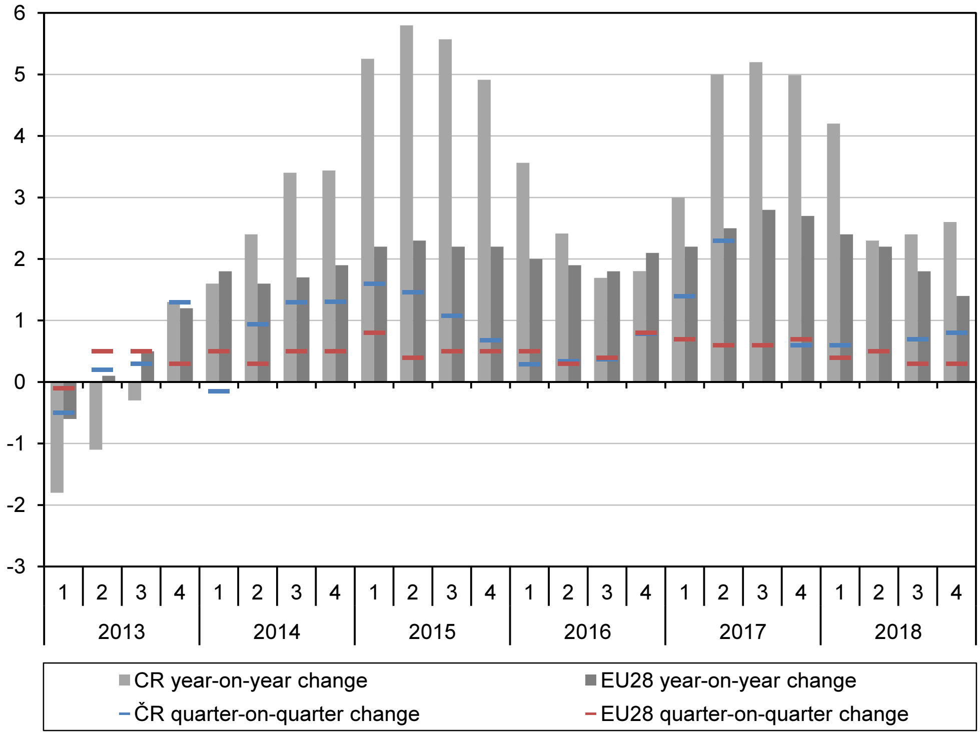
2. Overall Economic Performance

Growth of Gross domestic product contracted last year…

Gross domestic product (GDP) grew by 2.9%[1] last year. That is by 1.6 p.p. less than in year 2017. It represented the third largest addition in the last ten years. Year-on-year dynamics during the year contracted at first (4.2%, 2.3%, 2.4% in Q1, 2 and 3), the growth slightly increased again in Q4 (2.6%). All its components supported the GDP growth relatively equally in 2018. The domestic demand represented by the final consumption expenditure (1.7 p.p.)[2] and gross capital formation (0.8 p.p.) dominated. The effect of the foreign demand strengthened especially at the end of the year. The foreign trade balance contributed 0.4 p.p. to the GDP growth. The quarter-on-quarter dynamics of GDP attained rather solid levels during the year and accelerated in its second half (0.6%, 0.5%, 0.7% and 0.8% in individual quarters). Gross value added (GVA) grew by 3.0% last year. Especially the services sector, benefiting from the strong domestic demand, supported the growth. Weight dominant manufacturing further prospered, however its contribution to the GVA growth was lower compared to the preceding year. The year-on-year addition of GVA was 2.9% in Q4.

Chart 1 GDP (volume indices, adjusted for seasonal and calendar effects, in %)



Source: CZSO, Eurostat

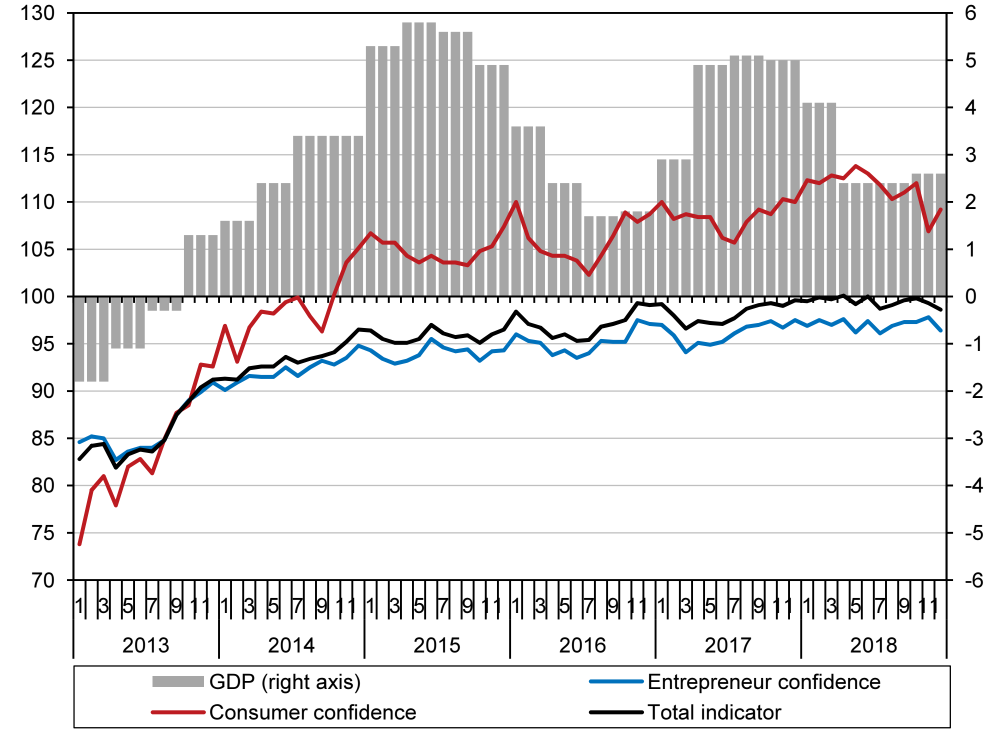
… similarly to the EU.

Total GDP growth in the European Union arrived at 1.9% in 2018 and it slowed down by 0.5 p.p. compared to year 2017. While the dynamics of the final consumption expenditure in the EU (1.5%) was weaker than the total GDP growth, growth of the capital expenditure was relatively strong (3.8%). Investment activity was especially significant at the newer Union members. Combination of strong growth of investments and consumption expenditure caused, that only new members were placed on the second to thirteenth positions of the fastest growing EU economies. Ireland (6.7%) ranked the first similarly to year 2017, followed by Malta (6.6%) and Poland (5.1%). The GDP of the Union increased by 0.3% in Q4 compared to the previous quarter.

[1] The development of the GDP, gross value added and their components is expressed with the help of the volume indices (i.e. adjusted for changes in prices) and adjusted for seasonal and calendar effects. Data are valid as of 2.4.2019.
[2] Additions to the GDP change after exclusion of imports for final use.

Year-on-year addition reached 1.4%. Relatively marked fall of the year-on-year rate of growth can also be linked to the stagnation of the largest EU economy – Germany. Here, the year-on-year dynamics was 0.6%, economic growth was the second lowest in the Union. The GDP of Italy remained the same year-on-year, the economy of France expanded by 1.0%. Malta (7.4%), Latvia (5.6%) and Hungary (4.9%) recorded the highest year-on-year addition in Q4.

Chart 2 GDP (volume indices, adjusted for seasonal and calendar effects, year-on-year in %, right axis) **and confidence indicators** (2005 = 100, left axis)



Source: CZSO

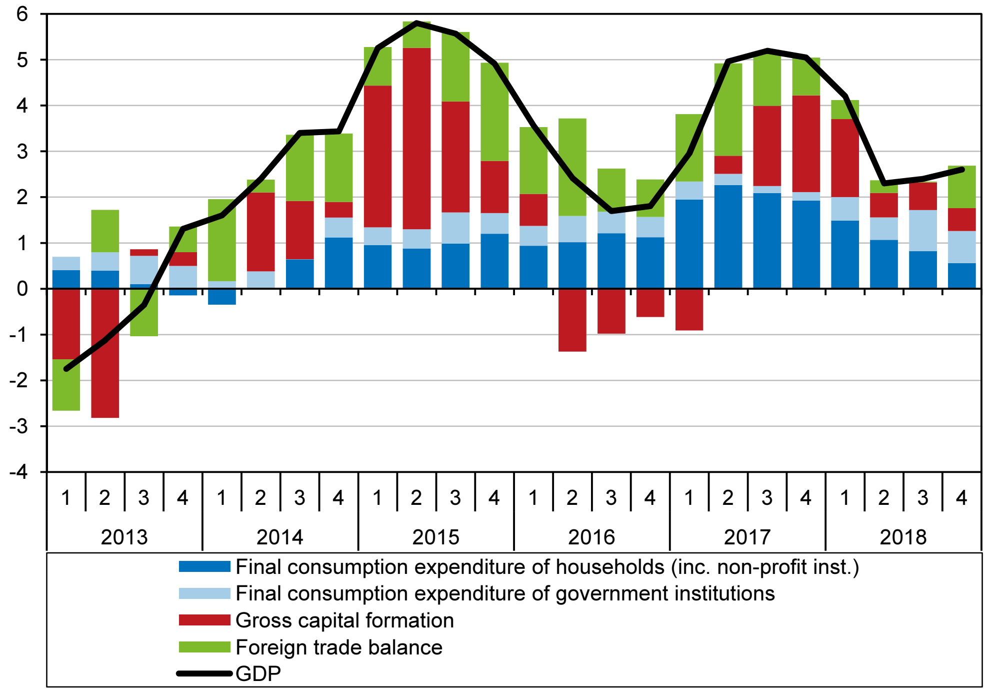
Increase of the volume of paid out salaries and wages hit the highest value in the last twenty years last year.

The volume of paid out salaries and wages increased by 9.3% last year compared to the year before. That is the most since year 1996. Simultaneously, the employment increased by 1.6%[3], the increase of the volume of paid out funds was thus reflected in the average wage. The volume of salaries and wages grew by 6.6%[4] in real terms last year. The year-on-year addition to the volume of salaries and wages amounted to 7.5% in Q4 only, which is the least since Q1 2017. Growth in real terms formed still solid 4.8%. Strong growth of salaries and wages was experienced across the branches last year. Volume of wage resources increased by 8.1% in manufacturing, by 9.1% in trade, transportation, accommodation and restaurants; information and communication services experienced an acceleration to 10.6% (accompanied by simultaneous increase of employment by 4.6%). Real estate activities waited to see a double-digit growth of salaries and wages (12.3%) and the branches with the predominant public sector[5] continued in the strong year 2017 (12.0%). The volume of paid out wages climbed to 6.9% in construction (given the fall of employment by 0.4%). Salaries and wages grew the slowest in financial and insurance activities (5.9 %), the employment did not grow here at all in contrast to the rest of the economy. The year-on-year dynamics of the volume of salaries and wages slowed down across the branches (the most for the real estate activities to 8.1%, to 7.4% for

[3] Employment in the national accounts conception, data regarding persons as well as hours worked are seasonally adjusted.
[4] Converted into the real expression using the deflator of final consumption expenditure of households.
[5] Public administration, education, health and social care.

branches with the predominance of the public sector) in Q4. The grouping trade, transportation, accommodation and food service activities presented an exception, with the rate of growth accelerating to 9.0%. Record rate of growth of the volume of salaries and wages did not do without partial changes in the structure of distribution of created gross value added. Also for this reason, the profitability of non-financial businesses[6] fell to 47.0% last year, the lowest point in the available time series. Nevertheless, this indicator remains above average compared to the EU average (it fluctuates around 40% in the long-term).

Chart 3 Contribution of expenditure items to real GDP change* (volume indices, year-on-year growth, contributions in p.p., GDP in %)



Source: CZSO
*after exclusion of imports for final use

Consumption remained the key pro-growth factor. Its year-on-year dynamics slowed down in case of households towards the end of the year.

Total growth of final consumption expenditure attained 3.3% in 2018. The dynamics managed to stay above the 3% boundary already four years in a row. Household consumption grew by 3.1% and government institutions by 3.7% (the most since 2003). Total consumption increased by 2.6% year-on-year in Q4 only (the dynamics slid below 3% after 14 quarters). The smaller addition of household expenditure was mainly behind the weaker growth (2.2%, the least since Q3 2014), resulting also in a lower addition to the GDP growth (0.6 p.p.). On the contrary, the government institutions expended on consumption by 3.6% more year-on-year, which contributed 0.7 p.p. to the growth.

Households put more money aside last year.

Slower dynamics of household consumption emerged despite the record average wage growth last year. Households in fact saved a notable part of income. The savings rate[7] arrived at 10.8% last year. Even though it presents a relatively low number in the long-term view (the savings rate generally exceeds 11%), it is a considerable increase compared to the record low value of year 2017 (9.5%).

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[6] Profitability rate of the non-financial businesses is defined as the share of the gross operating surplus relative to the gross value added (B.2g/B.1g). This indicator represents the profitability of the production factors from the production process.
[7] The household saving rate is defined as the share of gross savings and gross disposable income with the inclusion of adjustment for net share of households on pension funds reserves B.8g/(B.6g+D.8). Gross savings represent the part of gross disposable income, which was not consumed in the form of final consumption expenditure.

Average monthly household income per capita[8] was 26 389 CZK last year and it grew by 1 810 CZK year-on-year, which is the largest nominal increase in the whole available time series. Household income growth per capita in real terms attained 4.7% last year (adjusted by the deflator of household final consumption expenditure for year 2018). Social transfers in kind[9] are also part of these incomes. Their average monthly value per capita amounted to 4 689 CZK last year and it participated by 17.8% on total household income.

Investment expenditure grew strongly for households, government institutions as well as non-financial businesses last year.

Gross fixed capital expenditure increased by 5.7% last year. Fixed capital expenditure, which is represented by investments in the national accounts, grew by 10.4% (and their contribution to the GDP growth totalled 2.0 p.p.). Change of stock of inventories had an adverse effect[10] (-1.2 p.p.). Investment expenditure grew by 10.4% in Q4. At the same time, the quarter-on-quarter decrease of 0.2% occurred for the first time since Q2 2016. Quarter-on-quarter dynamics of the gross fixed capital formation nevertheless reached a very high level in Q1 to 3 (4.6%, 2.7% and 2.9%). From the point of view of individual sectors, non-financial businesses contributed to the growth of the gross fixed capital formation by more than one half last year and its investment grew by 9.7% in nominal terms. Investment rate[11] of non-financial businesses thus grew by 1.5 p.p. year-on-year to 29.6% (the most since year 2013). Government institution sector provided the second largest contribution. Its investment activity (nominal increase of 27.7%) was among other things influenced by the cycle of European funds drawing (necessity to finalise drawing before the end of the year). Households also provided a relatively high contribution, they invested by 9.5% funds more compared to year 2017. Their investment rate[12] grew for the fifth year in a row and arrived at 9.4% (the most since year 2010). In contrast the financial institutions, which were considerably boosting their fixed capital formation expenditure during years 2015 to 2017, did not continue in this trend last year (slump of 15.3%).

Heightened activity of the government institution sector affected investment into other buildings and structures

Investment into other buildings and structures[13] grew the most in the last year (14.4%). Dynamics of component, where the government institution sector plays a significant role was accelerating since the beginning of the year. Mild slow down to 13.1% was recorded in Q4; where especially the high basis from the last year is behind this. The results were mostly affected by the accelerated drawing of European funds. Double digit growth of investment into housing continued (12.8%). The dynamics held up throughout the whole year. In Q4, investment into housing increased by 12.1% year-on-year. Strengthened investment activity involved the businesses as well. It is apparent especially on the increase of investment into ICT and other machinery and equipment by 10.1% (it was 3.3% in 2017). The acceleration

[8] Average monthly household income per capita in the nominal expression is defined as the share of adjusted disposable household income and mean population.

[9] Social transfers in kind (D.63) include the value of individual services and goods provided by government institutions and non-profit institutions serving households (NPISH), and also material benefits provided by municipalities (including reimbursement of approved household expenditure for certain types of goods and services) and all values of non-market services of government institutions and NPISH provided for individual consumption. Individual services and goods provided to households by government institutions and non-profit institutions serving households represent a value of goods and services provided in the form of health and social care, education, housing etc. These are especially in-kind benefits associated with the health insurance (payments for medical aids, medical, dental treatment, surgery etc.) covered by the health insurance companies to those, who provide these goods and services.

[10] High comparative basis of the last year is the main reason. Inventory stock grew fast throughout the whole year 2017 year-on-year and the total change amounted to +49.0 CZK bn. In the last year, the inventory stock grew only in Q1 and in total it decreased by 10.4 bn. Last year´s fall did moderated in the course of the year, nevertheless it stumbled when compared to year 2017, when the increase featured an upward tendency towards the end of the year. This difference thus dampened the contribution of capital outlays to the GDP growth for the most part of the year.

[11] Investment rate of the non-financial businesses is defined as the share of gross fixed capital formation relative to the gross value added (P.51g/B.1g). This indicator expresses the proportion of investment into the non-financial assets (buildings, machinery etc.) and value created during the production process.

[12] Household investment rate is defined as the share of gross fixed capital relative to the gross disposable income with the inclusion of adjustment for net share of households on pension funds reserves (P.51g/B.6g-D.8).

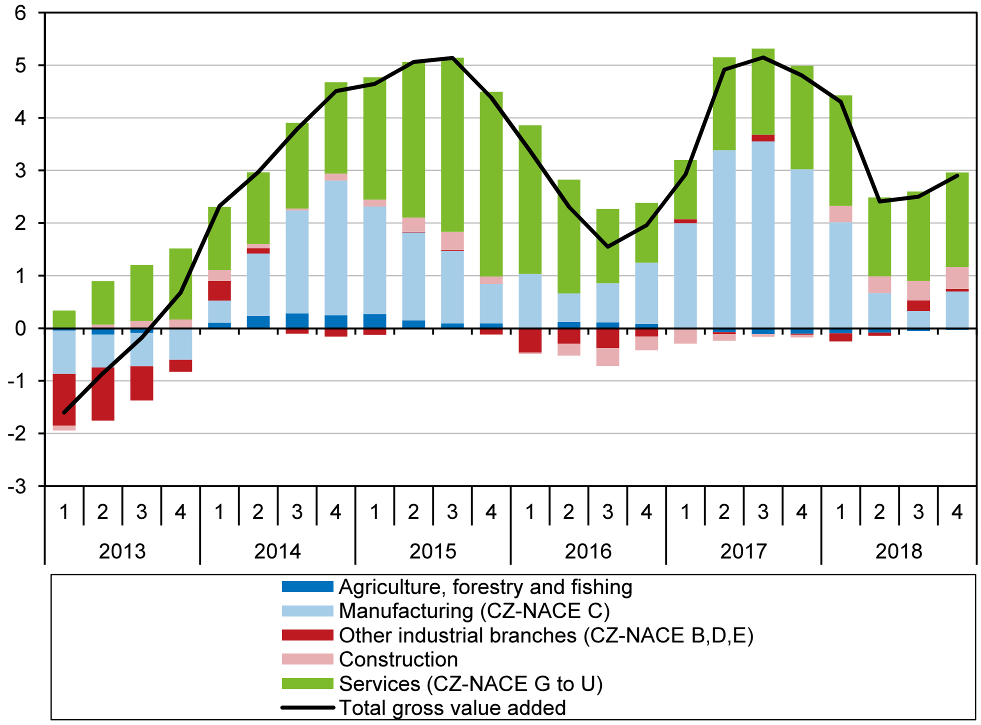
[13] Data regarding the type classification of gross fixed capital formation are not seasonally adjusted.

was 14.4% in Q4. Last year, the growth of expenditure on transportation vehicles accelerated as well to 8.8%. Investments into the products of intellectual property increased by 4.8%.

Contribution of the foreign trade balance to the GDP growth became stronger especially in the end of the year.

Foreign trade balance with goods and services reached 331.9 CZK bn[14] in 2018. It is by 49.8 bn less compared to the previous year. The slump occurred nearly exclusively for the trade with goods (surplus of 205.4 bn). Surplus of the trade with services remained practically unchanged (126.6 bn). Surplus amounted to 87.4 bn in Q4 and it fell by 8.8 bn year-on-year. Addition of the foreign trade balance to growth nevertheless strengthened towards the end of the year to 0.9 p.p. Both export and import increased year-on-year last year. Resulting balance was however marked by the fact, that the higher demand was to a large extent saturated by imports. It was valid both for the household consumption (contribution to the GDP growth 1.5 p.p. without exclusion of import for final use, 1.0 p.p. after exclusion) and the investment activity (2.6 p.p. without exclusion, 2.0 p.p. after exclusion).

Chart 4 Contributions of branches to real change in GVA (volume indices, year-on-year contributions in p.p., GVA in %)



Source: CZSO

Domestic demand favourably boosted mainly the services sector. Impact of manufacturing on the GVA growth was milder this time.

Growth of the gross value added was mostly supported by the services sector in year 2018 (1.8 p.p.). Services had the strong effect to the same degree in Q4. Among them, the weight dominant grouping trade, transportation, accommodation and restaurants recorded the most significant results last year (0.8 p.p., growth by 4.1%) last year. Information and communication, which experienced an above average GVA growth in the last two years (6.7% last year) and grow already six years in a row, recorded the second largest contribution (0.4 p.p.). Financial and insurance activities had a contribution in the size of 0.3 p.p. Manufacturing, which was the main driving force in the previous years, was more in the background (contribution 0.9 p.p., growth 3.4%). Construction had a favourable effect on the GVA dynamics throughout the

[14] According to the methodology of quarterly national accounts (import and export in CIF/FOB prices).

whole year (0.4 p.p.). Its GVA increased by 6.7%, which is the most since year 2004. Only this year it was possible to exceed the nominal level of GVA from year 2010[15].

[15] Value expressed in 2010 constant prices has not been exceeded yet.