SPECIAL ANALYSIS

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The Czech Republic in Numbers: the End of the Negative Mood

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Introduction

The Czech Republic has sometimes been called an assembly plant in the heart of Europe, export dependent on Germany. Is this claim still valid?

The country can be proud of the openness of its economy with a diversified portfolio of both export partners and commodities that travel across its borders - in the Central European region the Czech Republic even has the highest proportion of high-tech exports.

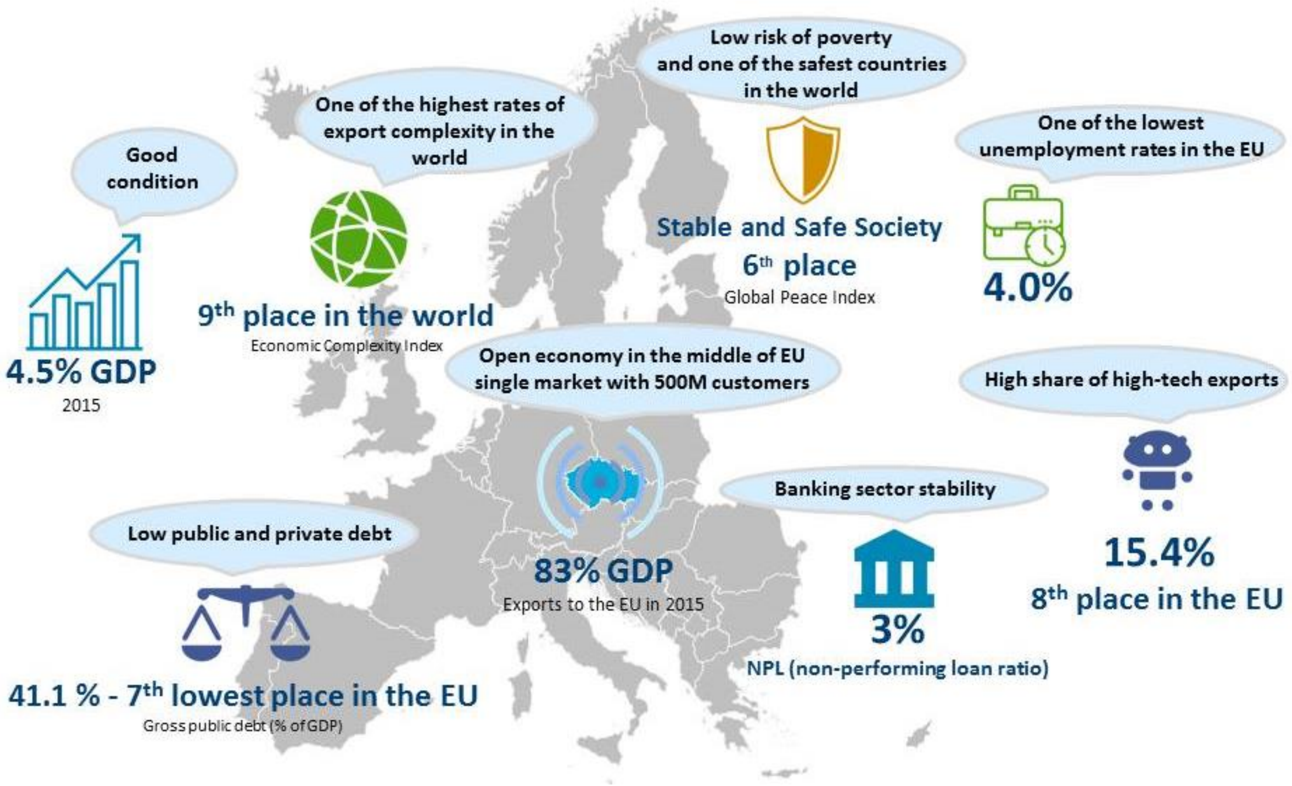
The wide range of products produced in the Czech Republic also testifies to the very high economic complexity - 9th place in the world according to the Economic Complexity Index. The largest trading partners of the Czech Republic are Germany, Slovakia, Poland, the United Kingdom, France and Austria. In total, exports to European countries amount to 89.6%.

The good condition of the economy is also underscored by steady growth - in 2015 the Czech Republic ranked at a top position in the EU with its 4.5% GDP growth. In the coming years it is expected that the Czech Republic will maintain its growth trajectory - almost 3% in 2017 and 2018 respectively.

The dismal situation surrounding the banking sectors in some EU member states has often filled the lines of newspaper pages lately – at present it is Italy which is struggling with problems. The Czech Republic has one of the most stable banking sectors in the EU however. Credit risk, which is expressed as the amount of so-called non-performing loans (NPLs) over total loans (the NPL ratio), has had a downward trend in the past 5 years - in March 2016 it reached the level of 3% and the Czech Republic thus ranks among the countries with the lowest share of NPLs in the EU. Also the capital adequacy ratio (the higher the value reached, the greater the financial stability of a bank, increasing the likelihood that it will be able to meet its obligations) is at a high level - in June 2016 it amounted to 17.8%. Banks would therefore be capable of withstanding even adverse economic developments.

What then is behind the "negative" mood of Czechs? Once it would have perhaps been the situation on the labour market - today it is certainly not because in September 2016 in fact the unemployment rate in the Czech Republic amounted to 4% and Czechs therefore were "the nation with the least unemployment in the EU". Although hourly labor costs in the Czech Republic are among the lowest in the EU, that does not mean a low level of quality of the workforce - on the contrary, the labour force is competitive and educated, and not only technically.

The very good level of security paints an overall good picture of the Czech Republic – According to the Global Peace Index 2016, the Czech Republic is the 6th safest country in the world - and has a low number of inhabitants at risk of poverty and social exclusion.



In which areas does the Czech Republic stand out?

1. Stability and industrial tradition

The European Commission estimates economic growth for the Czech Republic for the years 2017 and 2018 amounting to 2.6% of GDP, respectively 2.7% of GDP, which is roughly one percentage point more than the predicted average for the European Union.

Acceleration of investment has an influence on the positive development and the main driving force will be domestic demand, supported by a positive contribution from net exports. This amount is gradually decreasing however, as demand for imports grows.

The Czech Republic is a small open export-oriented economy with a strong industrial base. Among the EU member states it is among the most industrialized. Now this focus can constitute a competitive advantage for the future.

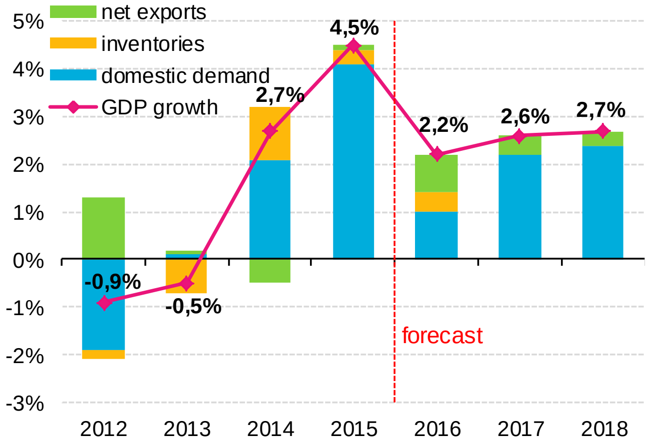
Simply said the development of industry is entering its next phase - that is the fourth industrial revolution. Currently the notion of Industry 4.0, which was introduced at the Hanover Fair in Germany in 2011, is fundamentally changing the concept of industry, logistics, trade and other integral parts of the economy, hence the whole of society. The interdependence of the Czech economy with the German can help it remain at center stage when the near future of production is being formed – that is the transition from assembly-line manufacturing to highly sophisticated production, where there is a connection between all intelligent devices, production lines and products, all production systems, warehouses, logistics and services into a single intelligent information network.

Within this framework the smart devices of customers, manufacturers and suppliers will communicate with each other without human help and respond to clients' needs in real time. The Czech government has also been dealing with this topic a long time. In mid-2016 it approved the Initiative Industry 4.0 (Iniciativa Průmysl 4.0) which has as its goal maintaining and further increasing the competitiveness of the Czech economy.

Czech industry has not been only assembly plants for a long time - there are many firms and products here with high added value. The fact that the Czech Republic is not dependent on just one product, but that an incredibly wide variety of products is produced here is also demonstrated by its 9th place in the world in the Economic Complexity Index (ECI).

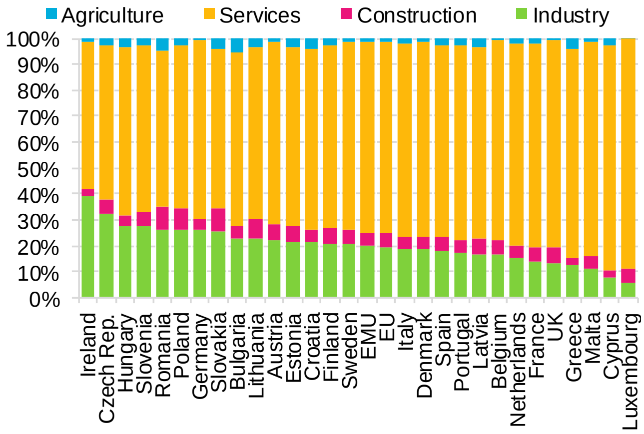
The Czech Republic has also achieved very good results in the field of high-tech exports, where it ranks in the forefront among the countries of the European Union.

Czech Republic - GDP and contributions to growth



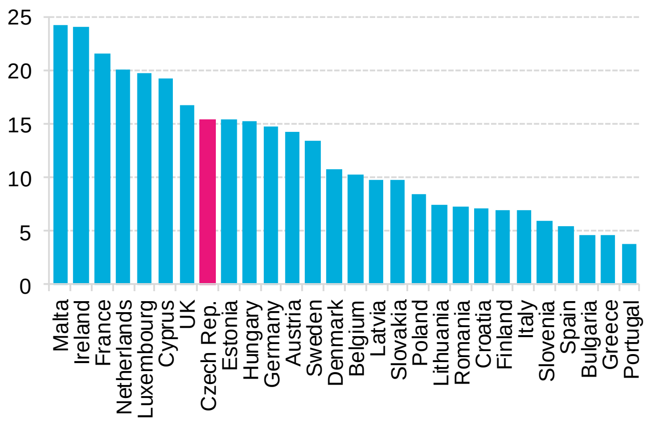
Source: European Commission

Sectors of National Economy (% GVA; 2015)



Source: Eurostat; Industry NACE rev.2 B-E

High-tech exports (%, 2015)



Source: Eurostat; (% of total)

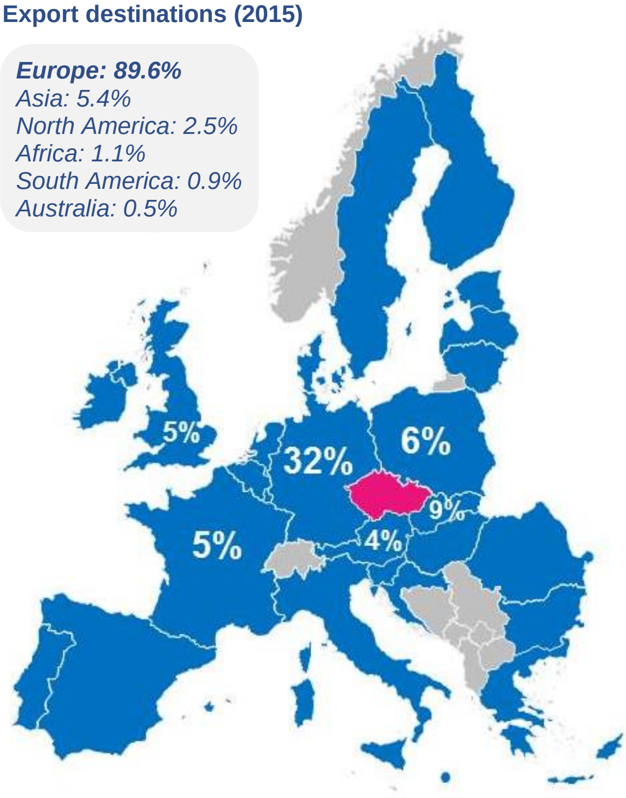
2. High degree of openness of the economy

The orientation towards the European market is clearly evident in the share of exports – the Czech Republic sends almost 90% of all exports to Europe (83% to the European Union).

The major trading partners of the Czech Republic are Germany to where about a third of all exports go, then Slovakia (9%), Poland (6%), the UK (5%), France (5%) and Austria (4%).

Among the commodities which are most exported are cars (11%), spare parts (8.1%) and computers (5.6%).

Export destinations (2015)



Source: CSO

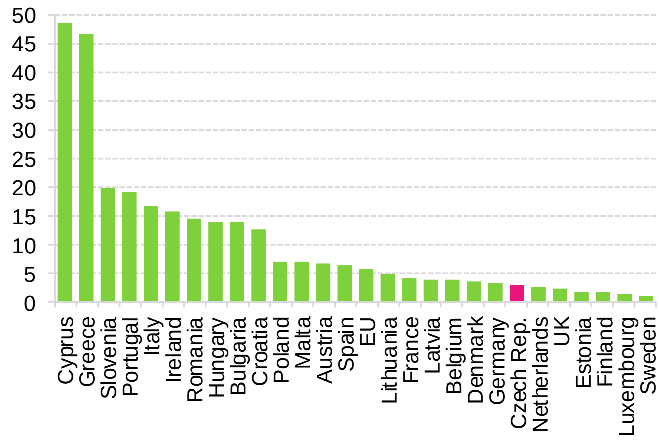
3. Stable banking sector

We can say that within the countries of the European Union the Czech banking sector is among the stable and profitable ones. This holds true whether we are talking about the ratio of loans to deposits, which in the long term has achieved levels of around 75%, or the share of so-called bad loans (non-performing loans - NPLs) to total loans (the non-performing loan ratio), where the Czech Republic has reached some of the lowest levels in the European Union (banks classify loans as "bad" if the borrowers stop repaying the loan or interest – this generally happens if the debtor has not paid for more than 90 days).

In March 2016 the value of the NPL ratio amounted to 3% - this was the 7th lowest level in the EU countries. The average level of NPLs in the EU reached 5.7% - for comparison here are the NPL ratios in Canada, the US and Japan, where values reached 0.5%, 1.5% and 1.6% (according to the World Bank, 2015). The capital adequacy ratio is also moving at a high level. In this indicator the higher the value reached, the greater the financial stability of a bank, and the probability that it will be able to meet its obligations increases – in June 2016 the capital adequacy ratio reached 17.81%.

According to the results of the stress tests of the Czech National Bank, the Czech banking sector would be able to withstand even adverse economic developments.

Non-performing loan ratio (%, March 2016)



Source: European Banking Authority; data for SK is not available

4. A good place to live

Finally let's look at how living conditions are for the inhabitants of the Czech Republic.

Historically the unemployment rate could contribute to a worsening mood. At present, however, the Czech Republic can boast that it holds the top position in the EU – in September 2016 the unemployment rate in the Czech Republic amounted to 4%, which is the lowest unemployment in the EU.

The Czech Republic also ranks near the lowest in the EU in hourly labour costs, which of course does not mean that the level of the labour force is also low - conversely, the Czech Republic has educated and competitive workers.

People in the Czech Republic can also feel safe – according to the Global Peace Index, the Czech Republic in fact took 6th place in the world (fourth from the EU countries). Compared to other countries the Czech Republic also has a low number of residents who are at risk of poverty – according to Eurostat in 2015 this was 14% of the total population (the lowest in the EU).

Global Peace Index 2016 in EU countries

Rank	Country	Rank	Country
2	Denmark	**24**	Slovakia
3	Austria	**25**	Spain
5	Portugal	**26**	Croatia
6	**Czech Republic**	**29**	Bulgaria
10	Slovenia	**31**	Romania
11	Finland	**32**	Latvia
12	Ireland	**36**	Estonia
14	Sweden	**37**	Lithuania
16	Germany	**39**	Italy
18	Belgium	**46**	France
19	Hungary	**47**	UK
21	Netherlands	**71**	Cyprus
22	Poland	**82**	Greece

The State of Peace: *very high* *high* *medium*

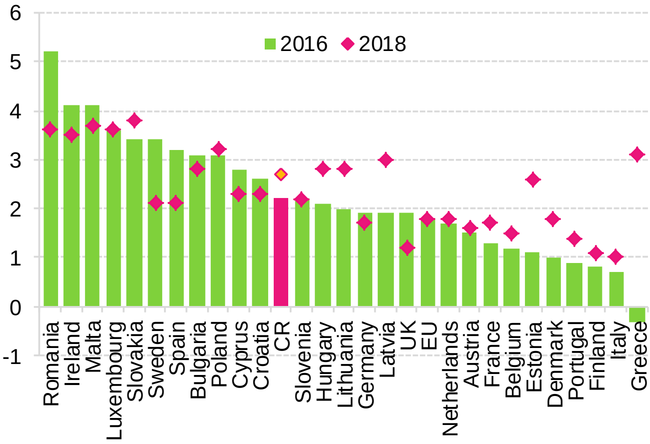
Source: Global Peace Index Report; data for Malta and Luxembourg are not available

What is the European Commission's view?

The fact that the Czech Republic can boast of a stable macroeconomic environment and that it is currently in good condition is demonstrated not only by the numbers but also by increasing confidence and household consumption. In 2015 the Czech economy experienced some of the highest economic growth in the EU. It is necessary to add that the drawing of EU money from the 2007-2013 programming period was also hiding behind this success. Nevertheless it is important to build on these achievements and also to maintain continued positive development. The Commission's autumn economic forecast, which was published on 9 November, suggests more about how the economy of the European Union, thus all the member states, will develop in the coming years. After a six-month pause the Commission has again presented data for many economic indicators now also with a view to 2018.

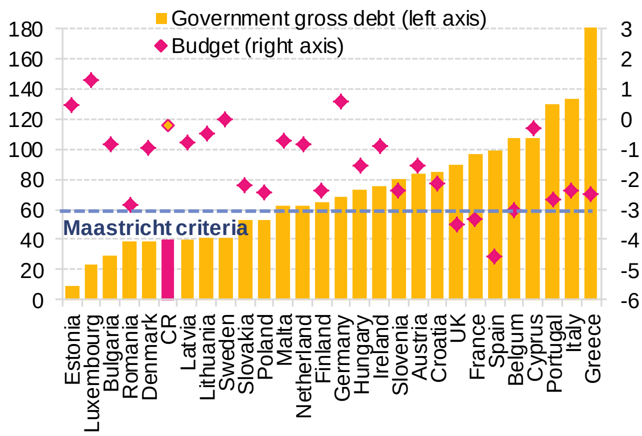
The outlook carries a slightly positive note, as economic growth should be positive in all member states in 2017 and 2018, even if this growth will not be at all dizzying. The main driver of economic growth should be private consumption. The Commission predicts growth in the eurozone of 1.5% in 2017 and 1.7% in 2018. Growth throughout the EU is in a similar vein: the Commission expects growth of 1.8% for 2016 and in the following two years 1.6% and respectively 1.8% in 2018. This growth will have a positive impact in reducing the unemployment rate, budget deficit and public debt. Between the years 2016 and 2018 this should fall in the EU by 2.7 percentage points to 83.9% of GDP. The highest reduction of public debt should be recorded in Greece

GDP in the EU (%)



Source: European Commission

Government debt and public budget in the EU



Source: European Commission; % GDP; 2016

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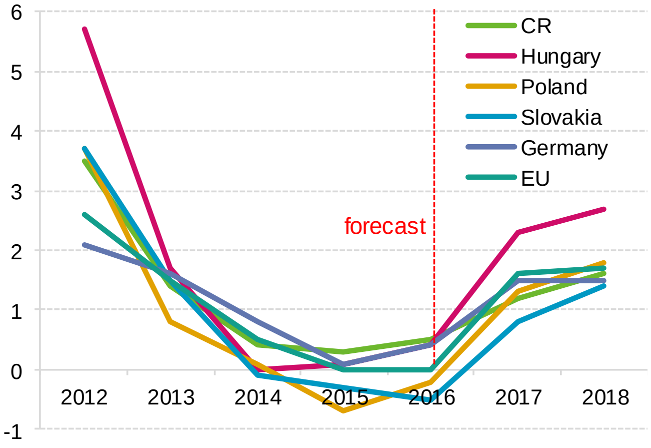
between those years and that should be by more than 9 percentage points. However it must be noted that even so Greece will have public debt amounting to 172% of GDP in 2018, making it one of the most indebted countries in the world. The union is slowly breaking away from the very low inflation of 2015 which amounted to 0.0%. Falling oil prices kept the rate of inflation at low levels in the first half of 2016 since when it has begun to slowly increase. Even so, the Commission envisages inflation in the eurozone and throughout the EU of 0.3% for the year 2016. A gradual increase in energy and commodity prices with an increase in consumption, which will be positively affected by rising wages, should increase inflation in the EU in 2017 to 1.6% and in 2018 to 1.7%. In 2017 therefore the rate of inflation in all member states should already be positive. Still however, the differences between individual countries will be very small. The lowest inflation rate should be in Cyprus at 0.7% and the highest in Estonia (2.6%).

Inflation in selected EU countries (%)



Source: European Commission

The situation on the labour market is evolving very positively. The unemployment rate in the EU is approaching the pre-crisis level and the rate that is predicted for 2018 (7.9%) is truly exceptional for the EU.

	CR		EU	
%, % of GDP	**2017**	**2018**	**2017**	**2018**
GDP growth	2.6	2.7	1.6	1.8
Inflation	1.2	1.6	1.6	1.7
Unemployment	4.1	4.0	8.3	7.9
Budget balance	-0.6	-0.7	-1.7	-1.6
Public debt	39.1	38.5	85.1	83.9

Source: European Commission

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