

Czech Republic

Growth is expected to be 4¾ per cent in 2005, with an exceptionally large contribution from net exports. For 2006 and 2007 the trade component will fall while domestic demand is expected to strengthen and GDP growth is projected to be 4½ per cent. This will bring inflationary pressure and a slight tightening of monetary policy.

Though growth performance has strengthened since the early years of the decade, better progress in improving the business environment and labour-market efficiency would help reduce downside risks. In fiscal policy, even though there are good prospects of fulfilling the Maastricht criteria, further reform to the financing and provision of public services is needed to reduce the risk of unsustainable public finances in the longer term.

Even though export growth slowed considerably in 2005, the contribution of net exports to growth increased because import volume growth slowed even more strongly. The import slowdown in part reflects muted domestic demand, but investment and detailed trade data also suggests that manufacturing activity has broadened and reduced the volume of imported intermediate goods used by producers. Recent monthly data show a pick-up in trade and there was an encouraging increase in domestic-demand growth in the second quarter. In addition, retail sales suggest that consumption is acquiring momentum. While inflation was low in the first half of 2005, partly reflecting falling import prices, it has since increased due to steep rises in transport and administered fuel prices.

Signs of a pick-up in trade and consumption after a slow first half

Though the Maastricht-defined deficit is expected to increase by one percentage point to 4% of GDP in 2005, this is a better outcome than previously expected. The 3% deficit outcome in 2004 had been helped by the inclusion of the reclassification of a state guarantee worth 0.8 percentage points of GDP and at the beginning of 2005 a deficit outturn of at least 4¼ per cent was expected. However, monthly revenue figures over the course of the year have exceeded expectations, notably in excise duty and value-added tax, and the deficit is now expected to be only 4%. Reduction in the government deficit is expected to continue, despite tax cuts in 2006, and the outcome for 2007 is projected to be close to 3¼ per cent.

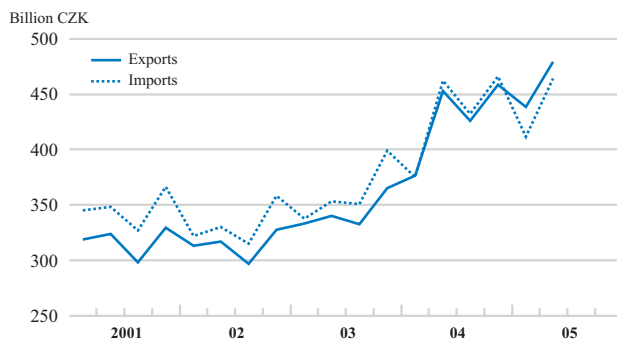
Fiscal balances for 2005 have been surprisingly good

Growth is expected to fall only marginally in 2006 and 2007 with annual outcomes of 4½ per cent. The projection has export growth rising by close to 13% in 2007 as well as increased import growth. The latter not only reflects export trends,

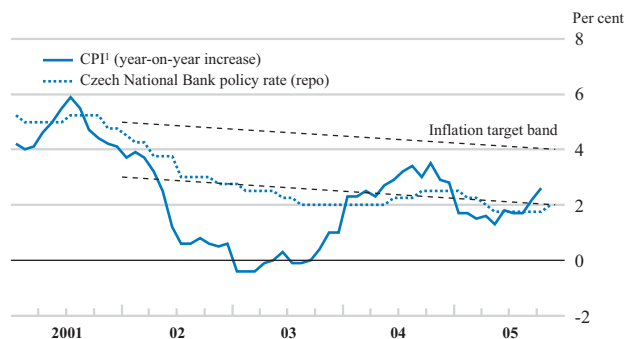
Growth in 2006 and 2007 will remain robust

Czech Republic

Net exports have turned positive



Inflation has picked up



1. Consumer price index.

Source: Czech National Bank; Czech Statistical Office.

Czech Republic: Demand, output and prices

	2002	2003	2004	2005	2006	2007
	Current prices CZK billion	Percentage changes, volume (1995 prices)				
Private consumption	1 234.7	4.6	2.1	2.0	3.4	4.2
Government consumption	555.2	3.8	-2.0	-0.5	0.5	0.6
Gross fixed capital formation	643.3	4.7	7.6	3.4	6.0	6.0
Final domestic demand	2 433.3	4.5	2.6	1.8	3.5	3.9
Stockbuilding ¹	30.9	-1.1	0.1	-1.1	0.0	0.0
Total domestic demand	2 464.1	3.5	2.6	0.8	3.8	3.9
Exports of goods and services	1 485.5	7.5	21.9	8.5	11.2	12.8
Imports of goods and services	1 535.0	7.9	18.4	2.9	10.4	12.3
Net exports ¹	-49.5	-1.3	0.4	5.1	0.1	-0.3
GDP at market prices	2 414.7	3.2	4.4	4.8	4.5	4.5
GDP deflator	—	2.6	3.0	0.3	2.9	2.8
<i>Memorandum items</i>						
Consumer price index	—	-0.1	2.8	1.9	2.8	3.0
Private consumption deflator	—	1.8	2.7	1.4	2.4	3.0
Unemployment rate	—	7.8	8.3	8.0	7.8	7.6
General government financial balance ²	—	-12.4	-3.0	-4.0	-3.6	-3.2
Current account balance ²	—	-6.3	-5.2	-4.0	-2.8	-2.1

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods, (<http://www.oecd.org/eco/sources-and-methods>).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

2. As a percentage of GDP.

3. Since the change in methodology in 2004, high-risk state guarantees are classified as capital transfers as soon as they are called for the first time. In 2003, the activation of guarantees issued mainly for the banking sector accounted for about 7.7 percentage points of the deficit.

Source: OECD Economic Outlook 78 database.

Statlink: <http://dx.doi.org/10.1787/133453852348>

but also strengthening private consumption which will be driven in part by cuts in personal-income tax. Demand pressure is expected to bring upward pressure on inflation. In 2006 this will be exacerbated both by continuing effects from the run-up in oil prices and, to some extent, by housing-rent increases due to legislative changes. These temporary effects will have dissipated by the end of 2006 and inflation will average around 3% in 2007. The monetary response to these inflation developments is not expected to be dramatic, in part because they are temporary but also because, despite the increases, inflation looks set to remain comfortably within the Central Bank's target band of 3+/-1%.

Export growth is uncertain and important reforms are stalling

There is a risk that the fall off in export growth in 2005 reflects something more permanent than base-level effects from the previous year. As regards fiscal policy, the 2006 budget spending exceeds ceilings set by the government's medium-term expenditure framework which was set up only in 2004. Though the budgeted spending does not strongly compromise fiscal goals, the apparent disregard for the ceilings has somewhat damaged the credibility of the expenditure framework. Slow progress on long-intended structural reforms means that downside risks in the growth outlook are larger than they would otherwise be and pose a threat to long-term fiscal sustainability. In particular, though some progress has been made recently regarding pensions, taxation and business legislation, reform of the labour code has been lacklustre, welfare reform has been timid and the government is not intending to embark on major reform of public health care before the general elections which are due to take place in June 2006.

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Conventional signs

\$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
..	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

Summary of projections

	2005	2006	2007	2005		2006		2007		Fourth quarter			
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	2005	2006	2007
	Per cent												
Real GDP growth													
United States	3.6	3.5	3.3	3.7	3.3	3.5	3.5	3.3	3.2	3.2	3.7	3.4	3.1
Japan	2.4	2.0	2.0	1.7	1.9	2.1	1.9	2.0	2.0	2.1	3.2	2.0	2.1
Euro area	1.4	2.1	2.2	2.2	1.9	2.0	2.2	2.1	2.2	2.2	1.8	2.1	2.2
Total OECD	2.7	2.9	2.9	3.1	3.0	2.8	2.6	2.9	3.2	2.9	3.0	2.8	2.9
Inflation													
United States	2.7	2.5	2.3	2.9	2.2	2.3	2.3	2.3	2.6	2.2	2.9	2.3	2.2
Japan	-1.1	-0.1	0.6	-0.2	0.0	0.1	0.3	0.5	0.6	0.7	-1.3	0.2	0.8
Euro area	1.8	1.7	1.9	1.9	1.5	1.5	1.5	1.8	2.0	2.1	1.9	1.6	2.0
Total OECD	2.1	1.9	1.9	1.5	1.4	2.1	2.4	2.0	1.7	1.8	1.9	2.0	1.9
Unemployment rate													
United States	5.1	4.8	4.7	5.0	4.9	4.9	4.8	4.8	4.7	4.7	5.0	4.8	4.7
Japan	4.4	3.9	3.5	4.3	4.1	4.0	3.9	3.8	3.7	3.5	4.3	3.8	3.3
Euro area	8.7	8.4	8.1	8.6	8.5	8.5	8.4	8.4	8.3	8.2	8.6	8.4	8.0
Total OECD	6.5	6.3	6.0	6.4	6.3	6.3	6.2	6.2	6.1	6.1	6.4	6.2	5.9
World trade growth	7.3	9.1	9.2	9.3	8.8	8.8	8.9	9.1	9.3	9.4	8.1	8.9	9.3
Current account balance													
United States	-6.5	-6.7	-7.0										
Japan	3.4	3.9	4.7										
Euro area	-0.2	-0.2	-0.1										
Total OECD	-1.8	-2.0	-2.0										
Cyclically-adjusted fiscal balance													
United States	-3.6	-4.2	-3.9										
Japan	-6.3	-6.1	-6.4										
Euro area	-2.2	-2.1	-2.0										
Total OECD	-3.1	-3.3	-3.2										
Short-term interest rate													
United States	3.5	4.8	4.9	4.2	4.6	4.9	4.9	4.9	4.9	4.9	4.2	4.9	4.9
Japan	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.3	0.6	0.0	0.0	1.0
Euro area	2.2	2.2	2.9	2.2	2.2	2.2	2.2	2.3	2.6	2.8	2.2	2.3	3.3

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

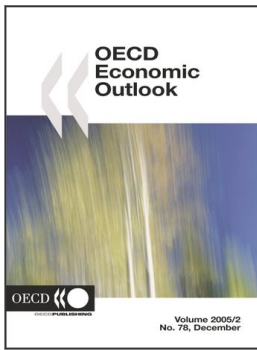
Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;

- unchanged exchange rates as from 11 November 2005; in particular 1\$ = 118.00 yen and 0.85 euros;

The cut-off date for other information used in the compilation of the projections is 22 November 2005.

Source: OECD Economic Outlook 78 database.



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