

# THE CZECH ECONOMY DEVELOPMENT IN 2017

Summary data on the Czech Republic

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Prepared by: Office of the President of the CZSO, Compendious Analyses Unit

Director: Egor Sidorov, Ph.D.

Authors of Publication: Bc. Jiří Kamenický, Mgr. Bc. Karolína Sůkupová

Contact person: Bc. Jiří Kamenický, e-mail: [jiri.kamenicky@czso.cz](mailto:jiri.kamenicky@czso.cz), ph. 274 052 741

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**Zlín** | tř. Tomáše Bati 1565, 761 76 Zlín | ph.: 577 004 931, 577 004 935  
e-mail: [infoservis-zl@czso.cz](mailto:infoservis-zl@czso.cz) | [www.zlin.czso.cz](http://www.zlin.czso.cz)

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### Chapters prepared by:

Jiří Kamenický            Summary (Chap. 1), Chap. 3, Chap. 6, Chap. 8

Karolína Súkupová      Summary (Chap. 1), Chap. 2, Chap. 4, Chap. 5, Chap. 7

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Latest information provided in this report has been dated the 16th March 2018.

## 1. Summary

- The gross domestic product (GDP) expanded by 4.5% in 2017<sup>1</sup>. Significant acceleration was achieved by cooperation of all GDP components. The growth was supported by the domestic consumption and foreign demand in the first half of the year, the investment activity joined these factors in the second half of the year. The year-on-year rate of GDP growth was rising during the year 2017. Domestic consumption was fuelled by a considerable rise of earnings of households. Expenditures on domestic consumption contributed 1.7 p.p. to the GDP growth last year.<sup>2</sup> The view on the type classification of gross fixed capital formation indirectly implies, that households and businesses were the more active investors. Resulting contribution of the gross capital formation to growth arrived at 1.0 p.p. Contribution of the foreign demand has been the highest since year 2012 and reached 1.8 p.p.
- The gross value added increased by 4.5% in 2017, which presents a nearly double pace compared to the previous year. Both manufacturing and services sector assisted the last year's growth by a similar portion, with the weight of the services sector strengthening in the course of the year. Manufacturing was pulled by the manufacturing of motor vehicles incl. the subcontractor fields, machinery also prospered and the renewal of the production capacities in the chemical industry and energetics also had a positive effect. The financial and insurance activities remained the most dynamic branch of services similarly to year 2016. Positive confidence indicator of consumers supported by the development of the disposable incomes of households led to the growth of the retail sales for the non-food goods – it reached a ten-year maximum (8.8%) and simultaneously the fifth rank among the EU states.
- Positive balance of the trade with goods and services ensured the positive surplus of current account of balance of payments. It amounted to 54.2 CZK bn. The Czech export attained 3 489.1 CZK bn and increased year-on-year by 5.8%. The exporters of the most significant articles of the Czech export prospered – exporters of motor vehicles, machinery and equipment and electrical appliances. Value of goods imported into the CR increased by 6.6%. Faster dynamics of imports was among other things the result of the growth of prices of oil, natural gas and basic metals.
- The consumer prices rose by 2.5% in 2017, the most since year 2012. Food and non-alcoholic beverages was the fastest growing segment of the consumer basket, contributing 0.9 p.p. to the total growth of prices. Higher prices of housing and energies and transport also markedly contributed. The industrial producer index also rose by 1.8% after years of declines, however its year-on-year dynamics weakened over the year. On the contrary, the prices of agricultural producers achieved a high growth of 8.0%. Prices of exports and imports were to a considerable extent impacted by the appreciating koruna foreign exchange.
- Year 2017 saw several significant changes in the setting of the monetary policy. Initially, the CNB ended the forex interventions in April. Subsequently, two increases of the monetary policy-relevant rates occurred (for the first time since 2008) in the second half of the year. It impacted the interbank interest rates, which also started to rise, but the interests on the accounts of households and businesses did not change to any noticeable extent. Interest rates on mortgages experienced the highest shifts; they mildly grow since the end of 2016.
- Favourable tendencies prevailed on the labour market, especially the persons in the employee positions enjoyed their benefits. The number of workers<sup>3</sup> increased by 1.6% for the whole year, the most since 2008. The highest number of persons held a job in the history of the independent CR. Higher number of entrepreneurs also contributed to the employment growth, from the point of view of branches then especially trade, transportation, accommodation and food service activities, but also other areas of services. General unemployment rate reached 2.0% for males and 2.9% for females in December. The number of long-term unemployed persons totalled only 40 thousand persons in Q4. The supply of job vacancies registered in the labour offices accelerated, three quarters of the year-on-year addition of positions however consisted of positions requiring a minimal qualification. Intensifying tension on the labour market was also reflected in the dynamic growth of wages. The average gross monthly wage crossed the 30 thousand boundary in Q4 2017 for the first time in history and strengthened by 8.0% year-on-year. The highest relative growth was concentrated in the branches with a low level of earnings, which became evident from the moderate lowering of the wage differentiation. Despite the growing inflation, the purchasing power of wages in 2017 strengthened. The real wage was raised by 4.4%, the most following the year 2003.

<sup>1</sup> Data regarding the GDP, gross value added and their components are expressed in constant prices and adjusted for seasonal and calendar effects. There were two working days less in 2017 in comparison to the preceding year.

<sup>2</sup> After exclusion of imports for final use.

<sup>3</sup> Seasonally adjusted data in the national accounts conception.



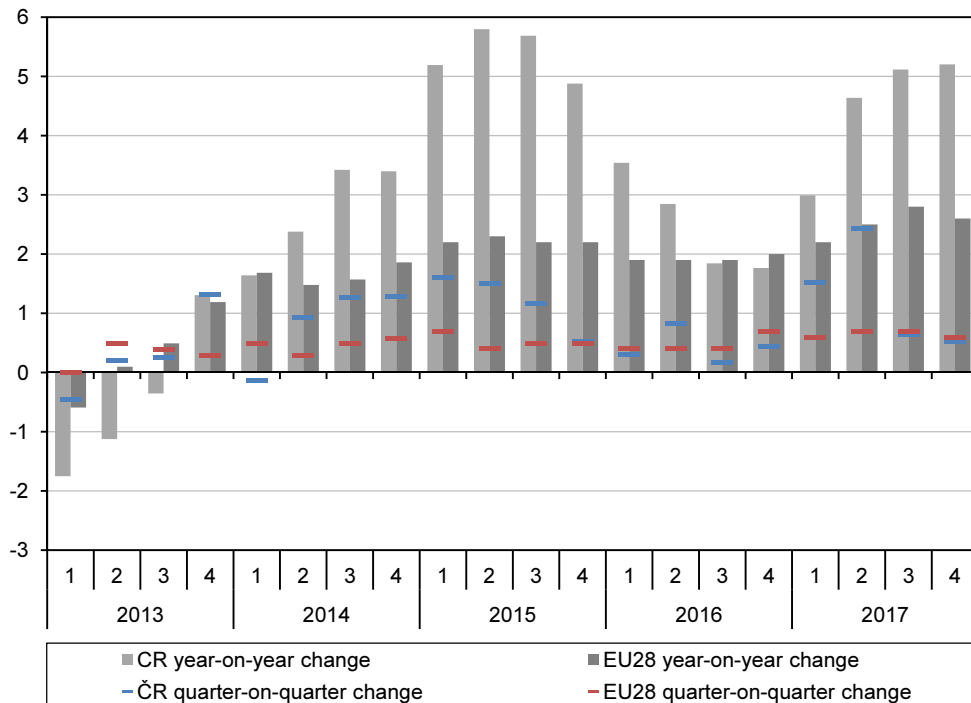
- State budget (SB) ended (based on the cash fulfilment approach) in 2017 in mild deficit (6.2 CZK bn). It presented the second most favourable result after year 1996. Both revenues and expenditures of the SB were, similarly to year 2016, notably affected by the irregularities in the drawing on funds from the EU budget. The share of investment on the total SB expenditures reached 6.4%, which was the least since year 1998. Strengthening economic growth was mirrored in the savings of some types of social benefits, in the 7.3% growth of the state-wide tax revenues, but also in the higher collection of insurance. The pension account thus for the first time in nine years extricated itself from the deficits. The state debt noticeably fluctuated due to the effect of extraordinary factors in the course of 2017. It amounted to 1 625 CZK bn at the end of December and stagnated year-on-year. The rate of indebtedness of the whole sector of government institutions attained 35.1% of GDP in Q3 2017, it lowered by nearly one tenth year-on-year.

## 2. Overall Economic Performance

Year-on-year dynamics of the gross domestic product was exceeding 5% in H2.

The gross domestic product (GDP) expanded by 4.5%<sup>4</sup> in 2017. It represents the second highest value since the expansion year 2007. The economic growth was higher only in 2015, when the economy was considerably stimulated by the finalisation of drawing of resources from the European funds. The year-on-year dynamics was strengthening in the course of the last year. Acceleration manifested in comparison to year 2016 already in H1 (3.0% in Q1, 4.6% in Q2). The year-on-year growth was 5.1% in Q3 and 5.2% in Q4. All GDP components shared in the high year-on-year increase. The growth was supported in a stable manner by the large contribution of the domestic consumption (especially households) as well as the foreign demand over the whole year. On these foundations, a growing contribution of the investment activity could have built in the second half of the year. The quarter-on-quarter dynamics differed from the year-on-year one. The GDP attained the highest quarter-on-quarter additions in Q1 and 2 (1.5% and 2.4%), the pace slackened to 0.6% and 0.5% in individual quarters in the second half of the year. The gross value added (GVA) increased by 4.5% in 2017. The year-on-year growth of GVA somewhat exceeded the GDP addition in Q4 itself, when it reached 5.4%.

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



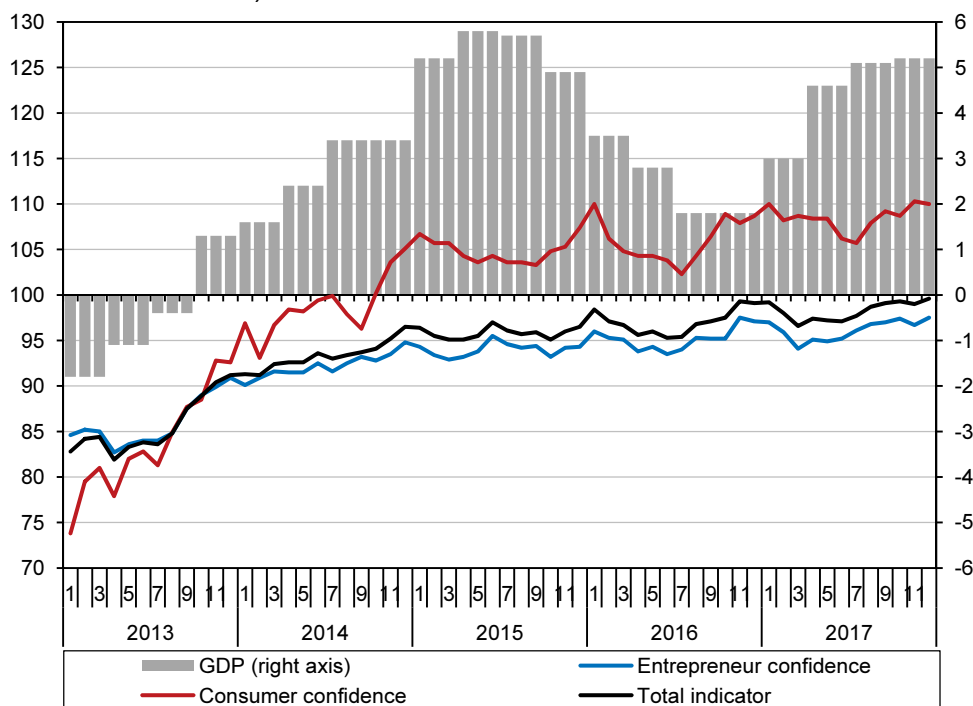
Source: CZSO, Eurostat

<sup>4</sup> 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 were published on 2. 3. 2018 and the revised data will be published on 3. 4. 2018.

The European economy also prospered.

The year-on-year GDP growth gained pace compared to year 2016 in the European Union as well. The GDP expanded by 2.4%<sup>5</sup> in the EU last year. It moderated to 2.6% year-on-year in Q4 itself. Romania achieved the highest GDP increase based on the available data in 2017, specifically 7.0%. Malta (6.6%) and Slovenia (5.0%) were other strongly growing economies. According to data for Q1 to Q3, Ireland will likely be placed on the position of the fastest growing economy or tightly below, where the year-on-year dynamics was manifesting even double-digit values. Economies of Italy (1.5%, still the highest growth since 2010), Belgium (1.7%), Great Britain (1.7%) and France (1.8%) had to face less than 2% growth. Countries neighbouring the Czech Republic also enjoyed a successful year, which was in the end favourably mirrored in the performance of the domestic economy via foreign trade. German economy increased pace and its GDP rose by 2.2% in 2017 here, Slovakia strengthened by 3.4%, Poland experienced a jump acceleration to 4.6% and Austria also nearly doubled its growth (2.9%) compared to year 2016. Quarter-on-quarter dynamics of the GDP growth in the EU crossed the 0.5% boundary in 2017 (0.6%, 0.7%, 0.7% and 0.6% in individual quarters).

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

Domestic consumption expanded fastest since year 2007. Mostly households were spending.

Domestic consumption expenditures grew by 3.3% in 2017, which is the most since 2003. Year-on-year growth of the household consumption accelerated (4.0%, the most since 2007), on the contrary the government expenditures were not expanding as fast as in the preceding two years last year (1.6%). The dynamics of the household consumption reflected the marked growth of wages as well as the positive expectations regarding the future economic development. Its year-on-year growth overtook the 4% boundary in Q2 to Q4. Similarly to GDP, the quarter-on-quarter dynamics of consumption also slowed down during the year. The quarter-on-quarter additions of expenditures on total consumption amounted to 0.6% in both Q3 and 4. The household consumption itself also increased in the same way during Q4. Look on the year-on-year dynamics of expenditures based on durability showed, that the growth of expenditures on durable items slowed down the most in 2017 (from more than 10.0% to 5.9%<sup>6</sup>) and the growth of expenditures on short term consumption goods (4.1%) and services (2.7%) accelerated. Total

<sup>5</sup> Data for Ireland and Luxembourg not available. Slovakian data are not adjusted for calendar effects.

<sup>6</sup> Data regarding the household consumption based on the durability of goods are not seasonally adjusted.



Growth of household consumption was partially satiated through foreign supply.

consumption expenditures contributed to the year-on-year GDP growth by 1.7 p.p.<sup>7</sup> in 2017, in that household consumption by 1.4 p.p. Consumption contributed to growth the most in Q2 (1.8 p.p.). The contribution was shrinking moderately in the next time periods. As is evident from the comparison of additions to the GDP development after and without exclusion of imports for final use, the accelerated growth of the household consumption was to a considerable extent saturated by foreign supply in Q2 to Q4.

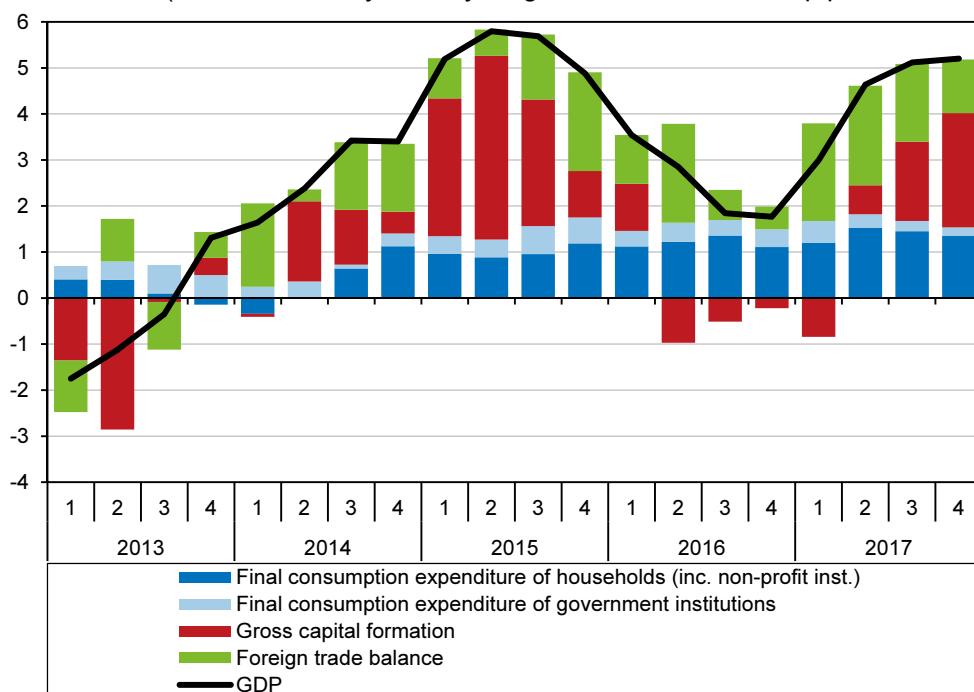
Wages and salaries markedly grew in both nominal and real terms.

The mentioned growth of wages was really exceptional. Nominal increase of the volume of paid out salaries and wages achieved 7.9% in 2017, the most since year 2007. Rising inflation led to the increase in the difference between the real and nominal growth of salaries and wages compared to years 2013–2016. In real terms, there was by 5.3%<sup>8</sup> of paid out wage resources more last year. The pace of the volume of paid out salaries and wages was accelerating during the year and it reached 8.4% in Q4 (the most since Q2 2008). Growth of total employment (persons) also mildly increased last year and arrived at 1.6%<sup>9</sup>. Total employment gauged by the number of hours worked grew faster (1.9%).

Wages grew in all branches. It was accompanied by growth of total employment as well.

Manufacturing, which employs the highest number of workers, drove the total growth of wages and salaries in the last year. The volume of paid out wage resources increased by 8.6% here, while the employment did not increase much in this branch (0.6%). Trade, transportation, accommodation and restaurants is on the second place, the volume of wages rose by 8.3%. At the same time the employment increased here by 2.4%. Salaries and wages in the branches with the predominance of the public sector rose by 8.5%. Information and communication achieved the highest growth of the volume of earnings (9.1% given the 3.8% growth of employment). Professional, scientific, technical and administrative activities experienced the same growth of employment, but lower volume of the paid-out wages (7.9%). Construction (3.6%) and financial and insurance activities (4.5%, the only branch with the reduction of employment of 1.0%) attained the lowest growth of the paid-out wages.

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



\* Contributions to GDP change after exclusion of imports for final use.

Source: CZSO

<sup>7</sup> Contributions to GDP change after exclusion of imports for final use.

<sup>8</sup> Converted into the real expression using the deflator of final consumption expenditure of households.

<sup>9</sup> In the national accounts conception, seasonally adjusted.

Investment supported the acceleration of the year-on-year GDP growth in H2.

Investment activity stood behind the strong GDP growth in Q3 and 4. Contribution of the expenditures on gross fixed capital formation to the GDP growth amounted to 1.2 p.p. in 2017. The importance of the investment activity for the GDP growth was increasing during the year. As with the consumption expenditure the increased demand for investment goods was also partially saturated by the foreign supply. Investment rose by 5.8% in 2017. Although this GDP component was still stagnating in Q1. In the following three quarters, the year-on-year additions already exceeded 7.0% and the investment expenditure rose by 7.9% in Q4. In part the low comparative basis from year 2016 had an effect, nevertheless the quarter-on-quarter dynamics showed the increase of the investment activity especially in Q2 and 3. Based on the type classification of gross fixed capital formation, investment into the transport vehicles and machinery (8.9%<sup>10</sup>), housing (7.0%) and ICT and other machinery and equipment (6.6%) grew the fastest in 2017. First two mentioned categories experienced a moderation of the year-on-year rate of growth, the third and most significant by volume item offset the fall from year 2016. Stated composition of the expenditure on gross fixed capital formation points to the key role of businesses and households in the last year investment activity. The growth of investment into the products of intellectual property also increased (to 5.4%). On the contrary, expenditures on other buildings and structures remained on the exceptionally low level of year 2016 last year, when their growth attained 0.9%. This investment category includes infrastructure projects, which are the domain of the government institutions sector. At the same time, it also consists of various industrial buildings and warehouses. Both strong economic growth and the logistically advantageous location of the Czech Republic stimulated their construction.

Look on the type classification of the gross fixed capital formation implies, that mostly businesses and households invested.

Foreign trade surplus mildly grew last year. Trade with services is mostly behind it.

Foreign trade resulted in positive balance in the amount of 364.5 CZK bn<sup>11</sup> in 2017 and thus the increase of 8.0 bn manifested. The growth of the surplus could be observed in all quarters, its main part however was created in Q1 (year-on-year increase of 6.5 CZK bn.). Total increase is the result of a marked enlargement of the surplus of the trade with services balance (122.3 CZK bn, year-on-year addition of 13.0 bn). Surplus of the foreign trade with goods arrived at 242.3 CZK bn last year and it shrank by 5.0 bn year-on-year. The terms of trade were 99.0% in year 2017. They moderated during the year and already reached a positive result in Q4 (100.3%). Loss from the movements of the terms of trade, expressed as a difference between the GDP and the real gross domestic income in 2017, arrived at 38.5 CZK bn. It presented the first negative result since year 2012.

Manufacturing and services sector both supported to the same extent the year-on-year growth of GVA.

View of the supply side of the GDP confirms the continuing key role of manufacturing in the Czech economy. The gross value added of the relevant branches increased by 7.6%. The addition to the total year-on-year growth of the GVA was very stable throughout the year and it was 2.1 p.p. The services activities were also very important. Total contribution of services to the GVA growth achieved also 2.1 p.p. last year and the role of services was strengthening during the year. Their addition to the year-on-year growth of GVA was 2.8 p.p. in Q4. Among the services branches, the trade, transportation, accommodation and restaurants contributed the most (0.6 p.p.) together with the professional, scientific, technical and administrative activities (0.5 p.p.). Finance and insurance activities also fared well (contribution 0.4 p.p.). All branches contributed positively in the last year, so even construction, which experienced relatively adverse situation in 2016 also achieved a positive, even though a small contribution in the last year (0.1 p.p.).

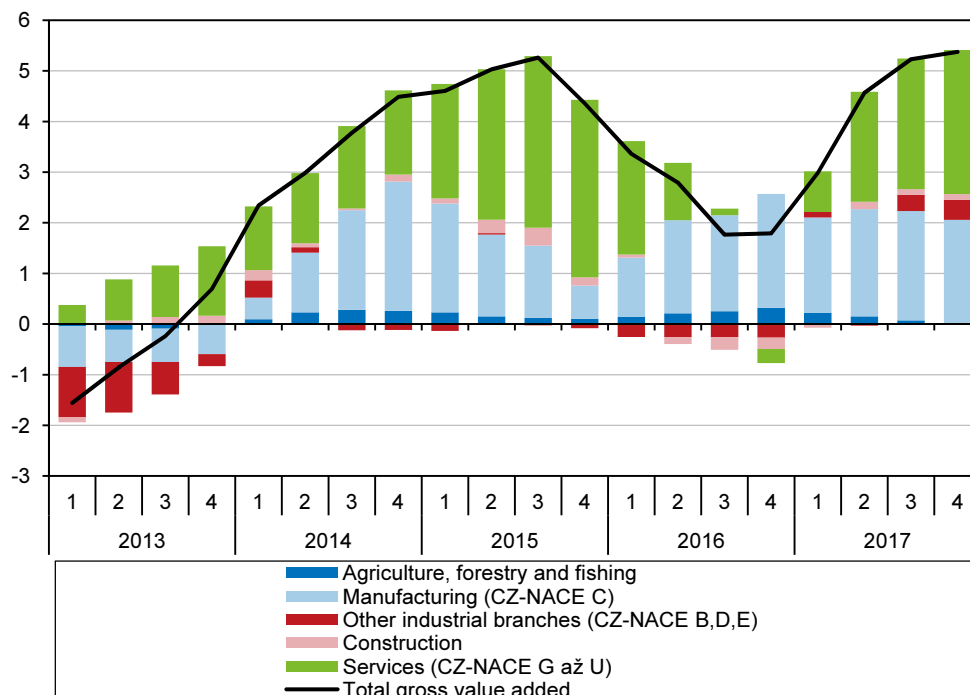
<sup>10</sup> Data regarding the type classification of gross fixed capital formation are not seasonally adjusted.

<sup>11</sup> Based on the methodology of the national accounts.





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



Source: CZSO

### 3. Branches Performance

Gross value added increased by 4.5% last year mainly thanks to the acceleration in the first half of the year. All ten main branch groupings participated on the growth.

The Czech economy prospered also in the last year. The growth of the gross value added<sup>12</sup> nearly doubled compared to the rate of growth attained in 2016 (to 4.5%). The last year thus ended next to year 2015 among the most successful in the last decade. It was mostly due to the substantial acceleration of performance in the first half of the last year, nevertheless the GVA strengthened by a significant 0.6% compared to the preceding quarter (similarly to the EU) even in the last three months of 2017. Quarter-on-quarter growth of GVA persisted already for the nineteenth time in a row, in total then the performance of all branches jumped by 18.2% since the end of the last recession. In contrast to the preceding years of the current expansion, all main branch groupings contributed to the year-on-year GVA growth last year. Improvement of the performance in energetics and construction also played a part.

Contribution of manufacturing to growth of total GVA remained stable in the last seven quarters, in contrast it markedly strengthened in services sector.

Manufacturing sustained the key role it plays among branches also last year when it contributed to the year-on-year growth of total GVA from nearly one half. Favourable results of industrial exporters were reflected in the high GVA growth rate of this branch (+7.6%, the highest in the last six years). Strong growth of GVA was achieved together with weak rise of employment (+0.6%) as well as hours worked (+1.0%), which had a positive effect on the development of productivity. The performance of the services sector increased by more modest 3.5%, nevertheless it contributed to the growth of the GVA of the whole economy comparably to manufacturing in the last year. While contributions of manufacturing to growth stagnated in the last seven months, the role of the services sector on the contrary strengthened, which was accompanied by more intensive creation of new job positions. Services were driven by the most weight dominant group trade, transportation, accommodation and restaurants for the most part of the last year. However, financial and insurance services represented the most dynamic segment similarly to year 2016 (+9.3%, the most after year 2008). The professional, scientific, technical and administrative activities also benefited from the growing demand in the last years. On the contrary, the GVA in the branches with the dominant share of state<sup>13</sup> increased (together with employment)

Dynamic growth of the financial sector performance as well as the weak dynamics of the branches with the dominant share of state endured.

Despite the fact, that the very good harvest from

<sup>12</sup> Data regarding the GVA are expressed in constant prices and adjusted for seasonal and calendar effects.

<sup>13</sup> Includes public administration and defence, education, health and social care and it creates nearly one quarter of the GVA of the whole services sector.

years 2014 till 2016 was not repeated last year, value added in the primary sector still kept growing.

only slightly above 1%, still it was the fastest pace in the last seven years. Value added of the branch agriculture, forestry and fishing rose already fourth year in a row, it however reduced from the pace in year 2016 by one half last year (to 4.7%). The poorer harvest of majority of main types of cereals (especially of corn), oilseed rape as well as fruit stood behind the slow down. The harvest of sugar beet and legumes was above average thanks to the larger harvesting areas. Output of the animal production featured stabilisation similarly to the employment in the whole branch.

Industrial output rose by the highest pace in the last seven years. Favourable tendencies pervaded the overwhelming majority of the subbranches.

Data from the business statistic also provide evidence of the favourable development of the industry. Its output (according to the industrial producer index<sup>14</sup>) increased despite a temporary worsening in the summer period<sup>15</sup> by 6.9% for the whole year. It thus reached the best result since 2010, when it was recovering from the consequences of a deep recession. Positive tendencies were apparent also at the end of the year – the year-on-year output hiked up to 7.6% in Q4. Not only the good economic situation in the main export territories, but also the strengthening domestic demand stood behind these results. The dominant branch – manufacturing of motor vehicles (together with its key subcontractor fields) sustained high growth rates last year. The renewal of production capacities of the chemical industry, temporarily reduced in the preceding years and energetics also aided. However, the majority of the smaller industrial activities also fared well.

Stably growing motor vehicle manufacturing contributed to the growth of the whole industry by one third, together with the subcontractor fields by one half.

Motor vehicle manufacturers increased their output in 2017 by 9.8% and they thus provided nearly one third (together with the subcontractor fields<sup>16</sup> one half) of the growth of the total industrial production. Strong demand on both the European and Asian markets, but also at home, was mirrored in the record number of the manufactured vehicles<sup>17</sup>.

Growth notably accelerated in machinery, manufacture of computers, electronic and optical products.

Machinery industry experienced successful year also thanks to the strong domestic demand (+9.2%, the growth oscillated between 2% and 3.5% in the previous five years) and it participated on the growth of the whole industry by one tenth. Both the second most significant by weight manufacturing activity – manufacture of metal products and the strongly export oriented manufacture of computers, electronic and optical products (with the growth of output by 12.2%, by 3.2% in 2016) contributed to a similar extent. Contribution of the chemical industry was also important, its output enlarged by nearly one fifth compared to year 2016<sup>18</sup>, the most from the individual sections of industry.

Higher production of electricity in the nuclear plants pushed the growth of energetics.

Energy industry also experienced an exceptional year, its production fastened from 0.9% in 2016 to last year 4.8% (highest pace after year)<sup>19</sup>. Gradual recovery of the demand in construction assisted the output of manufacture of other non-metal mineral products (+9.1%, -2.0% the year before).

On the contrary, the more domestic market-oriented food industry as well as the beverage industry were ascribed much more modest growth (+2.0% and +3.9%) and they thus did not breach the trends from the preceding years. Among the smaller activities, the export focussed pharmaceutical industry fared well (+10.6%, +32.1% in five years). Also, the textile, paper and furniture industries were growing continuously in the last five years.

<sup>14</sup> Included branches: Mining and quarrying, Manufacturing, Energetics. All year-on-year rates of growth of output (at the level of activity sections as well as divisions) are adjusted for calendar effects. Not adjusted, the year-on-year growth in industry was 6.5% last year (there were two calendar days less).

<sup>15</sup> In quarter-on-quarter expression, the industrial production temporarily slowed down in Q3 (0.0%) after the strong growths in the first half of the year (+2.9%, +2.8%). However, the growth renewed in Q4 (+1.9%).

<sup>16</sup> It involves the manufacture of electrical appliances (with the year-on-year growth of output of 9.1%) and manufacture of rubber and plastic products (+8.3%).

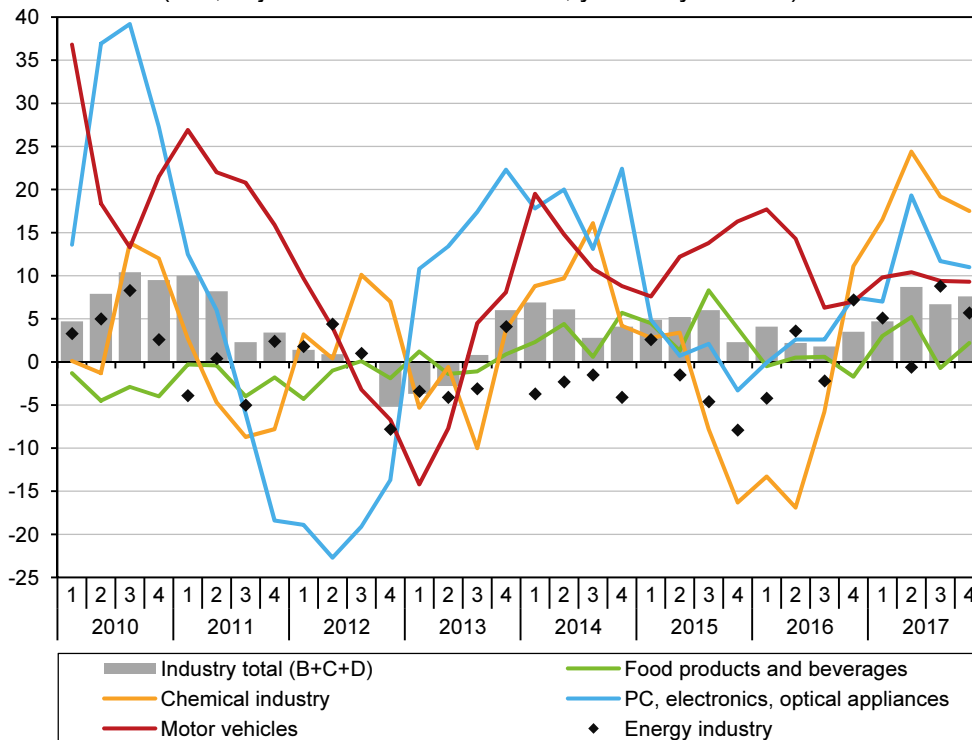
<sup>17</sup> Based on the data of the Automotive industry association, there were 1.41 mil private vehicles manufactured in the CR in 2017, by 5.2% more year-on-year. Manufacturers of other types of motor vehicles also registered a growth.

<sup>18</sup> Output of the chemical industry exceeded the level before the emergencies (Q2 2015) already at the beginning of year 2017.

<sup>19</sup> Especially the high last year growth of electricity production participated on this (+4.5%, to 87 TWh), in that by 17.6% in nuclear power plants.



**Chart 5 Production in industry and selected manufacturing branches**  
(real, adjusted for calendar effects, year-on-year in %)



Source: CZSO

Adverse tendencies from the view of output as well as employment continued in the mining industry or metallurgy and foundry industry.

The long term structural problems persisted in some industrial activities. Output in mining and quarrying has been declining due to the controlled reduction of the black coal mining already sixth year in a row (by 1.7%<sup>20</sup>, in total by more than one quarter). Nominal sales of the mining businesses however increased after five years last year (by 8.7%), since they absorbed the prices of materials. Output was mildly falling (similarly to the previous two years) in metallurgy and foundry industry. Not even the Q4 2017 brought some more favourable results despite the growth of orders as well as import of basic metals. Output in the manufacture of leather again mildly dropped last year after the short revival, it was by nearly 30% weaker compared to the expansion year of 2007<sup>21</sup>. On the contrary, the small but growing in the long-term activity – manufacture of other (mostly rail) transportation equipment had the last year fall (by 9.1%, the deepest from all sections of industry) more as a one-off deviation due to the volatile nature of orders, which also the favourable development of employment confirmed.

Growth of the sales of industrial businesses from direct export mildly lagged behind the pace of domestic sales. Rate of growth of new orders did not ease up significantly during 2017, entrepreneur confidence also remained in the positive band.

The nominal sales of businesses from the industrial activity rose by 7.2% during the year 2017. They increased in all more significant industrial branches. Growth of sales from direct export (+6.5%) mildly lagged behind the pace of the domestic sales (+8.1%), which last manifested in year 2008. Recovery in the chemical industry, but also good results of machinery and subcontractors for the motor vehicle manufacturing stood behind the growth of the domestic sales last year. Rate of growth of new industrial orders did not slacken much during the year. Their value was by 7.1% higher year-on-year in Q4. Stock of work expanded in all twelve monitored branches. Only manufacturers of motor vehicles signalled only a mild growth at the end of the year (+0.3%), partially due to the higher comparative basis. Seasonally adjusted balance of the confidence indicator in industry mildly fell in H1, this development was compensated in the next part of the year. The value of the balance was (+6 p.p.) in December 2017 similar to the situation twelve months ago. In December, 24% of industrial businesses expected the growth of the production activity in the next three months (20% the year before). One seventh of businesses also considered the increase of employment (one fifth year ago). Outlooks markedly improved in energy

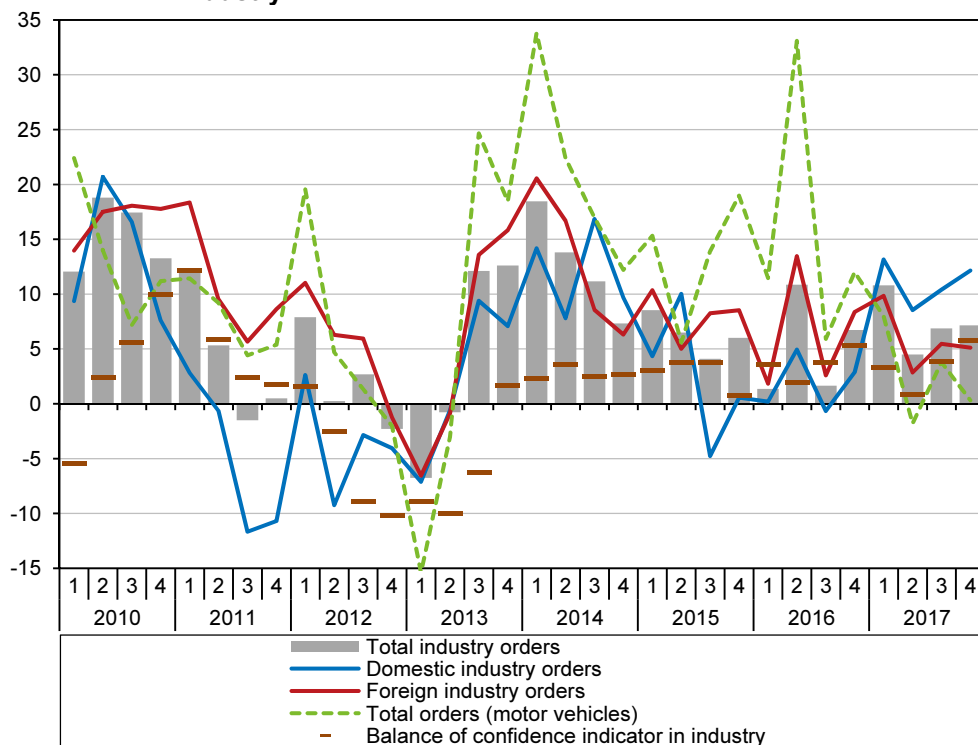
Lack of employees as a barrier to growth increased in industry last year, role of the inadequate demand slightly weakened.

<sup>20</sup> Last year's fall was however the mildest in the last six years.

<sup>21</sup> Last year, 10 out of 24 manufacturing branches lagged behind its output level of year 2007. Among the more weight significant activities, it was food industry (-5%), metallurgy and foundry industry (-12%) and manufacture of other non-metal mineral products (-13%).

industry, the mining industry stabilised. Record 43% of industrial businesses stated the lack of labour force as a barrier to growth at the beginning of 2018, 35% then the inadequate demand (42% the year before).

**Chart 6 New orders in manufacture of motor vehicles, in industry in total (in current prices, year-on-year in %) and balance of confidence indicator in industry**



Source: CZSO

Construction output mildly increased exclusively thanks to the building construction last year. Output of the civil engineering construction was limited by the low volume of completed projects supported from public investment sources for the whole last year.

Construction output was similarly to year 2016 limited by a low volume of public investment last year. Quarter-on-quarter growth of the construction output<sup>22</sup> commenced in the second half of year 2016 was halted in Q1 2017 (-0.2%) and not even the second half of the year changed that. Year-on-year growth achieved 3.6% last year, compared to year 2016 however (-5.8%) it presented at least a partial recovery for the whole branch. It was however only thanks to the more significant by weight building construction (+6.6% last year), since the adverse development of the civil engineering construction prevailed for the whole year (-3.9%, +0.7% in Q4 – mild growth was especially the reflection of a very low comparative basis).

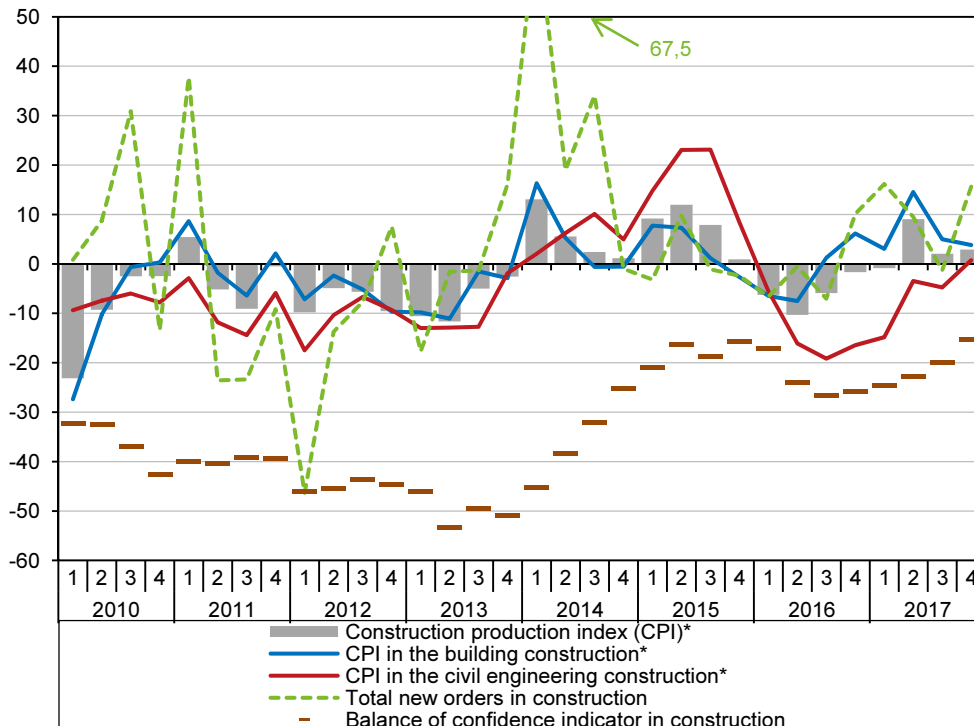
Building construction was assisted by the gradual development of the residential construction. Number of commenced residential dwellings was rising already fourth year in a row (to last year’s 31.5 thousand). Family houses added the most to the growth, other forms of construction also experienced higher growth – except for flats in the non-residential buildings and also in community care homes and boarding houses, where the volume of construction was record low. The number of flats commenced in the multi-dwelling buildings was the highest in last eight years (7 244), still it did not represent even one half of the volume for the record year 2007.

More than one fifth of the total started dwellings was located in the Central Bohemia. There were by 976 flats more commenced in Prague compared to year 2016 (with the second lowest construction since the half of 90s), still the construction (3 734) was by nearly one third weaker than in year 2015 and it did not achieve half of the average from period 2005–2007.

<sup>22</sup> All year-on-year data related to the construction output are adjusted for calendar effects.



Chart 7 **Construction output\*, value of new orders (year-on-year in %) and balance of confidence indicator in construction**



\*Adjusted for the effect of the number of working days.

Source: CZSO

Mild year-on-year growth of new construction orders was apparent throughout the most of the year. Negative balance of entrepreneur confidence in construction improved.

Weak growth of the average size of one order signalled continuing lack of more significant number of large projects.

Sales in selected services accelerated and reached the fastest rate of growth following year 2007.

Transport and storage and branch accommodation, food service and restaurants

The value of new domestic orders (for businesses with 50 employees and more) grew year-on-year for the most part of the year 2017. It was by 15.6% higher in Q4 (without the significant difference between the building and civil engineering construction). Average value of new order increased by one tenth last year (to 3.3 CZK mil), it oscillated around 4 mils in both years 2014 and 2015. Balance of all not yet completed orders was 133 CZK bn at the end of the year 2017, it rose by mild 3.5% year-on-year. Drop of the stock of jobs from abroad was compensated by both private (+2.6%) and public orders (+9.3%). Approximate value of one granted building permit fastened growth (to 24%, from 12% in the year of 2016). It was driven predominantly by new construction similarly to year 2016. Residential as well as non-residential buildings contributed by a similar share. Seasonally adjusted balance of the entrepreneur confidence in construction remained in the negative band. However, an improvement gradually occurred during the year, this trend slowly gained strength and was also confirmed by the data from the beginning of year 2018. Proportion of businesses anticipating the reduction of the construction activity or employment fell considerably year-on-year. However, only less than one tenth of businesses expected a growth of the construction activity. Only 15% of businesses did not perceive any significant barrier to their growth. 40% signalled the inadequate demand (54% at the beginning of year 2017), 24% lack of employees (11%).

Growth of sales in selected services<sup>23</sup> accelerated to 4.2% in 2017 (from 0.8% the year before last) and achieved the best year-on-year rate of growth in the last ten years. This favourable shift was apparent across all activity sections of services (the most in professional, scientific and technical activities, the least in real estate activities). It is apparent from the quarter-on-quarter rates of growth, that the output acceleration of services started already in Q3 2016, it weakened during the year 2017 and the sales in fact already stagnated in Q4.

Branch transport and warehousing contributed to the year-on-year growth of sales in services for the most part of year 2017, only in Q2 the role of this branch temporarily weakened to the benefit of the information and communication and also

<sup>23</sup>Excluding trade, financial and insurance activities, science, research and public services. All data for services are in constant prices, year-on-year data are adjusted for calendar effects, quarter-on-quarter data are adjusted for seasonal effects (including the effect of the number of working days).

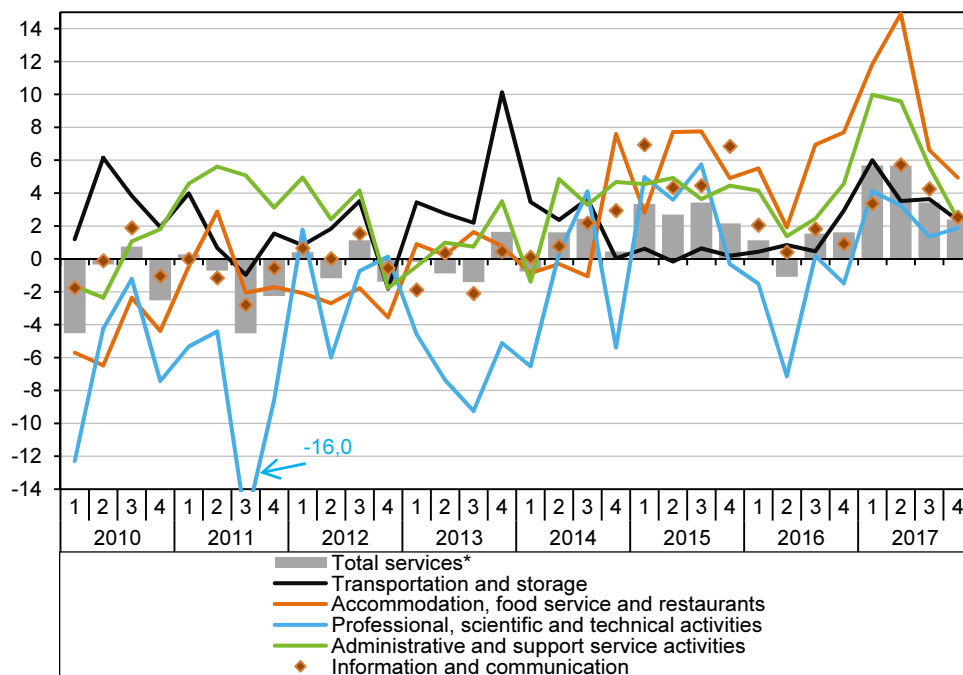
contributed the most to the growth of sales in services last year.

Strong demand in the long term for information activities, programming or services of job agencies prevailed. Positive turn was apparent at travel offices and agencies.

The revival of construction was reflected in sales of the architectural and engineering activities.

accommodation, food service and restaurants. Storage and other transportation support activities added the most to the growth of sales in transportation and storage (+3.8%) last years, they profited from the dynamic development in both industry and trade. Development of tourism was reflected in more than 10% growth of sales in the air transportation (the highest after year 2005). In the section of transport, higher transport freight rates were evident (based on data for Q1 to Q3 they grew year-on-year in all main types of transport). Increased mobility was connected to tourism, but the higher commuting to work likely also had an impact (in association to the record number of employed). The dynamic growth in accommodation continued last year (+8.1%) as well as in food service and restaurants (+10.0%). Both partial branches benefited from the growing household consumption as well as the development of the incoming tourism<sup>24</sup>. Number of overnight stays of guests in the mass accommodation facilities rose by 7.3%. Strong demand after the processing of data, web portals and hosting, programming and advisory in the IT area pushed information and communication branch in the long term (+3.9%). Travel agencies, offices (+9.0%, even though sales fell in total by nearly one fifth in years 2013 to 2016) contributed to the growth of the administrative and support service activities (+6.7%). The double-digit growth of sales of the job agencies also continued. Branch professional, scientific and technical activities strengthened by 2.6% and recorded only the second year-on-year growth following year 2008. Revival in the architectural and engineering activities also manifested (+1.2%, -9.3% the year ago) and was connected with the better performance of especially the building construction. Growth of demand for legal and accounting activities continued for already third year. While sales for the market research and public opinion polling were rising, they on the contrary somewhat decreased for the advertising activities.

Chart 8 Sales in services\* and their selected branch sections (in real terms, adjusted for effects of number of working days, year-on-year in %)



\* Excluding trade, financial and insurance activities, science, research and public services.

Source: CZSO

High rate of growth of retail sales strengthened further last year and hit the ten-year maximum.

Consumer sentiment satiated by the favourable situation on the labour market moved near the historical maximum during the year 2017. Retail sales<sup>25</sup> rose by 5.9% year-on-year, the highest pace after year 2007. While the pace of retail trade with food remained below the 3% boundary already for the second year, the sales of non-food goods – driven by the dynamical growth of the internet shops – jumped up to 8.8%. Retail with clothes, footwear and leather goods (11.5%) and with a mild distance also the goods for culture and recreation fared well among the specialised shops. The

<sup>24</sup> The transfer of some activities from the grey economy in connection with the measures introduced in the previous year on the side of tax collection could also be evident in the high pace of sales in 2017.

<sup>25</sup> Data do not include the motorist segment (CZ-NACE 45). Retail data are adjusted for calendar effects in constant prices.



Growth of retail sales placed the Czech Republic on the sixth rank among the EU states, in case of sales for non-food goods on the fifth best position.

strong demand for computer as well as communication equipment renewed with a one-year break. Sellers of fuels received by 5.8% higher sales. Sales in the motorist segment slowed down to exact 3%, signs of saturation were visible after strong years of 2014 to 2016. It concerned sales of motor vehicles, on the contrary the rates kept the same as in the previous years for repairs and maintenance of motor vehicles. The CR belongs to countries with the fastest growth of the retail sales in the EU<sup>26</sup> in the last three years. Only Romania (+11.2%), Slovenia (+8.2%) and Poland (+6.4%), Slovakia (+6.1%), Cyprus (+5.9%) showed faster pace last year. The pace was 2.5% in the EU, 1.9% in Germany, 0.8% in Spain, sales moderately fell in Italy and Belgium.

## 4. External Economic Relations

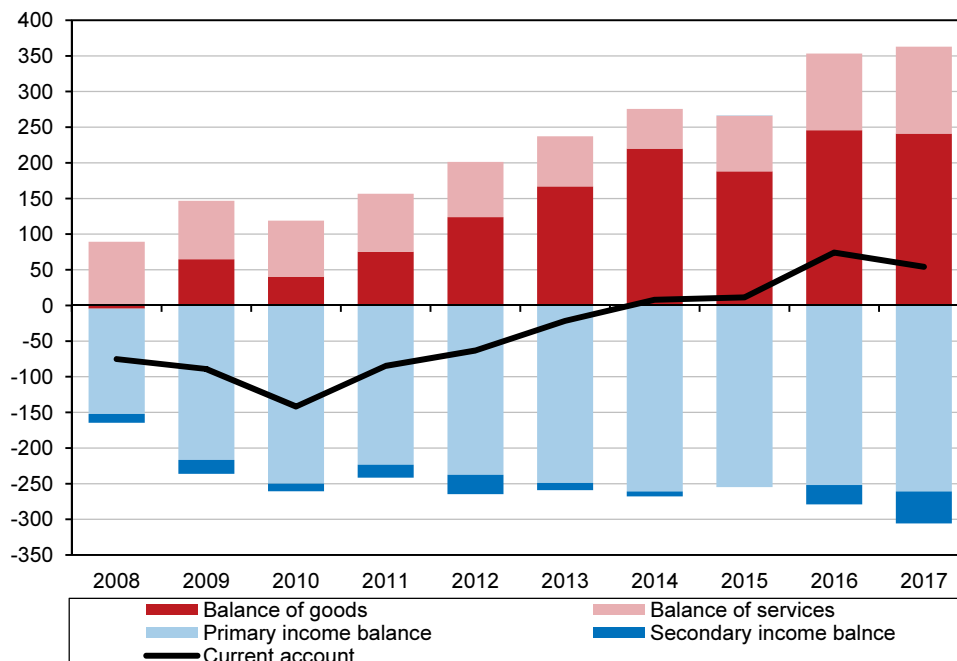
Positive balance of trade with goods and services contributed to the achievement of the current account of the balance of payment surplus in year 2017.

Balance of the current account of the balance of payments ended in surplus also in year 2017<sup>27</sup>. It was in the amount of 54.2 CZK bn and it lowered by 20.1 bn. The positive balance of the trade with goods (240.9 CZK bn) contributed the most to the surplus. The trade with services also attained a surplus (122.0 bn.), which increased by 14.4 CZK bn year-on-year. In contrast the balance of both primary and secondary incomes worked in the direction of deficit. Deficit of the primary incomes was 260.8 CZK bn in 2017 and deepened by 9.1 bn year-on-year. It was the result of the year-on-year increase of the inflow of the primary incomes by 17.9 CZK bn. Secondary incomes ended in deficit of 45.0 bn in 2017. It is mainly the consequence of the marked fall of the inflow of secondary incomes from abroad. Surplus of the capital account arrived at 46.5 CZK bn.

Primary incomes again worked in the direction of the balance of payments deficit.

Deficit of primary incomes was caused by the net outflow of incomes from investment in the amount of 321.2 CZK bn. That is by 9.7 bn more than in year 2016 (the inflow of incomes from investment from abroad increased by 15.0 bn last year). At the same time the net outflow of incomes from direct investment reached 345.9 CZK bn last year, by 20.1 bn more than in year 2016. Deficit of incomes from the portfolio investment moderated to -14.9 bn in 2017. Compensations to employees mostly mitigated the deficit of the primary incomes. Their balance achieved surplus in the amount of 37.7 bn. 64.0 CZK bn poured in the form of compensations to employees from abroad into the CR (by 6.1 bn more than in year 2016).

Chart 9 **Current account of the balance of payments**  
(cumulation of Q1 to Q4 in CZK bn)



Source: CNB

<sup>26</sup> International comparison draws on data published on 20<sup>th</sup> March of 2018.

<sup>27</sup> Data from the ARAD database of the Czech National Bank.

Results of the financial account were markedly impacted by the development in Q1.

Financial account (FA) finished in surplus of 117.1 CZK bn in 2017. At the same time both asset and liability side of the financial account gained double the level from year 2016. Flows to the FA had the largest volume in Q1, when the investors reacted to the nearing termination of the forex intervention of the CNB. The increase of the reserve assets in the amount of 1 246.4 CZK bn (in that 1 119.2 bn in Q1) exclusively stood behind the resulting surplus, which the FA keeps achieving since year 2012. Net inflow of direct investment arrived at 135.3 CZK bn (profit reinvestments shared in that from 106.9 bn). Net inflow of portfolio investment was 268.3 CZK bn last year. Shares in investment funds nevertheless made net outflow in the size of 43.5 CZK bn. Investment into the debt securities presented the source of the deficit in the item portfolio investment. Their net inflow was 311.8 CZK bn for year 2017 (by 140.8 bn more than in 2016). Main focal point of this capital inflow was in Q1 and 2 of the year. Development of the proportion of domestic bonds in the hands of foreign holders<sup>28</sup> illustrates it. It considerably increased during the year 2016 (from 23.67% in January 2016 to 38.66% in January 2017). It was 47.26% at the end of March and it peaked in September (51.35%). It gradually declines since then. It was 41.64% at the end of December 2017.

Export grew relatively fast last year.

Value of exports reached 3 489.1 CZK bn in year 2017<sup>29</sup>. It thus increased by 189.9 bn (5.8%) compared to year 2016. It represents the most significant increase since year 2014 (when the value of exports was notably impacted by the koruna foreign exchange depreciation). If we thus omit the year 2014, it is the largest increase since year 2012 (6.0%). Rate of growth of export was maintained relatively strong throughout the whole year 2017. The value of export grew the most year-on-year in Q1 (9.3%), subsequently the pace kept stable above the 4% boundary. The increase was 4.8% year-on-year in Q4.

The EU countries remain as the main business partner of the Czech Republic.

The territorial structure of exports did not change significantly in 2017. The European Union remained the dominant destination for the Czech export (83.9% of export), the share of export into countries outside the EU stayed at 16%. Not even the higher dynamics of exports into countries outside the EU (6.2%) managed to change this structure. The largest proportion of exports (32.2%, 1 125.0 CZK bn) headed in year 2017 to Germany and the export into this destination rose by 6.1% year-on-year (64.5 CZK bn). Its dynamics however lost pace markedly during the year (from 9.9% in Q1 to 3.7% in Q4). The described slowdown however was common to majority of significant business partners. The value of exports to Poland (9.4%, +19.1 bn), Austria (9.9%, +13.7 bn) and France (7.9%, +13.0 bn) also recorded marked increase in 2017. The share of export into these countries also moderately (within the order of tenths of p.p.) increased. On the contrary, export to Slovakia observed a fall (-2.2%, -7.0 CZK bn). Export to the Great Britain also mildly declined (-0.7%) and its share on the total Czech exports fell below 5%. Exports to China recorded exceptionally high increase in 2017 (+5.7 bn, 16.0%). As a result, the proportion of China on the Czech exports increased to 1.2%. Similarly, also the exports to Russia grew (+5.9 bn, 9.4%). In the context of the long-term development however it depicted only a small correction, the value of exports still does not attain the level from years 2012–2014.

Main export articles – motor vehicles, machinery and equipment and electrical appliances supported the growth the most.

Year 2017 did not alter anything on the position of motor vehicles as a key product in the structure of the Czech exports. Total value of exports of motor vehicles only tightly did not hit 1 000 CZK bn (995.1 bn) and increased year-on-year by 71.4 bn (7.7%). Motor vehicles formed 28.5% of export last year. Exporters of machinery and equipment also experienced a favourable year (growth of 27.3 CZK bn, 7.5%) and electrical appliances (+21.8 bn, 8.0%). The value of export of computers, electrical and optical equipment (+10.8 CZK bn, 3.6%) also grew mildly in comparison to year 2016, the value of export of these goods (309.2 CZK bn) however did not exceed year 2015. The value of chemical substances and products again rose following two years of decreases (+18.8 CZK bn, 13.4%). Following the

<sup>28</sup> Based on the data from the Ministry of Finance of the CR. State bonds according to the type of holder.

<sup>29</sup> Statistical data of the foreign trade in the national conception in the nominal terms including only the trade with goods. The value of exports is captured in the FOB prices, i.e. including the costs connected with the transport to the CR boundaries. Import depicted lower in this chapter is in CIF prices, i.e. including costs associated with the transportation abroad, up all the way to the CR boundaries. Data valid as of 9. 3. 2018.





enforced outage, this branch thus gradually recovers (export reached the value of 159.7 CZK bn, which is more than in years 2015 and 2016, year 2014 has not been exceeded yet).

Price shifts also affected the import dynamics.

The value of imports into the CR also grew in 2017. It arrived at 343.8 CZK bn and increased by 208.3 bn (6.6%). Import thus grew faster than export last year. Raised prices of some materials presented a significant factor (oil and natural gas, basic metals). The Czech Republic more imports than exports these materials, thus the price shifts led to a higher growth of import. Similarly, to export, the year-on-year growth rate of imports attained the highest values in the first half of the year. In Q4, the year-on-year increase of imports was 4.9%.

Imports from countries outside the EU sharply increased.

A more detailed view of the import structure further illustrates especially the price changes, that occurred in 2017. The increase of imports from countries outside the EU reached 11.1% (104.3 CZK bn) and it nearly became equal to the absolute additions to the imports from the EU (4.9%, 105.4 bn). The rise of prices of oil and natural gas is the most apparent on the trade with Russia. Imports from this destination increased by 36.8% in 2017 (30.9 CZK bn). In 2016, the import generally stagnated and the last year changed it. The growth of imports from both Germany (+42.6 CZK bn, 5.0%) and Austria (+7.7 CZK bn, 8.0%) fastened its pace. The import from the United States also increased by 11.2 bn (15.3%).

The value of oil and natural gas import markedly increased.

Strong domestic demand supported the year-on-year rise of motor vehicle imports in 2017, reaching 40.3 CZK bn (7.9%). The imports of electrical appliances also grew significantly (+20.0 bn, 8.5%). Raised prices were reflected in the jump increase of the value of import of basic metals (+39.7 bn, 17.7%). The higher demand on the part of the Czech chemical industry joined the price factor as well for the import of oil and natural gas. It resulted in the increased value of imports by 32.2 CZK bn (36.1%).

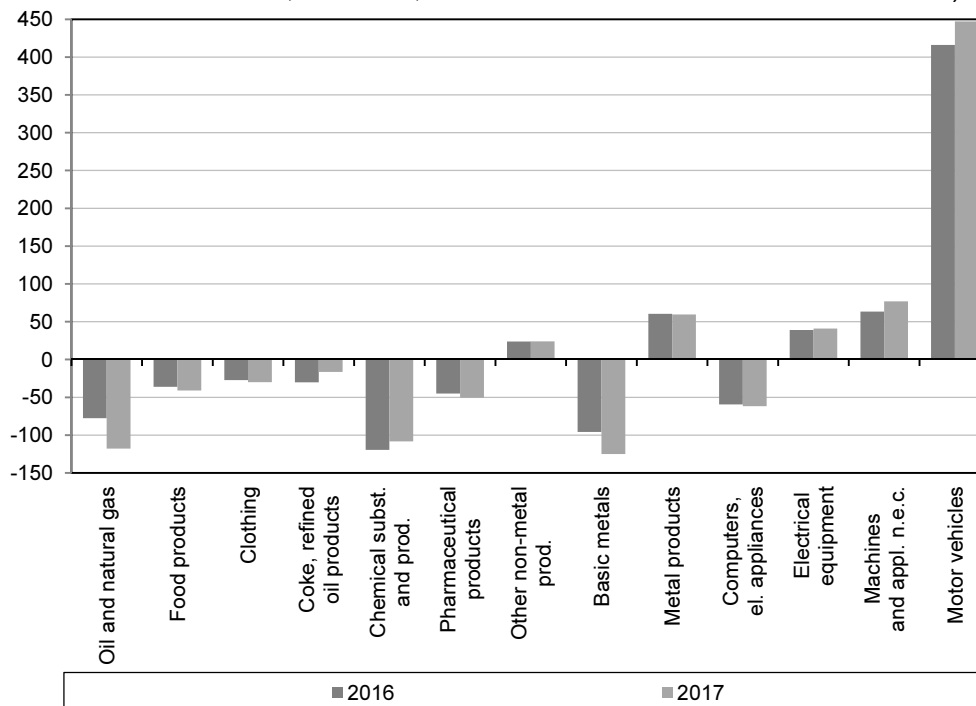
Foreign trade balance was positive, but the surplus fell year-on-year.

Balance of the foreign trade with goods achieved a surplus in the amount of 145.3 CZK bn in 2017. The positive balance thus year-on-year decreased by 18.4 bn. The drop can be connected to the above-mentioned year-on-year increase of prices of materials, which raised the value of imports. Also, for this reason, the deficit of trade with countries outside the EU markedly deepened (by 71.7 bn), while the surplus of the trade with the EU increased by 51.3 bn in 2017. The positive balance of trade with Germany was growing the most (by 21.9 bn). The CR achieved trade surplus with the Netherlands (in the amount of 7.0 bn) following the five years of deficits. Positive trade balance with France rose by 7.5 CZK bn. Deficit with Poland, growing in the recent years, moderated by 17.6 CZK bn in 2017. Deficit with Russia more than doubled in 2017 (deeper by 24.9 CZK bn), trade deficit with China mildly increased (by 8.0 bn.).

Deficit of the trade with the countries outside the EU deepened.

From the view of the individual divisions of the classification of production, motor vehicles (447.1 CZK bn), machinery and equipment (76.8 CZK bn) and metal products (59.5 CZK bn) contributed the most to the resulting surplus of the trade balance in 2017. First two divisions also experienced a considerable enlargement of the surplus (by 31.1 bn for the motor vehicles, 13.4 bn for the machinery and equipment). Basic metals (deficit in the size of 125.0 bn), oil and natural gas (-117.8 bn) and chemical substances and products (-108.3 bn) had the highest effect in the direction of the negative balance of the foreign trade in 2017. Because of the changes in prices, the deficit of trade with basic metals deepened by 29.2 CZK bn and the deficit with oil and natural gas by 40.1 bn. Already mentioned revival of the Czech chemical industry was apparent in the moderation of the deficit of trade with the chemical substances and products by 11.2 CZK bn.

Chart 10 **Balance of foreign trade\* in foreign trade statistics** (accumulation Q1 to Q4, in CZK bn, selected divisions of the CZ-CPA classification)



\*in the national conception

Source: CZSO

## 5. Prices

Total price level went up.

Growth of the total price level gauged by the GDP deflator attained 1.3% in year 2017. Growth of the total price level thus did not reflect the increase of prices of goods consumed by households (2.5%) and the government sector (3.3%). Prices of the investment products also increased slightly (1.1%). Total growth of the price level was however softened by the negative terms of trade (99.0%).

Growth of consumer prices was the highest since 2012.

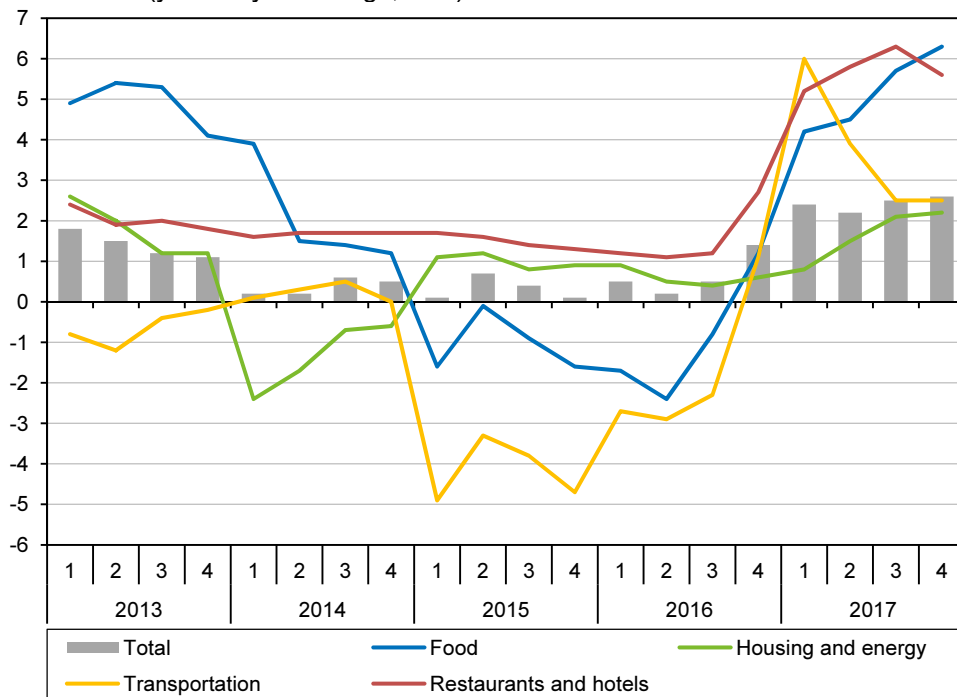
Year 2017 significantly differed with respect to the development of the consumer prices from the preceding three years. The consumer price index rose by 2.5% compared to year 2016. That is the most since year 2012 (3.3%). Viewed in the individual quarters, the year-on-year rate of growth of prices gradually accelerated (with the exception of Q2). Already in Q1, the sharp acceleration was impacted by the marked increase of the prices of transport, in the rest of the year the main determinants of the dynamics of the consumer price index was the food. Food and non-alcoholic beverages added to the yearly increase of prices 0.9 p.p. Items housing, water, energies and fuels and transport in the order of the size of their addition ranked behind them (0.4 p.p.). Influence of costs of housing however strengthened during the year, mainly due to the accelerating growth of the imputed rent.

The effect of the low comparative basis of year 2016 was evaporating at the end of the year and the year-on-year pace of growth of prices weakened.

Year-on-year increase of prices was 2.6% in Q4. At the same time the year-on-year rate of growth was weakening during the last three months. Because the effect of the low basis of year 2016 was evaporating. In October, the year-on-year addition thus neared the 3% boundary, in December it fell below 2.5%. The impact of food and non-alcoholic beverages (contribution 1.1 p.p.) even more than in the preceding quarters strengthened in the last quarter of 2017. Growing of prices of housing and energies also continued, at the end they contributed to the growth of the total index by 0.6 p.p. Transportation, as well as food service and accommodation added to the growth 0.3 p.p.



Chart 11 Prices in the selected divisions of the consumer price index (year-on-year change, in %)



Source: CZSO

Food and non-alcoholic beverages contributed the most to the growth of consumer prices.

Prices of food and non-alcoholic beverages were raised by 5.2% in 2017. It is the most since year 2012. Prices grew relatively significantly for most of the divisions of the classification, however the raising of prices of baking products and cereals by 5.1%, milk, cheese and eggs by 10.8% and meat by 4.4% played a key role. These three items together comprise more than 10% of the consumer basket weight. Increased prices of oils and fats (mostly butter) by 14.2% presented a somewhat lesser burden on consumers. Development in Q4 did not differ much from the rest of the year. The prices of food and non-alcoholic beverages rose by 6.3% year-on-year towards the end of the year and especially the above-mentioned groups of goods participated.

Prices of housing accelerated during the year.

Prices of housing, water, energies and fuels in total grew by 1.7% for year 2017, but the growth accelerated during the year. Especially imputed rents increased (4.2%), however the conditions on the real estate market affected the prices of rents from flats as well (2.2%). The prices of electricity, heat, gas and also other fuels mildly decreased during the whole year (-0.7%). In Q4 itself, the prices of housing and energies rose by 2.2% year-on-year (in that imputed rent by 5.1%). Prices of transport increased by 3.7% in 2017. In the first half of the year, their growth was driven by the year-on-year increase of the prices of fuels, heightened by the extraordinarily low comparative basis of year 2016. In H2, the prices of personal transportation vehicles grew faster.

Prices in restaurants markedly increased.

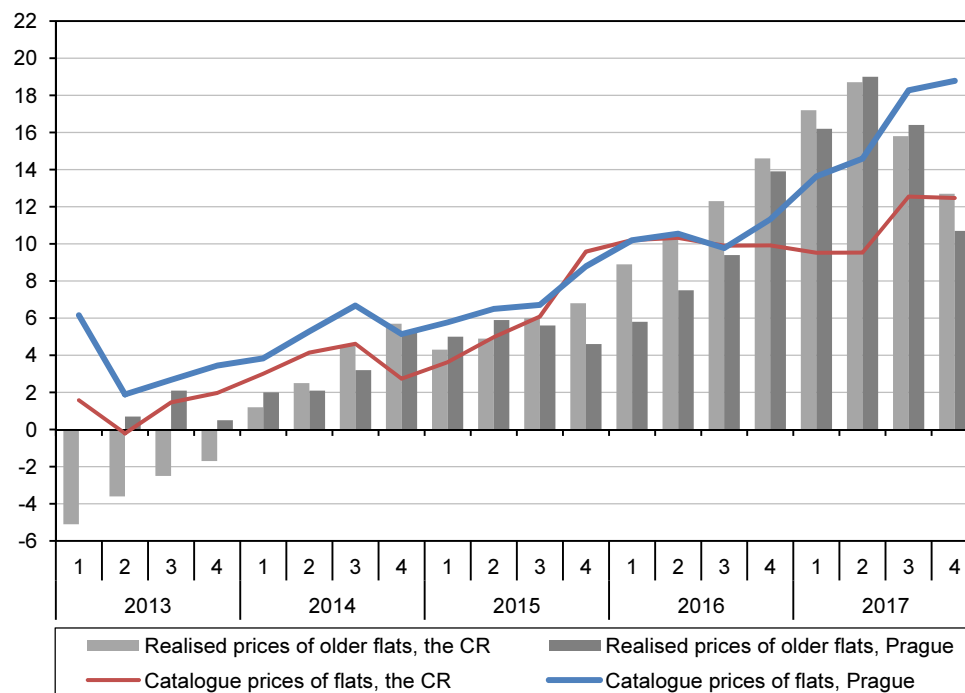
The fourth item, which considerably affected the growth of the consumer price index throughout the whole year, was restaurants and hotels. Prices increased by 5.7% here for the whole year 2017. The relatively high increase of wages in food service and accommodation, which also transferred into the final prices, can be seen behind this development.

Growth of prices for sales of older flats slowed down in H2 2017.

The question of housing availability became even more acute in year 2017. Year-on-year growth of the index of supply prices of flats in the CR moved around 10% already since the end of year 2015 and it accelerated to 12.5% in Q3 and Q4 2017. Even though the supply prices of flats outside Prague grew only on average by 4.7% year-on-year during the last year. But supply prices of flats in Prague grew by staggering pace (on average 16.4%). Their growth accelerated during the year and it reached 18.8% in Q4. Year-on-year growth of prices of the completed sales of

second-hand flats in the CR peaked (18.7%) in Q2 2017 and it subsequently slowed down. It was however still higher than 10%. Prices of completed sales of second-hand flats grew in Prague on average slightly slower than in the rest of the CR last year. Viewed from the quarter-on-quarter development, there is a turn apparent in the prices of completed sales of second-hand flats. Index considerably slowed down its growth in H2, the prices fell in Prague in Q4 for the first time since the end of year 2013. Completed prices of new flats in Prague reflected the sharp rise of prices of flats in new construction projects and they grew on average by 13.6%. Towards the end of the year however the year-on-year increase markedly slowed down and the quarter-on-quarter growth was negative in Q7 2017 for the first time since Q2 2014.

Chart 12 Prices of real estate (year-on-year change, in %)



Source: CZSO

Consumer prices grew faster also in Europe.

Increase of the harmonised index of the consumer prices reached 1.7% in the European Union in year 2017. Development of the consumer prices in the euro area started to lag behind the average of the whole union in Q2 of the year. The prices rose by 1.5% in the euro area for the whole year 2017. The Czech Republic was placed between the states with the highest price growth for the whole year. The consumer prices grew the fastest in 2017 in Lithuania (3.7%), Estonia (3.6%) and Latvia (2.9%, here it however slowed down at the end of the year). The price growth remained near zero for the whole year in Ireland (0.3%). Following the revival in the first half of the year, the year-on-year rate of growth of prices also dropped in Cyprus (0.7%). Consumer prices grew by less than 1% in Finland (0.8%) in 2017.

Producer prices grew the fastest in the recent years last year. Their dynamics was accelerating towards the end of the year.

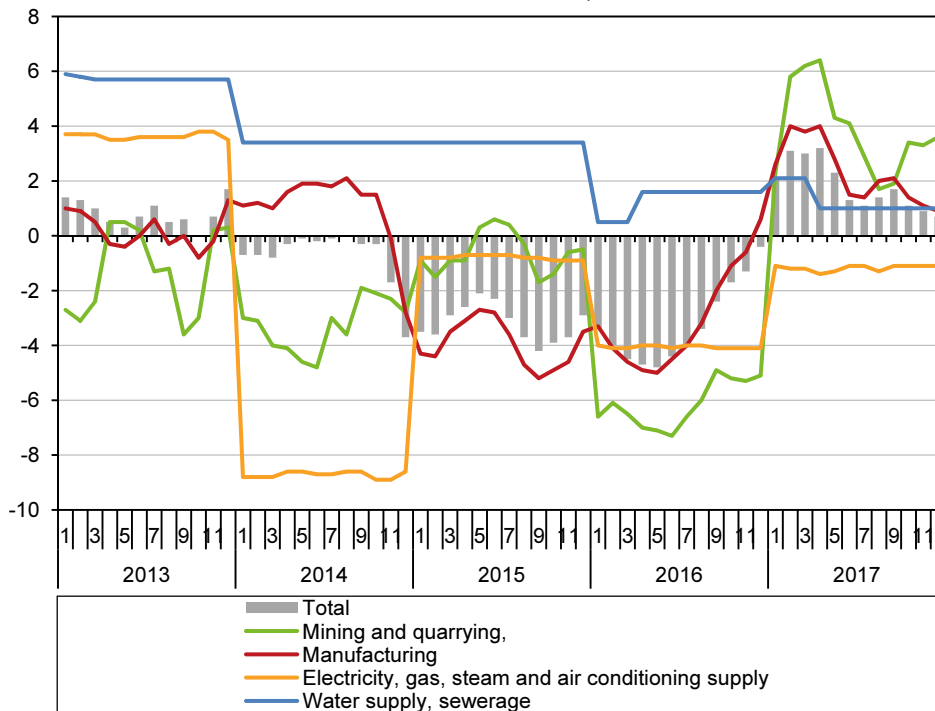
Industrial producer prices grew by 1.8% in 2017. It is the highest value since year 2012 and change compared to dynamics of years 2014–2016, when the industrial producer prices were sinking. Nevertheless, the growth of prices was slowing down during the year, year-on-year pace fell to 0.9% in Q4. Development of prices of coke and refined oil products contributed to the growth of the index in 2017, increase of the prices of food products, beverages and tobacco by 2.6% was also significant. Raised prices of general metals and metal products by 5.3% also added to the increase considerably in 2017. In contrast, the prices of transport equipment were falling, by 2.2% for the whole year. In Q4 itself, the prices of general metals and metal products were growing the most year-on-year (5.1%). Thanks to a high weight in the index, the food products, beverages and tobacco also had a more notable contribution to the total growth (year-on-year growth 2.2% in Q4, slowdown compared to the previous quarters). Prices of transport equipment worked in the direction of fall, by 3.4% in Q4 and also the prices of electricity, and gas, steam and air conditioning supply, which were falling the last four years.



Growth of producer prices reached 3.5% in the EU.

Gradual slowdown of the growth of prices of industrial producers did not avoid even the European Union (EU28). Industrial producer index here increased by 3.6% in 2017. While the growth of prices reached 5.0% in Q1, it was 2.9% year-on-year in the last quarter. The index grew the fastest in Belgium (8.9%), Great Britain (6.2%) and Poland (4.7%) in 2017. The Czech Republic belonged among countries with the lowest growth of the industrial producer prices. The prices grew slower only in Luxembourg (-1.9%), Malta (0.7%) and Slovenia (1.3%) in 2017.

Chart 13 **Prices of main groups of industrial producers** (year-on-year change, in %, based on CZ-CPA classification)



Source: CZSO

Agriculture producer prices grew the most out of the monitored price indices.

Prices of agricultural producers grew by 7.3% in 2017. It is the most since 2011. At the same time, it represents a significant change against the falls in years 2014-2016. The price dynamics reached its peak in Q3, but the year-on-year increase arrived at relatively high value of 8.0% also, in the last quarter. Prices grew in both animal and plant production. In plant production, they increased by 1.7% in 2017. Increase of the prices of fruit and vegetables by 6.3% contributed (price index excluding vegetables rose only by 1.1%). However, a turn also occurred with the development of prices of cereals (growth by 1.7%), especially wheat (3.0%) and rye (2.3%). Prices of oil plants increased after four years of declines (4.1%). The acceleration of the growth of prices of oilseed rape contributed 4.4%. Animal production added to the total growth of the agricultural products more (increase of 15.2%). Increase of prices of livestock participated by 4.9% (especially pigs and piglets by 11.2%). However, the increase of prices of animal products by 25.4% was the strongest impulse. Prices of milk rose by 25.8%, prices of eggs by 23.0%.

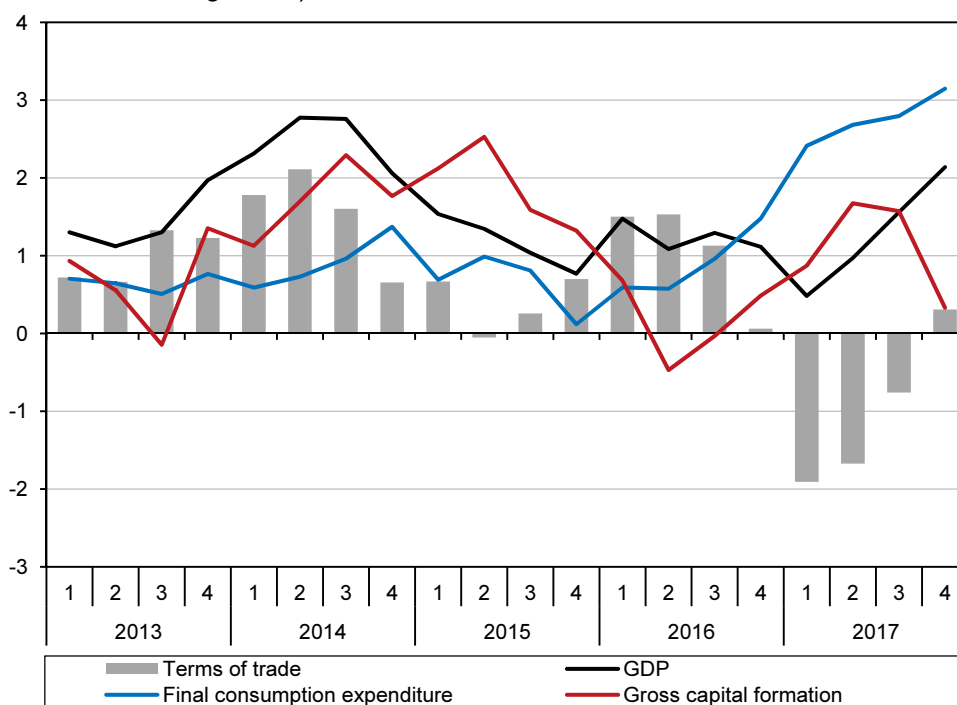
Market services in the price area recorded recovery. Total growth reached 1.3%.

Prices of market services likely broke the stagnation lasting practically since 2010 in 2017. The prices rose by 1.3%, that is the most since year 2009. At the same time the growth was accelerating during the year – it reached 1.7% in Q4. Towards the end of the year, the year-on-year growth of prices of individual services also accelerated. Among the weight significant items, mainly the prices of advertising services and market research increased by 2.7% (by 4.1% in Q4) last year. Architectural and engineering services and technical testing and analysis in total increased prices by 1.4% (by 3.0% in Q4). Total development affected in the positive direction also the increase of prices of services in the area of programming and advisory by 1.3% in 2017 (1.8% in Q4).

Export prices grew in the first half of the year, they however sank in H2.

Export prices fell in total year-on-year by 0.1% in 2017. The year-on-year dynamics were positive in the first half of the year, the prices were falling year-in-year in H2. Especially the prices of exported machines and transport equipment (-2.2%) and industrial consumer goods (-1.0%) were sinking in 2017. In contrast, the prices of export of mineral fuels (16.3%) and other materials (10.3%) were markedly growing. Prices of imports in total increased by 0.9% year-on-year in 2017. Similarly to exports, the prices of mineral fuels (13.9%) as well as other materials (10.3%) were growing and machines and transport equipment (-2.9%), industrial consumption goods (-2.2%) and animal and plant oils (2.6%) worked in the direction of fall in 2017. The terms of trade were 99.0% in 2017. Trade with animal and plant oils (105.6%), mineral fuels (102.1%), industrial consumption goods (101.2%) as well as machines and transport equipment (100.7%) achieved positive terms of trade. Terms of trade for semi-finished products (96.9%) and beverages and tobacco (97.5%) were significantly negative.

Chart 14 **Deflators** (adjusted for seasonal and calendar effects, year-on-year change, in %)



Source: CZSO

## 6. Labour Market

Growing economy was heightening the demand for labour force, which however still more markedly faced the inadequate supply. Employment kept significantly growing, the largest number of persons had a job in the history of the CR.

Favourable tendencies from the previous years continued on the labour market during 2017. Simultaneously, the growing tension arising from the non-satiated demand of business for the labour forces was still more apparent. At the background of this fact, the employment was strengthening for the most part of the year. The number of workers<sup>30</sup> increased by 1.6% compared to year 2016, it was the highest year-on-year rate of growth since the expansion year 2008. Nevertheless, the quarter-on-quarter growth of employment halted in the last three months of the last year. Mainly the high basis stood behind it (growth in the preceding quarter was the strongest since the end of expansion in the previous decade<sup>31</sup>). The largest number of people were employed at the end of last year in the CR in its history (5.36 mil). The business cycle impacted here together with the inflow of the labour force from abroad, but also the shift in the age structure of the population or the regular increases of the retirement age.

<sup>30</sup> Unless stated otherwise, data regarding employment are in the conception of the national accounts adjusted for seasonal effects in this chapter.

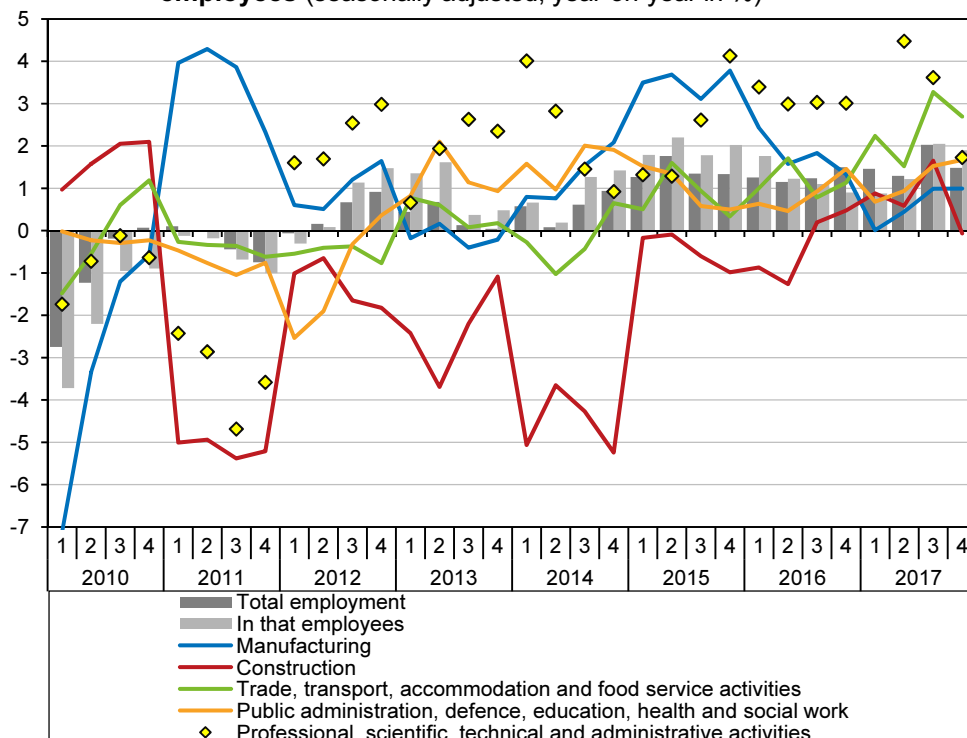
<sup>31</sup> Similar situation also occurred in both Q3 2015 and 2016. In both cases it represents only a one-off deviation from the longer-term growth trend.



Employment rate kept further increasing. The CR held front position in the whole EU in case of males.

More detailed data of the Labour force sample survey (LFSS) suggest, that the main source of the employment growth was the net inflow from unemployment in Q1 to Q3 2017 (resulting from its further reduction). Already 74.3% of population aged 15-64 years held a job in Q4 2017. Year-on-year rate of growth of the employment rate slightly weakened – from 2.1 p.p. (in Q4 2016) to 1.4 p.p. (a year later). Older employees held a larger share on this growth (above 55 years), however the employment rate rose in all age groups (apart from females aged 35 – 39 years). Employment of males achieved 81.4% in Q3 and it was the highest in the EU already for more than one year. Employment of females ranked the CR still only to the eleventh place, even though it grew year-on-year by double pace compared to the Union (from 64.5% to 66.7%).

Chart 15 **Total employment in selected branches and number of employees** (seasonally adjusted, year-on-year in %)



Source: CZSO (national accounts)

Both employees and self-employed contributed to the higher employment last year.

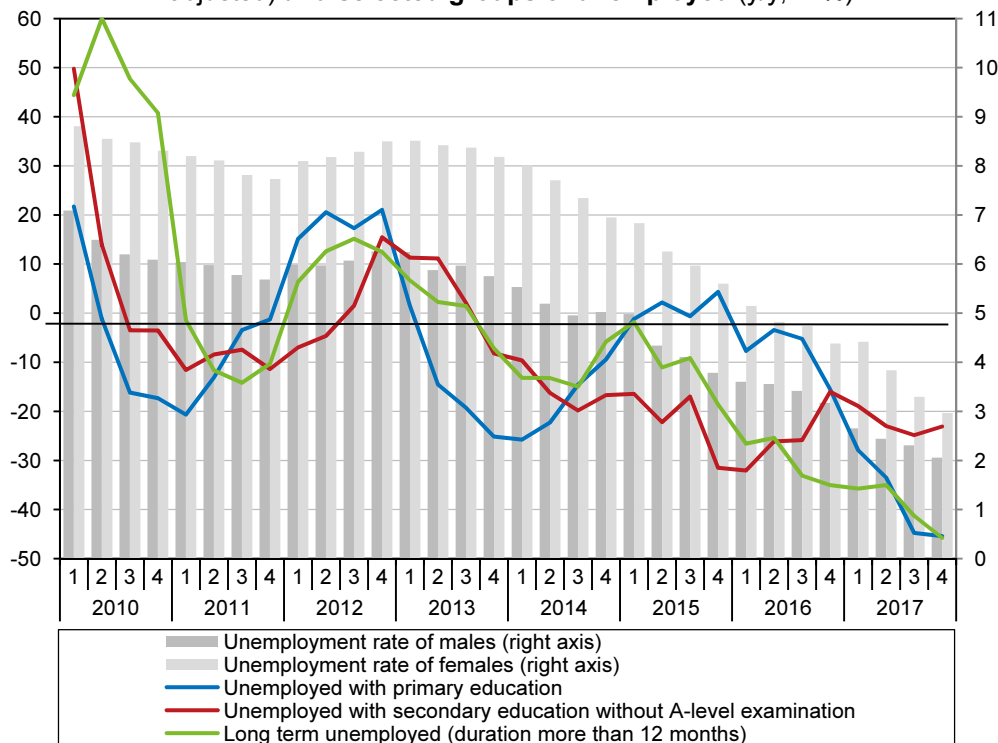
Focal point of growth of new job positions moved from manufacturing to services. Construction revived, recession in mining and quarrying on the contrary continued.

Mostly employees contributed to the higher employment in 2017. Self-employed however also participated by one sixth, their growth pervaded majority of significant branches. Number of self-employed increased already second year in a row. From the point of view of branches, especially services drove the growth of the total employment in 2017. The role of manufacturing, which intensively hired employees in years 2015 and 2016, gradually weakened. By 71 thousand people more worked in the services sector compared to year 2016, by 8 thousand more in manufacturing. Within the services sector, the branch professional, scientific, technical and administrative activities and also information and communication created relatively the most new working positions (by 3.8% more in both cases). Mild increase of employment continued in branches with the state dominance<sup>32</sup> – mainly in defence and education. The six years lasting reduction of employment in construction halted, exclusively due to the effect of higher number of self-employed (they benefited from the higher demand for smaller construction works, whose development was not negatively affected by the irregularities in the drawing of European funds). The number of hours worked in the whole economy increased by 1.9% last year and it showed higher rates of growth than the total employment already for the second year. One of the reasons is also the growing number as well as proportion of persons working in the second employments, as evident from the LFSS<sup>33</sup> data.

<sup>32</sup> Includes branches: Public administration and defence, education, health and social care.

<sup>33</sup> 139 thousand persons worked this way in Q3 2017, 114 thousand two years ago.

Chart 16 **General unemployment rate of males and females (in %, seasonally adjusted) and selected groups of unemployed (y/y, in %)**



Source: CZSO (LFSS – Labour Force Sample Survey)

Pace of the reduction of the unemployment rate did not slacken during 2017 thanks to the favourable development for the long-term unemployed persons, resp. persons with the lowest education level.

General unemployment rate was continuously sinking to the historical minimums in the context of the independent CR as well as its position within the EU. In December 2017, there were 2.4% of unemployed persons aged 15-64 years (based on the seasonally adjusted data), by 1.3 p.p. less year-on-year. The rate of growth of the unemployment reduction compared to both years 2015 and 2016 did not slacken, which was especially thanks to the favourable development in the first half of year 2017. 2.0% of males and 2.9% of females were without a job at the end of the year (year-on-year reduction of unemployment was comparable for both genders). Persons who were without a job for more than one year participated on the lower number of unemployed (by 63 thousand) from more than one half. The frequency of long-term unemployed lowered to record 40 thousand in Q4. It was connected to the marked improvement in the position of persons with the lowest education level on the labour market. Unemployment of persons with the primary education fell from 18.5% to 10.1% (the strongest year-on-year reduction in the history of the CR).

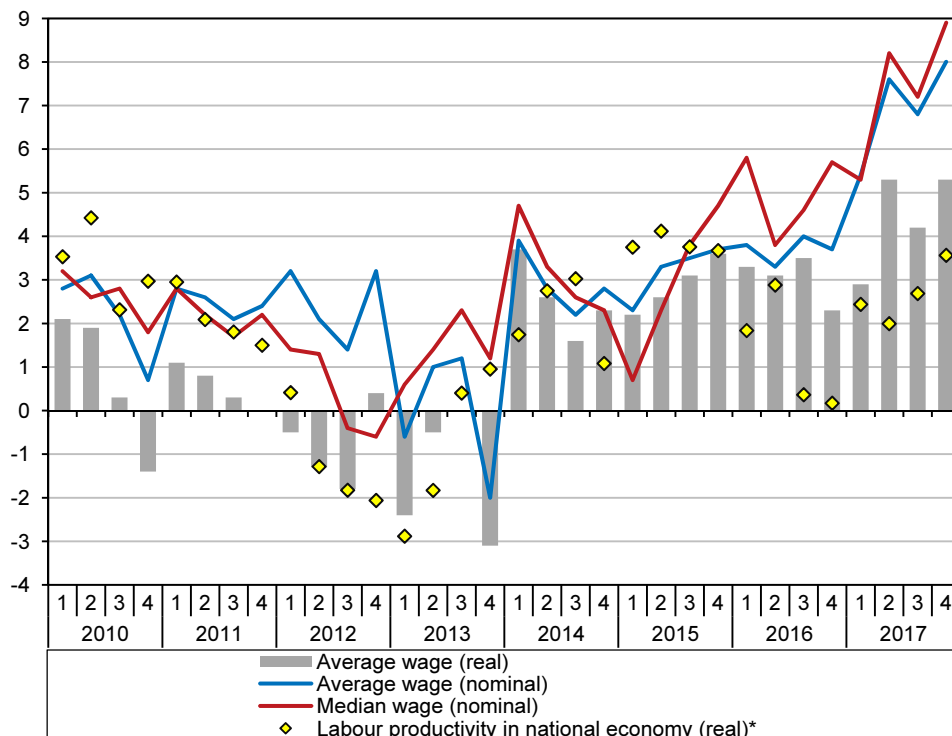
Supply of vacancies at LO nearly doubled year-on-year. More than three quarters of additions however consisted of positions with minimal declared demands on qualification.

The supply of vacancies at labour offices (LO) accelerated in 2017. Their number overtook the 200 thousand boundary for the first time in history at the end of September, by the end of the year there were already 217 thousand job vacancies (by 84 thousand more year-on-year). Year 2017 was the first in the history of the CR, when the number of vacancies month-on-month grew (despite seasonal effects) continuously for the whole year. More than three quarters of the year-on-year addition represented positions with a minimal qualification requirement, when the primary education was sufficient. This fact together with substantial reduction of the level of long-term unemployed suggests, that the employers can experience difficulties with covering such vacant positions by the domestic workers. From the view of branches, manufacturing majorly contributed to the expansion of the supply. There was total of 1.3 applicants per 1 vacancy at the end of the year, the least since half of the nineties. The chance for placement improved year-on-year in all regions, with respect to qualification then mostly for craft and repairmen and assemblers as well as the machine and equipment operators.





Chart 17 **Average gross monthly wage and wage median (employees in full-time equivalent, year-on-year in %) and labour productivity\***



\*Share of seasonally non-adjusted GDP and employment (in the national accounts conception) Source: CZSO

Wage growth accelerated during the year. Increasing lack of available employees on the market as well as the heightened activity of the state stood behind it.

Nominal growth of wages was the largest in the last nine years in 2017. Earnings in branches with low wage level still grew relatively the most.

Relative wage differences between both branches and regions were reduced and proved prevailing strong demand for less qualified workers.

Good economic results of businesses, continuing positive expectations, but also the deepening mismatch between the supply of the labour force and demand for it led to the dynamization of the wage growth during 2017. The state also played important role – by strengthening the wage tariffs of its own employees as well as the further increase of the minimal wage boundary (incl. the secondary impact on the tied guaranteed wages). The average gross monthly wage crossed the 30 thousand boundary for the first time in history in Q4 2017 and it strengthened year-on-year by 8.0% (by 3.7% the year before). The growth culminated in both Q2 and 4 during the year 2017, which was also linked to the year-on-year larger volume of paid out bonuses. The wages hiked up by 7.0% in total for the whole year, which corresponds to the rates of growth from the expansion years 2007 and 2008. Employees in accommodation, food service and restaurants were the most better off already third year in a row by 11.9% last year). Still it presented the branch with the lowest level of wages (17.5 thousand CZK). The growth of the minimal wage also pushed the earnings in the administrative and support service activities (+8.0%). In branches with the predominance of state, the cultural, entertainment and recreational activities recorded the highest rate of growth of wages (9.3%), especially due to the marked acceleration in Q4 (+13.4%). The earnings also grew dynamically in health and social care (+9.1%) last year. In contrast, despite improvement, the dynamics as well as the absolute size of wages in education remained below the level of the national economy towards the end of the year. Weight dominant manufacturing copied with respect to the size of wages as well as their dynamics the values for the whole economy in the last three years. The relative growth was more modest in the majority of branches with the above average wage level, specifically in financial and insurance activities (+3.6%<sup>34</sup>). In most of them it was however offset by the strong growth of employment (information and communication, energetics). Wage differentiation slightly reduced last year, the median wage exceeded the rates of growth of the average wage for already two and a half years. The increase of the rate of growth of the average real wage was also a positive trend – it strengthened by 4.4% in 2017, the most after year 2003.

<sup>34</sup> It represented the only from the 19 main branches, where the last year's rate of growth did not significantly rise compared to year 2016 (+3.3%). In absolute terms however, the addition to wages (+1819 CZK) was here comparable to the branch accommodation, food service and restaurants or the whole economy last year.

## 7. Monetary Conditions

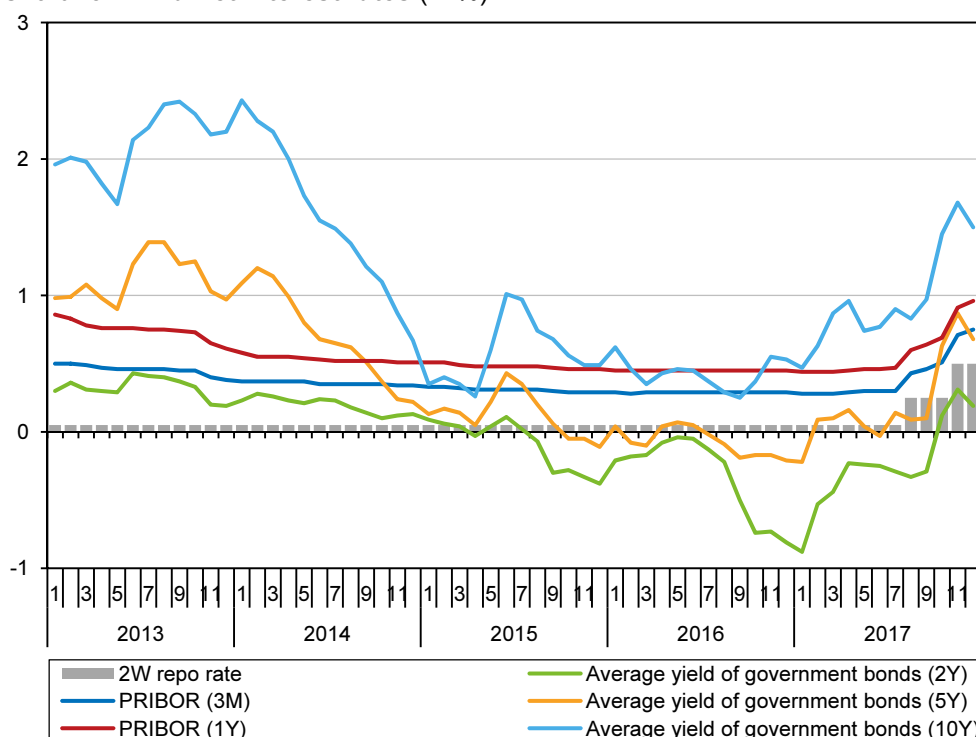
Since the April termination of the regime of forex intervention the koruna foreign exchange was appreciating against both euro and dollar.

CNB decided twice for the increase of the monetary policy-relevant interest rates in 2017.

Year 2017 brought a range of changes in the area of the monetary conditions. After the April termination of the forex intervention, koruna returned to the regime of the managed floating. The koruna foreign exchange was thus appreciating against the important foreign currencies during the year. Foreign exchange against euro kept on the value 27.02 CZK/EUR<sup>35</sup> for the whole Q1. After the termination of intervention, it gradually appreciated and its average value was 25.65 CZK/EUR in Q4. Koruna appreciated against euro by 5.5% since the 2<sup>nd</sup> January till the 29<sup>th</sup> December. The koruna foreign exchange appreciated even more significantly towards the American dollar. Its average value reached 25.38 CZK/USD in Q1, it was 21,79 CZK/USD in the final quarter. For the whole year 2017, koruna appreciated against dollar by 17.5%. The slump of the prices of the foreign trade represented the immediate impact of this appreciation

Termination of the regime of interventions was to certain extent the return to the classical instruments of the monetary policy. The change of the monetary policy-relevant interest rates manifests for the first time since November 2012. At first, the repo rate was increased from 0.05% to 0.25% at the beginning of August and the lombard rate from 0.25% to 0.50%. It was the first growth since year 2008. Further shift upwards eventuated at the beginning of November. The repo rate was increased to 0.50% and the lombard rate to 1.00%. In connection to the discussion regarding the stability of the financial system, the CNB also applied some instruments of the macro-prudent policy. For once, it tightened the recommendations related to the provision of mortgages and also increased the rate of the capital reserve for some banks. At the end of year 2017, it also announced the increase of the rate of the counter-cycle capital reserve valid as of 1. 7. 2018 (from 0.5% to 1.0%, further increase to 1.25% as of 1. 1. 2019).

Chart 18 **Market interest rates (in %)**



Source: CNB

Interbank rate as well as yields on the government bonds

Increase of the monetary policy-relevant rates directly impacted the interbank interest rates. The three-month PRIBOR rate rose by 0.47 p.p. since January till December 2017 and it was 0.77% in December (the most since September 2012).

<sup>35</sup> Foreign Exchange rates announced by the CNB data in working days. Unless stated otherwise, all data in this chapter have been taken over from the ARAD database of the Czech National Bank.



increased.

The one-year PRIBOR increased by 0.52 p.p. The December value of 0.96% was the highest since October 2010. The yields of the government bonds went also up. Bonds with the maturity of two years reached the record minimum of the yield with the value of -0,88% in January, but they kept above zero already in Q4 (0.12% in October, 0.31% in November, 0.19% in December). The yields of the short-term bonds thus remained in the negative numbers since August 2015 till September 2017. Yields of bonds with the maturity of 5 years increased from -0.22% to 0.68% from January till December 2017 (they reached a maximum of 0.87% in November). The growth of yields of the long-term bonds (maturity 10 years and more) commenced already in Q4 2016. The growth trend was confirmed in year 2017 and the yields improved from 0.47% in January to 1.50% in December.

Interests on the current accounts still remain on nearly zero values. Rates on the consumer credits were falling, those on mortgages mildly rising.

Interest rates on deposits did not mirror neither the shifts in the monetary policy-relevant nor the interbank rates in 2017. Interests on the current accounts of households (0.04%) as well as non-financial businesses (0.02%) remained at the practically zero level. Some shifts upwards were evident towards the end of the year on deposits with the agreed maturity for the non-financial businesses (they had nearly zero interest in Q1 to Q3). The only type of deposit, whose interest copied the development of the main rates were the deposits with maturity between 1 and 2 years. Their interest increased from the April minimum of 0.42% to 1.12% in December. The drop of interests on the consumer credit for households continued. Their interest fell below 10.0% in February, in December the average interest already moved at the level of 8.7%. On the contrary, the interest rates of mortgages gradually increased. Interests on fixed rate credits with terms between 1 to 10 years grew the most (by 0.29 p.p.). Rates for this type of mortgages are still however the lowest in comparison to the other fixed rates. Interest rates on credit for the non-financial businesses did not change significantly during the year. A slight growth was apparent only in Q4.

Households took on debt for the reason of the purchase of real estate as well as consumption. Data regarding the number of new contracts however show stagnation.

The volume of credit provided to households grew throughout the whole year 2017. It increased by 109.6 CZK bn for the 12 months (credit in CZK; credit in foreign currency is negligible for the Czech households) and the total volume of credit provided to households overtook 1.5 trillion in Q4. Considerable increase manifested especially in the first half of the year (52.9 CZK bn), H2 2017 lagged behind the same period of the previous year by 2.8 bn. The Czech households utilise the credit mostly for the reason of purchasing a real estate. The volume of mortgages provided increased by 91.5 bn last year (by 14.5 bn more than in year 2016) and it reached 1 035.2 CZK bn as of 31. 12. Data related to the number of new contracts to mortgages (available only as of 30. 9.) nevertheless show, that while the volume of credit grew, the number of new contracts fell year-on-year in both Q2 and Q3. Q4 2016 can be seen as the peak, when 60.0 thousand new contracts were signed (year-on-year increase by 12.5 thousand, number grew year-on-year also in Q1 2017). The reason of this development could be the expected tightening of the conditions for the provision of mortgages as well as the sharp increase of the prices of real estate. The volume of consumption credit increased by 13.1 CZK bn last year (by 1.6bn less than in 2016) and it arrived at 198.5 CZK bn as of 31. 12. Total indebtedness of households was 1 595.8 CZK bn as of 31. 12. Debts connected to housing participated from 72.2%.

Credit in foreign currency affected the most the financial and insurance activities last year. In recent years however, they play important role also for the non-financial businesses.

The volume of credit and liabilities for the non-financial businesses increased by 45.9 CZK bn for year 2017. The largest share (55.8%) had as of 31. 12. the long-term credit, which also expanded the most (by 20.8 CZK bn). The volume of short term credit also however recorded a marked increase (by 17.3 bn.). Credit denominated in the foreign currency held an important role (they comprised 29.6% of the total volume of credit as of 31. 12.), whose volume expressed in korunas affected the last year's strengthening. Volume of credit and liabilities in the foreign currency thus increased by 35.1 CZK bn for Q1 (12.9%) and the short-term credit formed one half of this increase. In the remaining quarters, a weakened interest for credit in currency was apparent (drop by 4.4 bn, in 2016 in the same period an increase by 34.9 bn). Credits in foreign currency were reflected also in the view according to branches. Their major increase was apparent for financial and insurance activities in Q1 (by 39.1%, 40.0 CZK bn), fall of 51.9 bn occurred in Q4.

Less extreme, but similar development of the volume of credit was also apparent for the real estate activities. Manufacturing also increased the proportion of credit in the foreign currency up to 50.4% at the beginning of the year towards the end of March (it was 46.8% at the end of year 2016). For the rest of the year, the value in CZK was gradually sinking (given more by the appreciation of koruna). Total volume of credit in manufacturing grew equally throughout the year (average year-on-year pace of 4.2%). Transport and storage (+6.3 CZK bn, 15.2%) followed in the long-term strong growth of the credit financing in 2017, credit financing for accommodation, food service and restaurants (28.6%) also markedly increased. Volume of credit was falling for mining and quarrying for the whole year (by 9.6 CZK bn for the whole year, 46.2%).

## 8. State Budget

Expanding economic growth assisted the state budget to reach the second most favourable balance after year 1996.

The state budget (SB)<sup>36</sup> ended in 2017 in mild deficit (6.2 CZK bn). The favourable result from the preceding year (+61.8 bn) was not repeated, it was markedly affected by the completion of incoming payments from the EU budget tied to the ended programme period. Still, the last year's result was the second best after year 1996. Still the SB was achieving mild surpluses for the most of the year 2017, only the accelerated drawing of investment as well as some current expenditure towards the end of the year<sup>37</sup> drew it into deficit. The achieved deficit was by 53.8 CZK bn lower in contrast to the approved budget (even by 132 bn in year 2016). SB was affected by both the expanding economic growth and the slower commencement of the drawing of the European funds<sup>38</sup> throughout the whole last year. SB balance, comprising the key component of the deficit or surplus of the sector of the government institution budget, arrived at +0.1% in relation to the nominal GDP last year (+1.3% a year before).

Total SB revenues lowered for the first time in four years. The swift growth of the tax income including insurance was not enough to offset the sharp fall of the resources from the EU budget.

Total SB revenues lowered by 0.6% last year. It occurred for the first time since 2012, when the domestic economy was gripped by recession. The sharp decline of the income from the EU budget stood exclusively behind the last year's result (by 82 CZK bn year-on-year, to 77 bn), which was simultaneously by 21 bn deeper than the budget anticipations. The anticipation was on the contrary exceeded for all more volume significant tax revenues. State-wide collection of all tax revenues (incl. insurance) grew by 6.9% last year and approached the value from year 2016 (+7.2%, the highest after year 2007). Rate of growth of tax revenues weakened in the second half of the last year, especially due to the less favourable collection of the corporate taxes.

VAT contributed to the growth of the tax revenues by nearly one half last year, driven mostly by the strengthening expenditures on final households as well as government institutions consumption.

While the high collection of the corporate taxes drove the growth of the SB tax revenues (excluding insurance) in both years 2015 and 2016, on the contrary it was VAT last year, which contributed to the growth by nearly one half. VAT collection strengthened by 8.3<sup>39</sup> year-on-year, at the level of all public budgets then by 9.1% (by 5.4% the year before). The accelerated growth was caused especially by the development in Q2. The transfer of some activities from the grey economy due to recent measures introduced on the side of the tax collection also contributed to this result. Still, the economic growth mirrored also in the final consumption expenditures – which increased in nominal terms for households year-on-year by 6.5%, for government institutions by 5.0% in 2017, continued to represent the key factor behind the higher collection of VAT.

Collection of consumer tax on mineral oils increased thanks to the higher freight transport. Collection of tax on

The SB received by 2.9% more from all consumer taxes year-on-year in 2017. The collection of two most significant subgroups – tax on mineral oils and tax on the tobacco products strengthened by a similar pace. Growing freight transportation had a positive effect in the weight dominant tax on the mineral oils, especially the

<sup>36</sup> Unless stated otherwise, all data related to the state budget are sourced from the data of the Ministry of Finance on the cash fulfilment.

<sup>37</sup> The balance was +26.5 CZK bn in total for the first ten months of 2017. The capital outlays increased during November and December (by 30 CZK bn to 81.6 bn). Rate of growth of expenditure on the wages of state employees also accelerated, similarly to the non-investment outlays to business entities or state funds.

<sup>38</sup> According to the calculations of the MF, the SB balance adjusted on both income and expenditure side for the resources on programmes from the EU budget and Financial mechanisms (EEA and the Norway Grants, Swiss – Czech Cooperation Programme) arrived at -1.3 CZK bn in 2017 (-13.6 bn the year before).

<sup>39</sup> The proportion of the SB on the state-wide VAT revenue fell from 70.25% to 69.68% due to the change of the budget appropriations of taxes to the benefit of municipalities starting 1. 1. 2017. Reciprocally, the percentage share of the tax revenue – from the tax returns on income taxes of natural persons was amended.



tobacco products was supported by the January increase of rate of this tax.

Collection of corporate tax grew by the weakest pace for the last four years, among other things due to the strengthening wage costs of firms.

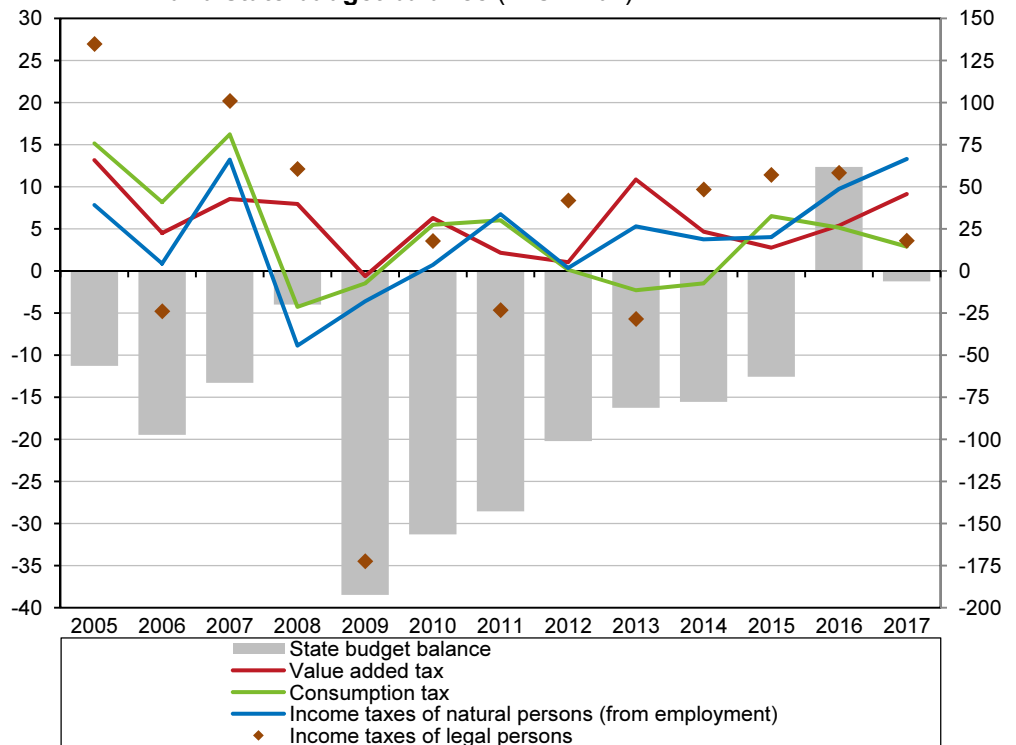
Record level of employment, heightening growth of the average wages as well as the increase of the level of the minimum wage increased dynamics of the growth of the collection of income taxes of natural persons from employment.

consumption of the diesel fuel and jet fuel was growing. Year-on-year rate of growth of the retails sales for fuels nearly doubled during 2017 (from 3.4% in Q1 to 6.6% in Q4). These influences overtook the impact of the instruction of the so called green fuel also for the animal primary production, which in contrast mildly subdued the collection of tax. With respect to the collection of tax on tobacco products, especially the increased tax rate since January 2017 stood behind its growth.

Speed of the collection of the corporate tax was weakening during 2017 and the state-wide collection was lower compared to the same period of the last year already in Q3. It concerned the first year-on-year fall since the end of year 2013. Thanks to a higher collection in Q4, the yearly budget anticipations for this tax was fulfilled. Its collection was by 3.6% higher year-on-year, however it was the weakest growth in the last four years. The mildly falling profitability of businesses from years 2016 (and partially also 2017) already started to show to a higher extent, mostly due to the intensifying wage costs. Last year's collection still did not reach the level from the peak of the business cycle of the last decade, partially also because of the mild reduction of the tax rates.

In contrast, with respect to the collection of the income tax of natural persons (ITNP) from employment, the development of the labour market was still favourable. Its state-wide collection strengthened for already a third year in a row (up to last year's +13.3%) and it tightly exceeded the record year-on-year growth from the expansion year of 2007. Expanding economy also stimulated the business activity, which showed also in the higher collection of the ITNP from the self-employment (by 11.2% to 7.6 CZK bn). Collection of this tax grew already third year in a row. Collection of ITNP from capital revenues arrived at 16 CZK bn last year. It was the only more significant tax by volume, where the state collected less last year. Not only the prevailing low interest rates on deposits had an impact here, but especially the legislative change associated with the tax exemption for the retirement entitlement of the defence forces.

Chart 19 State wide collection of tax income (year-on-year in %) and state budget balance (in CZK bn)



Source: MF CR

Current expenditures contributed exclusively to the increase of the SB expenditures and grew the fastest in the last eight years.

Total SB expenditures grew by 4.9% last year to near 1 280 CZK bn. Similarly to year 2016, the current expenditures contributed exclusively to their growth, their rate of growth was the highest in the last eight years (+5.5%). Capital expenditures again fell despite the low comparative basis last year (-3.1%). While the drawing of investment stayed only tightly behind the budget anticipations in year 2016, this difference consisted of more than 22 CZK bn already last year. Their drawing recorded more

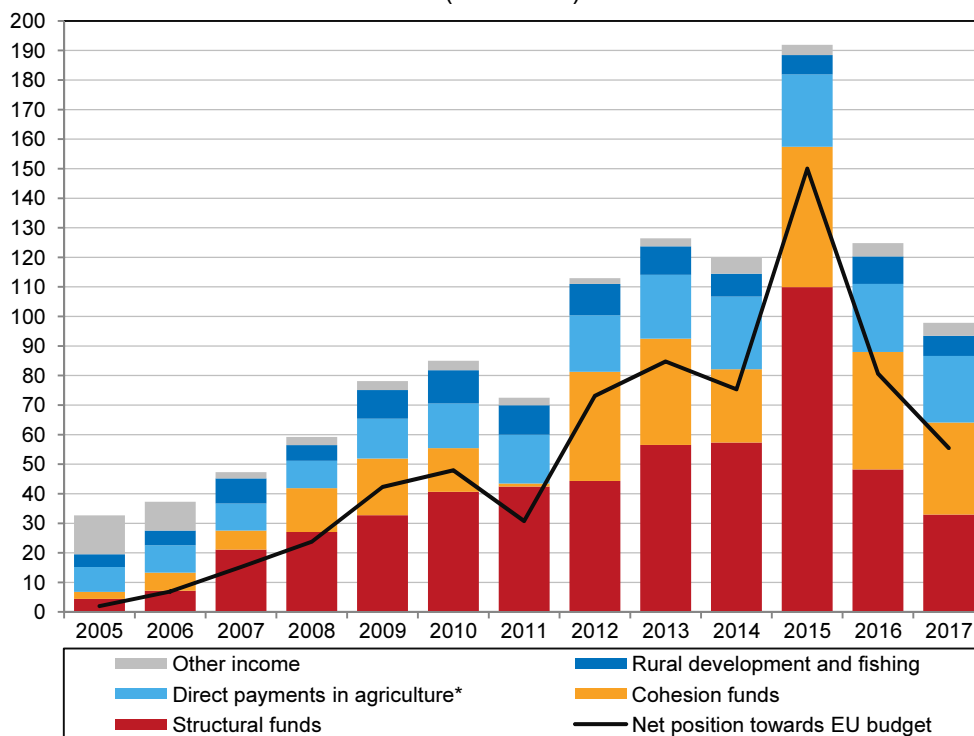
„Failing to complete the drawing of investment in relation to the budget anticipations deepened to 22 CZK bn last year.

Positive balance of the CR towards the EU budget shrank to a six-year minimum. The weaker drawing of the structural funds, including among other the projects hard on investment preparation were the cause.

considerable irregularities<sup>40</sup> during the year. The volume of investment completed by means of common programmes of the EU and CR (from the programme period 2014–2020) attained 36.9 CZK bn, doubled year-on-year. Nearly one half from this volume was financed with the assistance of the operational programme (OP) Transportation, one fifth then via the OP Environment. All expenditures to finance the common EU and CR programmes (incl. current outlays) arrived at 91.1 CZK bn last year and practically stagnated in comparison to year 2016. Just under 55% of all SB capital expenditures were directed solely to the national projects and thus did not have any relation to the EU. The volume of such assigned investment (44 CZK bn) stagnated year-on-year, it was however by nearly one half larger compared to year 2015. The proportion of investment on total SB expenditures was falling already second year in a row and comprised mere 6.4%, which was the least since year 1998.

Drawing of the SB investment intended to the European projects is with a certain delay evident in the development of the position of the CR towards the EU budget. Even though the CR acquired in “net” from the EU nearly 98 CZK bn last year, it was the least in the last six years. It was associated with the deeper reduction of the reimbursed funds in the area of the structural funds. Their last year’s amount (33 CZK bn) nevertheless slightly increased the level from years 2007 and 2008, resp. from the commencement of the preceding programme period. Drawing of funds meant for direct payment in agriculture or the rural development on the contrary functioned relatively continually in the recent years. The total payment of the CR into the EU budget also remains stable. In the last five years, it fluctuated around 43 CZK bn per year.

Chart 20 Structure of the CR income from the EU budget and net position of the CR towards EU (in CZK bn)



\* Includes also the market operations and veterinary measures.

Source: MF CR

Mainly higher expenditures on wages of employees in areas with the state dominance and on the pension

Non-investment transfers to the public budgets on the regional level, whose growth accelerated to 13.4% (from 4.6% in 2016) participated the most on the higher SB current expenditures (by 62.6 CZK bn) year-on-year last year. These expenditures especially reflected the growth of earnings of employees in the regional

<sup>40</sup> Nearly one half of the yearly volume of investment was drawn in the last quarter. Further one quarter then in Q3 2017.



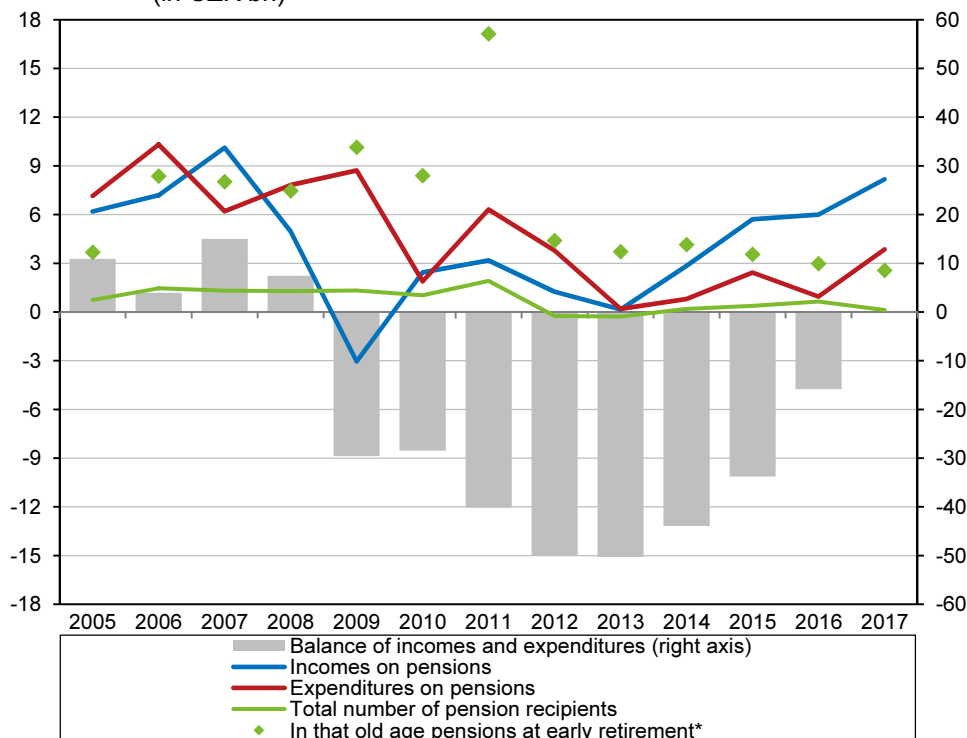
adjustment drove the growth of the current expenditures.

Dynamical growth of the collection of insurance together with the minimal addition to the number of pensioners led to the marked improvement of the pension account balance. It broke free from the deficit for the first time in nine years.

education<sup>41</sup>. The weight dominant item of social benefits also shared in the current expenditures in one quarter, its increase (+16.9 bn) was affected primarily by the pension adjustment. The rate of growth of expenditures on the wages of state employees nearly doubled (to 9.2%), mainly thanks to the increase of the wage tariffs. The non-investment transfers to contributory organizations also recorded high dynamics (+13.8%), including e.g. universities or the research agencies. The volume of non-investment transfers to the business entities also increased by nearly one tenth (to 48.3 CZK bn). These transfers are linked to a significant extent to the support of the sustainable sources of energy.

41.4% of all SB expenditures were aimed at the social benefits last year (by 0.7 p.p. less year-on-year). Full 78% of expenditures on social benefits were directed to pensions, where the state expended by 3.9% more year-on-year (by 0.9% in 2016). The impact of the new legislative amendment allowing to increase pensions above the level of the standard adjustment was projected in the growing pace of expenditures. On the contrary the number of all pension recipients (2.896 mil persons) expanded only slightly (+0.1%). Apart from the demographic effects, it was also connected to the favourable situation on the labour market and consequent "lower demand" for early retirement (year-on-year relative addition of persons with the permanently shortened pension was the weakest in the last four years last year). Record level of employment accompanied by the strengthening wage growth supported the dynamic collection of insurance (+8.2%, the highest after 2007). Rate of growth of insurance on pensions kept growing during the year 2017 (it was 6.6% year-on-year in Q1, it attacked 10% towards the end of the year). These tendencies resulted in the considerable improvement of the pension account balance<sup>42</sup>, which was by nearly 16 bn more favourable year-on-year and attained +0.1 CZK bn. Pension account thus extracted itself from the deficit for the first time since the end of expansion phase of the last decade.

Chart 21 Pension recipients, income and expenditure on pensions from the state budget (year-on-year in %) and pension account balance (in CZK bn)



\* Old age pension income awarded before the pension age is reached and shortened for the earliness is for the whole time period of the drawing the benefit. Source: MF CR, CSSA

<sup>41</sup> As of 1<sup>st</sup> September 2016, the wages were raised to teachers (+8%), but also non-educational employees (+5%) – their wages were also raised starting 1<sup>st</sup> July 2017 (by further 9.4%). Wages then rose also to the educational employees (+15%) as of 1<sup>st</sup> November 2017.

<sup>42</sup> It is expressed as the difference between revenues and expenditure on the pensions from the SB (based on preliminary data).

Rate of growth of other social benefits reduced last year and thus increased markedly slower than expenditures on pensions.

Higher incomes of household from employment led to the reduction of expenditures on material deprivation or state social support.

Size of the state debt substantially fluctuated during the year 2017. The expectations linked to the termination of the regime of forex interventions manifested. State was selling bonds for negative yield in a higher extent.

Rate of indebtedness of the whole sector of the government institutions attained 35.1% of GDP in Q3, it lowered by nearly one tenth year-on-year.

Rate of growth of the SB expenditures on other social benefits (apart from pensions) reached 1.3% and it lowered to one half compared to year 2016. The impact on the economic growth of the household income is still more evident. State expended less especially on the material deprivation assistance benefits (year-on-year by one fifth, by 35% in three years, resp. 3.9 CZK bn), where both the weight dominant allowance for living and supplement for housing significantly shrank. State social support benefits fell by 1.3%, whose growth lasting the four preceding years thus halted. Mainly the lower volume of the supplements for housing and child allowances were behind this development. Mild growth of the foster care benefits as well as the weight dominant group of the parent benefits (this benefit is not linked to the income of the family and its development thus more suggest the mild growth of the natality in the recent years) worked in the opposite direction. Smaller savings were achieved with the unemployment support (4.9% year-on-year, by 19% in the three years, resp. 1.8 CZK bn). Increase of the relative representation of the frictional component of unemployment as well the strengthening rising of wages stood in the background (with the impact on the size of the paid-out benefits)<sup>43</sup>. On the contrary, the growth of the sickness benefits continued already for the fifth year (by 7.8% in 2017)<sup>44</sup>. It was connected both to the stronger drawing of the maternity benefits due to the slightly higher birth rate and mainly to the larger volume of sickness benefits (+7.7%) as a result of both increased sickness rate and growing number of persons with health insurance. The SB spent 25.1 CZK bn on the care benefits (for persons on long term sickness leave), by 9.0% more year-on-year<sup>45</sup>.

Net expenditures on the state debt equalled 39.8 CZK bn in year 2017. They declined (even though by a slower pace) already for the fourth year in a row – in total they were thus by 21.9% lower. Lower interest rates on the market with the state bonds were behind the cut in the first half of the year and also the weaker borrowing need of the state (due to the improving SB balance). State debt considerably fluctuated during the year 2017<sup>46</sup> and it was 1 625 CZK bn at the end of December, by 0.7% more year-on-year. While the internal indebtedness mildly increased (+27 bn), the CZK value of the external debt sank already third year in a row, since the state met its borrowing need exclusively on the domestic market. The external debt thus shared by 15.6% on the total state indebtedness and within Q4, it represented the lowest share in the last ten years. The volume as well as the share of the koruna bonds held by the non-residents markedly fell in connection to the outflow of the speculative capital in Q4 2017 (from 51.4% to 41.6%), and it thus returned to the value from the beginning of the year.

Consolidated debt of the whole sector of the government institutions (reflecting also the budget of the regional municipalities or health insurance companies) attained according to the up-to-date data of the CZSO size 1 739 CZK bn at the end of Q3 2017<sup>47</sup>. The rate of indebtedness was 35.1% of GDP and fell by 3.1 p.p. year-on-year, which was the similar result of both reduction of the absolute size of the debt and the growth of the nominal GDP. Apart from the central government institutions, the local government institutions also significantly participated on the reduction of the absolute size of the debt. The government institutions administered the surplus of 84 CZK bn in Q1 to 3 2017 (50 CZK bn the year before). All government subsectors showed positive balance, as well as its year-on-year enlargement. Central government institutions contributed to the increase of the total surplus the most.

<sup>43</sup> Even though the total number of unemployed registered with the LO fell by more than 100 thousand, the number of persons with the right to claim support was lower only by 17.3 thousand year-on-year at the end of December 2017. The long-term unemployed succeeded to find a job in a higher extent. The number of applicants with the right to the unemployment support thus mildly increased to 30.5% (from 27.0% last year). The average monthly size of the unemployment support was 6 969 CZK at the end of year 2017, 6 457 CZK the year before.

<sup>44</sup> The difference between the revenues and expenditures in the area of the health insurance remained according to the data of the MLSA positive (+3.1 CZK bn) in 2017 as a result of the strong growth of the collection of insurance (+10.7%).

<sup>45</sup> Acceleration of the rate of growth was caused mainly by the legislative amendment, which raised the contribution in all grades of dependence by 10% as of 1. 8. 2016.

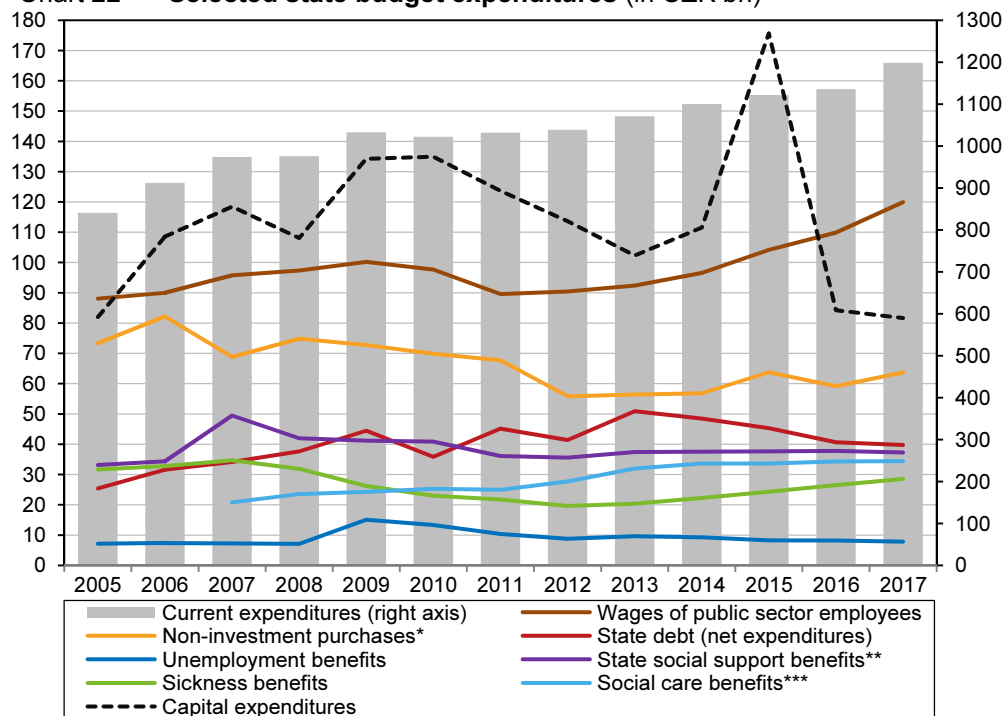
<sup>46</sup> The debt hiked to 1 789 CZK bn during Q1 and recorded the fastest quarter-on-quarter growth since year 2010 (+11%). This short-term increase was connected to the specific situation on the bond market due to the expectations associated with the termination of the regime of forex interventions. State bonds were sold for the negative yield in the value of 493 CZK bn in 2017, which brought additional revenues into the state budget in the amount of 1.2 bn. The proportion of the state debt, which does not carry any interest costs, rose from 12.0% to 15.2% during the year 2017.

<sup>47</sup> The CZSO will publish the preliminary data regarding to debt and deficit of the government institutions sector for the whole year 2017 on 4th April 2018, Eurostat then on 24th April 2018.





Chart 22 Selected state budget expenditures (in CZK bn)



\* Include mainly expenditure on the purchase of services (IT, rents), expenditure on water, fuel and energy purchases, expenditure on material purchase, expenditure on repairs and maintenance. On the other hand, interests, guarantees and other financial outlays on the state debt are excluded.

\*\* including the foster care benefits

\*\*\* Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits (based on Act on State Social Support)

Source: MF CR, MLSA

CR was the fourth relatively least indebted EU country.

Tendency to lower the relative indebtedness is apparent on the level of the whole EU since the half of 2015 nevertheless it occurred only very gradually till now.

The CR was the fourth relatively least indebted country of the EU at the end of Q3 2017 (with the distance behind Estonia, Luxembourg and Bulgaria). It was the best position since the accession of the CR into the EU. The indebtedness rate did not significantly decrease – in contrast to the CR – in the EU since the end of the last recession. It fell by exactly 3 p.p. in the last three years, by mere 0.4 p.p. against Q3 2016 (to 82.5% of GDP). 24 countries of the Union signalled the year-on-year reduction of the indebtedness (19 the year before). The position of the most indebted economies however improved only marginally. In Italy and France, troubled by high unemployment, the indebtedness rate even increased (by 2, resp. 1 p.p. year-on-year). Only one third of the euro area members fulfilled the Maastricht debt criterion (60% of GDP), in that from the core countries (EU15) only Luxembourg and Netherlands. Only Germany, Sweden and Malta managed to decrease their indebtedness to the level close to the pre-crisis year 2008 so far.