

## CZECH REPUBLIC

An export-led recovery began in 2013 and is expected to gather pace in 2014 as world trade strengthens, reversing the two-year decline in private investment. Stronger consumer confidence and higher real income growth should raise private consumption growth. However, only in 2015 will the pace of GDP growth start to reduce economic slack and the unemployment rate.

A slightly supportive fiscal policy stance is appropriate, as fiscal consolidation at this point could derail the fragile recovery. Once the recovery is solidly in place, measures to secure fiscal sustainability should be adopted. The central bank started intervening in the foreign exchange market late in 2013, judging that unconventional monetary policy was needed to preserve the credibility of the inflation target in the face of a prolonged period of low inflation and the threat of deflation. The authorities should return to the floating-rate policy as soon as deflation risks have definitively receded. Active labour market policies should be enhanced to avoid unemployment becoming entrenched.

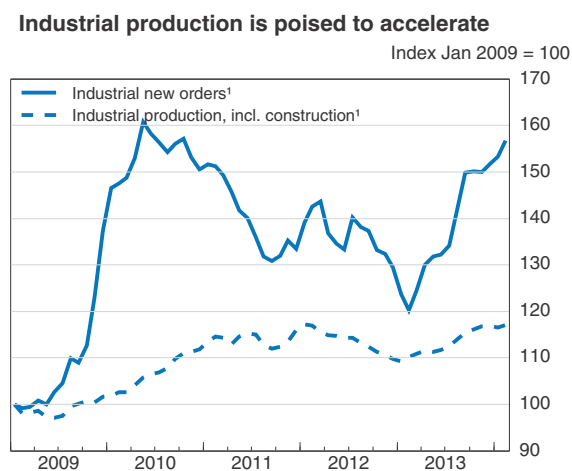
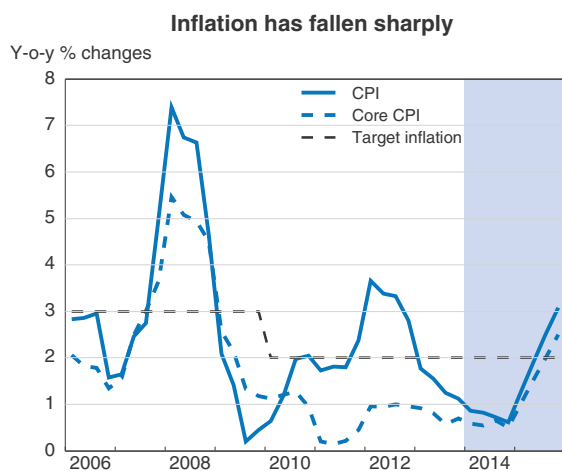
### A recovery is finally underway

The economy is gathering pace in response to faster export growth, which is stimulating industrial production and manufacturing orders. Together with improving confidence in industry, this is feeding into a slow rise in private investment growth. However, household spending and housing investment are still weak, reflecting declining real incomes.

### Fiscal policy is slightly supportive

Fiscal consolidation was halted in response to the protracted decline in output in 2013. Looking ahead, fiscal policy is planned to be slightly supportive with the general government deficit kept below 3% of GDP, even though spending on salaries and investment is set to rise. Nonetheless, once the recovery is well established measures to improve fiscal sustainability are needed, particularly to contain ageing-related spending pressures.

## Czech Republic



1. 3-month moving average.

Source: OECD Economic Outlook 95 database; Czech Statistical Office; and OECD, Main Economic Indicators database.

StatLink <http://dx.doi.org/10.1787/888933049401>

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


	2010	2011	2012	2013	2014	2015
	Current prices CZK billion	Percentage changes, volume (2005 prices)				
<b>GDP at market prices</b>	3 787.8	1.8	-0.9	-0.9	1.2	2.4
Private consumption	1 915.6	0.5	-2.1	0.1	0.9	1.7
Government consumption	807.5	-2.7	-1.9	1.6	1.1	2.0
Gross fixed capital formation	928.8	0.4	-4.3	-3.6	0.4	3.2
Final domestic demand	3 651.9	-0.2	-2.6	-0.4	0.9	2.1
Stockbuilding <sup>1</sup>	9.5	0.1	-0.1	-0.2	-0.2	0.0
Total domestic demand	3 661.3	-0.1	-2.8	-0.7	0.6	2.1
Exports of goods and services	2 518.8	9.6	4.7	0.2	5.0	5.4
Imports of goods and services	2 392.4	7.0	2.5	0.6	4.6	5.3
Net exports <sup>1</sup>	126.5	1.9	1.7	-0.3	0.6	0.5
<i>Memorandum items</i>						
GDP deflator	–	-0.9	1.6	1.9	1.6	1.5
Consumer price index	–	1.9	3.3	1.4	0.1	2.0
Private consumption deflator	–	0.5	2.7	1.1	0.0	1.9
Unemployment rate	–	6.7	7.0	6.9	6.9	6.8
General government financial balance <sup>2</sup>	–	-3.2	-4.2	-1.5	-2.1	-2.6
General government gross debt <sup>3</sup>	–	48.2	55.7	57.1	58.8	60.9
General government debt, Maastricht definition <sup>2</sup>	–	41.4	46.1	46.0	47.8	49.8
Current account balance <sup>2</sup>	–	-2.7	-1.3	-1.5	-0.6	-0.3

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP.

3. As a percentage of GDP at market value.

Source: OECD Economic Outlook 95 database.

StatLink  <http://dx.doi.org/10.1787/888933051073>

### Monetary policy should continue to support the economy

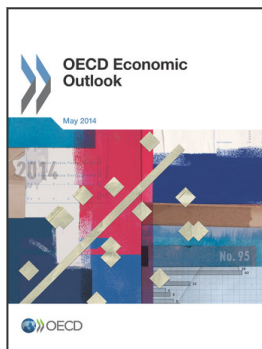
In late 2013, as traditional monetary policy appeared to be exhausted, deflation risks led the central bank to begin exchange rate intervention in the form of a floor for the koruna, leading to an immediate depreciation of about 4½ per cent. In early 2014, inflation fell to 0.2%, well below the National Bank's 2% target, reflecting the slack in the economy and a sharp decline in administered prices. Inflation is expected to rebound to within the central bank's tolerance band of 1% to 3%, as the effects of the weaker koruna feed through and the cuts in administered prices no longer affect year-on-year inflation. The need for the exchange rate floor is thus likely to diminish soon.

### Growth will depend on external demand

Rising exports, which will benefit from growth in export market, will feed into confidence and private investment. Real wage increases and higher employment will underpin private consumption. However, the modest pace of the recovery will allow only a small reduction in economic slack.

### Risks remain external and tilted to the downside

The deep integration of manufacturing into the German supply chain means that the recovery remains vulnerable to disinflationary or financial market shocks originating in Germany or its main trading partners. Events in Ukraine also constitute a negative risk. On the upside, a faster-than-projected recovery of the labour market would mean a stronger pick-up of private consumption.



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