

Fixed Income

CZGB Focus

Lower CZGB supply in second half of year



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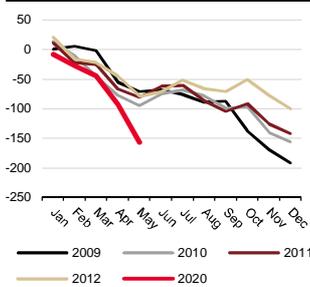
The government is proposing a further increase in the state budget deficit to CZK500bn. The main reason is the rise in spending to support the economy at this time of crisis. In our opinion, however, the government will continue to have problems implementing expenditure plans, which will lead to a deficit of only CZK400bn. This also implies less additional CZGB issuance, further reduced by using state financial assets and the drawdown of EUR loan programs. In our view, the MinFin has only CZK56.7bn left to issue by the end of the year, which shouldn't be a problem to place.

Government proposing further increase in budget to CZK500bn

This year, the MinFin has twice increased the planned state cash budget deficit from the original CZK40bn to the current CZK300bn to support the domestic economy during the crisis. Now, the government is proposing a further increase in the deficit to CZK500bn (9.2% of GDP). The proposal envisages a further downgrade in total revenues of CZK63.4bn (down by a total of CZK213.3bn compared to the original proposal). **This change is not based on the ministry's macroeconomic forecast**, as the new one will be published only in August. The new revenue estimate is nevertheless more in line with our expectations due to our more pessimistic outlook for this year's economic downturn and given the new measures to support the economy.

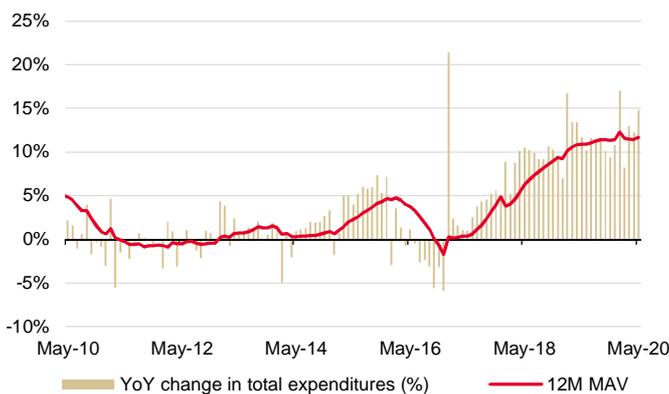
The biggest changes are in expenditure, which is to be boosted by another CZK136.6bn (up by a total of CZK246.7bn compared to the original proposal). The whole amount aims to increase the government budget reserve and thus has no specific purpose.

Development of state budget compared to previous crisis (CZKbn)



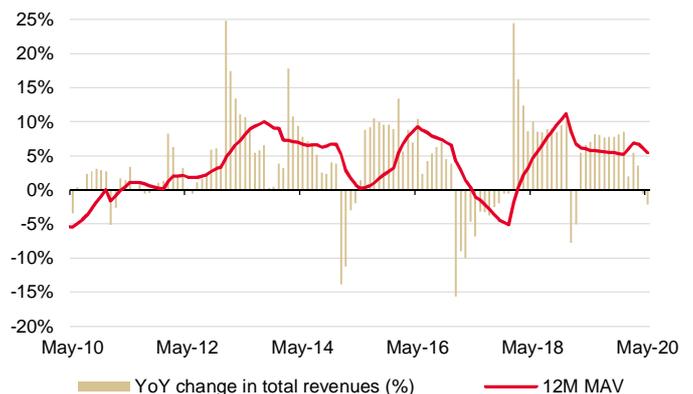
Source: MFCR, Economic & Strategy Research, Komerční banka

Budget expenditures not growing versus previous years



Source: MFCR, Economic & Strategy Research, Komerční banka

Revenue shortfall will be visible in the coming months

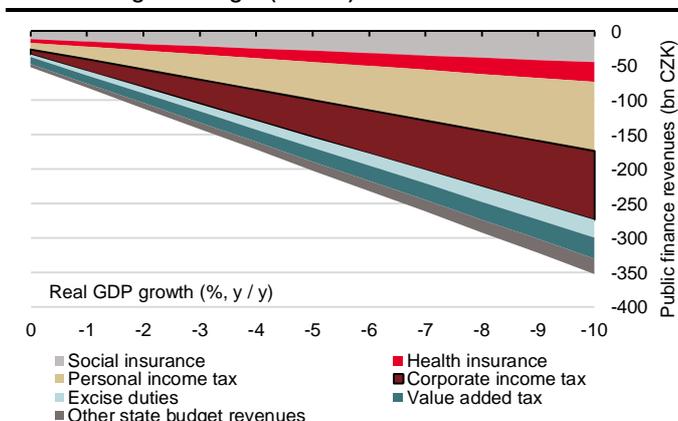


Source: MFCR, Economic & Strategy Research, Komerční banka

According to the MinFin, the current budget reserve of CZK78.8bn has already been fully allocated on crisis-related outlays and a further increase is therefore necessary. The new budget proposal doubles the reserve to CZK215.4bn, which in our view accommodates downside risk to the budget and the economy for the remainder of the year.

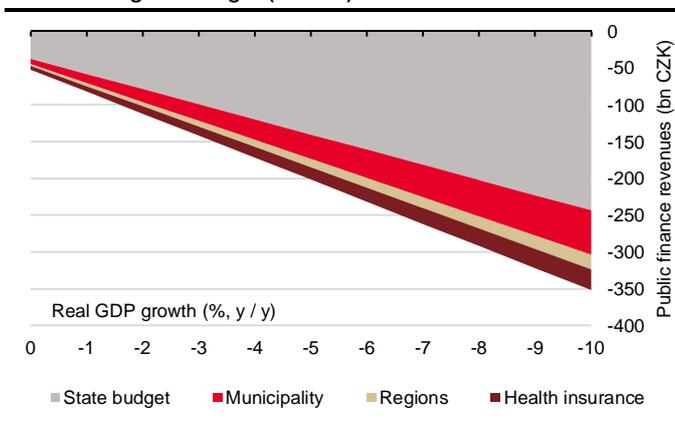
One of the government’s main arguments for the increase in the state budget deficit is a presumed rise in financing for municipalities and to boost infrastructure investment. This year, a record amount of CZK140.5bn is to flow to investment, and in addition, the state budget has c.CZK33bn of unused expenditure from previous years (combined amount equals 3.3% of GDP). However, due to the two-month lockdown and the dispute between the municipalities and government over funding (local governments have been forced to co-finance part of the pandemic relief programmes), we assume that most investment projects at the regional level have been stopped or postponed and will be difficult to re-start this year. In addition, the recent shutdown of the economy has led to the departure of a large proportion of foreign workers, upon whom the domestic construction sector depended, and we do not expect a significant easing of the labour market (or the possibility of a reshuffle of employment) until the second half of the year. Consequently, we assume any additional increase in public investment above the currently planned level would exceed the capacity of the economy.

Public finance revenue scenarios by category compared to the MinFin’s original budget (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

Public finance revenue scenarios by recipient compared to the MinFin’s original budget (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

Due to the slow implementation of the already introduced measures to support the economy, and taking into account the expected decline in state budget revenues and the aforementioned changes, **we increase our expected deficit to CZK400bn from the previous CZK340bn, which would mean a total public finance deficit of 7.9% of GDP.** That compares to the new official plan of a CZK500bn shortfall.

The government wants the proposal to increase the state budget deficit be discussed as a legislative emergency. The proposal will likely be discussed by the Budget Committee of the Chamber of Deputies this week and subsequently should be discussed in the Chamber. So far, only the Communist Party, which supports the minority government in the Chamber of Deputies, will probably seek partial adjustments. We thus assume that the basic framework of the change in the state budget will go through the legislative process in June.

CZGB supply to be subdued in 2H20 nevertheless

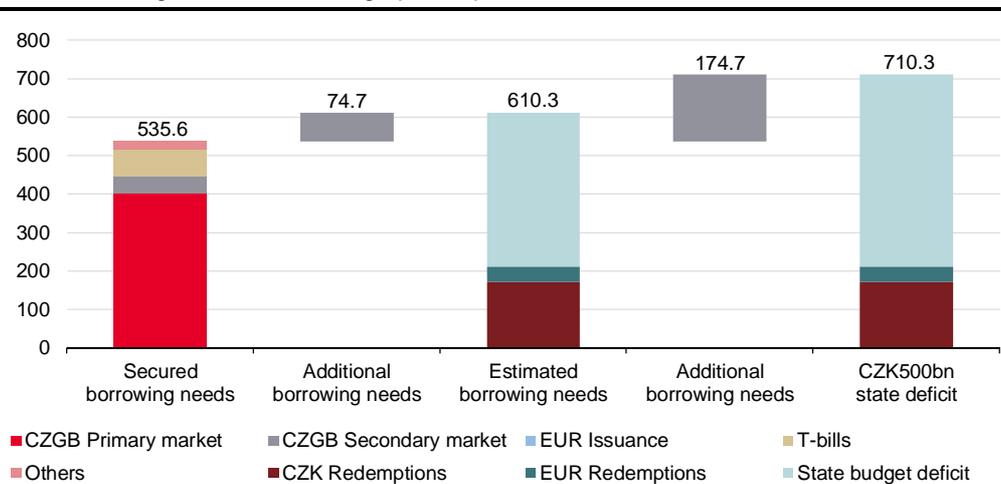
According to our calculations, the MinFin has already secured all its borrowing needs related to the CZK300bn budget deficit and other state liabilities through CZGB issuance and operations in the secondary market. However, the new proposal would imply significant additional borrowing needs of CZK174.7bn. On the other hand, as we expect the budget deficit to be lower than indicated in the new plan and as the government wants to use CZK18.9bn of reserves in financing, we estimate that **only CZK74.7bn of borrowing needs remain.**

In our opinion, potential additional CZGB issuance will also be reduced by the EUR loan programs of the European Commission and the Development Bank of the Council of Europe

to support the economy. In these, the government can borrow up to CZK18bn this year on very favourable terms, which can thus serve as EUR source to cover CZK40bn equivalent of euro-denominated short-term money market loans. EUR loans from supranational institutions could thus serve in part to replace the originally planned issuance of euro-denominated government bonds.

In nutshell, there is a room for an additional CZK56.7bn of CZGB issuance over the remainder of the year. If the ministry follows the already published calendar in the rest of June (max. CZK7bn to be sold indicatively), CZK8.3bn per month remains for 2H20, which in our view gives the MinFin a high degree of freedom and so previous flare ups of CZGB supply will likely not be repeated. If the state budget were eventually to move towards the planned CZK500bn, remaining CZGB issuance would increase to CZK156.7bn, i.e. CZK25bn per month, which is only slightly above last year's monthly average.

State borrowing needs and coverage (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

For next year, the current maturity calendar offers a record CZK292.6bn, the most since 2013. To this we add our estimated state budget deficit of CZK300bn, which indicates at least as high borrowing needs as this year.

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