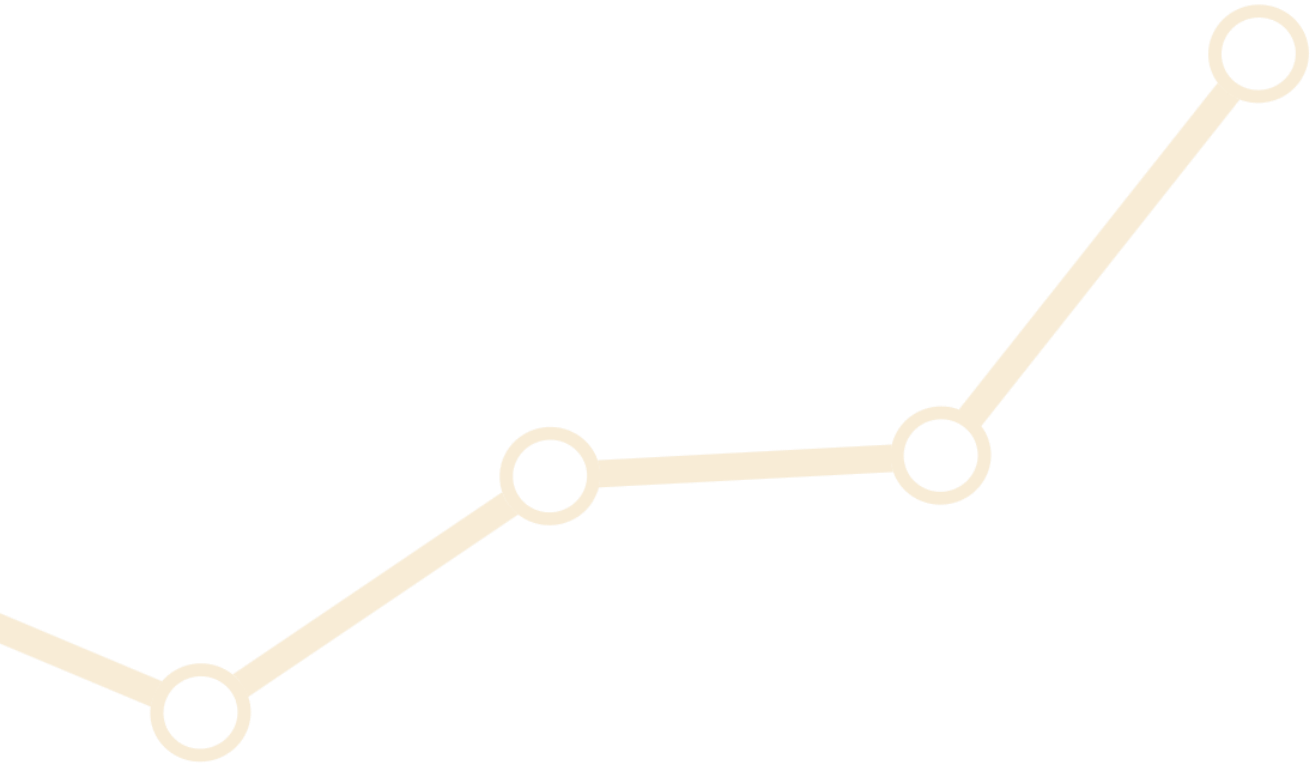


Deciphering the Landing  
for the Czech Economy:  
Insights from the Beveridge Curve

# RILSA Policy Briefs No. 1 | 2024

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The Research Institute for Labour and Social Affairs (RILSA) is a scientific and research institution that conducts independent research in the field of labour and social affairs at the regional, national and international levels. In addition to scientific and research activities, the Institute provides professional advice and consultation and information services in all its areas of activity.

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## Summary

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- According to a recent report by Eurostat (2023), the Czech economy is characterised by the lowest level of matching efficiency between job-seekers and vacant positions of any EU member country. This policy brief attempts to determine potential reasons for such inefficiency by adopting a broad view that includes an investigation of the Beveridge curve that indicates an inverse relationship between the job vacancy rate and the unemployment rate in the Czech economy.
- The inverse Beveridge curve relationship between 2008 Q1 and 2019 Q4 was in alignment with theoretical expectations. However, a significant shift was observed thereafter.
- The shift in the scatter plot in the north-west quadrant from 2020 Q1 onwards, despite the absence of economic expansion, suggests the occurrence of structural changes in the labour market. This pattern potentially signifies a discrepancy between the skills of the workforce and the requirements sought by employers. Such an incongruity thus resulted in a scenario in which job openings remained vacant despite the availability of workers, which, in turn, contributed to the deceleration of the economy. It is important to note that the shift was neither cyclical nor temporary; rather it is an enduring phenomenon, as indicated by the observation that the curve has remained entrenched in the north-west quadrant for the past ten quarters.
- When these findings are considered in parallel with the current decline in real wages, stringent monetary policies and impending fiscal contraction, a complex economic scenario emerges. The decrease in real wages may signal challenges in terms of preserving the purchasing power of workers, thus potentially affecting consumption and overall economic growth. The tight monetary policy implemented by the Czech National Bank aimed at curbing inflation has further constricted aggregate demand. Moreover, the resulting fiscal contraction implies the need for reductions in government spending and increases in taxation, both of which are likely to significantly impact aggregate demand and overall economic activity. Collectively, these factors are, thus, contributing to the likelihood of a 'hard landing' scenario for the Czech economy.
- This policy brief discusses the benefits of introducing pro-growth and inclusive policy measures aimed at averting a sudden economic downturn.

## Importance of the research

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The significance of this brief can be classified in terms of three main categories:

1. **A Crucial Insight into Labour Market Dynamics:** This brief critically examines labour market shifts through the lens of the Beveridge curve and provides insight into the working of the Czech economy. It identifies potential structural changes in the labour market and reveals a significant incongruity between the skills offered by the workforce and the requirements of employers. The investigation of changes in the Beveridge curve is aimed both at enhancing the understanding of policymakers with concern to the factors that are driving this mismatch and providing them with guidance in terms of improving job matching and bolstering productivity.
2. **An Essential Understanding of Economic Risks:** The findings elucidate the risks faced by the Czech economy, primarily the potential for an abrupt deceleration or 'hard landing'. By examining a holistic picture that includes declining real wages, stringent monetary policies and impending fiscal contraction, the study provides essential insight into how these factors could combine so as to form a complex economic scenario. It is anticipated that the knowledge derived will contribute to formulating strategic economic safeguard policy approaches.
3. **Guidance for Proactive and Inclusive Policies:** Finally, the outcomes of the study are of critical importance in terms of shaping policy discussions on pro-growth and inclusive policy measures, concerning which the brief underscores the imperative for targeted intervention across three pivotal domains: the labour market and fiscal and monetary policies, as contextualised within the broader framework of international conditions.

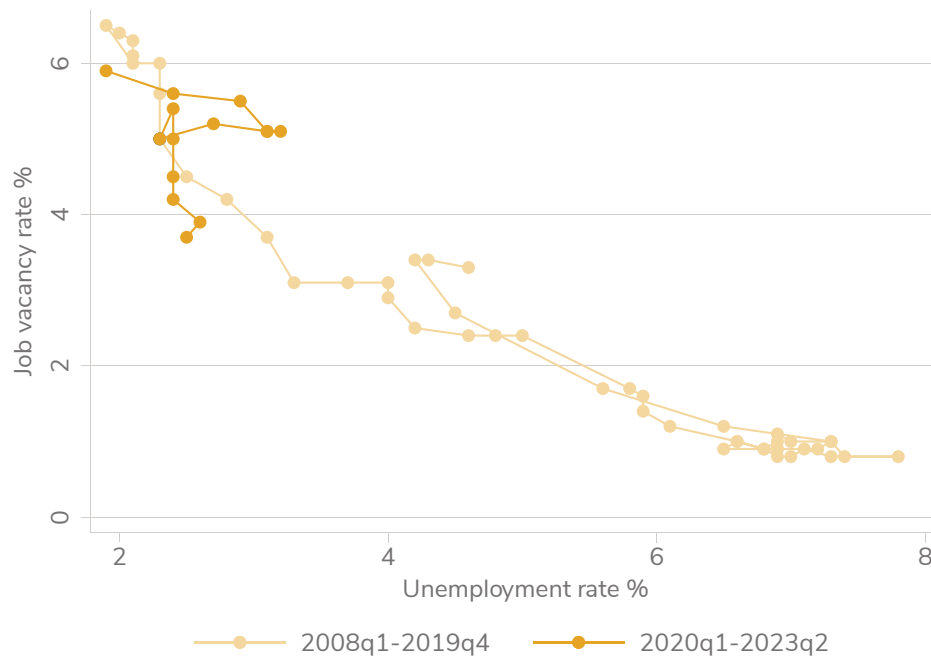
## Main findings

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Figure 1 presents the Beveridge curve for the Czech economy from 2008 Q1 to 2023 Q2. The inverse relationship observed between the unemployment rate and the vacancy rate from 2008 Q1 to 2019 Q4 is in line with traditional economic theory, which suggests that as the unemployment rate decreases, the vacancy rate should increase and vice versa.

The shift in the scatter plot to the north-west quadrant from 2020 Q1 onwards reveals a consistent pattern of a high vacancy rate and a low unemployment rate, which typically indicates economic expansion. However, this was not the case of the Czech economy during the monitored period.

Figure 1 Beveridge Curve for the Czech Republic



The more detailed consideration of the vertical movement in the north-west quadrant revealed that fewer job openings were available despite the unchanged nature of the unemployment rate. This incongruity indicates either a deceleration in terms of the creation of job positions or a shift in the nature of available positions so that they require different skill sets or qualifications than those possessed by the unemployed population. As a result, this mismatch presents challenges for jobseekers –in terms of securing suitable employment positions, which potentially results in prolonged periods of unemployment for certain segments of the workforce despite the overall unemployment rate remaining constant.

This finding can be traced back to the disruptive impacts of the COVID-19 pandemic on the global and local labour market spheres. The sudden onset of the pandemic necessitated rapid adjustments to production methodologies across sectors, which led to changes in the demand for certain skills. This scenario resulted in an increase in vacancies versus relatively unchanged unemployment rates due to mismatches in terms of job skills and the geographical distribution thereof, and concerns over job stability.

Here, it is also worth noting that, compared to the other EU countries, the shift in the Beveridge curve in the Czech Republic appears to be enduring rather than temporary. Should this trend continue and worsen over time, it could result in long-term structural challenges in the labour market. Prolonged mismatches between available job positions and the skills and/or preferences of the workforce could impede both economic growth and productivity. Left unaddressed, this situation could present obstacles to sustained economic stability and potentially elevate the risk of a significant economic

downturn. Consequently, the analysis provided herein is of prime importance in terms of policymakers forming a comprehensive understanding of this phenomenon.

Decreases in real wages pose a challenge in terms of maintaining the purchasing power of workers, thus potentially impeding both consumption and overall economic growth. Furthermore, declining wage levels may, at least partly, explain the persistence of high vacancy rates - the anchoring of the Beveridge curve in its current position, since the wages offered may persist below the equilibrium wage levels, thus discouraging the participation of both domestic and foreign potential employees who have alternative options to precarious employment.

Hence, the critical question arises: does the ongoing persistent trend of the Beveridge curve indicate a potential 'hard landing' for the Czech economy, especially when one takes into account other recent economic developments?

The current economic landscape, with its various inter-related factors, has led to the emergence of a complex scenario. The decline in real wages, the implementation of stringent monetary policies by the Czech National Bank aimed at combatting inflation, and the forthcoming introduction of fiscal contraction policies collectively point to an economic slowdown. This confluence of economic indicators has the potential to result in a precarious economic trajectory marked by heightened uncertainties and potential challenges in terms of sustained growth. The anticipated repercussions include an increase in the unemployment rate and a significant decline in the availability of job positions, thus amplifying the risk of an economic downturn.

As a result, the 'hard landing' scenario is not entirely implausible, especially considering the complex interplay of the above factors and bearing in mind that labour market conditions do not appear to be easily self-correcting (Birinci and Ngan, 2023).

## Discussion

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The prolonged positioning of the Beveridge Curve in the north-west quadrant over the past two years indicates that the labour market challenges faced by the Czech Republic are structural in nature rather than merely transient and/or cyclical. Consequently, it is becoming increasingly evident that a pronounced skills and regional mismatch prevails within the Czech labour market. However, the structural characteristics of the Czech industrial landscape, which is still reliant, inter alia, on the availability of low-skilled, low-wage positions, do not advocate for the primary alignment of the skills available with prevailing market demands. Instead, the Czech labour market should aim towards qualitative advancements that eschew the support of less productive and antiquated industries. In order to effectively pursue this trajectory, it is imperative that a robust and stable social security system be in place that is able to protect those vulnerable to the changes inherent in such a transition, accompanied by active labour market policies. Thus, the transformation process need not precipitate a harmful downturn for the economy as a whole.

Despite the ostensibly 'tight' labour market conditions in the Czech Republic, both consumption and retail sales continue to exhibit a consistent decline, which was exacerbated by the recent spike in price levels. This phenomenon suggests that regardless of the current tightness of the labour market, the principal impetus driving this trend comprises the precipitous decline in real wages and the resultant diminishing share of wages in the national income. Furthermore, notwithstanding elevated post-COVID-19 savings rates, and the presumably highly unequal distribution of savings among the population, the heightened propensity to consume on the part of low- and mid-income households necessitates the introduction of targeted economic stimuli for these groups. Given the recent changes to the tax system, which are generally unfavourable for these socioeconomic segments, it is imperative that broader societal consumption is encouraged. Proposals in this respect include shifting the tax burden from low to high-income earners (concerning both labour and capital income) and increasing currently low wealth tax rates. Alternatively, discretionary measures, such as a substantial increase in the minimum wage, would both improve economic conditions via increased consumption and expedite the transition by amplifying the motivation to replace low-skilled with higher productivity job positions. Moreover, the regulatory and supervisory authorities, such as the Office for the Protection of Competition (ÚOHS), should act to combat monopolistic tendencies that are evident in various Czech economic sectors. Such preventive action is essential in terms of eliminating the exploitation of market power by dominant companies, which allows for the setting of excessive profit margins that contribute significantly to the escalation of price levels.

From the supply-side point of view, net investment in the Czech Republic has stagnated, which has resulted in a corresponding stagnation in terms of the expansion of the capital stock of the economy. The growth in investment is predominantly attributable to capital depreciation as dictated by the industrial structure of the Czech economy. The adoption of a trajectory aimed at the expansion of capital stock would serve to fortify long-term aggregate supply, thus mitigating potential inflationary pressures.

The current combination of monetary and fiscal restrictions poses a significant threat to the economic trajectory of the Czech Republic. Inflation is driven primarily by price-inelastic products, the prices of which are only minimally (and indirectly) responsive to interest rate adjustments. Therefore, sustained high interest rates may prove to be both insufficient in terms of mitigating inflation and an obstacle to economic growth. Moreover, the fiscal consolidation package introduced at the beginning of 2024 due to concerns about the state of public finances, is likely to further restrain aggregate demand and, thus, overall economic growth. The potential impact on the labour market, including a moderate increase in the unemployment rate, threatens to undermine the convergence of Czech wage levels to those of the EU15, thus potentially offsetting positive real wage outlooks in the medium term.

As a small, open economy, the Czech Republic is required to contend with adverse global developments, particularly the uncertainty surrounding the geopolitical situation primarily in the Middle East and Eastern Europe, especially with respect to supply chain interruptions and spikes in commodity prices. In addition to weak domestic demand and geopolitical uncertainty, the Czech Republic is no longer able to rely on high demand in the economy of its primary trading partner, Germany, which is currently experiencing an economic deceleration.

Many of the economic performance indicators in the Czech Republic have, to date, persistently lagged behind the EU average and the current situation does not indicate improvements in this respect going forward. Since the activation of self-correcting market mechanisms appears in the current context unlikely, it is essential that astute and focussed economic policies be introduced so as to avert the impending 'hard-landing' for the Czech economy.

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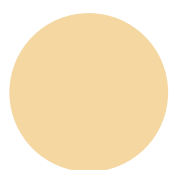
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