**Economic Analysis of the Czech Republic**

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**Your Company:** Amazon.com, Inc. (Amazon)

1. **What are the Czech Republic’s overall levels of trade (exports and imports) and what are the most important products imported and exported?**

Overall level of exports: 30th largest export economy of 221 countries, with $152B in exports in 2016 (Simoes, 2017).

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| *Figure 1: Top 5 Exports 2016* | |
| **Value (billion US$)** | **Product** |
| 18.40 | Cars |
| 12.80 | Vehicle Parts |
| 7.21 | Computers |
| 2.74 | Telephones |
| 2.29 | Insulated Wire |

Overall level of imports: 29th largest import economy of 221 countries, with $140B in imports in 2016 (Simoes, 2017).

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| *Figure 2: Top 5 Imports 2016* | |
| **Value (billion US$)** | **Product** |
| 8.58 | Vehicle Parts |
| 6.51 | Computers |
| 3.89 | Cars |
| 3.31 | Packaged Medicaments |
| 2.92 | Broadcasting Equipment |

1. **Which are the Czech Republic’s most important trade partners (other countries) and what are its levels of FDI (inflows and outflows) with other countries (and which are the most important countries)?**

Germany is the Czech Republic’s most important trade partner by far historically and currently, with 30% of their exports going there and 27% of imports coming from there as well. China is an emerging partner, contributing to 12% of Czech imports (Simoes, 2017). Germany is a major source of FDI also, but the Netherlands take the largest share of both FDI inflows and outflows from the Czech Republic with 23.4% and 33.9% respectively (Nejman, 2018).

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| *Figure 3: Top 5 Export Partners*  *2016* | |
| **Value (billion US$)** | **Country** |
| 46.00 | Germany |
| 11.10 | Slovakia |
| 7.67 | United Kingdom |
| 7.56 | France |
| 7.50 | Poland |

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| *Figure 4: Top 5 Import Partners 2016* | |
| **Value (billion US$)** | **Product** |
| 37.90 | Germany |
| 17.30 | China |
| 11.70 | Poland |
| 7.47 | Slovakia |
| 6.04 | Italy |

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| *Figure 5: Top 5 Sources of FDI*  *2016* | |
| **Value (% of total 3,124.2 billion korunas)** | **Country** |
| 23.4 | Netherlands |
| 14.1 | Germany |
| 11.9 | Luxembourg |
| 11.0 | Austria |
| 7.8 | France |

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| *Figure 6: Top 5 Targets of FDI 2016* | |
| **Value (% of total 498.1 billion korunas)** | **Country** |
| 33.9 | Netherlands |
| 15.9 | Slovakia |
| 9.9 | Cyprus |
| 5.3 | Romania |
| 4.9 | Luxembourg |

1. **What percentage of the FDI inflows are “capital formation”, what percentage are “portfolio” investments?**

As of June 14th in the Czech Republic in 2018, capital formation inflow amounted to 24,569.3 million korunas. Portfolio investment inflow meanwhile was 44,226.0 million korunas. Both of these increased from the previous year. The total foreign direct investment inflow (calculated by adding direct investment, portfolio, and other liabilities) was 148,177.5 million korunas. This put the percentage of capital formation at 16.58% and portfolio investment at 29.85% of FDI inflows (CNB, 2018). In other words, a large percentage of foreign direct investment inflows to the Czech Republic are passive, such as investing in appreciating assets like equity and real estate. Somewhat less goes toward physically building home company assets, such as factories and office buildings. This is exemplified in Amazon’s recent activity in the Czech Republic, as they once more began buying office space and building facilities that will hold new employees.

1. **Given all the EU’s external trade agreements (i.e., non-EU countries), are there any that are particularly important to the Czech Republic?**

88% of Czech exports go to EU countries, so any change in external trade partnerships with the EU could have a ripple effect (Workman, 2018). Two EU trade agreements are currently under negotiation that could have especial impact on the Czech Republic’s economy: the EU-China Investment Agreement that began negotiations in 2013, and the Transatlantic Trade and Investment Partnership with the US that also began in 2013 but were put on indefinite hold in 2016 (European Commission, 2018). Both of these countries are important trade partners for the Czech Republic, and successful agreements could facilitate trade tremendously while failure could damage or even remove some of the most important players from the Czech economy.

The Czech Republic itself has a Bilateral Investment Treaty with the US in addition to being a GATT signatory and a member of multilateral organizations such as the WTO (ITA, 2018). Their main regional treaty comes with policies enacted to avoid double taxation over goods and services traveling between the countries, as well as a general lowering of trade barriers between the two nations. Month to month the Czech Republic exports more to the US than it imports from there, with 2017’s net trade outflow of 2.319B USD being indicative of the annual average (US Census Bureau, 2009). Outside of the EU, the US is a profitable buyer for the Czech Republic’s export-based economy and the two nations are politically amicable.

Some trade is also done with China, and it is a major partner for the cheap import of manufacturing supplies. This is likely to change soon however as the Czech Republic transitions from a manufacturing economy to a services-based one, if the many current disputes lodged against China’s practices do not incite punitive measures first. A relatively negligible amount of trade in cheap resources also occurs with developing countries--such as Brazil, India, and Turkey--and transitioning economies, such as the Russian Federation and Ukraine (MPO, 2018).

1. **Based on the most recent data you can find, what is the exchange rate of the koruna *vis* *a vis* the dollar and how volatile is the koruna?**

Current data has the exchange rate at roughly 22 korunas to the US dollar; more precisely, 22.1635:1 as of June 24, 2018 (Investing, 2018). Volatility was expected to increase after the removal of the floor against the euro, and has had an average volatility level of 11.69% over the last 2 years (Tukiainen, 2018). As the highest mean volatility of the koruna has been 32.99% and the lowest 4.74%, the change in the local currency does not seem to have affected the system relatively much in the short term (Winfrey, 2017). Indeed, it seems to be continuing its legacy of helping its country weather changes (which its people tend to dislike), such as the 2008 recession. When compared to the euro this general stability yet slight increased volatility from the removal of the exchange rate cap are further confirmed, as the euro’s volatility over the past 2 years has been an average of 9.90% (Vlab, 2018).

1. **Over the last 3 years, has the koruna appreciated or depreciated relative to the dollar, and by how much?**

From 2015 to 2017 the koruna depreciated 10% on average relative to the dollar with an 11 year low of 13.8% depreciation in 2015, as it was dragged down by ties to the euro which depreciated against the US dollar during that time when investments after the 2008 recession began failing (Johnstone, 2015). In 2017 alone however, the koruna appreciated 16% relative to the dollar, as a cap on the value of the koruna was removed in April 2017 when the Czech National Bank ended their exchange rate floor with the euro --previously 27:1 to make sure the koruna’s growing strength would not add to disinflationary pressures (Chisholm, 2017). This rapid and continuing appreciation has increased the value of the koruna, made import prices lower, and kept inflation low; leading to local consumers attached to their prosperous currency and unwilling to switch to the euro despite it being a requirement of EU membership.

1. **What sort of currency management “system” does the Czech Republic use? How has this impacted prices in the Czech Republic?**

As of 2017, the Czech Republic was under a stabilized arrangement (ie, a fixed rate system with an official exchange rate relative to the floating euro, rather than floating itself wherever the market determines the rate should be), as is common with smaller countries. The country was and is using the koruna as legal tender, and has been in an inflation-targeting framework with a de facto exchange rate to the euro (IMF, 2016). The exchange rate floor against the euro enacted in 2013 to artificially keep the koruna’s value low successfully created a stable inflation rate of just over 2%. This, compounded with wage increase battles due to very low unemployment, has allowed Czechs to achieve relatively profitable incomes. With the cap removed in April 2017 and the economy transitioning to more of a soft fix during the period of ensuing volatility, the koruna quickly appreciated against the dollar and reduced import prices with its gained value, creating an even more favorable environment for local consumers. These factors contribute to a popular unwillingness to adopt the euro, which as Great Britain experienced when they gave it a trial run will not only reduce Czech sovereignty, but pull prosperous currencies to their average value, increasing prices in the country.

1. **Which of the economic dimensions noted above would be important for your company?**

Appreciation of the koruna could create an opening for Amazon as an already-cheap import option for a wide array of both everyday and special goods. They will be attractive to consumers who will likely weigh how good the pricing is as more important than any historical concern with online security. International online services are also more or less immune to fluctuations in local currency, and the minor volatility of the koruna after the removal of the cap would not pose the same problem it would to local competitors, creating another potential window of opportunity to frame Amazon as the cheapest quality option available. This is also an indication of the stability of the Czech Republic, making it a safe option for Amazon; political uprisings are unlikely to occur, volatility of the koruna is relatively low, and there is an able workforce.

Sentiments toward the US are generally friendly as well, considering the willingness to create a bilateral treaty; there would not be the animosity towards trading with a US company that many European international companies face in the Czech Republic, as a result of negative attitudes toward the EU that many (generally older) Czechs feel. This is not to mention the decreased trade barriers and lack of double taxation between the nations as negotiated by the treaty. It would also help that Amazon would need to create jobs in the Czech Republic to sustain their new facilities for office space, distribution, and more. These jobs would help offset the unemployment rates currently raising wages unnaturally, as well as bring in capital investment. Since the capital investment percentage of foreign direct investment inflows is not currently very high, the Czech Republic would welcome Amazon cash and likely offer incentives for them to build in their country rather than just invest in equity and the like.

1. **Is there any other important information regarding the Czech Republic’s economic situation not covered above?**

An important factor in the Czech economy now is the nearly-full employment rate, with unemployment currently at 2.8% thanks in part to an aging population and strong anti-immigration sentiments. Companies are competing for employees by raising wages, which may counteract recent deflationary measures such as the purposeful devaluation of the koruna. Long-term sustainability of the current high GDP growth rate will also be strained while the country transitions from manufacturing to a services-based economy.

A second factor is that the country will eventually have to change from the koruna to the euro to comply with EU standards and the Maastricht Treaty’s Ascension Requirements, despite it not being a small economy which tend to be more receptive to the euro’s benefits. This will remove the koruna’s ability to weather external forces on the economy, bring prices into line (decreased) with those of the rest of the EU, and possibly revert recent successes against inflation. However, it would end the minor current exchange rate volatility after the removal of the euro to koruna cap, as well as provide the support of the ECB.

1. **Taking all this economic information about the Czech Republic into account, write a short, one-paragraph description of the Czech Republic’s economic status. In your answer be sure to highlight those factors that you think are most important drivers in the country’s economy.**

As cited in previous sections of this report, the Czech Republic is currently a welcoming and rapidly-growing fixed-rate market economy with strong trade relations throughout the EU and with the US. As an export-based economy (around 80% of their GDP, primarily in automobiles), the nation was vulnerable to the sudden decrease in demand from Germany and other trade partners during and after the 2008 recession. This was reflected in their own minor recessions in 2012 and 2013. However, having a local currency that could weather the effects--and pay off household debt even with the USD supply shrunken--better than the internationally-linked euro allowed the Czech Republic to take manageable losses and come back a few years later as the fastest-growing economy in the EU at around 4% growth annually. The nation also has incredibly low unemployment and inflation at about the same number: 2.3%. The latter was thanks to a cap on the koruna enacted in 2013 keeping the value of the koruna low (27:1 against the euro). This cap was recently removed, drastically appreciating the local currency and reducing import prices as well as invigorating belief and pride in the sovereignty of the economy after a distressed history. Foreign direct investment is another indicator of this, with high overall numbers of investment and a sizable portion of it being in capital formation, demonstrating a trust in the country’s political and otherwise stability (including relatively low currency volatility) and prosperous economy among investing companies. The future is uncertain but hopeful; although extremely low unemployment is raising wages unnaturally, trade is set to strengthen outside of the EU with countries the Czech Republic already favors (such as China and the US).

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