26 January 2018 Public Finance

The Czech Republic Rating Report

SCOPE **AA** STABLE OUTLOOK

Credit strengths

- Broad and diversified economy
- Sound public finances
- Resilient current-account balance
- Healthy banking sector

Credit weaknesses

- Demographics
- Household financial vulnerability

Rating rationale and Outlook: The AA rating is supported by a broad and diversified economy, sound government finances, resilient current-account balance and a healthy banking sector. The rating faces challenges in demographics and financial household vulnerability. Overall, the credit-supportive factors outweigh the risks and the rating is affirmed at AA. The rating Outlook is Stable and reflects Scope's view that the rating risks are overall balanced.

Figure 1: Sovereign scorecard results

Scope's sovereign risk categories	Czech Republic	Peer Comparison		
		Average	Poland	Slovakia
Domestic economic risk				
Public finance risk				
External economic risk				
Financial risk				
Political and institutional risk				
Qualitative adjustment (notches)	3		1	1
Final rating	AA		A+	A+

AAA	AA	A	BBB	BB	B	CCC	CC	C

NB. The comparison is based on Scope's Core Variable Scorecard (CVS), which is determined by relative rankings of key sovereign credit fundamentals. The CVS peer group average is shown together with two selected countries chosen from the entire CVS peer group. The CVS rating can be adjusted by up to three notches depending on the size of relative credit strengths or weaknesses.

Source: Scope Ratings GmbH

Positive rating-change drivers

- Acceleration of reforms
- Strong increases in investments
- Further strengthening of structural growth factors

Negative rating-change drivers

- Significant slowing of growth
- Fiscal slippage
- Further delays to reforms

Ratings & Outlook

Foreign currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

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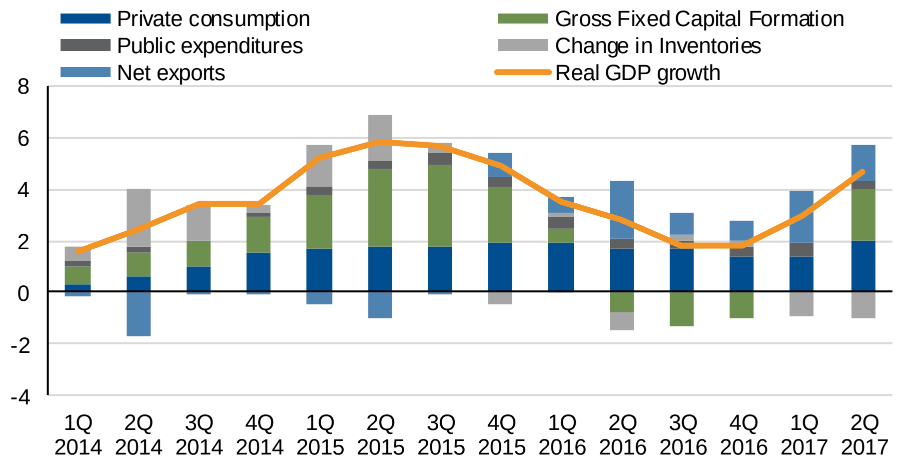
Domestic economic risk

Robust growth

Figure 2: Percentage-point contribution to annual real GDP growth



Source: Czech Statistical Office, Calculations Scope Ratings GmbH

Economic growth remains solid in the Czech Republic with real GDP averaging well over 2% since 2014. Scope expects GDP growth in 2017 to accelerate to 4.3%, driven by robust domestic demand and a dynamic external sector. Growth is set to slow to 3.0% in 2018, constrained by high capacity utilisation and the limited availability of skilled workers. The economy is broadly diversified with strong industrial activity deeply linked to foreign markets. Growth remains supported by extremely low unemployment and rising wages, which drives strong demand from Czech households. Since the beginning of 2017, the unemployment rate in the Czech Republic has been the lowest in the EU and is still decreasing. There are no major distortions in the economy, which is open to foreign investment and shows both strong product and labour market flexibility. Some high frequency indicators, such as business and consumer confidence, point to continuing positive momentum for the economy, with business confidence up more strongly than consumer confidence. Scope expects GDP growth to be moderate in the coming quarters.

The economy continues to be heavily export-oriented, with exports increasing at over 4% in Q2 2017, following the recovering trend in core European trading partner markets. Imports are also rising, but at a lesser rate, leading to net exports providing a positive contribution to GDP expansion.

Notwithstanding strong external demand, domestic demand remains the driver of growth, spurred by strong household disposable income growth, in turn benefiting from rising wages, sustained low inflation and very low unemployment. Real government consumption increased in 2016 due to an increase in public-sector wages. The amendment of the Public Procurement Act[1] pushed several procurement contracts from 2016 to 2017, which reduced spending in 2016. The full impact of this Act is yet to be seen, but its effects are

[1] On 1 October 2016, the Public Procurement Act entered into force, as an application of the EU public procurement legislation which governs concession agreements and concession proceedings. The amendment to the Act introduced formal changes to procurement and tender evaluation, notably the introduction of evaluations based on the quality-to-price ratio, or 'economic benefit'. There is also a new statutory duty to publish contractual documentation in a contract register. According to data from the Public Procurement Bulletin, the need to adjust contractors' administrative processes due to these and other changes resulted many public procurements being brought forward before the amendment's effective date. http://ec.europa.eu/regional_policy/sources/policy/how/improving-investment/public-procurement/study/country_profile/cz.pdf

expected to gain pace in the near-term, increasing transparency of public spending, and contributing to the fight against corruption.

At the height of the great financial crisis in 2012, the economy exhibited a negative output gap; however, new investments from non-financial corporations, supported by EU funds, and productivity gains, aided the subsequent recovery and helped lead to a positive output gap. The central bank estimates the annual output gap of the Czech economy to be around 1% in 2017, which should persist until 2019 with potential growth at 3%.

Household financial vulnerability

Real estate investment growth, mostly concentrated in the housing market, is limited by supply: in 2016, construction output declined as EU funds slowed, and building permits stabilised at 2013 levels, around 22,000 per quarter. In addition, rising demand from a growing economy, persistently low interest rates (despite the start of a credit cycle tightening), and tight labour market conditions are exerting pressure on house prices, especially in Prague where apartment prices rose by an annual rate of 18.8% in Q4 2017, compared to 4.7% countrywide. This may feed back into further credit growth directed to housing investment, and the central bank sees this as a potential downside risk. Household vulnerabilities are linked to the currently high loan-to-income ratios. The banks recently began to tighten lending standards. Rising interest rates also represent a risk to highly leveraged households. Scope believes that household financial vulnerability is a credit weakness.

Inflation on the upper band of the target…

The currently positive output gap supports inflation, which during 2017 grew above the central bank target of 2%. This was mostly due to core components and food, with the rising oil price not yet passing through to increased inflation due to the recent appreciation of the koruna. Overall, the Czech central bank expects inflation to continue for the time being, despite the negative base effect of a VAT decrease on selected items during 2016 and early 2017. Overall, tradeable goods benefited from the appreciation of the koruna after the floor to the euro was abandoned.

…but monetary tightening cycle has already started

Monetary policy, which includes a 2% inflation target with an acceptance band by ±1pp, mainly operates through the two-week repo rate. Under this monetary policy, foreign exchange interventions are to be used as “a fine-tuning instrument, […] mainly to smooth the effects on interest rates caused by unexpected liquidity fluctuations in the market. These instruments are rarely used.”[2]

Anticipating an inflation increase, the central bank began a tightening cycle in August 2017. To date, two interest rate hikes brought rates from 0.05% to 0.50%, with the expectation that these will be tightened by another 100bp by the end of 2019. In order to address the inflationary pressures generated by housing prices and associated expansion of lending, the central bank increased the counter-cyclical capital buffer for banks to 1.25% of total risky assets, one of the highest in the EU.

Public finance risk

Sound public finances

Scope considers the country’s public finances to be sound, thanks to low indebtedness, a healthy economic growth outlook, and prudent fiscal policy. Overall, the debt-to-GDP ratio is one of the lowest in the EU and is projected to decrease to 31% by 2019. The current political standstill and election calendar has not impacted the budget process: the fiscal law for 2018 was proposed by the previous administration ahead of the October 2017 elections, and was approved by the parliament and signed by the president by the end of the year.

[2] https://www.cnb.cz/en/monetary_policy/instruments/

The 2018 budget sets out revenues of CZK 1,314.5bn and expenditures of CZK 1,364.5bn. The fiscal deficit in 2018 is expected to be CZK 50bn, driven by a generous 15% wage increase for teachers and 10% for public-sector workers, a 4.4% rise in the pension bill, and increases in various other welfare payments. The budget foresees that the strong expenditure growth will be financed by even-stronger inflows from tax revenues, based on growing employment, wages and corporate profits as GDP expands, and better prevention of tax evasion (VAT reporting, electronic registration of sales). Government financing needs in 2018 will be CZK 351.6bn, or around 7% of GDP, with net interest payments expected to remain below 1% of GDP, and net interest payments as a percentage of fiscal revenues is 3.4%.

The rating is supported by a positive trajectory in fiscal consolidation, with a continued strengthening of the fiscal framework. A new fiscal law was passed in 2017 aimed at creating an independent fiscal council to assess compliance with fiscal rules and evaluate the long-term sustainability of public finances, setting fiscal limits for both central and local governments. The general government balance is expected to remain in surplus over the medium term, averaging 0.5% in 2017 and 0.6% in 2018, underpinned by steady revenue growth from taxes and social contributions aided by vigorous wage growth and measures against tax evasion.

Pension liabilities and demographic challenges

The Czech Republic faces significant demographic challenges that Scope sees as a credit weakness. Low unemployment rates (2.8% in 2017) are largely due to decreases in the overall working-age population, which shrank from 7.4m in 2009 to 7m in 2016, while the labour force increased from 5.2m in 2011 to 5.4m in 2016. The rising labour force in the face of a declining population points to a rapid increase in participation rates, which have moved from below EU average to well above. Hence, despite an ageing population, the Czech Republic exhibits high labour market flexibility. However, Scope believes that labour shortage will persist due to low fertility and immigration rates, placing a constraint on stronger economic expansion.

Although Czech population projections are relatively pessimistic and may have negative effects on fiscal accounts, their ongoing impact on pension expenditure is tempered by the moderate pension account deficit, which in 2016 was only 0.3% of GDP. Upward pressure on the pension deficit stems from the joint effect of the recently introduced ceiling on the retirement age and a longer life expectancy. The retirement age is one of the lowest in the EU[3], and low compared to the average life expectancy in the Czech Republic. Despite these potential liabilities, Scope believes that the government will take a dynamic and proactive approach to tackling the effect of demographics on the pension system[4]. This is based on the revision to the Pension Law[5], which will require adjustments to retirement age based on changes in life expectancy and Czech demographics.

Declining financing needs

The government's expected financing needs for 2018 are CZK 351.6bn (6.7% of GDP), reflecting a budgeted deficit of CZK 50bn, and high redemptions of maturing debt. In the last few years, the Treasury has taken advantage of favourable conditions on money markets. Treasury bills were issued at negative yields and the government has been actively retiring short-term debt. Overall debt has remained stable in absolute terms since 2012, but decreased in terms of GDP by nearly 10 percentage points, from 41.1% to 31.4%.

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[3] The retirement age is being increased to 65 years for both men and women.

[4] http://www.mfcr.cz/assets/en/media/Fiscal-Outlook-of-the-Czech-Republic-November-2017.pdf

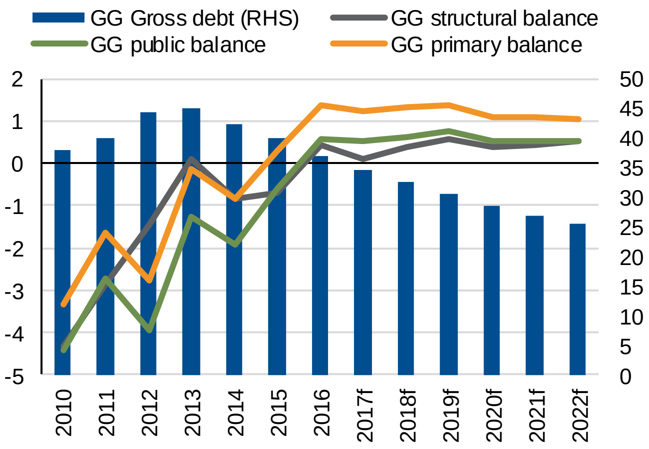
[5] Act No. 203/2017 Coll.

Average debt maturity was 4.8 years in 3Q 2017, but the Treasury targets to increase it to 6 years in the medium-term horizon.

Debt sustainability remains strong

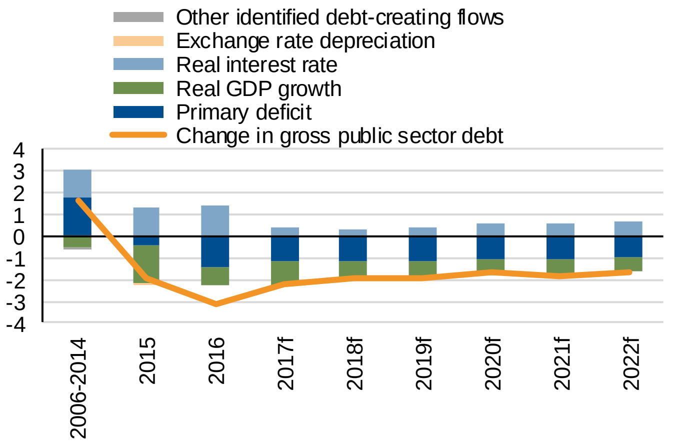
The Czech Republic's debt sustainability metrics remain strong, given the low debt burden and robust growth. Some debt metrics are particularly favourable to debt sustainability: only 14% of debt is short term, and only 13% is in foreign currency. The currency exposure results from a threshold retained by the Ministry of Finance back in 2011 to limit debt increases caused by currency volatility. Scope believes the recent strengthening of the koruna will last as long as the interest rate differential to the ECB exists. This dynamic could help to further reduce debt. The persisting interest rate differential vis-a-vis the ECB will support debt sustainability going forward. According to the debt management office, total financing needs will decrease in the medium term, as they will pass from CZK 351.6bn in 2018 to CZK 283bn in 2020, or from 6.6% to 4.9% of GDP.

Figure 3: Fiscal developments, % of GDP



Source: IMF

Figure 4: Debt-creating flows, % of GDP



Source: IMF

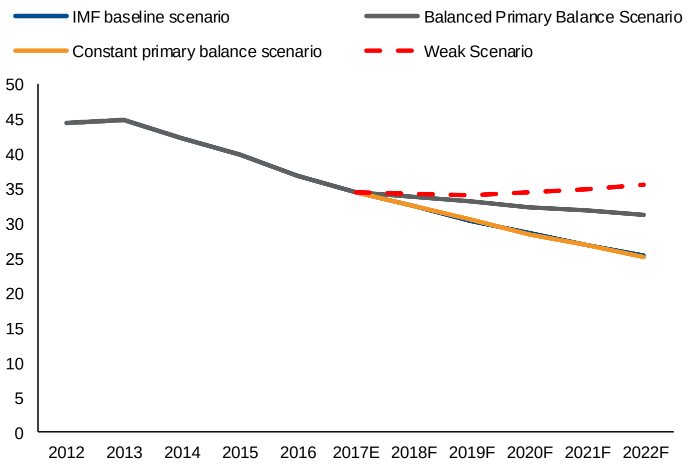
Even in the event of a weak scenario (simulating the effect of a macroeconomic downturn and a response of increased government expenditure, leading to an increase in interest rates), public debt sustainability, while worsening, would remain well below historical levels, in Scope's view. A constant primary balance scenario is essentially identical to the IMF baseline scenario, while a balanced primary balance scenario leads to slightly higher debt levels.

Figure 5: Parameters for public debt sustainability analysis

2017-2024 average	Real GDP growth (% change)	Primary balance (% of GDP)	Real eff. interest rate (%)	Debt end period (% of GDP)
Historic values (2013-2016)	2.5	0.2	0.7	41.0
IMF baseline	2.5	1.2	0.6	29.7
Constant primary scenario	2.5	1.2	0.5	29.7
Weak scenario	1.8	-0.2	1.4	39.6
Balanced primary balance scenario	2.6	0.0	0.5	33.6

Source: Source: Calculations Scope Ratings GmbH

Figure 6: Debt sustainability scenarios, % of GDP



Source: Calculations Scope Ratings GmbH

External economic risk

Resilient current account

The Czech economy benefits from a resilient current-account balance, which has been in surplus since 2014. More recently, the current-account surplus was 0.6% of GDP in 2017, down from 1.1% in 2016. Large surpluses in goods balances are offset by deficits in income, driven by returns on a large foreign direct investment stock.

The country's positive trade balance continues to be sizeable, driven mainly by trade in goods. The strength of the trade surplus is expected to continue due to the structure of the economy itself, as well as the solid outlook of main trading partners, largely in core Europe.

Over the next several years, however, reviving investments will support imports and reduce the trade surplus. Labour costs, on the other hand, will put additional pressure on export competitiveness. All in all, Scope does not expect the current-account balance to deteriorate significantly.

Financial account in equilibrium

Influenced by inflows in the early days after the currency floor was abandoned, the Czech economy in Q2 2017 recorded a small surplus in its financial account, with an increase in reserve assets and inflows into portfolios and other investments. Large portfolio investment outflows, due to closing positions opened during the currency floor regime, were balanced by other investment inflows equalling the outflows in Q3 2017, and the financial account was in equilibrium. Here the floating of the koruna resulted in a reduction of Czech bonds held by foreign investors[6]. Scope does not believe these specific outflows to be credit-relevant.

Increase of external debt

The Czech Republic's external debt rose to CZK 4.5bn at the end of September 2017, with exposures under one year at 57.9%. In GDP terms, the amount is approximately 91.2% of GDP at Q3 2017. Looking at the sectoral breakdown, banking is the most exposed with 45% of the liabilities, including those of the Czech National Bank (CNB). The level of official

[6] https://www.cnb.cz/en/statistics/bop_stat/bop_q/komentar.html; http://www.mfcr.cz/en/themes/state-debt/loans-from-the-eib

http://www.mfcr.cz/en/themes/state-debt/publications-and-presentations/debt-portfolio-management-quarterly-review/2017/debt-portfolio-management-quarterly-repo-29883/

reserves further corroborates the external position assessment, with reserves exceeding short-term external debt (79.3% in H1 2017).

Scope acknowledges that the concentration of external debt on short-term maturities and the dynamic compared to GDP are potential weaknesses, but this is mitigated by sufficient reserves cover and a level of external debt well under 100% of GDP.

Koruna float, but no euro adoption yet

After the euro trading floor was removed, the koruna appreciated gradually, benefiting also from a monetary policy tightening in advance of the ECB. The Czech National Bank (CNB) has shown a strong commitment to financial stability, and while the koruna has appreciated against the currencies of major trading partners, the CNB continues to actively ensure that exchange rate movements are moderate. Further management of the monetary policy through exchange rate interventions, however, is considered an additional instrument to interest rate measures. Commitment to a flexible exchange rate was reconfirmed until the adoption of the euro was reconsidered, which is not currently on the agenda.

Financial stability risk

A robust, liquid and profitable banking sector

The country benefits from a robust, liquid and profitable banking sector. The banking sector is liquid with a loan-to-deposit ratio of 80%, and well capitalised with a Tier 1 ratio of 16.9 % and a capital conservation buffer of 2.5%. The sector is highly concentrated with virtually no small or medium-sized banks, the result of consolidation when banks were privatised and then cleared of their non-performing loans. Financial intermediation is almost wholly foreign-owned.

CNB proactive to constrain loan growth

According to the October 2017 Banking Survey[7], standards for consumer credit have been eased, whereas standards for loans to non-financial corporations remain unchanged. To address stronger real estate exposures and rising property prices in Prague, banks have further tightened credit standards for residential mortgage loans in line with tougher macroprudential measures by the CNB. At the same time, banks' cost of funds has increased due to developments in financial markets and greater risks in housing markets. Loan loss provisioning, though decreasing, remains high, reaching 73.8% in Q3 2017, while regulatory capital to risk-weighted assets was 17.37% in Sept 2017[8]. In addition, the average interest margin of banks, though constrained by stiff competition, remains among the strongest in Europe, and the banking sector enjoys high profitability.

Institutional and political risk

Political uncertainty ahead

The immediate political situation in the Czech Republic is developing, in Scope's view. Neither the October parliamentary elections nor the mid-January presidential elections led to a decisive majority or the formation of a strong government. Scope believes that risks from the political situation are neutral. Fiscal policy for 2018 was already approved by the previous administration, and Scope does not expect any significant departure going forward. On top of this, despite persistent Eurosceptic sentiment, a more structural deviation from the European framework, such as a 'Czexit', no longer seem to be a consideration.

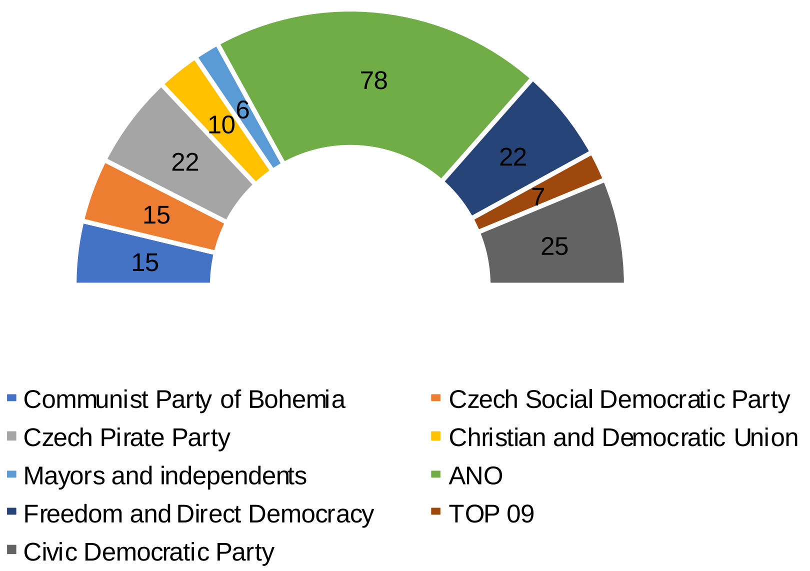
After the October elections, the composition of the Lower House was again dominated by the ANO party (78 seats of 200), followed by the centre-right Civic Democratic Party (25 seats), the Czech Pirate Party (22 seats), the anti-EU Freedom and Direct Democracy (22 seats), and the Communist Party (15 seats). Under the Czech constitution, a new administration requires a parliamentary vote of confidence, which the ANO failed to receive

[7] https://www.cnb.cz/en/bank_lending_survey/

[8] https://www.cnb.cz/en/supervision_financial_market/aggregate_information_financial_sector/financial_soundness_indicators/fsi_ukazatele_kons.html

on the first attempt – after three failed attempts, the president will call for a new election. Scope believes the president will avoid the need for new parliamentary elections. Therefore, any administration formed is likely to be based on a minority coalition and to maintain policy continuity.

Figure 7: Composition of the Chamber of Deputies (October 2017)



Source: Czech Statistical Office

Methodology

The methodology applicable for this rating and/or rating outlook, Public Finance Sovereign Ratings, is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA):http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.
A comprehensive clarification of Scope's definition of default and definitions of rating notation can be found in Scope's public credit rating methodologies on www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if it were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

I. Appendix: CVS and QS Results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on relative rankings of key sovereign credit fundamentals, signals an indicative 'a' rating range for the Czech sovereign. This indicative rating can be adjusted by the Qualitative Scorecard (QS) by up to three notches depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative analysis.

For the Czech Republic, the QS signals relative credit strengths for the following analytical categories: 1) strong economic outlook with good growth potential; 2) good economic policy framework; 3) good macroeconomic stability; 4) strong flexible fiscal performance; 5) strong debt sustainability; 6) very good market access and funding sources; 7) resilience against current-account vulnerability; 8) resilience against short-term shocks; 9) good recent policy decisions; 10) good financial sector performance and oversight; and 11) resilience to macro-financial vulnerabilities and fragility. Relative credit weaknesses are not signalled.

The combined relative credit strengths and weaknesses generate a three-notch adjustment and indicate a sovereign rating at AA for the Czech Republic.

A rating committee has discussed and confirmed these results.

Rating overview

CVS indicative rating range	a
QS adjustment	AA
Final rating	AA

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest. The result is converted into an indicative rating range that is always presented in lower case.

Within the QS assessment, the analyst conducts a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, review of debt sustainability, fiscal and financial performance, and policy implementation assessments.

There are three assessments per category for a total of fifteen. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analyst's recommendation to the rating committee.

II. Appendix: CVS and QS results

CVS

Rating indicator	Category weight
Domestic economic risk	**35%**
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	**30%**
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	**15%**
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exchange rate	
Total external debt	
Institutional and political risk	**10%**
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	**10%**
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**a**
QS adjustment	**AA**
Final rating	**AA**

QS

Maximum adjustment = 3 notches

	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	◉ Strong outlook, good growth potential	○ Neutral	○ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential well under trend or negative
Economic policy framework	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Macroeconomic stability and imbalances	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Fiscal performance	○ Exceptionally strong performance	◉ Strong performance	○ Neutral	○ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	◉ Strong sustainability	○ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	◉ Very good access	○ Neutral	○ Poor access	○ Very weak access
Current-account vulnerabilities	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
External debt sustainability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Vulnerability to short-term shocks	○ Excellent resilience	◉ Good resilience	○ Neutral	○ Vulnerable to shock	○ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Geo-political risk	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial sector performance	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Financial sector oversight and governance	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Macro-financial vulnerabilities and fragility	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate

*** Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10**

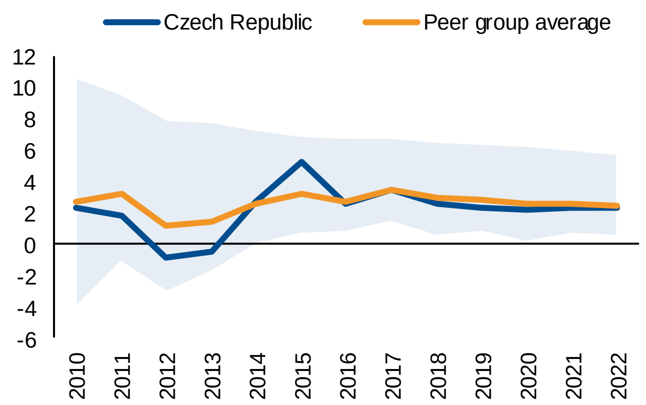
Source: Scope Ratings GmbH

Foreign- versus local-currency ratings

The Czech Republic's debt is predominantly domestic. Because of its history of openness to trade and capital flows, Scope sees no evidence that the Czech Republic would differentiate among any of its contractual debt obligations based on currency denomination.

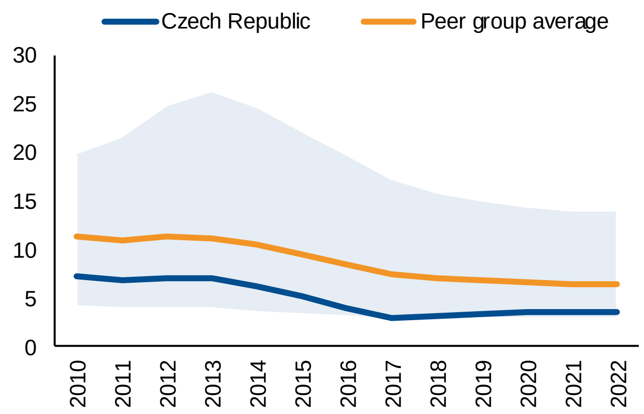
III. Appendix: Peer comparison

Figure 8: Real GDP growth



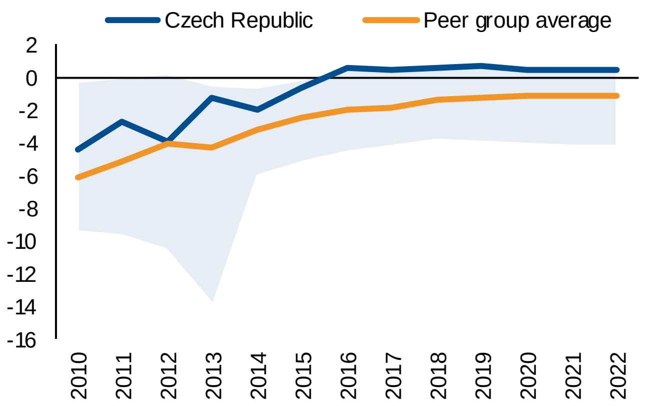
Source: IMF, calculations Scope Ratings GmbH

Figure 9: Unemployment rate, % total labour force



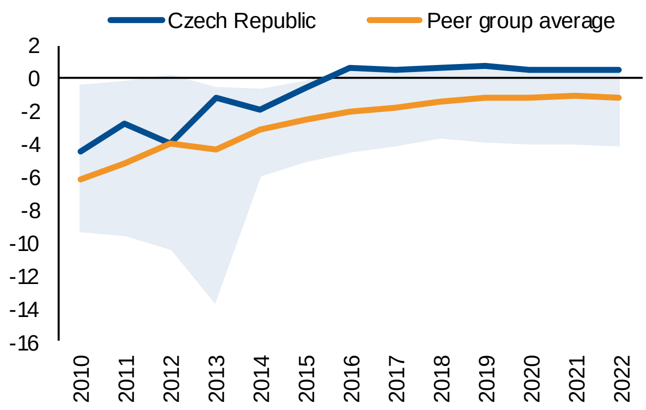
Source: IMF, calculations Scope Ratings GmbH

Figure 10: General government balance, % of GDP



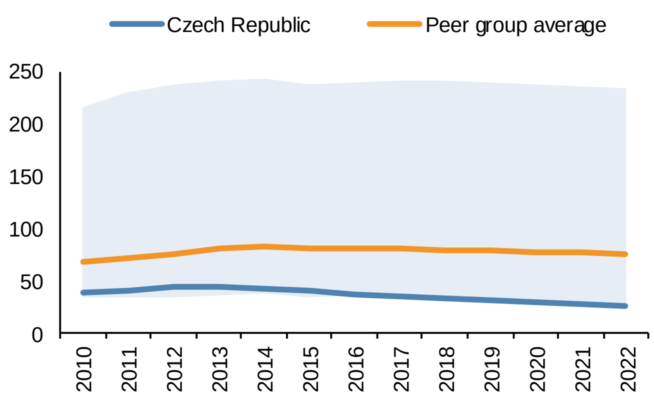
Source: IMF, Calculation Scope Ratings GmbH

Figure 11: General government primary balance, % of GDP



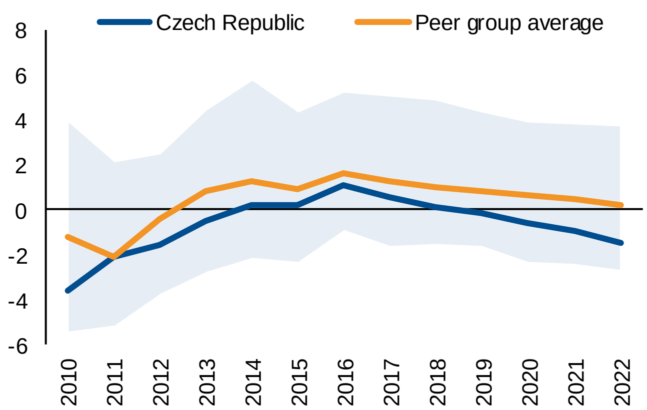
Source: IMF, Calculations Scope Ratings GmbH

Figure 12: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

Figure 13: Current-account balance, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

IV. Appendix: Statistical tables

	2012	2013	2014	2015	2016	2017E	2018F
Economic performance							
Nominal GDP (CZK bn)	4,059.9	4,098.1	4,313.8	4,595.8	4,773.2	4,994.9	5,188.3
Population ('000s)	10,505.0	10,516.0	10,512.0	10,538.0	10,554.0	10,579.0	10,593.0
GDP-per-capita PPP (USD)	29,047.3	30,485.7	32,357.6	33,743.2	34,711.3	-	-
GDP per capita (CZK)	386,457.9	389,699.4	410,351.7	436,103.9	452,275.1	472,170.5	489,800.0
Real GDP growth, % change	-0.8	-0.5	2.7	5.3	2.6	4.3	3.0
GDP growth volatility (10-year rolling SD)	3.6	3.7	3.6	3.5	3.1	2.8	2.8
CPI, % change	3.3	1.4	0.3	0.3	0.7	2.3	1.8
Unemployment rate (%)	7.0	7.0	6.1	5.0	4.0	2.8	3.0
Investment (% of GDP)	26.2	24.7	25.9	28.0	26.3	26.6	26.5
Gross national savings (% of GDP)	24.6	24.1	26.1	28.2	27.4	27.2	26.6
Public finances							
Net lending/borrowing (% of GDP)	-3.9	-1.2	-1.9	-0.6	0.7	0.5	0.6
Primary net lending/borrowing (% of GDP)	-2.8	-0.2	-0.8	0.3	1.4	1.8	1.3
Revenue (% of GDP)	40.5	41.4	40.3	41.1	40.1	40.4	40.8
Expenditure (% of GDP)	44.5	42.6	42.2	41.7	39.4	39.9	40.1
Net Interest payments (% of GDP)	1.2	1.1	1.1	0.9	0.8	1.4	0.7
Net Interest payments (% of revenue)	2.9	2.6	2.7	2.2	2.0	3.4	1.7
Gross debt (% of GDP)	44.5	44.9	42.2	40.0	36.8	34.5	32.5
Net debt (% of GDP)	28.3	29.1	29.4	28.1	24.8	27.6	25.8
Gross debt (% of revenue)	109.7	108.6	104.6	97.3	91.7	85.6	79.7
External vulnerability							
Gross external debt (% of GDP)	60.0	63.2	69.6	70.2	73.9	-	-
Net external debt (% of GDP)	-1.1	-5.1	-4.5	-8.2	-13.5	-	-
Current-account balance (% of GDP)	-1.6	-0.5	0.2	0.2	1.1	0.6	0.1
Trade balance [FOB] (% of GDP)	-	4.1	5.1	4.1	5.2	5.0	4.9
Net direct investment (% of GDP)	-3.0	0.2	-1.9	1.1	-3.0	-	-
Official forex reserves (EOP, Mil.USD)	44,883.0	56,217.0	54,493.0	64,491.0	85,726.0	-	-
REER, % change	-2.8	-2.3	-5.2	-0.7	2.5	-	-
Nominal exchange rate (EOP, CZK/EUR)	25.1	27.4	27.7	27.0	27.0	-	-
Financial stability							
Non-performing loans (% of total loans)	5.2	5.2	5.6	5.5	4.6	-	-
Tier 1 Ratio (%)	14.9	16.0	16.5	17.1	17.1	-	-
Consolidated private debt (% of GDP)	70.7	73.7	71.5	68.1	68.7	-	-
Domestic credit-to-GDP gap (%)	16.2	16.3	10.9	0.0	-1.5	-	-

Source: IMF, European Commission, European Central Bank, Czech National Bank, World Bank, Scope Ratings GmbH

V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

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Person responsible for approval of the rating: Dr Giacomo Barisone, Head of Public Finance

The ratings/outlook were first assigned by Scope as a subscription rating in January 2003. The public ratings/outlooks were last updated in 28.07.2017.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on the Czech Republic are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Sovereign Ratings Calendar of 2018" published on 22.12.2017 on www.scoperatings.com). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation was due to the recent revision of Scope's Sovereign Rating Methodology and the subsequent placement of ratings under review, in order to conclude the review and disclose ratings in a timely manner, as required by Article 10(1) of the CRA Regulation.

Rating Committee: the main points discussed were: (1) the Czech Republic's economic outlook; (2) the fiscal performance and debt sustainability; (3) banking sector performance and soundness; and (4) the declining population and pressures this creates on the reform programme and investments; and (5) foreign capital inflows and exchange rate shocks.

Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: Czech National Bank, BIS, Ministry of Finance, IMF, OECD, ECB, European Commission, Eurostat, and Haver Analytics.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

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