

# CZECH ECONOMIC UPDATE

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## MACROECONOMIC DATA AND FORECASTS

		2007	2008	10/09	11/09	12/09	01/10	2009F	2010F
Inflation	% , y/y, eop	5.4	3.6	-0.2	0.5	1.0	0.6	1.0	1.9
	% , m/m	-	-	-0.2	0.2	0.2	1.1	-	-
	% , 12m average	2.8	6.3	1.6	1.3	1.0	0.9	1.0	1.4
Industrial prices	% , y/y, eop	5.3	-0.2	-4.6	-2.4	-0.8	-1.6	-0.8	1.5
	% , m/m	-	-	-0.2	0.4	0.1	0.4	-	-
	% , 12m average	4.1	4.5	-2.8	-3.1	-3.1	-3.2	-3.1	1.0
Unemployment rate	% , eop.	6.0	6.0	8.5	8.6	9.2	9.5	9.2	9.8
	% , 12m average	6.6	5.4	7.6	7.9	8.1	8.4	8.1	9.8
Industrial production	% , real	10.8	-1.5	-7.2	-0.1	2.1	2.0	-13.0	4.0
Construction output	% , real	7.1	0.1	0.1	7.8	3.0	-4.5	-1.7	1.0
Retail sales	% , real	10.0	3.4	-4.7	-4.9	-5.5	-3.0	-4.7	1.0
State budget	CZK bill.	-66.4	-19.4	-138.1	-169.4	-192.4	13.1	-192.4	-165.0
Trade balance	CZK bill.	85.0	67.5	17.5	14.5	5.0	0.0	155.0	80.0
FOREX reserves	USD bill.	34.9	37.0	41.4	42.5	41.5	42.0	41.5	44.0
PRIBOR 3M	% average	3.1	4.0	1.9	1.8	1.6	1.5	2.2	1.9
CZK/EUR	Average	27.8	24.9	25.8	25.8	26.1	26.1	26.4	25.6
CZK/USD	Average	20.3	17.0	17.4	17.3	17.8	18.3	19.1	17.4
				Q4/08	Q1/09	Q2/09	Q3/09		
GDP	% , y/y	6.1	2.3	0.5	-4.2	-4.7	-4.1	-4.2	1.5
Current account	USD bill.	-3.3	-6.6	-3.0	1.1	-1.4	-1.1	-1.1	-3.3
	% of GDP	-1.8	-3.1	-3.1	-3.3	-2.5	-2.3	-0.6	-1.5
Financial account	USD bill.	4.9	8.9	2.8	-0.3	1.3	1.9	2.4	1.4
	% of GDP	2.7	4.1	4.1	4.4	3.2	2.9	1.2	1.0

Source: Czech National Bank, Czech Statistical Office, Ministry of Finance

Note: KB forecasts marked red, italics

## UNEMPLOYMENT CONTINUES TO GROW, VACANCIES ARE SCARCE

- The situation on Czech labour market sharply deteriorated during 2009. Number of unemployed far exceeded the symbolic threshold of half million and the registered unemployment rate went up from 6.8% in January to 9.2% in December. In average, the unemployment rate raised to 8.1% (while it stood at 5.4% in 2008 only). With the overall GDP slump expected at more than 4% in 2009, the drop in demand for labour is an inevitable reaction of firms coping with the falling demand for their production and trying to cut down costs. Still, number of employed narrowed by 1.1% only during Q1-Q3 2009, far less than was the respective fall in output. Negative trend in output was cushioned by certain labour market adjustment. Number of part-time workers grew 10.1% during Q1-Q3 2009 and the growth has been accelerating, reaching 12.2% in Q3. Similarly, number of work hours in main job shrank by 1.5% in average during Q1-Q3 2009, with certain acceleration of the decline (it amounted to -2.3% in Q3).
- Regardless of the soaring unemployment, average real wage exhibited solid growth in Q3 (4.7%; average 2.4% in Q1-Q3 2009), mainly as a result of reduction in employment of least-qualified low-wage workers, which are the easiest to replace. In contrast, firms hesitate to lay off high-qualified employees, as these would be hard to hire back once the production and demand for labour rebounds. The industrial sector was hit the most so far, although recently a cut down in employment has started in construction and services as well. In 2009, the largest growth in number of unemployed was registered in occupations supplying to the industrial sector: particularly craft and related trades workers and plant and machine operators and assemblers. These categories account for almost one third of all the unemployed. As regards the age structure of unemployed, relatively largest increases were registered in age group 20-25 years and, to lesser extent, also in age group 26-40 years. On the other hand, the share of unemployed older than 40 and, particularly, older than 50 has been continuously falling. Besides the potential effect of early retirement, this might be considered an evidence of the above-described rational behaviour of firms.

## CONSUMER PRICES

- In December 2009, headline inflation stood at 0.2% m/m. The result was mainly influenced by the rise in prices of food and non-alcoholic beverages, a standard seasonal feature. Other categories of goods witnessed rather a decline or stagnation of prices as a result of weak consumer demand. An opposite effect on the inflation was recorded in prices of transport, post and telecommunication and prices of alcoholic beverages. The CPI raised 1.0% y/y; the development was influenced by a growth in prices of transport, where the rise of automotive fuel prices accelerated mainly as a result of low comparative basis. A considerable price growth was again registered in housing. The price drop in foods and non-alcoholic beverages category decelerated. Prices of goods declined 0.2% y/y; prices of services grew 2.6% y/y.
- Overall in 2009, average inflation reached weak 1.0% (it stood at 6.3% in 2008), which is the second lowest figure in the Czech history. It was influenced by the high comparative basis and by a general pressure towards price decline during domestic and global recession. Prices of foods and non-alcoholic beverages fell 3.9%, prices of alcohol and tobacco added 6.5%. Prices in transport category declined 5.8%, opposite development was recorded in category housing (+7.2%).
- **Outlook January:** A sharper pick up in prices is expected in January due to a growth of indirect taxes and regulated rentals. **The CPI is expected to raise 1.1% m/m and 0.6% y/y.**

## PRODUCER PRICES

- In December 2009, prices of industrial producers increased 0.1% on monthly basis. The figure mostly reflects increasing prices of chemicals and chemical products, transport equipment and coke, refined petroleum products; the rise in prices of food products, beverages and tobacco was milder. On the other hand, negative trend was recorded in prices of mining and quarrying and basic pharmaceutical products only. The year-on-year fall in industrial PPI decelerated to 0.8%. The general result was continuously pulled down by a substantial drop of producer prices in manufacturing and raw materials. On the other hand, the PPI in electricity and gas production increased, as did prices of water producers. Among the manufacturing industries, the largest slumps were recorded in prices of metals and foods. After thirteen months of declines in a row, prices of coke and refined oil products went up substantially.
- Agricultural prices increased on month-on-month basis (+1.2%) mainly as a result of an increase in prices of crop products, growth in animal products prices was not as pronounced. Year-over-year price slump has tended to decelerate during last months, although it still reached strong -12.7% in December. The turnaround in m/m trend might be soon reflected in pick up of food prices and overall consumer inflation.
- **Outlook January: Industrial PPI is expected to grow 0.4% m/m, and drop by 1.6% y/y.**

## UNEMPLOYMENT

- The December's unemployment rate increased to 9.2%, i.e. recorded 0.6 percentage point growth compared to the previous month and corresponds with the level reached for the last time in January 2006. Besides the unfavourable effect of economic climate, the development was also negatively impacted by seasonality and termination of seasonal works in construction, agriculture etc. Women unemployment rate grew to 10.4% and unemployment of men to 8.4%. The unemployment rate overgrew the level recorded in December 2008 substantially, by 3.2 percentage points. Despite the dynamic growth, the Czech Republic remains one of the countries with the lowest levels of unemployment among the EU countries (harmonized Czech unemployment rate reached 7.6% in November, while the EU-27 average amounted to 9.4%).
- The number of registered unemployed persons went up to 539.1 thousand (+5.9% m/m). The fall in supply of vacancies decelerated slightly when number of vacancies fell 6.1% m/m (reaching 30.9 thousand), which represents a year-on-year drop of two-thirds. Overall, the figures recently jumped to 17.4 unemployed per vacancy (UV ratio), which is the highest value in history of the Czech Republic. The UV ratio increased considerably when it averaged on 6.8 in Q1 2009.
- **Outlook January: We expect the unemployment rate further to increase to 9.5%.**

## INDUSTRY

- In November 2009, real industrial production fell 0.1% y/y and 0.3% m/m. The development was partially affected by one extra working day compared to previous year; adjusted for this influence the industry gets to a stronger decline of -2.5% y/y. The data also reflect a positive statistical effect of falling comparative basis of 2008, which drives the growth rates up. The November's figure is the most promising result since September 2008, when the last positive growth figure was registered. Yet, the data do not give a favourable picture of the situation in the sector; industry was pulled mainly by foreign scrapping premia, reflected in a pick up of automotive industry and following manufacture of rubber and plastics, among the other industries, a positive development was registered in food industry, pharmaceuticals and chemistry and also in manufacture of paper. The November's fall in industrial production was to major extent caused by a drop

in manufacture of machinery and equipment, manufacture of other non-metallic mineral products and manufacture of electrical equipment. The fall in employment in industry continued and reached 12.5% y/y. Nominal wages increased 7.5% y/y despite the unfavourable labour market situation mainly as a result of reduction of less-qualified and low-wage employment.

- Sales in the industry were 3.1% down y/y; real direct export sales declined 0.9% y/y (i.e. less than domestic sales), and their share on total industrial revenues was 46.9%. The value of new orders added 8.0% y/y, and orders from abroad even 11.0% y/y.
- **Outlook December:** The flash estimate of the CZSO points to a growth of 2.1% y/y.

#### CONSTRUCTION

- In November 2009, construction output increased 7.8% y/y; real output adjusted for seasonal factors was 2.8% up m/m. November's development was partially affected by one extra working day compared to previous year; adjusted for this influence the construction gets to a growth of 6.4% y/y. Exceptionally favourable climatic conditions affected the development positively and enabled to perform all construction works; average November's temperature was 2.8° C higher compared to the long-term average. After thirteen months of drops in a row, dynamics of building construction turned to black numbers, when it increased 3.4% y/y. Civil engineering supported this development by its solid growth of 16.3% y/y. Certain weak turnaround was also registered in the development of forward-looking indicator of business confidence in the sector, which stabilised after the lasting huge slump during the whole 2009. Still, the data do not point towards favourable future perspectives of the sector. The sector registered the third month of employment reduction, reflecting the expected attenuation of its production (-1.1% y/y).
- **Outlook December:** In December, the y/y figures will be statistically improved by lower comparative basis and one extra working day compared to 2008. Certain stimulation effect might also stem from the increased VAT in 2010, leading to a shift towards finishing already started constructions in 2009. **We expect a growth of 3% y/y.**

#### RETAIL SALES

- In November 2009, total retail sales including automotive sector decreased by 4.9% y/y, seasonally not adjusted. Retail trade was on a decline for the fourteenth month in a row. The development was partially influenced by an extra working day compared to November 2008. After adjustment for this effect and seasonal factors, year-on-year fall stood at stronger 6.1%. Retail sales decreased 2.9% m/m, which is the most pronounced slump since March 2008. The largest drops were recorded in sale of motor vehicles and non-food items. On the other hand, sales in non-specialized stores with food, beverages and tobacco dominating (mainly big chain stores) represented a stabilizing element in the overall development. Furthermore, positive development was registered in sale of pharmaceutical and medical goods (+4.7%). Retail sales of foods increased 1.1%, non-food goods were 4.2% down y/y. The largest slumps were recorded in sale of household products in specialized stores (-9.3%), sale of automotive fuel (-3.3%) and clothing and footwear (-7.4%). Sales and repairs of motor vehicles subtracted 11.0% y/y.
- **Outlook December:** We expect a drop in retail sales around 5.5% y/y.

#### FOREIGN TRADE

- In November 2009, the exports of goods stagnated year-on-year, and the imports fell 8.0%. The trade balance registered a surplus of CZK 14.5 bill., which is by CZK 15.6 bill. more than a year ago. The exports returned back to previous year's level after thirteen months of a decline in a row; however, a considerable role in this development played the low comparative basis. This favourable figure was also highly affected by a growth of surplus in trade with machinery and transport equipment, where the Czech export largely profited from foreign fiscal stimulation programmes. The import sustains low as a reflection of weak domestic demand of firms and households. The outcome of foreign trade was determined by an improvement of trade outcome in all SITC sections with the exception of beverages and tobacco. The largest growth of trade surplus was registered in machinery and transport equipments. Furthermore, an improvement followed in miscellaneous manufactured articles and in crude materials. Overall, foreign trade balance during January–November 2009 reached high CZK 150.4 bill., mainly as a result of low prices of crude oil, weak domestic demand and foreign scrapping bonuses.
- **Outlook December:** The trade balance is expected to register a surplus around CZK 5 bill.

## FINANCIAL SECTOR

		03/09	04/09	05/09	06/09	07/09	08/09	09/09	10/09	11/09	12/09
Money supply M2	CZK bill.	2628.4	2655.6	2676.9	2623.4	2607.6	2601.2	2564.9	2593.1	2607.1	2651.4
	%, y/y	11.7	11.3	10.9	9.3	6.5	5.2	3.7	2.9	2.3	0.9
Deposits with MFIs, total	CZK bill.	2757.0	2780.1	2848.1	2834.6	2824.3	2813.1	2806.0	2841.7	2792.8	2818.7
	%, y/y	10.6	10.0	11.1	7.7	5.3	3.6	4.6	5.4	3.0	1.6
Credits with MFIs, total	CZK bill.	1949.4	1956.5	1954.7	1964.6	1962.4	1965.9	1970.9	1975.8	1977.3	1972.7
	%, y/y	12.9	11.4	8.9	7.2	6.3	4.6	3.0	2.4	1.7	1.5
Credits to corporates	CZK bill.	835.2	825.3	819.9	818.5	809.4	810.3	808.9	803.9	800.0	784.0
	%, y/y	9.2	6.3	3.9	0.8	0.1	-2.6	-5.0	-6.5	-7.3	-8.1
Credits to households	CZK bill.	906.3	915.4	922.6	933.1	943.0	950.8	958.4	966.5	972.1	983.3
	%, y/y	19.9	18.8	17.7	16.7	15.6	14.8	13.8	13.2	12.3	12.1
Credits on housing	CZK bill.	633.0	639.6	645.0	652.2	658.8	664.5	670.2	676.0	681.4	690.3
	%, y/y	18.3	17.4	16.6	15.7	14.9	13.8	13.0	12.2	11.7	11.7
Consumer credits	CZK bill.	174.7	176.2	178.4	180.4	182.5	183.8	185.0	186.4	186.5	187.2
	%, y/y	20.3	19.0	17.5	16.4	15.4	14.5	13.3	12.8	11.4	9.9

Source: Czech National Bank

## NEWS FROM ABROAD

- Regulators and policymakers appear to have found some common ground at the World Economic Forum in Davos agreeing on the need to ensure changes to the financial regulation on global level. Meanwhile, bankers were at odds about how to fight back against this push for tougher financial regulation, with commercial and investment banks split in reaching an agreement. IMF's chief Strauss-Kahn warned of excessive reliance on exports that are often expected to drive national economies from global recession. Consequently, he foresees the economic growth slower than many countries hoped.
- Greece and EU leaders worked hard in Davos to assure that this euro area member needs no bailout and is focused on getting its fiscal situation in order. Concerns over Greece's ability to rein in its spending and to service its heavy debt have continued to haunt the markets, putting pressure on the euro and even prompting speculation that Greece could be forced out of the currency bloc. Greek 5-year CDS reached a record high 422.5 bps last week. Greece has pledged to reduce its budget deficit from an estimated 12.7% GDP in 2009 to 8.7% this year through welfare cuts, tax reforms and savings on public sector wages. European Monetary Affairs Commissioner Almunia said there was no risk that Greece would default or leave the euro area.
- The US economy grew at an annualized rate of 5.7% in the fourth quarter of 2009, which is the highest dynamics in last six years, confirming the recovery steaming ahead. The acceleration in U.S. economic growth at the end of last year has raised optimism about the outlook for global growth and supported recent dollar appreciation. The main driver of this favourable figure was a sharp decrease in inventories slashing. Furthermore, investment spending turned into black numbers. In contrast, consumers were rather cautious in their expenditure; consumption growth slightly decelerated compared to previous quarter. A big question is whether the relative stability of domestic consumption and turnaround in investment is a precursor of a coming decline of the unemployment rate, presently standing at a 10 % high.
- In mid-January, Chinese central bank raised the minimum reserve requirements, gradually trying to curb the massive credit expansion which largely supported Chinese economic dynamics previous year. GDP growth reached huge 10.7% in the fourth quarter of 2009 and China replaced Germany on the position of leading world exporter. Still, several economists have raised concerns about the sustainability of its current development.

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