



**5<sup>TH</sup> DEUTSCHE EUROSHOP REAL ESTATE SUMMER**

# ECONOMIC OVERVIEW OF THE CZECH REPUBLIC

**SIGNS OF GROWTH ARE EVERYWHERE**

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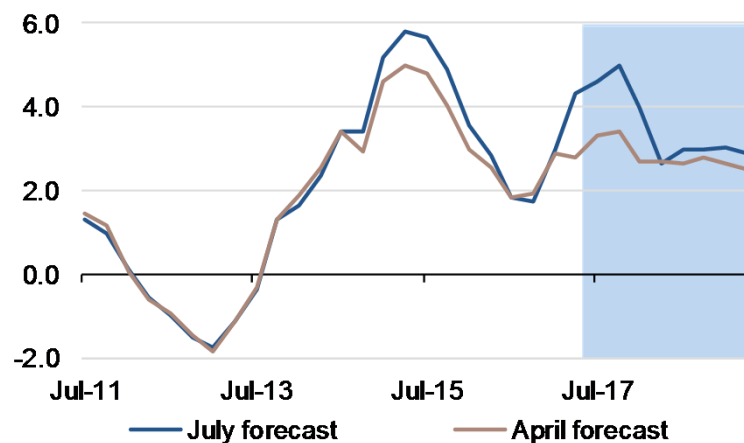
# CZECH MACROECONOMIC OUTLOOK

THE CZECH ECONOMY RIDES THE GLOBAL RECOVERY WAVE

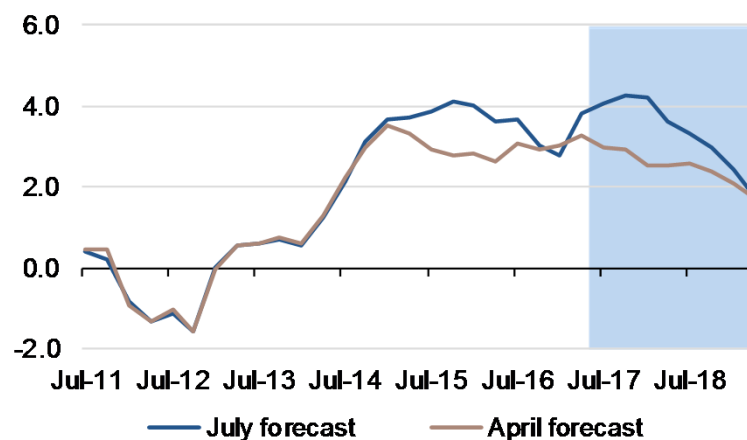
# THE REVISION OF NATIONAL ACCOUNTS CHANGED OUR VIEW ON THE ECONOMY

- The CZSO notably revised its entire time series for GDP and components since 2014
- **The Czech economy added 5.4% (prev. 4.6%) in 2015 and 2.5% (prev. 2.3%) in 2016**
- The revision was attributable mainly to stronger household consumption and investment activity

## GDP grew faster...



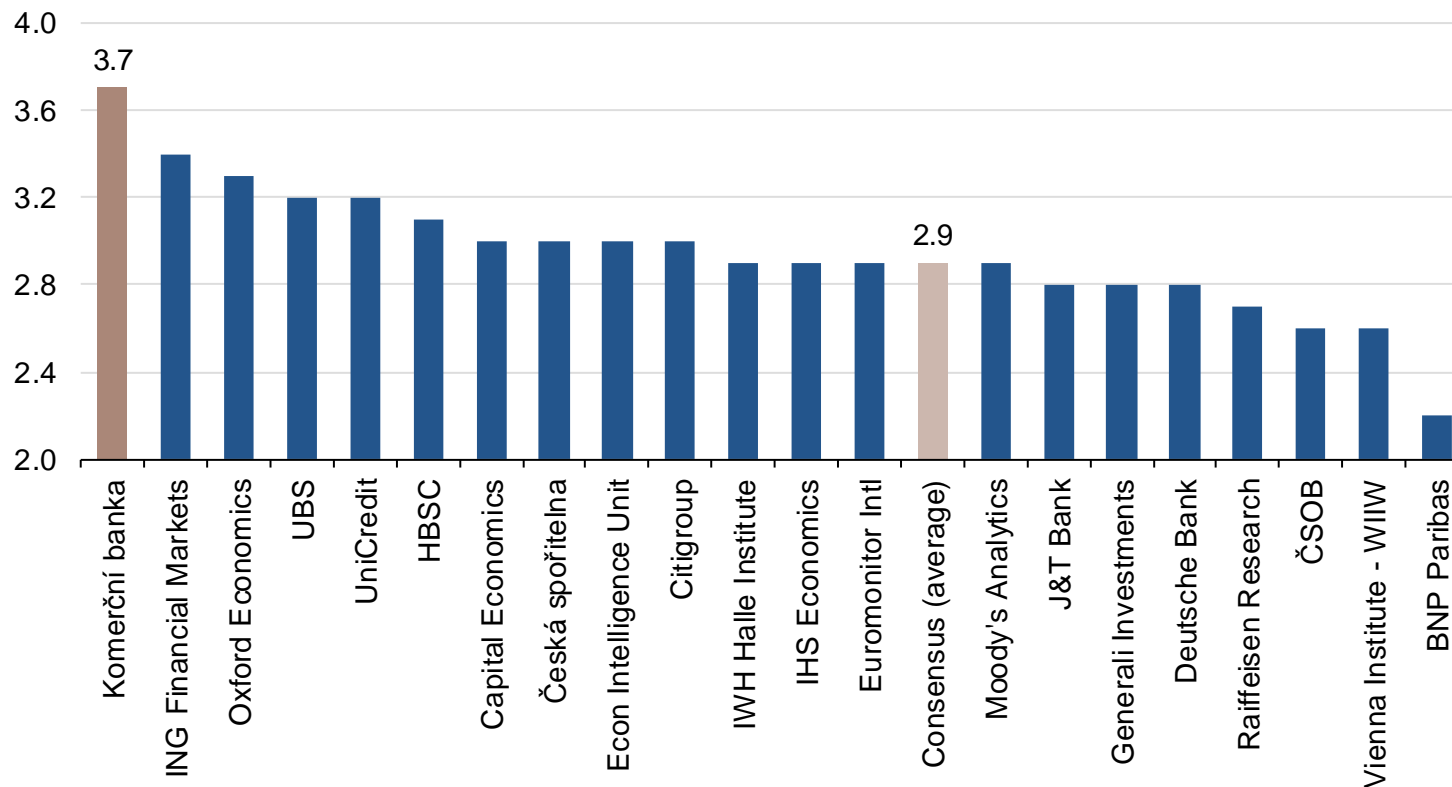
## ...thanks to household consumption



Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

# OUR FORECAST IS THE MOST OPTIMISTIC ON THE MARKET

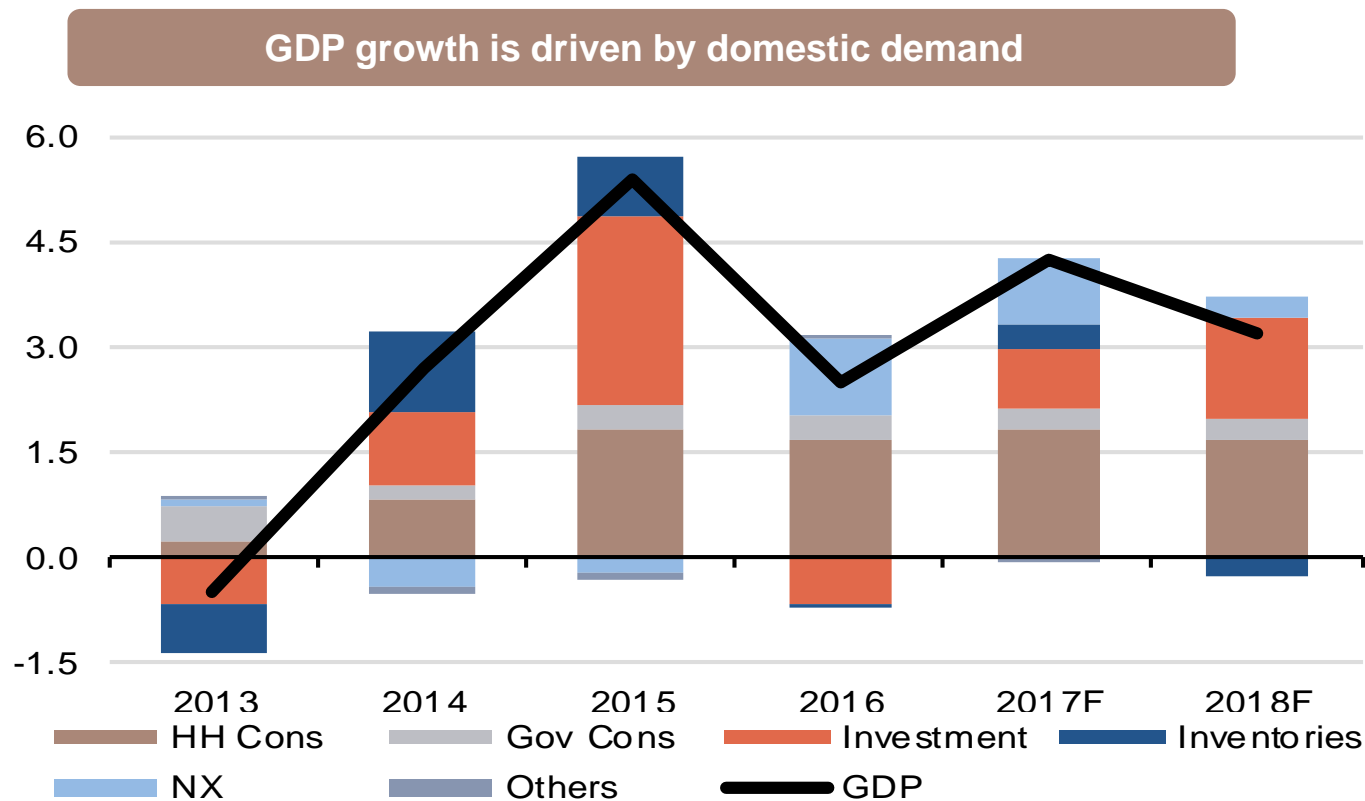
Our prognosis of GDP growth is the most optimistic on the market (July 2017)



Sources: Consensus Forecast, Economic & Strategy research, Komerční banka

# CONSEQUENTLY, WE RAISED OUR 2017 GDP GROWTH FORECAST

- We have revised outlook for domestic GDP by 0.6pp to 4.3%
- Next year, we expect an expansion of 3.2%

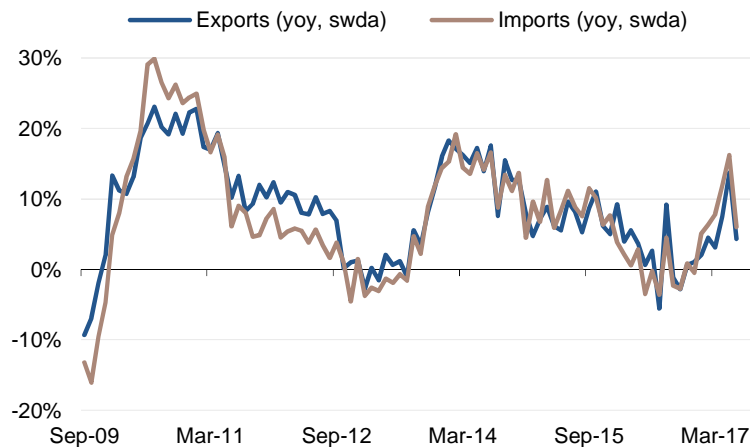


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

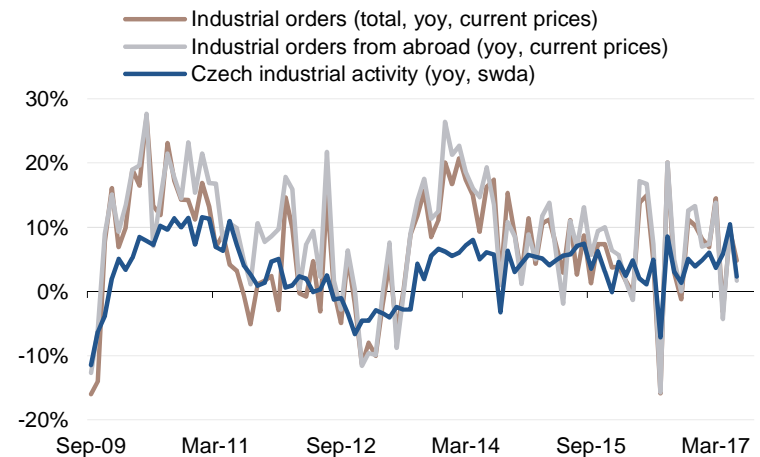
## IN THE FIRST HALF OF THE YEAR, ACTIVITY SURGED

- The revival of global trade and acceleration in the euro area economy has raised demand for Czech products
- Higher demand spilled over into industrial production
- Automotive production was the main driver, but the rise in exports and production was visible in most categories

### External trade is set to intensify...



### ...industrial production is increasing

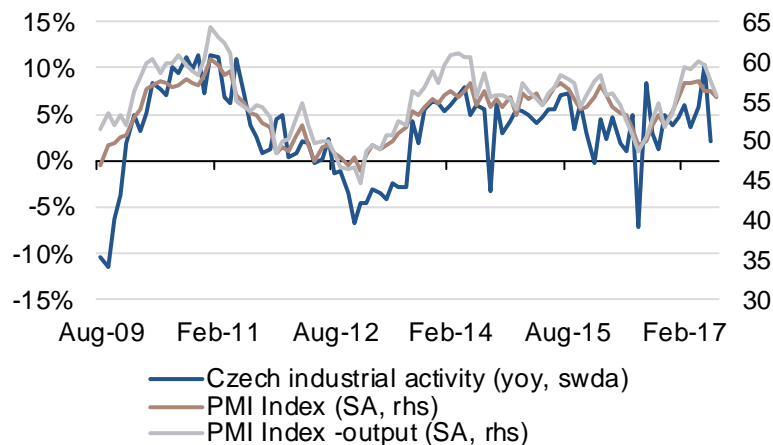


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

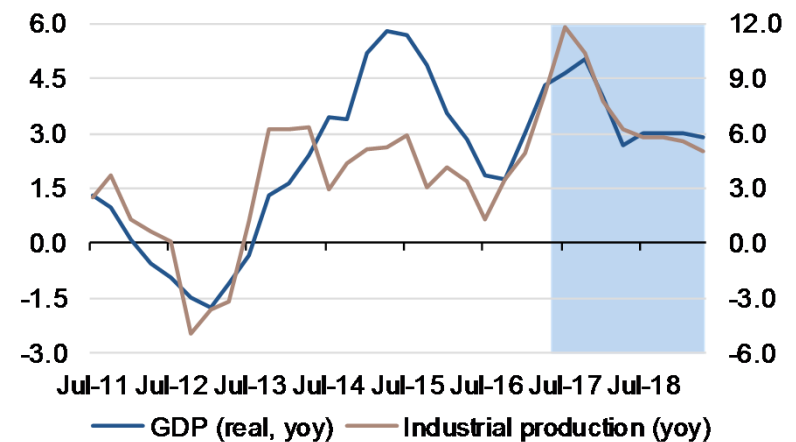
# POSITIVE TRENDS IN INDUSTRY ARE SET TO CONTINUE

- We expect industrial production to increase 8.8% on average in 2017, mainly given the strong 1H17...
- ...and then decelerate to 6.4% in 2018 as external demand growth is expected to slow

## The positive mood in industry



## Strong industrial output will boost GDP growth

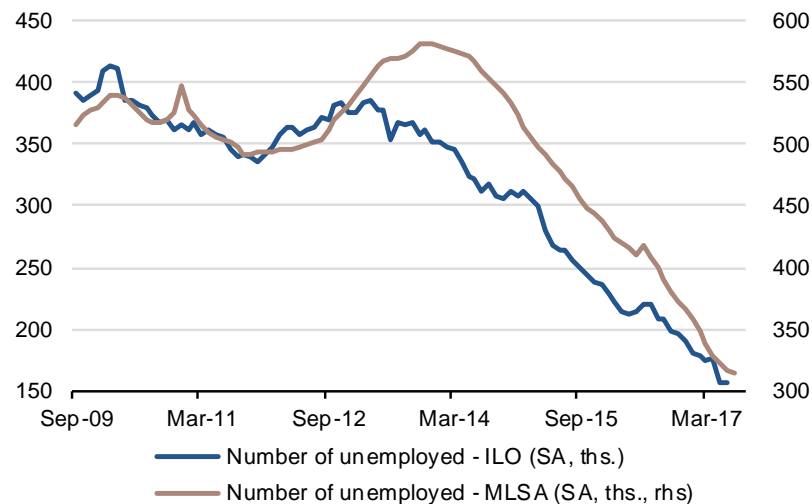


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

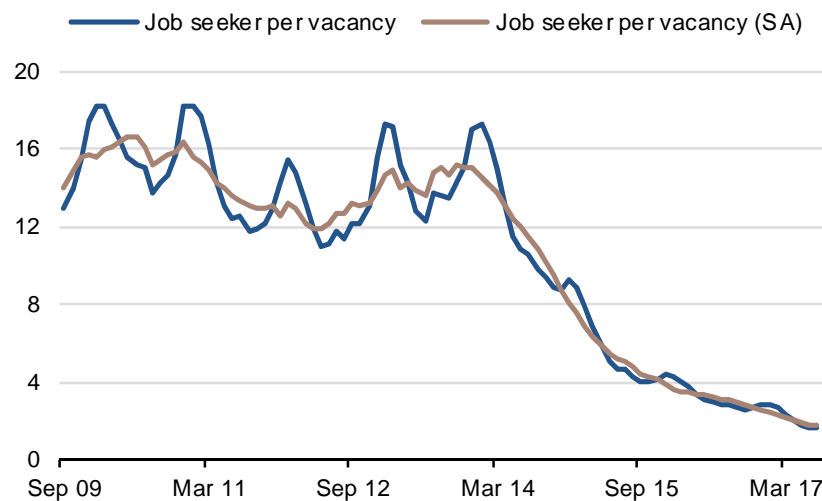
# NO ONLY INDUSTRY IS MISSING A LABOUR FORCE

- Unemployment rates are at historical lows
- The number of unemployed is below 300,000 for the first time since 1998
- The number of vacancies (183,500 in June) is the highest in history

## Number unemployed (thousands)



## Job seekers per vacancy



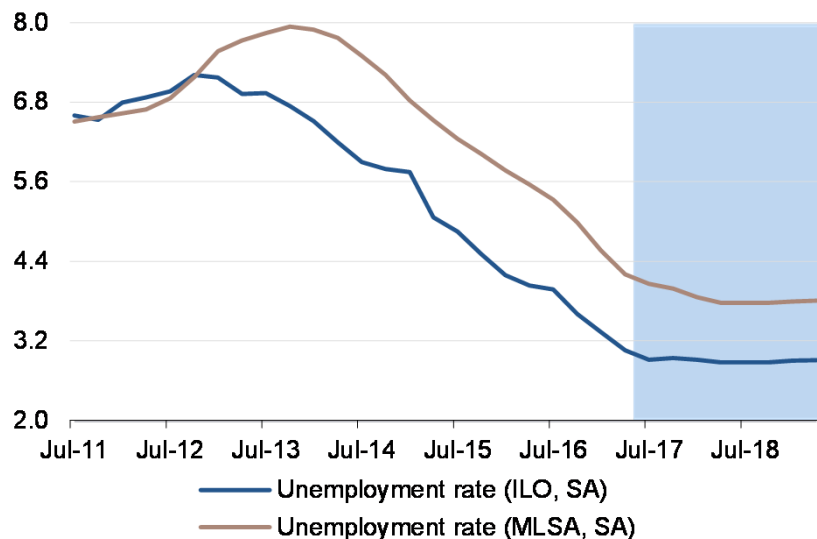
Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka



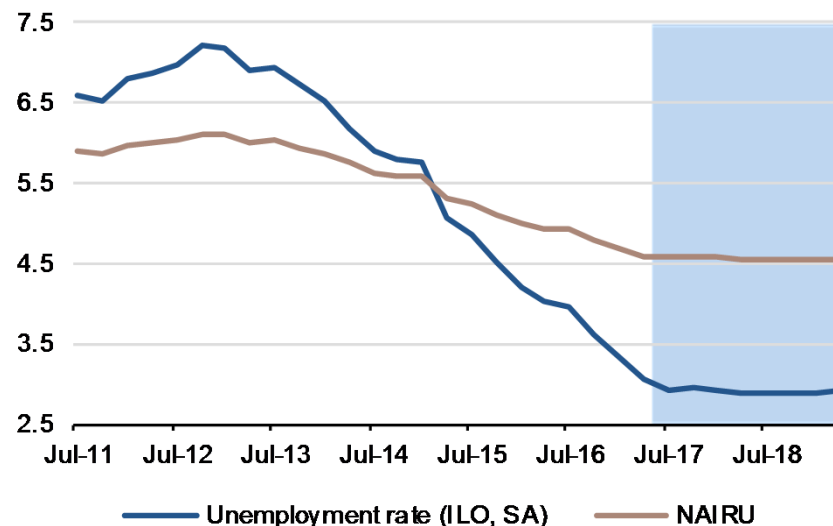
# THE DECLINE OF THE UNEMPLOYMENT RATE WILL DECELERATE

- The unemployment rate does not have not much room to decline, and we expect it to average 3.1% this year and 2.9% next (ILO methodology)
- We see employment growth slowing to 1.4% in 2017 and 0.4% in 2018
- Corporations must focus on productivity growth

### Unemployment rate (%)



### Unemployment rate substantially below NAIKU

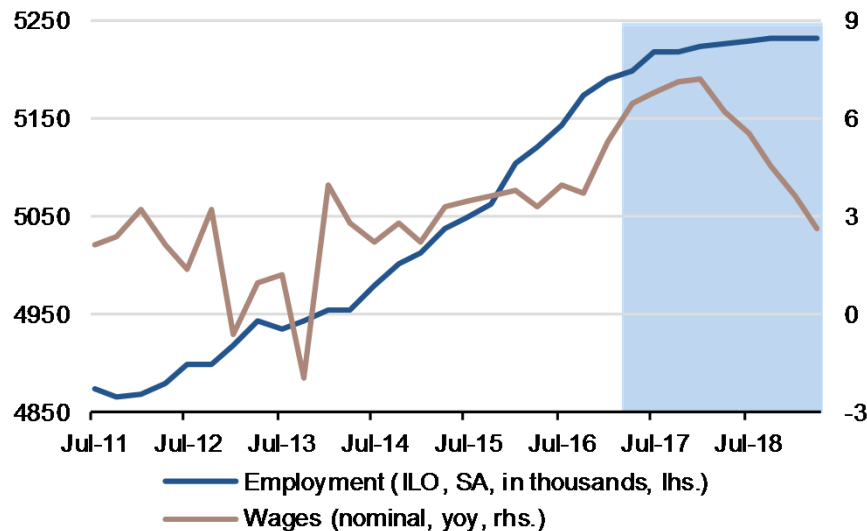


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

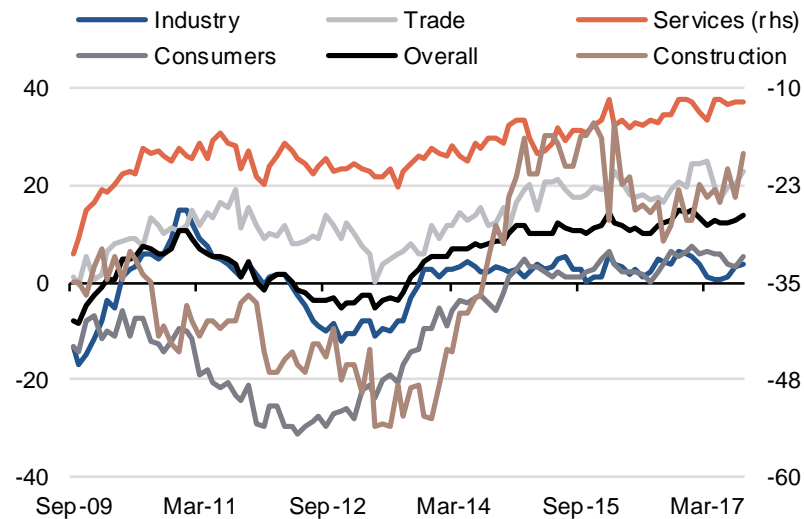
# A TIGHT LABOUR MARKET PUSHES WAGES HIGHER

- This year, wage growth should climb to 6.4%
- Next year, we expect a 5.9% increase in nominal wages

## Wages will grow



## Consumer confidence remains solid

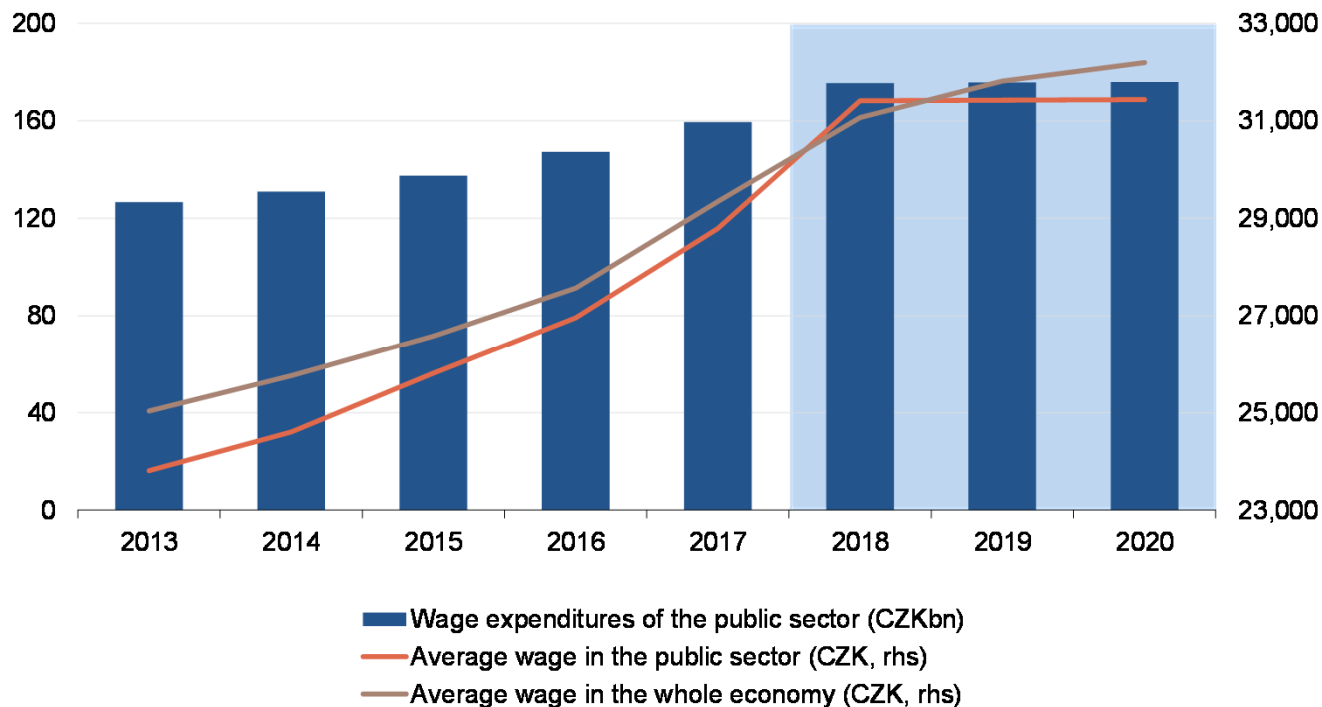


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

## POLITICAL CYCLES INCREASE PUBLIC SECTOR WAGES

- In 2018, the average wage in the public sector is set to increase as much as 9% to CZK31,411 and significantly surpass the average wage in the whole of the economy
- Public servants and teachers will enjoy the biggest increase in wages (10%).

Public expenditures on wages will rise considerably in 2018  
(budget outlook in the shaded area)

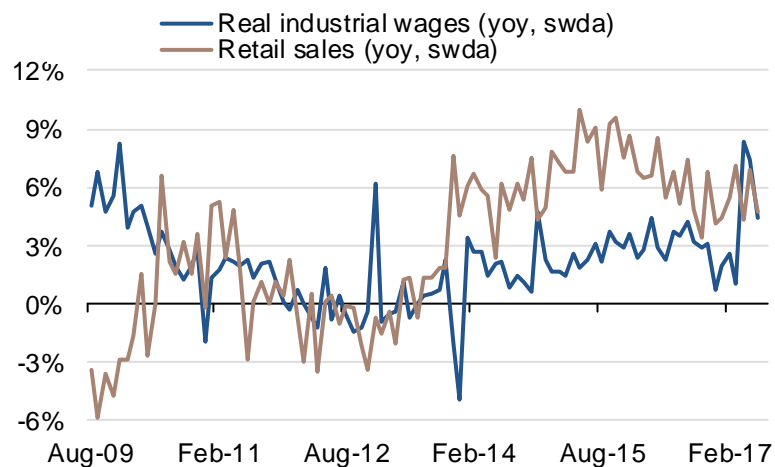


Sources: CZSO, Ministry of Finance, Economic & Strategy research, Komerční banka

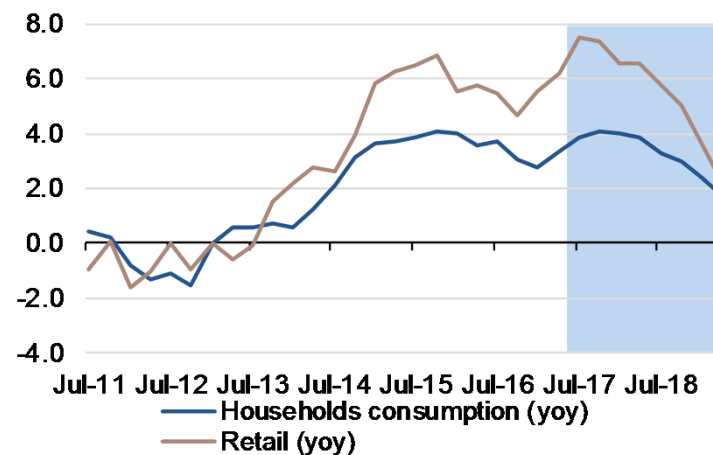
## WAGE GROWTH IS REFLECTED IN HOUSEHOLDS' WILLINGNESS TO SPEND

- **Consumer confidence remains relatively strong**, although it has declined from its historical highs at the beginning of the year
- It still shows that households are not afraid to spend money
- **This year, household consumption should rise 3.8% and 3.6% next year**

### Retail sales show the strength of domestic demand



### Household consumption is set to rise further (% , yoy)

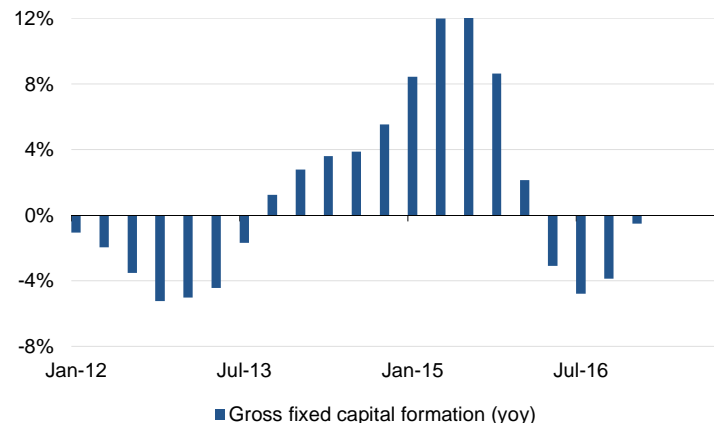


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

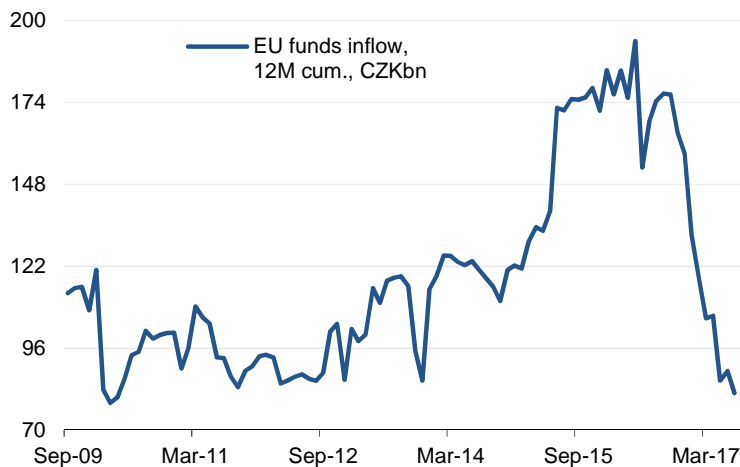
# EUROPEAN FUNDS WERE MISSING IN 2016

- In 2015, gross fixed capital formation increased 10.4%
- ...and created half of the 5.4% GDP growth
- A slow start of the new programming period, problems with EIA...

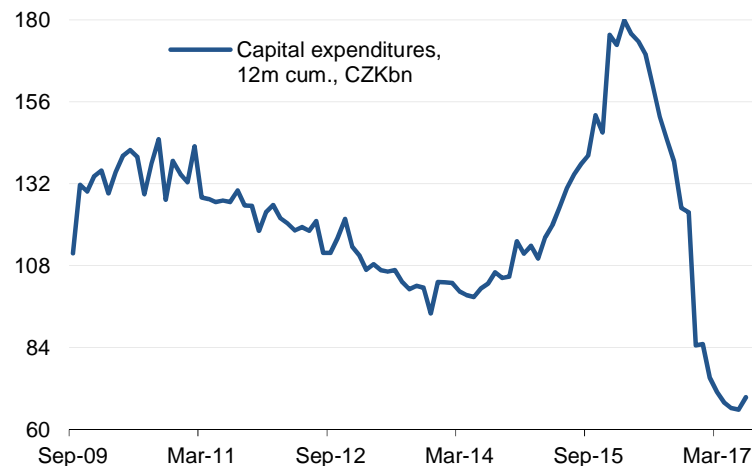
## Last year, investment dropped



## European funds became unavailable...



## ...which was also visible in expenditures

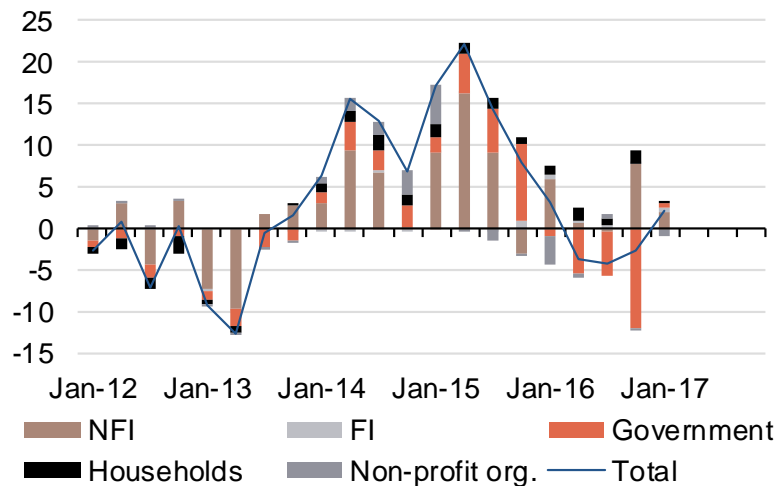


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka, Ministry of Finance CR

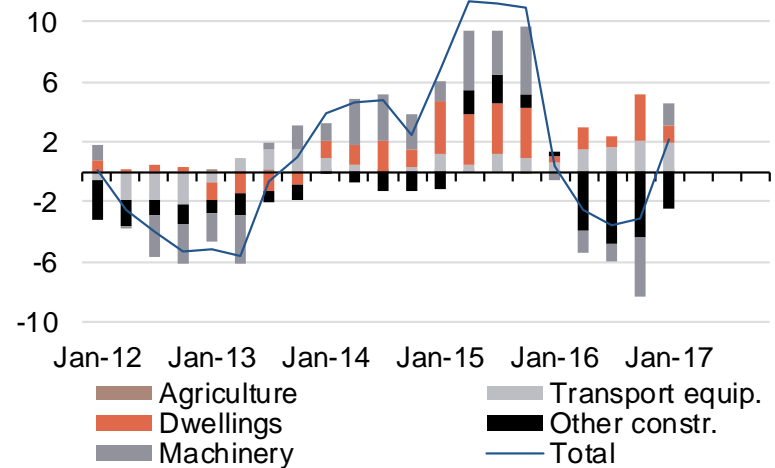
# INVESTMENT ACCELERATING

- Corporations will have to increase productivity to raise production
- We expect higher investments of the private sector into the modernisation of production
- **Given still-negative yoy investment growth in 1Q17, we expect only mild investment growth of 3.2% this year**
- **Next year, we expect an acceleration to 5.9%**

## Government consumption is returning (% , y/y)



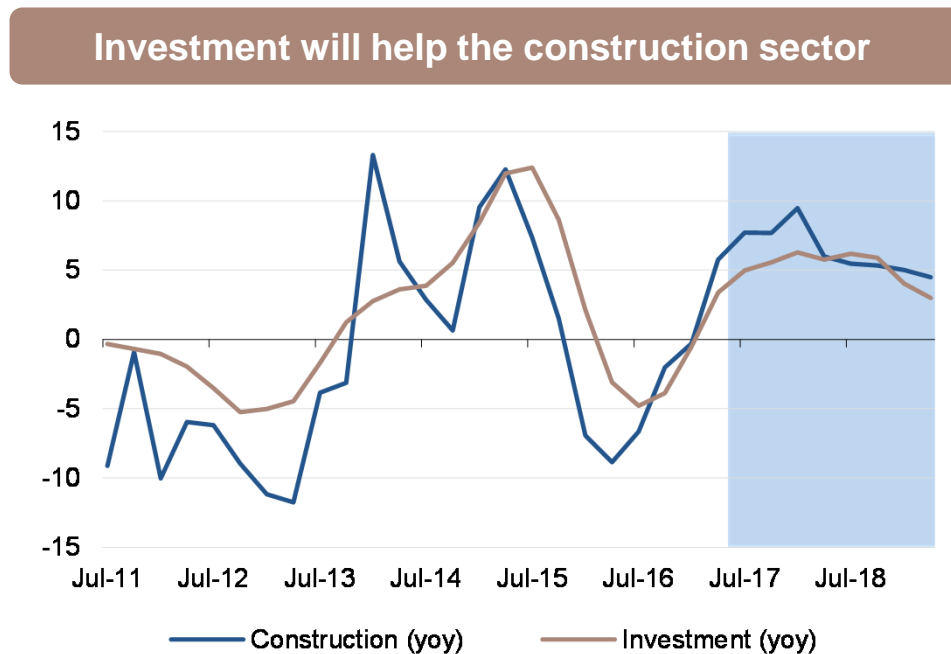
## Engineering works hinder investment



Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka

## INVESTMENT WILL HELP THE CONSTRUCTION SECTOR

- Programmes that must be tapped by the end of 2018 have a total allocation of EUR3.8bn, or some CZK99bn
- At the end of March 2017, there was as much as EUR3.2bn (CZK84bn) left to be tapped for the remainder of 2017 and 2018 (or the allocation would expire)
- In our view, public investment should increase a sizeable CZK30bn next year as the country will rush to absorb as much EU money as possible

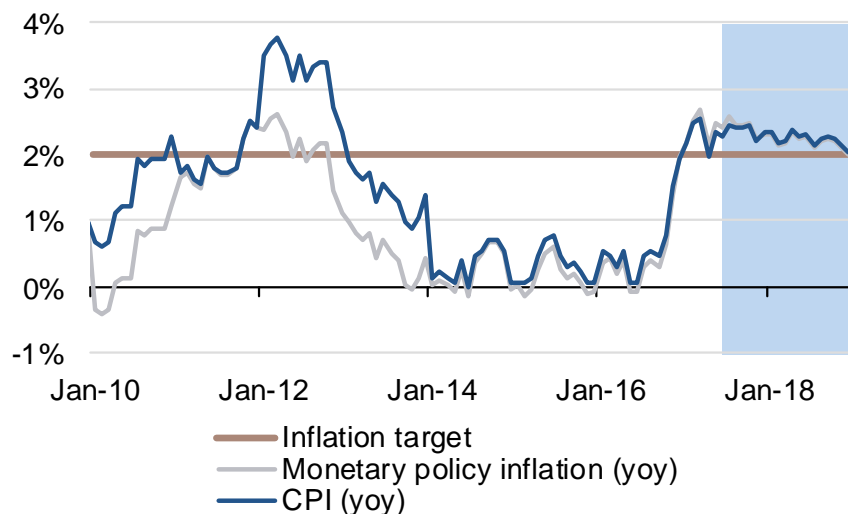


Sources: CZSO, Economic & Strategy research, Komerční banka

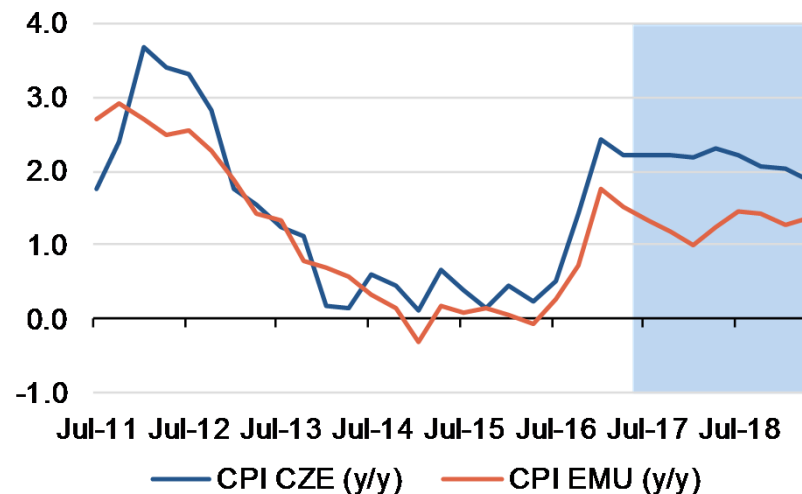
## INFLATION: TUG OF WAR BETWEEN DOMESTIC AND EXTERNAL FORCES

- **Domestic price pressure should strengthen**, as we expect steeper wage growth and stronger private consumption
- In contrast, we see less inflationary pressure from abroad, and we expect the koruna to appreciate against the euro
- **We keep our forecast for average inflation in 2017 unchanged at 2.3%. For 2018, we see inflation easing modestly to 2.2%**

### Inflation to remain just above the target throughout 2017 and 2018



### Inflation in the CR and EMU

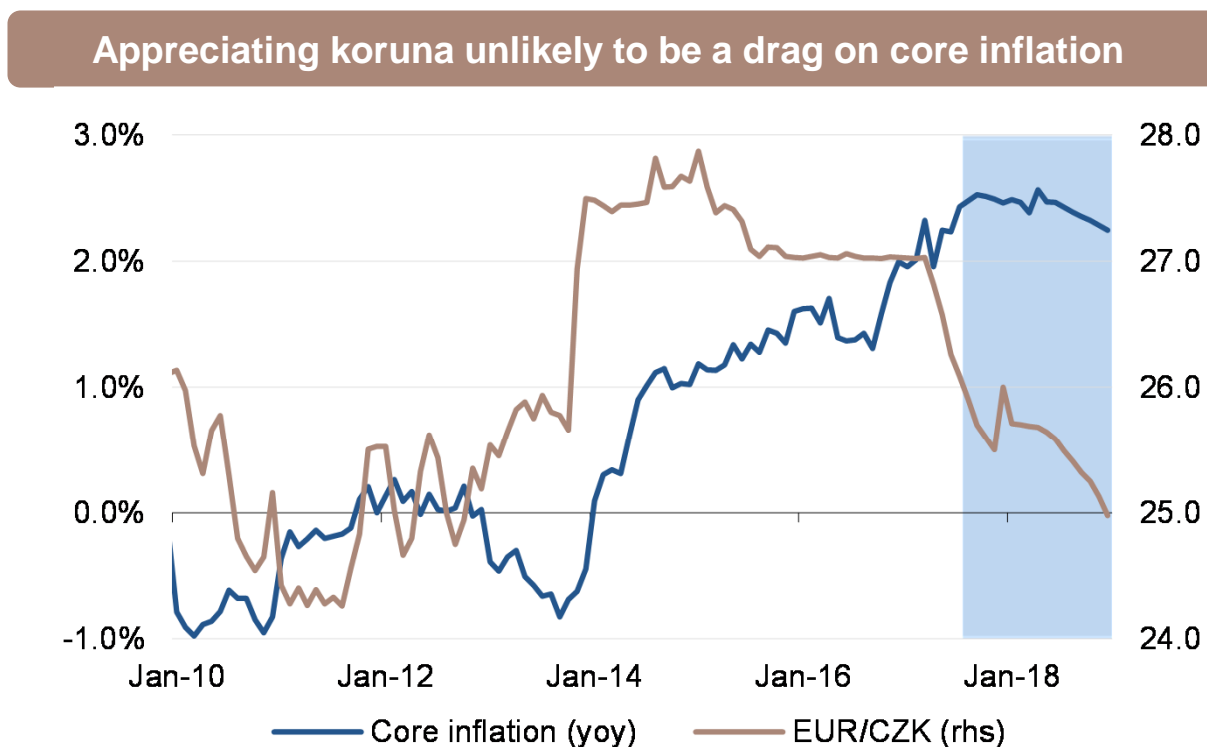


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka



## APPRECIATING KORUNA UNLIKELY TO BE A DRAG ON CORE INFLATION

- Since the beginning of the year, core inflation has not dipped below 2%
- Though the koruna should strengthen further, we do not think it will be enough to lower core inflation
- Thus, we forecast the core price at 2.3% this year and 2.4% next year



Sources: CZSO, Economic & Strategy research, Komerční banka

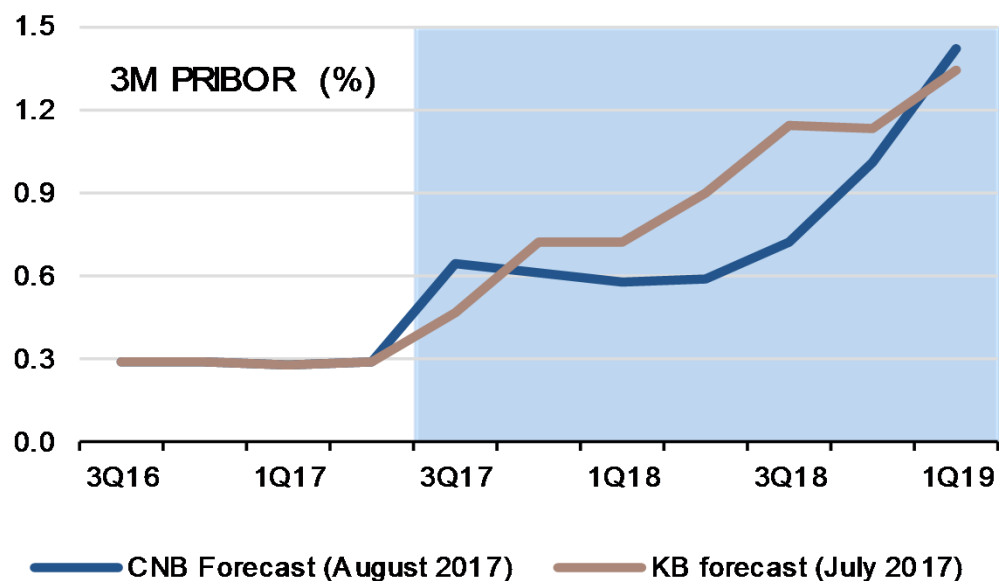
# FX COMMITMENT DEAD: LONG LIVE INTEREST RATES

PERSISTENT INFLATIONARY PRESSURE TO INDUCE ADDITIONAL HIKE  
THIS YEAR

## AFTER 10 YEARS, THE CENTRAL BANK HIKES RATES

- At the beginning of August, the Czech National Bank (CNB) raised its key rate by 20bp
- After four years and nine months, the rate has moved away from the zero lower bound
- The central bank's forecast shows the next hike coming in 3Q18, even though the CNB expects stronger economic activity and likely stronger wage growth

The CNB pauses its forecast for one year before raising rates again

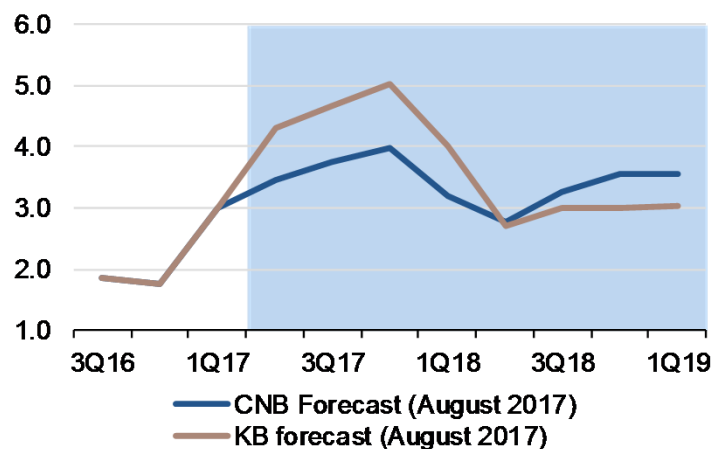


Sources: CNB, Economic & Strategy research, Komerční banka

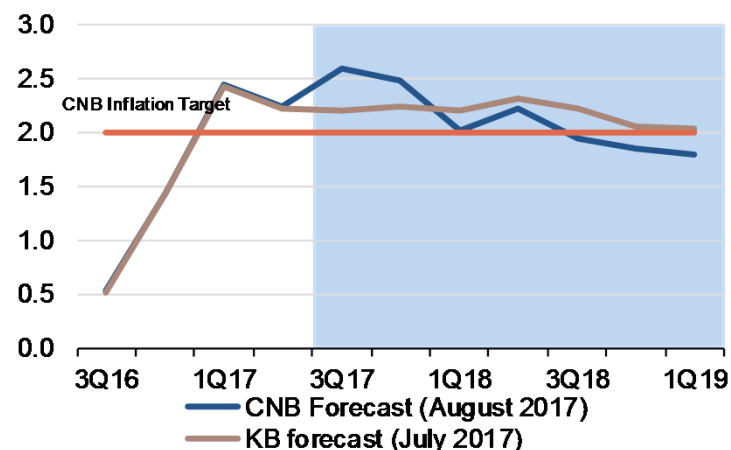
## THREE RATE HIKES NEXT YEAR, ANOTHER THIS YEAR?

- Our prognosis assumes another rate hike in November. August's CNB prognosis is, however, a risk to our forecast
- Our forecast, which saw inflation pressures in the economy remaining strong and a need for the central bank to cool them with rates hikes, remains unchanged – **next year, three times**

Our and the CNB prognosis expect GDP to accelerate substantially



The CNB expects inflation to decelerate next year (%)



Sources: CNB, Bloomberg, Macrobond, Economic & Strategy research, Komerční banka

## A CONTINUOUS DOWNWARD TREND IN EUR/CZK

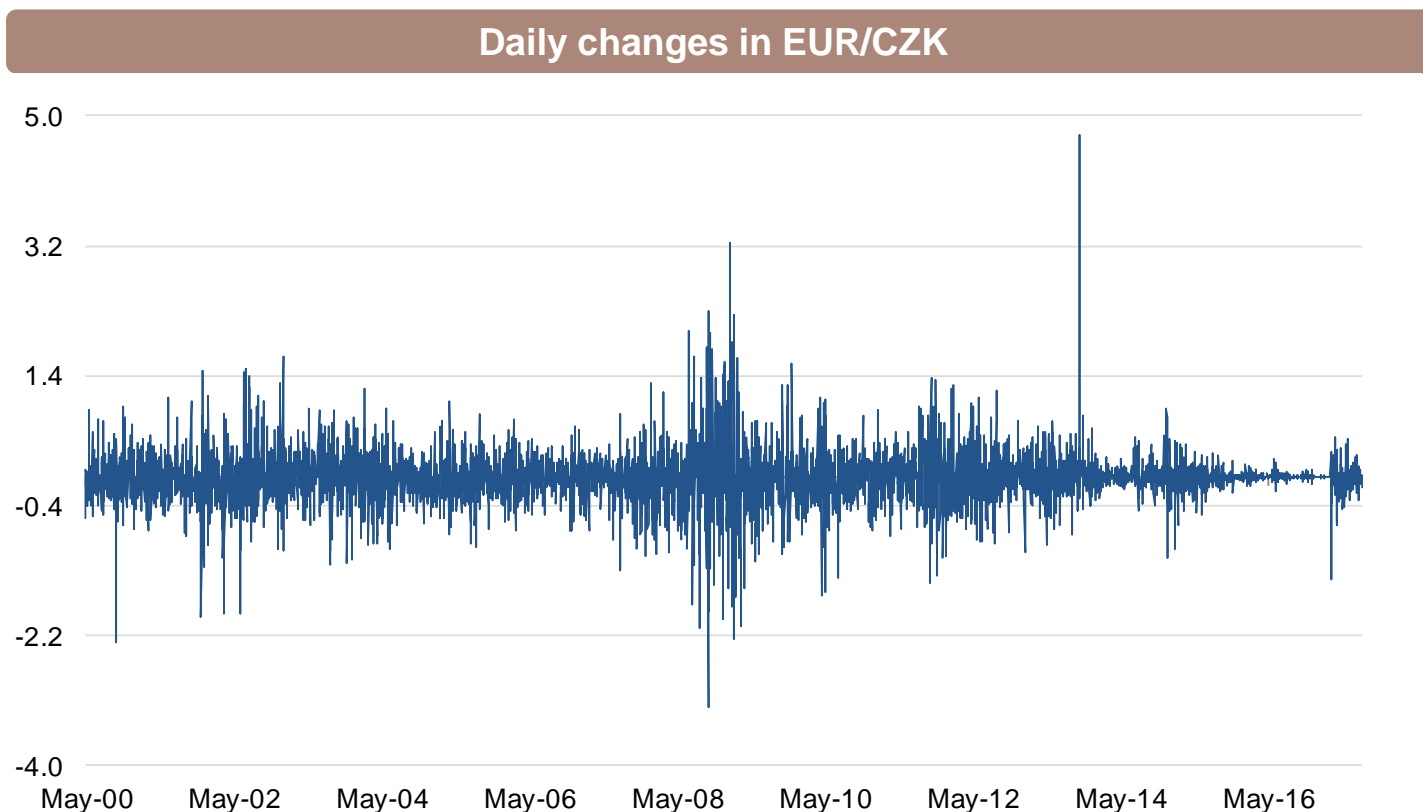
- The end of the exchange rate commitment at the beginning of April triggered an appreciation trend in the Czech currency
- EUR/CZK averaged 26.53 in 2Q17 and stood at 26.15 at end-1H17 versus our forecasts of 26.60 and 26.20, respectively



Sources: Datastream, Economic & Strategy research, Komerční banka

# EXCHANGE RATE VOLATILITY REMAINS BEHIND EXPECTATIONS

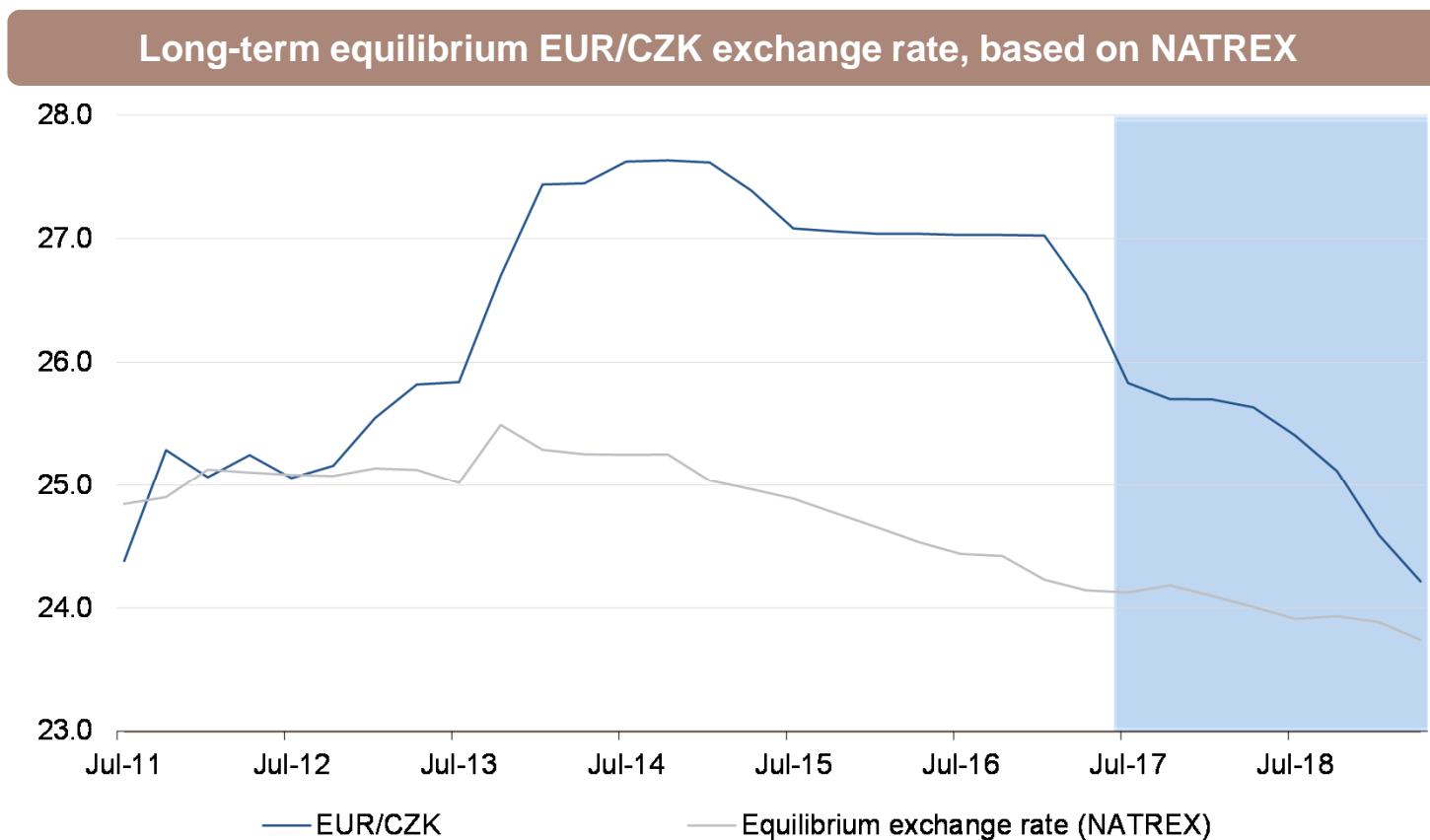
- While koruna appreciation has been more or less in line with our assumptions, **volatility remains surprisingly low**
- **Daily exchange rate changes have been far from where they were before the exchange rate floor was introduced in November 2013**



Sources: Bloomberg, Economic & Strategy research, Komerční banka

## ACCORDING TO EQUILIBRIUM EXCHANGE MODELS, THE KORUNA HAS ROOM TO APPRECIATE FURTHER

- We calculate the long-term equilibrium exchange rate based on the NATREX approach at EUR/CZK 24.20 for 3Q17
- Toward this level, the rate should converge gradually over a two-year horizon

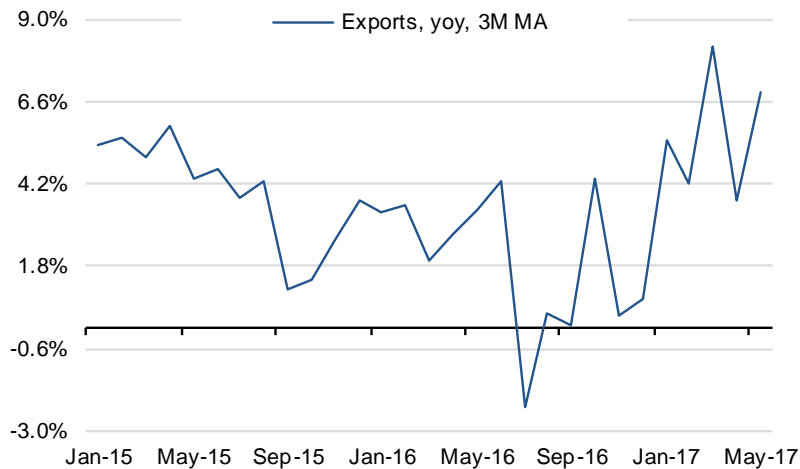


Sources: Bloomberg, Economic & Strategy research, Komerční banka

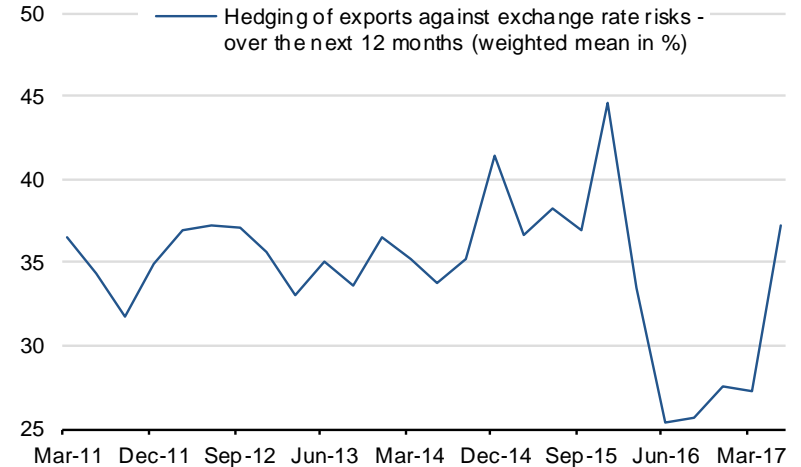
# EXPORTS HAVE GAINED STRENGTH THIS YEAR

- The level of currency hedging has increased significantly, and in June it exceeded levels seen before the exchange rate floor was introduced
- But the export growth rate surprised us on the upside during 1H17
- In addition, the first signs of increased private sector investment activity reflect a tendency for a lower rate of profit repatriation

## Exports have gained strength this year



## Hedging ratio of Czech exporters for the next 12 months

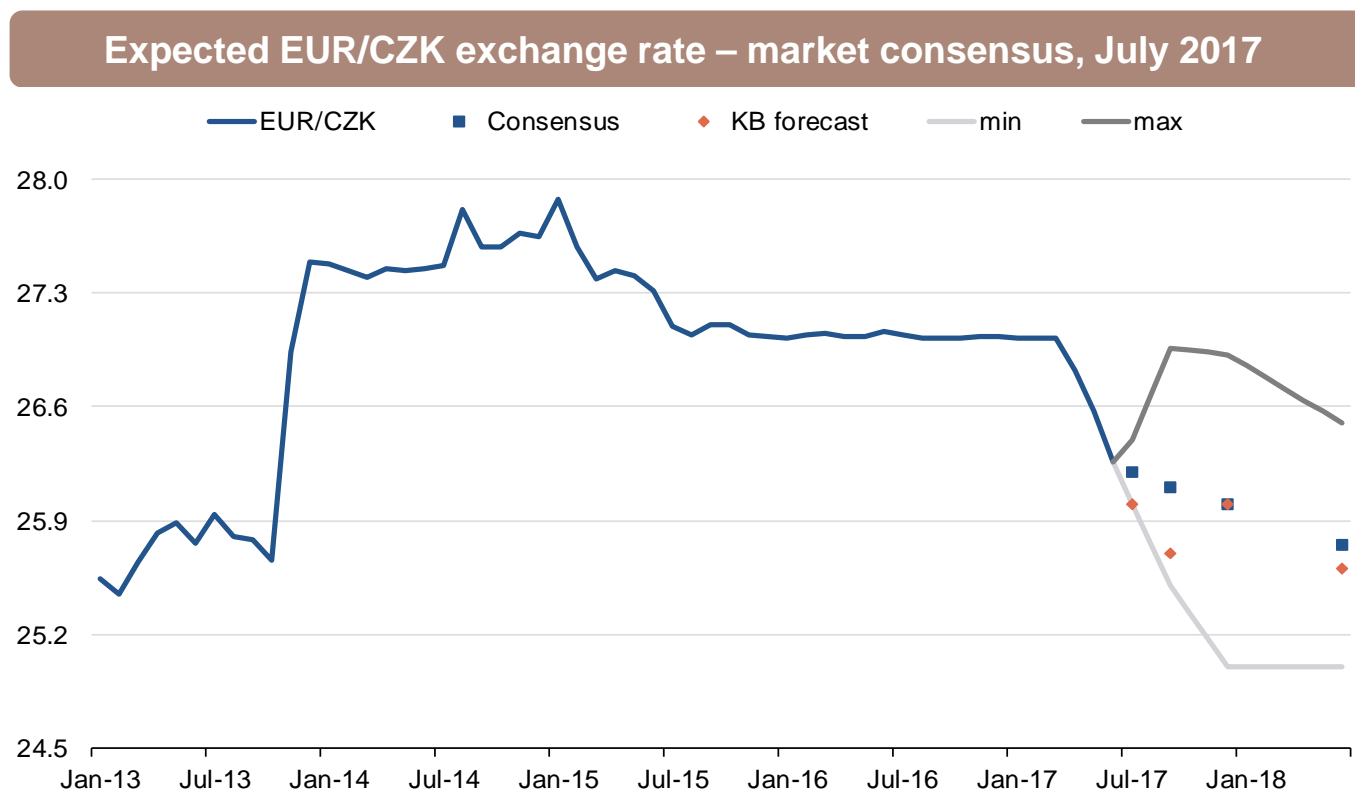


Sources: CZSO, Macrobond, Economic & Strategy research, Komerční banka



## THE KORUNA SHOULD BE EVEN STRONGER ON OUR FORECAST HORIZON

- We see the exchange rate flirting with the 25.50 level within 2H17
- The trend of koruna appreciation should continue during 2018, and it could even dip below the 25 mark in 2H18
- However, be aware of the “year-end effect”



Sources: Reuters, Economic & Strategy research, Komerční banka

# CZECH REPUBLIC: SUMMARY OF ECONOMIC FORECASTS

## Key economic indicators

	2016	2017	2018
GDP (real, yoy)	2.5	4.3	3.2
Household consumption (real, yoy)	3.6	3.8	3.6
Fixed investments (real, yoy)	-2.4	3.2	5.9
Foreign trade (CZK bn) (*)	487	456	475
Industrial production (real, yoy)	3.4	8.5	6.4
Retail sales (real, yoy)	5.7	6.4	6.2
Wages (nominal, yoy)	3.7	6.4	5.9
Unemployment rate (MLSA)	5.4	4.2	3.8
Inflation (yoy)	0.7	2.3	2.2
Taxes (contribution to yoy inflation)	0.1	-0.1	0.0
Core inflation (yoy) (**)	1.6	2.3	2.4
Food prices (yoy) (**)	-0.9	4.0	1.5
Fuel prices (yoy) (**)	-8.5	7.5	2.6
Regulated prices (yoy) (**)	0.2	0.1	2.1
3M PRIBOR (average)	0.29	0.4	1.0
2W Repo (average)	0.05	0.2	0.9
EUR/CZK (average)	27.03	26.3	25.5

Source: Economic & Strategy Research, Komerční banka

Note: (\*) foreign trade according to cross border statistics;  
 (\*\*) other parts of inflation are adjusted for primary effect of indirect tax changes.

Source: CZSO, MLSA, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka

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# AWARDS OF KB CZECH REPUBLIC AND SLOVAKIA RESEARCH



#2 BEST OVERALL FORECASTER - SLOVAKIA



#3 BEST OVERALL FORECASTER - CZECH REPUBLIC

**Consensus Economics**  
**Forecast Accuracy**  
**Award Winner**

**2014 Slovakia**

**Consensus Economics**  
**Forecast Accuracy**  
**Award Winner**

**2013 Czech Republic**

# SG LEADER IN GLOBAL CROSS ASSET RESEARCH

## Macro & Strategy



- #1 Global Strategy
- #1 Multi Asset Research
- #1 Global Economics
- #1 Index Analysis

## Fixed Income



- #2 Overall Credit Strategy
- #2 Overall Trade Ideas
- #1 Non-Bank Financial Institutions / #1 Autos
- #1 Consumer Products & Retail / #1 TMT
- #1 General Industries / #1 Corporate Hybrid Bonds

## Commodities



- #1 Best Overall Commodity Research
- #1 Research in Base Metals
- #1 Research in European Oil & North America Oil
- #1 Research in North American Natural Gas
- #1 Research in Soft Commodities
- #1 Research in Precious Metals

## Equity



- #1 France (Country Research)
- #2 Quantitative/Database Analysis
- #1 SRI & Sustainability
- 15 sector teams in the **Top 10**