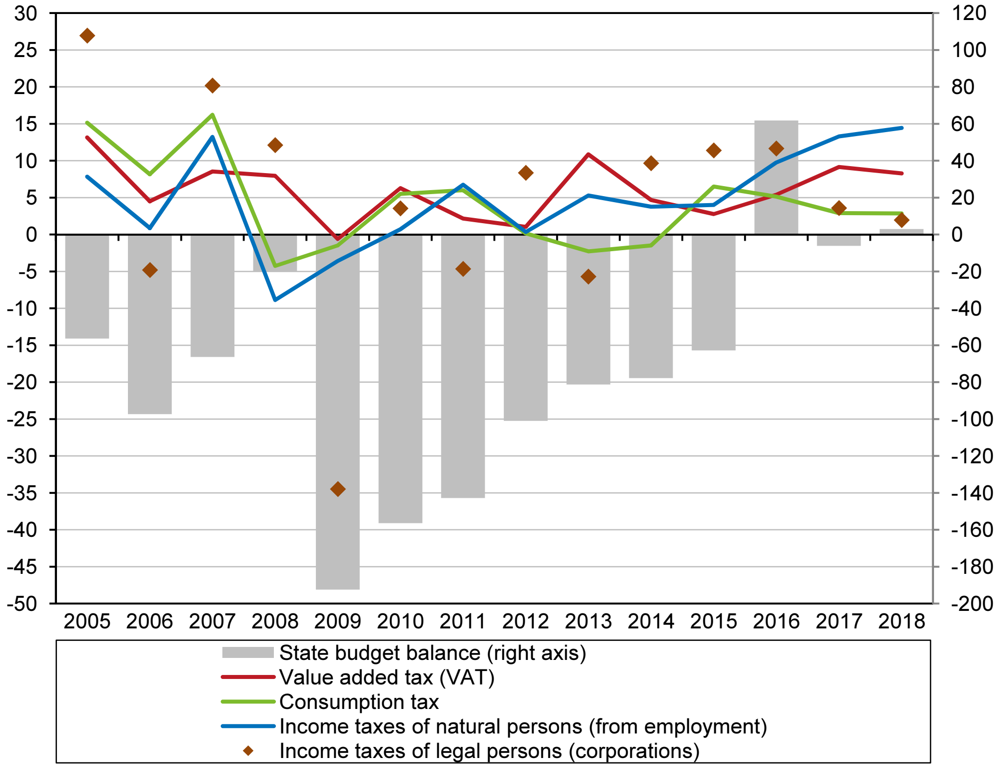
8. State Budget

State budget ended in yearly surplus only for the second time since 1995.

Balance of the state budget (SB)[1] attained the size of +2.9 CZK bn in 2018. It comprised the second best result after year 1995 and at the same time the fifth yearly surplus in the history of the independent CR. Resulting balance last year – similarly to years 2016 and 2017 – considerably exceeded the budget expectations (by more than 50 CZK bn). Despite signs of contraction, the economic growth still played a key role in the state budget, the importance of public investment (at first directed mainly on the European projects, towards the end of the year more also on the exclusively national projects) also increased in the second half of the year. Total SB revenues strengthened by 130 CZK bn last year compared to year 2017, expenditures by 121 bn – both budget items grew swifter than was their budget anticipation (by 5.8 p.p., resp. by 1.8 p.p.). SB balance, which represents a dominant item of the budget deficit or surplus of government sector institutions budget amounted to +0.1% in relation to the nominal GDP for the first three quarters.

Chart 18 State wide collection of selected tax incomes (year-on-year in %) **and state budget balance** (in CZK bn)



Source: MF CR

State wide collection of all tax income grew the fastest since the expansion year 2007.

Non-tax and capital revenues and received transfers (+47 CZK bn[2]) contributed to the year-on-year growth of the SB revenues from more than one third. Nevertheless, the tax revenues, which increased by 7.2% year-on-year (excluding social security insurance by 5.8%) had a dominant effect. With respect to the change of the budget allocation of taxes, which re-directed further part of total collection (for VAT) to the local government budgets to the detriment of the SB, the state-wide rate of growth provides a better picture regarding the real dynamics of tax collection. It shows that the total tax collection

Collection of majority

[1] Unless stated otherwise, all data related to the state budget stem from the data of the Ministry of Finance regarding the cash fulfilment.
[2] It concerned mainly the final payments related to the completed programme period of 2007 – 2013 (in the amount of 23.9 CZK bn). The revival of drawing tied to the current programme period also partially contributed to the growth in the previous months. Stronger income from the sale of the emission allowance, which reached nearly 15.0 CZK bn also had an effect (by 9.0 CZK bn more than in the approved budget).

main tax revenues copied the budget anticipation, it exceeded it more for collection of social security insurance.

strengthened by 8.2%, the most since the business cycle peak year 2007. The good condition of the local economy in the long-term bore its fruit (mirrored on the labour market), for a lesser part likely also the efficiency of the tax collection. Higher collection of social security insurance (+46.9 CZK bn), income tax of natural persons (+17.9 bn) and VAT (+13.0 bn) contributed the most to the growth of the SB budget revenues last year. While the collection of tax incomes (excluding social security insurance) finished according to the budget anticipation, collection of social security insurance surpassed it by 16.2 CZK bn 3.3 p.p.

Year-on-year increase of the VAT collection slightly surpassed the rate of growth of final consumption expenditure in the whole economy.

In case of VAT, which holds dominant weight, the year-on-year growth of the state-wide collection arrived at 8.3% last year (4.9% at the level of SB). Even though the pace eased compared to year 2017, it still slightly surpassed the dynamics of final consumption expenditure in the economy, which strengthened by 6.7% nominally in 2018. Rate of growth of the collection of consumption taxes remained last year (similarly to the preceding year) tightly below the 3% boundary. Mainly the swiftly growing collection of taxes on tobacco products (+6%) contributed to larger collection. Negative impact of the anti-smoking regulation (in force since June 2017) anticipated by the budget proved less significant than the effect of the repeated increase of rates on tobacco products (since January 2018). Collection of weight dominant group – tax on mineral oils – increased only by 1.2%[3] and attained the weakest growth in the last five years. Influence of the favourable impact of the economic growth on private as well as freight transport was dampened by the negative effect linked with administrative and price impacts[4].

Higher collection of consumption taxes was driven mainly by the collection of tax on tobacco products.

Pace of collection of income tax of natural persons (ITNP) from employment further quickened.

All main types of direct taxes contributed to the growth of their state wide collection last year – income tax of natural persons (ITNP) from employment the most. Its year-on-year growth climbed up to 14.4% (despite high basis of year 2017) and achieved faster rate of growth than in the business cycle peak in the last decade. Even though the collection of this tax reached double digit pace already eight quarters in a row, its dynamics slightly weakened in the last quarter of the last year (to +12.8%). It was apparently connected to the slowing pace of employment growth. While the annual collection of ITNP from employment strengthened already fourth year in a row, growth rate of corporate tax contracted to a five-year minimum last year (+2.0%). It copied the declining profitability of businesses mainly through the work of growing wage costs in years 2017 as well as 2018. Collection of ITNP from independent activity grew by 2.9% last year (by 11.2% the year before that). In spite of moderate strengthening of the number of self-employed persons as well as measures leading to higher efficiency of the tax collection, the last year´s collection (in contrast to year 2017) was behind the budget anticipation. Changes in the possibilities of tax deductions worked against higher growth of collection (rebates on the second spouse and tax benefits on dependent children). Collection of ITNP from capital yields on the contrary recorded a favourable development, growing by 15.1% last year – the fastest in the last four years.

On the contrary, the growth of collection of ITNP from independent activity as well as the corporate tax contracted and did not fulfil the budget anticipations.

Net position of the CR towards the EU budget slumped to seven-year minimum last year. Incomes from both structural funds and on rural development

Public finances of the CR are also significantly affected by the financial relations with the EU. The CR gained from the EU budget (based on MF data) 94.8 CZK bn in 2018. This volume did not change much in the year-on-year comparison (-3.5%), but the structure shifted. The volume of resources from structural funds (+8.3 CZK bn) and on rural development (+1.6 bn) increased, the role of the cohesion funds on the contrary weakened

[3] Data CZSO also prove the slowdown of the year-on-year rate of growth. Consumption increased in the weight dominant category – diesel fuel – by 1.1% in 2018 (while it strengthened by 3.5% in year 2017). Consumption of the jet kerosene also recorded a slower pace last year (+8.6%, resp.+15.1%). Consumption of the petrol in fact stagnated last year the same way as in year 2017.

[4] It is so called green fuel enabling the refund of this tax in the area of animal primary production. This deduction is already fully manifesting in year 2018 (contrary to previous year). Rising prices could have also partially negatively affected the consumption of petrol and diesel fuel. While the consumer prices of fuels were falling in the first half of year 2017 (and rather stagnated in Q3), the situation was the opposite for the most of the year 2018.

increased.

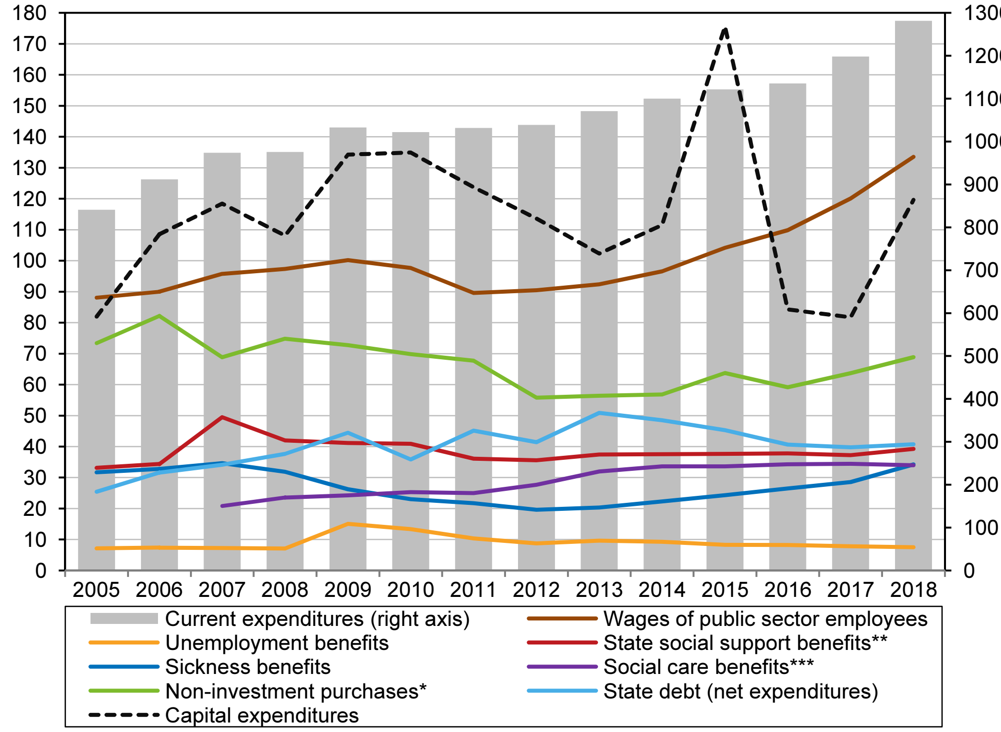
(-12.3 bn). Net position of the CR towards the EU budget decreased fell to a seven year minimum last year (+45.3 CZK bn). It was connected to the speed of drawing on funds, their relatively lower total volume (in comparison to preceding programme period 2007–2013) as well as growing contributions of the CR into the EU budget (49.6 CZK bn last year, by one sixth more year-on-year).

Swift growth of the SB outlays was driven by both current outlays and investment last year.

Growth of total SB outlays reached 9.5% year-on-year last year and accelerated already second year in a row. It was from more than two thirds driven by current outlays, in contrast to years 2016 and 2017 however, there was also an effect of higher capital outlays. State budget used 119.6 CZK bn for investment last year, by nearly one half more year-on-year. Similarly to year 2017, a marked irregularity in the drawing of investment during the year was apparent, since one half of their annual volume was allocated to Q4. Contrary to years 2016 and 2017, last year´s volume of investment surpassed the budget anticipation (by more than one quarter). Slightly more than half of all investment (64.7 CZK bn) was directed to the advanced financing of common CR and EU programmes[5] (by 27.3 CZK bn more year-on-year). While the acceleration of SB investment was driven by boosted drawing on European funds in Q3 2018, larger expenditure on exclusive national projects mainly contributed in the last part of the year (unrelated to the EU)[6]. Despite this improvement, the share of investment on total SB outlays was „only“ 8.5% in 2018. It constituted the highest value in the last three years, but also the third lowest in the last 14 years.

Investment significantly surpassed the budget anticipations only due to the accelerated advanced financing of „European projects“ last year.

Chart 19 Selected state budget expenditures (in CZK bn)



* Excluding the expenditure on servicing the state debt and expenditure on realisation of guarantees.
**Also includes the foster care benefits.
*** Includes Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits (based on Act on State Social Support).
Note: Net outlays on state debt also include receipts of the chapter State debt.
Source: MF CR, MLSA

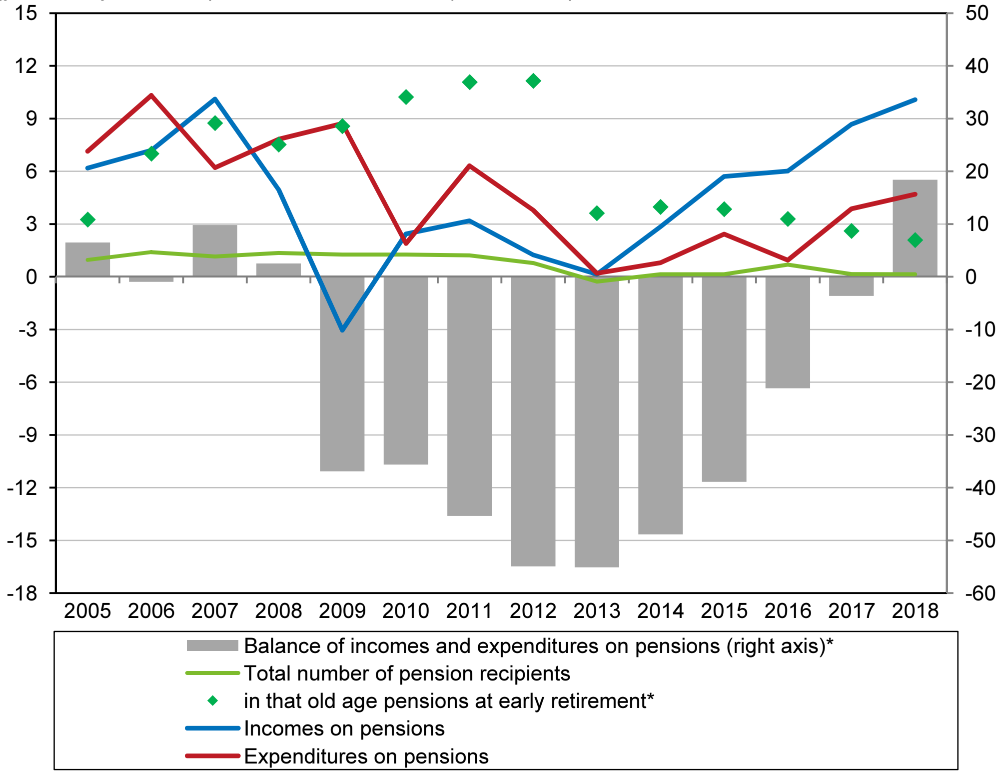
[5] There were in total nearly 127 CZK bn expended on the common CR and EU projects last year, which was also assisted by the higher engagement of claims from non-consumed outlays from the past years (beyond the approved budget for year 2018). In years 2016 and 2017, slightly over 90 bn were usually directed to these projects (when including both investment and current outlays).

[6] SB investment realised exclusively via the national resources amounted to only 23.2 CZK bn during Q1 to 3 2018 (mildly above 40% of the annual amount anticipated by the budget). In Q4 only, there were nearly 32 bn allocated this way. In spite of this, the yearly drawing of this group of investment remained slightly below the budget anticipation last year.

Current outlays grew the fastest after year 2006. More than one half consisted of larger expenditure on wages and pensions.

SB current outlays strengthened by 7.0% year-on-year last year, the fastest pace after year 2006. Still their drawing remained closely behind the budget anticipation[7]. Growth of total outlays (+83 CZK bn) was associated from more than one half with the strengthening of the average size of pensions and also the increase of wages of employees working in fields with the dominance of state. Expenditure on salaries in central bodies of the state administration (primarily tied to the increase of the wage tariffs, not growing employment) went up by 11%. Non-investment transfers to local government budgets increased (+13%, similarly to year 2017), allocated in the first place to direct subsidies of basic and secondary schools and also to transfers to municipalities and regions according to the Social Services Act. Both the non-investment transfers to business entities (+9 CZK bn), where it comprised of especially the funds for the support of renewal sources of energy, and higher compulsory payments of the CR into the EU budget (+7.4 CZK bn) contributed to the growth of the current outlays significantly.

Chart 20: Pension recipients, income and expenditure on pensions from the SB (year-on-year in %) **and their balance** (in CZK bn)



* Expresses the difference between incomes and expenditures on pensions from the state budget. The balance of incomes and expenditures includes also the cost of administrating the pension insurance system.
** Old age pension income awarded before the pension age is reached and shortened for the earliness for the whole time period of the drawing the benefit. Source: MF, MLSA

Non-pension social benefits grew the fastest in the last five years …

Even though the expenditure on social benefits expanded year-on-year by notable 26.6 CZK bn, their share in the total SB outlays shrank already second year in a row (to 39.7%). Despite the strengthening of the social benefit is traditionally pushed by the weight dominant item of expenditure on pensions, the non-pension social benefits also shared in their growth from more than one quarter last year. Their growth significantly accelerated (from 1.2% in 2017 to last year´s 6.2% – the highest rate of growth in the last five years and reached a higher rate than expenditure on pensions.

…mainly due to the acceleration of the

Sickness benefits, whose rate of growth considerably increased last year (to 19.8%), added the most to the growth of the expenditure on non-pension social benefits in 2018

[7] This would be among the all main types of outlays more notably exceeded only for non-investment transfers to non-profit or contributory organizations (by 8.5, resp. 4.5 p.p.) last year.

growth of expenditure on sickness benefits. Lower expenditure on material deprivation benefits and unemployment benefits worked in the opposite direction.

(similarly to the preceding five years). It was associated with the continuing growth of the temporary work incapacity as well as higher average daily sickness (derived from the level of earnings in the previous months). Stronger drawing of maternity benefits (due to higher natality) exerted much lower level of impact as well as this year´s introduction of new benefits (long-term care benefits, father post-natal care). SB expended more also on some social care benefits – for health disabilities as well as the care benefits (for persons on long-term sickness leave). Drawing on other types of social benefits was positively affected by the favourable situation on the labour market (continuing reduction of unemployed, higher engagement of formerly economically inactive as well as strengthening growth of average wages). Drop of expenditure on material deprivation benefits was deepening already fourth year in a row (down to -27%)[8]. The state „saved" considerably less on the support of unemployed (-3.9%) last year, among other things also due to the high proportion of the frictional component of the unemployment as well as the growth of the average monthly unemployment benefit. On the state social support benefits, which are paid out in relation to the household income (child allowance, allowance for living, birth allowance), the SB spent by 8.3% less year-on-year. However, the volume of weight significant parent benefits expanded (+8.6%). By more than one quarter more now travelled to the so far relatively marginal foster care benefits.

Growth of expenditures on pensions accelerated, still the pension account balance finished in record surplus.

Expenditure on pensions expanded already second year in a row and their last year´s rate of growth (+4.7%) was the highest since year 2011. Given the stagnation of the number of persons receiving pension[9], this acceleration resulted from the new setting of their adjustment[10]. Extraordinarily favourable situation on the labour market stimulated the growth of the collection of insurance on pensions (+10.1%, equal to the so far record pace from year 2007). Pension account balance[11] thus for the first time in the last ten years ended in surplus (in the record amount of 18.4 CZK bn).

Fall of net expenditures on state debt halted last year. The size of state debt remained stabilised. State continued to cover its borrowing needs primarily on the domestic market.

Four years lasting slump of the net expenditure on state debt[12] halted in year 2018, when these expenditures hit 40.7 CZK bn last year (by 2.4% more year-on-year). Swiftly growing interest rates on state bonds affected the last year´s development. State debt amounted to 1 622.0 CZK bn at the end of year 2018 and remained nearly the same year-on-year (-0.2%). Differently from year 2017, the fluctuation of debt within the calendar year was significantly curtailed. The fall of the koruna value of the foreign debt continued already for the fifth year in a row. It thus shared 14.5% on the total state debt at the end of year 2018 (the least in this part of the year for the last eleven years). Debt securities remain the dominant instrument despite slight decrease of their weight. Financial institutions stay as the most significant owner of koruna state bonds, decrease of the role of non-residents ceased falling during the last year and their proportion arrived at 41.8% at the end of the last year. Households possessed only 0.5% of state bonds, the least in the last eleven years.

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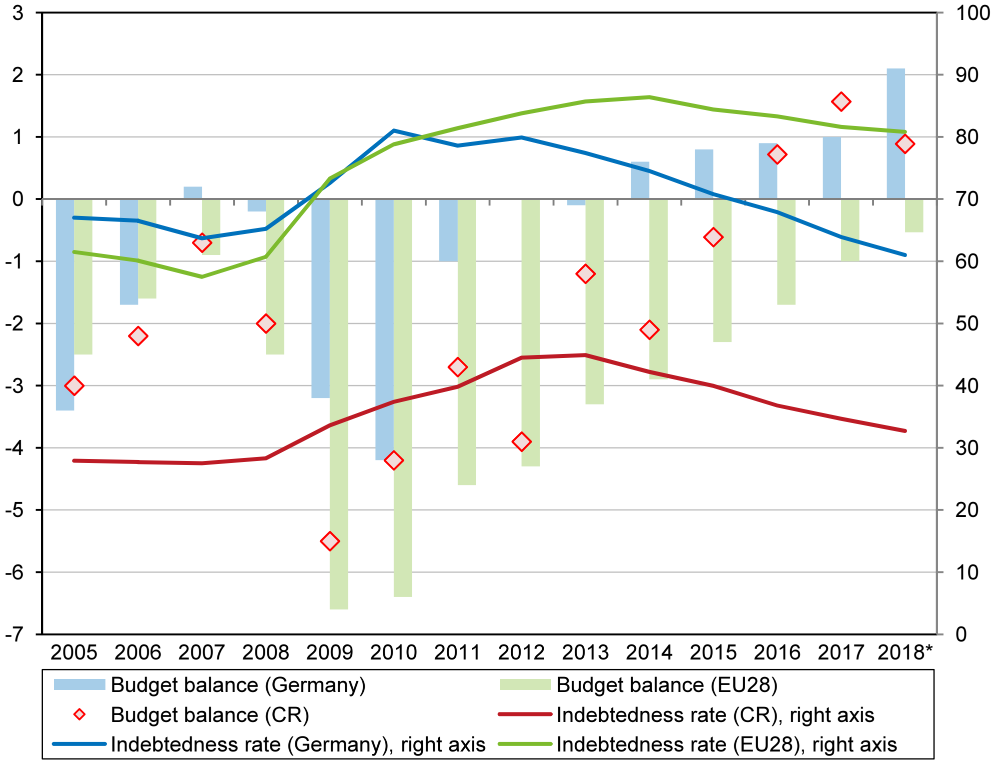
[8] According to the MLSA data, 11.3 CZK bn was drawn for this purpose in year 2014, only 5.4 bn already last year. Number of recipients of material deprivation benefits fell from 240 thousand to 111 thousand persons in the same time period (based on December data).
[9] Total 2.89 mil persons were receiving some form of pension according to the data of the Czech Social Security Administration in December 2018. Mild year-on-year growth of the frequency of old-age pensioners (+0.3%) was offset by the reduction of persons on disability pension (-0.6%) last year.
[10] Starting January 2018, the basic pension assessment was raised by 150 CZK and the percentage assessment by 3.5% (i.e. on average by 475 CZK per month).
[11] It is expressed as the difference between revenues and expenditures on the pensions from the SB. It also includes the expenditure on administration of the pension insurance system, which based on the preliminary data of the MF achieved the size 6.4 CZK bn in 2018. The system of pension insurance would have surplus already in year 2017 if expenditures on administration would be excluded.
[12] It is the balance of the budget chapter 396 – State debt.

Chart 21: Budget balance and indebtedness rate of the government institutions sector in the CR, Germany and the EU (% of GDP)



*Budget balance for year 2018 for Germany and the EU expresses the average from quarterly seasonally adjusted data (for Q1 to Q3). Indebtedness rate for Germany and EU depicts the state at the end of Q3 2018. Indicator for the CR expresses the state as of 31.12. in the whole time series (in case of indebtedness rate) and the actual state for the whole year (in case of budget balance).
Source: CZSO, Eurostat

Government institution sector achieved surplus last year already third year in a row. It contracted by nearly one half compared to year 2017, primarily due to the dive of surplus of local government institutions.

Consolidated debt of the whole sector of government institutions (taking into account also the budget of municipalities or health insurance companies) reached according to the CZSO the value 1 735.1 CZK bn at the end of Q4 2018. Absolute size of the debt remains stabilised already sixth year in a row. The indebtedness rate was 32.71% of GDP and in comparison to year 2017 it fell by 1.95 p.p. It fell primarily due to the strengthening of the nominal GDP, the year-on-year debt decrease itself (by 14.5 CZK bn) shared only less than one seventh. The government institution sector achieved budget surplus in the amount of +47.4 CZK bn in the CR in 2018, annual positive result prevailed already third year in a row. All subsectors of government institutions achieved surplus last year – similarly to year 2017. Only social security funds managed to improve the last year´s result (by 8.2 bn). The surplus of the whole sector was 0.89% in relation to the GDP last year, it presented the second largest value in the comparable time series since year 1995 (balance hiked up to +1.57% in the record year 2017). Weaker year-on-year result was influenced especially by the lower budget surplus of the local government institutions (by

22.9 CZK bn) with swift growth of investment in its background[13] last year .

Tendency to lower the indebtedness rate is apparent at the level of the whole EU since the half of year 2015, so far however was implemented only very gradually.

The CR was based on up-to-data data at the end of Q3 2018 (33.9% of GDP)[14] the fourth relatively least indebted EU country (with larger distance behind Estonia, Luxembourg and Bulgaria). Indebtedness rate fell year-on-year both in the EU and the euro area already fourth year in a row, the rate of reduction however is not successful at accelerating despite long-term economic growth. The indebtedness rate fell only by 4.8 p.p. to 80.8% in the Union for the last five years to 80.8%, since the position of the most indebted economies improved only negligibly. 24 Union states signalled a year-on-year decrease of indebtedness in Q3 2018, however among the most indebted economies only Portugal recorded a more significant shift. Indebtedness rate grew in Greece and Cyprus. Less than half of the euro area members showed indebtedness below 60% of GDP, in that from the core countries (EU15) only Luxembourg, Netherlands and Finland. Only Germany and Malta succeeded in lowering their indebtedness rate below the level close to the pre-crisis year 2008 (further only Sweden and Estonia were approaching this level).

[13] Gross fixed capital formation here increased by 39% year-on-year last year to 113.5 CZK bn and in contrast to the central government institutions, it already nearly reached record size from year 2015 (influenced by an accelerated drawing on funds from the EU budgets at the end of the programme period).

[14] Preliminary data regarding the debt and deficit of the government institution sector for the whole year 2018 will be published by Eurostat on 23rd April 2019.