

8. State Budget

State budget was staying in surplus within H1 already for the fourth time in a row, its size was however lower year-on-year.

The marked decline of income flowing from the European funds anticipated by budget was only partially offset by growing tax revenues.

Year-on-year rate of growth of the VAT collection accelerated during the first six months of year 2017.

State budget (SB) was most influenced by the strengthening economic growth together with the irregular cycle of the drawing of resources from the European funds in the course of the first half of the year. The SB achieved a moderate surplus of 4.6 CZK bn in H1 2017 (based on the data of the Ministry of Finance on cash fulfilment). The positive balance was in this period attained already for the fourth time in a row, this year's result was however at the same time the weakest after year 2014. The narrowing surplus mirrored the effect of the notable irregularities in the flows of the resources from the EU budget¹. Revenues of the SB from the EU were by nearly 60% lower this year. This slump was connected with the fact, that the vast majority of the last year's revenues was still linked to the programme period 2007 till 2013 and also with the slow last as well as this year's onset of the drawing of funds in the new programme period. The favourable economic development further stimulated the growth of the total tax revenues, whose state-wide collection thus accelerated to 8.7% (the best result in the first half of the year after year 2005). The SB balance forming the key component of the deficit or surplus of the government institution sector arrived at +0.2% in relation to the nominal GDP (+1.7% a year ago).

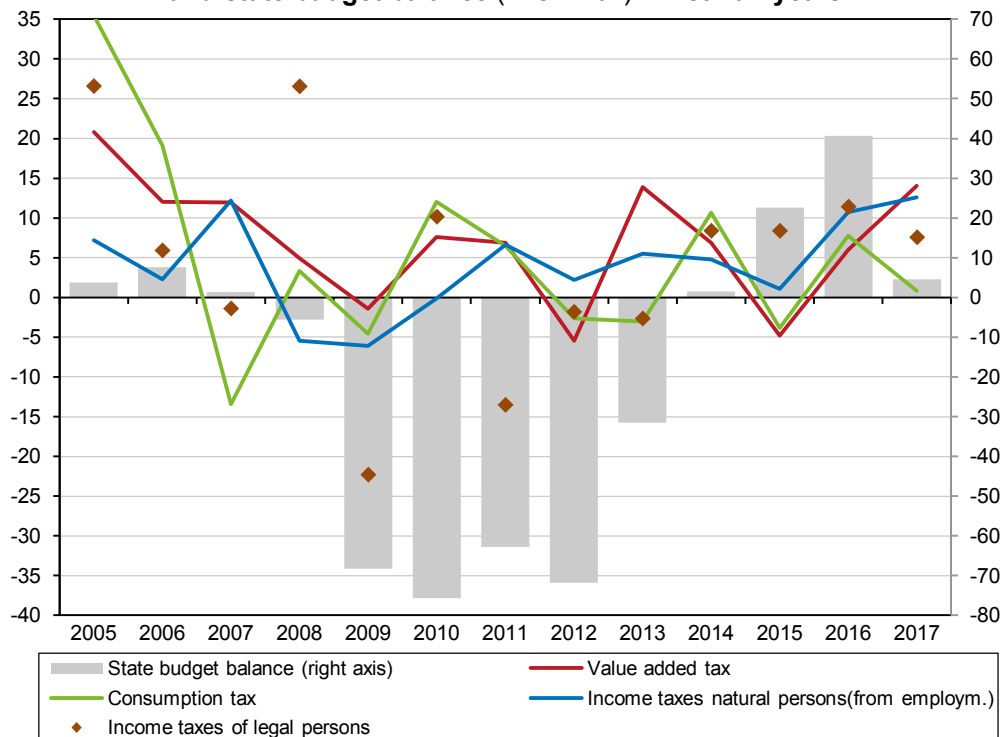
The rate of growth of the state-wide collection of the weight dominant tax – VAT – more than doubled year-on-year – to 14.1% (it increased by 13.1% at the level of the SB)² primarily due to the pace acceleration in Q2 2017. The recent transfer of some activities from the grey economy due to the effect of the recent measures, introduced on the side of the tax collection, likely also partially contributed to this result. The long term favourable development of the economy, which was manifested also by the swift growth of final consumption expenditure in H1 (in nominal terms by 6.1% for households, by 5.5% for the government institutions³) had also positive effect. This year's growth of the VAT collection is also affected by the fact, that its last year's collection (in contrast to other taxes important by volume) did not tightly fulfil the budget anticipations. On the contrary the lowering of the VAT rate for the food service activities as well as for newspapers and magazines had a partial negative impact on this year's collection of the tax.

¹ According to the calculations of the MF, the SB adjusted on both income and expenditure side for the resources from the EU budget (and financial mechanisms) ended in deficit of 13.2 CZK bn this year (such adjusted result would represent a deficit of 30.8 bn in H1 2016).

² The proportion of the SB on the state-wide VAT revenue fell from 70.25% to 69.68% due to the change of the budget appropriations of taxes starting 1. 1. 2017. Reciprocally, the percentage share of the tax revenue – from the tax returns on income taxes of natural persons was amended, specifically for the benefit of the SB.

³ Data are not adjusted for the seasonal and calendar effects. There were 4 working days less both year-on-year and quarter-on-quarter in Q2 itself. The year-on-year rate of growth of the total nominal final consumption expenditure stagnated during the first half of year 2017 (6.0% in Q1, 5.9% in Q2), after the adjustment it on the contrary increased (it was 5.4% in Q1, 6.4% in Q2).

Chart 20 State wide collection of tax income (year-on-year in %) and state budget balance (in CZK bn) in 1st half-years



Source: MF CR

The mild growth of the collection of the consumption taxes was affected by short term lowering of the collection of tax on tobacco products in the first half of the year.

The growth of the collection of all consumption taxes (against the rates from year 2016) was slowing down this year. The SB acquired by 2.3% more year-on-year in Q1, the revenue in effect stagnated in Q2. This development was mainly affected by the drop of collection of taxes on the tobacco products (by 2.4% in H1). The administrative influences having a short term negative effect⁴ thus exceeded the impact of the increase of rates of the consumption tax on tobacco products⁵. On the contrary, the collection of the weight dominant consumption tax – on mineral oils – has been so far fulfilling this year’s budget anticipations. It was higher by 2.5% compared to H1 2016, it was driven mostly by the higher consumption of the diesel fuel and jet fuel. The introduction of the so called green fuel also into the animal primary production had the opposite negative effect.

Growth of the collection of the corporate taxes lagged behind the last year’s record pace. Rising wage costs were still more reflected in the growing costs of wages.

Even though the state-wide collection of corporate tax increased by brisk 7.6% in H1, it presented the weakest result in the last four years. The slightly falling profitability of businesses from years 2016 (and partially also 2017) due to the growing wage costs already starts to be reflected in this year’s collection⁶. The year-on-year rate of growth of the collection of income tax of natural persons (ITNP) from dependent activity kept further quickening and it strengthened by 12.6% for the whole half year. It thus tightly overtook the up-to-date record growth from the first half of year 2007. The collection was positively affected by the favourable situation on the labour market (high growth of employment, raising of average wages both in the business sector and the activities with the dominance of state) as well as the administrative measures of the state (repeated growth of the minimum wage limit, instruments to limit the grey economy). The state-wide collection of the ITNP from the self-employment activity was also more favourable year-on-year this year, it reflected not only the financial situation of the small entrepreneurs, but also their increasing number. On the contrary, the collection of ITNP from the capital revenues reduced by nearly 4%. The weaker rates among other things reflected also the

On the contrary the collection of the income tax of natural persons from employment further gained pace, since it benefited from the favourable situation on the labour market.

⁴ The taxes for cigarettes with old covers, which had to be withdrawn from the circulation, were returned. The withdrawal of cigarettes was connected to the introduction of new products burdened by a higher tax rate and containing more thorough health warning.

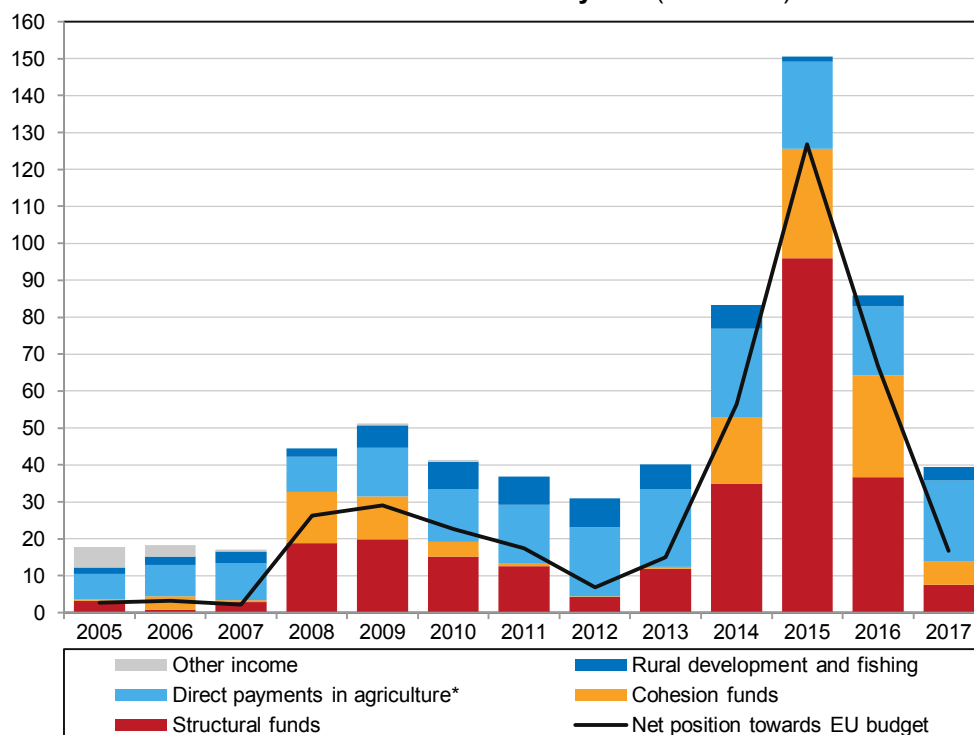
⁵ The effect of the increased rates for the first eight months of year 2017 was already stronger and the collection of taxes on tobacco products was already by 0.8% higher year-on-year.

⁶ This fact is even more supported by the data from the first eight months of the year (which already take fully into consideration the payments of all large taxpayers for year 2016), when the year-on-year increase of the corporate tax collection lowered below 2%.



prevailing low interest rates on deposits. The tax exemption for the retirement entitlement of the defence forces also had a negative effect.

Chart 21 **Structure of the CR income from the EU budget and net position of the CR towards EU in 1st half-years (in CZK bn)**



*Includes also the market operations and veterinary measures.

Source: MF CR

High growth rates of total tax revenues markedly exceeded the budget anticipations and contrasted with low revenues from the EU budget.

All SB tax revenues (including social security insurance) grew by 8.2% in the first half of the year and significantly overtook the annual budget anticipations (3.9%). In contrast the total SB revenues were by nearly 21 bn lower compared to H1 2016 and their rate of growth (-3.2%) slightly lagged behind the budget anticipations so far. This result was influenced by strong fall of the revenues from the EU sources. The CR acquired in total 39.5 CZK bn⁷ from the EU budget in H1 2017. It presented only one quarter of the amount from the first half of year 2015, when the drawing of the funds from the EU budget reached the peak. Apart from the volume of finances, their structure also changed. Especially the break of the more project demanding structural actions (e.g. transportation constructions financed from the structural funds) stood behind the weaker drawing at the beginning of the new programme period. On the contrary, the volume of the direct payments in agriculture did not practically change in the last five years (it even slightly rose against H1 2016).

Low drawing of investment continued during 2017.

Total SB outlays strengthened by 2.5% year-on-year from January till June 2017. The growth of the current outlays (5.9%) was in contrast to the slump of investment (by 48%) in accordance with the budget anticipations. The capital expenditure only negligibly crossed 20 CZK bn. Nearly one half of that headed to the financing of the common CR and EU programmes (all expenditure, i.e. the non-investment as well on these projects arrived at 34 bn, by 16 bn less year-on-year). The drawing of investment did not improve much even during the summer holidays⁸. The share of investment on all SB expenditure lowered to 3.2% (the lowest value after year 2000).

Especially the higher social benefits and expenditure on wages to public sector employees contributed to the growth

Mainly the weight dominant item of the social benefits (+13.5 bn) was behind the higher current expenditure (+34 CZK bn) in H1. The non-investment outlays to the business subjects also notably contributed, they were nearly by one third higher year-on-year. The expenditure on the salaries of state employees rose by 7.6% (it

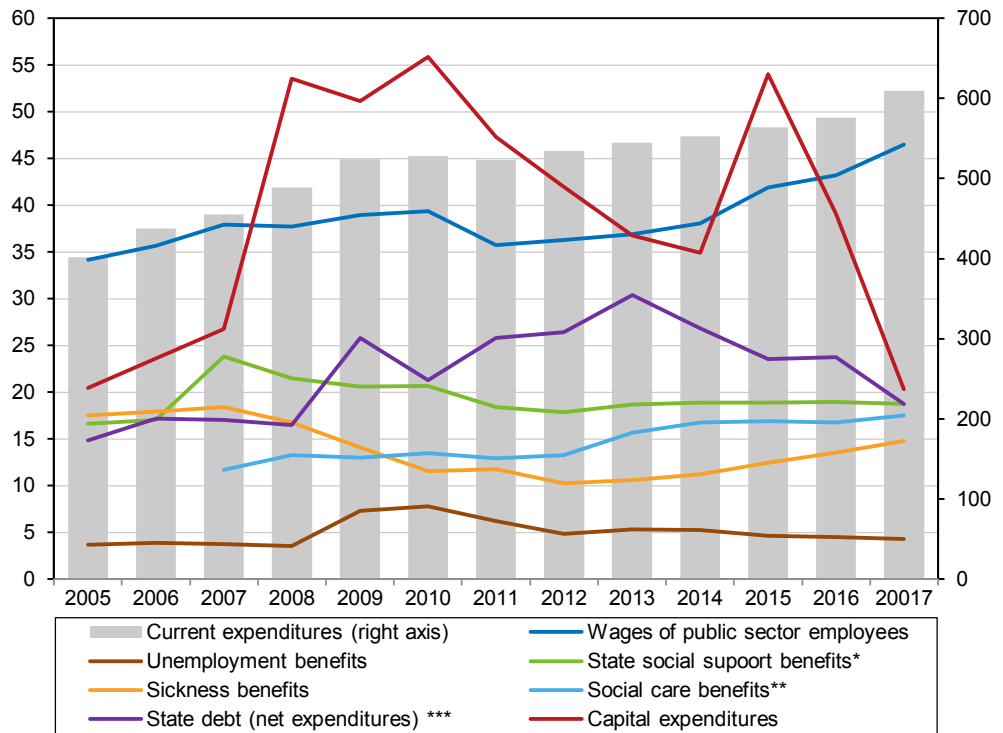
⁷ According to the more detailed data published by the MF CR at the beginning of August 2017.

⁸ Total capital expenditure of the SB attained 34.4 CZK bn since January till August 2017, it comprised nearly one third of the yearly value anticipated by the budget. Expenditure to cover the common programmes of the CR and the EU from the programme period 2014-2020 mildly increased to 16.6 CZK bn.

of the current expenditure.

was a higher pace compared both to the previous year and Q1 2017). The growth of earnings of employees in the regional education manifested in the higher non-investment transfers to the public budgets on the regional level (+9.1%, +4.6% for the whole last year). Less funds were on the contrary expended on the non-investment transfers to state funds (-5.5 bn). The more long-term trend of the reduction of net expenditure on state debt further continued (5 bn).

Chart 22 Selected state budget expenditures in 1st half-years (in CZK bn)



* including the foster care benefits

** Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits (based on Act on State Social Support)

***Net expenditures also include the income of the chapter State debt.

Source: MF CR, MLSA

The increase of the total social benefit expenditure was primarily impacted by the resources on pension. These grew the most dynamically within the last six years in the first half year.

Year-on-year rate of growth of the expenditure on social benefits increased already for the fourth time in a row within H1 and achieved 5.3% in year 2017. It was driven mainly by the weight dominant expenditure on pensions (+6.0%), since the new legislation, which enables to increase pensions above the framework of the standard adjustment was utilised. 2.89 million persons were receiving the pensions from the state at the end of June. Their number stagnated year-on-year (slight growth of the number of paid out pensions by 0.7% was offset by the reduction in all other pension categories). Even though the growth of expenditure on pensions was the highest in the last six years this year, the pension account deficit⁹ was further reduced (down to 6.8 CZK bn in H1 2017). The strengthening growth of the insurance collection, whose pace (+7.3%) approached the values from the peak of the business cycle in the preceding decade, had a positive effect.

The growth of the sickness benefits insurance continued, the social care benefits strengthened via the legislative amendment.

Expenditure on other social benefits (apart from pensions) was by 3.0% higher. Their year-on-year rate of growth was growing already second year in a row. Higher expenditure on sickness insurance benefits stood behind this result (already for the fifth time in a row, by 4.5 bn more in total) due to the growing sickness rate, but also higher drawing of the maternity benefits. The assistance to care to persons in long-term sickness also grew by 1.5 CZK bn (as a result of 10% across-the-board adjustment in August 2016). The growth of the foster care benefits also continued in growth by a milder pace. The state paid out less on the unemployment benefits (-3.4%), which were paid out to one quarter of all registered job applicants. Improved financial situation of households was reflected in the lower volume of paid out benefits of the state social support (-1.5%) and especially in the deepening of the fall of the

The more favourable financial situation of households was reflected in the reduction of volume of the material

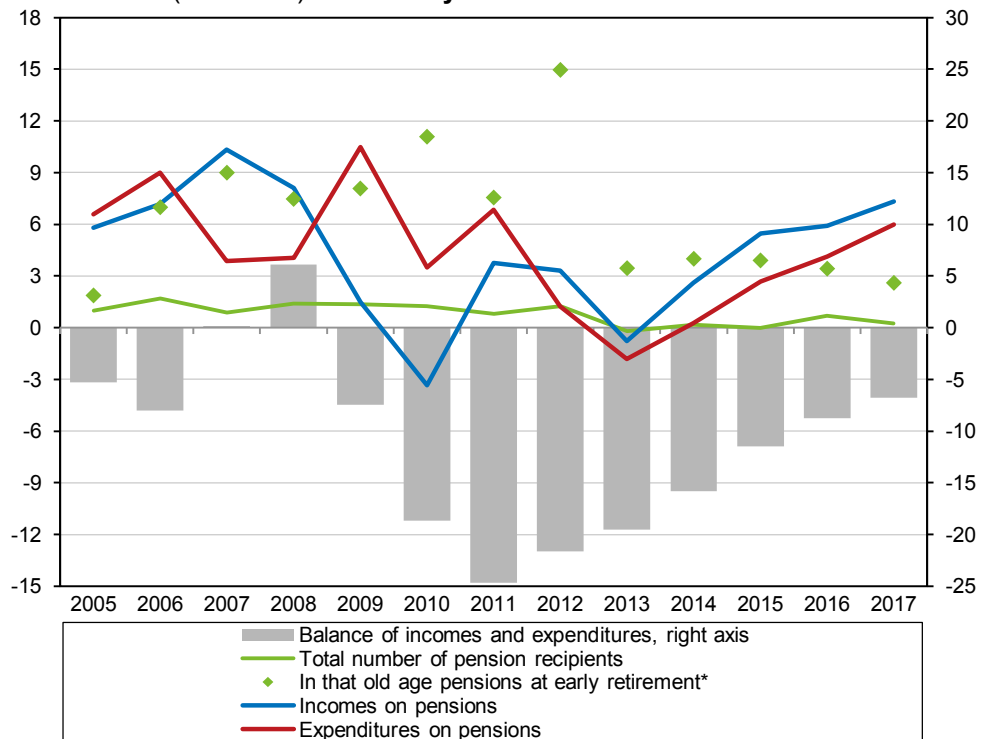
⁹ It is expressed as the difference between revenues and expenditure on the pensions from the SB (based on preliminary data).



deprivation assistance benefits as well as the state social support.

expenditure on material deprivation assistance benefits (to -17%, the drop amounted to 30% in the last three years).

Chart 23 Pension recipients, income and expenditure on pensions from the state budget (year-on-year in %) and pension account balance (in CZK bn) in 1st half-years



* Old age pension income awarded before the pension age is reached and shortened for the earliness is for the whole time period of the drawing the benefit. Source: MF CR, CSSA

The size of the state debt stabilised following the one-off increase in Q1 in the subsequent months.

The state debt reached the so far record size of 1 789 CZK bn at the end of June. The more significant growth of the indebtedness (by 10.9%) occurred during Q1, its level stabilised in the next quarter. Sharp increase of the debt was associated to the large volume of issued medium and long-term state bonds (LSB), aimed to cover the LSB repayments, that is expected in the remaining part of this year. More intensive issue of government treasury bills realised for the reasons of utilisation of negative yields manifested throughout the whole half-year¹⁰. These operations led to the growth of the internal indebtedness. In contrast the crown value of the external debt slightly shrank since the beginning of the year (by 2.6%). The share of the external debt fell below 15% for the first time since the beginning of year 2008. The inflow of the speculative capital into the CR in connection with the expected exit from the regime of forex interventions peaked in the first third of the year. It was also evidenced by the strong growth of the volume of the Czech bonds held by foreign investors. While they owned crown bonds worth 424 CZK bn at the end of year 2016, it was already 718 CZK bn at the end of this year's April (47% of the value of all crown bonds). This volume in effect did not change in the course of Q2.

The proportion of foreign investors on the total possession of the Czech state bonds still remained high.

Relative indebtedness of government institutions in the CR did not attain even one half of the EU level despite the increase in Q1.

The debt of the whole sector of the government institutions (reflecting also the budget of the regional municipalities or health insurance companies) attained according to the up-to-date data of the CZSO the amount of 1 925 CZK bn at the end of Q1 2017¹¹ and it was 39.9% in relation to the GDP. The absolute size of debt increased by 9.7% during the first months of year 2017. It presented the largest quarter-on-quarter addition since year 2010, when the impact of the economic recession fully took effect. Nevertheless, this year's debt enlargement was connected to the specific situation on the bond market reflecting the expectation of the nearing end of the forex intervention

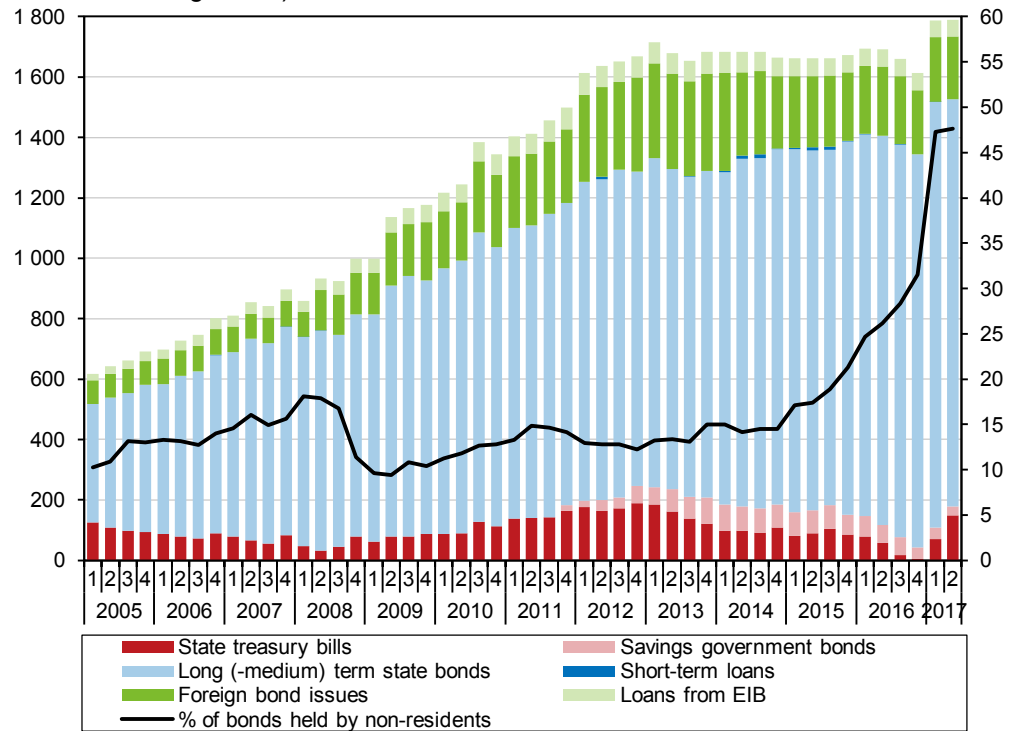
¹⁰ The proportion of the short-term debt increased due to these operations. The share of the value of bonds with maturity within 18 months on all bonds arrived at more than 30% at the end of June 2017, by 5 p. p. less a year ago.

¹¹ The CZSO publish the preliminary data regarding to debt and deficit of the government institutions sector for Q2 2017 on 4th October 2017, Eurostat then on 24th October 2017.

The position of the most indebted countries of the Union did not improve in the last year.

regime. The central government institutions nearly exclusively participated on the growth of the debt, since the indebtedness of the local government institutions lowered both year-on-year and quarter-on-quarter. The CR was the eight relatively the least indebted country at the end of Q1 (only Estonia, Luxembourg and Bulgaria had a notably lower debt than the CR) and in spite of mild worsening of the position at the beginning of the year its indebtedness did not reach even half the level of the EU (84.1%). The indebtedness of the EU shrank year-on-year only by 0.2 p. p., since the situation did not improve in the most hit countries.

Chart 24 **Structure of the CR state debt (balance at the end of quarter, in CZK bn) and share of CZK bonds held by non-residents (in %, right axis)**



Source: MF CR

