

Czech economy: ups and downs

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Conference on European Economic Integration 2013

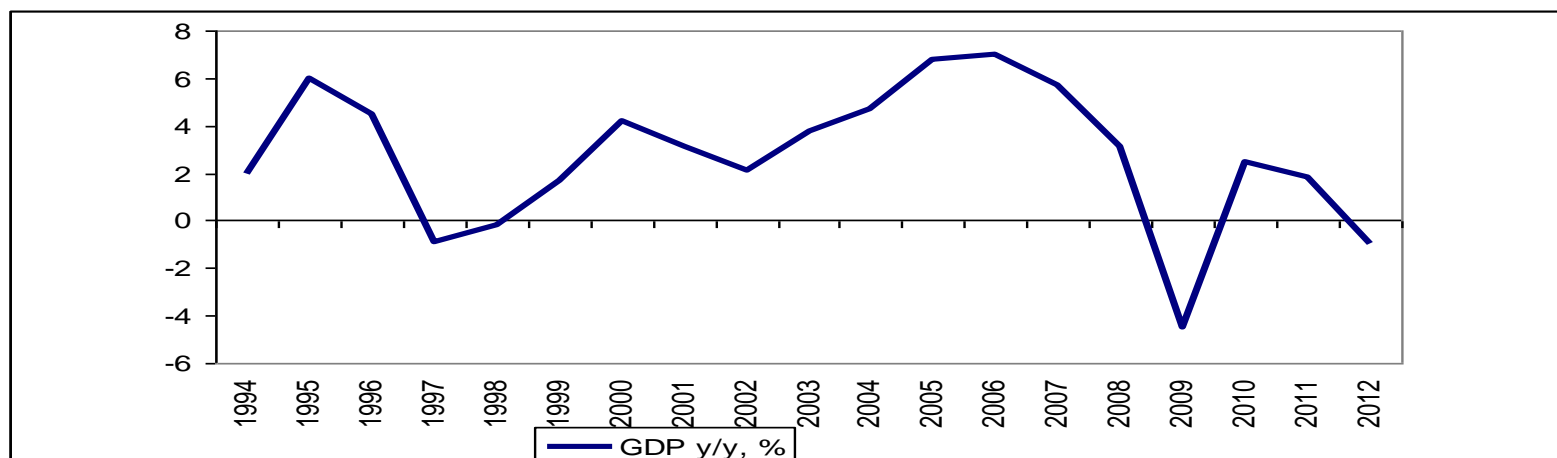
18th – 19th November 2013

Vienna

Czech Republic – basic background

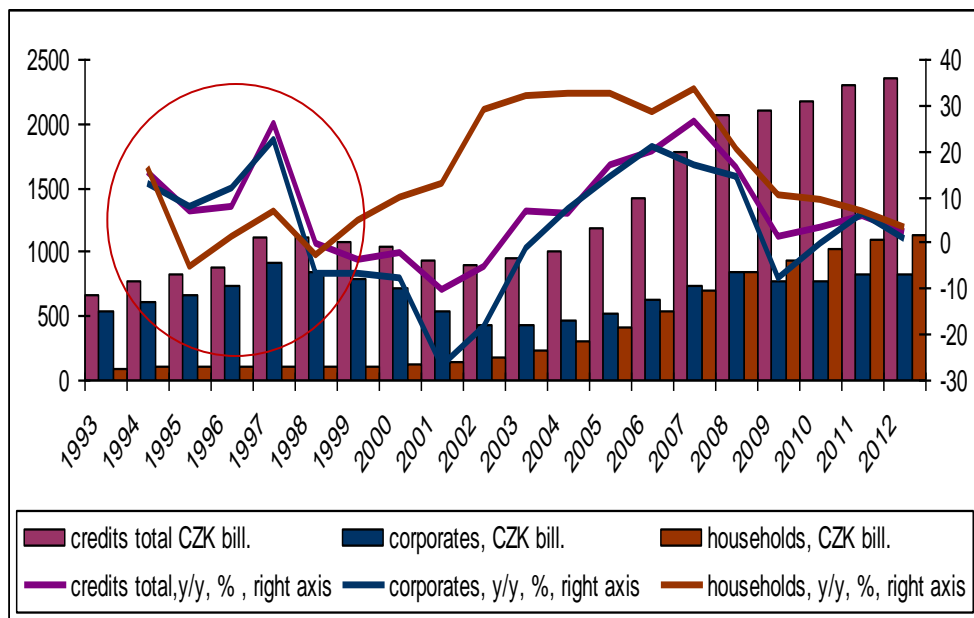
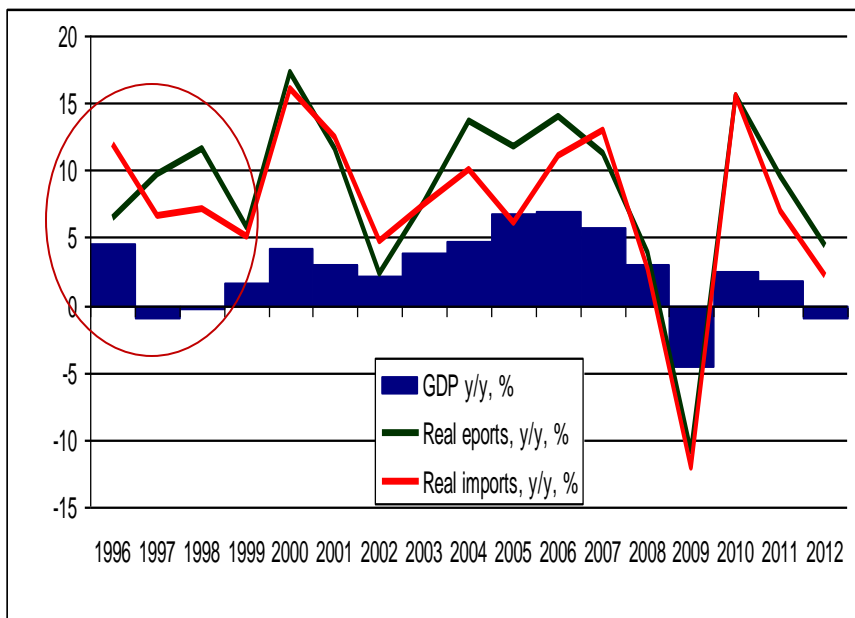
- EU member country outside Eurozone
- Monetary policy framework – inflation targeting
- Small and open economy with limited (natural) resources
 - Population of 10 mil.
 - GDP per capita – 20 500 USD
 - Foreign trade turnover – 140% of GDP
- Strongly dependent on foreign environment
 - EU – 90% of exports (30% Germany)
- High share of pro-cyclical industries

Basic story of previous two decades



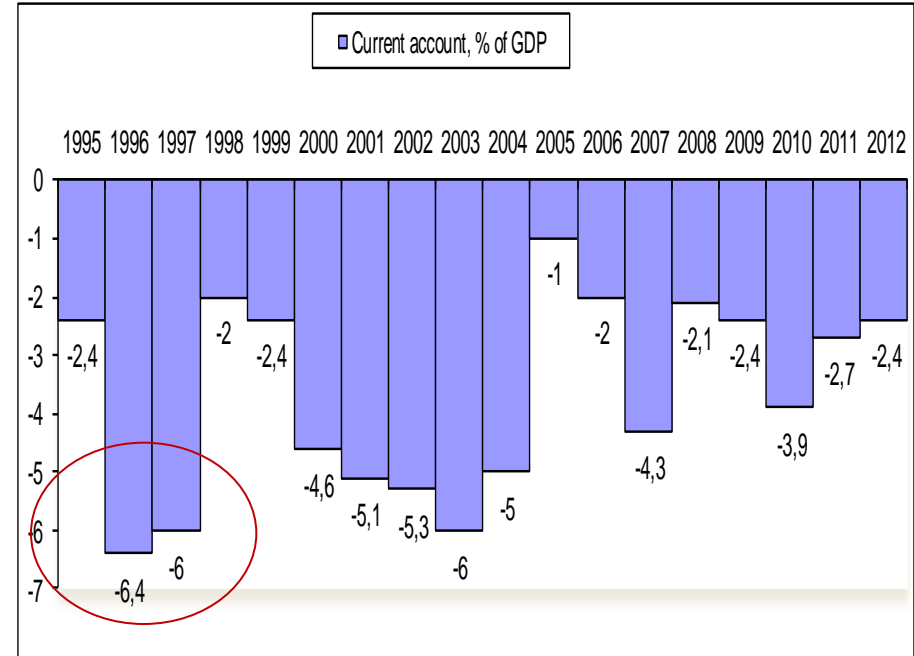
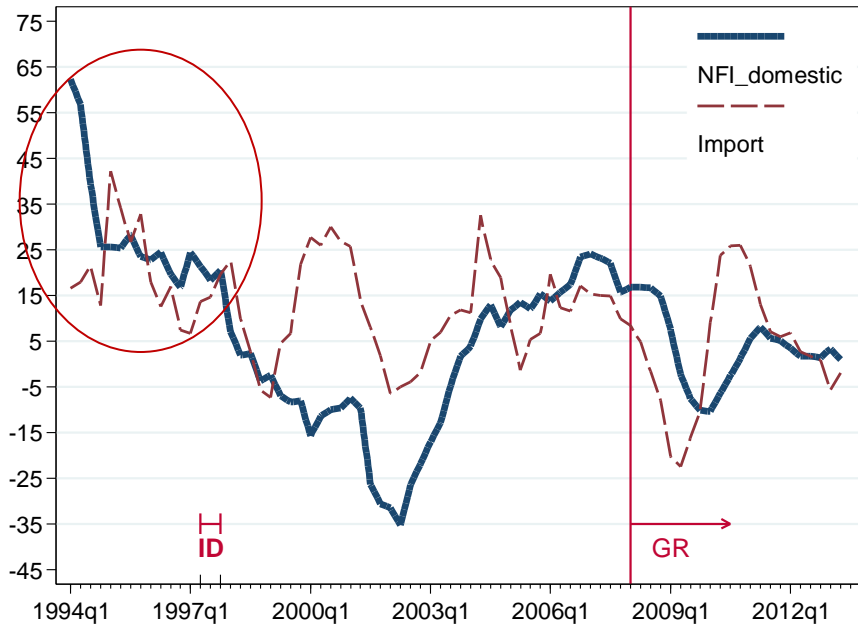
- First post-transformation recovery 1994–1996
- May 1997 monetary crisis followed by recession
- Banking crises and credit crunch 1998–2002
- Recovery as of 2000 with growth peaking in 2005–2007 („golden age“)
- Big slump (crisis) in 2009 followed by moderate growth 2010-2011
- Recovery after 6 quarters of recession in H2/2013?

First post-transformation recovery ...



- Recovery 1994–1996 driven by domestic demand – both consumer and investment
- Massive imports and corporate credit boom
- Strong inflow of foreign capital
- 1994–1995: CZK 200 billion of debt capital

....led to overheating and external imbalance...



- Growth and credit boom crowded in imports
- Massive imports led to external imbalance

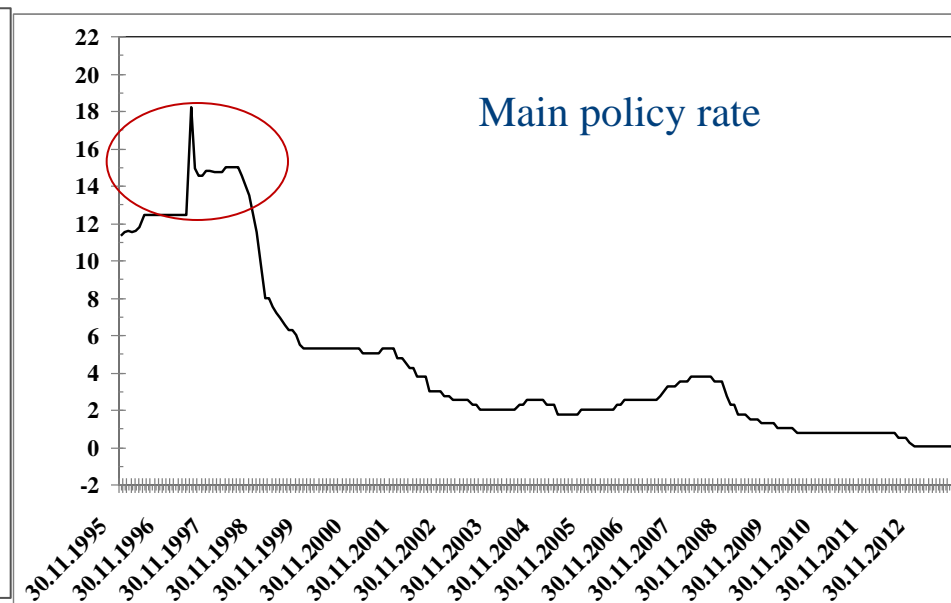
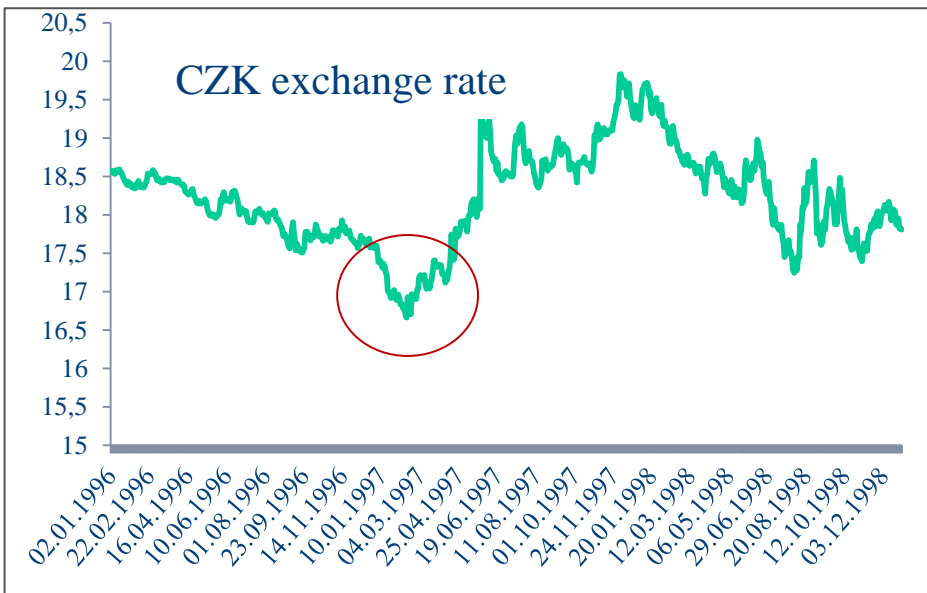
Subsamples correlations – contemporaneous vs. (x_t, y_{t+4}) :

until 1998q2 ['Transformation']: 0.101 vs. **0.796^{***}**

1998q3–2007q4 ['Golden Age']: 0.305 vs. -0.027

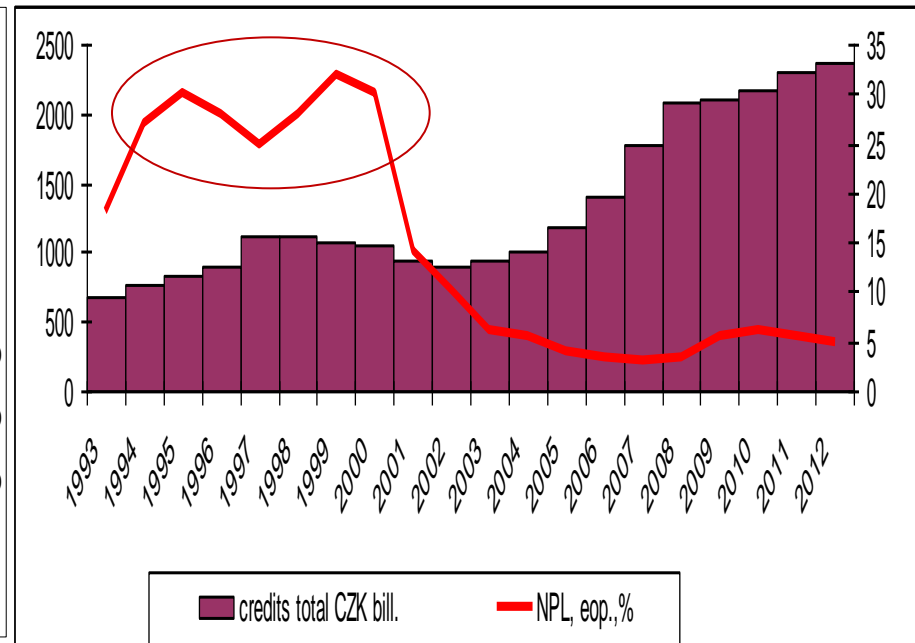
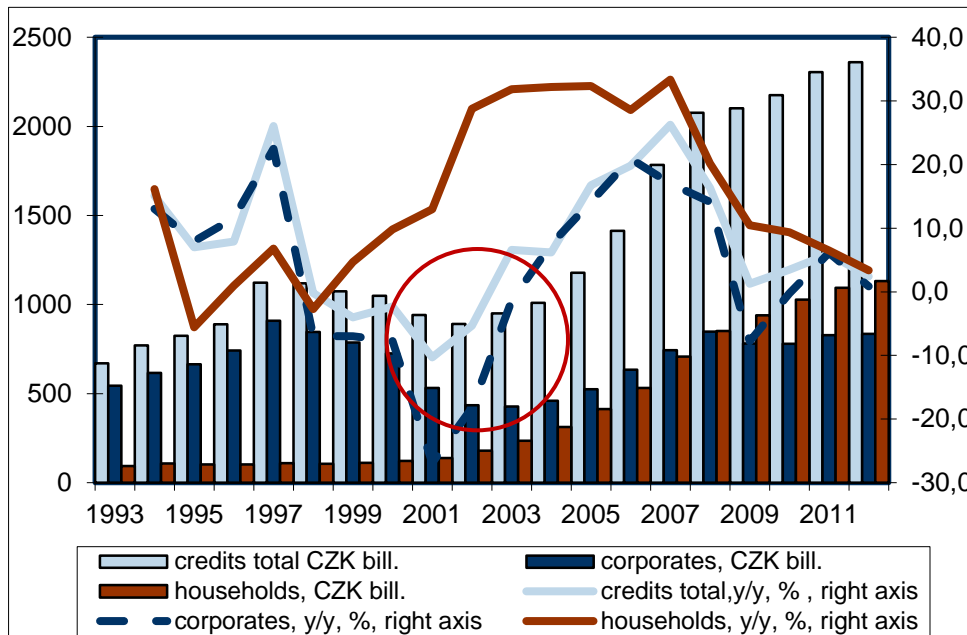
2008q1–2013q2 ['Great Recession']: -0.004 vs. -0.907^{***}

...which triggered May 1997 monetary crisis...



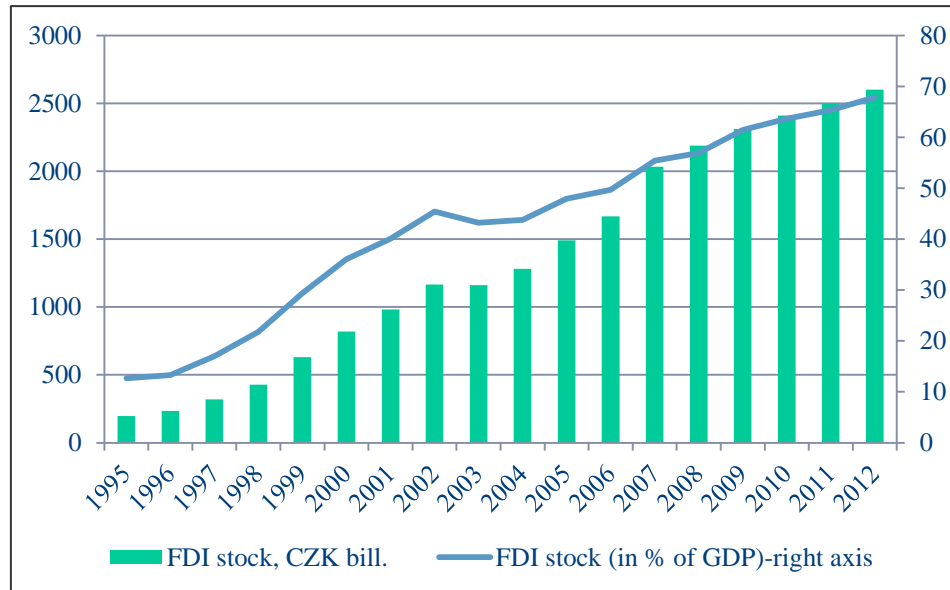
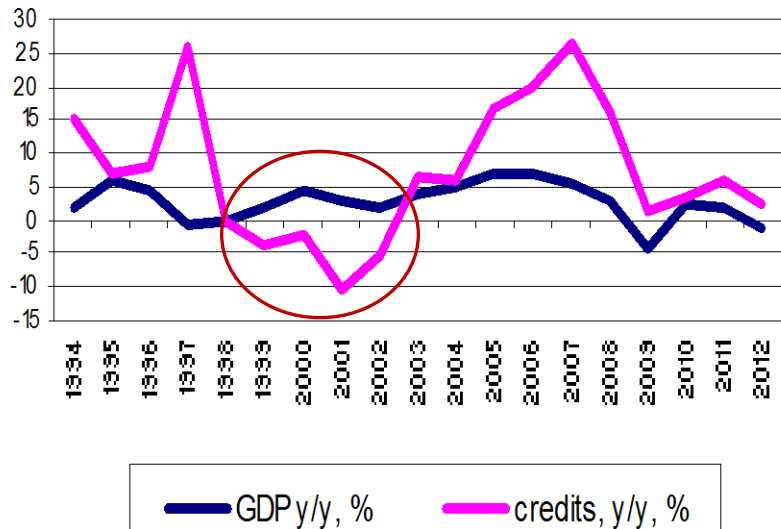
- Fixed ER & liberalization of financial account promoted the short-term capital inflow
- Signs of overheating visible as of 1996, CNB tightened monetary policy H2/96
- Speculative attack on CZK (partly triggered by Asian contagion)
- Crisis revealed the weaknesses of monetary policy regime – two goals (M2 and ER)
- Managed floating introduced (end of May 1997)
- Introduction of Inflation targeting at the end of 1997

... followed by banking sector crisis and credit crunch



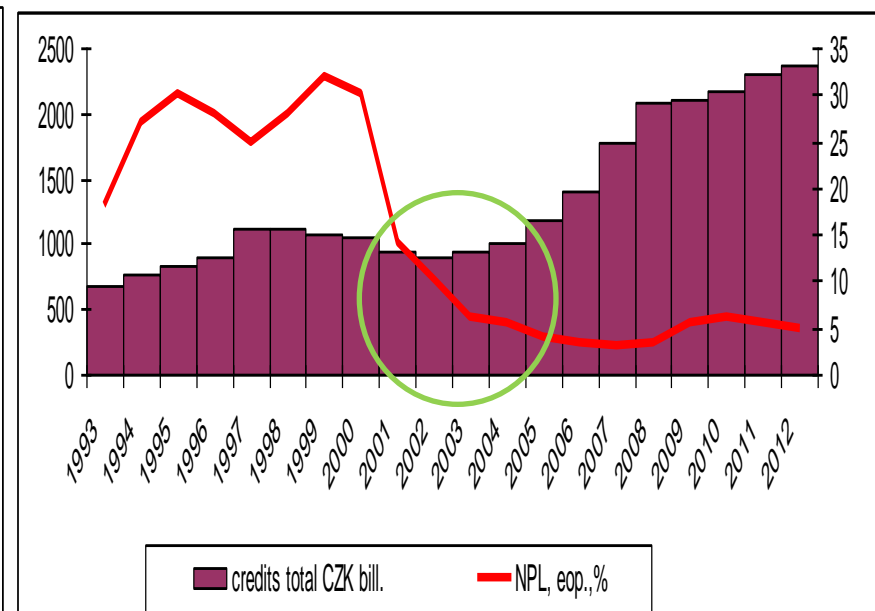
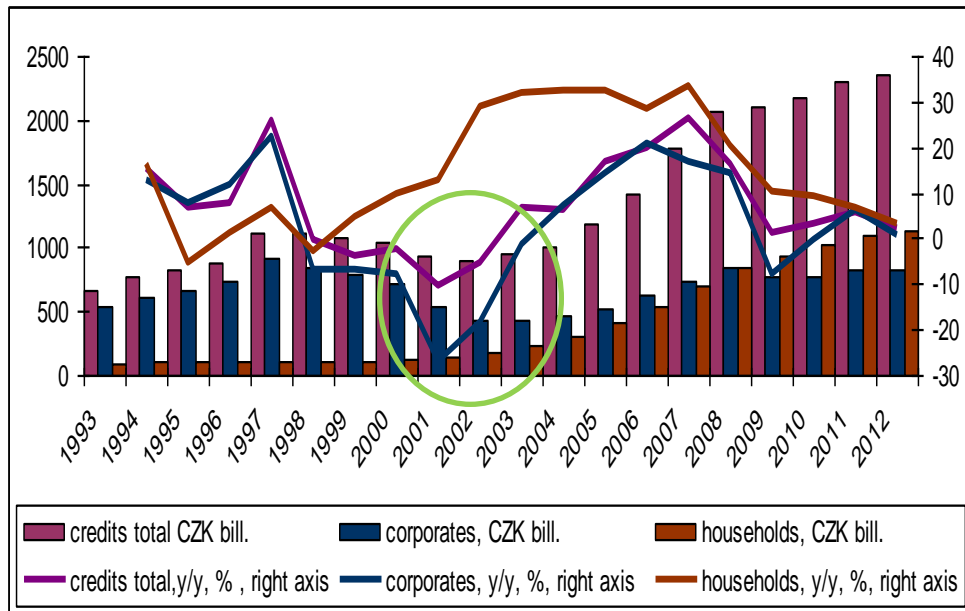
- Corporates credits growth/boom up to 1997 – unsustainable
- NPLs around 30%
- Banking crisis and credit crunch 1998–2002

Creditless recovery as of 1999...



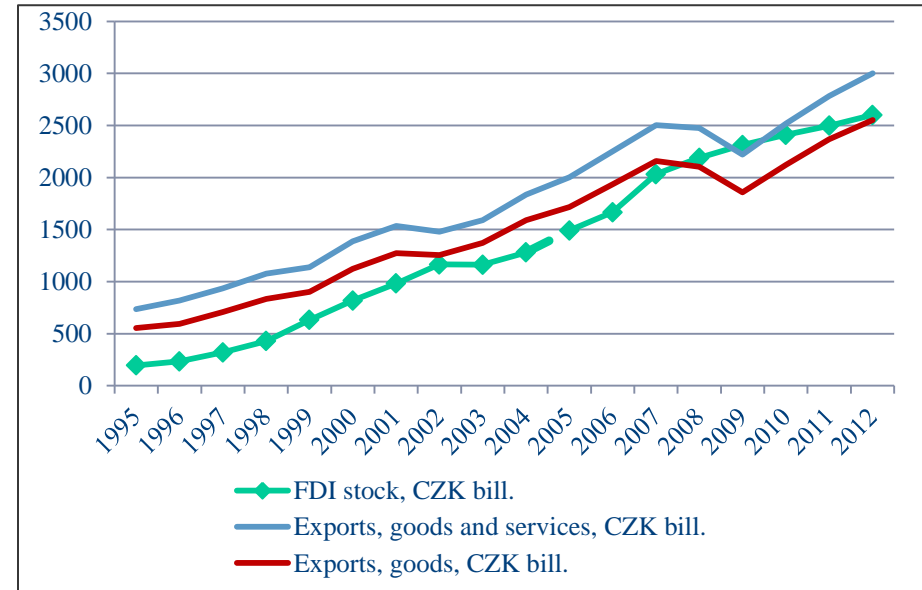
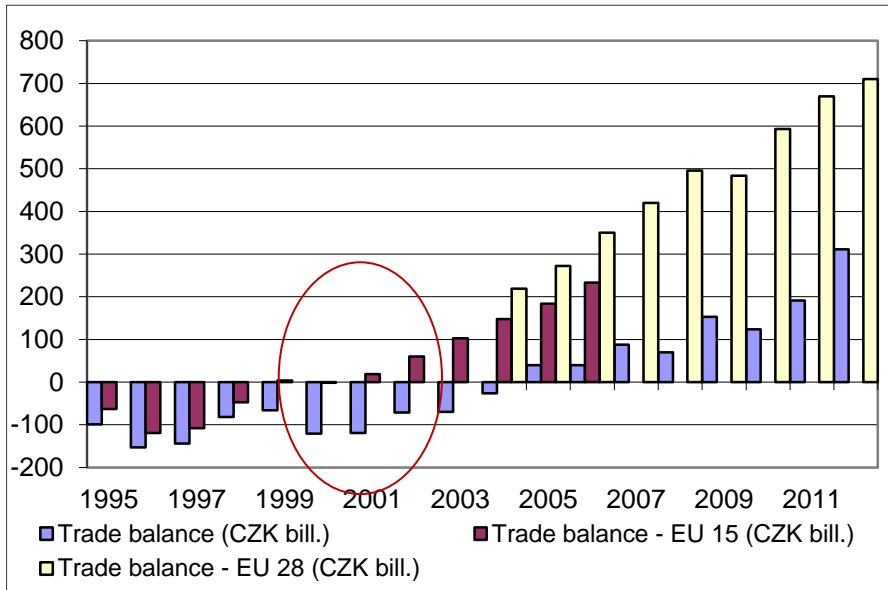
- Restoration of credit creation only after privatization of four big banks
- The gap between domestic savings and investment being filled with FDI
- Massive inflow of FDI boosted investment and exports

....followed by restoration of banks' lending ...



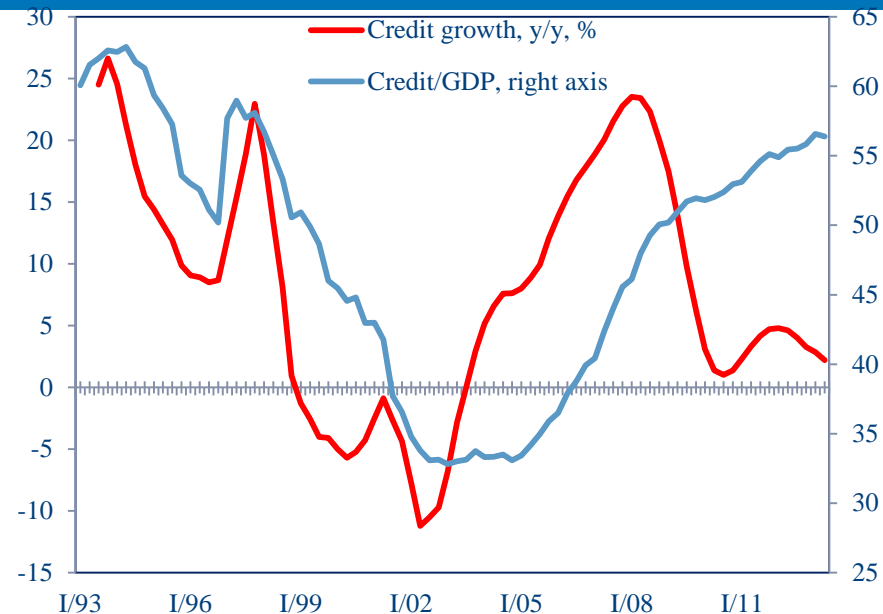
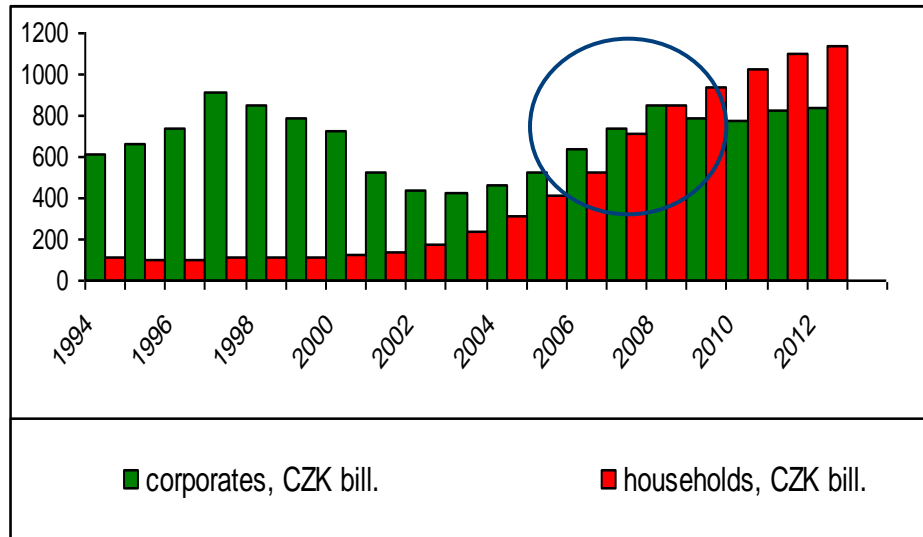
- Cleaning up the portfolios (strong decline in NPLs)
- Privatization of big banks – sales to strategic foreign partners
- Restoration of banks' lending during 2001–2003

...which did not provoke external imbalances



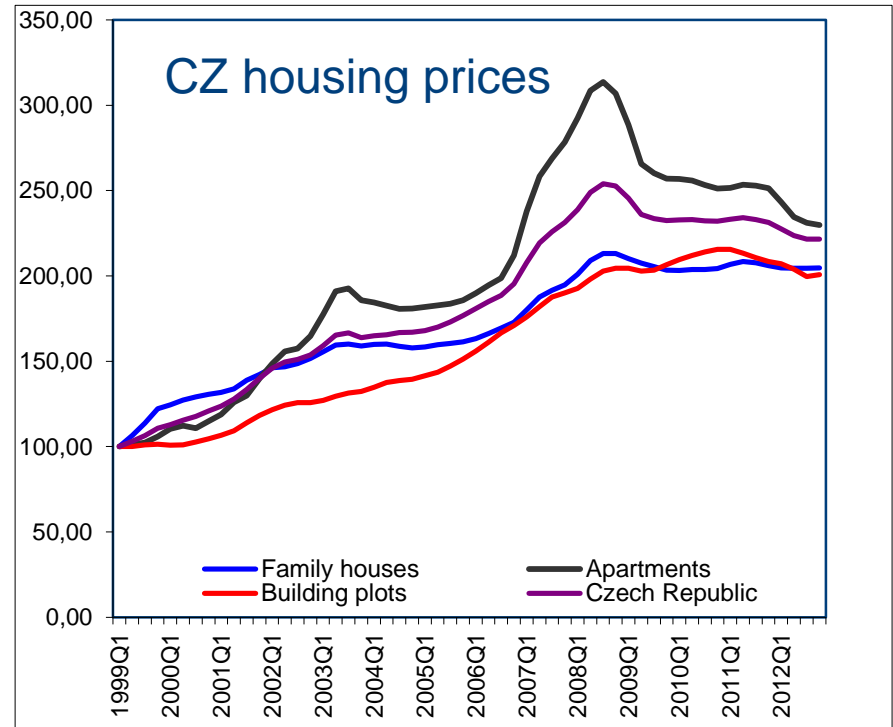
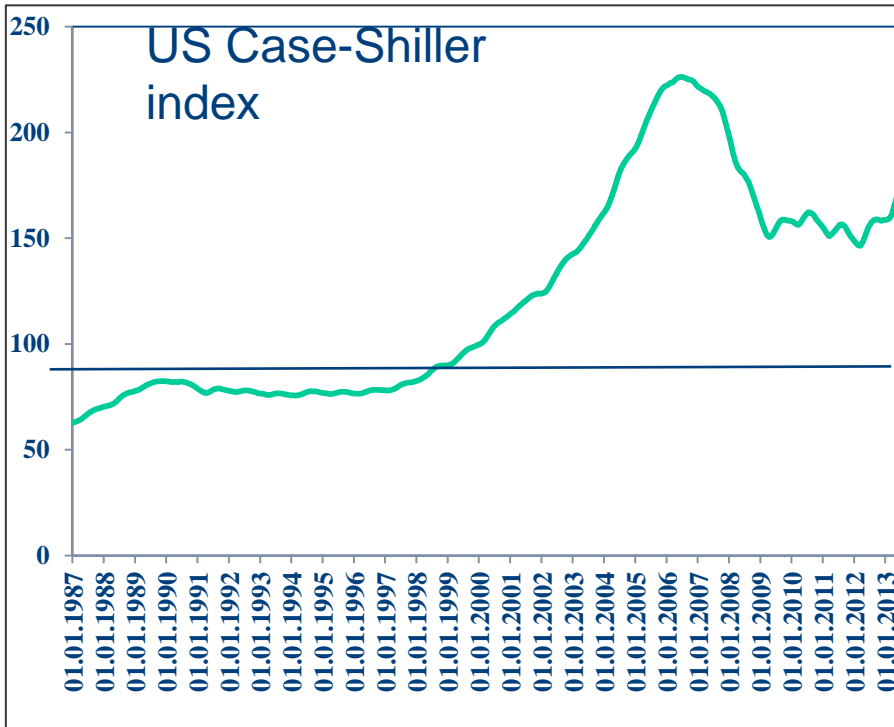
- Exports boosted driven by FDI inflow and forthcoming EU accession
- Trade balance with EU turned to surpluses as of 1999
- Trade surpluses have continued in growth since 2004

'Golden age' 2005–2007



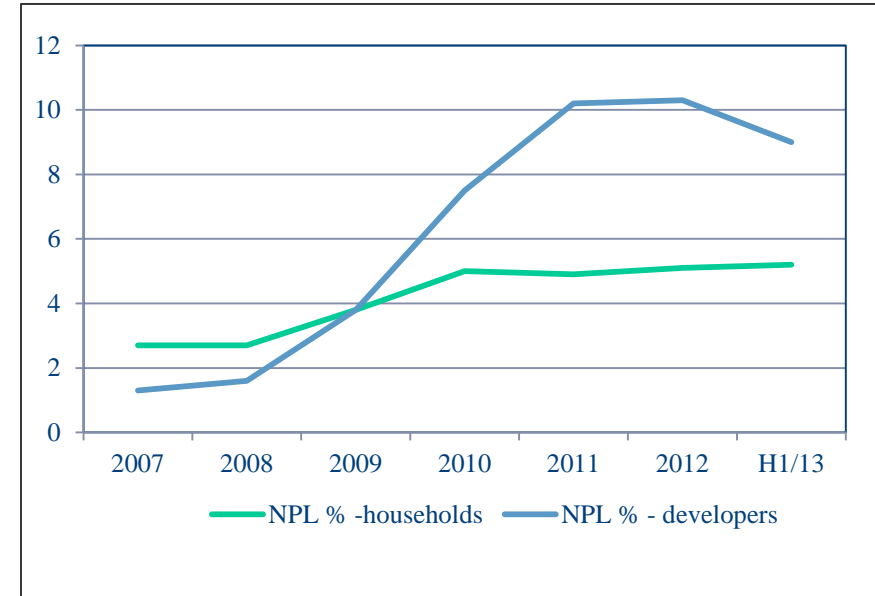
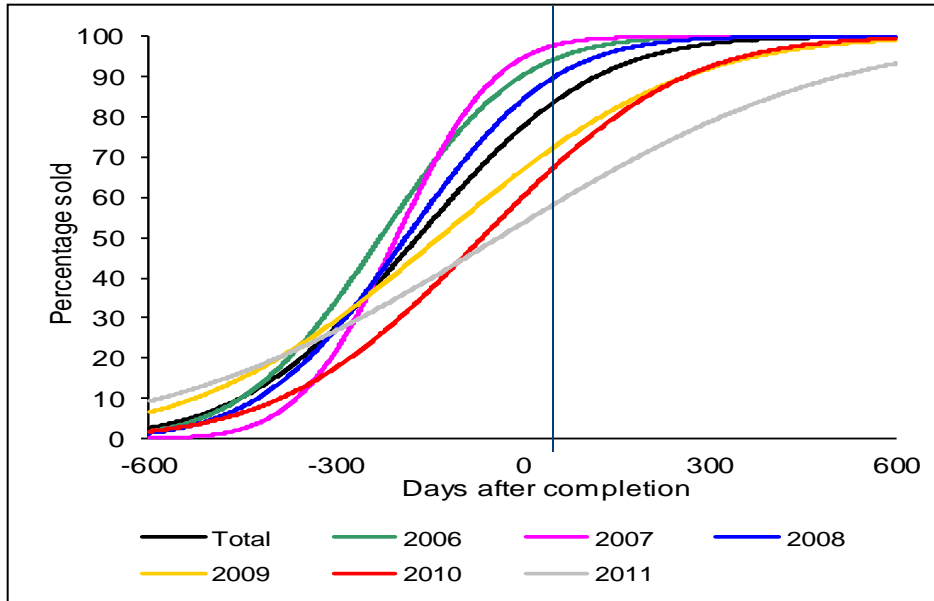
- Companies benefited from flourishing external demand
- Household consumption driven by record high consumer confidence
 - Change in behavioural patterns combined with easy access to credit led to high growth of credits to households
- In spite of high credit growth, the ratio Credits/GDP has not reached the former level (around 60%)

...led to overheating on the housing market...



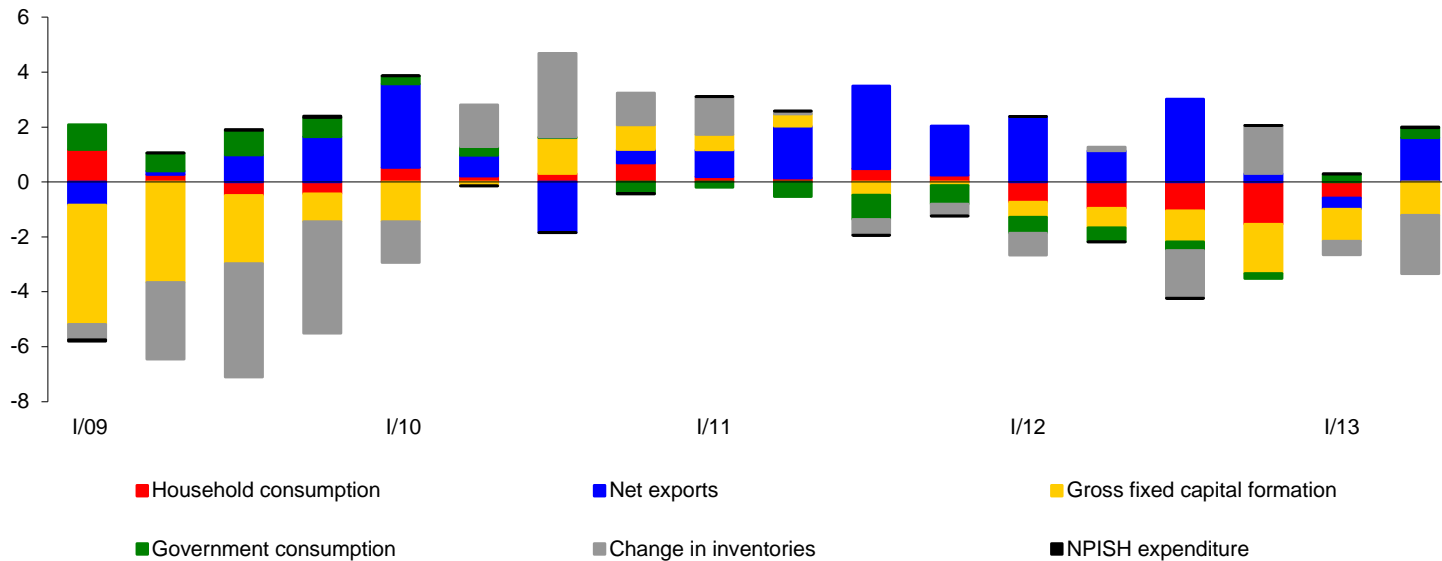
- Bubble on the housing market seems evident in the hindsight
- Unsustainable if the crisis and the lesson from subprime mortgage had not come?

..hopefully the bubble burst just in time



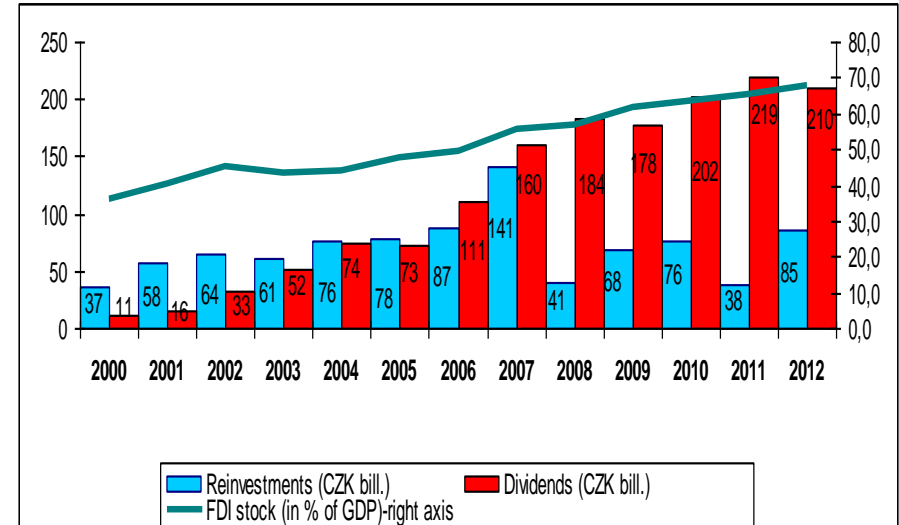
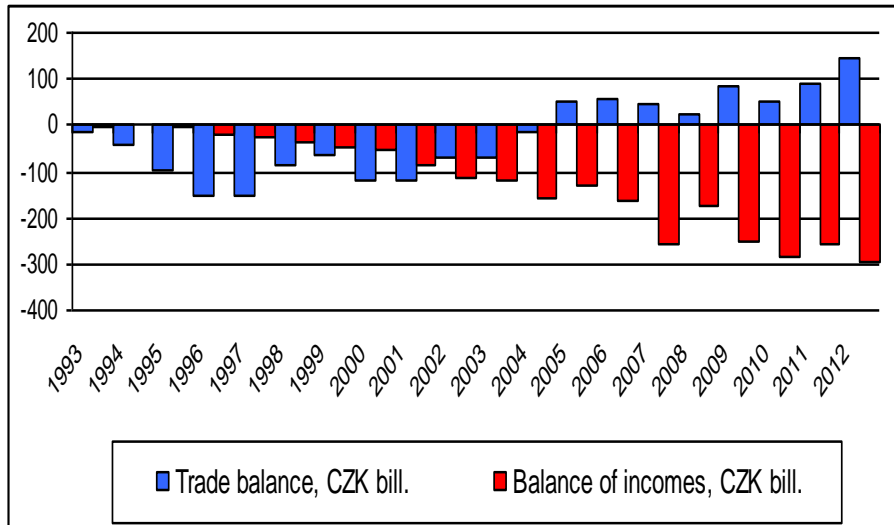
- NPLs in the sector of developers have stabilized in H/2013 (below 10%)
- NPLs in the sector of households stable around 5%
- Refinancing at low rate levels – risks after „return to normal MP“ ?

Crisis – recovery – recession



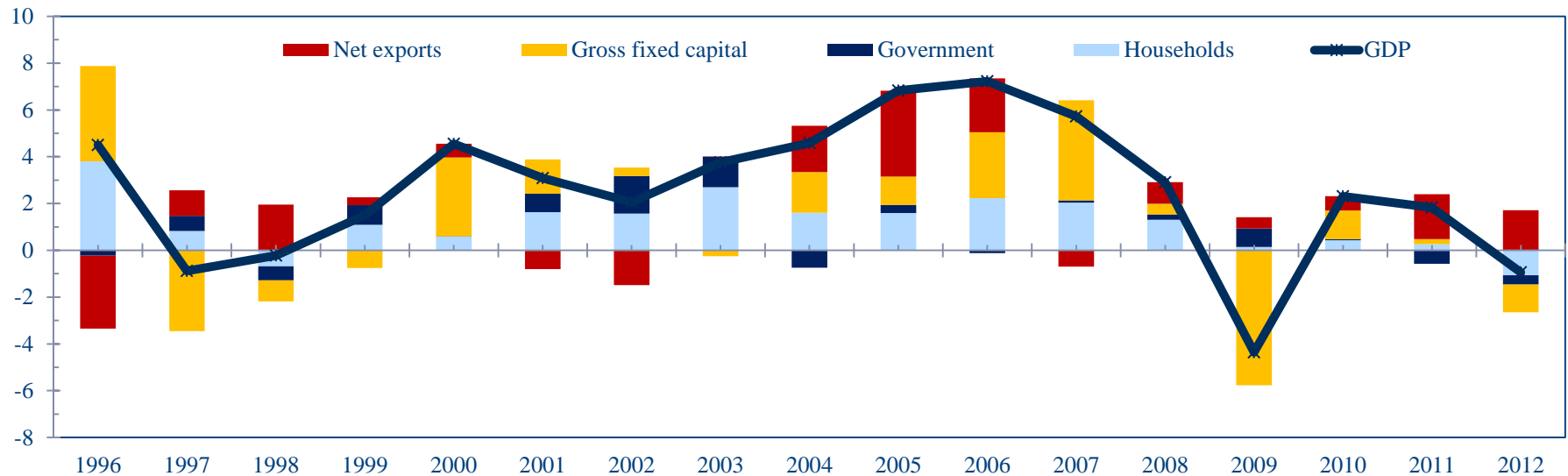
- Positive contribution of net exports overweighted by weak domestic demand
- Weak consumer demand – decline in real income and uncertainty
- Investment worst hit – down by 25% in comparison with the peak (Q1 2008) – links to FDI ?

The role of FDI revisited



- Foreign controlled companies generate approx. one third of total investments
- Sharp change in foreign investors behavior as of 2008
- From reinvestments to repatriations of profits: „No free lunch“
- Uncertain future ahead – not only export demand but also investments are affected by „multinationals“

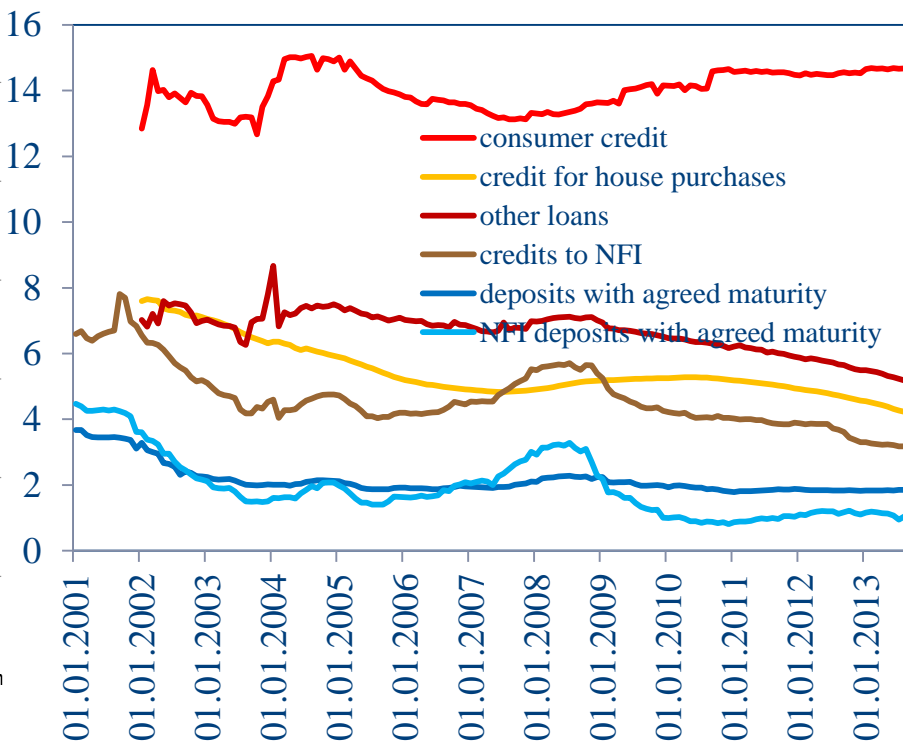
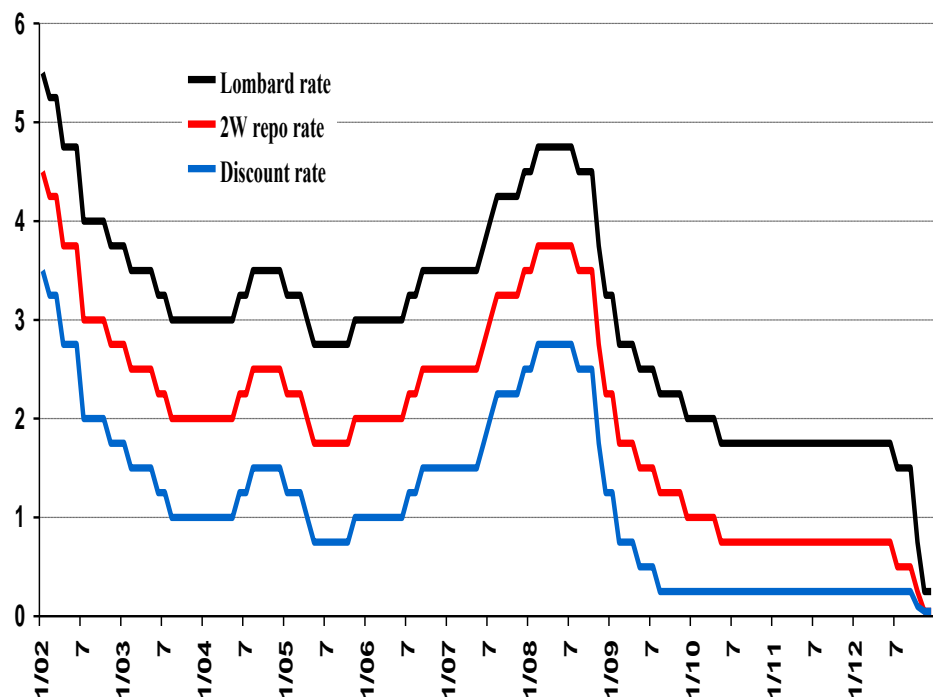
The crisis revealed vulnerabilities...



- Vital dependence on foreign demand has been the main cause of prolonged weaknesses
- Vulnerabilities on the supply side – concentration matters
- Institutional weaknesses
- Despite adverse condition, financial system has remained stable

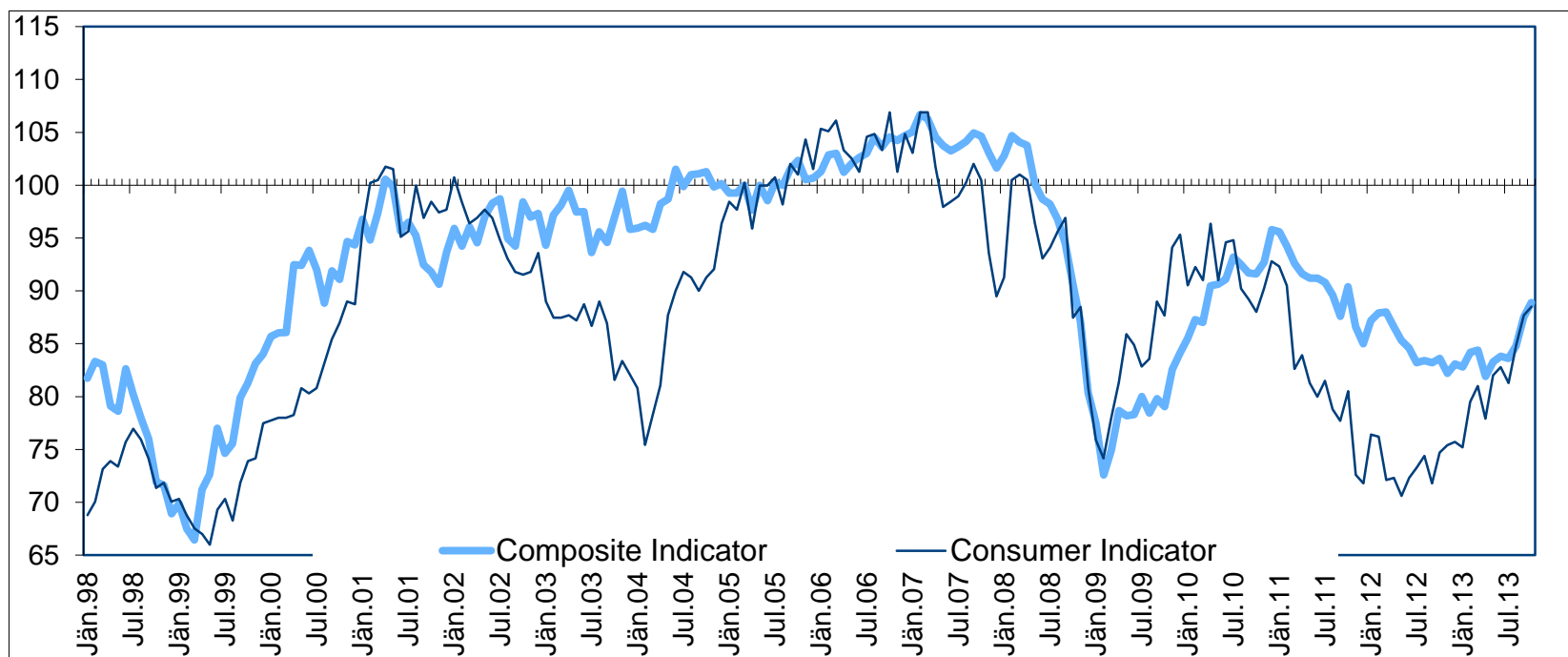
...that monetary policy reaction cannot overcome

Policy interest rates in the Czech Republic



- Transmission weaker than in „normal times“
- After reaching the ZLB exchange rate started to be used for further easing
- Policy mix is expected to be better balanced (2012: tight fiscal and easy monetary policy)

Crisis of confidence seems to be over?





Thank you for your attention

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