8. State Budget

State budget slumped to the deepest deficit in the contemporary history in Q2.

State budget (SR)[1] ended in considerable deficit of 195.2 CZK bn for H1 2020. Compared to the so far record half yearly value from year 2010, which already for the most part reflected the impacts of the deep economic recession, this year´s deficit was more than twice and a half higher. Even though the SB budget struggled with deficits in all months of this year up to now, the May deficit (64 bn) contributed the most to the half yearly result. Impacts of intensive counter pandemic measures were already considerably felt during Q2, both on the revenue and outlay side of the budget. It inevitably brought the need for fundamental revision of the originally approved yearly budget deficit[2].

Downturn of economic activity together with measures to strengthen the liquidity of firms led to 12.6% decrease of state-wide tax collection.

Total revenues of the SB fell by 5.9% year-on-year in H1, resp. by 44 CZK bn. Within H1, it presented the first decrease since year 2017, which was however influenced by the slump of the European subsidies, which occurred at the onset of new programme period at that time. The tax revenues of the SB itself lastly fell year-on-year in H1 2012. Depth of the downturn of economic activity also proves the decrease of state-wide tax collection (at the level of all public budgets) in the first this year's half, which was 12.6%, resp. 65 CZK bn (without insurance on social security). While the collection fell „only" by 10.2% in H1 2009. This year's collection however included the significant effect of measures on the strengthening of liquidity of firms affected by the slump of sales[3]. Decrease of the total revenues of the SB was dampened by the growing inflow of funds from the EU budget.

Marked deprivation of collection of direct taxes affected negatively the most the total tax collection.

Collection of the corporate tax, which was by one quarter lower year-on-year (it still registered weak growth by 1.6% in Q1), contributed the most to the decrease of half yearly tax SB revenues. Above mentioned tax measures played a major role. Collection of income taxes of natural persons slumped by 18.5% in H1. Its size was affected by the paid out compensation bonuses (especially self-employed – in the size of 21 CZK bn), lengthened deadline of filing the tax returns by tax payers, growth of number of persons drawing care benefits as well as decrease of volume of paid out wages in the economy due to the reduction of employment together with lowering of the growth pace of the average wage.

Lower VAT collection reflected the deeper March and April decrease of retail sales. Decrease of collection nearly halted in June.

From the weight dominant tax – VAT – flew into the SB by 6.1% (resp. by 8.2 CZK bn) less year-on-year in H1. This decrease reflected especially the downturn of retail sales in March and April, since the collection of taxes grew during the first two months of the year. The June VAT collection itself did not significantly lag behind the last year´s level anymore (–1.6%). Half yearly collection was also adversely affected by the deferral of part of payments (in the amount of 5.8 CZK bn), lowering of tax tariff for some items[4] also had an effect. Higher expenditures of the government sector had the opposite influence.

Lower transport performance manifested in 10% decline of collection of tax on mineral oils. Limitations of relations with non-residents also affected the weaker collection of

Total collection of the SB from consumer taxes weakened to 6.5% year-on-year in H1 (resp. nearly 5 CZK bn). Especially the fallout of collection of tax on mineral oils (by 10%) due to the considerable reduction of transport performance (including transit transport) had an effect. More detailed data of the CZSO regarding the consumption of oil products suggest, that the largest downturn occurred during April[5]. The counter pandemic measures also afflicted the weaker collection of other consumer taxes, for example for beer (by 8%), where

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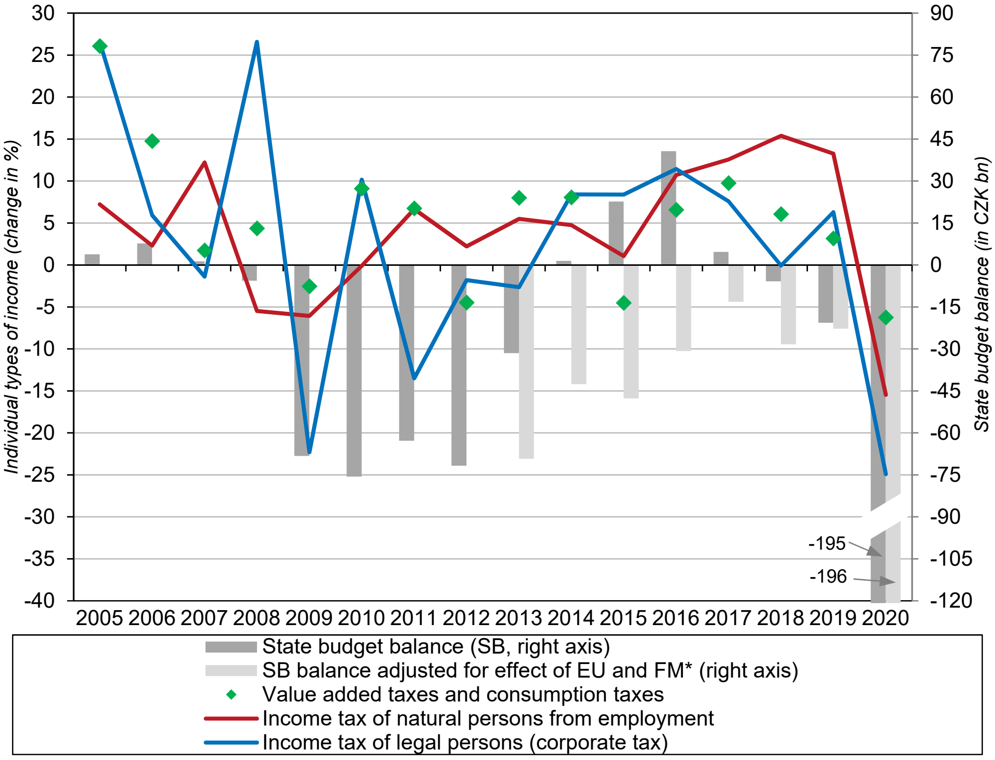
[1] Unless stated otherwise, all data related to the state budget stem from the data of the Ministry of Finance regarding the cash fulfilment.
[2] This deficit in the amount of 40 CZK bn stemmed from Act on the state budget of the CR (approved on 4th December 2019). Acts expecting deepening of the deficit to 200, resp. 300 bn were approved in the course of March and April 2020, deficit 500 bn was approved at the beginning of July.
[3] It was mainly the remission of the June advance payment for both the income tax of natural persons (NP) and legal persons (LP), possibility to lodge the tax returns of NP and LP for year 2019 and its payment only on 18th August, paid out compensations bonuses (especially self-employed) and also longer term for part of VAT payments. According to the MF estimation, the above-mentioned amendments led to decrease of the state-wide tax collection by 53 CZK bn in H1.
[4] It concerned mainly the regular public transport, heat, air conditioning and also food services.
[5] In April, the consumption of diesel decreased by one fifth year-on-year, for petrol even by one third. The May decrease moderated to 9%, resp. 19%, for kerosene however the unprecedented fall further deepened (from 73% to 89%). Even though the consumption of all main oil products grew for the first two months of year 2020 (e.g. diesel +1.8%, petrol +0.4%).

tax on beer or tobacco products.

higher consumption of bottled beer was not adequate to offset lower slump of draught beer or tobacco products, where the collection despite increased tax tariff fell 3% (among other things due to temporary slump of across the border purchases from Germany and Austria). Collection of tax on alcohol, where the effect of tariff growth was hampered by lower consumption, also did not fulfil the budget anticipations, also as a consequence of the dramatic slump of the arrival tourism in the whole Q2.

Chart 16 State wide collection of selected tax incomes (year-on-year in %) **and state budget balance** (in CZK bn, right axis) **in accumulation for H1**



*Balance adjusted for resources on programmes from the EU budget (incl. financial mechanisms), which were pre-financed from the SB and are subsequently reimbursed from the EU and FM budgets. Data available since year 2013.
Source: MF CR

Rate of growth of total SB outlays accelerated. It was driven by higher current outlays as well as investment.

More than one third of current outlays growth was linked to the counter pandemic measures,…

Total SB outlays increased by 17.0% year-on-year in H1, resp. by 130 CZK bn (by +13.0% for Q1). Even though the double-digit growth was recorded also during years 2018 and 2019, this year´s half yearly pace belongs to the highest in the history of independent CR[6]. The achieved rate of growth was more than quadruple compared to the originally approved budget (from the end of year 2019). Mainly current outlays contributed to the growth (+15.5%, +112 bn), more than one third of their addition was attributed to direct SB outlays connected to counter pandemic measures[7]. It was evident the most in the acceleration of non-investment transfers to business entities (+83%, from more than one half driven by the compensation of part of wages to employees within the Antivirus programme), non-investment purchases and associated outlays (+27%, nearly exclusively due to the purchases of protective aids and materials) or current transfers to state funded organizations (+23%, in two thirds due to the partial debt relief to hospitals and strengthening of transfers in the area of cultural activities).

… higher drawing of social benefits, especially non pension

Measures stimulating incomes, resp. household consumption (social benefits, wages in the public sector) remained the dominant source of SB current outlays growth. Current transfers

[6] Within the first half year, the total budget outlays grew the most in the period after year 2000 in year 2008 (by 12.5% year-on-year), when they were however accompanied by high inflation (year-on-year growth of consumer prices was 6.3% for the whole year 2008).
[7] For H1 2020 it was especially programme Antivirus (13.6 CZK bn), care benefits for employees and self-employed (7.9 bn), purchase of protective aids and other outlays in connection to covid-19 (9.6 bn), debt relief for selected hospitals (6.6 bn) and increase of the state payment per insured person (3.0 bn).

however also contributed similarly.

to regional budgets strengthened by one seventh year-on-year (mainly due to increase of wage resources to employees of primary as well as secondary schools and also in the area of social care). Wage outlays in the central government institutions featured more modest growth (+4.1%, four year minimum). Even though the year-on-year rate of growth of outlays on social benefits increased by 13.3% and strengthened by more than one half compared to the last year, proportion of benefits on all SB outlays decreased already third year in a row (to record 37.9%). For the first time after year 2014, the growth of social transfers was driven primarily by non-pension benefits, which expanded by one third year-on-year (to 86 CZK bn). Paid out benefits of sickness insurance accelerated (+10.2 bn)[8], which was the result from two thirds of the payment of care benefits provided for the reason of closing schools and other institutions. The increase of total morbidity however also had an effect (particularly due to the cancelled grace period), drawing of parental benefits was also slightly higher. State social care expenditures strengthened by one third (+6.6 bn), nearly exclusively due to the effect of legal increase of the parental allowance. Long term growing care allowance also accelerated (by one fifth, resp. 2.9 bn). The state expended more on the unemployment benefits for second year in a row. Even though the levels of registered job applicants have not expanded so far[9], the volume of paid out benefits increased by 0.9 bn, resp. by one fifth compared to last year´s H1 (the most after year 2009)[10]. On the other hand, the total financial situation of households has not markedly worsened so far also thanks to the extraordinary public transfers. It is also proved by the six years lasting year-on-year decrease of the volume of paid out benefits of material deprivation assistance (by 61% in total, by 2% this year)[11] or decrease of paid out child allowances.

Swift growth of outlays on wages in both education and social care continued.

Total financial situation of households has not markedly worsened also thanks to the extraordinary public transfers so far.

Revenues of the pension insurance fell for the first time after year 2013. Pension account deficit reached six year maximum.

Year-on-year growth of expenditures on pension attained 8.0% in H1 and only slightly lagged behind the last year´s pace (8.8%), which however was the highest after year 2009. Given the stagnation of the total number of persons receiving pensions (including old age pensioners) the effect of legislative amendments became fully evident[12]. Revenues of the pension insurance went down (by 1.1%) for the first time after year 2013. It was the consequence of worsened situation on the labour market (lowering of employment as well as number of hours worked, slowdown of growth of average wages), but also the budget measures aimed at the support of small businesses[13]. Pension account balance[14] thus returned to deficit after two surplus years. It amounted to 12 CZK bn in Q1, which presented the worst result in the last six years.

Investment growth from the SB further accelerated, mainly thanks to higher outlays on transport infrastructure.

With the approaching end of the current programme period of the EU, the drawing of European funds gradually accelerates in the CR. Total capital outlays of the SB were 64.5 CZK bn in H1 and increased by two fifths, resp. 18.7 CZK bn in H1. Mostly investment from national resources (+13.7 bn) shared in this growth, which was associated with higher outlays on transport infrastructure. Still the funds on common programmes of the CR and EU (35.5 bn) formed predominant part in the total volume of investment. Proportion of investment on all SB outlays was expanding third year in a row and reached 7.2%, which was the most in the last five years. Net position of the CR towards the EU budget was +50.1 CZK bn in H1 and doubled

[8] It had adverse effect on the considerable year-on-year deepening of the sickness insurance deficit (from –1.5 CZK bn to –13.0 CZK bn). It was even larger than for pension insurance for H1 2020.
[9] The ratio of unemployed applicants (on population in the productive age) was 3.7% at the end of June and it rose by 1.1 p.p. year-on-year. Number of applicants entitled to unemployment benefits expanded from 68 to 93 thousand, their proportion on all unemployed remained the same for the last two years (35%).
[10] It was the effect of development mainly in May and June 2020, when the volume of unemployment benefits enlarged by 47%, resp. 71% year-on-year.
[11] The development in Q1 2020 stood behind the favourable result (–11%), the volume of claimed benefits already increased year-on-year in Q2 (+7%).
[12] Basic pension assessment increased by 220 CZK (3 490 CZK), percentage assessment increased by 5.2% and an additional amount of 151 CZK. Based on the CSSA data, the average monthly old age pension (alone) was 14 427 CZK in Q2, by 1 019 more year-on-year.
[13] It was related to the cancellation of minimal advance deposit for self-employed on social security insurance with the estimated budget impact in the amount of 4.8 CZK bn (based on the MF).
[14] It is expressed as the difference between revenues and expenditures on pensions from the SB. Expenditures on administration of the pension insurance system are not included in the expenditures (they arrived at 6.3 CZK bn based on the MF data in 2019).

Positive balance of the CR towards the EU budget doubled year-on-year.

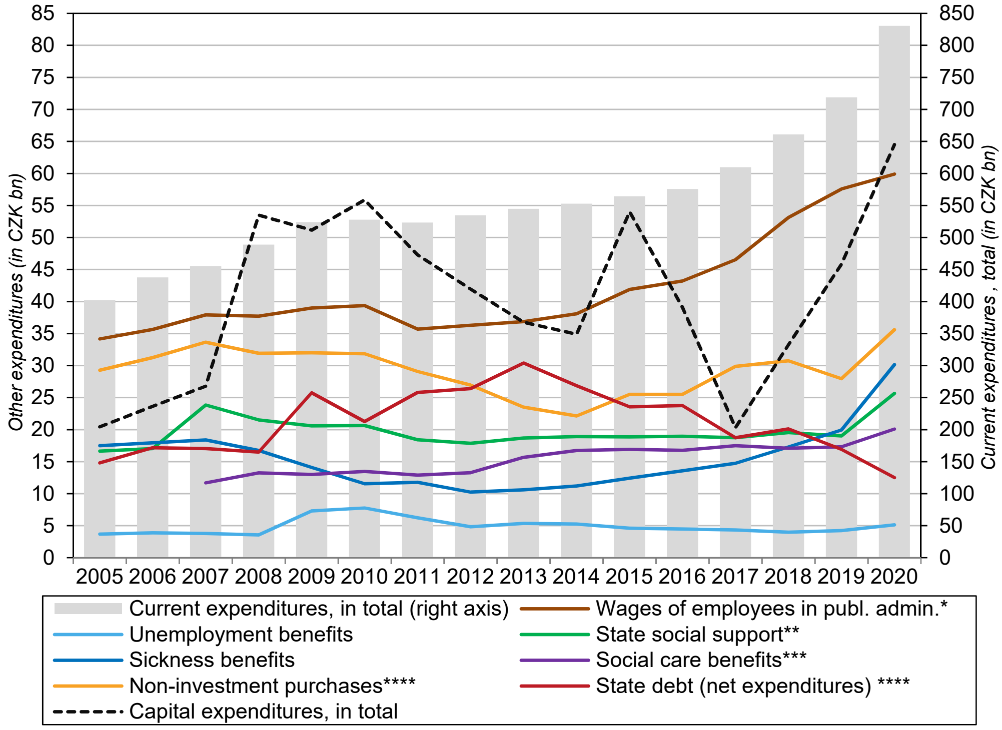
year-on-year. It was mainly thanks to the inflow of funds from the structural funds (+21.7 bn) as well as the cohesion funds (+5.1 bn). On the contrary, direct payments in agriculture, which formed one quarter of total revenues from the EU this year (from 82.1 bn), flowed undisturbed.

Size of the state debt accelerated during H1. Volume of issued state bonds overtook half a trillion CZK.

Value of the state debt accelerated in Q2 2020. At its end, its value was 2 157 CZK bn, quarter-on-quarter increase then 384 bn. The debt expanded by one quarter year-on-year and neared the record pace from Q3 of the crisis year 2009. To cover this year´s exceptional SB deficit, planned debt instalments (concentrated especially to the second half of year 2020) as well as strengthening liquid reserves, a record volume of state bonds (533 CZK bn)[15] was issued during H1. Similarly to the previous years, the borrowing activity was limited to the domestic market. Koruna value of the external debt thus further shrank (by 7% year-on-year). At the end of June 2020, the external debt constituted already less than one tenth of the total state debt (minimum in the last sixteen years). Financial institutions with 61% share remain the key holder of the domestic state bonds, non-residents owned 35% of bonds. In Q2 2020, position of financial institutions strengthened, and the weight of non-residents was one of the weakest since the end of year 2016 (when the CNB forex interventions were still in place). Net SB outlays to service the state debt[16] were 12.5 CZK bn in H1 and decreased by one quarter year-on-year.

Among holders of domestic bonds, the weight of financial institutions increased to the detriment of non-residents.

Chart 17 Selected expenditures of the state budget in accumulation for H1 (in CZK bn)



*Covers expenditures on salaries in central government institutions. Does not include e.g. wage costs of regional education.
**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.
****Contains mainly expenditures on purchase of services, materials, energies or other services (e.g. expenditures on repairs and maintenance).
*****Corresponds to the balance of the budget chapter State debt.
Source: MF CR, MLS

Indebtedness rate of the government institution sector so far increased only slowly compared to

Consolidated debt of the government institution sector was 1 894 CZK bn at the end of Q1 2020[17] based on the CZSO data. It strengthened by 3.2% year-on-year, and in comparison to the end of the last year even by 8.9%. More significant quarter-on-quarter growth of debt at the

[15] Their average annual yield was 1.15%, average maturity then 5.5 years.
[16] Corresponds to the balance of the budget chapter State debt (no.396). It consists of net interest outlays and also fees.
[17] Preliminary data regarding the debt and deficit of the sector of government institutions for Q2 2020 will be published by CZSO on 5th October, by Eurostat at the end of October 2020.

the long-term minimum from the end of year 2019. Budget balance however already deepened more.

year beginning was however apparent also in the previous three years. Indebtedness rate equalled 32.8% of GDP in Q1 and since the end of the last year, when it arrived at ten year minimum, increased by 2.6 p.p. Even though the domestic economy was only on the threshold of recession in Q1, budget deficit of government institutions already tested a boundary of 2% of GDP, which was the worst result since the end of 2014. It was connected with a fact, that a year-on-year decrease of total revenues of the sector (by 1.5%) occurred after more than three years due to the weaker collection of weight significant taxes. Dynamics of total outlays however remained high (+9.8%).

Budget deficit of government institutions in the EU countries increased to -2.3% of GDP at the beginning of the year.

Quarter-on-quarter growth of the indebtedness rate reached ten year maximum in the EU in Q1. Worse position of states with fast outbreak of the covid-19 infection had an effect among other things.

Worsening of the condition of public finances was apparent in the vast majority of the EU states. Seasonally adjusted budget balance decreased by 1.6 p.p. to –2.3% of GDP quarter-on-quarter in Q1 2020, that is to the lowest level since the end of year 2014. Only Germany, Netherlands and Luxembourg kept a mild surplus (up to 1% of GDP) from the monitored countries[18]. Total nominal revenues of the government sector shrank year-on-year in half of the Union states. For outlays it concerned only Cyprus and their growth rate even strengthened in the half of states compared to the beginning of the last year (especially in countries of central and eastern Europe). The indebtedness rate in the EU continued in the descending tendency despite slowing growth of the economy for the most part of the last year. Turning point occurred already at the end of year 2020, when the indebtedness strengthened by 1.8 p.p. quarter-on-quarter (the most after year 2010) to the level of 79.5% of GDP. Negative development was more evident in the euro area countries (+2.2 p.p.), however 90% of Union states experienced at least a mild worsening. The indebtedness increased in 10 countries year-on-year – the most in Finland (+4.7 p.p.) and Romania (+3.6 p.p.), states strongly afflicted by the coronavirus epidemic (Spain, Italy, France, Belgium) were also included. In the CR, similarly to majority of its neighbours, the indebtedness mildly decreased. The CR thus held position of the fourth least indebted Union economy.

[18] It concerns 21 countries providing seasonally adjusted data. Non adjusted data suggest that only four states achieved surplus. The balance worsened in the whole EU (apart from Cyprus) compared to Q1 2019. Belgium, Italy, Malta, Romania and France had the deepest deficit (over 9% of GDP) this year.