CZECH REPUBLIC

Economic growth is projected to remain strong in 2019 and 2020, although it will slow. Increasing wages and low unemployment will keep household consumption growth high. Private investment will stay robust, in particular in housing and manufacturing. Export growth will continue to be solid. However, labour shortages will remain a bottleneck to higher economic growth.

Inflation will stay above the target of the central bank. As the exchange rate remains relatively stable, monetary policy should keep on progressively normalising interest rates. Fiscal policy is slightly expansionary and, if needed, further government spending could be used to support long-term growth. Fiscal space is ample to invest in infrastructure, childcare facilities and training to boost productivity, labour participation of women with young children and older workers.

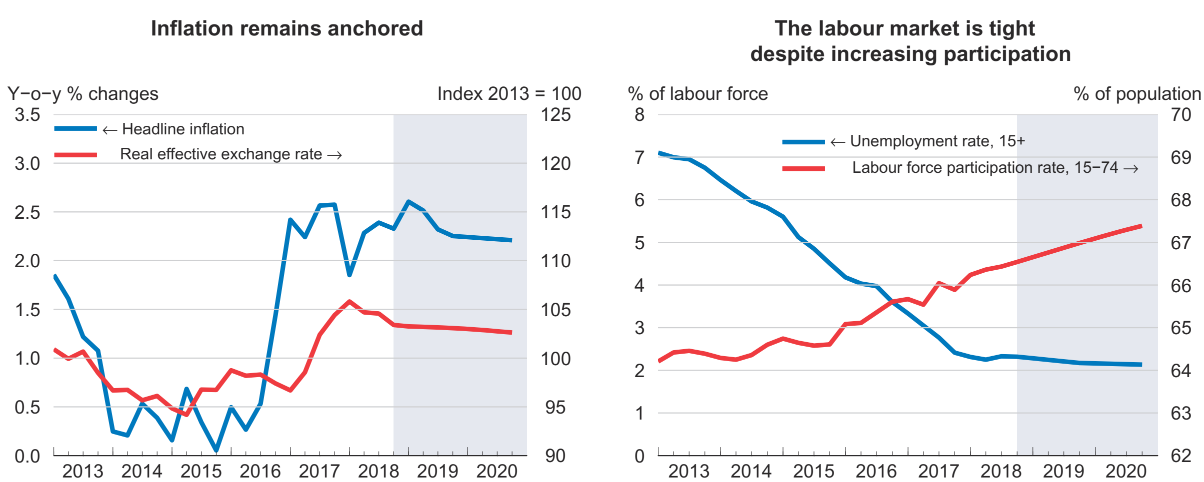
Household consumption and investment are boosting growth

Private investment has increased markedly. Firms are investing to increase capacity but also to augment capital intensity to cope with labour shortage. Government infrastructure projects and high demand for residential housing will keep pushing up construction through 2019. Household consumption remains strong, supported by income and employment growth and lower saving. Imports are growing faster than exports, reflecting import-intensive investment and household demand for imported goods in line with consumption patterns. Exports, though increasing, are impeded by limitations on production capacity, in particular in the car industry. The labour market is tight despite increasing labour participation, in particular from older people.

Policy measures are needed to address labour shortages and rising house prices

High oil prices and strong wage growth will keep inflation slightly above the central bank's target. Therefore, the Czech National Bank is projected to keep raising interest rates throughout 2019 and 2020. Higher rates in the euro area will ease the risk of further

Czech Republic



Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933876537

Czech Republic: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices CZK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 597.8	2.4	4.5	3.0	2.7	2.6
Private consumption	2 152.8	3.6	4.4	3.9	3.5	3.2
Government consumption	883.1	2.7	1.3	2.7	2.0	1.8
Gross fixed capital formation	1 217.4	-3.3	3.7	8.5	4.4	3.9
Final domestic demand	4 253.4	1.4	3.5	4.9	3.4	3.1
Stockbuilding[1]	67.7	-0.3	0.1	-1.4	-0.2	0.0
Total domestic demand	4 321.0	1.1	3.6	3.3	3.2	3.1
Exports of goods and services	3 728.8	4.1	7.2	4.5	4.0	3.9
Imports of goods and services	3 452.0	2.6	6.3	5.1	4.8	4.7
Net exports[1]	276.8	1.4	1.2	-0.1	-0.3	-0.4
Memorandum items						
GDP deflator	_	1.3	1.5	1.8	1.6	2.1
Consumer price index	_	0.7	2.5	2.2	2.4	2.2
Core inflation index[2]	_	1.6	2.0	2.4	2.4	2.2
Unemployment rate (% of labour force)	_	3.9	2.9	2.3	2.2	2.1
Household saving ratio, net (% of disposable income)	_	6.5	4.3	3.5	3.3	3.2
General government financial balance (% of GDP)	_	0.7	1.5	1.3	1.3	1.0
General government gross debt (% of GDP)	_	47.7	44.0	42.1	40.3	39.0
General government debt, Maastricht definition (% of GDP)	_	36.8	34.6	32.7	31.0	29.6
Current account balance (% of GDP)	_	1.6	1.1	0.8	0.3	0.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933877601

appreciation of the koruna. Higher domestic interest rates will reduce strong housing demand and household credit. Nevertheless, allowing the central bank to set binding prudential rules applicable to individual loans would limit excessive indebtedness of households and the risks it poses to the financial system.

The fiscal position is strong and continues to be mildly expansionary. The primary balance will remain positive in the next two years, further bringing government debt down. Therefore, government spending could be mobilised to expand and update transport infrastructure, offsetting monetary policy tightening.

To ensure continued economic growth, mobilising all potential sources of labour supply is necessary. The increasing labour shortage has already led to a higher participation of traditionally disadvantaged groups, such as the young, non-native and older people. However, the participation of inactive persons could be enhanced through special training and adaptation programmes. In addition, labour participation of women with young children remains low compared to the OECD average. The strong fiscal position could also be used to finance the development of affordable and quality childcare facilities and to accompany the reduction in the duration of parental leave. Finally, augmenting migration quotas from non-EU countries would ease tensions in the labour market.

Growth is projected to remain robust though slowing down

Economic growth will remain above potential in 2019 and 2020 and rely slightly more on domestic demand than on external sector. In particular, investment and consumption, including government spending, will be the main engines of economic growth. Labour shortages will remain a drag on growth. The main source of internal risk is accelerating wage and price inflation leading to a more aggressive monetary policy response. On the external side, the Czech economy remains exposed to any disruption on trade given its strong integration into global value chains.

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