.9
Payments	8.6	8.6	10.1	10.4	10.9	10.9	11.0	11.2	11.5	11.7
Factor income (net)	-4.5	-5.3	-5.3	-4.2	-4.2	-3.6	-3.3	-3.0	-2.7	-2.6
Transfers	-0.5	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Capital account	1.1	1.7	0.6	1.2	0.4	1.3	1.4	1.5	1.5	1.4
Errors and omissions	-0.1	0.1	-0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial account (change in stocks, + = increase)	2.8	-0.3	-4.1	1.9	2.1	1.5	1.8	2.0	2.0	2.0
Direct investment, net	-2.6	-0.5	-1.2	-0.2	-0.9	-0.9	-0.9	-0.8	-0.6	-0.7
Portfolio investment, net	-2.3	1.2	4.7	1.2	0.6	0.6	0.9	1.3	1.3	1.3
Other investment and derivatives, net	6.7	-4.8	-2.7	0.5	-0.5	-0.9	-0.5	-0.2	0.1	1.0
Reserve assets	0.8	4.7	-4.4	0.5	2.8	2.7	2.3	1.7	1.2	0.3
Memorandum items										
Gross official reserves (billions of euros)	135.4	153.3	131.3	134.3	143.3	152.3	160.3	166.3	170.9	171.9
in months of the current year's imports	12.1	11.2	7.7	7.9	8.2	8.0	8.0	7.9	7.6	7.2
as a ratio to the short-term debt	142.8	136.7	118.6	119.1	121.9	123.3	125.0	126.2	126.8	126.5
External debt, percent of GDP	74.8	75.2	67.5	62.1	64.5	65.0	64.9	64.1	63.0	61.1

Sources: Czech National Bank; Czech Statistical Office; and IMF staff estimates and projections.

Table 3. Czech Republic: General Government Operations, 2020–29
(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Staff Projections					
Revenue	40.6	40.1	39.9	40.1	40.5	40.5	40.4	39.4	39.2	39.0
Taxes	19.5	18.6	18.5	18.6	18.9	18.9	18.5	18.4	18.3	18.3
Personal income tax	5.1	3.6	3.5	3.7	3.9	3.9	3.9	3.9	3.9	3.9
Corporate income tax	3.0	3.6	4.0	4.2	4.3	4.2	3.9	3.8	3.8	3.8
VAT	7.2	7.3	7.6	7.5	7.3	7.4	7.4	7.4	7.4	7.4
Excise	3.0	2.9	2.4	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Other taxes	1.1	1.1	1.0	1.1	1.3	1.3	1.2	1.2	1.2	1.2
Social contributions	15.6	16.1	15.4	15.3	15.8	16.1	16.2	16.2	16.0	15.8
Capital and other current transfers and subsidies	1.8	1.8	1.8	1.8	1.7	1.7	1.7	0.9	0.9	0.9
Other revenue	3.7	3.6	4.2	4.4	4.1	3.8	4.0	4.0	4.0	4.0
Property income	0.6	0.6	1.1	1.3	0.9	0.7	0.7	0.7	0.7	0.7
Sales of goods and services	3.1	3.1	3.1	3.1	3.1	3.0	3.3	3.3	3.3	3.3
Expenditure	46.3	45.0	43.0	43.9	43.3	43.0	42.2	41.2	41.2	41.2
Expense	41.5	40.5	38.5	39.0	38.6	38.1	37.6	37.1	37.1	37.1
Compensation of employees	10.9	10.7	9.8	9.7	9.6	9.7	9.8	9.7	9.7	9.7
Use of goods and services	5.9	5.6	5.6	5.7	5.9	5.8	5.6	5.6	5.6	5.6
Interest	0.7	0.7	1.1	1.3	1.6	1.6	1.6	1.6	1.6	1.6
Subsidies	3.0	3.2	2.1	2.7	1.8	1.9	1.6	1.4	1.3	1.2
Grants	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social benefits	17.6	17.1	16.5	17.0	17.3	17.0	17.0	16.8	16.9	17.0
Other expenses	3.0	2.8	2.9	2.3	2.1	1.8	1.6	1.6	1.6	1.6
Net acquisition of nonfinancial assets	4.7	4.6	4.5	4.9	4.7	4.9	4.7	4.1	4.1	4.1
Gross Operating Balance	-0.9	-0.4	1.5	1.1	1.8	2.4	2.8	2.4	2.1	2.0
Net lending/borrowing (overall balance)	-5.6	-5.0	-3.1	-3.8	-2.9	-2.5	-1.9	-1.8	-2.0	-2.1
Net financial transactions	-5.6	-5.0	-3.1	-3.8	-2.9	-2.5	-1.9	-1.8	-2.0	-2.1
Net acquisition of financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	5.6	5.0	3.1	3.8	2.9	2.5	1.9	1.8	2.0	2.1
Adjustment and statistical discrepancies 1/	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum item:										
General government debt	36.9	40.7	42.5	42.4	43.5	44.5	45.4	45.6	45.9	46.4
Primary balance	-5.1	-4.4	-2.6	-3.2	-1.6	-1.3	-0.6	-0.5	-0.7	-0.9
Structural balance 2/ 3/	-3.9	-4.4	-3.2	-2.6	-2.2	-2.2	-1.8	-1.8	-2.0	-2.1
Cyclically adjusted primary balance	-3.5	-3.9	-2.7	-2.9	-1.1	-1.0	-0.5	-0.5	-0.7	-0.9
Change in cyclically adjusted primary balance	-3.3	-0.4	1.2	-0.2	1.8	0.1	0.5	0.1	-0.3	-0.1
Output gap	-4.0	-1.3	0.3	-1.0	-1.4	-0.6	-0.1	0.0	0.0	0.0
Nominal GDP (billions of Koruna)	5,828	6,308	7,050	7,619	8,022	8,423	8,778	9,141	9,510	9,893

Sources: Ministry of Finance and IMF staff estimates and projections.

1/ Adjustments for cash-accrual differences, valuation changes and other discrepancies.

2/ In percent of potential GDP.

3/ Structural balances are net of temporary fluctuations in some revenues and one-offs. COVID-related one-offs are however included.

Table 4. Czech Republic: Macroeconomic Framework, 2020–29
(Annual percent change, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Staff Projections					
Real sector										
Real GDP	-5.3	4.0	2.8	-0.1	1.0	2.4	2.2	2.1	2.0	2.0
Private consumption	-6.4	4.2	0.5	-2.8	1.6	2.3	2.1	2.5	2.7	2.7
Public consumption	4.1	1.5	0.4	3.5	3.3	1.3	1.1	1.2	1.2	1.2
Investment	-9.3	18.5	10.2	-6.5	-3.8	3.0	3.0	3.0	3.0	3.0
Fixed investment	-4.8	6.7	6.3	2.5	-0.2	0.3	4.0	4.0	4.0	4.0
Exports, goods and services	-8.5	8.2	5.1	2.7	2.2	5.6	4.5	4.4	4.4	4.4
Imports, goods and services	-8.4	13.7	5.9	-0.9	1.6	5.9	4.6	4.8	5.1	5.1
contribution of net exports (percent)	-0.6	-2.8	-0.3	2.6	0.6	0.2	0.2	-0.1	-0.3	-0.3
Inflation (CPI, percent)	3.2	3.8	15.1	10.7	2.5	2.4	2.0	2.0	2.0	2.0
Unemployment (percent of labor force)	2.5	2.7	2.2	2.6	2.8	2.5	2.4	2.4	2.4	2.4
Output gap 1/	-4.0	-1.3	0.3	-1.0	-1.4	-0.6	-0.1	0.0	0.0	0.0
Gross domestic savings (in percent of GDP)	26.5	26.1	26.3	28.3	28.0	26.2	26.4	26.7	26.9	27.1
Public	11.4	11.3	12.4	11.6	12.6	13.9	13.9	13.9	13.9	13.9
Private	15.1	14.8	13.9	16.7	15.4	12.3	12.5	12.8	12.9	13.2
Gross capital formation (in percent of GDP)	24.7	28.1	31.0	28.0	26.4	26.0	26.0	26.2	26.4	26.6
Balance of payments										
Current account balance	1.8	-2.1	-4.7	0.3	1.6	0.3	0.4	0.5	0.5	0.5
Trade balance	4.8	1.7	-0.3	3.8	5.1	3.0	2.9	2.7	2.6	2.5
Services balance	1.9	1.9	1.4	1.2	1.3	1.4	1.4	1.3	1.2	1.2
Net factor income	-4.5	-5.3	-5.3	-4.2	-4.2	-3.6	-3.3	-3.0	-2.7	-2.6
Current transfers	-0.5	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Capital account balance	1.1	1.7	0.6	1.2	0.4	1.3	1.4	1.5	1.5	1.4
Errors and omissions, net	-0.1	0.1	-0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (change in stocks, + = increase)	2.8	-0.3	-4.1	1.9	2.1	1.5	1.8	2.0	2.0	2.0
Direct investment, net	-2.6	-0.5	-1.2	-0.2	-0.9	-0.9	-0.9	-0.8	-0.6	-0.7
Portfolio investment, net	-2.3	1.2	4.7	1.2	0.6	0.6	0.9	1.3	1.3	1.3
Other investment and derivatives, net	6.7	-4.8	-2.7	0.5	-0.5	-0.9	-0.5	-0.2	0.1	1.0
Reserve assets	0.8	4.7	-4.4	0.5	2.8	2.7	2.3	1.7	1.2	0.3

Sources: Czech National Bank, Czech Statistical Office, Ministry of Finance, and IMF staff estimates and projections.
1/ In percent of potential GDP.

Table 5. Czech Republic: Monetary Accounts, 2017–24M7 (Billions of Koruna)

	2017M12	2018M12	2019M12	2020M12	2021M12	2022M8	2022M12	2023M6	2023M12	2024M6	2024M7
CENTRAL BANK											
Net foreign assets	**2985**	**3030**	**3216**	**3346**	**3485**	**2928**	**2802**	**2821**	**3075**	**3210**	**3287**
Net domestic assets	**-97**	**-110**	**-165**	**-351**	**-430**	**294**	**-19**	**578**	**187**	**404**	**334**
Net domestic claims	-267	-281	-290	-421	-538	-7	-508	-1	-279	2	1
Claims on Central government (net)	-270	-282	-292	-423	-540	-9	-510	-2	-281	0	-2
Claims on State and Local Government	0	0	0	0	0	0	0	0	0	0	0
Claims on Public Nonfinancial Corporation	0	0	0	0	0	0	0	0	0	0	0
Claims on Private Sector	0	0	0	0	0	0	0	0	0	0	0
Claims on Other Depository Corporations	0	0	0	0	0	0	0	0	0	0	1
Claims on Other Financial Corporations	2	1	1	1	1	1	1	1	1	1	1
Other items net	170	171	125	70	109	301	489	579	465	403	333
Monetary base	**2888**	**2921**	**3051**	**2995**	**3055**	**3222**	**2783**	**3399**	**3262**	**3614**	**3620**
OTHER DEPOSITORY CORPORATIONS											
Net foreign assets	**-1017**	**-1007**	**-965**	**-841**	**-940**	**-640**	**-599**	**-519**	**-598**	**-548**	**-535**
Net domestic assets	**5194**	**5450**	**5690**	**5968**	**6584**	**7379**	**6836**	**7721**	**7594**	**8137**	**8191**
Net domestic claims	5782	6038	6304	6637	7264	8018	7505	8392	8312	8834	8886
Claims on Central government (net)	456	504	505	798	994	1192	1158	1331	1378	1446	1474
Claims on State and Local Government	44	47	50	54	58	57	61	64	62	59	59
Claims on Public Nonfinancial Corporation	0	0	0	0	0	0	0	0	0	0	0
Claims on Private Sector	2602	2777	2911	3029	3282	3455	3428	3559	3655	3754	3787
of which: Private Sector Credit	2595	2769	2906	3022	3273	3445	3418	3547	3641	3738	3770
Claims on Central Bank	2342	2350	2450	2331	2370	2552	2092	2734	2580	2940	2946
Claims on Other Financial Corporations	339	361	389	424	561	763	766	705	638	636	619
Other items net	-588	-588	-614	-669	-681	-640	-669	-671	-718	-697	-695
Liabilities to the Central Bank	0	0	0	0	0	0	0	0	0	0	741
Liquid Liabilities	**3677**	**3921**	**4178**	**4585**	**4918**	**5308**	**5255**	**5847**	**5846**	**6218**	**6305**
Transferable deposits	3224	3386	3529	4127	4364	4227	4100	4237	4298	4549	4620
Other deposits	453	530	648	457	555	1081	1154	1606	1544	1668	1684
Securities other than shares	0	5	1	1	-1	-1	1	4	4	1	1
Non-liquid liabilities	459	463	484	479	657	839	870	814	784	791	801
DEPOSITORY CORPORATIONS											
Net foreign assets	**1,968**	**2,023**	**2,251**	**2,505**	**2,545**	**2,288**	**2,202**	**2,303**	**2,477**	**2,662**	**2,752**
Net domestic assets	**2,299**	**2,530**	**2,591**	**2,814**	**3,135**	**4,293**	**3,863**	**4,756**	**4,422**	**4,816**	**4,781**
Net domestic claims	3,173	3,407	3,564	3,885	4,356	5,460	4,905	5,658	5,454	5,896	5,939
Claims on Central government (net)	186	221	213	376	454	1,183	648	1,328	1,097	1,446	1,472
Claims on State and Local Government	44	47	50	54	58	57	61	64	62	59	59
Claims on Public Nonfinancial Corporation	0	0	0	0	0	0	0	0	0	0	0
Claims on Private Sector	2,602	2,777	2,911	3,030	3,282	3,455	3,429	3,559	3,655	3,754	3,787
of which: Private Sector Credit	2,746	2,955	3,136	3,286	3,665	3,872	3,862	3,995	4,103	4,231	4,259
Claims on Other Financial Corporations	341	362	390	425	562	764	767	706	639	637	621
Other items net	-873	-877	-973	-1,071	-1,221	-1,167	-1,042	-902	-1,031	-1,081	-1,158
Broad money	**4,227**	**4,494**	**4,779**	**5,255**	**5,611**	**5,990**	**5,954**	**6,517**	**6,533**	**6,898**	**6,983**
Memorandum items:											
Year-on-year growth (percent)											
Monetary base	**56.3**	**1.1**	**4.5**	**(1.8)**	**2.0**	**(10.2)**	**(8.9)**	**(2.1)**	**17.2**	**6.3**	**5.9**
Broad money	**10.4**	**6.3**	**6.4**	**10.0**	**6.8**	**5.5**	**6.1**	**9.7**	**9.7**	**5.8**	**6.6**
Claims on private sector											
Depository Corporations ,Claims on Private	6.2	6.7	4.8	4.1	8.3	8.6	4.5	5.7	6.6	5.5	5.6
Depository Corporations, Credit to Private	6.3	6.7	4.9	4.0	8.3	8.6	4.4	5.7	6.5	5.4	5.5
Financial Corporations, Credit to Private											
Broad money multiplier (ratio)	**1.46**	**1.54**	**1.57**	**1.75**	**1.84**	**1.86**	**2.14**	**1.92**	**2.00**	**1.91**	**1.93**

Sources: Czech National Bank; Czech Statistical Office; Ministry of Finance; Haver Analytics, and IMF staff estimates and projections.

Table 6. Czech Republic: Financial Soundness Indicators, 2017–24Q1
(In percent, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024Q1
Core FSIs								
Regulatory capital to risk-weighted assets	18.1	18.3	19.7	22.1	21.2	20.3	20.6	20.2
Tier 1 capital to risk-weighted assets	17.5	17.8	19.2	21.4	20.5	19.5	19.5	19.5
Nonperforming loans net of provisions to capital	14.8	12.0	9.4	10.2	9.1	7.8	6.8	8.2
Capital to assets (leverage ratio)	6.5	6.5	6.8	7.3	6.9	6.7	6.3	6.1
Nonperforming loans to total gross loans	3.7	3.1	1.7	1.9	1.7	1.5	1.2	1.4
Provisions to nonperforming loans	49.2	51.8	55.4	50.4	52.2	53.4	52.5	52.0
Return on assets	1.4	1.3	1.4	0.7	1.1	1.3	1.3	1.3
Return on equity	13.7	14.2	15.0	7.3	11.1	15.1	15.1	13.9
Interest margin to gross income	59.2	64.8	69.0	66.7	64.9	70.0	66.9	65.8
Noninterest expenses to gross income	47.1	47.1	51.1	55.8	55.9	48.0	50.2	52.0
Liquid assets to total assets	20.3	15.1	29.1	30.4	33.0	28.7	27.9	28.5
Liquid assets to short-term liabilities	39.8	30.0	38.7	40.9	45.1	40.3	37.6	37.8
Additional FSIs								
Large exposures to capital					56.1	92.5	79.9	
Gross asset position in financial derivatives to capital	18.8	19.1	21.8	23.8	37.3	60.7	33.8	56.5
Gross liability position in financial derivatives to capital	19.0	18.6	22.9	24.0	44.0	71.6	40.8	65.3
Trading income to total income	12.7	6.8	3.5	5.1	5.1	3.3	5.2	5.9
Personnel expenses to noninterest expenses	43.4	44.5	41.3	40.5	40.7	40.0	40.9	38.4
Customer deposits to total (noninterbank) loans	128.3	128.2	72.8	82.3	78.6	81.5	77.7	76.5

Sources: IMF Financial Soundness Indicators.

Annex I. Estimating Potential Growth

1. **Different migration scenarios could increase or lower medium-term potential growth by around 0.25 percent from its medium-term estimate of 2 percent.** This annex projects the potential growth rate of the Czech economy over the medium term using a production function approach. It shows that potential growth has been on a decreasing trend since the early 2000s and is estimated to be at around 2 percent in the medium term. A shrinking working age population is expected to contribute negatively to growth while higher migration could make up for this and bring potential growth up by around 0.2-0.3 percent per year. TFP trend growth is expected to remain below its historical rate going forward given several structural headwinds facing the economy.

Figure 1. Potential Growth via a Production Function Approach

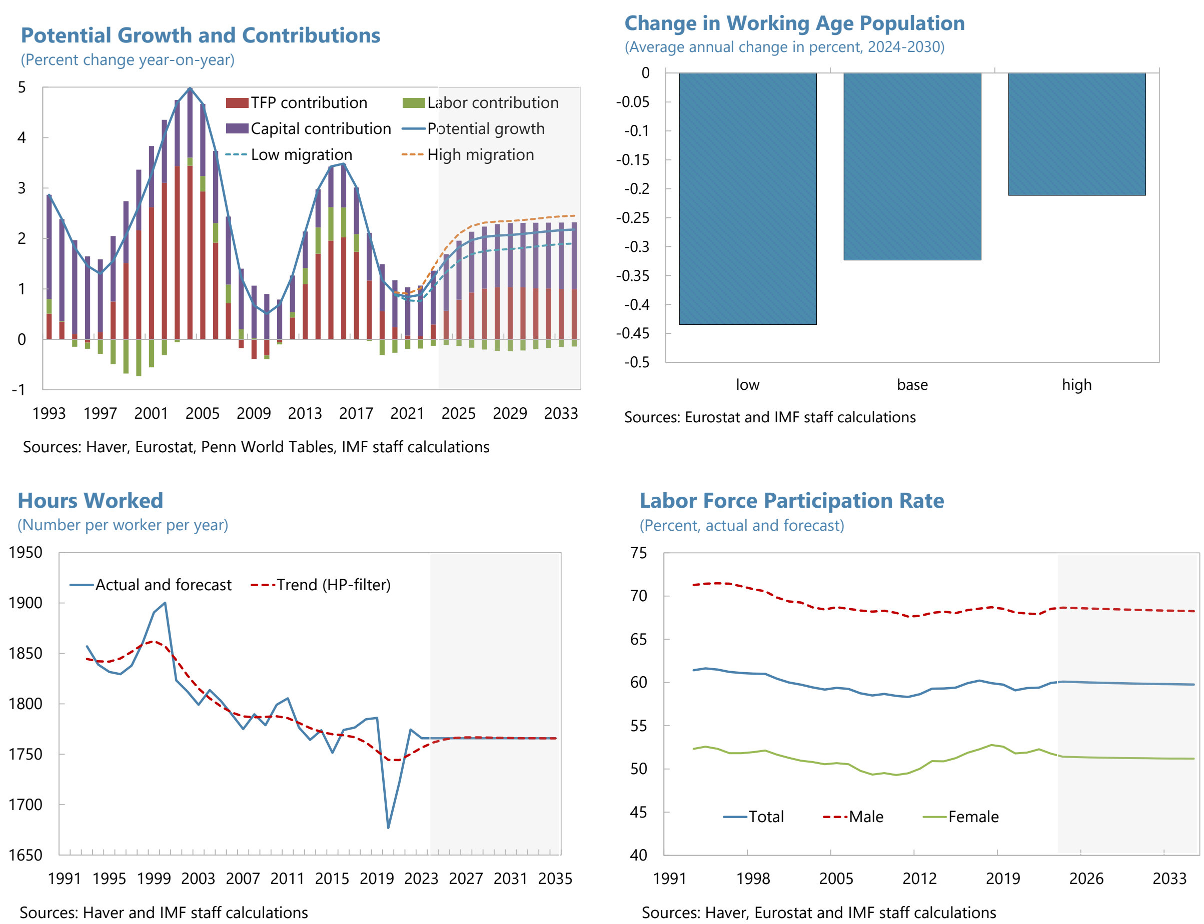
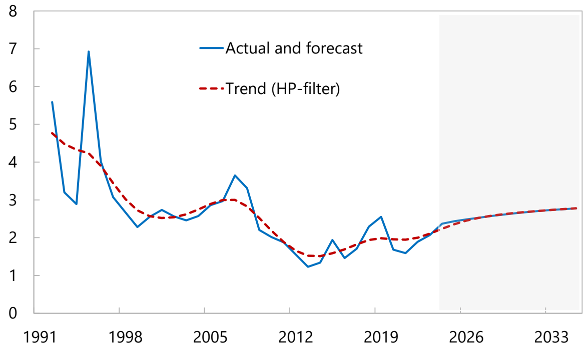


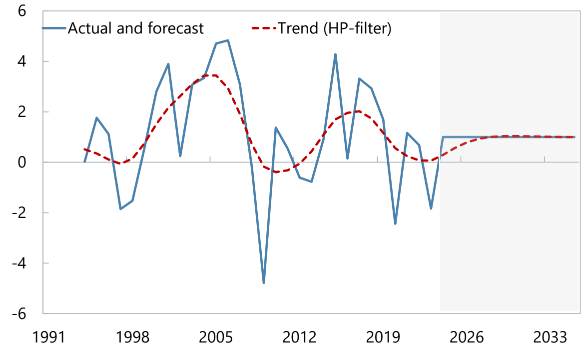
Figure 1. Potential Growth via a Production Function Approach (concluded)

Capital Stock Growth
(percent change year-on-year)



Sources: Haver and IMF staff calculations

Total Factor Productivity Growth
(Percent change year-on-year)



Sources: Haver, Penn World Tables, Eurostat and IMF staff calculations

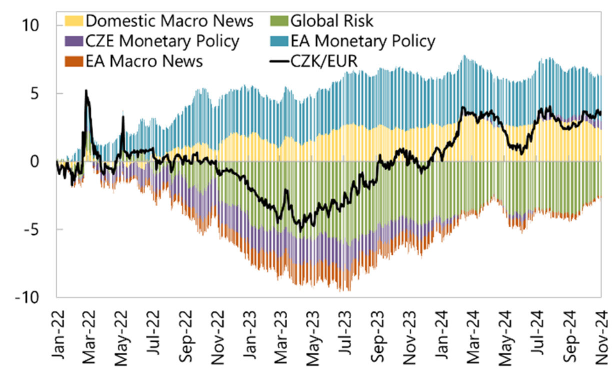
Annex II. Understanding Czech Koruna Exchange Rate Fluctuations

1. The exchange rate can potentially respond to domestic and foreign financial and real factors. This annex presents the results of an estimated daily SVAR with sign restrictions to explain the recent evolution of the Czech koruna exchange rate vis-à-vis the euro.[1] The estimation period starts in 2018 after the CNB exited the exchange rate floor.

2. Negative domestic macro news, easing monetary policy and higher risk perceptions fully explain CZK depreciation against the euro since mid-2023. The recent period of deprecation since April 2023 has been driven largely by negative domestic macro news under low GDP growth, higher risk sentiment and, to a lesser extent, easing domestic monetary policy. News about euro area macroeconomic developments have played a further, albeit small role in driving depreciation pressures.[2]

Czech Koruna/Euro Exchange Rate Decomposition

(percent change since start 2022, +ve CZK depreciation)



Sources: IMF staff calculations and Haver Analytics.

3. Foreign factors have played a relatively larger role than domestic factors in explaining the exchange rate evolution over the last years. The effect from tight domestic monetary policy that has led to appreciation pressures on the CZK in 2022 and then to depreciation pressures in 2024 has been relatively small compared to the overall contribution from tighter euro area monetary policy. External risk considerations weighing on the Czech economy have also played a larger role than news about domestic macroeconomic events.

Table 1. Czech Republic: Sign Restrictions Used to Decompose the Czech Exchange Rate

	CZK/EUR (+depreciation)	CZE 10-year Interest Rate Swap	CZE 10-year – EA 10- OIS Rate	PX Stock Index	STOXX 600 Stock Index
Positive Domestic Macro News	-	+	+	+	
Global Risk	+	+	+	-	-
Domestic Monetary Policy Tightening	-	+	+	-	
EA Monetary Policy Tightening	+	+	-	-	-
Positive EA Macro News		+	-	+	+

[1] The Bayesian SVAR uses high-frequency financial data and exploits information from the co-movements in asset prices for identification. For a similar approach see Brandt, L., A. Saint Guilhem, M. Schröder and I. Van Robays (2021), "What drives euro area financial market developments? The role of US spillovers and global risk", ECB Working Paper Series, No. 2560.

[2] The CZK/EUR impact response to a euro area (EA) macro news shock is left unrestricted to let the data speak as the Czech koruna often appreciates to positive EA news such as the PMI. The analysis abstracts from foreign exchange interventions as those data are not available at daily frequency.

Annex III. Risk Assessment Matrix

Conjunctural Risks [1]			
Risks	Likelihood	Impact on Czechia	Recommended Policy Response
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	High	High The war in Ukraine or other regional conflicts increase likelihood of trade and supply chain disruptions, higher inflation, and confidence shocks.	Diversify trade, particularly imports of energy. Develop contingency plans. Accelerate investments in energy efficient and renewable sources of energy, and in critical energy infrastructure such as the Poland – Czech Republic gas pipeline being revamped.
Commodity price volatility. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	High	High Supply disruption will cause high and volatile food and energy prices in the region.	Keep participating in European policy responses. Diversify energy and food supply. Incentivize domestic production of food and renewable energy.
Social discontent. High inflation, real income loss, spillovers from conflicts (including migration), and worsening inequality stir social unrest, drive populist policies, and increase resistance to reforms, especially in the context of polarized or disputed elections. This exacerbates imbalances and weakens growth prospects, leading to policy uncertainty and market repricing.	High	Medium High and volatile food and energy prices, and lower real income in the region could increase the risks of social unrest.	Continue to engage in European policy responses, diversity energy and food sources, encourage domestic production of food and renewable energy, and direct support measures towards vulnerable populations.
Global growth surprises: • **Slowdown.** Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs. • **Acceleration.** Positive supply-side surprises, monetary easing, productivity gains from AI, and/or stronger EMDE performance raise global demand and trade, and ease global financing conditions.	Medium Low	Medium Given its integration in global value chains and strong trade links with Germany, Czech Republic's inflation and economic activities would be significantly affected by recession in Europe and recurrent energy crises and supply disruptions.	Keep participating in European policy responses. Monetary policy stance should be forward-looking, and data driven. Diversify energy and food supply. Incentivize domestic production of food and renewable energy.
Monetary policy calibration. Amid high uncertainty and data surprises, major central banks' stances turn out to be too loose, hindering disinflation, or too tight for longer than warranted, which stifles growth and triggers increased capital-flow and exchange-rate volatility in EMDEs.	Medium	Medium The Czech Republic faces the same monetary policy calibration risks. Combatting inflation and maintaining inflation expectation anchored are still policy priorities.	Maintain a cautious risk management approach and a data dependent monetary easing approach to ensure inflation remains anchored and inflation rate converges to target.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Risks	Likelihood	Impact on the Czech Republic	Recommended Policy Response
Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdowns and elevated policy uncertainty (including from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	Medium	Low The Czech Republic would be relatively insulated given the high reliance on domestic financing in both public and private sectors.	Closely monitor and manage financial sector risks. Enhance the resilience of household and financial sectors by fine-tuning the macroprudential toolkit as needed.
Sovereign debt distress. Domino effects from high global interest rates, deteriorating debt sustainability in some AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, loss of market access, and contraction of growth and social spending.	Medium	Medium The Czech Republic would be less exposed to these shocks because of its high dependence on domestic financing in both public and private sectors, along with its relatively low debt level.	Vigilantly monitor and manage financial sector risks. Strengthen the resilience of household and financial sectors by adjusting the macroprudential toolkit as required.
Structural Risks			
Source of Risks, Likelihood, and Time Horizon		Impact on the Czech Republic	Recommended Policy Response
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	High	High Geopolitical fragmentation between Europe and Russia have escalated due to support for Ukraine and could potentially intensify further if the war worsens, leading to broader regional consequences.	Allocate further targeted fiscal assistance with focus on critical security-related sector. And continue to enhance the effectiveness of the AML/CFT frameworks to safeguard financial integrity.
Cyberthreats. Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets), technical failures, or misuse of AI technologies trigger financial and economic instability.	High	High Given the ongoing geopolitical tensions with Russia and recent cyber-attacks, there are risks of additional cyber threats.	Enhance preparedness for cyberattacks through extensive risk monitoring in cooperation with private and public sector stakeholders.
Climate change. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability. A disorderly transition to net-zero emissions and regulatory uncertainty lead to stranded assets and low investment.	Medium	Medium The Czech Republic's strategy on climate adaptation identifies industry and energy as the main sectors subject to climate change risks and emphasis on connectivity across sectors.	Accelerate the implementation the National Action Plan on Adaptation which established a robust scheme to build and enhance the energy sector's climate resilience.

Annex IV. External Sector Assessment

Overall Assessment: The projected external position for 2024 is moderately stronger than the level implied by fundamentals and desirable policy settings. The estimated CA gap is 1.5 percent of GDP, with a range of 1.0 to 2.0 percent of GDP, reflecting uncertainty around the point estimate. The REER gap is estimated to be -2.8 percent (±0.9) percent implying that the exchange rate was moderately weaker than implied by fundamentals and desirable policy settings. For the first three quarters of 2024, the 4-quarter average of the current account balance to GDP ratio increased to 1.3 percent of GDP from -0.7 percent a year earlier.

Potential Policy Responses: The external position projected for 2024 is moderately stronger than implied by fundamentals and desirable policy settings. The external sector assessment finds small contributions from policies to the gap. If the CA gap widens further in the future in a way that indicates significant imbalance, then the authorities could consider implementing structural policies to reduce it.

Foreign Assets and Liabilities: Position and Trajectory

Background. The net international investment position (NIIP) improved to about -13 percent of GDP in 2023 from about -20 percent in 2022. Gross assets and liabilities fell to 111 and 125 percent of GDP, respectively. Gross external debt (61 percent of GDP in 2023) remains relatively contained and is expected to continue falling over the medium-term. Through mid-2024, the NIIP has improved to -9 percent of GDP and external debt remained at about 61 percent of annual GDP (over the last 4 quarters). The NIIP is expected to improve in the medium term together with the financial account.

Assessment. The current NIIP and its projected path do not imply risks to external sustainability.

2024 (est.) (% GDP)	NIIP: -10	Gross Assets: 124	Res. Assets: 52	Gross Liab.: 134	Debt Liab.: 57

Current Account

Background. The 4-quarter current account to GDP ratio (CA) registered deficits from mid-2021 through mid-2023, reflecting a sharply lower trade balance, driven by supply-side disruptions and surging energy prices. As energy prices have fallen and supply disruptions waned, the monthly CA turned positive again in August 2023 driven by a steady increase in the goods balance from slightly negative levels to pre-energy shock levels of above 4 percent in 2024. In the medium term, the CA is expected to remain in a small surplus as historically sizable negative income balances resulting from previous inward direct investment weigh against the goods and services surplus.

Assessment. For 2024, given staff's forecast, the current account is assessed to be moderately stronger than implied by fundamentals. The EBA CA model estimates a norm of 0 percent of GDP against a cyclically adjusted CA surplus of 1.5 percent of GDP. The resulting EBA gap amounts to 1.5 percent of GDP. The policy gap is 0.5 percent, explained by more expansionary fiscal policy and faster credit creation in the rest of the world. No adjustors have been applied to the assessment.

2024 (% GDP)	Proj. CA:	Cycl. Adj. CA:	EBA CA Norm:	EBA CA Gap:	Prim. inc. Adj.:	Trade bal. Adj.:	Staff CA Gap:
	1.6	1.5	0.0	1.5	0.0	0.0	1.5

Real Exchange Rate

Background. The CPI-based real effective exchange rate (REER) has appreciated by about 30 percent since the authorities exited the koruna floor in April 2017 notwithstanding transitory periods of nominal depreciation especially vis-à-vis the US dollar following the onset of the pandemic and of the war in Ukraine. Other real appreciation measures, however, indicate a lower degree of appreciation, including those computed through unit labor costs, production price indices, or GDP deflators.

Assessment. The IMF staff gap implies a REER gap of -2.8 percent (with an estimated elasticity of 0.54 applied). , moderately weaker than implied by fundamentals and desirable policy settings. The EBA REER level and index models suggest overvaluation of 12 and 38 percent, respectively, largely reflecting unexplained residuals. Based on the CA gap model, staff assesses the REER gap in a range of -3.7 to -1.9 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account (measuring the change in net assets abroad) increased to 1.9 percent of GDP in 2023 from -4.1 percent of GDP in 2022, driven by smaller inflows of direct investment, decreased outflows due to financial derivatives and other investment along with a constant value of reserve assets compared to FX sales in 2022, while portfolio investment outflows decreased. The financial account is expected to remain in surplus in 2024 and to increase further over the medium-term.

Assessment. Risks related to capital flows are assessed to be relatively small.

FX Intervention and Reserves Level

Background. Gross international reserves increased by EUR8 billion to EUR148 billion (44 percent of GDP) in 2023, reflecting mainly positive portfolio returns and about EUR1.3 billion in foreign exchange sales by the CNB. This reflects the central bank's policy to sell part of its income from FX assets with a cap of EUR300 million per month with the explicit mandate to execute transactions with minimal impact on the exchange rate. These monthly FX sales have continued throughout 2024. The CNB has not intervened in the foreign exchange market to affect the exchange rate since October 2022.

Assessment. Reserves exceeded 9 months of imported goods and services in 2023 and are expected to remain broadly constant in 2024. They are assessed to be sufficient to insulate against external shocks and disorderly market conditions. Reserves remain between 3 and 4 times above the IMF's reserve adequacy metric.

Annex V. Sovereign Risk and Debt Sustainability Framework

Figure 1. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near-term and medium term horizons.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low against a mechanical low signal.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test		…	
Long term	…	Moderate	Long-term risks are assessed as moderate. The large amortization module shows gradual increase in GFN and debt relative to GDP both under the baseline and customized scenarios (with t+5). GFN and debt relative to GDP are expected to in crease with climate change adaptation and mitgation.
Sustainability assessment 2/	…	…	Not required for surveillance-only countries.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: The risk of Czech Republic experiencing sovereign stress is low overall. Czechia borrows from the market and there are no significant near term borrowing risks. The public debt ratio is projected to increase in the medium term. Most indicators have started to normalize as the recovery from the COVID-19 shock has proceeded well and support measures to the cost-of-living crisis (has been) phased out. Over the long term, the analysis highlights that risks are assessed as moderate. The large amortization module shows an increase in GFN and debt relative to GDP. GFN relative to GDP is expected to increase with climate change mitigation.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						
Subsectors captured in the baseline					Inclusion	
CPS / NFPS / GG: expected / CG — 1 Budgetary central government					Yes	
CPS / NFPS / GG: expected / CG — 2 Extra budgetary funds (EBFs)					Yes	
CPS / NFPS / GG: expected / CG — 3 Social security funds (SSFs)					Yes	
CPS / NFPS / GG: expected — 4 State governments					Yes	
CPS / NFPS / GG: expected — 5 Local governments					Yes	
CPS / NFPS — 6 Public nonfinancial corporations					No	
CPS — 7 Central bank					No	
CPS — 8 Other public financial corporations					No	
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
4. Accounting principles:	Basis of recording		Valuation of debt stock			
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
5. Debt consolidation across sectors:		Consolidated		Non-consolidated		

Color code: chosen coverage (green) Missing from recommended coverage (red) Not applicable (grey)

(Chosen coverage, shown in green: GG; Yes rows 1–5; Currency & deposits, Loans, Debt securities; Cash basis; Nominal value 5/; Non-consolidated. Missing from recommended coverage, shown in red: Oth acct. payable 2/, IPSGSs 3/. Not applicable, shown in grey: No rows 6–8.)

Reporting on Intra-Government Debt Holdings

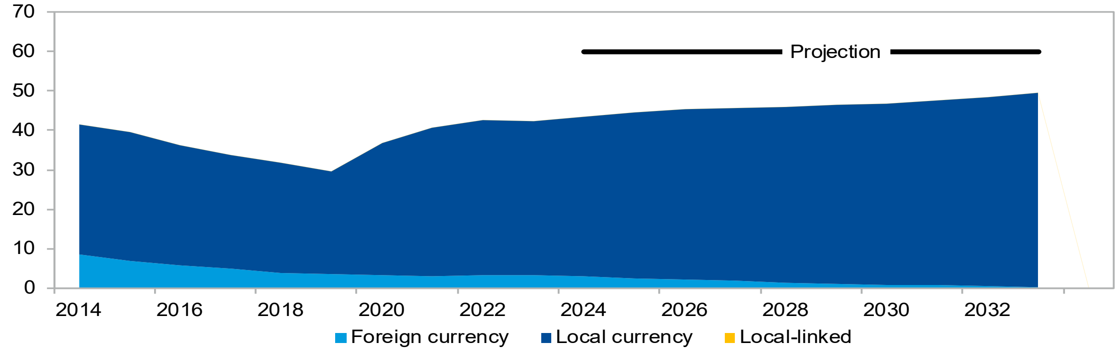
Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt									0
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The coverage in this SRDSA is for the general government. The DSA is prepared on a cash basis so there is no significant other accounts payable.

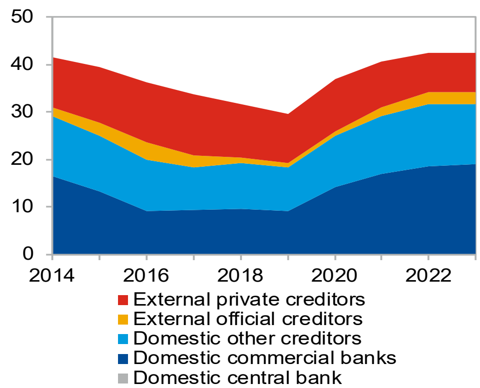
Figure 3. Public Debt Structure Indicators

Debt by Currency (percent of GDP)



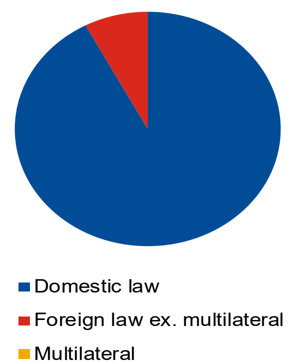
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



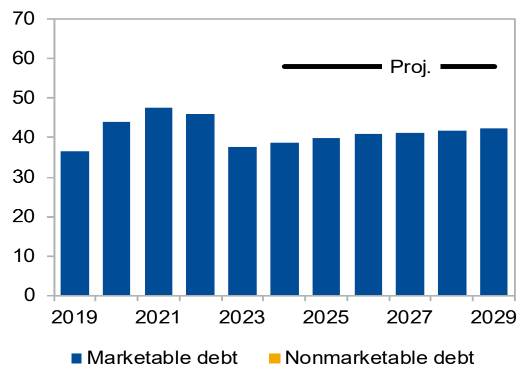
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



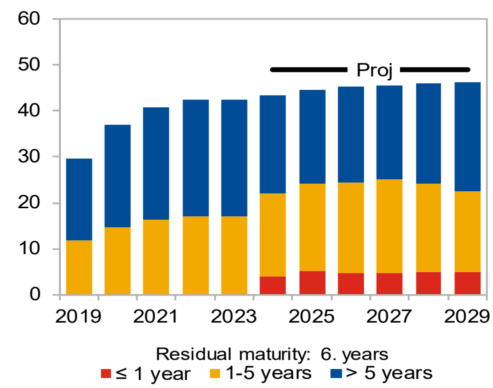
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: In Czech Republic, most debt is denominated in local currency, with moderate non-resident holdings. Currency risks are also minimal for Czechia. In the medium term, more than half of the instruments will be matured after 5 years and public debt will be mainly in domestic currency. The authorities indicated that their debt issuance strategy focuses on issuing local currency debt with an average maturity ranging between 5-7 years.

Figure 4. Baseline Scenario

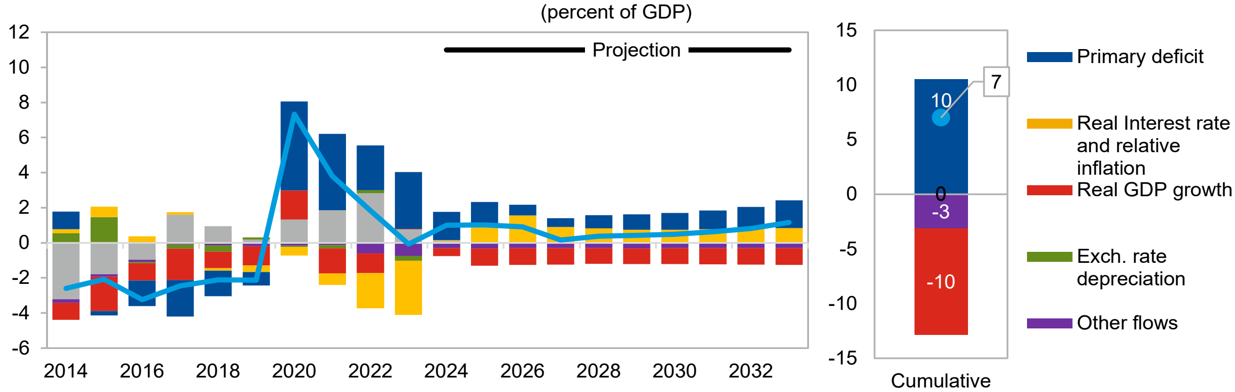
(Percent of GDP unless indicated otherwise)

(percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	42.4	43.5	44.5	45.4	45.6	45.9	46.4	46.8	47.5	48.3	49.5
Change in public debt	-0.1	1.0	1.0	0.9	0.2	0.4	0.4	0.5	0.6	0.8	1.2
Contribution of identified flows	-0.8	0.9	1.0	0.9	0.2	0.4	0.4	0.5	0.6	0.8	1.2
Primary deficit	3.2	1.6	1.3	0.6	0.5	0.7	0.9	1.0	1.1	1.2	1.6
Noninterest revenues	39.4	40.1	40.2	40.1	39.1	38.9	38.7	38.7	38.7	38.7	38.6
Noninterest expenditures	42.6	41.8	41.5	40.7	39.6	39.6	39.6	39.7	39.8	39.9	40.2
Automatic debt dynamics	-3.3	-0.4	0.1	0.6	0.0	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1
Real interest rate and relative inflation	-3.1	0.1	1.0	1.6	0.9	0.8	0.7	0.7	0.8	0.8	0.8
Real interest rate	-3.2	0.0	1.0	1.6	0.9	0.8	0.7	0.7	0.8	0.8	0.8
Relative inflation	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	0.0	-0.4	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Real exchange rate	-0.3	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	7.4	7.8	6.9	8.5	8.0	9.1	10.0	10.6	11.3	11.5	11.9
of which: debt service	4.9	6.5	5.9	8.2	7.8	8.7	9.4	9.9	10.5	10.6	10.7
Local currency	4.5	6.0	5.5	7.8	7.5	8.4	9.1	9.7	10.3	10.4	10.5
Foreign currency	0.4	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Memo:											
Real GDP growth (percent)	-0.1	1.1	2.3	2.2	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Inflation (GDP deflator; percent)	8.2	4.2	2.6	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	8.1	5.3	5.0	4.2	4.1	4.0	4.0	4.0	4.0	4.0	4.0
Effective interest rate (percent)	0.0	4.2	5.1	5.7	4.1	3.9	3.7	3.7	3.7	3.8	3.8

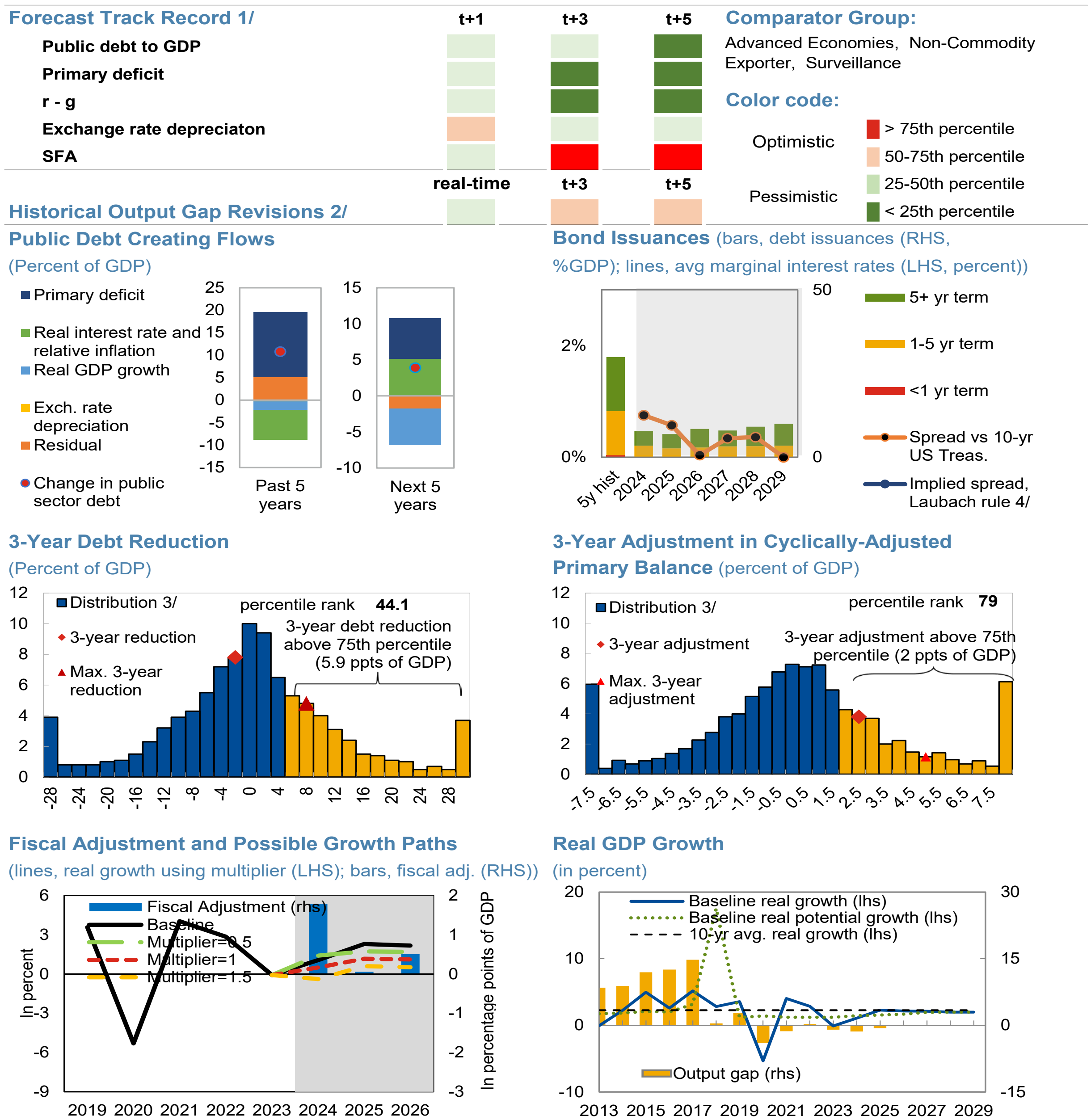
Contribution to Change in Public Debt

(percent of GDP)



Staff commentary: Public debt will rise in 2024 and 2025 and stabilize in the medium term. From 2029, public debt is projected to increase, driven by additional aging (healthcare and pension) spending pressures.

Figure 5. Realism of Baseline Assumptions



Commentary: The 3-year adjustment in the cyclically-adjusted primary balance is within the highest 75-percentile. The unwinding of COVID-19 related spending and energy support measures led to a decline in the cyclically adjusted primary balance. Following a sharp decline in 2023, staff is projecting a recovery in private consumption in 2024-25, despite the contractionary fiscal stance in 2024. Therefore, the growth projection is higher than the levels implied by the fiscal multipliers in 2024-25.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

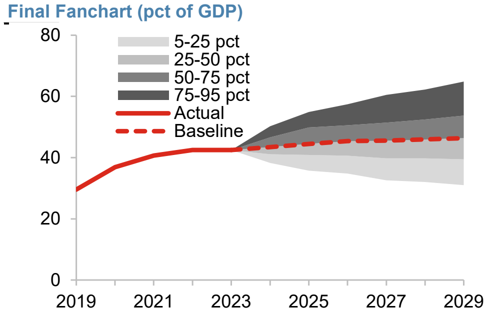
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

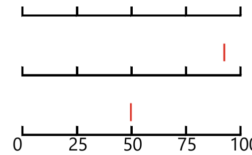
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. Medium-Term Risk Assessment

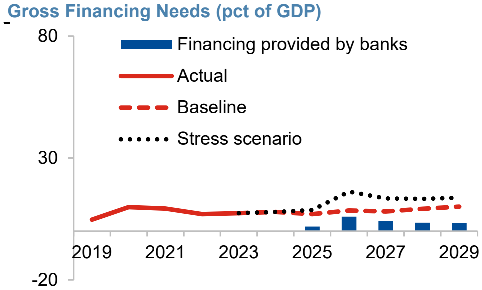
Final Fanchart (pct of GDP)



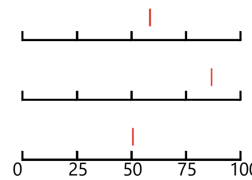
Debt fanchart module	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	33.8	0.5	
Probability of debt non-stabilizaiton *(percent)*	87.3	0.7	
Terminal debt-to-GDP x institutions index	12.4	0.3	
Debt fanchart index (DFI)		1.5	
Risk signal: 3/		Moderate	



Gross Financing Needs (pct of GDP)



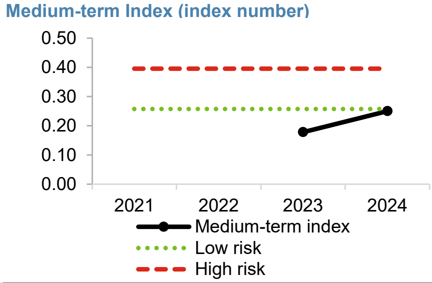
Gross financing needs (GFN) module	Value	Contrib	Percentile in peer group
Average baseline GFN *(percent of GDP)*	8.4	2.9	
Initial Banks' claims on the gen. govt *(pct bank assets)*	14.5	4.7	
Chg. In banks' claims in stress *(pct banks' assets)*	3.7	1.2	
GFN financeability index (GFI)		8.8	
Risk signal: 4/		Moderate	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index (index number)



Medium-term risk analysis

	Value	(normalized)	Weight	Contribution
Debt fanchart index	1.5	0.3	0.5	0.2
GFN finaceability index	8.8	0.2	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.

Prob. of false alarms, 2024-2029, if stress predicted: 42.0 pct.

Commentary: The fanchart risk score is moderate, given the relatively wide fanchart and probability of debt not stabilizing. Gross financing needs are manageable and staff assesses that the banking sector is broadly resilient, well capitalized, liquid, and profitable. It is expected that the banking sector will have ample borrowing space with vulnerabilities easing as the monetary stance is relaxed. The risk signal of the GFN module is moderate.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 7. Long-term Risk Assessment: Large Amortization

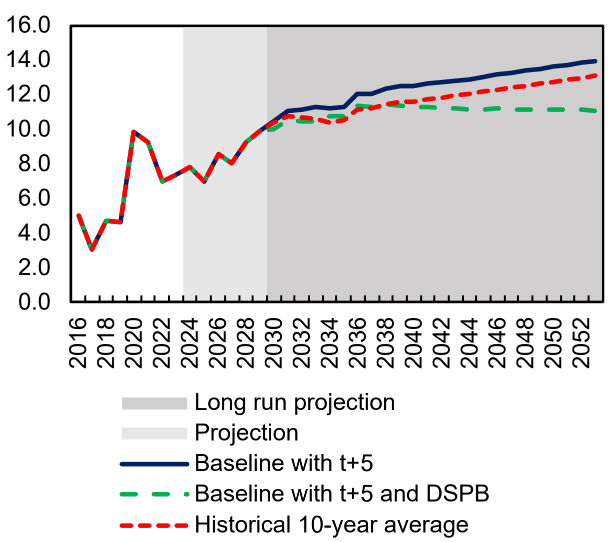
Triggered Modules

Large amortizations	Pensions	Climate change: Adaptation	Natural Resources
	Health	**Climate change: Mitigation**	

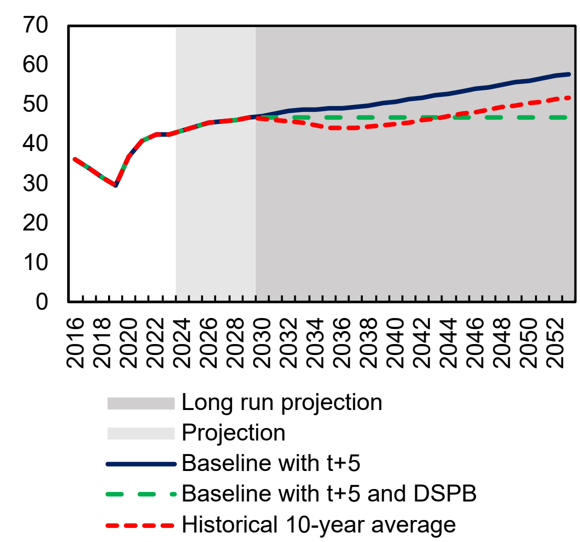
Long-term Risk Assessment: Large Amortization

Projection	**Variable**	**Risk Indication**
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio



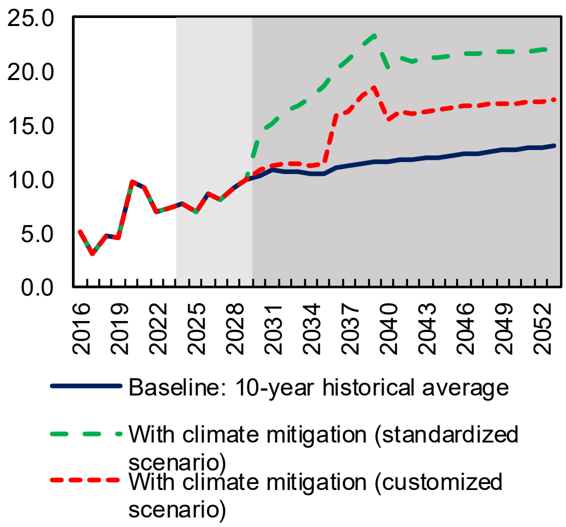
Total Public Debt-to-GDP rRtio



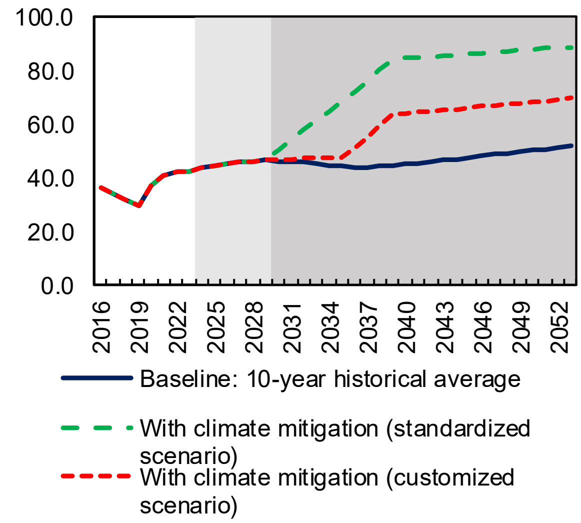
Commentary: Staff's baseline scenario, Baseline with t+5, shows both GFN- and public debt-to-GDP ratios increasing over the long-term as spending pressures (healthcare and pension) rise. The Baseline with t+5 and DSPB scenario shows an increase in the long-term GFN-to-GDP ratio and stabilization of the public debt ratio at lower levels than staff's baseline.

Figure 8. Climate Change Mitigation

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



Commentary: Both the gross financing ratio to GDP and the public debt ratio to GDP increase higher than the baseline when climate mitigation is incorporated. Under the stress scenarios, the GFN-to-GDP ratio will increase above 10 percent in the long-term and public debt-to-GDP will increase above 55 percent.

Annex VI. Data Issues

Table 1. Czech Republic: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	A		
Granularity 3/	A		A	A	A		
			A		B		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance* , January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund are adequate for surveillance.
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data collection and dissemination is overall adequate for surveillance. Granularity of financial soundness indicators (FSI) could be improved by including data on non-bank financial institutions (NBFI), given their increasing share in total financial assets.

Changes since the last Article IV consultation. No changes.

Corrective actions and capacity development priorities. None.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff.
Staff does not use any data and/or estimates in the staff report in lieu of official statistics.

Other data gaps. None.

Table 2. Czech Republic: Data Standards Initiatives

Czech Republic adheres to the Special Data Dissemination Standard (SDDS) Plus since April 2016 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 3. Czech Republic: Table of Common Indicators Required for Surveillance
As of 12/9/2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Czech Republic[8]	Expected Timeliness[6,7]	Czech Republic[8]
Exchange Rates	9-Dec-24	9-Dec-24	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov-24	Nov-24	M	M	M	M	1W	7D
Reserve/Base Money	Oct-24	Nov-24	M	M	M	M	2W	14D
Broad Money	Oct-24	Nov-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	Oct-24	Dec-24	M	M	M	M	2W	14D
Consolidated Balance Sheet of the Banking System	Oct-24	Dec-24	M	M	M	M	1M	1M
Interest Rates[2]	Nov-24	Nov-24	D	D	D	...	...	...
Consumer Price Index	Oct-24	Nov-24	M	M	M	M	1M	NLT 15D
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Jun-24	Sep-24	Q	Q	A/Q	Q	2Q/12M	4M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Sep-24	Oct-24	M	M	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Jun-24	Jul-24	Q	Q	Q	Q	1Q	1Q
External Current Account Balance	Jun-24	Jul-24	Q	Q	Q	Q	1Q	75D
Exports and Imports of Goods and Services	Oct-24	Nov-24	M	M	M	M	8W	40D
GDP/GNP	Sep-24	Oct-24	Q	Q	Q	Q	1Q	70D
Gross External Debt	Jun-24	Jul-24	Q	Q	Q	Q	1Q	NLT 1Q
International Investment Position	Jun-24	Sep-24	Q	Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VII. Authorities' Response to Past IMF Policy Recommendations

	Key Recommendations	Actions
Monetary	Staff recommended maintaining a sufficiently tight monetary policy stance until there was firm evidence that inflation was on course to converge to target.	As inflation steadily declined back towards the 2 percent target inflation expectations re-anchored, the CNB lowered the policy rate by a cumulative 275 basis points to 4.25 percent. The monetary policy stance is still tight.
Fiscal	Staff recommended that the PIT and real estate related taxes delivered pre-pandemic tax revenue as a percent of GDP and the pension reforms was further advanced.	No changes were introduced on the PIT and real estate related taxes. A Pension reform package was approved by the cabinet and passed the first reading in parliament.
Financial	Staff recommended reactivating the limits on the Debt-to-Income (DTI) and the Debt-Service-to-income (DSTI) to manage potential systemic risks.	The DTI and DSTI remain deactivated, reflecting light flows on new mortgage loans. The LTV ratio limit is set at 80 percent.
Structural	Staff recommended stepping up policies to enhance employment prospects for disadvantaged groups and continuing efforts to effectively integrate refugees and facilitate the inflow of migrants. Staff also encouraged reforms to support technological innovation.	Some progress was made on increasing the number of childcare services in support of mothers with young children. The 2025 draft state budget prioritizes spending in education, research and development, infrastructure, and defense.

INTERNATIONAL MONETARY FUND

CZECH REPUBLIC

January 7, 2025

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | European Department

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FUND RELATIONS _____ 2

FUND RELATIONS

(As of November 30, 2024)

Membership Status: Joined 01/01/1993; Article VIII.

General Resources Account

	SDR Million	Percent Quota
Quota	2,180.20	100.00
Fund Holdings of Currency	1,616.67	74.15
Reserve Position	563.54	25.85

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	2,869.82	100.00
Holdings	2,566.23	89.42

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	March 17, 1993	March 16, 1994	177.00	70.00

Projected Payments to the Fund

Forthcoming (SDR Million)

	2024	2025	2026	2027	2028
Principal					
Charges/Interest		10.24	10.23	10.23	10.24
Total		10.24	10.23	10.23	10.24

Implementation of HIPC Initiative: Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable.

Implementation of Catastrophe Containment and Relief (CCR): Not applicable.

Exchange Rate Arrangement: The currency of the Czech Republic is the Czech koruna, created on February 8, 1993, upon the dissolution of the currency union with the Slovak Republic, which had used the Czechoslovak koruna as its currency. The de jure exchange rate arrangement is free floating and the de facto exchange rate arrangement is floating. The external value of the koruna is solely determined by supply and demand in the interbank foreign exchange market, in which the Czech National Bank (CNB) might participate.

The Czech Republic has accepted the obligations of Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions. The Czech Republic maintains exchange restrictions for security reasons, based on UN Security Council Resolutions and Council of the European Union Regulations that have been notified to the Fund for approval under the procedures set forth in Executive Board Decision No. 144–(52/51).

Last Article IV Consultation: Concluded on January 22, 2024 (IMF Country Report No. 24/28).

FSAP Participation

An FSAP was carried out in late 2000/ early 2001. The Financial System Stability Assessment was considered by the Executive Board on July 16, 2001, concurrently with the staff report for the 2001 Article IV Consultation. An FSAP update was carried out in 2011. ROSCs on: banking supervision; data dissemination; fiscal transparency; securities market; and transparency of monetary and financial policies were published on the Fund's external website on July 1, 2000.

Technical Assistance (last mission)

Department	Timing	Purpose
FAD	June/July 1999	Medium-term fiscal framework
MCM	February/June 1999	Integrated financial sector supervision (with WB)
RES	June/August 2000	Inflation targeting (financed by MFD)
STA	November 2006	GFSM 2001 implementation
FAD	December 2024	Tax Administration Diagnostic Assessment