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Czech Republic joins the trade-surplus country club

Joining the EU on 1 May 2004 did not upset the Czech economy. Real GDP growth, year-on-year, rose to 4.4% in the first quarter of 2005, thanks mostly to greater gross fixed investment and favourable foreign trade results.

EU accession stimulated trade expansion. As CZK figures at current prices indicate, both export and import growth rates experienced an upswing during the accession period. Year-on-year, export growth rose from 13% in the first quarter of 2004 up to 33% in the second quarter, while import growth leapt from 11% to 31% over the same period. Later on, this growth gradually decelerated; by the first quarter of 2005, it had dropped back to pre-accession levels. Exports, however, have grown faster than imports throughout; in the first quarter of 2005, the Czech Republic achieved an overall trade surplus amounting to EUR 500 million. April 2005 likewise ended with a trade surplus and the same held true for the period May 2004 to April 2005 as a whole. This improvement occurred despite accelerated GDP growth (which generally tends to boost import growth) and regardless of the 9% appreciation of the Czech koruna from Q1 2004 to Q1 2005 (3.04 against 3.33 EUR per 100 CZK). Machinery and transport equipment have generated these high and ever-increasing surpluses. This trend is likely to strengthen with the new Toyota-Peugeot-Citroen plant in Kolín having started production earlier this year. It will be bringing out three versions of a small passenger car. Were it not for the acquisition of military equipment from abroad adding to import growth, the results would have been even better. In the longer term, the Czech Republic stands good chances of firming up its position as a trade-surplus country.

Contrary to trade in goods, the trade surplus in services is shrinking. In March 2005, the country recorded a major deficit for the first time. The balance of incomes, which has always been negative, has also taken a turn for the worse. Nevertheless, in February and April 2005, the current account yielded a slightly positive result. The Czech government sold its shares in Czech Telecom to Spain's Telefónica for almost EUR 3 billion; hence, the inflow of foreign direct investment in 2005 will be quite significant.

Overall the ever-improving trade balance, coupled with its positive impact on the current account and the high inflow of foreign direct investment, tends to build up pressure in favour of currency appreciation. In keeping with its managed floating regime, the Czech National Bank (CNB) has endeavoured to keep appreciation at a modest level so as to prevent any stress in terms of the Czech enterprises' competitiveness. The CNB adheres to interest rates that rank among the lowest in Europe; it also cooperates closely with the government in order to avoid accretion of appreciation pressure due to the marked inflow of FDI.

The characteristic feature of the country's economic climate is low inflation. In terms of both inflation and interest rates, the Czech Republic has already met the Maastricht criteria. The same also applies to government debt, which was close to 39% of GDP in 2004; however, it does not apply to the government deficit. The latter fell to 3% in 2004, but a figure of 4.7% has been projected for 2005. Only after the parliamentary elections scheduled for June 2006 will a more restrictive budgetary policy come into effect. The early introduction of the euro is not on the Czech political agenda; the Czech authorities recently mentioned 2010 as the target year.

In 2004 a number of large financial and non-financial corporations registered excellent results. Czech agriculture would also appear to have benefited from EU accession; it accrued profits of the order of EUR 300 million in sharp contrast to the losses it suffered throughout most of the transition and post-transition period. This has come about as a result of larger support payments (up from EUR 700 million in 2003 to 930 million in 2004) and higher farm-gate prices.

Data for the first months of the current year suggest that the initial accession party is coming to a close. Not only has foreign trade expansion quietened down, but industrial output growth has also slowed up to year-on-year 4.4% in the first quarter of 2005. High growth in manufacture of machinery and transport equipment stands in contrast to a decline in leather, non-metallic mineral products and wood processing. Whereas the production of intermediate goods rose, that of capital goods stagnated and consumer durables declined.

A long-lasting coalition crisis culminated in the prime minister being replaced; that, however, did but little harm to the economy. As for the parliamentary elections due in mid-2006, one factor in the government's favour will be the best macroeconomic data for a decade; this, however, is no guarantee that it will regain popularity. At the beginning of June, the Deputy Prime Minister, Martin Jahn, presented a strategy for promoting long-term growth promotion. This forward-looking stance could heighten the government's popularity; at the same time, however, it might also disappoint voters left of centre. The same holds true for the discussion on pension reform, which has gained momentum over the past few months. For the time being, the mandatory pay-as-you-go system, which is complemented by a voluntary fully funded second pillar, is not in bad shape. However, a very low birth rate and increasing life expectancy make for an ageing population; this fuels the popular misconception that a fund-based system could lessen the burden on the working-age population in the future. However important they may be, reform discussions such as these that give rise to fears about cutbacks in social security can have a negative impact on private consumption growth – and thus on overall GDP growth as well. As the experience of other countries in Central and Eastern Europe has shown, transforming the pension system will be a costly undertaking for the government in budgetary terms.

In 2005 – and probably in 2006 as well – economic growth should not differ much from 2004; it should remain within the range of 4-5%. Inflation will drop back to around 2% and the CNB will keep interest rates low: something that should help to limit the currency appreciating against the euro. The government deficit was exceptionally low in 2004; it will probably increase in 2005. The current account deficit will lessen on account of continued strong export performance.

Table CZ

Czech Republic: Selected Economic Indicators

	2000	2001	2002	2003	2004 ¹⁾	2004 1st quarter	2005	2005 forecast	2006 forecast
Population, th pers., mid-year ²⁾	10272.5	10224.2	10200.8	10201.7	10206.9	10205.3	.	.	.
Gross domestic product, CZK bn, nom. ³⁾	2150.1	2315.3	2414.7	2555.8	2750.3	644.7	682.1	2920	3110
annual change in % (real) ³⁾	3.9	2.6	1.5	3.2	4.4	4.1	4.4	4.3	4.3
GDP/capita (EUR at exchange rate)	5878	6644	7683	7867	8446	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	12760	13470	14260	14660	15650	.	.	.	.
Gross industrial production									
annual change in % (real)	5.4	6.5	4.8	5.8	9.9	9.0	4.0	6	6
Construction industry									
annual change in % (real)	5.3	9.6	2.5	8.9	9.7	16.1	-3.1	.	.
Consumption of households, CZK bn, nom. ³⁾	1108.8	1179.4	1220.6	1300.5	1362.5	317.8	325.8	.	.
annual change in % (real) ³⁾	2.9	2.8	2.7	4.6	2.0	2.8	1.3	3.0	3.3
Gross fixed capital form., CZK bn, nom. ³⁾	594.9	638.6	643.3	685.6	749.9	169.3	179.9	.	.
annual change in % (real) ³⁾	4.9	5.4	3.4	4.7	7.6	7.9	5.5	6	5
LFS - employed persons, th, avg. ⁴⁾	4731.6	4750.2	4764.9	4733.2	4706.7	4675.9	4704.4	.	.
annual change in %	-0.7	0.4	0.3	-0.7	-0.6	-1.4	0.6	.	.
LFS - employed pers. in industry, th, avg. ⁴⁾	1429.4	1470.6	1463.1	1424.7	1409.0	1398.8	1400.9	.	.
annual change in %	-2.7	2.9	-0.1	-2.6	-1.1	-1.9	0.2	.	.
LFS - unemployed, th pers., average	454.5	421.0	374.1	399.1	425.9	443.8	429.3	.	.
LFS - unemployment rate in %, average ⁴⁾	8.8	8.1	7.3	7.8	8.3	8.7	8.4	8.7	9
Reg. unemployment rate in %, end of period	8.8	8.9	9.8	10.3	9.5	10.7	9.4	9.8	10
Average gross monthly wages, CZK ⁵⁾	13614	14793	15866	16920	18035	16708	17678	.	.
annual change in % (real, gross)	2.4	3.8	5.4	6.5	3.7	6.3	4.1	.	.
Consumer prices, % p.a.	3.9	4.7	1.8	0.1	2.8	2.3	1.7	1.8	2.2
Producer prices in industry, % p.a.	4.9	2.8	-0.5	-0.3	5.7	1.8	6.9	4	2.5
General governm. budget, EU-def., % GDP ⁶⁾									
Revenues	38.5	39.1	40.2	41.6	42.7	.	.	.	.
Expenditures	42.1	45.0	46.8	53.2	45.7	.	.	.	.
Deficit (-) / surplus (+)	-3.7	-5.9	-6.7	-11.6	-3.0	.	.	-4.2	-3.5
Public debt, EU-def., in % of GDP ⁶⁾	18.2	27.2	30.7	38.3	37.4	.	.	38.0	40.0
Discount rate, % p.a., end of period	5.0	3.8	1.8	1.0	1.5	1.0	1.3	.	.
Current account, EUR mn	-2945	-3652	-4426	-5044	-4490	-418	485	-2000	-2200
Current account in % of GDP	-4.9	-5.4	-5.6	-6.3	-5.2	-2.1	2.1	-2.1	-2.1
Gross reserves of NB incl. gold, EUR mn	14159	16400	22614	21340	20884	22076	21246	.	.
Gross external debt, EUR mn	23285	25368	25738	27624	33258	26543	34286	.	.
FDI inflow, EUR mn	5404	6296	9012	1863	3596	890	982	.	.
FDI outflow, EUR mn	47	185	219	183	440	36	29	.	.
Exports of goods, BOP, EUR mn	31483	37251	40711	43051	53714	11461	14624	64000	74000
annual growth rate in %	27.8	18.3	9.3	5.7	24.8	8.8	27.6	19	16
Imports of goods, BOP, EUR mn	34876	40675	43026	45243	54414	11423	13979	63000	71700
annual growth rate in %	32.0	16.6	5.8	5.2	20.3	7.0	22.4	16	14
Exports of services, BOP, EUR mn	7436	7913	7501	6882	7787	1608	1909	8600	10200
annual growth rate in %	12.5	6.4	-5.2	-8.3	13.2	601	18.7	10	19
Imports of services, BOP, EUR mn	5904	6211	6792	6466	7396	1553	1853	8400	10000
annual growth rate in %	7.6	5.2	9.4	-4.8	14.4	9.6	19.3	14	19
Average exchange rate CZK/USD	38.59	38.04	32.74	28.23	25.70	26.28	22.90	.	.
Average exchange rate CZK/EUR (ECU)	35.61	34.08	30.81	31.84	31.90	32.85	30.02	30.0	29
Purchasing power parity CZK/USD	14.36	14.60	14.27	14.40	14.54
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Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) According to ESA 95, real change based on constant prices of previous year. - 4) From 2002 weighted according to census 2001. - 5) Enterprises with more than 20 employees, including part of the Ministry of Defence and the Ministry of the Interior. - 6) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.