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CZECH REPUBLIC

## Czech PMI remains in contraction zone despite some relief

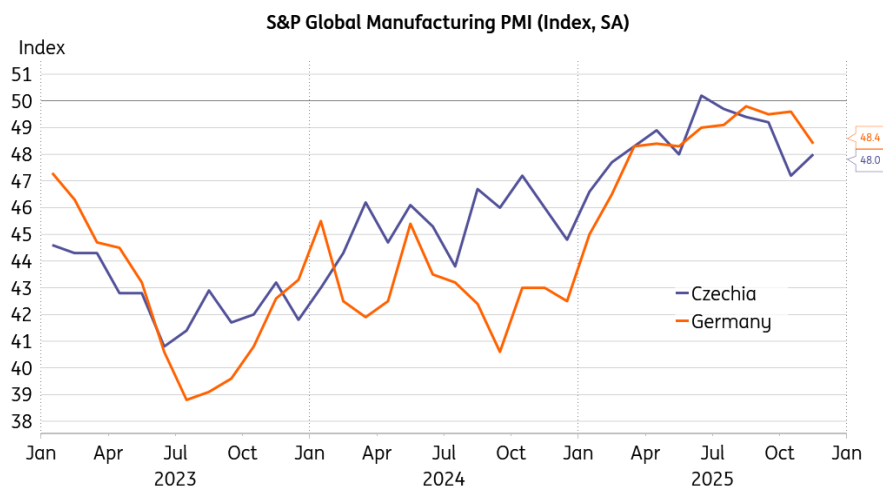
The PMI picked up but remained in the contraction zone. Czech firms are seeking overseas customers, as demand from the eurozone's most prominent trading partners remains lukewarm. Supply chain disruptions linked to Chinese export controls point to rising input and output prices amid falling production – a classic negative supply shock. Voilà



### Output falls while price level rises

The Czech PMI remains below the expansion threshold at 48.0 points, but improved slightly above market expectations. Operating conditions deteriorated to a lesser extent in November than previously, thanks to a less pronounced decline in overall new orders. Export orders expanded for the first time since February 2022, predominantly driven by efforts to find new export markets and clients to help manufacturers increase international sales. That said, November's production still fell faster than in the preceding month, mainly due to supply chain issues. Operating conditions have deteriorated at a moderate pace for the fifth month in a row, as manufacturers remain cautious amid still subdued business confidence. Due to challenging demand conditions, companies again reduced headcount and input purchases as part of cost-reduction efforts.

## Too bad for too long: what now?



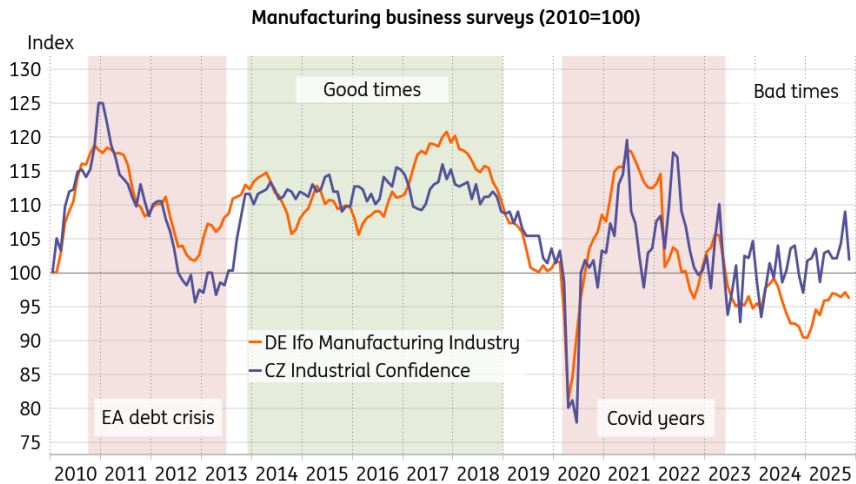
Source: S&P Global, Macrobond

However, inflationary pressures rose in November after output prices increased for the first time in six months, driven by a sharper rise in input prices. Higher costs were linked to supply shortages and higher energy prices. Production inventories continued to fall at a noticeable pace in November, while finished goods inventories registered a renewed decline, as Czech manufacturers aimed to reduce costs. Pressures on supply chains have intensified, for example, through shortages of some commodities after China tightened export controls. Voilà! A negative supply shock is here – producing less, but at higher prices.

## The EU is still on the move in its correspondence chess approach

Czech firms seem to have an appetite to evolve, find new customers, and invest. The still-subdued demand from the main eurozone trading partners is the decisive limiting factor, along with more severe supply chain issues, and the difficult-to-navigate European economic landscape. The outlook for Czech industry is far from bleak. Yet, we seem to stand at a crossroads: i) a sustainable liftoff together with the eurozone's trading partners, or ii) a descent into the abyss of industrial history.

## Not exactly a party-like mood in manufacturing

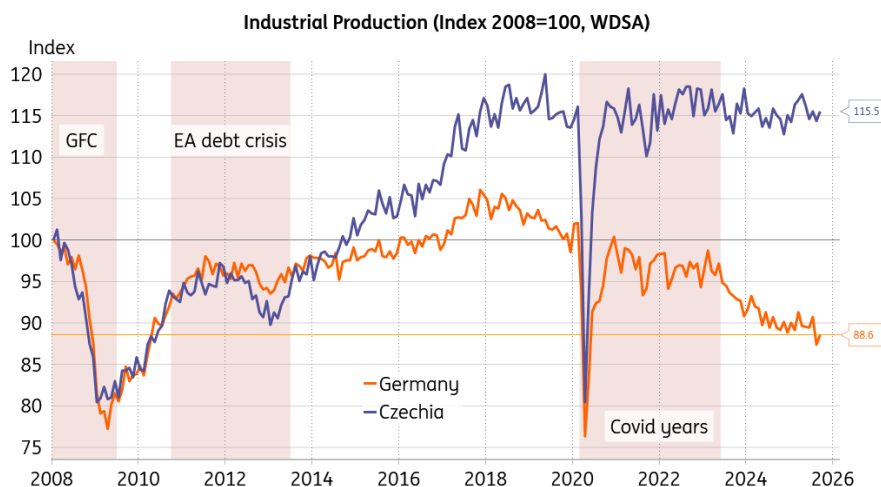


Source: Macrobond

Looking at business confidence in the longer term, it's clear that the good times for European manufacturing are long gone. We see that the mood can be pretty upbeat and stable in good times, such as between 2014 and 2018. However, this is becoming a distant memory, as confidence levels have remained depressed after the pandemic, close to the bottom of the eurozone debt crisis.

Indeed, confidence in the industry is, for all the right reasons, ripe for a series of sessions on Sigmund Freud's couch. This reality is underscored by the fact that industrial production in Czechia has been suffering from stagnation since 2018. Meanwhile, production in Czechia's most significant trading partner - Germany - has experienced a steady decline over the same period, now sliding back to levels last seen in 2010. This is no trivial matter, and whether we like it or not, it inevitably weighs on the EU's overall economic performance.

## Czech industrial output remains in limbo



Source: Macrobond

In any case, the evidence suggesting that Czech industry is gradually decoupling from its troubled German counterpart appears to be mounting. How will this dismal story ultimately play out? The outcome will largely depend on whether – and how – the EU tackles its well-known, long-ignored, yet still pressing challenges that continue to stifle growth and investment incentives.

This raises an important question: What decisive policies has the European Commission adopted over the past decade to strengthen the position of Europe’s industrial base? Meanwhile, pressure from member states is intensifying. Global competition remains fierce, and under all circumstances, the old maxim holds true: *Non progredi est regredi* – not to advance is to retreat.

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