

EVOLUTION OF THE CAPITAL MARKET AND MACROECONOMICS OF AN EMERGING MARKET. CASE STUDY FOR THE CZECH REPUBLIC

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Abstract

The economic and financial state of an emerging European country is undeniably closely related to the evolution and mechanisms that engage the European Union markets. The objective of this paper is to analyze in parallel the macroeconomic and capital market evolution of the Czech Republic, in the context of integration at European level, in order to highlight these connections and compare the path of these indicators with those of other emerging European countries.

This paper studies the contagion of emerging markets to events that create inflections of markets at international level, as well as the correlations between the stock market and macroeconomic indices, in order to highlight those factors that lead to a direct influence of the macroeconomic and stock market environment. Through a descriptive analysis of the most relevant capital market indicators and macroeconomics, the study empirically addresses the evolution of the Prague stock exchange in parallel with the economic condition of the Czech Republic, finding similarities and differences in the behavior of these indices. For this analysis, the following indicators were selected: the total value of the traded shares, the number of domestic companies listed on the stock exchange, GDP per Capita, the annual evolution of GDP, the consumer price index, foreign direct investments, net inflows, as well as the current account balance. The study may represent a starting point in a broader analysis of the correlations of the economic and financial mechanisms that are based on the phenomenon of globalization, leading to the determination of common factors that affect the emerging markets in similar stages of development.

Keywords: Czech Republic, macroeconomic indicators, capital market, globalisation

Clasificare JEL : E03, F62, F65

1. Introduction and context of the study

Member of the European Union since 2004, with a similar course to Poland in terms of transition to the Western economy. With an economy focused on industry (28%) and a level of exports of 80% intra-Community, of which more than 30% to Germany, according to the statistical data provided by the EU for 2020, the Czech Republic has integrated into the European economy bringing an important contribution in the technological and industrial field. The Czech republic's transition from a closed economy like Czechoslovakia to a free market was a successful one. Comparing it to neighboring economies, Czechoslovakia benefited from relatively favorable conditions, which facilitated the economic reforms that occurred after the fall of the communist bloc. The stable monetary policy of the socialist period and the low external debt compared to Hungary and Poland were essential factors in reshaping the macroeconomic and financial environment and adapting to the new challenges offered by the Western competitive environment.

2. Evolution of the capital market and macroeconomics of Czech Republic

The Czech Republic has one of the most developed former communist markets, with the advantage of an economy based on industry and innovation, which gives it sustainable development. Even though the Czech Republic has the internal economic and financial resources for a viable development, its integration at European level has a considerable impact on the

indicators recorded, the analysis below wanting to highlight the causal factors that determined the course of the Czech market in the period 2000-2020.

The degree of globalization of the Czech Republic is also proven by its geo-political status within the European Union, noting that it has been an EU Member State since 2004, as well as a member of the Schengen area since 2007.

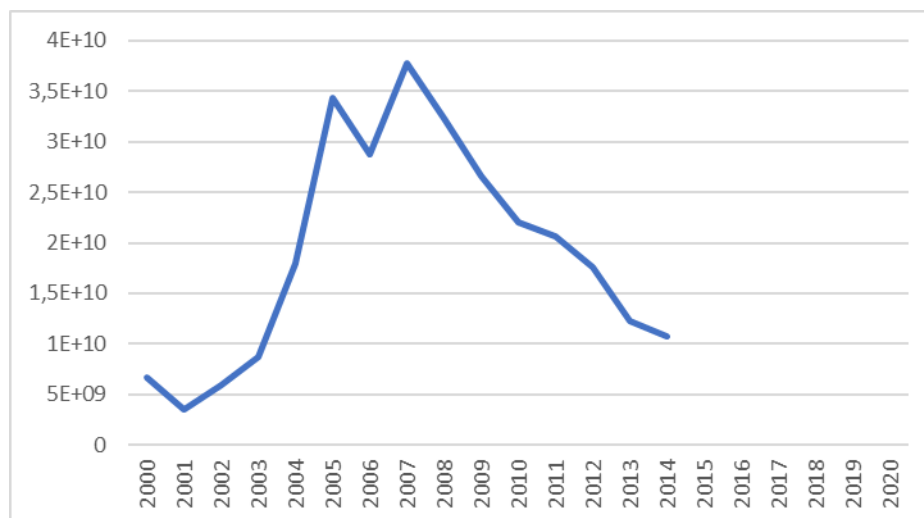


Figure 1. The total value of the shares traded in the Czech Republic (US\$)

Source: processing according to the data available on the <https://data.worldbank.org>

Regarding the total volume of traded shares, an indicator whose values were not officially indexed in 2015-2020, we note an extremely accelerated ascent in the two years leading up to accession to the European market. This high level remained for a short period of time, with the 2008 crisis radically affecting the Czech capital market. It is worth mentioning that this regression was not a sudden one, and then followed by a stabilisation, as happened in the case of Poland, we identify similarities in the evolution of this indicator rather in the history of the Hungarian capital market. The steady downward trend recorded by the Czech Republic in terms of shares traded on the Exchange continued over a longer period of time, which is why we can say that the Czech Republic faced the effects of the economic crisis in the medium and long term.

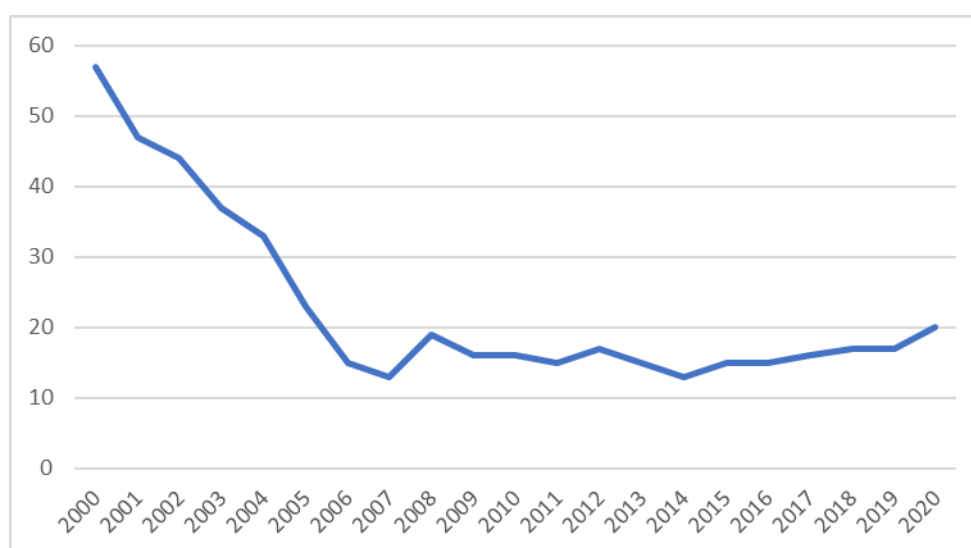


Figure 2. Local companies from the Czech Republic listed on the stock exchange

Source: processing according to data available on the <https://data.worldbank.org>

As we have noted in previous analyses in the case of the number of domestic companies listed on the stock exchange, we can see that this indicator was not in an obvious correlation with the other indicators of the capital market. In the case of the Czech Republic, the number of listed companies decreased significantly in the period 2000-2006, and in the post-crisis period this indicator stabilized at values between 13 and 20.

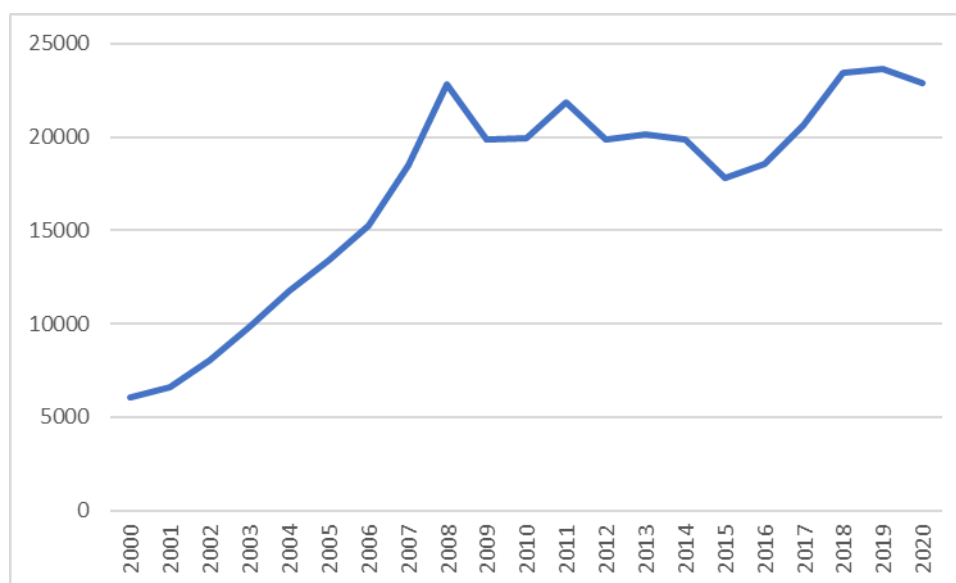


Figure 3. GDP per Capita in Czech Republic (US\$)

Source: processing according to data available on the <https://data.worldbank.org>

From a macroeconomic point of view, the Czech Republic has overall developed positively. Considering the GDP per capita indicator to be the most relevant in analyzing the living standards of the population, we consider that the Czech Republic is a market that has seized the opportunities offered by the integration into the European community. As in the case of the countries previously analyzed, a significant increase in gross domestic product is observed, measured both in terms of population ratio and in

in terms of annual percentage growth in the years preceding accession to the European Union, as well as in the years that followed.

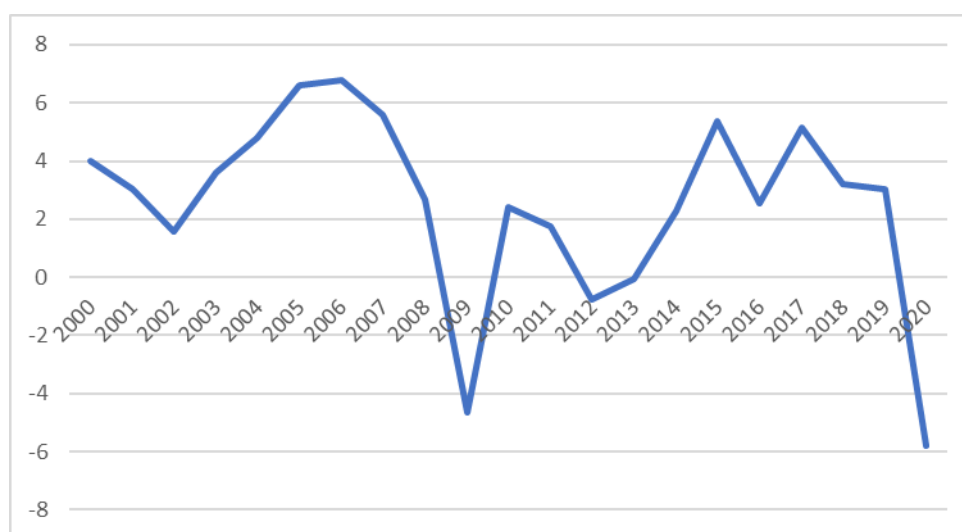


Figure 4. GDP evolution in the Czech Republic (% annually)

Source: processing according to data available on the <https://data.worldbank.org>

We note that even in the case of the Czech Republic, the indicators recorded an involution during the economic crisis similar to the other emerging markets of Europe, but we consider the decrease to be one within the normal range, which could be recovered in a relatively small time. Thus, GDP per capita recorded in 2008-2020 a relatively linear evolution, at the end of the analyzed period being at the level of 2007.

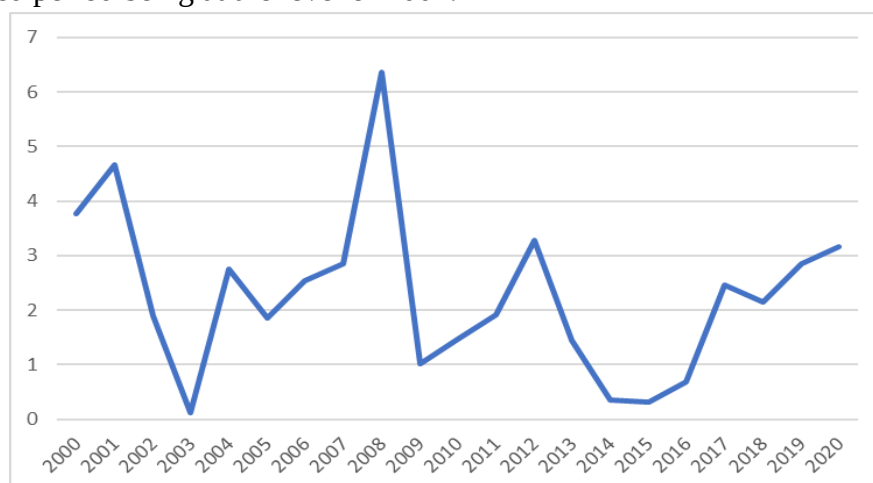


Figure 5. Consumer Price Index in Czech Republic (% annually)

Source: processing according to data available on the <https://data.worldbank.org>

Studying the evolution of GDP as an annual percentage, we notice two significant negative inflection points that coincide with the two critical moments, namely the economic crisis of 2008 and the one caused by the Covid-19 pandemic, in 2020. Except for these two moments, the evolution of gross domestic product was a positive one, registering annual increases of up to 6.6%.

We carry out the analysis with the consumer price index and we note that in the case of the Czech Republic this indicator recorded positive waves throughout the period, reaching a maximum of inflation in 2008, of 6.3%. Looking at the entire period of time analyzed, we can only notice this only difficult moment, the inflation being below the critical limit of 5%.

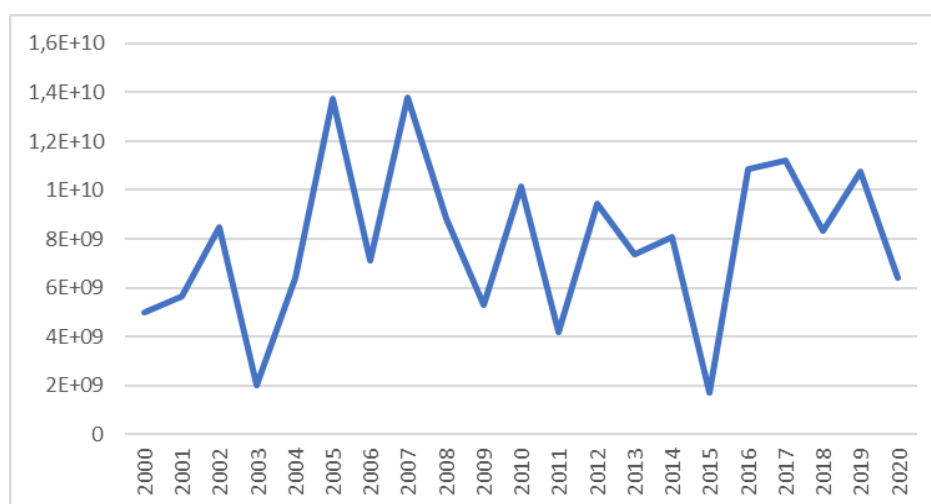


Figure 6. Foreign direct investment in Czech Republic, net inflows (US\$)

Source: processing according to data available on the <https://data.worldbank.org>

Regarding the evolution of foreign direct investments, we note its high degree of volatility, not being able to find correlations between this indicator and the evolution of the other analyzed indices. We can rather characterize this index as atypical compared to the evolution of the other macroeconomic indicators, its unstable trend not being able to define a direct relationship with

them. However, we observe a significant decrease in foreign investment in the period 2007-2009, but a causal link with the economic events of the period can be argued with caution, given the large fluctuations observed in the long term in the analyzed period.

The overall state of the Czech Republic's economy can be argued more solidly on the basis of the balance of account, the path of which we consider to be more correlated with the macroeconomic reality. Thus, in the period 2000-2013, the Czech Republic recorded a deficit, which in our opinion was kept under control. We justify this observation by keeping over a long period of time a relative stability of the negative values. Since 2013, the current account balance has been positive, which shows that the Czech Republic is finding its way to the premises of becoming one of Europe's developed economies. In our opinion, the favorable trend demonstrated by the macroeconomic evolution entitles the Czech Republic to aim for a privileged state among the developed countries of the European Union, demonstrating through stability, domestic production capacity and a clear increase in the living standards of the population.

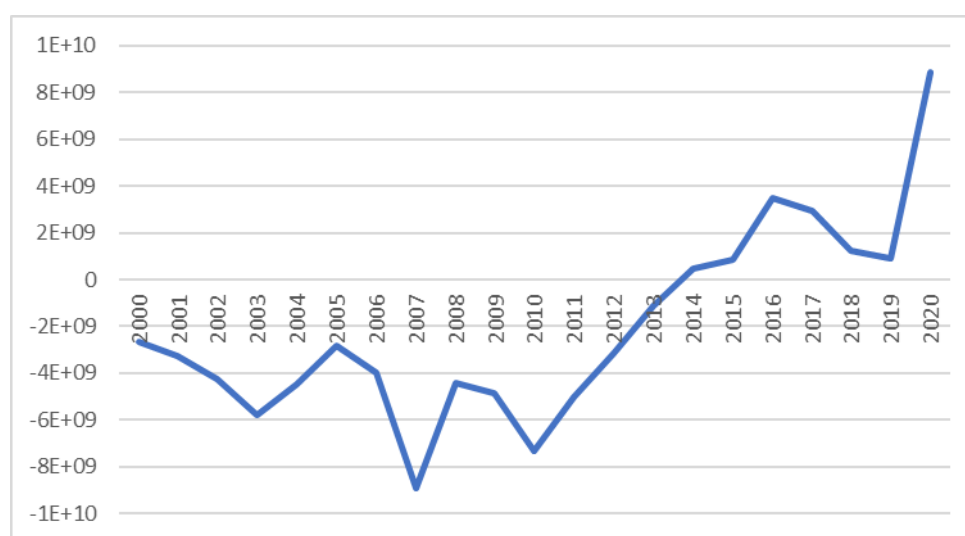


Figure 7. Balance of the current account of the Czech Republic (US\$)

Source: processing according to data available on the <https://data.worldbank.org>

3. Conclusions

Analyzing the evolution of capital market and macroeconomic indicators in the case of the Czech Republic, it is found that the capital market is in correlation with the economic environment in important moments of inflection, in which the international context determines substantial changes in the business environment. The most conclusive example is the 2008 crisis, which significantly affected all the indicators analysed. Also, the period before the crisis recorded a positive evolution, a trend that characterized not only the Czech market, but overall, the European market.

From the point of view of the volatility of the indices, we note that the macroeconomic situation during the analyzed period was relatively stable, which gave the economic environment the positive premises of a solid economic development. By controlling the inflation indicator and combating the involution of gross domestic product, the Czech Republic had a fairly rapid recovery after the 2008 crisis, managing, unlike other emerging markets (exemplifying here with Greece) to re-enter a positive path. It is worth noting, however, that foreign direct investment varied significantly from one year to the next, while the median of this indicator remained constant in the long run.

In conclusion, the Czech Republic's market registered a positive evolution, the main reason being the integration of the economic and financial market in the regional context of

the European Union. Government measures as well as fiscal policies have brought major benefits both from a macroeconomic point of view and for the evolution of the stock market environment. We can thus conclude that the Czech emerging market has benefited from the advantages of globalisation even more than the developed European markets, even if the degree of economic and financial integration is not as high.

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