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REPORT FROM THE COMMISSION

Czechia

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

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REPORT FROM THE COMMISSION

Czechia

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Data notified by the Czech authorities on 31 March 2020 and subsequently validated by Eurostat[1] show that the general government surplus in Czechia reached 0.3% of GDP in 2019, while general government gross debt stood at 30.8% of GDP. According to the 2020 Convergence Programme, Czechia plans a deficit of 5.1% of GDP in 2020, while debt is planned at 37% of GDP.

The planned deficit for 2020 provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Against this background, the Commission has therefore prepared this report, which analyses Czechia's compliance with the deficit criterion of the Treaty. The debt criterion can be considered to be met as the debt ratio in 2019 is below the Treaty reference value of 60% of GDP. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

[1] https://ec.europa.eu/eurostat/documents/2995521/10294648/2-22042020-AP-EN.pdf/6c8f0ef4-6221-1094-fef7-a07764b0369f

Table 1. General government deficit and debt (% of GDP)

		2016	2017	2018	2019	2020 COM	2021 COM
Deficit criterion	General government balance	+0.7	+1.5	+0.9	+0.3	-6.7	-4.0
Debt criterion	General government gross debt	36.8	34.7	32.6	30.8	38.7	39.9

Source: Eurostat, Commission 2020 spring forecast

2. DEFICIT CRITERION

Based on the 2020 Convergence Programme, Czechia's general government deficit in 2020 is planned to reach 5.1% of GDP, above and not close to the Treaty reference value of 3% of GDP.

The planned excess over the Treaty reference value in 2020 is exceptional, as it results from a severe economic downturn. Taking into account the impact of the COVID-19 pandemic, the Commission 2020 spring forecast projects a contraction of real GDP in 2020 by 6.2%.

The planned excess over the Treaty reference value is not temporary based on the Commission 2020 spring forecast, which projects the general government deficit to remain above 3% of GDP in 2021.

In sum, the planned deficit for 2020 is above and not close to the 3%-of-GDP Treaty reference value. The planned excess is considered to be exceptional but not temporary as defined by the Treaty and the Stability and Growth Pact. Hence, the analysis suggests that *prima facie* the deficit criterion for the purpose of the Treaty and Regulation (EC) No 1467/97 not fulfilled.

3. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission" need to be given due consideration.

In the current situation, a key additional factor to take into consideration regarding 2020 is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

3.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Member States have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures will contribute to substantially higher government deficit and debt positions.

3.2 Medium-term economic position

Czechia's economy is set to suffer a strong hit from the COVID-19 pandemic in 2020. As external demand drops and lockdown measures disrupt economic activity, according to the Commission 2020 spring forecast GDP is expected to drop by 6.2% in 2020. Investment is expected to contract sharply, owing to value-chain disruptions, increasing uncertainty and workforce shortages during the lockdown period. Trade is also set to be affected strongly due to the structure of Czechia's exports. This a mitigating factor in the assessment of Czechia's compliance with the deficit criterion in 2020. The economy is expected to gradually recover in 2021, growing by 5% but remaining below the 2019 level. The upturn is forecast to be mainly driven by an increase in private consumption and investment. Unemployment is expected to be affected as well, reaching around 5% in 2020, but its increase should be cushioned by the government's measures, a previously tight labour market and a low share of temporary contracts. Nonetheless, there is a great degree of uncertainty surrounding the near-term macroecomic outlook..

3.3 Medium-term budgetary position

Based on outturn data and the Commission 2020 spring forecast, Czechia was compliant with its medium-term budgetary objective in 2019.

After the start of the pandemic, the State budget for 2020 had to be revised to a deficit of 5.5% of GDP. The 2020 Convergence Programme provides information on substantial measures to contain the pandemic and to support the economy. According to the authorities, the total amount of direct fiscal support provided to the economy until 22 April 2020 was around 4% of GDP, out of which 2.2% of GDP as expenditure. These measures will add to the previously agreed increases in public wages, pensions and other social benefits. Some new measures have also been discussed and may further affect the State budget. Overall, the Programme expects a deficit of 5.1% of GDP in 2020.

In 2021, according to the Convergence Programme, the deficit is expected to decrease to 4.1% of GDP. The recovery in tax revenue is expected to be modest, whereas current expenditures are expected to continue growing. The Parliament recently fast-tracked a legislative amendment to the Law of Fiscal Responsibility, without a prior consultation of the

Czech Fiscal Council, making room for the measures related to COVID-19 recovery needs. In particular, the amendment increased the maximum structural deficit for 2021 from 1% to 4% of GDP, , beyond the medium-term objective of a structural deficit of 0.75%, and allowed for a gradual adjustment path between 2022 and 2027, with an annual consolidation of at least 0.5 percentage points of GDP between 2022 and 2027.

3.4 Other factors put forward by the Member State

On 11 May 2020, the Czech authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities.

4. CONCLUSIONS

According to the Convergence Programme Czechia's general government deficit in 2020 is planned to reach 5.1% of GDP, above and not close to the 3% of GDP Treaty reference value. The planned excess over the reference value is considered to be exceptional but not temporary.

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors.

Overall, since the planned deficit is well above 3% of GDP and the excess not temporary, and taking into account all relevant factors, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.