



Economic Trends 38

October 2003

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Released for printing on October 6, 2003.

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CZECH ECONOMY IN 2003

Kamil Janáček
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Economic Growth

In the first half of 2003, the GDP grew by 2.3 %. The main factor of economic growth was final consumption, increasing by 4.0 %; government consumption grew by 2.1 % and household consumption by 5.0 %. Capital formation increased by 3 % due to increase in stocks. Fixed capital formation practically stagnated (-0.3 %) – machinery investments declined while investments in buildings grew. The negative impact of net exports deepened: the trade with goods deteriorated by CZK 3 bill. and trade with services deteriorated by CZK 9.5 bill.

Although the GDP growth has been higher than in majority of the EU countries, it is obvious that it is based on domestic consumption, predominantly on the households one. Strong consumer demand has been pulled by rapid growth of real incomes (exceeding 5 %) combined with historically low level of interest rates and aggressive policy both of financial and non-financial institutions providing consumer credits. From longer-term point of view, economic growth based merely on final consumption cannot be regarded as sustainable.

Despite low demand in the EU countries, industry continued to grow rapidly in the first seven months of 2003. The industrial output increased by 5.8 %, January to August 2003. At the same time, industry was the most important sector in GDP growth: GDP in industry increased by 3.3 %, accounting for 39 % of total GDP. Industry has been growing without significant fluctuations since September 2002, i.e. for eleven consecutive months. The figures from industry have been showing that the growth of output has been

pulled primarily by foreign demand. Growth in industry thus has been supported primarily by exports of foreign controlled companies. Direct export sales of companies under foreign control represent roughly one half of all export sales (47.2 %) and share of exports on their sales amounts to 68.1 %.

Growth in industry has been increasingly labour saving: productivity has been continuing to grow as well as dismissals of workers. Labour productivity increased by 8.4 %, real wage grew by 5.3 %, while number of employees declined by 3.0 %. The dismissals from industry have been the main source of ongoing pressures on the labour market.

While construction output more or less stagnated until May 2003, unexpected boom occurred as of June. Double-digit growth rates from June, July and August pushed the growth in construction to 6.8 %, January to August 2003. Large building and civil engineering projects have been standing behind recovery of construction. The segment of housing has been continuing to grow since the beginning of the year, representing however only 20 % of total construction output. In contrast to previous year, GDP in construction increased by 0.9 % in the first half of 2003, which indicates improving structure of the construction output.

Due to strong consumer demand, retail sales speeded against 2002. The growth of retail sales reached 4.7 %, January – July 2003. The automotive segment has been the main source of speeding-up in retail trade in 2003, fuel sales increasing by 11.3 %, car sales and repairs by 4.8 %. At the same time, both food and non food items showed growth slightly under 4 %. Growth in retail trade was the main factor of growth in services; sales in services increased by 3.3 %, in the first half of 2003. However, GDP in services increased by only 0.9 %.

In the first half of 2003, the GDP grew by 2.3 %. The main factor of economic growth was final consumption.

Although the GDP growth has been higher than in majority of the EU countries, it is obvious that it is based on domestic consumption, predominantly on the households one.

Growth in industry has been supported primarily by exports of foreign controlled companies. Direct export sales of companies under foreign control represent roughly one half of all export sales.

Foreign Trade and Exchange Rate

January to August 2003, the trade deficit amounted to CZK 36.6 bill, which is almost exactly the same figure as a year before. The imports increased by 8.0 % while the exports rose by 8.4 %. The difference between growth rates of exports and imports narrowed. Both the exports and imports were pushed up by depreciation of the CZK exchange rate against EUR. In spite of weak European conjuncture, the exports to EU grew rapidly, January to August by above average 9.8 %.

The Czech exporters were able to shift – at least partially – their activities from Germany which has been hit worst by the recession, to countries showing higher demand (France, The Netherlands, Italy or Spain). Though the individual shares of these countries have been under 5 %, their importance in the Czech foreign trade has been gradually increasing; they have been able to compensate partly for weak German demand.

In the first half of 2003, the current account deficit amounted to CZK 58.2 bill., which was approximately the same level as in the first half of 2002. However, quite notable deterioration was observed in the second quarter of the 2003. The deterioration of current account in Q2 was a consequence of deterioration in services and transfers. The incomes from services (transport, tourism, etc.) declined by CZK 4.5 bill. Transfers turned to the red for the first time in the history of the Czech Republic due to transfer of funds from a government account to CME following the international arbitration ruling. Both the trade deficit (CZK -13.3 bill.) and the incomes deficit (CZK -30.8 bill.) did not show significant changes against Q2 2002. Anyway, the incomes balance remained the most significant long-term risky factor for the Czech external balance.

Although, the balance of payments for the first half of 2003 was roughly balanced, the second quarter of 2003 ended in the red. At the same

time, the inflow of FDI (CZK 34.1 bill.) continued at a pace similar to that in Q1 2003 (CZK 32.3 bill). The level of FDI inflow amounting to around USD 1 bill. each quarter seems to be a mid-term potential after the end of Czech privatisation.

In the third quarter of 2003, the exchange rate of Czech currency oscillated between 31.70 - 32.50 CZK/EUR, with average value of 32.17 CZK/EUR. Nevertheless, the exchange rate of CZK suffered from rather high volatility which gave to arose concerns of the Czech National Bank. The main reason of the exchange rate developments were the uncertain prospects of the Government public finance reform. On the other side, the depreciation of the CZK against the USD was caused primarily by the USD/EUR developments and was not so strongly affected by domestic factors.

Inflation

Consumer prices kept the disinflation trend, standing at 0.0 % year on year at the end of September 2003. The average inflation rate thus amounted to 0.0 %, which is a new historical record low. The CPI was pushed down by two main reasons: low food prices which have been continuously depressed by low import prices and by freeze of regular deregulation process in July 2003.

As in European Union countries, producer prices have been even more depressed than consumer ones. Also, the impact of low import prices seems to be more intensive on the part of producer prices. In August 2003, yearly producer price index stood at -0.4 %, reflecting partly the temporary hike of world oil prices. Anyway, deflation tendencies showed a slight weakening in the third quarter of 2003.

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Unemployment

In the first nine months of 2003, labour market followed regular seasonal trends. The unemployment rate exceeded the 10 % level in January and February 2003 declining to 9.4 % at the end of May 2003. Later on, regular summer increase occurred due to new school graduates entering the labour market pushing the unemployment rate to 10.1 % at the end of September. The situation on labour market

deteriorated from a year earlier: both the unemployment rate and ratio between unemployed and vacancies are higher in 2003. However, summer increase of the unemployment rate (0.7 percentage point) was slightly lower in 2003 than in 2002 showing that situation on labour market is more or less stabilised with no signs of further deterioration.

Table 1: Main Macroeconomic Indicators

		1999	2000	2001	2002	06/03	07/03	08/03	2003F
Inflation	%, y/y	2.1	3.9	4.1	0.6	0.3	-0.1	-0.1	1.0
Inflation	%, m/m	-	-	-	-	0.0	0.1	-0.2	-
Industrial prices	%, y/y	3.4	5.0	0.8	-0.7	-0.9	-0.6	-0.4	0.5
Industrial prices	%, m/m	-	-	-	-	-0.2	-0.2	0.1	-
Unemployment rate	%, eop.	9.4	8.8	8.9	9.8	9.5	9.9	10.0	10.5
Industrial production	%, real	-3.1	5.1	6.8	4.8	6.2	4.8	5.8	5.0
Construction output	%, real	-6.5	5.3	9.6	2.5	12.2	15.9	18.7	7.0
Retail sales	%, real	2.1	4.6	4.3	2.7	7.5	6.4	n.a.	4.5
State budget	CZK bill.	-29.6	-46.1	-67.7	-45.7	-53.4	-62.1	-71.9	-120
Trade balance	CZK bill.	-69.9	-120.8	-119	-74.5	-3.2	-11.9	-7.0	-65
FOREX reserves	USD bill.	12.9	13.1	14.8	23.7	25.5	25.2	24.6	25.0
PRIBOR 3M	% average	6.85	5.36	5.2	3.55	2.33	2.25	2.06	2.3
CZK/EUR	Average	36.88	35.6	34.1	30.81	31.41	31.88	32.29	31.7
CZK/USD	Average	34.60	38.6	38.0	32.74	26.94	28.04	29.0	28.5
GDP	%, y/y	0.5	3.3	3.1	2.0	n.a.	n.a.	-0.1	2.3

Source: Czech National Bank, Czech Statistical Office, forecasts by Komerční banka (bold figures)

Outlook

Consumer demand will remain strong until the end of year 2003. At the same time, investment demand will recover only gradually, depending on world economy conditions. For the time being, the revival of the European economy does not seem probable until the end of this year. The growth of Czech GDP will thus amount to 2.0 – 2.3 % in 2003.

The export outlook and investment climate in the Czech Republic will improve only slowly and rather slightly. We can expect that the EU entry in May 2004 will help to boost the FDI inflows and push the fixed capital investment up. But this will affect the economic performance only in the second half of 2004

when we expect the GDP growth accelerating to 3 % (or slightly above).

Industry will continue to grow without significant volatility until the end of year – the industrial output will increase by approximately 5 %. Strong fluctuation of construction output in individual months of 2003 makes the predictions somewhat unclear, however, new building permits granted for large transport infrastructure constructions (railway corridor and highways) give a small reason to some optimism: we expect that full-year growth of construction output in 2003 could reach 7 – 8 %.

Consumer prices will most probably stop to decline in the last quarter of 2003.

For the time being, the revival of the European economy does not seem probable until the end of this year. The growth of Czech GDP will thus amount to 2.0 – 2.3 % in 2003.

Industry will continue to grow without significant volatility until the end of year – the industrial output will increase by 4.5 - 5 %.

In 2003, we expect the year-end inflation to be at 1.3 % and average inflation slightly above zero (around 0.2 %).

Nevertheless, monthly increases will be very moderate due to strong competition in the retail trade and the low probability of a hike of prices on world oil markets. In 2003, we expect the year-end inflation to be at 1.0 % and average inflation slightly above zero.

Producer prices will continue to move below the consumer ones. Summer oil price hike was a temporary one, therefore its effects will be most probably short-term and limited similarly to those around the Iraq conflict. Nevertheless, the weakening of deflation tendencies observable as of June 2003, will push the end of year PPI above zero – to around 0.5 %. At the same time, the yearly 2003 average will be under zero, reaching -0.3 %.

After the depreciation in the course of the third quarter 2003, the CZK will recover and will

move in the range of 31.0 to 31.6 CZK/EUR during the rest of the year. The average exchange rate for the whole year will be around 31.7 CZK/EUR. The depreciated CZK exchange rate (in comparison with 2002) will support both the exports and imports also in the last quarter. Although the trade deficits from July and August were slightly above the levels from the first half of the year, full-year trade deficit will be similar to that in 2002, that is CZK 65 – 70 bill.

However, the trade balance does no longer represent the main cause of current account deficit which is estimated to exceed 5 % of GDP in 2003. This level of current account deficit does not represent significant macroeconomic risk and will be to a high extent covered by FDI inflows which are estimated around USD 4 bill.

Current account deficit is estimated to exceed 5 % of GDP in 2003. This deficit will be to a high extent covered by FDI inflows which are estimated around USD 4 bill.

SLOVAKIA: RECENT ECONOMIC DEVELOPMENTS

Kamil Janáček

Among the four Visegrád Central-European countries, Slovakia has shown fastest economic growth in 2003; as indicated in Table 1, Slovakia's GDP grew by about 4 % in the first half of the year.

However, main factors driving Slovak economic growth have substantially changed, compared

government consumption, and leading to a hazardous public finance deficit of 7,2 % of GDP in 2002. Hence the strongly reform-oriented government that arose from the 2002 election started radical measures aimed at completing the structural reforms initiated in 1999, and at bringing the deficit in 2006 toward the magical (Maastricht-criteria) limit of 3 % of GDP.

Prices of gas and electricity have been deregulated. An extensive reform of health care started (patients have to pay partly for some services, the number of free-of-charge medicines is reduced). The government also sets much stricter rules for obtaining social

Table 1: GDP 2000 – 2003 (real growth rates in %)

	2000	2001	2002	1Q 2003	2Q 2003
GDP	2.2	3.3	4.4	4.1	3.8
Household consumption	-1.8	4.0	5.4	2.6	-0.2
Government consumption	1.3	5.1	4.0	1.7	-1.2
Fixed capital investment	1.2	9.6	-0.9	-2.0	-0.4
Exports of goods and services	13.8	6.5	5.9	21.4	24.1
Imports of goods and services	10.2	11.7	5.3	16.4	15.3

Source: Slovak Statistical Office

to 2001 and 2002. In those years, economic growth was mainly driven by domestic demand. In 2003, foreign demand has become the main engine of economic growth, while household

allowances and unemployment benefits, to prevent their misuse. And last but not least, the pension age has been postponed.

Table 2: Consumer prices 2000 – 2003 (growth rates in %)

	2000	2001	2002	3/2003	6/2003	8/2003
CPI, y/y, end of period	8.4	6.4	3.4	8.0	8.4	9.2
CPI, average	12.0	7.1	3.3	7.6	7.9	8.9

Source: Slovak Statistical Office

consumption, government consumption and fixed capital investment show very slow growth or stagnate.

The pre-election situation in 2002 led to a strong use of fiscal policy, inducing both private and

One of the consequences has been a sharp jump of inflation in 2003 (see Table 2). However, a substantial part of the price increase is caused by deregulation and by tax changes. Core inflation increased by 2.7 % in August, year on year. Over 2004, a relatively high

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Table 3: Unemployment (in %, end of period)

2000	2001	2002	3/2003	6/2003	8/2003
18.6	19.2	17.4	16.5	14.6	14.4

Source: Slovak Statistical Office

inflation can again be expected, due to a radical tax reform including the unifying of the present two VAT rates to one single level of 19 % (today, 14 % and 20 %).

Cuts in unemployment – and sickness benefits, and reductions in social allowances, brought the unemployment rate down relatively rapidly (see Table 3). Amendments of the Labour Code set stricter limits for overtime, made part-time jobs more feasible, and layoffs easier. Stricter conditions for obtaining the unemployment benefits prevent people who work abroad, or in the shadow economy, from at the same time drawing the benefits. The powers of trade unions in bargaining with employers have also been limited. The Slovak example documents very clearly the well-known economic truth: an overly generous social system leads citizens to its over-use or misuse. On the other side, stricter conditions for drawing social benefits and unemployment allowances force people to seek new jobs more actively, instead of a passive reliance on the social safety net.

As said, Slovak government seeks to cut the public budgets deficit - to 4 % of GDP in 2004 - and at the same time to proceed with a radical reform of the tax system. The government aims to introduce a flat personal income tax (to replace today's rates ranging from 10 to 38 %) and corporate income tax (currently at 25 %) at a single rate of 19 %. Value-added tax will be uniformly set also at 19 %. At the same time, a broad range of tax exemptions will be eliminated.

The net impact of the tax changes will decrease the revenues of the 2004 budget by roughly 1 per cent of GDP. The aim of the government is to narrow the deficit, and to offset the decrease

in revenues by cutting spending by 4 % in real terms, i.e. by 2 per cent of GDP. Slovak government has also announced that if, by the half of 2004, public finance deficit exceeds the planned 4 % of GDP, additional cuts in budget expenditures will be undertaken. The middle-term aim is to cut the public deficit further, to 3.5 % of GDP in 2005, and to 3 % of GDP in 2006. Deficit of this magnitude should enable public debt to decline from 44 % of GDP at the end of 2002 to 41 % of GDP in 2006. Thus Slovakia could be ready – provided the country also fulfils the inflation criterion – to join the European Monetary Union in 2007 (or, more realistically, in 2008).

Monetary Policy

National Bank of Slovakia over 2003 is holding its basic two-week repo rate at 6.5 %, under the level of inflation (see Table 2). Three-week Pribor moved within the interval of 6-0 – 6.4 % in January to August 2003, so that Slovakia had, and has, negative interest rates. On September 25, 2003, NBS cut the repo rate by 25 basis points to 6.25. Nevertheless, all commercial real interest rates remained negative.

The main task of the SNB was to prevent a further strengthening of the Slovak koruna, with only a partial success (see Table 4). A moderate weakening of the SKK in August and September 2003 did not result from monetary policy but, rather, was consequence of tensions in the government coalition.

In real terms, sharply increased inflation appreciated SKK by more than 10 per cent from its 2002 average. Rather strong productivity gains, however, have helped to keep competitiveness, as has the decline in real wages.

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Slovakia thus was able to keep high growth rates of exports, in spite of low economic activity in the European Union where 60 % of Slovak exports go. Very good export results also helped to cut the current account deficit from 8.2 % of GDP in 2002 to about 4.8 % expected in the current year.

Negative real interest rates have supported continued strong demand for consumer and mortgage credit. Credits to households are growing at double-digit growth rates. The credits to

separately, or whether to sell in one package. As a result, SE will not be privatized before the second half of 2004.

After this, the government intends to sell state minority shares in previously privatized companies – Slovak Telecom and SPP (natural gas utility). Thus privatization should be completed in 2005. Privatization incomes will be used, especially in 2004, to lower the deficit of government budget.

Table 4: Exchange Rate of Slovak Koruna

	2000	2001	2002	3/2003	6/2003	8/2003
SKK/EUR (average)	42.54	43.28	42.67	41.78	41.50	41.93
SKK/USD (average)	46.20	48.36	45.27	38.66	35.49	37.49

Source: National Bank of Slovakia

households grow more dynamically than their deposits; Slovak banks are thus forced to finance domestic lending by increased borrowing from abroad.

Strong economic growth, radical structural reform, and the approaching date of EU entry have increased the creditworthiness of Slovakia in international financial markets. That is reflected also in very beneficial conditions for financing the budget deficits: in May 2003, government issue of 500 mil. EUR Eurobonds was with the coupon only 5 basis points above Euribor.

Privatization

The government has passed a bill allowing privatization, in so-called strategic industries, of majority shares owned by Slovak state (till now, the law did not permit to sell more than 49 % of shares in such industries). The bill is important for the last large state-owned company, SE (Slovenské Elektrárne, or Slovak Electricity).

The original intention to privatize SE in 2003, however, is being delayed. The government is undecided as to whether to divide the company into classical and nuclear parts and sell them

Outlook

Under the assumption that the coalition government will remain intact and in power, it is highly probable that the far-reaching fiscal and social system reform will proceed as planned. Success of reforms, continued inflow of FDIs and declining current account deficit will push the Slovak koruna to appreciate during the 2004. The EU entry will be another factor pushing SKK up.

The NBS will try to slow this appreciation trend by cutting interest rates. We expect cuts in the range of 75 to 150 basis points, from the fourth quarter of 2003 till the end of 2004.

As pointed above, due to solid prospects for dynamic growth, strong fiscal adjustment, and deep structural reforms, Slovakia seems to be better placed than Poland, Hungary or Czech Republic to meet the Maastricht criteria by 2006 (or during 2007). Under this condition, the adoption of euro in 2007 – or, more realistically, in 2008 – is highly probable.

Strong economic growth, radical structural reform, and the approaching date of EU entry have increased the creditworthiness of Slovakia in international financial markets.

Due to solid prospects for dynamic growth, strong fiscal adjustment, and deep structural reforms, Slovakia seems to be better placed than Poland, Hungary or Czech Republic to meet the Maastricht criteria by 2006 (or during 2007).

THE EU SLOWDOWN: IMPACT ON CZECH FOREIGN TRADE

Eva Zamrazilová

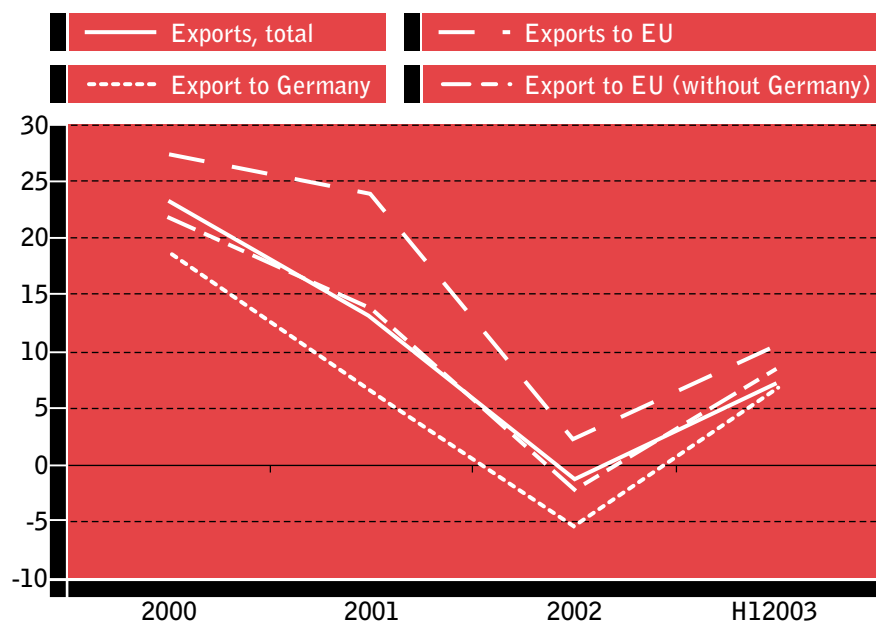
Small size and insufficient resources of raw materials are the main reasons of the Czech economy high openness. This openness has been gradually increasing in the course of transformation process, the turnover of foreign trade with goods and services exceeding the volume of GDP by 35 %, in the first half of 2003. All these characteristics make the Czech economy strongly vulnerable to external shocks and changes in overall external environment. Czech

European sluggish growth, major impacts may be seriously analysed.

Slowdown of West European conjuncture strongly hit the Czech exports in 2001 their slowdown being observable as of second quarter of 2001. It is well illustrated in Figures 1 and 2. Due to the decisive share of the EU countries on the Czech exports, the developments of exports to EU almost perfectly copy the developments of total exports. The decline of exports was even more pronounced in the case of Germany – Czech main trading partner (accounting for 40 % of Czech exports in 2000).

The decline in exports was accompanied by the decline in imports due to high import intensity of

Figure 1: Czech Exports (growth rates in %, yearly data)



Source: Czech Statistical Office

Czech macroeconomic condition is primarily determined by two basic factors: world raw material prices on the one side and level of foreign demand on the other one.

macroeconomic condition is primarily determined by two basic factors: world raw material prices on the one side and level of foreign demand on the other one. In the first decade of the transformation process, Czech economy succeeded to integrate into trade among developed countries, the share of EU countries on Czech exports amounting to 70 %. Therefore, a strong decline of economic growth in the eurozone in the second half of 2001, gave to arose serious concerns about its impacts to Czech macroeconomic developments. After two years of

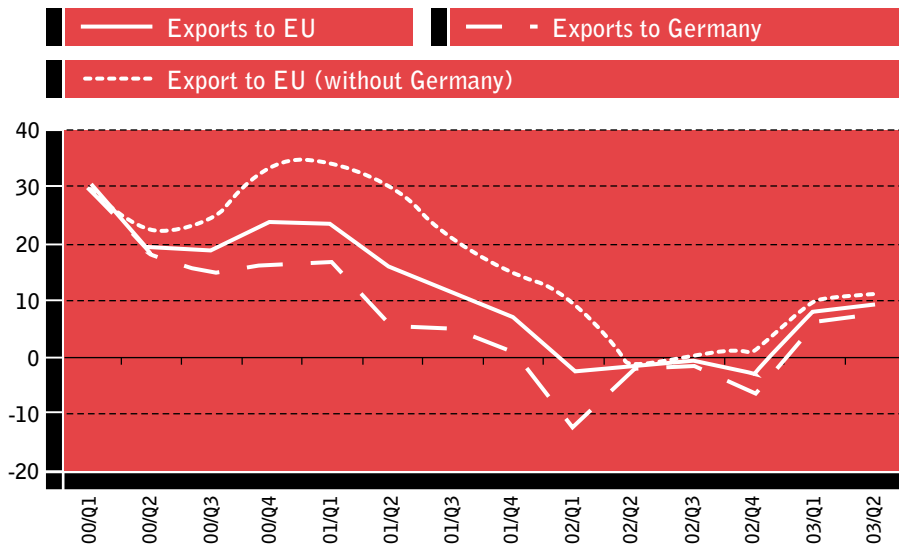
Czech exports (see Figure 3). Moreover, favourable developments of prices in foreign trade helped to offset the impact of weakening foreign demand. The oil prices were approximately by 15 % lower than a year before, being pressed down by weakening world economic activity. Note that the decline of oil prices in Autumn 2001 was quite surprising for most analysts who expected another oil price hike after the US terrorist attacks. The average exchange rate was at 34.1 CZK/EUR and 38 CZK/USD. If the import prices

remained at levels of 2000, the trade deficit would amount to approximately CZK 150 bill. in 2001, instead of real deficit of CZK 119 bill.

2002 was the year of strong decline both of exports and imports. Similar to 2001, development of prices in foreign trade affected

divided into two parts: the effect of exchange rate and the effect of raw material prices. Strong exchange rate which hit Czech exports in 2002 (see Figure 4) was lowering the imports at the same time, the favourable impact on the part of imports being more significant. The positive impact of strong CZK on trade balance can be

Figure 2: Czech Exports (growth rates in %, quarterly data)



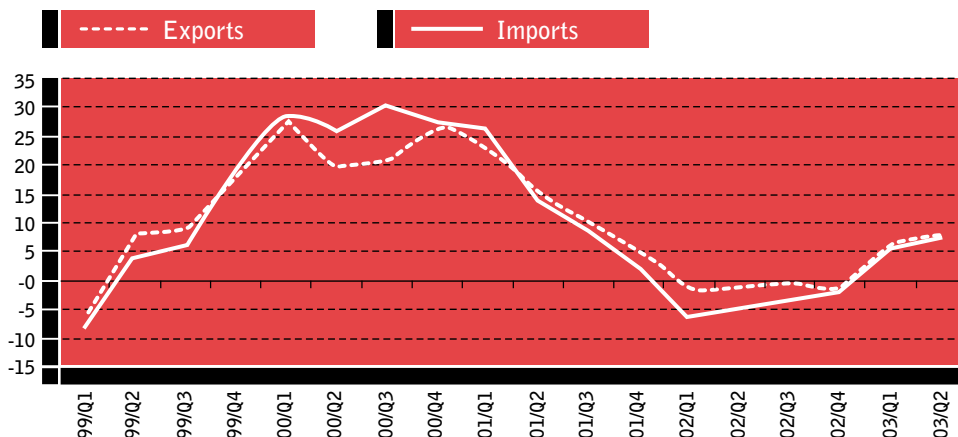
Source: Czech Statistical Office

the real trade balance favourably. If the import and export prices had remained the same as in 2001, the trade deficit would have reached CZK 110 bill. instead of real deficit of CZK 74.5 bill. Favourable developments of prices in foreign trade thus "improved" the trade balance by approximately CZK 35 bill. This effect can be

estimated at approximately one quarter of the overall price effect. Major part of the trade balance improvement in 2002 thus belonged to developments of world raw material prices.

To sum up, the eurozone slowdown did not deteriorate Czech trade balance due to several

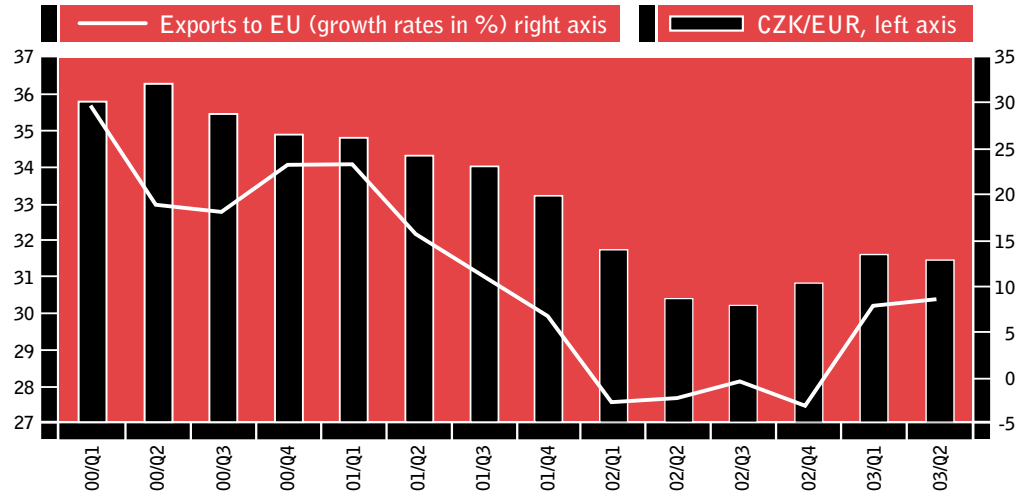
Figure 3: Czech Imports and Exports (growth rates in %, quarterly data)



Source: Czech Statistical Office

Strong exchange rate which hit Czech exports in 2002 was lowering the imports at the same time, the favourable impact on the part of imports being more significant.

Figure 4: Exports and Exchange Rate



Source: Czech Statistical Office, Czech National Bank

factors. First, slowdown of exports provoked slowdown of imports due to high import intensity of Czech exports (see Figure 3). The decline of imports was more significant than the decline of exports, perhaps also due to the fact that the effect of strong exchange rate is more intensive on the part of imports. Second, favourable developments of world raw materials prices (especially the oil price)

since – see Table 2. This is even more pronounced regarding that, in 1999 and 2000, the trade balance with the EU was positively affected by the surplus with Germany which was reduced in forthcoming two years.

Favourable results in trade with EU were thus reached especially due to flexibility of the

Table 1: GDP: Selected EU Countries (growth rates in %)

	1999	2000	2001	2002	2003f
Euro Zone	2.8	3.5	1.4	0.8	0.6
Germany	1.6	3.0	0.6	0.2	-0.1
Austria	2.7	3.5	0.7	1.0	0.6
France	3.2	3.8	2.1	1.2	0.8
Italy	1.6	2.9	1.7	0.4	0.6
The Netherlands	4.0	3.3	1.3	0.2	-0.1
Spain	4.2	4.2	2.7	2.0	2.0
Belgium	3.2	3.7	0.8	0.7	1.0

Source: Czech Statistical Office

Note: Growth Rates above the Euro Zone are bolded

were helpful to Czech trade balance. Naturally, the world material prices were pressed down predominantly by low world economic activity.

Analysing the trade with EU countries, surprisingly favourable outcomes may be depicted. While the trade balance with EU was slightly negative in 2000, growing surpluses have been reaching ever

exporters. During slowdown from 2001 up to now, Czech exporters proved to be able to shift their activities from countries hit most by economic slowdown to those which suffered less and showed better condition. Table 1 shows the different extent of slowdown which was the deepest in Germany, less profound in France, Italy or Spain – see Table 1. Table 3 shows

Favourable results in trade with EU were reached especially due to flexibility of the exporters.

Table 2: Selected EU Countries: Trade Balance with Czech Republic (CZK bill)

	1999	2000	2001	2002	H12003
EU	3.9	-1.7	18.5	60.0	64.0
Germany	49.3	53.0	27.9	26.0	23.1
Austria	3.7	5.6	9.8	11.7	12.3
France	-12.4	-16.6	-12.1	-5.3	-2.9
Italy	-19.3	-21.8	-21.3	-20.8	-4.5
The Netherlands	-1.2	-3.2	2.6	17.5	13.1
Spain	0.8	-4.6	-3.5	-0.2	1.6
Belgium	-2.0	2.9	4.9	-0.2	2.0

Source: Czech Statistical Office

extremely rapid growth of exports to France, Italy, the Netherlands, Spain or Belgium in 2001. After slowdown – which was primarily a consequence of strong CZK in 2002, double digit growth rates of exports appeared again, in the first half of 2003. Regarding persisting weak West European demand in the first half of 2003, the depreciation of the CZK in the first half of 2003 was

Surpluses are reached not only in trade with Germany but also with Austria, France, Italy, the Netherlands, Belgium and Spain. The share of the latter countries on Czech exports are low, not exceeding 5 %, however, their shares on Czech exports have been gradually increasing and their total impact to Czech trade balance has been gaining on importance. The processes of increasing

Table 3: Selected EU Countries: Growth of Czech Exports (growth rates in %)

	2000	2001	2002	H12003
EU	22.1	13.4	-2.2	8.3
Germany	18.8	6.6	-5.7	6.6
Austria	12.6	9.1	-5.2	20.8
France	26.9	20.7	7.2	10.4
Italy	27.3	21.7	-1.4	15.4
The Netherlands	16.1	37.3	37.6	12.1
Spain	16.7	24.8	10.0	15.5
Belgium	30.7	54.5	-21.8	0.7

Source: Czech Statistical Office

a significant factor of acceleration of the Czech exports into EU visible as of the beginning of 2003 (see Figure 4). In the first half of 2003, the surplus with the EU amounted to 64 bill. which is higher than surplus from 2002.

The surplus in trade with EU 14 (that is EU without Germany) amounted to CZK 34 bill. in 2002 and to CZK 40 bill. in the first half of 2003, up from CZK -54.7 bill. in 2000. Those are very progressive results which were not affected by favourable developments of raw material prices.

intensity of foreign trade to those EU countries would be probably slower if it had not been for the German recession which speeded the necessity of Czech exporters to find new territories.

Also, some commodity aspects should be outlined. Major part of surplus in the trade with the EU was reached in SITC 7 and 8 groups (i.e. machinery and transport equipment and industrial consumer goods, the surplus in these commodity groups amounting to CZK 130 bill in

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Table 4: Selected EU Countries: Shares on Exports (in %)

	1999	2000	2001	2002	H12003
EU	69.2	68.5	68.9	68.4	70.6
Germany	41.9	40.4	38.2	36.5	36.9
Austria	6.5	6.0	5.8	5.5	6.1
France	3.9	4.0	4.3	4.7	4.8
Italy	3.7	3.8	4.1	4.1	4.7
The Netherlands	2.4	2.3	2.8	3.9	4.2
Spain	1.7	1.6	1.8	2.0	2.2
Belgium	2.1	2.2	3.0	2.4	2.4

Source: Czech Statistical Office

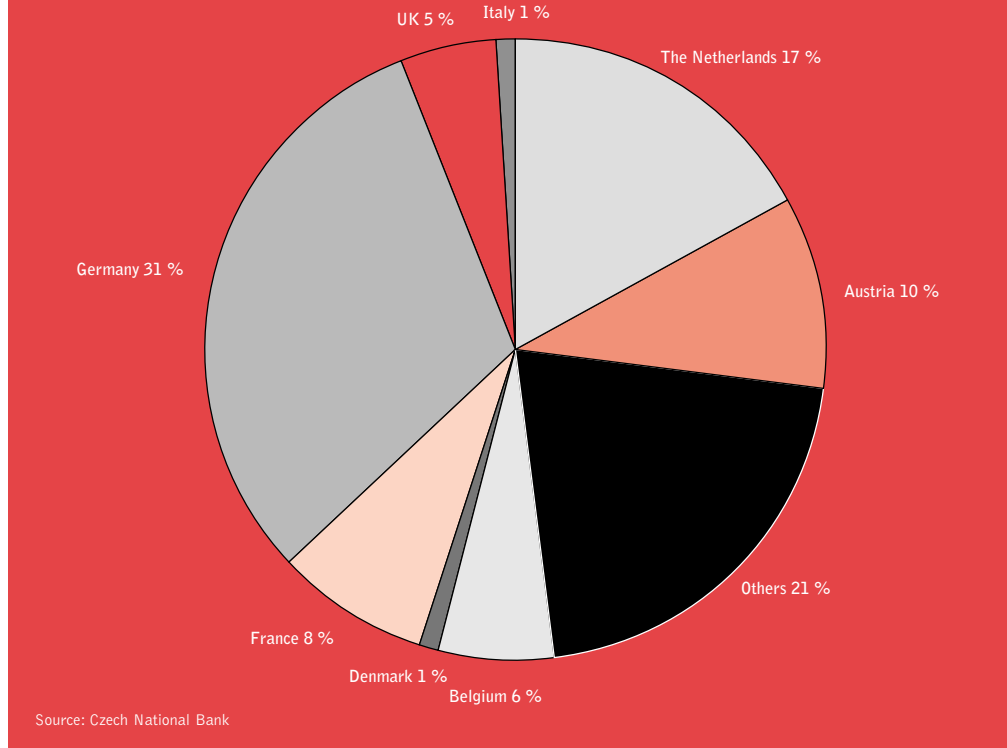
2002 and to CZK 93 bill. in H1 2003. In a more detailed insight to commodity structure in the first half of 2003, road vehicles made for the biggest surplus (CZK 29.4 bill) followed by office machines and automatic data processing machines (CZK 28.8 bill.).Also furniture, telecommunications equipment and metal products contributed significantly with solid surpluses of CZK 12.4 bill., CZK 11.6 bill and CZK 8 bill., respectively.

On the other hand, chemicals is the group producing trade deficit with EU (CZK – 38.9 bill.),

out of which pharmaceutical products are responsible for the deficit of CZK – 12 bill. and plastics for CZK – 14 bill.

The structure of Czech exports to EU is based predominantly on SITC 6 (21.2 %), SITC 7 (55 %), and SITC 8 (12%) accounting for almost 90% of exports. The variety of exported articles within these major groups has been rather dispersed. In SITC 6, especially metal products are very important, with the share of 7 % on exports to EU. As for machinery, the share of vehicals is

Figure 5: FDI Inflows, 1993 - 2002



Growing exports and increasing export performance of various machinery products to EU is strongly correlated with the FDI inflows. Industrial companies under foreign control have been the most important ones in ongoing restructuring processes in the Czech industry.

naturally the most important one with 17 % on exports to EU. Nevertheless, many other kinds of machinery have been gaining on importance (electrical machinery, office machines, power generating machinery, different industrial machinery etc) their exports to EU increasing by above average growth rates. Shares of these different machinery products were reaching from 5 – 10 % on exports to EU, their shares increasing slowly but gradually. Definitely no more applies that the Czech exports to developed economies are based predominantly on vehicles exports.

Growing exports and increasing export performance of various machinery products to EU is strongly correlated with the FDI inflows. It is no coincidence that almost 50 % of Czech industrial direct export sales has been belonging to industrial companies under foreign control. These companies have been the most important ones in ongoing restructuring processes in the Czech industry which enables to increase competitiveness on foreign markets. These companies have been also able to adapt their production and exports to changing demand on developing West European markets. In this respect, it is useful to remind that West European countries have been accounting for major part of FDI inflows which amounted to more than CZK 1200 bill. during the last decade (see Figure 5).

After the EU accession, also the investments from small and medium sized enterprises can be expected. In forthcoming years, the yearly inflow of FDI can be expected at approximately USD 3.5 – 4 bill., with ongoing effects on restructuring, competitiveness and export performance of domestic companies.

UNEMPLOYMENT IN THE CZECH REPUBLIC: PRESENT STATE AND OUTLOOK

Kamil Janáček

Unemployment in the Czech Republic has remained just under 10 % over the last five years. This means that, permanently, half a million Czechs are jobless. The unemployment rate stays at this level, whether the economy is in recession (1998-1999), or growing (2000-2003). Evidently, Czech unemployment is not cyclical but structural.

There are strong regional differences in the rate of unemployment: on the one hand, there is Prague and surroundings, where unemployment is around 3 % (a level practically bordering on full employment); on the other, some regions in North Bohemia and North Moravia have unemployment hovering around 20 %. Situation in those regions is all the more difficult that a strongly above-average unemployment has been typical here for more than a decade.

As the relatively high unemployment rate is a persistent phenomenon, its cutting to a level considered as socially acceptable (around 4 %) will be a several-years task. The condition is to pursue a set of policies aimed at making the labour market more flexible, and fostering new job creation. Such policies have a broader character, and exceed the single powers of the Ministry of Labour and Social Affairs.

1. The notion that economic growth in itself will automatically push unemployment down has not proved to be true (see Table 1). Revival of economic growth at the start of the present decade was accompanied by continuing restructuring within Czech firms. The effect of faster growth was compensated, in relation to labour market, by a trend of downsizing in privatized firms. Moreover, the technological and organizational know-how brought by foreign investors is mainly labour-saving, not labour-intensive.

2. The relative "softness" and generousness of the social safety net means that people are not forced to seek new jobs actively. Weak control mechanisms also make it

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possible to work in the shadow economy, drawing at the same time unemployment benefits or social allowances. It is vital to shed all the pseudo-social considerations, and to set much stricter rules for obtaining social allowances and unemployment benefits. Slovakia which – in spite of a strong resistance by part of the public - was not afraid to introduce stricter rules, is now getting first positive results: during the first 8 months of 2003, unemployment rate has declined by 4.5 percentage points (with economic growth unchanged).

3. A more flexible labour market requires also a more flexible concept of labour contracts. Legislation should only set some basic standards, on a certain level. Other conditions must be left to be agreed between the employers and employees (full- or part-time jobs, flexible working hours, level of lay-off compensations, time-limited work contracts, etc.). Proposals - which await codification - to reglement the number of hours worked go exactly against a de-regulated labour market.

4. Minimum wage must not be too high, and the tax burden on labour should not be further increased. A high minimum wage prevents hiring of less-skilled or unskilled labour. And, if the proportion between minimum wage and average wage exceeds some level (OECD empirical data suggest that the limit is 40 %), it blocks hiring of exactly those groups that are most hit by unemployment. No less devastating for the labour market is the high

barriers for upstarts - has direct effect in new job creation. Experience of some countries (USA, Canada) shows that this supports especially new high-skilled jobs, created mostly in services.

Newest steps of the Czech government, within the reform of public finance, however go against this trend. Measures in the fields of taxation and social insurance will create new burdens for the self-employed, and will force part of them to lay off workers, or even shut down their businesses.

6. Changes of the education system. Even in regions with higher-than-average unemployment, employers have problems to find workers of some professions, mainly for jobs requiring secondary or university education. It is necessary to end with over-specialization of secondary schools, and to create school leavers with broader backgrounds, capable of flexible adaptation and re-training. The same is true of university education – students should get a broader, more general basis, to be ready for re-training within the so-called life-cycle education. It is evident that Czech education system only partly meets these requirements.

7. Co-ordination of policies, seeking a synergy effect. Changes in legislation must guarantee that social allowances go only to those in need, not to the free-riders. Economic policy should create a business-friendly environment for everyone – not just for selected groups.

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Business-friendly economic policy, less regulatory and more growth-oriented, can secure faster economic growth over the long run, creation of new jobs, and lower unemployment.

Table 1: Unemployment Rates, 1993- 2003 (end of period)

1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	9/2003
3.5	3.2	2.9	3.5	5.2	7.5	9.4	8.8	8.9	9.8	10.1

Source: Ministry of Labour and Social Affairs.

burdening of jobs with taxes and other payments by employers. Comparison of countries with high and low indirect wage costs shows a positive correlation between high costs for employers, and unemployment. Lowering this burden has a positive impact both on competitiveness of exports, and on creation of new jobs.

5. Support of business activity, especially of small- and medium-sized firms – which should include lower taxes, free consulting services, easier access to credit (credit guarantees), support of exports, and less bureaucratic

Tax support should be available also for those who by themselves organize and finance such activities that are, within various government programs, financed by public money.

To conclude, business-friendly economic policy, less regulatory and more growth-oriented, can secure faster economic growth over the long run, creation of new jobs, and lower unemployment. As experience of OECD countries shows, there is no other recipe for cutting unemployment.

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