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Czech Economy briefing:

Economy developments in Czech Republic in 2017

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Year 2017 has been very favourable for the Czech Republic and its economy. Its economic growth was very robust (after a slowdown in growth in 2016), driven mainly by strong domestic demand. The labour market has neared full employment (the unemployment rate is expected to reach only 3% in 2017), inflation rate was about the Czech National Bank´s target of 2% (effective from January 2010) and external deflationary pressures have faded. The macroeconomic indicators have been looking very positive (see Table 1.1).

The Czech economy´s performance increased year-on-year by 5.0% in the 3rd quarter of 2017 (i.e. markedly more than the average of the European Union growth about 2.6%; the Czech economy belongs to the fastest growing member states of the European Union), due to both strong domestic demand (investment and private consumption) and external demand (CZSO 2017). According to the European Commission (2017a), the economy is forecasted to growth by 4.3% in 2017 (in comparison to 2.6% in 2016). The Czech GDP per capita in current purchasing power parity[1] has been increasing steadily in both absolute and relative terms compared to EA19, thanks to an exceptional economic growth – see Figure 1.1. In 2016, the Czech GDP per capita (25,700 PPS; Ministry of Finance 2017b) was the highest in Central Europe and even higher than the GDP per capita of Greece or Portugal.

A dynamic growth of private consumption is supported by growth in nominal wages (by 6.5% in the 1st half of 2017) and the highest overall employment in the Czech Republic´s history (more than 73%) as well. Household net disposable income has been growing steadily (in 2015, it was 12% higher than in 2005 – more than the average cumulative gain for the OECD over the decade; OECD 2017a; Ministry of Finance 2017b) and this trend should continue next year – see Figure 1.2. A lack of workers in blue collar professions

[1] In 2016, the Czech Republic, the purchasing power parity was 17.58 CZK/PPS compared to the EU28 and 17.14 CZK/EUR compared to the EA19.

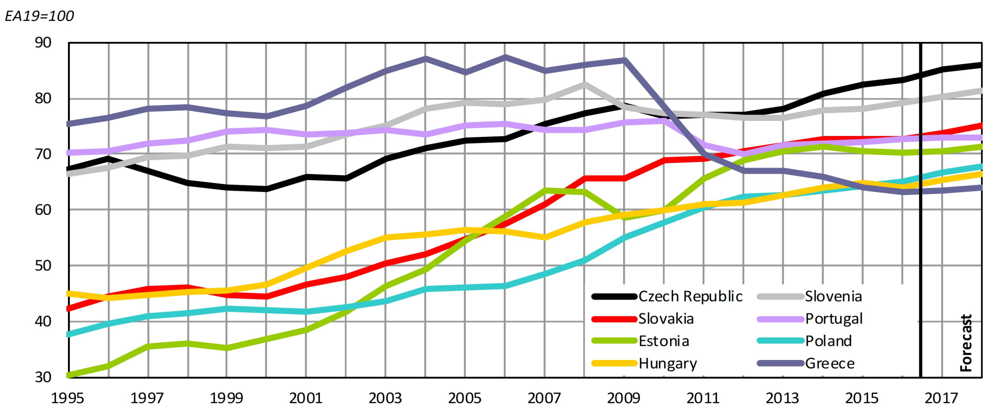
is registered (Ministry of Industry and Foreign Trade 2017a). The technical and building professions (machine fitters, mechanics, plumbers, masons, tilers) are suffering from the greatest labour shortage, followed by the personal services sector.

Indicators	2016	2017	2018	2019
GDP growth (%, yoy)	2.6	4.3	3.0	2.9
Inflation (%, yoy)	0.6	2.4	2.1	2.0
Unemployment (%)	4.0	3.0	2.9	2.9
Public budget balance (% of GDP)	0.7	1.2	0.8	0.6
Gross public debt (% of GDP)	36.8	34.6	33.3	32.5
Current account balance (% of GDP)	-0.1	-0.2	-0.3	-0.6

Table 1.1: The Czech Republic – Main Economic Indicators, 2016-2019

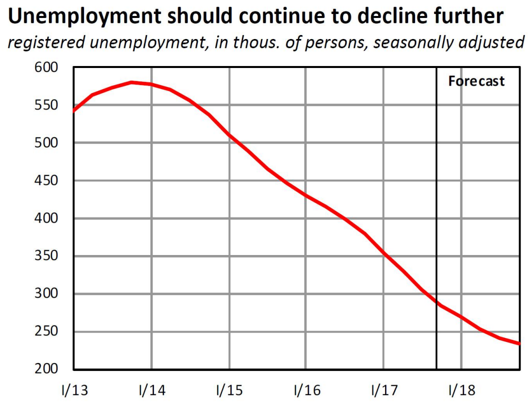
Source: European Commission (2017).

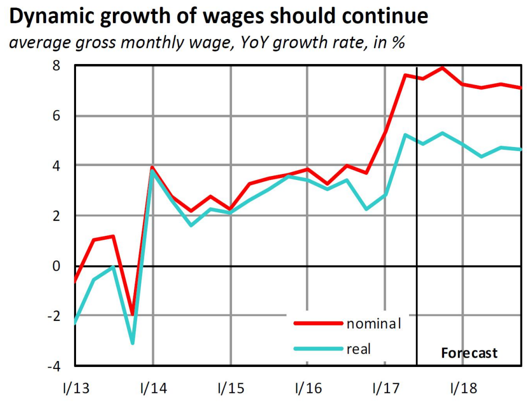
Figure 1.1: GDP per Capita in Selected Countries (Using Current Purchasing Power Parities)



Source: Ministry of Finance of the Czech Republic (2017b).

Figure 1.2: Czech Republic – Unemployment Rate and Wages





Source: Ministry of Finance of the Czech Republic (2017b).

A solid export growth has been partly neutralised by strong import growth. Imports have been growing a little bit faster than exports, given the upswing in investment, relatively high import content of Czech investment (Eurostat 2017a), and growing household private consumption. However, the surplus on the balance of goods is expected to reach almost 5% of GDP and the surplus on the balance of services more than 2% of GDP in 2017 (Ministry of Finance 2017b). The balance on foreign trade has been significantly supporting the growth dynamics of GDP.

From November 2013 to April 2017, the Czech National Bank used the exchange rate as an unorthodox instrument to mitigate deflationary pressures by enforcing a floor on the koruna-euro exchange rate. Exit from the exchange floor has been posing challenging policy questions, including on the optimal monetary policy in its aftermath, the reaction of real economy to this change etc. (IMF 2017a). On the other hand, there was no extraordinary volatility on the foreign exchange market. According to Jiří Rusnok, Governor of the Czech National Bank, this was "*a positive move, signalling the beginning of a tighter monetary stance*" (IMF 2017b). Following the exit from the exchange floor and a slight appreciation of the Czech koruna, monetary policy has been mostly accommodative.

The financial sector remained appropriately capitalised, liquid and resilient (with low interest rates boosting capital investment). The good sign is that the indebtedness of Czech households is far below European average levels in spite of a recovery in credits (mainly mortgages). The Czech National Bank has responded to the risks arising from the residential housing market (e.g. with tighter limits on loan-to value ratios) and has been overseeing the households´ indebtedness to prevent the economy from the risks of taking too much debt.

At the end of the third quarter of 2017, the government debt ratio declined to about 35% of GDP, which is also one of the lowest levels in the European Union, mainly due to better tax collection and strong economic performance of Czech companies and the whole economy.

The positive economic development is reflected in very favourable credit ratings of the Czech Republic, affirmed by all major rating agencies, i.e. it is a very reliable economy and may enjoy "considerable interest from domestic and foreign investors" (Ministry of Finance 2017a). As for investment grades, the Czech economy ranked at A1 by Moody´s (similar to China, Estonia, Israel or Japan), AA- Standard & Poor´s (similar to China, Estonia or Chile) and A+ by Fitch (similar to Estonia, China, Slovakia or Chile), with a stable or positive outlook. In general, foreign currency long-term sovereign debt ratings have been continuously improving, having an important impact on the country´s borrowing costs. The Czech Republic has been given the highest total rating of all the countries in Central and Eastern Europe and a higher rating than the Eurozone countries.

In 2017, the Czech Republic ranked 31st out of 137 world economies, as the most competitive economy in Central Europe according to the World Economic Forum´s Global Competitiveness Report (Poland ranked 39th, Hungary 60th, Slovak Republic 59th). According to the Heritage Foundation´s 2017 Index of Economic Freedom, the Czech economy has been "mostly free" (it ranked 28th). The economic freedom trend has been improving as reforms in many important areas have gradually expanded the Czech Republic's private sector. This is also reflected in a high position in the World Bank´s Doing Business ranking (30th; in comparison with Poland´s 27th rank and Hungary´s 48th position; World Bank 2017).