

## 1. External Economic Environment

The 2009 developments of the global economy and the global markets were marked by moderate economic downturn. The world's most important economies recorded a drastic negative change in economic performance. The economic crisis, initially starting with a financial crisis in the U.S., the world's leading economy, finally manifested itself in other global economic centres – Europe and Asia. Its impact was differentiated. As a side effect of the downturn in economic activity, the world prices of different commodities dropped and the inflation rate in consumer prices was also lower. In addition, the adverse economic development was reflected in the decreased volume of international trade. External imbalance showed a more favourable development in the developed economies, while the internal imbalance deteriorated.

- **Global GDP declined by 0.6%**

The weakened rate of economic growth in 2008 turned into recession in the next year. According to the recent estimates of IMF, the world economy contracted by 0.8% in 2009. During the year, however, the most important economies showed signs of gradual recovery. The reason behind this was the rather strong domestic demand supported by the growth-oriented economic policy. Nevertheless, the slump in the first half of the year prevailed in the annual point of view and caused the year of 2009 to be below the average of the period 2001 to 2008. The difference was 4.5 percentage points. However, the downturn of global economic activity was not so dramatic, particularly thanks to the economic growth in the developing economies of China and India. Expansive monetary and fiscal policies in all countries hit by the recession also played an important role.

Hand in hand with the economic recession, there was also a lower willingness to trade on the world markets. Based on the IMF estimates, the world trade volume decreased by 10.7% in 2009 while, in the previous year, the intensity of international trade increased by 2.8%.

- **The year-on-year decline of the U.S. economy ...**

The adverse economic development in many countries was substantially influenced by the development in the world's strongest economy. On a year-to-year basis, the U.S. economy reported a 2.4% drop in 2009, which was significantly below the average of the period 2001 to 2008 (2.1%). The gradual stabilization of the real-estate market, banking and corporate sectors (also with the help of high public expenditure and state guarantees) calmed down domestic economic operators, allowing the American economy to start rebounding from the bottom in the second half of the year. Examples can include renewed creation of inventory by businesses as well as a rather strong domestic consumption supported by public expenditure and tax cuts.

**Table No. 1.1 Gross domestic product**

In %, year-on-year, 2000 constant prices

	2001	2002	2003	2004	2005	2006	2007	2008	2009
World	2.3	2.9	3.6	4.9	4.5	5.1	5.2	3.0	-0.6
Euro area	1.9	0.9	0.8	2.2	1.7	2.9	2.7	0.6	-4.1
Germany	1.2	0.0	-0.2	1.2	0.8	3.0	2.5	1.2	-5.0
U.S.A.	0.8	1.6	2.5	3.6	2.9	2.8	2.0	0.5	-2.4
Russia	5.1	4.7	7.3	7.2	6.4	7.7	8.1	5.6	-7.9
Japan	0.2	0.3	1.4	2.7	1.9	2.0	2.4	-1.2	-5.2
China	8.3	9.1	10.0	10.1	10.4	11.6	13.0	9.6	8.7

Note: The 2009 figures as estimated by IMF.

Source: IMF

- **... affected also the economies of the euro area and EU-27...**

On a year-to-year basis, the euro area<sup>1</sup> economies dropped by 4.1% on the average in 2009, in spite of the sizeable monetary and fiscal stimuli, particularly in the form of historically low interest rates of ECB. This performance was lower than the 2001–2008 average amounting to 1.7%. The intensity of the economic recession and its impacts varied throughout the euro area countries. Especially countries with substantial internal and external imbalances were hit rather severely. Spain, Greece

<sup>1</sup> In this part of the paper, the euro area includes the initial twelve countries, which accepted euro as the first.

and Ireland experienced a strong reduction in the economic performance. The euro area economy suffered, in particular, from decreasing exports, more stringent conditions on the banking market, insecurity and increasing unemployment resulting in reduction of household consumption. The decrease in EU-27 by 4.2% was slightly deeper than in 2008.

- ***... as well as the German economy***

The German economy was hit by the economic slump more severely in the past year than the euro area countries or the EU-27 average. The year-on-year decrease of economic performance reached 5.0%, which was a below-average value in terms of the medium-term average of the period 2001–2008 (amounting to 1.2%). Being an industry-oriented economy, a fall in exports and subsequently in industrial production with large unused capacities were the most difficult problems Germany faced.

- ***Out of the selected countries, the Russian GDP recorded the largest year-on-year drop***

The Russian economy recorded a sharp economic decline in 2009, which resulted in a GDP drop by 7.9% on a year-to-year basis, while the average growth in the period 2001–2008 was 14.4 percentage points higher. Since mid-2008 already, the oil price was gradually decreasing and Russia, as an important exporter of oil and natural gas, was losing money on the decrease in prices that continued in the first half of 2009 as well. Russia went through a period of massive loss of dynamics of domestic demand when both household consumption expenditure and corporate investment expenditure fell.

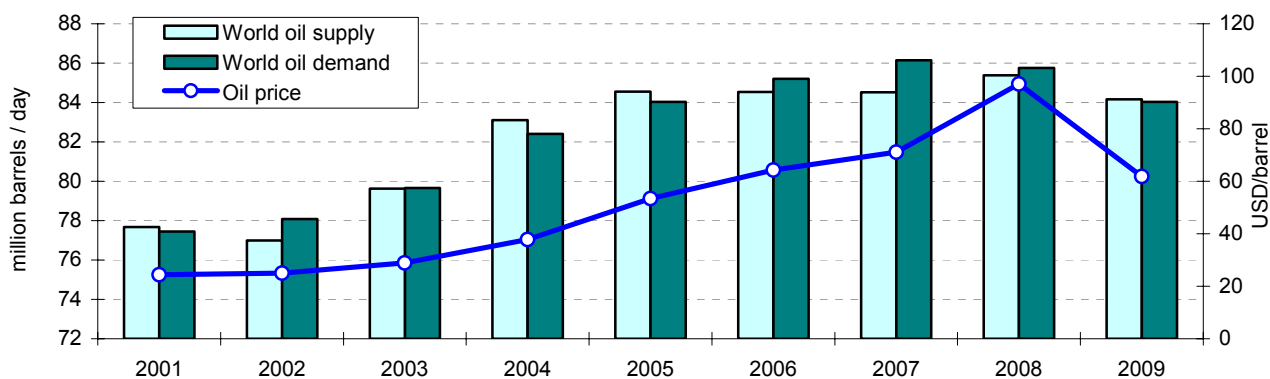
- ***China benefited from the undervalued Yuan***

Also the leading countries of the Asian continent recorded a GDP decrease in 2009, reaching 5.2% in case of Japan, or just slowdown of economic growth rate to 8.7% in case of China. The medium-term average of economic growth rates was 1.2% for Japan and 10.3% for China. Japan, as a country strongly dependent on the exports to USA and Europe, was negatively influenced by the decrease in foreign demand. Especially corporate investments and household demand experienced a substantial decrease. The Chinese economy benefited particularly from the artificially maintained exchange rate of Yuan, which was undervalued in relation to the main global currencies, thus supporting Chinese exports. Other factors included also the strong stimulating measures by the state in order to support supply and higher economic growth. The Chinese financial sector avoided the negative impact of the financial crisis, especially thanks to its precaution.

- ***Reduced demand resulted in a significant fall of oil prices ...***

The previous period set a strong growth trend for the prices of oil and other commodities on the world market, which culminated in 2008. This growth was mostly pulled by a larger demand of the developing economies than by oil supply. In the period 2001–2008, the oil price increased on average by 16.7% on a year-to-year basis. This trend was reversed last year and the oil price dropped by 36.3% in 2009. If in 2008 the average oil price was 97USD, it was only 61.8USD in the following year. The reason behind this was primarily a lower demand for oil on the world markets, which was caused by the downturn of economic activity. In the second half of the year, the demand was gradually rising, especially in China and other countries, although remaining at lower levels. The volume of the world oil demand in 2009 corresponded to the 2005 level. The oil supply responded, with a certain delay, to the slightly increasing need for oil as well. In spite of the decrease on both sides of the oil market, the volumes of world supply, world demand and the oil price in 2009 were still above the average of 2001–2008.

**Graph No. 1.1 Global oil supply and global oil demand (million barrels per day), oil price (USD/barrel)**



Note: Global oil supply and global oil demand are calculated as the simple average of quarterly data. The oil price is determined as the simple average of world oil prices for Brent, Dubai Fateh and West Texas Intermediate.

Source: Energy Information Administration, IMF

• **... and prices of all selected commodities** The economic downturn in the most important centres of the global economy and trade caused the prices to fall across all selected commodities, whereas just last year, there was an increase in the aggregate price index for commodities, food and drinks as well as, and particularly, for energy influenced by the accelerating oil prices. The decreasing demand of households and businesses for commodity production inputs in the past year was reflected in the overall decrease of commodity prices. The year of 2009 was marked by the sharpest fall in prices of energy and metals, by more than one-third compared to 2008. For energy, it is once again certainly possible to mention the factor of oil, which contributed to the dramatic year-on-year decrease in energy prices by 37% on average. The prices of industrial inputs dropped by more than 27% on a year-to-year basis. From the point of view of medium-term average of index growth in the period 2001–2008, all indices were at a much lower level. In general, the prices of commodities started growing again in the second half of 2009, particularly thanks to a moderate improvement of economic development in the developed economies and thanks to the increased demand in China and other Asian economies.

Deflation on the world commodity markets led to cost reductions for businesses operating in economies dependent on the imports of these raw materials and commodities. The prices of inputs used by industrial manufacturers were thus influenced in the downward trend, as were – in turn – also the consumer prices. During the period of recession and turbulent economic development, there is, most of the time, a growing tendency to invest money in precious metals that keep their value in the longer run. This behaviour can be documented by the above-average increase in the price of gold during the last year when the demand for gold grew significantly.

**Table No. 1.2 Change in commodity prices on the world market in dollar terms**

In %, year-on-year

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Aggregate index	-7.9	0.0	11.6	23.7	24.2	20.7	11.8	27.5	-31.0
Food and drinks	-3.0	5.2	6.1	12.6	0.6	10.3	15.1	23.3	-13.3
Industrial inputs	-6.6	-1.7	5.5	18.4	12.2	36.3	13.2	-5.7	-24.8
Metals	-10.3	-3.5	11.8	34.6	22.4	56.2	17.4	-8.0	-28.6
Energy	-10.6	-1.7	17.0	31.1	38.1	19.2	10.5	40.1	-36.8
Gold	14.6	17.1	12.5	8.7	35.7	15.4	25.6	14.6	21.5

Note: Energy includes oil, natural gas and coal.

Source: IMF, CZSO, own calculations

- **Very moderate inflation rate or even deflation in consumer prices**

The year of 2009 also brought a reversal in consumer prices. If the year-on-year values of the consumer price index in 2008 represented the highest results compared to previous years, the year of 2009 brought an unambiguous disinflation in the selected countries, and thus also a below-average change in prices compared to the average of the period 2001–2008. In China, Japan and U.S., disinflation resulted in an absolute decrease in prices. This was an indirect manifestation of the substantial fall in the global prices of important commodities and also the reduced demand. The largest deviation from the 2001–2008 average was recorded in 2009 for the consumer prices in China by -3.4 percentage points as well as in the U.S. by -3.2 percentage points. In EU-27, Germany and Russia, the difference from the medium-term average reached the nearly identical 1.6 and 1.7 percentage points, respectively.

**Table No. 1.3 Change in consumer prices**

	In %, year-on-year								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
EU-27	3.2	2.5	2.1	2.3	2.3	2.3	2.4	3.7	1.0
Euro area	2.4	2.3	2.1	2.1	2.2	2.2	2.1	3.3	0.3
Germany	1.9	1.5	1.0	1.7	1.5	1.8	2.3	2.8	0.2
U.S.A.	2.8	1.6	2.3	2.7	3.4	3.2	2.9	3.8	-0.4
Russia	21.5	15.8	13.7	10.9	12.7	9.7	9.0	14.1	11.7
Japan	-0.8	-0.9	-0.2	0.0	-0.3	0.2	0.1	1.4	-1.4
China	0.7	-0.7	1.1	3.8	1.8	1.6	4.8	5.9	-1.0

Source: OECD, Eurostat

- **End of strengthening of the crown against euro ...**

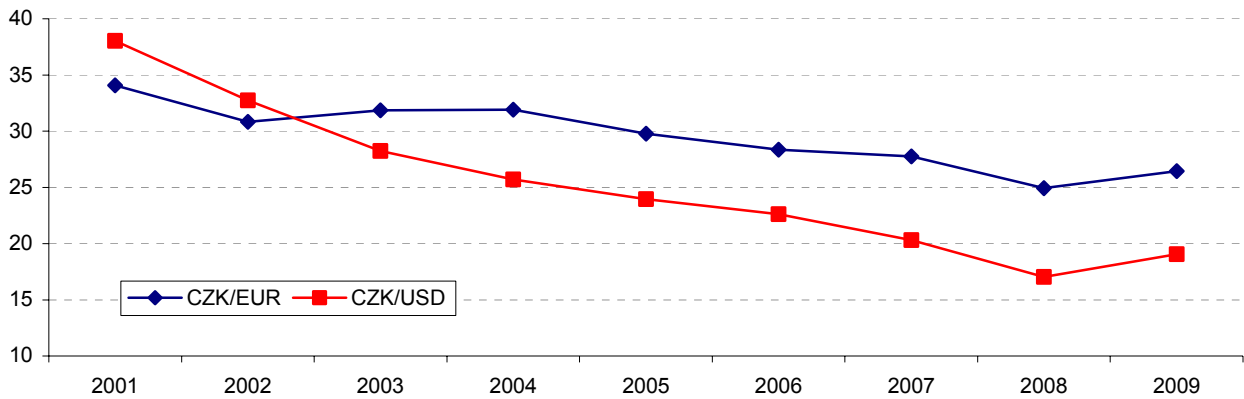
The medium-term strengthening of the Czech crown against the world's leading currencies – the euro and the U.S. dollar – was interrupted in 2009. The Czech crown weakened against euro by 5.6% on a year-to-year basis. However, the development trends of the exchange rate against euro have varied throughout 2009. Until mid-February, the exchange rate weakened up to nearly 29.50 CZK/EUR, then was strengthening until mid-September to close to 25 CZK/EUR to show depreciation tendencies since then. The final value at the end of 2009 was around 26.2 CZK/EUR. The reasons behind the exchange rate volatility lied, in particular, in fluctuation of short-term capital – first the flight of foreign investors from Czech crown assets in the first half of the year when the entire region was seen as being subject to a very high risk, then calming of the situation and return of the investors.

- **... as well as the U.S. dollar**

Similarly as in relation to euro, the Czech crown depreciated also against the U.S. dollar – as much as twice compared to euro (by 10.6% on a year-to-year basis). Also this exchange rate was subject to volatility. Until mid-February, the exchange rate weakened up to around 23.3 CZK/USD; afterwards the crown was altogether strengthening to slightly below 17 CZK/USD in the first half of November. Since then, the exchange rate against the U.S. dollar was again depreciating to approximately 18.2 CZK/USD at the end of 2009.

The exchange rate of euro against the U.S. dollar was appreciating, with slight fluctuations, nearly throughout the entire year of 2009. The better investment opportunities for foreign investors on European stock and commodity markets could have been the reason. Since the beginning of 2009, the exchange rate has been weakening and the U.S. dollar has been gaining against euro. The first news about the unfavourable fiscal situation in Greece has largely negatively influenced the development of the euro area exchange rate.

**Graph No. 1.2 Exchange rate of CZK/EUR and CZK/USD**



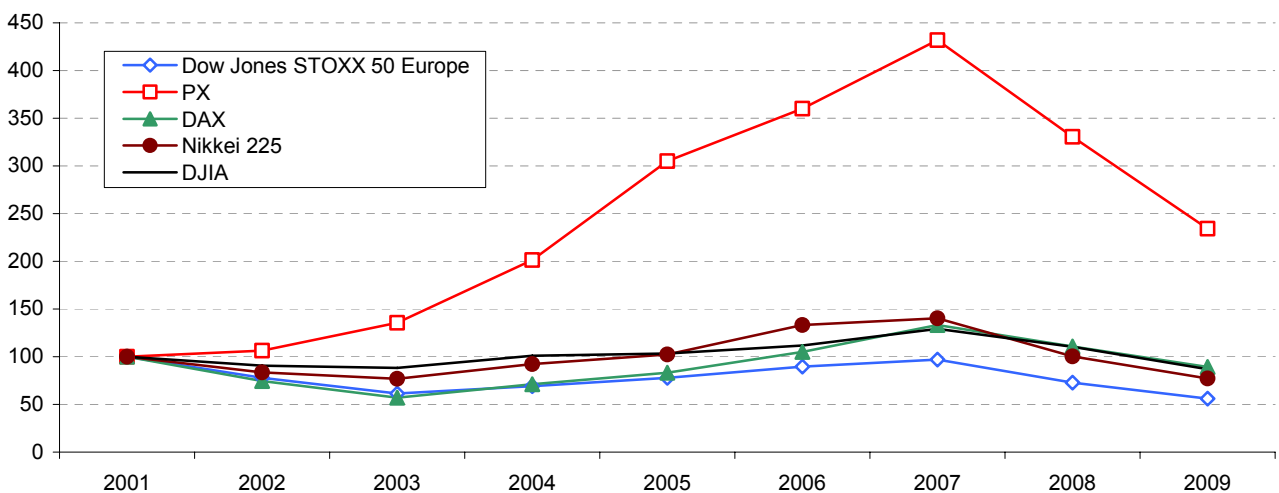
Source: CZSO

• **Stock market indices remained below the 2008 average in spite of trading recovery**

Since 2008, the selected stock markets have not been doing as well as in the previous period. The results of the selected 2008 stock market indices were affected by the drop from the high values at the end of 2007. This development caused that, although the activity on stock markets has been increasing nearly throughout the year of 2009, this-year's average values ended up below the 2008 average. Own calculations based on Eurostat data imply that, out of the selected stock market indices, the Prague stock-exchange securities recorded the worst result. PX dropped by more than 29% on a year-to-year basis. The stock exchange index PX was losing its value from January to February 2009; starting from March, its value was increasing again. Since the beginning of August 2009, the index value stabilized above the level of 1,100 points, while still being around the lowest value of 630 points in the middle of February. On contrary, the American Dow Jones index experienced the lowest decrease, dropping by 21.1%.

In global, the financial sector was stabilizing thanks to the state measures. Nevertheless, risk aversion and insecurity still prevailed among investors, with the correspondingly strong demand for risk-free financial instruments – government bonds or precious metals, as the case may be. The limited credit resources for both business and households, resulting from higher precaution by the banks, also played their role in investments on the stock markets.

**Graph No. 1.3 Stock market indices (2001=100)**



Source: Eurostat

• **Improvement of external imbalanced was in contrast ...**

Similarly to previous year of 2008, external imbalance expressed as the percentage share of balance of payments current account balance in GDP showed a much differentiated development in developed countries in 2009. Both imports and exports

had to be reduced to various extents as a result of the weakening domestic and foreign demand. However, these reductions did not have to be caused by the market functioning only, but also by the larger extent of trade protectionism. According to the preliminary estimates of IMF, the current account deficit in GDP was most of the times reduced in 2009. In the U.S. and Great Britain, for instance, it decreased roughly by a half to -2.9% and -1.3%, respectively. In spite of the decreased surplus of the current account, large countries and major exporters such as Germany, Japan, Russia and China maintained a positive share of the current account balance in GDP. The Baltic countries recorded a shift from the current account deficit to the current account surplus. Within Europe, the countries with the largest external imbalance included Greece (-11.2%), Portugal (-10.1%) and Spain (-5.1%).

- **... with the deteriorated internal imbalance**

The problems in the monetary and real economy affected, in many respects, the economic policy in most countries. The monetary conditions were becoming much more loose thanks to the money pumped into the economy and the interest rate cuts. Since 2008 already, also fiscal policy started becoming more expansive, aiming at supporting domestic supply and demand. Lack of funds on the revenue side and, on contrary, increased needs on the expenditure side resulted in deterioration of internal imbalance in many developed countries. According to the preliminary estimates of IMF, the share of public budget deficit in GDP increased steeply in 2009 in the U.S. to -12.5%, in Great Britain to -10.9%, in Japan to -10.3%, as well as in Southern European countries using euro.

- **Foreign demand for the Czech Republic recorded a sharp drop**

The Czech Republic, as a small open economy, is highly dependent on the economic development abroad. The European Union, holding a more than 86% share in Czech exports in 2009, naturally was and is its most important trade partner. The specific countries included, namely, Germany with over a 32% share in Czech exports, followed by Slovakia, Poland, France and Great Britain. The drastic decrease of imports to those countries in 2009 had a negative effect on the Czech economy in the form of lower export activities. Foreign demand (expressed as the imports of goods and services to the respective country) reduced the most in the U.S. and Japan last year; nevertheless, a more than 10% year-on-year decrease of imports of goods and services was true for nearly all important commercial centres. In Germany, this decrease reached nearly 9%, in EU-27 12.1%. In all important economies, the year-on-year changes in the imports of goods and services (from 2000 constant prices) in 2009 were much below the average compared to the period 2001–2008.

Not only the efforts of businesses to reduce and streamline production, but also the economizing efforts of households can be considered as factors behind the substantial reduction of import activities. Both resulted from the still increased insecurity of consumers as well as producers. At the same time, it provided an opportunity for changes in consumer preferences and for larger demand for domestic products in order to support the growth of the domestic economy.

**Table No. 1.4 Imports of goods and services**

In %, year-on-year, 2000 constant prices

	2001	2002	2003	2004	2005	2006	2007	2008	2009
EU-27	2.7	1.5	3.3	7.6	6.3	9.2	5.5	1.3	-12.7
Euro area	2.2	0.4	2.9	7.0	5.8	8.3	5.4	1.0	-11.9
Germany	1.2	-1.4	5.4	7.3	6.7	11.9	4.8	4.3	-8.9
U.S.A.	-2.8	3.4	4.4	11.0	6.1	6.1	2.0	-3.2	-13.9
Japan	0.6	0.9	3.9	8.1	5.8	4.2	1.6	0.9	-17.0

Source: Eurostat