

## Investment recovery will drive pick-up in growth

### General Information



<b>GDP</b>	USD185bn (World ranking 49, World Bank 2015)
<b>Population</b>	10.6mn (World ranking 85, World Bank 2015)
<b>Form of state</b>	Parliamentary Democracy
<b>Head of government</b>	Bohuslav SOBOTKA (Prime Minister)
<b>Next elections</b>	October 2017, legislative (Lower House)



### Strengths

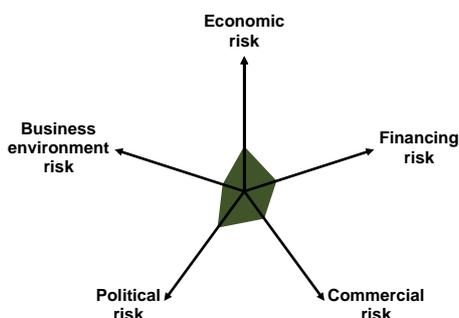
- EU membership and good international relations
- High income economy with fairly strong underlying macroeconomic fundamentals
- Solid monetary policy
- Favorable public finances
- Manageable external debt burden
- Sound banking sector that has proven resilient to adverse shocks
- Favorable business environment

### Weaknesses

- History of fragile coalition governments, resulting in often ineffective policymaking and slow reform progress
- High export dependence and unfavorable export structure

### Country Rating

**A1**



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Germany	28% 1	28% Germany
Slovakia	10% 2	12% China
Poland	6% 3	9% Poland
United Kingdom	5% 4	7% Slovakia
France	4% 5	5% Netherlands

By product (% of total)

Exports	Rank	Imports
Cars And Cycles	11% 1	8% Computer Equipment
Vehicles Components	8% 2	7% Electrical Apparatus
Electrical Apparatus	8% 3	6% Telecommunication Equipment
Engines	6% 4	5% Vehicles Components
Computer Equipment	6% 5	5% Engines

Source: Chelem (2015)

### Growth set to regain momentum

The Czech economy lost momentum in 2016, with real GDP growth decelerating to +2.4%, down from +4.5% in 2015. Fixed investment was the main driver of the slowdown, contracting by -3.5%, mainly due to base effects (+9% in 2015) and a much lower level of EU funds absorption. Otherwise, growth was broad-based. Both private and public consumption eased slightly but remained robust, increasing by +2.9% and +1.5%, respectively. Inventories added +0.5pp to overall 2016 growth. External trade activity moderated in 2016, with exports expanding by +4.3% (+7.7% in 2015) and imports by +3.2% (+8.2% in 2015). As a result, net exports added +1.1pp to 2016 growth (+0.1pp in 2015).

In Q1 2017, unadjusted real GDP rose by +3.9% y/y (calendar-adjusted by +1.3% q/q and +2.9% y/y), driven evenly by both domestic and external demand. Fixed investment is on course of a gradual recovery as EU co-financed investment activity should rise under the 2014-2020 programming period. We expect GDP growth to pick up to +3% in 2017, before slightly easing to +2.8% in 2018.

### Strong macroeconomic fundamentals

After three years of near-deflation, inflation is back on track, reaching 2% at end-2016 and averaging 2.3% y/y in January-April 2017. We expect it to remain within the 2%±1pp inflation target range of the Czech National Bank (CNB; the central bank) until end-2018. As a consequence, the CNB removed the exchange rate floor of EUR1:CZK27, which it had imposed in 2013 to fend off deflation, in April 2017. Following the lifting of the cap, currency volatility has slightly increased but at about +2% at the time of writing, the CZK appreciation against the EUR has been far from disorderly. Volatility is likely to continue in the short term. In the medium term, we expect a gradual strengthening of the CZK to a new equilibrium rate. In any event, expect the CNB to be prepared to mitigate potential excessive exchange rate fluctuations, if needed.

Public finances are favorable. The fiscal balance shifted to a surplus of +0.6% of GDP in 2016 and is forecast to be near-balanced in 2017-2018. Public debt has fallen to a moderate 37% of GDP.

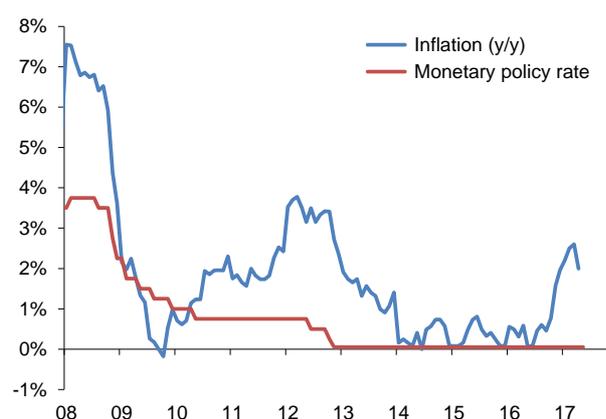
The external position is comfortable as well. The current account posted a surplus of +1.1% of GDP in 2016 and should remain in surplus in 2017-2018. Gross external debt is elevated in relation to GDP (75% in 2016) but moderate in relation to export earnings (93%) and the debt-service ratio is forecast at just 15% in 2017. Foreign exchange reserves have surged to EUR124bn in April 2017, sufficient to cover 11 months of imports or, in other terms, all external debt payments falling due in 2017.

### Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	4.5	2.4	3.0	2.8
Inflation (% end-year)	0.0	2.0	2.1	2.0
Fiscal balance (% of GDP)	-0.6	0.6	0.0	-0.1
Public debt (% of GDP)	40.3	37.2	37.0	36.0
Current account (% of GDP)	0.2	1.1	0.6	0.4
External debt (% of GDP)	70.2	74.8	72.9	72.0

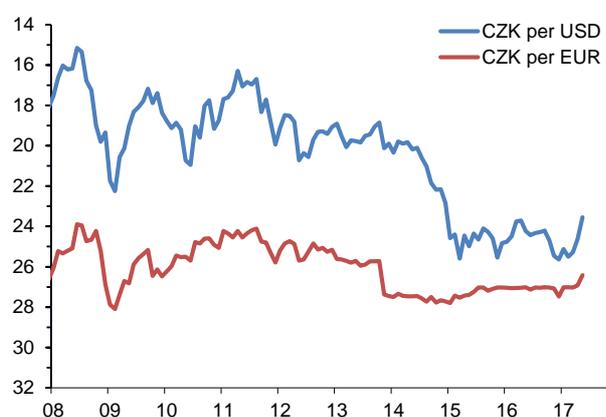
Sources: National sources, IHS, Euler Hermes

### Inflation rate and monetary policy interest rate



Sources: National sources, IHS, Euler Hermes

### Exchange rate of the CZK (inverted scale)



Sources: Czech National Bank, IHS, Euler Hermes

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