

8. State Budget

State budget balance dived thanks to the weaker balance in Q2 into a mild deficit. Half yearly balance was the weakest in the last five years.

The state budget (SB)¹ finished with mild deficit in the amount of 5.9 CZK bn² in the first half of this year. The budget balance sank into the deficits within the frame of this part of the year for the first time in the last five years. Traditionally it was caused by the weaker balance of the budget during Q2, since the SB achieved surplus (16.3 bn) for the first three months of the year. In spite of slowing down, the economic growth as well as the significantly uneven drawing of resources from the European funds (even though it bounced this year in a smaller extent compared to the previous four years) had the key effect on the budget of the state³. Acceleration of the current SB outlays also had an effect, when they rose by 8.4% already, the strongest year-on-year pace in the last twelve years. The SB balance, comprising the key component of the deficit or surplus of the budget of the government institutions sector, amounted in relation to the nominal GDP to -0.2% in H1.

Rate of growth of the state-wide collection of all tax receipts slowed down this year compared to strong years 2016 as well as 2017.

Higher collection of taxes, but in contrast to the last year also the growth of the non-tax revenues driven by the more intensive inflow of the resources from the EU contributed to the strengthening of the half-yearly receipts of the SB (by 8.5% year-on-year). It did not present the consequence of the accelerated drawing of European funds in the preceding months, but the finishing payments related to the already completed programme period⁴. State wide collection of tax receipts documenting the effect of the condition of the economy as well as the efficiency of the collection of taxes, strengthened year-on-year (excl. insurance) by 6.2% (however it exceeded the 9% boundary in the first half of both years 2016 and 2017). The high last year basis contained the effect of not only the culminating expansion, but likely also the impact of the control measures introduced on the side of the tax collection. Higher collection of taxes was driven mainly by the collection of value added tax (VAT) and the income tax of natural persons from employment this year.

Following the gradual evaporation of the exceptional growth factors, the development of the VAT collection again started to move closer to the development of final consumption expenditure.

State wide collection of the volume dominant tax (VAT) increased by 8.2% (at the level of the SB only by 4.9%)⁵. It considerably relaxed the pace from the record observed in H1 2017 (14.2%). The effect of the non-standardly high basis⁶ however gradually evaporated during Q2 2018 and the dynamics of the VAT collection more notably moved closer to the development of the final consumption expenditure of households or government institutions. Total growth of the collection of consumption taxes remained tightly below 1% this year (similarly to last year's H1). Moderate growth of the collection of weight dominant consumption tax on mineral oils (by 1.8%) was offset by smaller, but anticipated by the budget loss of income from taxes on tobacco products (-1.1%)⁷.

Collection of key

¹ Unless stated otherwise, all data related to the state budget are sourced from the data of the Ministry of Finance on the cash fulfilment.

² Some irregular transfers were also impacting the size of the balance. It was especially this year's expenditure on the replenishment of the EGAP insurance funds (4.3 bn) and last year's transfer of 5.8 CZK bn from the privatization accounts to cover the pension account deficit (SB did not perform this receipt this year).

³ According to the calculations of the MF CR, the SB balance adjusted on both income and expenditure side for the resources on programmes from the EU budget and Financial mechanisms (EEA and the Norway Grants, Swiss – Czech Cooperation Programme) arrived at -28.8 CZK bn in H1 2018 (-13.2 bn the year before).

⁴ It concerns the collection in the amount of nearly 20 CZK bn in the first two months of the year, which was the part of the final payments related to the programme period of 2007–2013. Without this extraordinary payment, the volume of resources received from the EU budget (incl. FM) would be on the contrary by 1 CZK bn lower year-on-year for the whole H1 2018.

⁵ Change of the budget appropriations of taxes came into force in January 2018, which decreased the proportion of the state budget on the statewide VAT collection from 69.68% to 67.5% to the benefit of the share of municipalities.

⁶ It was mainly the introduction of the control reports and electronic registration of sales – especially its second wave (effective since April 2017 for retail, wholesale). The VAT collection thus already in April 2018 collided with the higher comparative basis and its year-on-year growth halted after sixteen months (-2.6%). The VAT growth renewed in the subsequent months, however at weaker rates than at the beginning of year 2018.

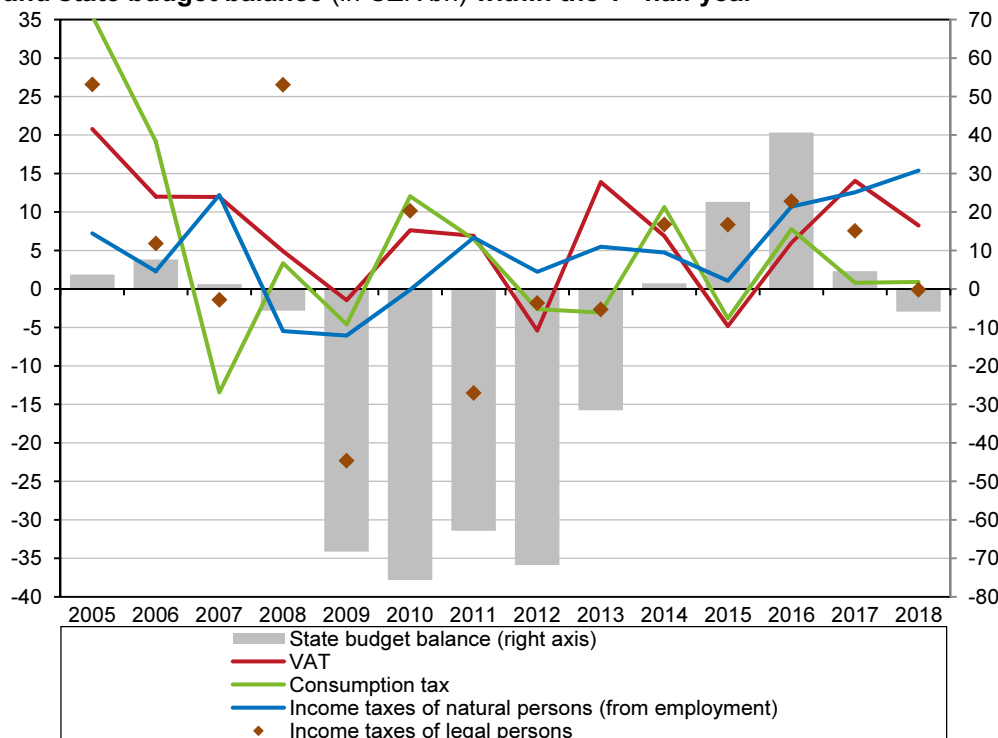
⁷ Mild fall of the collection of this tax is possibly associated with the adoption of the Act on health protection from the harmful effects of drugs (in force since June 2017). Its impact on the limitation of the consumption of cigarettes or shift of consumption to alternative products – e.g. the electronic cigarettes – is so far more significant in budget than the impact of the repeated increase of the rates on tobacco products (in force since January 2018).



components of the consumption tax stayed thanks to the effect of contradictory factors without significant changes.

Administrative and price factors⁸ prevented a more robust growth of the collection of tax on mineral oils (in connection with the effect of the favourable economic development on the rising mobility also supported by the warm weather). While the present this year's collection of the key components of the consumption tax reproduces the budget anticipations, it lags behind it somewhat for the VAT.

Chart 18: State wide collection of selected tax incomes (year-on-year in %) and state budget balance (in CZK bn) within the 1st half year



Source: MF CR

Collection of the corporate tax slowed down to the lowest rate of growth since the end of the last recession.

Volume of the collected corporate tax stagnated year-on-year in H1. Signs of the slowing down, connected to the lower profitability of businesses especially due to the rising wage costs were apparent already during the last year. Since the yearly payment of the tax from the largest payers is evident not only in June, but also in July, it is more suitable to compare the cumulation for the first seven months in the year. In this case, the year-on-year increase of the collection arrived at 2.6% (closer to the budget anticipated dynamics). However, simultaneously it was the weakest in the last five years (resp. since the end of the last recession).

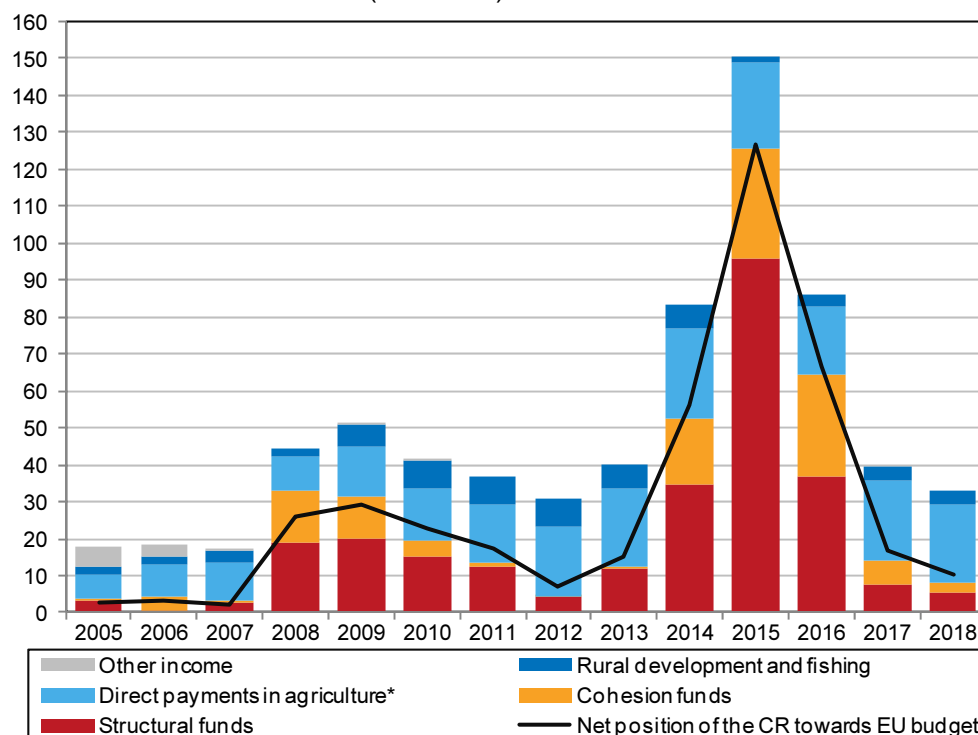
Development on the labour market was favourably mirrored in the collection of ITNP from employment. It rose by record 15.4% year-on-year.

State-wide collection of the income tax of natural persons (ITNP) from employment further strengthened. While it grew by 12.6% in the first half of the last year, it was already by 15.4% this year (year-on-year rates of growth were the same in both quarters of this year). Similar rate of growth occurred last time in Q2 of the expansion year 2007. The current collection dynamics contains not only the impact of the record number of employed and the accelerating average wages (due to the market factors also the increase of the minimum wage), but also the state tax policy (increased support for the families with children). Collection of ITNP from self-employment (paid by the payers) remained positive at the end of the half year already third year in a row

⁸ 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 this year (contrary to last 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, the situation was the opposite this year. The average July price of the diesel fuel (32.4 CZK/l) was the highest since July 2015, price of the petrol Natural 95 (33.1 CZK/l) even since December 2014.

(+0.7 CZK bn this year). At the same time however, it was lower by one half year-on-year⁹. The collection lied below the level of the last year also in Q1 (before the yearly income tax return). Despite longer term growth of the economy as well as the mild increase of the number of entrepreneurs, the collection of this tax stays behind the budget anticipation for now. ITNP collection stemming from the capital yields was by nearly one eighth higher year-on-year (although the collection was mildly falling year-on-year in the last year), the positive impact on the SB was nevertheless due to the low weight of this tax practically negligible.

Chart 19: Structure of the CR income from the EU budget and net position of the CR towards EU within H1 (in CZK bn)



* Includes also the market operations and veterinary measures.

Source: MF CR

Growth of the total SB outlays accelerated to a ten-year maximum this year. Current expenditures as well as the faster drawing of resources from the EU budget stood behind it... very low drawing of investment from the SB exclusively on the national projects however persisted.

Rate of year-on-year growth of the total SB expenditure markedly accelerated in H1 (to 10.2%, only 2.5% the year ago) and arrived at the ten-year maximum in this period. Expenditure was strengthening also during the year 2018 (+8.7% in Q1, +11.5% in Q2). Half-yearly growth of the total expenditure was driven primarily by the current outlays, investment however also contributed from one fifth. The decline of investment thus halted after two years. Their this year's volume (33 CZK bn) exceeded the last year's reality by nearly 13 bn (only by 5.5 bn in Q1 itself). The more up-to-date August statistics¹⁰ proves the gradual acceleration of the investment activity of the state. Expenditure on the common programmes of the CR and the EU stood behind this recovery (with the volume of 22.9 bn these were by 13.2 CZK bn higher year-on-year). Despite partial improvement the half-yearly drawing of all SB investment amounted to only 36% of the annual budget amount (expectation). The so far very low drawing of funds for exclusively national projects becomes evident (not related to the EU)¹¹. Proportion of investment on total SB expenditure was 4.8% in H1. Even though it was year-on-year by nearly one third higher,

⁹ With respect to the relatively low volume of this tax, its year-on-year comparison is very susceptible to the changes in the possibilities of the tax deductions (rebates on the second spouse and tax benefits on dependent children).

¹⁰ The volume of capital outlays of the SB reached already 48.4 CZK bn for the eight months (it was higher by 14.1 bn year-on-year). Nearly two thirds of this amount was directed to the financing of the common CR and EU programmes this year (including the common agricultural policy).

¹¹ Only 10 CZK bn from the annual anticipated amount (based on the approved SB) 54 bn was drawn on these purposes in this year's H1.



it presented at the same time the second lowest share in the last fourteen years. The proportion of investment aimed for the 10% boundary in the expansion year 2008.

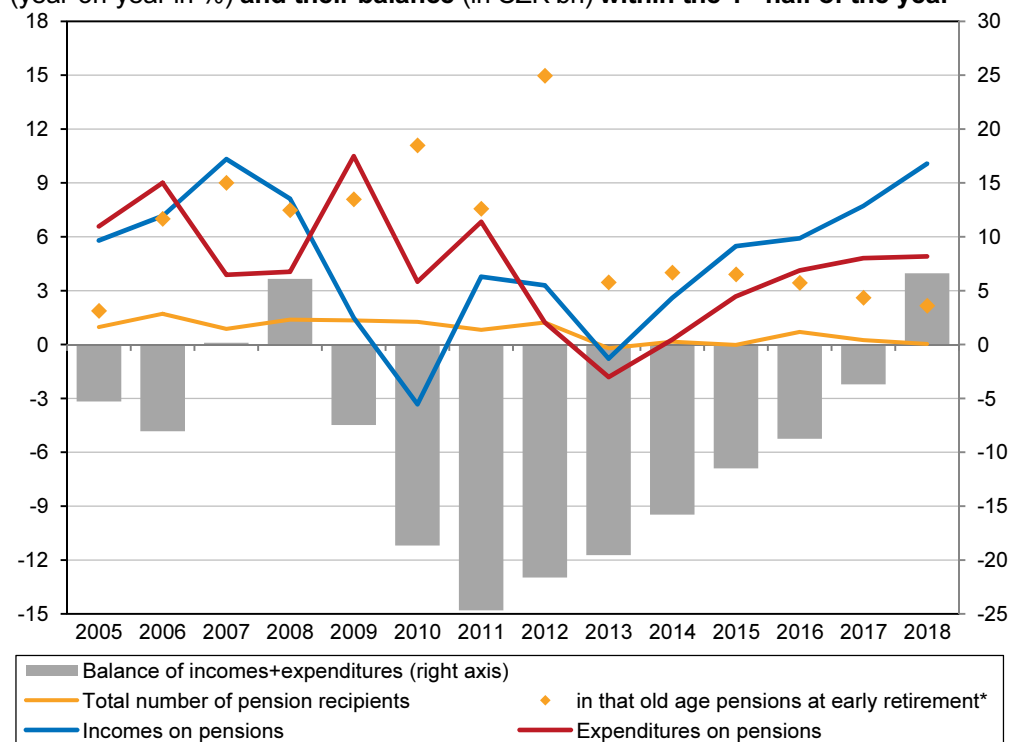
Size of the net position of the CR towards the EU weakened by one third year-on-year due to the slow onset of drawing in the area of structural and cohesion policy.

Total net position of the CR towards the EU also provides the evidence for the slower onset of the drawing of funds from the EU budget in the first third of the programme period. Positive balance of the CR reduced year-on-year by more than one third and amounted to 10.4 CZK bn for the whole H1. Given the comparable volume of half-yearly payments into the EU budget (just below 23 bn), the lower balance resulted exclusively from the weaker receipts. These decreased by one sixth (to 32.9 CZK bn)¹². The structure of receipts suggests, that the flows related to the structural funds and the cohesion fund caused the slower drawing. Payments in the area of the common agricultural policy are on the contrary free from large fluctuations in the past years.

Acceleration of the current SB outlays was for the large part connected to the increase of the wage resources for the public sector employees.

Growth of the current SB outlays was gaining pace already second year in a row. While these outlays were mostly driven by the higher social benefits in the last year's H1 (primarily pensions), non-investment transfers to regional budgets (+15.9 bn., resp. growth by 18.6%)¹³ participated the most on their year-on-year growth this year (+51.4 CZK bn). Expenditure on wages in the central bodies of the state administration increased by one seventh, nearly by double digit pace year-on-year. Higher expenditure was associated primarily with the increase of the wage tariffs.

Chart 20: Pension recipients, income and expenditure on pensions from the SB (year-on-year in %) and their balance (in CZK bn) within the 1st half of the year



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

Expenditures on pensions

Expenditure on social benefits, comprising more than two fifths of the current SB

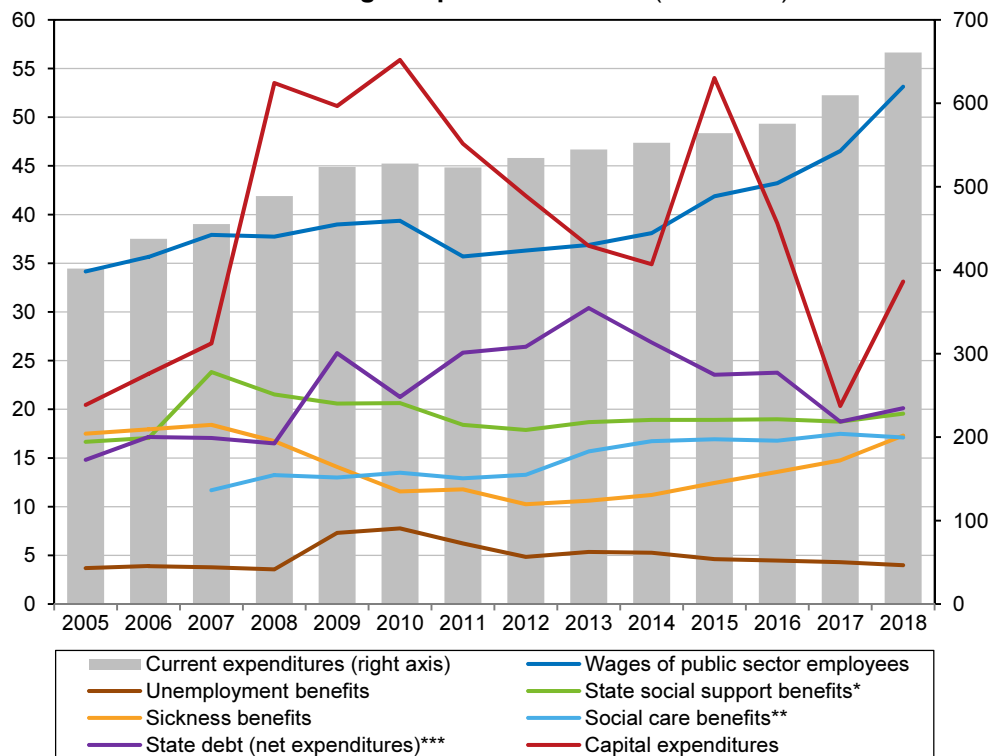
¹² Year-on-year decrease of the total incomes of the CR from the EU is not in contradiction with the above statement regarding this year's partial progress in the drawing of resources from the EU budget. Investment expenditure of the SB on the common CR and EU projects express the volume of all pre-financed funds. These will be only later with a certain lag evident in the total relationship of the CR towards the EU budget (on the income side, in the form of retrospectively refunded resources).

¹³ Subsidies on the direct costs of primary and secondary schools (growth of 10.4 CZK bn) and transfers to municipalities and regions according to the Social Services Act (+5.5 CZK bn). Year-on-year increase was related mostly to the increase of the wage resources.

grew nearly by 5%. Number of persons receiving the pension income stagnated. Rise of the number of recipients of the permanently shortened pension further weakened.

expenditure, increased by 13 CZK bn (by 0.5 bn less on a year ago) year-on-year in H1 2018. More than three quarters of resources on social benefits were directed on pensions, the state exerted by 4.9% more on them. Given the stagnation of the number of persons receiving pension (2.89 mil), the setting of the pension adjustment was completely determinative for the development of the expenditures¹⁴. The average monthly size of the old age pension (solo) according to the CSSA amounted to 13 633 CZK for males and 11 247 CZK for females in this year's Q2. The fact that despite the lengthening of the retirement age, the relative addition of persons with the permanently reduced pension (due to early retirement) weakens already third year in a row, is a positive factor. Given the strengthening universal lack of workers, the chances of employment also for seniors increases and for some of them the possibility of extra earnings becomes attractive as well¹⁵. Favourable situation on the labour market stimulated the growth of the collection of insurance on pensions. Its year-on-year rate of growth climbed already above 10% this year and neared the so far record dynamics from year 2007. Balance of the pension account¹⁶ thus ended in surplus (just below 7 CZK bn) for the first time in the last ten years. State received by 23.5 CZK bn more year-on-year and at the same time it formed the most significant component, which contributed to the growth of the total SB revenues this year.

Chart 21: Selected state budget expenditures in H1 (in CZK bn)



* 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) ***Net outlays also include receipts of the chapter State debt.
Source: MF CR

Growth of expenditure on non-pension social benefits accelerated especially due to higher

The SB expended 62 CZK bn on the other social benefits (apart from pensions) in H1 (by 4.8% more year-on-year, by 2.8% the year ago). If the dynamics of other social benefits was weaker compared to pensions in the preceding three years, their pace practically

¹⁴ 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 monthly).

¹⁵ CZSO data from the household surveys also indirectly prove this. Employment rate of persons aged 65 to 69 years equalled 13.6% in Q1 2018. It increased by precisely 2 p.p. year-on-year, even by 4.6 p.p. in the last four years.

¹⁶ It is expressed as the difference between revenues and expenditure on the pensions from the SB (based on preliminary data).



drawing of the sickness benefits.	aligned this year. The sickness benefits contributed the most to the growth of the expenditures on the non-pension social benefits this year (similarly to the previous three years), whose rate of growth doubled (to 17.4%) compared to last year. It was connected to the continuing growth of the temporary work incapacity as well as the higher average daily sickness benefits (derived from the level of earnings in the previous months). Drawing of the maternity benefits (due to the higher birth rate) as well as this year's introduction of new benefits (long-term care benefits, father post-natal care) had much smaller effect. SB further expended more also on some benefits of the social care – for health disabilities as well as the care benefits (for persons on long-term sickness leave).
Slump of the volume of paid out material deprivation benefits deepened. The size of other benefits paid out in connection to the household incomes also decreased.	The impact of the economic growth on the incomes of households was becoming more evident in the other types of the benefits. Savings were accomplished this year in unemployment benefits (7.4% year-on-year) ¹⁷ as well as the material deprivation benefits (28%, even 50% for four years). The SB spent in total by nearly one tenth less on the state social support benefits, that are paid out in connection to the household income (child allowance, allowance for living). On the other hand, the volume of weight significant parent benefits (+8.1%) expanded, the so far relatively marginal foster care benefits also received by one fifth more year-on-year.
Reduction of net expenditure on state debt did not continue this year any more. The nominal size of debt remained despite partial fluctuations stable.	Decrease of the net expenditures on the state debt (commenced after year 2013) ceased this year. Expenditures in this area crossed 20 CZK bn in H1 (7% rise year-on-year) ¹⁸ . The state debt amounted to 1 713.5 CZK bn at the end of June and it fell by 4.2% against the higher last year basis ¹⁹ . The absolute size of the debt stagnated in comparison to the preceding quarter. State further utilised the favourable conditions in part of the money market and was selling the treasury bills maturing still during this year in the larger extent. Borrowing need of the state continued to be focused exclusively on the domestic market. While the internal debt was thus growing, the CZK value of the external debt sank year-on-year by more than one quarter. The external debt shared on the total indebtedness of the state already by less than one eighth (lower share was last recorded at the end of year 2004). The composition of debt holders also changes. Approximately three quarters of the year lasting outflow of the speculative capital, manifesting in the fall of the volume of debt held by the non-residents, stopped at the beginning of his year's spring period (simultaneously with the exchange rate appreciation of koruna). Since then, the proportion of such held debt slightly grows. In the long term on the contrary, the proportion of the state debt held by the household sector shrinks.
Fall of the proportion of non-residents among the holders of the state debt halted in Q2.	
Despite mild worsening the CR belonged into the group of five least indebted economies within the EU also this year.	Debt of the whole sector of government institutions ²⁰ reached based on the current CZSO data the size 1 832.4 CZK bn at the end of Q1 2018 ²¹ . Nominal size of the debt fell year-on-year (by 4.1%), however it nearly did not change compared to period 2014 to 2015. Next to central government institutions, the local government institutions also participated on the reduction of the absolute size of the debt. This year's rate of indebtedness (35.8% of GDP) ranked the CR among the five best positioned EU countries. Only Estonia, Bulgaria and Luxembourg enjoy markedly more favourable position than the CR in the long-term. Even though the year-on-year decrease of the

¹⁷ 66 thousand unemployed registered with the LO claimed the unemployment benefits in June 2018 (by one eighth less year-on-year). It comprised just fewer than 30% of all job applicants. The average monthly size of the unemployment support was 7 382 CZK.

¹⁸ Balance of the budget chapter 396 – State debt. Expenditures on the debt repayment are affected not only by the borrowing need of the state, but also the situation on the bond markets. The average yields of the domestic state bonds relentlessly grow since the half of the last year.

¹⁹ The debt hiked to 1 789 CZK bn in Q1 2017 and recorded the fastest quarter-on-quarter growth since year 2010 (+11%). This short term increase was connected to the specific situation on the bond market due to the expectations tied to the termination of the forex interventions.

²⁰ Apart from the state budget takes into account also the budget of other central government institutions and also the municipalities and health insurance companies.

²¹ The CZSO will publish the preliminary data regarding the debt and deficit of the government institutions sector for Q2 2018 on 3rd October 2018, Eurostat then on 23rd October 2018.

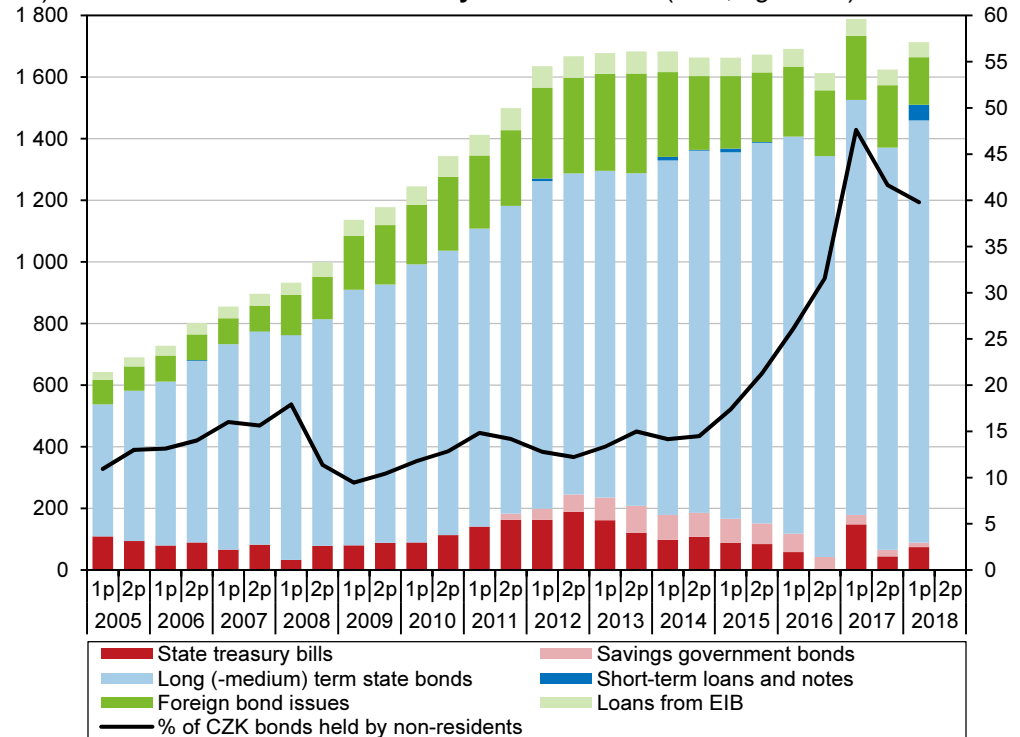
Rate of indebtedness was reduced nearly in all Union states year-on-year.

indebtedness rate prevails in the whole EU for nearly three years, its rate of growth does not rise much (it was -1.7 p.p. on average for the whole period). Nevertheless, the positive factor was, that all members of the Union (except for Greece) at least slightly reduced their indebtedness this year. The fact that only Germany and Malta find themselves in improved position this year compared to the indebtedness rate achieved ten years ago, provides the evidence of a very slow progress. Less than one half of the euro area member states featured indebtedness below the level of the Maastricht debt criterion (60% of GDP) according to data from Q1. Apart from Netherlands, it depicted mostly only the small economies.

Government institution sector continued with budget surplus. Results of the municipal and regional budgets contributed the most.

Sector of the government institutions in the CR recorded surplus of 8.6 CZK bn (in the methodology of the national accounting), resp. 0.7% of the GDP (1.7% of GDP after seasonal adjustment) for Q1 2018. Local government institutions contributed the most to the year-on-year expansion of the surplus (by 5.4 bn). Budgets of the health insurance companies were also more positive. On the contrary, the deficit of the central government institutions slightly deepened (nearly by 16 CZK bn).

Chart 22: Structure of the CR state debt (balance at the end of half-year, in CZK bn) and share of CZK bonds held by non-residents (in %, right axis)



Source: MF CR

