The Czech Republic Rating Report

SCOPE AA STABLE OUTLOOK

Credit strengths

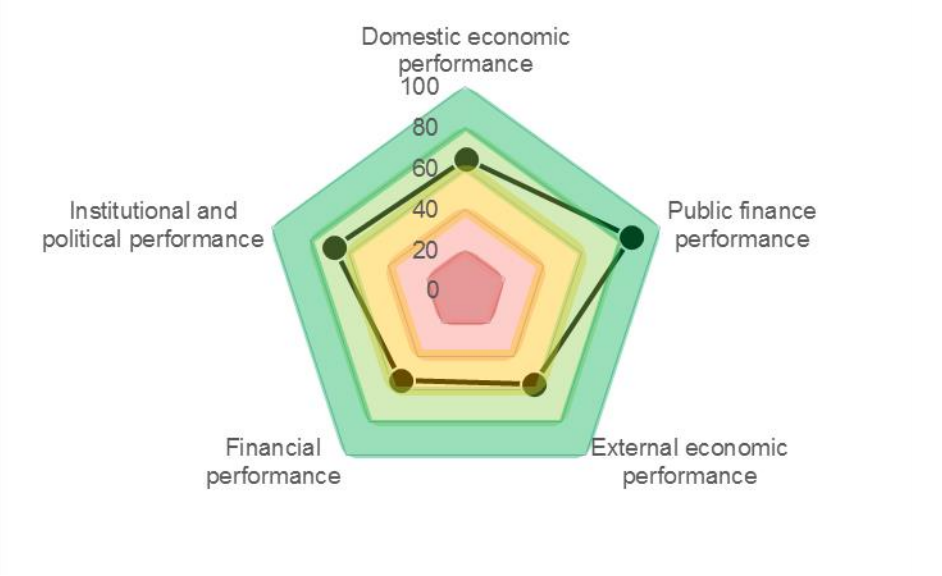
- Sound public finances
- Broad and diversified economy
- Healthy banking sector
- EU membership

Credit weaknesses

- Ageing population
- Skilled labour shortage
- Dependence on capital inflows
- Rising household debt

Rating rationale and Outlook: The AA rating is underpinned by a benign outlook for debt, a broad and diversified economy, strong domestic financing and a healthy banking sector. These credit strengths outweigh a high degree of exchange rate sensitivity, heavy dependence on capital inflows, the continued use of the koruna and challenges presented by an ageing population. While government policy remains on the path to reduce debt to take advantage of low interest rates, there is also a need to place greater emphasis on increasing labour productivity and hence growth potential. The rating outlook is Stable and reflects Scope's view that the rating risks are overall balanced.

Figure 1: Summary of sovereign rating categories



Source: Scope Ratings AG

Positive rating-change drivers

- Increased productivity
- Acceleration of reforms
- Strong increases in investments

Negative rating-change drivers

- Negative GDP shock
- Increases in government debt
- 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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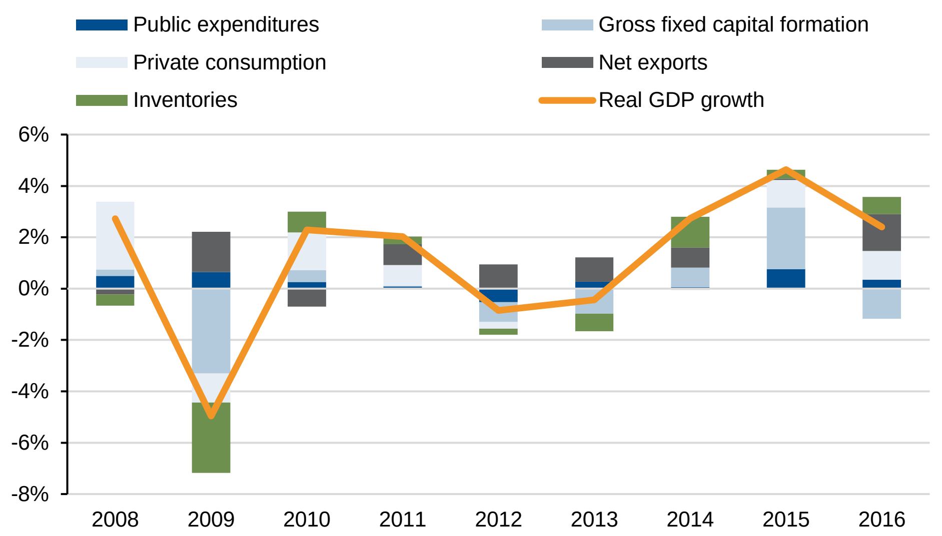
Domestic economic risk

Figure 2: Percentage point contribution to real GDP growth



Source: IMF, Calculations Scope Ratings AG

Broad, diversified economy

Real growth in the Czech Republic in recent years was well over 2% with a fair degree of volatility, reflecting the small size of the country and swings in investment[1]. The economy is broadly diversified with strong industrial activity centred on transport machinery (including aircraft), and machinery and electrical equipment. Growth is supported by very low unemployment and rising wages, which translate into strong consumer demand. The supply side of the economy is tightly integrated into global supply chains. There are no major distortions in the economy, which is open to foreign investment and shows strong product and labour market flexibility, with little labour market dualism between high-skilled and low-skilled workers, despite some skill mismatches. The economy is heavily export oriented, with exports at 80% of GDP and net exports trending upwards[2]. Trade concentration is increasing, with 55% of Czech exports coming from transportation equipment, and machinery/electrical equipment. Growth has been structured around the expansion of existing goods exports to existing markets, as well as product diversification in these markets. The sophistication of goods exported is also increasing, alleviating the negative effects of concentration.

Investments are under par, despite clear public infrastructure deficits: one estimate places annual investments necessary for just transportation at 2.5% of GDP to ensure the operation, maintenance and development of the Czech transportation infrastructure[3]. In this area, investments have lagged over the last seven years. Part of the problem is bureaucratic, with structural deficiencies in the preparation and implementation of projects due to multiple layers of administrative approval required, resulting in very long timelines of up to 15 years from initial impact assessment to project completion. Road construction is particularly subject to such problems, with many road projects behind schedule showing budget overruns and poor build quality[4].

Housing investment is lagging, with demand outpacing supply. Demand is up due to higher wages, low mortgage rates and an increasing number of households (up 19.7%

Table of Content

[1] Analysis for this section is based on research from the IMF 2017 Article IV Consultation, June 2017 (IMF Country Report 17/168), the European Commission Country Report SWD (2017) 69 final and the Financial Stability Report 2016/2017 of the Czech National Bank: hereafter, IMF, EC and CNB.
[2] IMF p 46ff
[3] EC, p. 23, citing The Transit Policy of the Czech Republic 2014-2020
[4] EC, ibid.

Investment growth under par

between 2000 and 2015, well above population growth of 2.6% over the same period)[5]. At the same time, building permits fell by 41.7% from 2008 to 2015, resulting in a serious demand overhang. Housing permits have picked up, but the construction sector remains subdued.

Heavily regulated economy

The Czech business environment is heavily regulated, with numerous administrative levels creating impediments to private-sector investment in many cases, especially for SMEs. Efforts are being made to reduce this, with progress made in several areas (it is now significantly easier to start a business, and minimum capital requirements for limited partnerships have been reduced), but the digitalisation of public services remains a problem. Administrative bureaucracy is largely a legacy issue, but it still stifles more dynamic business generation. Access to funds is not the problem, but non-bank financing is underdeveloped, with venture capital at only 0.001% of GDP vs an EU average of 0.024%[6].

Part of the problem is also the large number of SMEs. The firm dynamics of SMEs are in line with EU averages. There are, however, considerable gaps between the productivity of companies with fewer than nine employees and large corporations (250+). Small industrial companies have 34% of the productivity of large industrial companies and small services enterprises have 59% of the productivity of larger institutions, pointing to allocative efficiency problems in the economy. This is in part due to low worker mobility, cumbersome bankruptcy rules and difficulties for start-ups with bureaucracy and financing, which are, in turn, linked to demographic problems and current government fiscal priorities.

Demographics limit growth

Czech demographics are problematic, largely due to negative workforce growth rates, which, despite very high participation rates and very low unemployment, place limits on economic growth. Immigration faces significant bureaucratic hurdles and while wages show strong growth, they average out at 87% of the EU average. Long-term healthcare costs, pensions and infrastructure within an ageing society are also potential problems going forward. Current healthcare is universal and without co-payments, leading to the overconsumption of healthcare services, with expenditures per capita the third-highest in the OECD. The healthcare system shows relatively low cost efficiency with strong resistance to reform and, according to the IMF, the pension account balance will reach -2% of GDP in 2060, underscoring the long-term challenge to Czech public finances. Reforms aimed at limiting retirement are under consideration, but even if they were to be adopted, pension spending will reach 10.1% of GDP by 2060, compared to 8.5% in 2017 (if the pension age were only to be capped at 65, it would increase to 11.2% by 2060)[7].

These developments place real constraints on growth, as the workforce in the Czech Republic is at its functional limits and the relative lack of workers will hinder stronger growth going forward.

[5] EC p. 24ff
[6] EC, ibid.
[7] IMF, p. 30

Public finance risk

Sound and resilient government finances

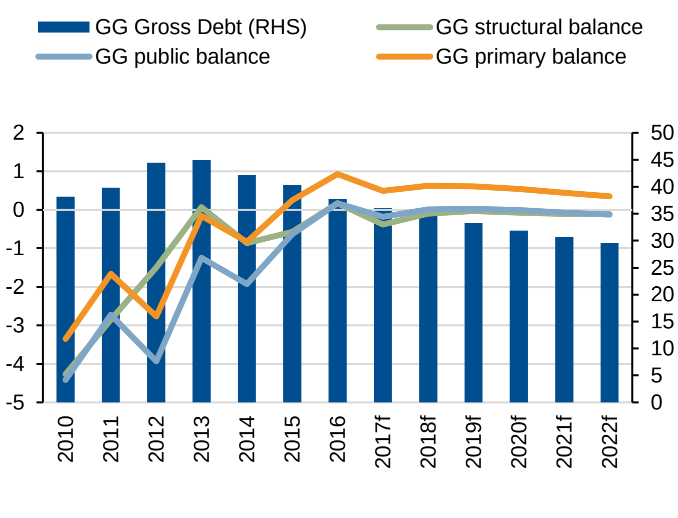
Government finances are sound and the positive primary surplus is bolstered by good revenues from taxes and social contributions, aided by strong wage growth, but also by capital underspending. Government financing needs are under 10% of GDP, interest payments as a percentage of revenues are under 1% going forward and net debt is under 10% of GDP. A new fiscal law was passed in January 2017 aimed at creating an independent fiscal council to assess compliance with fiscal rules and evaluate long-term sustainability of public finances, setting fiscal limits for both general and local governments. The fiscal rules include: a structural balance rule of -1% of GDP; debt brakes for the general government, capping debt net of cash reserves at 55% of GDP; and a 60% debt to revenue limit for local governments, with penalties for local governments in violation; as well as stricter requirements on individual government entities if numerical rules prove to be ineffective[8].

The Czech structural deficit remains below medium-term objectives – a positive development. There is a medium risk of fiscal stress over the long term, largely due to an ageing population.

Reforms needed

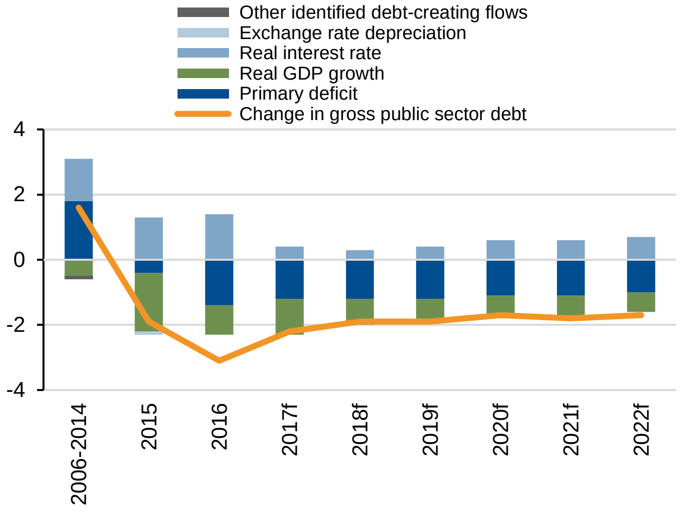
Reforms are needed to the fiscal framework in the Czech Republic, which the European Commission sees as being the weakest in the EU[9]. Expenditure ceilings have been subject to revisions and applied only to bodies within general government. Fiscal planning has not always been prudent and co-ordination mechanisms are not in place, making it difficult for the government to efficiently conduct multi-year planning. Scope believes that these deficits are being addressed by the new fiscal law.

Figure 3: Fiscal developments, % of GDP



Source: IMF

Figure 4: Debt-creating flows, % of GDP



Source: IMF

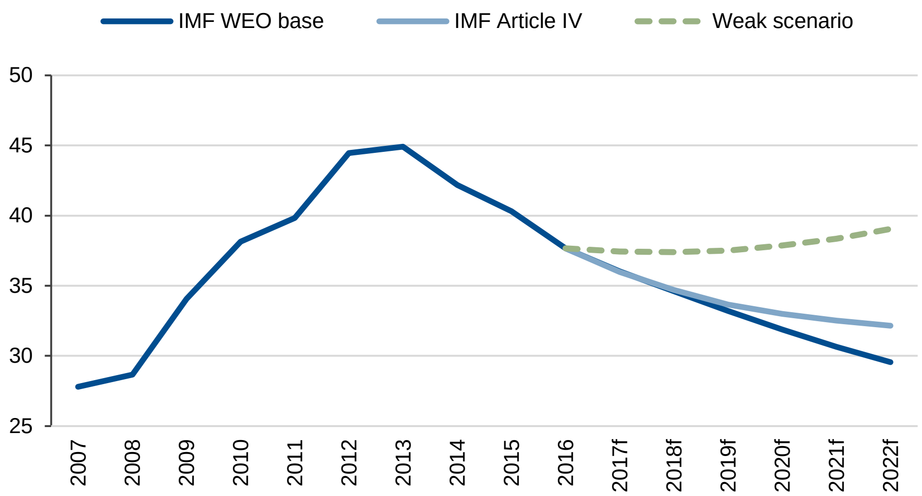
Debt sustainability strong

Debt is sustainable even under stress conditions. It was not necessary for the Czech government to expand government debt as a result of the events of the great financial crisis, leaving the country well placed in its peer group. Scope's debt sustainability analysis sees debt being drawn down to under 30% of GDP by 2022 under normal circumstances. While, under a Scope stress scenario[10], debt is no longer reduced, it does not exceed 40% and remains well under recent historical highs. Access to capital markets is strong with high levels of domestic savings.

[8] IMF, p. 26
[9] EC, p.15
[10] "Weak Scenario" in Figure 5

Government financing is aided by favourable market conditions. Of debt issuances in Q1 2017, 42.8% had maturities of one year or less, underscoring a trend to a shortened maturity structure, falling from 5.6 years at the end of 2013 to 5.1 years at the end of 2016[11]. However, the short-term debt stock of CZK 77.3 bn consists mostly of Treasury Bills (CZK 70.3 bn). While Scope does not necessarily see this as a source of risk, longer maturity periods would be prudent.

Figure 5: Debt sustainability scenarios, % of GDP



Source: IMF, Calculations Scope Ratings AG

Negative central bank equity

The Czech National Bank had negative equity for a number of years – the result of absorbing revaluation losses from having enforced the floor of the koruna-euro exchange rate[12]. Scope regards the use of revaluation accounts to reconcile as prudent, as it exposes equity to volatility rather than the bank's profit-and-loss statements. It does, however, raise the problem of the independence of the CNB under such circumstances, since central banks in such a situation may seek capital injections from the Ministry of Finance and hence become politically compromised, especially if a weak capital position leads to a large deviation from inflation targets[13]. Scope sees negative equity at the Czech National Bank as prudent based on reaching inflation targets and maintaining financial stability. Stress testing of the banking system in the Czech Republic has been exemplary[14] and Scope does not see any hindrances to the CNB's ability to achieve policy objectives. This is aided by the current interest rate regime, where domestic interest rates have declined to the point at which yield on acquired foreign reserves exceeds yield on instruments issued to finance reserve accumulation[15]. Risk to banks from exposure to Czech government debt is well under supervisory thresholds[16], further underscoring the strength of the Czech financial system.

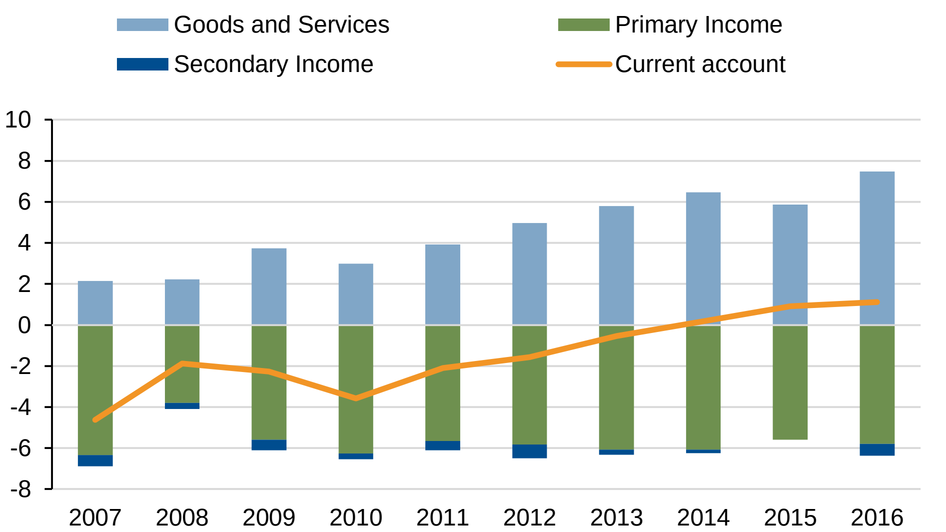
[11] Debt and Financial Assets Management Department
[12] Detailed in: Central Bank Finances, BIS Papers Nº. 71, p. 52
[13] Adler, Gustavo; Castro, Pedro; Tovar, Camilo E. "Does Central Bank Capital Matter for Monetary Policy?", IMF Working Paper WP/12/60, Feb 2012
[14] Ramlall, Indranarain: Central Bank Rating: A New Methodology for Global Excellence, Palgrave Macmillan, 2016
[15] Milton, Sue; Sinclair, Peter: The Capital Needs of Central Banks, Routledge 2011, p. 56
[16] CNB p. 71ff

External economic risk

Current account stable

The current account does not raise significant competitiveness concerns and is expected to remain stable[17]. It will be affected by modest appreciation of the koruna. Large surpluses in goods balances are offset by deficits in income, driven by returns on a large FDI stock. External debt is modest (75% of GDP in 2016) and largely long-term, reflecting loans across affiliated corporations. Scope believes the economy to be highly resilient to short-term shocks, albeit with vulnerabilities to downturns in the economies of major trading partners. Recent movements in the financial account point to stronger appetites for koruna-denominated assets, driven in part by speculation on currency appreciation (the koruna is considered by the IMF to be undervalued) and portfolio inflows driven by demand for government securities. Liabilities in the financial account stem from increases in short-term deposits with domestic banks and rises in reserve assets driven by CNB FX interventions. External liabilities are largely long-term, providing a cushion for the current account. The koruna is expected to appreciate over the medium term if the national income converges towards the European mean and if concentration in manufacturing does not intensify. This appreciation could occur if growth were to accelerate.

Figure 6: Breakdown of current account balance, % of GDP



Source: IMF, Calculations Scope Ratings AG

Financial stability risk

Removal of koruna floor successful

The recent removal of the floor on the koruna-euro exchange rate, first established in 2013 to protect industry from exchange rate variations, was orderly and did not lead to major swings in the currency, despite relatively large speculative inflows into the Czech Republic in advance of this[18]. The Czech National Bank has exhibited a strong commitment to financial stability and while the koruna has appreciated somewhat against major trading partners, the CNB continues to actively ensure that exchange rate movements are moderate. Inflation is low, with an overall average inflation over the last ten years of 2.1%.

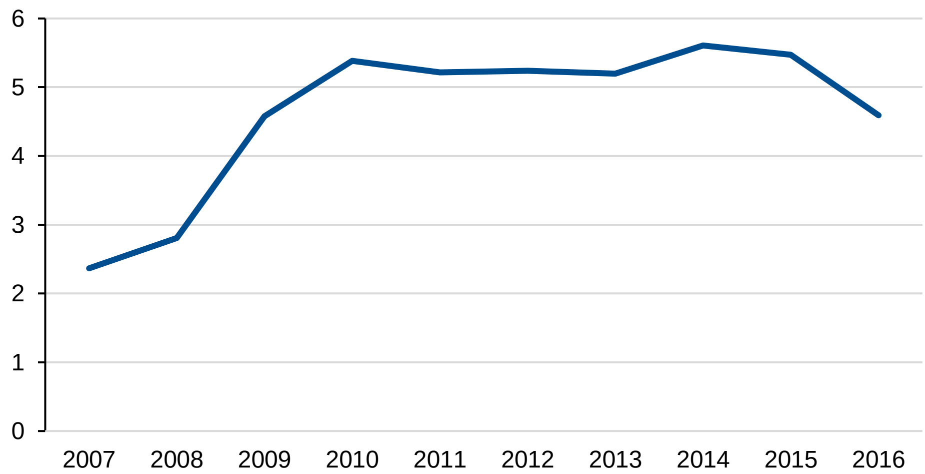
The banking sector is resilient with strong profitability[19]. It is highly concentrated with virtually no small- or medium-sized banks, the result of a strong consolidation process

[17] IMF,p. 42
[18] https://www.ft.com/content/f2636611-e5c3-354e-b467-c568942698f1?mhq5j=e1
[19] Černohorská, Liběna, Impact of financial crisis on the stability banking sectors in the Czech Republic and Great Britain, 4th World Conference on Business, Economics and Management, WCBEM, Procedia Economics and Finance 26 (2015) p 234-241

after bank privatisation and a post-privatisation clear-out of non-performing loans. This early consolidation means that there were no new oversight[20] rules or agencies introduced after the great financial crisis. Financial intermediation is almost wholly foreign owned. Banks are highly capitalised, margins are among the strongest in Europe and overall, the banking sector shows high profitability. Largely domestically oriented, the banking sector was not exposed during the great financial crisis, but did see the effects of decreased demand from trading partners indirectly.

The strong growth of loans to households for housing and consumption are driven by strong wage growth, resulting in robust banking profits and low risks. This, coupled with a high propensity to save in a conservative Czech workforce and low interest rates on savings, has led to strong bank profitability[21]. Assets of the banking sector are sound, with total assets at 133.2% of GDP in 2016. In 2015, the five largest banks shared over 63% of total assets, foreign ownership stood at over 88%. All banks in the Czech Republic are universal banks, reducing cluster risks. Fund generation is largely domestic, and Scope considers bank capitalisation to be prudent. Some cyclical and structural risks exist due to rises in maturity deposits and loans, an increasing share of non-residents in the domestic debt securities market and growing concentration of bank exposure to residential and commercial properties[22]. The banking sector exposure to Czech government debt was deemed by the CNB to be systematically important, but well under supervisory thresholds[23]. Capital outflows are largely governed by the repatriation of FDI profits[24].

Figure 7: Non-performing loans, % of total loans



Source: IMF

Institutional and political risk

Scope views the political situation in the Czech Republic as stable, despite recent political tensions within the coalition. Elections are planned for October of 2017. The government coalition of CSSD, KDU-SL and ANO represents a broad, centrist programme and centre-right opposition parties are currently polling at under 10%.

The government faces the challenge of drawing down debt further while implementing numerous reforms aimed at improving long-term planning, reducing bureaucratic

[20] Oversight is exclusively via Czech National Bank
[21] Dubská, Drahomíra, The Czech Banking Sector; Two Decades with the Shuttle Changes, Statistika, 2013, 93(1), p.71 ff
[22] CNB, p.11
[23] CNB, p. 71ff
[24] IMF, p.42

overhead, increasing government transparency (and hence reducing corruption) and bringing the Czech transportation infrastructure up to euro area norms. Although Scope believes that the Czech Republic faces some geopolitical risks due to heavy usage of natural gas and dependence on supplies from Russia via Ukrainian pipelines, these risks are not elevated. Overall, Scope sees the political constellation in the Czech Republic as credit positive, notwithstanding contrasting policy positions of coalition members heading into the election. Proportional voting systems tend to produce coalition governments and Scope does not expect any sharp turns in economic policy post-election.

The current government has been criticised by the IMF: rather than drawing down debt, the IMF feels that future fiscal policy should place emphasis on productivity gains to raise growth potential via investment in education and training, and emphasised the need for wider-reaching public administration reforms that increase the effectiveness of public sector investments. Currently, there are no unified and transparent plans for infrastructure development over a longer horizon and no measures are being put in place to improve government productivity[25]. Furthermore, the IMF estimates that a primary balance of -0.6% is consistent with constant debt in perpetuity at a ratio of 37.2% of GDP. The IMF believes this level would provide the government with significant fiscal space[26].

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-registration.
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.

[25] IMF, p. 31
[26] IMF, p. 30

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 3 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.

Combined relative credit strengths and weaknesses generate a three notch adjustment and signal a sovereign rating at AA for the Czech Republic.

A rating committee 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 rating score. 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		QS					
		Maximum adjustment = 3 notches					
Rating Indicator	Category weight		+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Domestic Economic Risk	**35%**	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 Growth Real GDP growth Real GDP volatility GDP per capita Inflation rate		Economic policy framework	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Labour & Population Unemployment Rate Population growth		Macroeconomic stability and imbalances	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Public Finance Risk	**30%**	Fiscal Performance	○ Exceptionally strong performance	◉ Strong performance	○ Neutral	○ Weak performance	○ Problematic performance
Fiscal Balance GG Public Balance GG Primary Balance GG Gross Financing Needs		Debt Sustainability	○ Exceptionally strong sustainability	◉ Strong sustainability	○ Neutral	○ Weak sustainability	○ Not sustainable
Public Debt GG Net Debt Interest Payments		Market access and Funding Sources	○ Excellent access	◉ Very good access	○ Neutral	○ Poor access	○ Very weak access
External Economic Risk	**15%**	Current account vulnerabilities	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
International Position IIP Importance of Currency		External debt sustainability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Curr. Acc. Financing Cur. account bal. T-W effective Exch. Rate Total External Debt		Vulnerability to short-term shocks	○ Excellent resilience	◉ Good resilience	○ Neutral	○ Vulnerable to shock	○ Strongly vulnerable to shocks
Institutional and Political Risk	**10%**	Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Control of Corruption Voice & Accountability		Recent events and policy decisions	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Rule of Law		Geo-political risk	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial Risk	**10%**	Financial sector performance	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
NPL Liquid Assets		Financial sector oversight and governance	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Credit to GDP gap		Macro-financial vulnerabilities and fragility	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Indicative Rating Range	**a**	* 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					
QS adjustment	**AA**						
Final rating	**AA**						

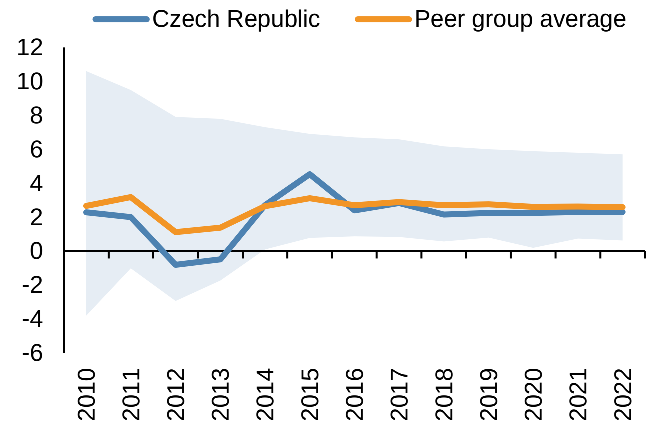
Source: Scope Ratings AG

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.

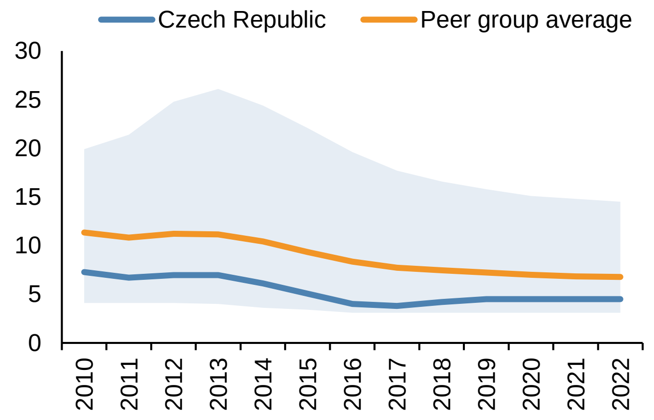
III. Appendix: Peer Comparison

Figure 8: Real GDP growth



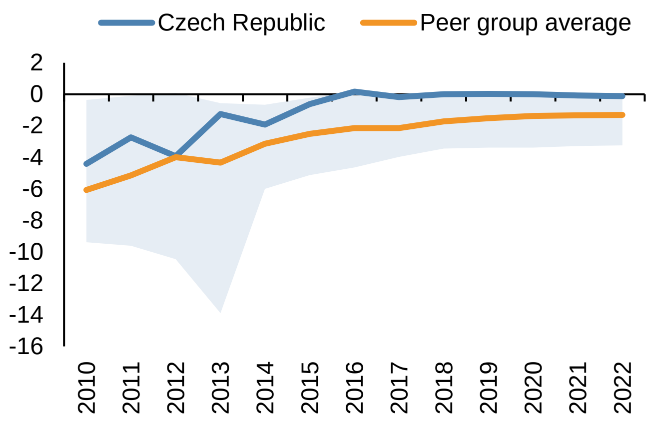
Source: IMF, calculations Scope Ratings AG

Figure 9: Unemployment rate, % total labour force



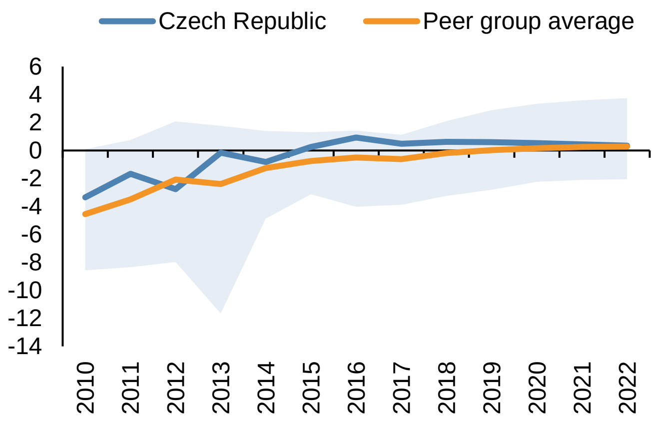
Source: IMF, calculations Scope Ratings AG

Figure 10: General government balance, % of GDP



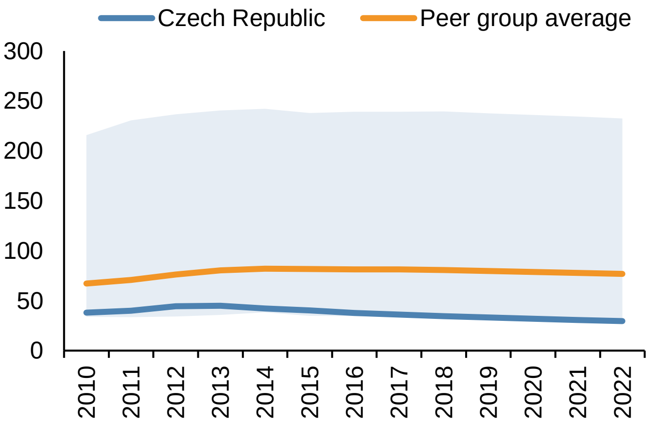
Source: IMF, Calculation Scope Ratings AG

Figure 11: General government primary balance, % of GDP



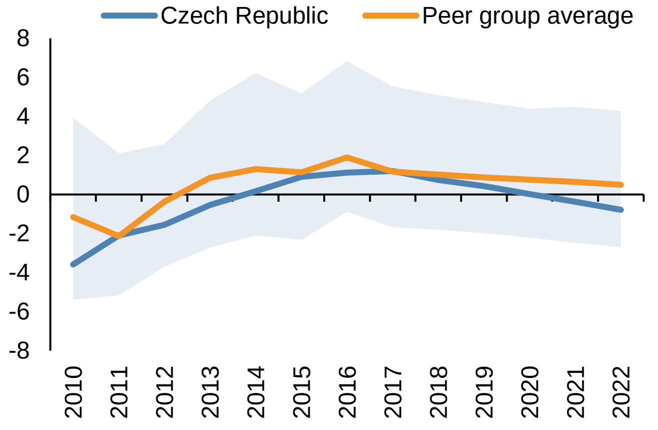
Source: IMF, Calculations Scope Ratings AG

Figure 12: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings AG

Figure 13: Current-account balance, % of GDP



Source: IMF, Calculations Scope Ratings AG

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	4,554.6	4,716.1	4,936.0	5,111.1
Population ('000s)	10,586.8	10,594.5	10,598.5	10,603.8	10,610.9	10,618.3	10,625.3
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	432,197.4	446,864.8	466,600.0	481,930.4
Real GDP growth, % change	-0.8	-0.5	2.7	4.5	2.4	2.8	2.2
GDP growth volatility (10-year rolling SD)	3.6	3.7	3.6	3.4	3.0	2.7	2.7
CPI, % change	3.29	1.43	0.34	0.34	0.69	2.30	1.80
Unemployment rate (%)	7.0	7.0	6.1	5.0	4.0	3.8	4.2
Investment (% of GDP)	26.2	24.7	25.9	27.4	26.2	26.2	26.1
Gross national savings (% of GDP)	24.6	24.1	26.1	28.3	27.3	27.4	26.8
Public finances							
Net lending/borrowing (% of GDP)	-3.9	-1.2	-1.9	-0.6	0.2	-0.2	0.0
Primary net lending/borrowing (% of GDP)	-2.8	-0.2	-0.8	0.3	0.9	0.5	0.6
Revenue (% of GDP)	40.6	41.4	40.3	41.3	40.9	40.8	41.1
Expenditure (% of GDP)	44.5	42.6	42.2	42.0	40.7	41.0	41.1
Net interest payments (% of GDP)	1.2	1.1	1.1	0.9	0.8	0.7	0.6
Net interest payments (% of revenue)	2.9	2.6	2.7	2.1	1.9	1.6	1.5
Gross debt (% of GDP)	44.5	44.9	42.2	40.3	37.7	36.0	34.6
Net debt (% of GDP)	-	-	-	-	-	-	-
Gross debt (% of revenue)	109.7	108.6	104.6	97.5	92.2	88.3	84.3
External vulnerability							
Gross external debt (% of GDP)	60.0	63.2	69.6	70.8	74.9	-	-
Net external debt (% of GDP)	-1.1	-5.1	-4.5	-8.3	-13.7	-	-
Current-account balance (% of GDP)	-1.6	-0.5	0.2	0.9	1.1	1.2	0.8
Trade balance [FOB] (% of GDP)	-	4.1	5.1	4.5	5.3	5.0	4.8
Net direct investment (% of GDP)	-3.0	0.2	-1.9	1.1	-3.0	-	-
Official forex reserves (EOP, USD m)	37,437.9	48,454.5	49,724.2	61,260.8	82,815.2	-	-
REER, % change	-2.8%	-2.3%	-5.2%	-0.7%	2.5%	-	-
Nominal exchange rate (EOP, USD/CZK)	0.1	0.1	0.0	0.0	0.0	-	-
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	16.3	16.2	-	-
Consolidated private debt (% of GDP)	70.7	73.7	71.5	68.0	-	-	-
Domestic credit-to-GDP gap (%)	16.1	16.2	10.9	1.0	-0.4	-	-

Source: IMF, European Commission, European Central Bank, World Bank, United Nations, Scope Ratings AG

V. Regulatory disclosures

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

Rating prepared by John F. Opie, Lead Analyst

Person responsible for approval of the rating: Karlo Stefan Fuchs, Executive Director

The ratings/outlook were first assigned by Scope as a subscription rating in January 2003. The subscription ratings/outlooks were last updated in 05.05.2017.

The senior unsecured debt ratings as well as the short term issuer ratings were assigned by Scope for the first time.

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 2017" published on 21.07.2017 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, (4) the declining population and pressures this creates on the reform programme and investments. The committee also discussed the dependency of the Czech Republic on foreign capital inflows and its exposure to 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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