

## **Listopad 2011: Rostoucí pesimismus a nejistota – November 2011: Increasing Pessimism and Uncertainty**

	2010 Realita- Reality	Předpověď- Forecasts	
		2011	2012
Reálný růst HDP - Real GDP growth (%)	2.3	<b>1.9</b>	<b>2.1</b>
Inflace - Inflation, consumer prices (%)	1.5	<b>1.7</b>	<b>2.8</b>
Nezaměstnanost - Unemployment (%, ILO)	7.3	<b>6.9</b>	<b>7.0</b>

Although the Czech economy returned to growth in 2010 and the growth even reached fairly promising levels in late 2010 and early 2011, the current outlook is substantially gloomier. Recent updates of forecasts of all major institutions (OECD, EC, IMF, MFČR, ČNB) are turning for the worse both for the Czech Republic and its main trade partners. This reversal seems to be confirmed by the flash estimate of real GDP for the 3<sup>rd</sup> quarter which suggests that the recovery has stalled. All of a sudden, the spectre of double-dip reappeared in full force.

This reversal has several causes, both domestic and foreign. The foreign causes include increasing pessimism in the economies of main trade partners of the Czech Republic. The extreme openness and concentration of exports to EU/EMU countries troubled by uncertainty concerning the future fate of the Euro and effects of uncoordinated austerity programs backfired again. The full extent of these effects is difficult to estimate, our current forecasts are based on expected significant slowdown for Germany. However, in the unlikely case of disintegration of EMU Czechia can experience not only slowdown but absolute decrease of demand for its exports. The current Euro-troubles can hit also Czech trade with non-EU countries which depends on financing by European banks whose credibility is decreasing with changes in their ratings.

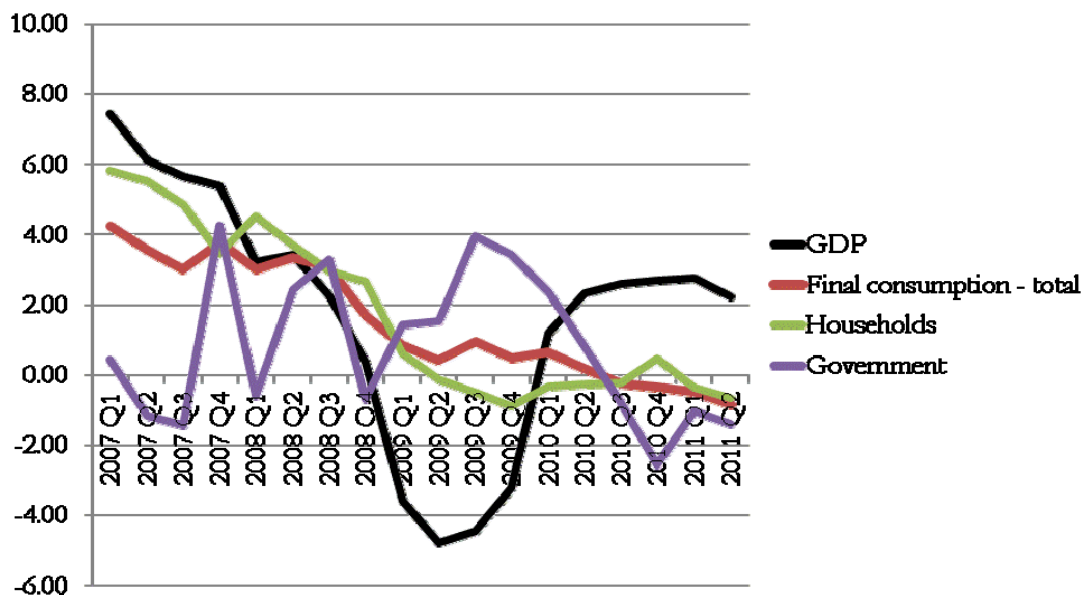


Chart 1 - Public and Private Demand in Czechia

To make the matters worse, the Czech Republic will not be able to rely on the moderating effect of domestic demand this time. Both government and household consumption have been declining in real terms (Chart 1) and this trend is unlikely to be reversed during 2012, both because of insistence on austerity measures and because of effects of the changes in VAT (increase of the lower rate to 14%) and of uncertainty on households' consumption.

Still, there are also a few positive factors which are worth mentioning in the current complicated situation: situation of Czech financial sector (esp. banking) remains stable and the sector is healthier than in most other developed countries. Direct exposure of Czech economy to the PIGS countries is also limited. Indebtedness of households and the share of non-performing loans – while creeping up – also seem to be below dangerous levels. And last but not least, the Czech government has been fairly successful both at tapping domestic demand for its bonds and in convincing rating agencies about its credibility.

All this means that Czech economy will be even more dependent on foreign demand than during the first stage of crisis in 2009 but also that it is ready for fairly fast growth if it faces stable growing foreign demand. The spectrum of resulting scenarios for 2012 is therefore extremely broad. If deceleration and pessimism in Germany turn out to be a short-term glitch, the Czech Republic would just slow down. If the EMU crisis turns into another round of recessions in Western Europe, the Czech economy can suffer a decline which can be even worse than 2009.