

1. External economic environment

The development of the world economy in 2008 was substantially affected by a serious economic recession. The world's strongest economy, the USA, experienced frequent and substantial upheaval in the financial markets which then spread to Europe and Japan. The unfavourable development and lack of trust in the global financial markets affected the world's real economy very negatively.

- ***The rapid slowdown of international economic growth***

Upon the basis of the available International Monetary Fund data, world economic growth culminated in 2007. In 2008, a relatively rapid fall in the growth rate of world GDP was noted from 5.2% to 3.2%. This slump also manifested itself in the below average nature of 2008 in relation to the averages for 2001 to 2007. The difference in comparison with this average was -0.8 percentage points. The fall in the growth rate for international (world) trade went hand in hand with the economic slowdown. According to IMF data, world trade increased in 2008 by 3.3%, which was 3.9 percentage points lower than in the previous year.

- ***The financial crisis in the USA resulted in an economic crisis***

The unfavourable economic development across almost all the continents was substantially influenced by the development in the world's strongest economy. The US economy slowed down year-on-year by 0.9 of a percentage point to 1.1% growth in 2008, which was significantly below the average for 2001 to 2007 (2.3%). Several moments in the American economy were also of fundamental importance for other developed countries. Several significant American financial institutions were taken over by other financial groups or by the state after experiencing difficulties. After the fall of the one of the most significant banking groups in September 2008, the mortgage crisis which had been ongoing since the middle of the year transformed itself into a crisis in the financial markets and the real economy.

The negative reports on the US financial system worsened the trust of the domestic and international subjects in the domestic financial markets. As a consequence of the fall in trust and the falling prices of real estate and assets, households limited their consumption. The interbank market ceased to function and banks stopped lending to one another. As a consequence, banks with insufficient liquidity made access to credit more difficult for American companies and consumers. Companies rapidly limited their production and their investment expenditure.

Table no. 1.1 Gross Domestic Product (in %, year-on year, constant prices 2000)

	2001	2002	2003	2004	2005	2006	2007	2008
World	2.2	2.8	3.6	4.9	4.5	5.1	5.2	3.2*
Eurozone	1.9	0.9	0.8	2.2	1.7	2.9	2.7	0.9
Germany	1.2	0.0	-0.2	1.2	0.8	3.0	2.5	1.3
USA	0.8	1.6	2.5	3.6	2.9	2.8	2.0	1.1
Russia	5.1	4.7	7.3	7.2	6.4	7.7	8.1	5.6
Japan	0.2	0.3	1.4	2.7	1.9	2.0	2.4	-0.6
China	8.3	9.1	10.0	10.1	10.4	11.6	13.0	9.0

Note: * The information for 2008 is the IMF estimate.

Source: IMF

- ***Economic growth slowed more in the EU 27 than in the Eurozone***

The financial crisis and the subsequent recession and its impact differed in intensity in various countries. In particular, states with significant internal and external imbalances were affected very strongly. The economy of the Eurozone slowed from 2.7% in 2007 to 0.9% in 2008. This output was 1.5% lower than the average for the period from 2001 to 2007. The growth in GDP in the EU 27 slowed slightly more (by 2 percentage points) to 0.9% as opposed to 2007.

- ***Above average GDP growth in Germany***

In 2008, the German economy reported a year-on-year growth in economic performance by 1.3%: this value was slightly above average from the point of view of the medium-term average for the period from 2001 to 2007 (1.1%). The economic growth in Germany was mainly led by growing company investments, although foreign demand fell in the second half of 2008 along with foreign trade and household consumption stagnated.

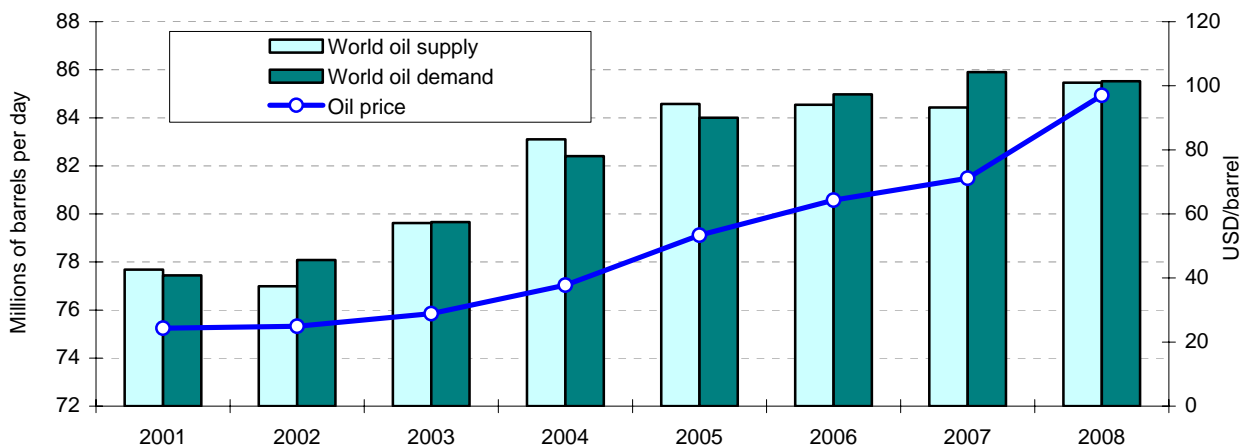
- **The pace of GDP growth in Russia slowed after two years of acceleration**

After a two-year period of acceleration in GDP growth, the Russian economy noted a slowdown in its growth rate by 2.5 percentage points to 5.6% in 2008. The average from 2001 to 2007 was 1 percentage point higher. In the first half of 2008, Russia benefited from high oil and gas prices as a significant exporter, but it suffered losses from the middle of 2008 when oil prices reached their peak.

- **The rapid fall of oil prices in the second half of 2008**
...

After the substantial increase in oil prices and the prices for further commodities in the world market in previous years, 2008 did not represent a change in the established trend from the point of view of the annual averages. In the period from 2001 to 2007, the oil price rose year-on-year on average by 15.4%, but this was twice as much in 2008 (36.4%). Even though the first half of 2008 was characterised by the repeated achievement of record oil prices, there was a rapid fall in prices in the second half of the year caused mainly by the relatively rapidly falling demand in world markets. The demand for oil had already fallen from the end of 2007. Whereas the price for a barrel of Brent crude was 135 USD in July 2008 (according to Czech Statistical Office data), it was almost 70% less in December (41.5 USD per barrel). The supply of oil reacted to the weakening demand with a slight delay and less oil began to be produced towards the end of 2008 thanks to the intervention of OPEC.

Graph no. 1.1 World oil supply and oil demand (in millions of barrels per day), oil prices (in USD/barrel)



Note: The oil price is designated as the simple average of the world Brent, Dubai Fateh and West Texas Intermediate oil prices.

Source: Energy Information Administration, IMF

- **... and some commodities**

As with the developments concerning oil prices, it was also possible to monitor similarly antithetic developments in the prices of some other commodities in 2008. 2008 was also characterised by the rapid acceleration of prices for energy or food and beverages by 40% or 23.3% respectively in comparison with 2007, although there was a significant fall in the prices of food and beverages in the second half of 2008 due to a high worldwide harvest. On the other hand, the prices of industrial inputs and metal fell year-on-year by almost 6% and 8% respectively. This development in the world commodity markets led to a reduction in costs for companies in those economies which are dependent upon the import of these raw materials and commodities. The pressure from the supply side of the economy in the second half of the year and the weakening demand caused the deceleration of the rate of inflation.

Table no. 1.2 The changes in the commodity prices in the world market expressed in dollars
(in %, year-on-year)

	2001	2002	2003	2004	2005	2006	2007	2008
Aggregate index	-7.9	0.0	11.6	23.7	24.2	20.7	11.8	27.5
Food and beverages	-3.0	5.2	6.1	12.6	0.6	10.3	15.1	23.3
Industrial inputs	-6.6	-1.7	5.5	18.4	12.2	36.3	13.2	-5.7
Metal	-10.3	-3.5	11.8	34.6	22.4	56.2	17.4	-8.0
Energy	-10.6	-1.7	16.9	31.2	38.1	19.2	10.5	40.1
Gold	14.6	17.1	12.5	8.7	35.7	15.4	25.6	14.6

Note: Energy includes oil, natural gas and coal.

Source: IMF, the Czech Statistical Office, own calculations

• **Consumer prices rose the most in the monitored period**

In a comparison of the annual data for the year-on-year changes in the consumer prices for 2008 with the average for the period from 2001 to 2007, 2008 achieved the highest value of change in the selected countries. The slowing growth in the world prices for significant commodities which was brought about by the global fall in economic activity in the second half of 2008 did not completely compensate for the substantial growth in prices from the first half of the same year. In 2008, the consumer prices which most deviated from the average for the period from 2001 to 2007 (4.0%) were in China (5.9%). In the Eurozone, Germany and the USA, the difference between the medium-term average and the value in 2008 was the same at 1.1 percentage points.

Table no. 1.3 The change in consumer prices (in %, year-on-year)

	2001	2002	2003	2004	2005	2006	2007	2008
Eurozone	2.4	2.3	2.1	2.2	2.2	2.2	2.1	3.3
Germany	2.0	1.4	1.0	1.7	1.6	1.6	2.3	2.8
USA	2.8	1.6	2.3	2.7	3.4	3.2	2.9	3.8
Russia	21.5	15.8	13.7	10.9	12.7	9.7	9.0	14.1
Japan	-0.8	-0.9	-0.2	0.0	-0.3	0.2	0.1	1.4
China	0.7	-0.8	1.2	3.9	1.8	1.5	4.8	5.9

Source: OECD, Eurostat

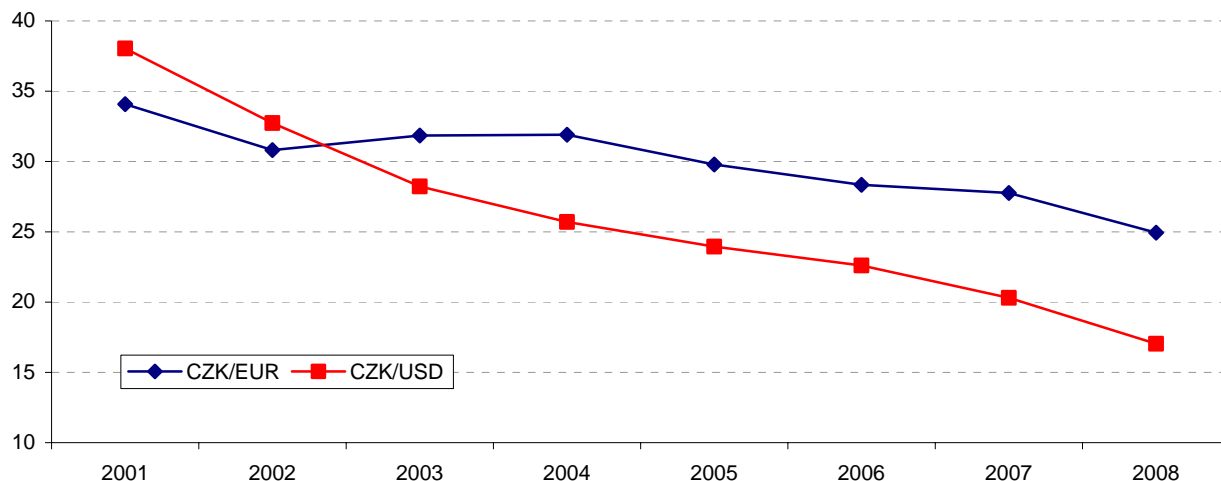
• **The crown exchange rate further strengthened**

In 2008, the Czech crown continued to strengthen against the main international currencies – by 10.2% against the Euro year-on-year and by 16.1% against the American dollar – and its exchange rate did not deviate from its medium-term trajectory. Naturally, the development of the crown exchange rate was significantly different in a comparison of the first and second halves of 2008. Whereas, the exchange rate strengthened against the Euro and the dollar in the first half of the year, a reversal occurred at the end of June and the crown embarked upon the path of depreciation: from a value of just under 23 CZK/EUR to almost 27 CZK/EUR at the end of the year. In the case of the dollar exchange rate, the lowest value was approximately 14.5 CZK/USD and the crown subsequently weakened to almost 20.5 CZK/USD.

The exchange rate of the American dollar weakened in the first half of 2008 primarily because of the worsening development of the American economy and the gradual reduction of interest rates to their historic minimum. Investors were also much more aware of the risks associated with the already traditionally high public budget deficit and the deficit in the current account for the balance of payments.

On the other hand, the correction of the previous rapid strengthening of the crown in the 2nd half of 2008 reflected the reduction of the Czech National Bank's interest rates and the increasing popularity of dollar assets. Investors also divested crown assets, because they had lost their trust in the region of Central and Eastern Europe under the influence of the unfavourable reports on the economic situation. This is born out by the fact that the Czech crown underwent similar movements to the Polish zloty or the Hungarian forint.

Graph no. 1.2 The CZK exchange rate against the EUR and USD

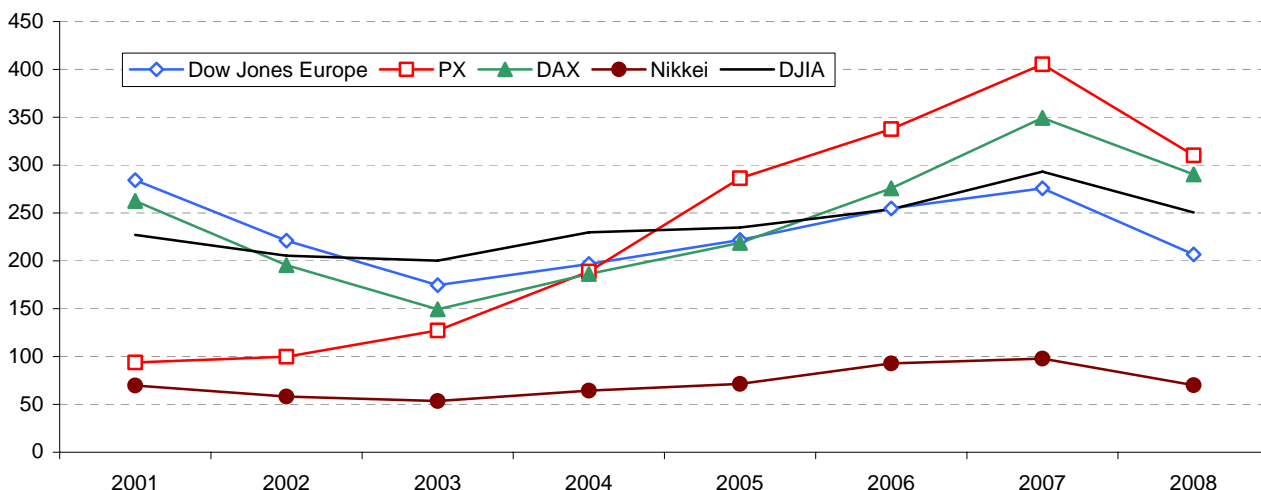


Source: the Czech Statistical Office

• **Stock market indexes fell**

From 2003 to 2007, it was possible to note an increase in the value of all the selected stock market indexes. The development in the stock markets in 2008 brought with it significant price volatility, within the framework of which the downward trend became established. The special calculations from the Eurostat data show that the American Dow Jones Index fell year-on-year by 14.5%, the German DAX fell by 16.9% and the Japanese Nikkei Index fell by more than 28%. The PX stock market index lost value relatively dramatically between September and October 2008, while it fell by almost 24% year-on-year for all of 2008. Similarly to the exchange rate movements, the movements in the stock market indexes in Central and Eastern Europe were caused by a loss of domestic and foreign investor trust in this region. Investors lost faith because of the significant uncertainties (the possible flight of liquidity from domestic banking institutions to their foreign owners) and domestic commercial subjects began to be considered to be less stable. The fall in the prices of securities influenced the size of the assets of banking and in particular non-banking subjects to a significant extent.

Graph no. 1.3 The stock market indexes (1995 =100)



Source: Eurostat

• **The differentiated development of the external and internal imbalance**

The external imbalance expressed as a percentage share of the balance of the current account of the balance of payments to the GDP developed differently in the developed countries. Both imports and exports were limited as a consequence of the weakening of domestic and international demand. According to the IMF data, the deficit of the current account to GDP fell most in 2008, for example, in Portugal (to -12.0%), Hungary (to -7.8%), Slovenia (to -5.9%) and Belgium (to -2.6%). On the other hand, it improved in the USA to -1.7%. There was also a significant reduction of the

share of the current account deficit to GDP in the Baltic states. The degree of the slump in exports and imports and the scope of the economic protectionism played a very important role in the development of the internal imbalances in the individual states.

Insufficient liquidity in the financial markets forced many developed countries to adopt measures to support and clean up financial institutions which had been hit with problems. Currency and fiscal policies aimed at supporting supply and demand began to be adopted during the economic recession. As a consequence of these policies, the internal imbalance (as the share of the deficit to GDP) worsened in 2008 by 6.1% in the USA, 5.6% in Japan, 6.4% in Ireland and 5.4% in Great Britain.

- **Foreign demand weakened significantly**

The economic development of the Czech economy was significantly influenced by the changes in foreign demand and therefore also by the economic recession abroad, because approximately one third of the production of companies in the Czech Republic heads abroad. In 2008, exported goods and services accounted for 30.4% of the production in the economy. The growth in the international demand of the most significant commercial partners towards the world (expressed as the total imports to the given country) was substantially reduced in 2008. The decisive factor for the Czech Republic was mainly the foreign demand in Germany, the Eurozone or the EU 27. Imports to the EU 27 increased year-on-year in 2008 by only 1.6%, which was 3.5 percentage points less in comparison with the average for the period from 2001 to 2007. The growth in imports to the Eurozone countries also fell by almost the same value (3.3 percentage points) to 1.2%. Germany's foreign demand fell year-on-year to 4.0% and this value was also under the average for the period from 2001 to 2007 (5.1%).

Not only the fall in the value of the assets of the foreign economic subjects (companies and households), but also the tightening up of the conditions for the provision of loans and the increased uncertainty reflected in the fall of the trust indicators to their historic minimum, which resulted in the reduction of consumer and investment expenditure, led to the fall in imports in the selected states. The newest data on the leading indicators of the economic cycle published by the OECD in March 2009 reached rock bottom (and have done so consecutively) and not only in the states of Western Europe, but also in the developing economies of China, India or Russia.

Table no. 1.4 Imports of goods and services (in %, year-on-year, constant prices 2000)

	2001	2002	2003	2004	2005	2006	2007	2008
EU 27	2.7	1.5	3.4	7.6	6.2	9.2	5.2	1.6
Eurozone	2.2	0.4	3.1	6.9	5.6	8.2	5.2	1.2
Germany	1.2	-1.4	5.4	7.3	6.5	11.9	5.0	4.0
USA	-2.7	3.4	4.1	11.3	5.9	6.0	2.2	-3.5
Japan	0.6	0.9	3.9	8.1	5.8	4.2	1.5	1.1

Source: Eurostat