

Investment recovery will drive pick-up in growth

General Information



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



Strengths

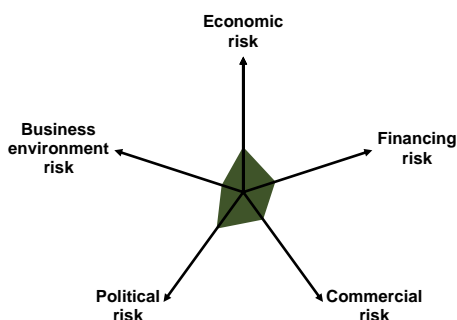
- EU membership and good international relations
- High income economy with fairly strong underlying macroeconomic fundamentals
- Solid monetary policy
- Favorable public finances
- Manageable external debt burden
- Sound banking sector that has proven resilient to adverse shocks
- Favorable business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

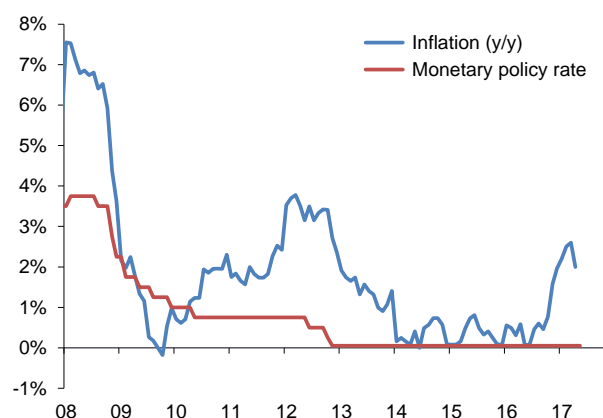
The external position is comfortable as well. The current account posted a surplus of +1.1% of GDP in 2016 and should remain in surplus in 2017-2018. Gross external debt is elevated in relation to GDP (75% in 2016) but moderate in relation to export earnings (93%) and the debt-service ratio is forecast 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

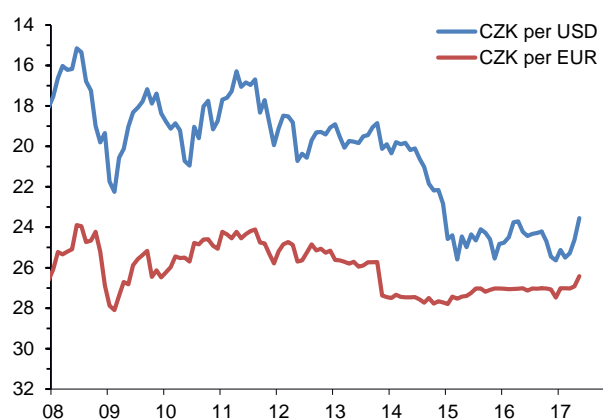
Sources: National sources, IHS, Euler Hermes

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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