

1.2. Current Trends and Outlook

- **According to IMF world economy to grow faster than expected**

The power of economic recovery is stronger than expected, which has lead the International Monetary Fund to revise the projected growth of global GDP in 2004 and 2005 upwards by 0.6 p. p. to the rate of growth of 4.6 % p.a.¹ The recovery is accompanied by a strong growth of world trade and major increase in the financial markets activity. The recovery is being backed up by factors like improvement in the economic situation of corporations including a strong rise in the corporate profit, favourable financial conditions, resuming growth of information technologies, positive effect of the growth of share market prices.
- **The geopolitical risks increased**

The extent of certain risks remains considerably high. Specifically, the geopolitical risks such as terrorism and oil prices growth, the size of the American economy external imbalance and the problems of medium term fiscal deficits in numerous high-income as well as transition economies. Domestic demand is strongest in countries featuring high external imbalance, with a worsening tendency in some countries.
- **The speed of growth is particularly affected by the exchange rate development**

Another important characteristics of the world economy was the process of depreciation of the American dollar and those currencies linked to the American currency, i.e. in particular the Asian countries. This depreciation tendency resulted in an increased contribution of exports to the economic growth. The opposite development was registered in countries with appreciating currency, i.e. mainly in the euro area.
- **The world markets oil and mineral price hikes**

The world commodity markets also experienced significant shifts. The price of oil (North Sea Brent) swelled from 26 USD/barrel in September 2003 to 38 USD in the half of May 2004, i.e. by 46 %. Essential part of this increase is thought to be a reaction on the weakening dollar. Further factors in play were higher than expected demand growth in the USA and China, relatively low stocks, postponement of the production resumption in Iraq, OPEC announcement regarding lowering of production and far from negligible speculation activities. Estimates of the average oil price in 2004 based on the prices of futures level around 32 USD/barrel. In comparison to the 1st half of 2003 the prices of metals and agricultural commodities also increased, by around 10 %. However, this growth is expected to slacken during 2004, the opposite development is expected regarding the prices of semiconductor components.
- **Low inflation development expected to continue**

Apart from a few countries the low inflation development is expected to continue. The projected growth of consumer prices in high-income countries should in 2004 hover around an average of 1.7 %. This forecast is based on continuing excess of production capacity, weak labour market demand and limits to producer prices growth due to the strong domestic as well as global competition. One digit inflation is also forecasted for the transition and low-income countries. Fears of deflationary pressures disappeared to a great extent as derived by the growing confidence in a sustainable recovery as well as the growth of commodity prices.
- **Favourable conditions predominate in the American economy**

The development of the American economy can lean on the expansionary fiscal and monetary policy, which improved the financial positions of the financial sector and created conditions favourable to investment activities. The debt equity ratio was cut down by 10 p. p. in 2003 and liquidity (the ratio of liquid assets to short term liabilities) reached its highest levels in the last 4 decades. Investment rose by 7.8 % in the Q4 2003, secured mainly by technological products with a share of 55 %. Assisted by a weak dollar, the exports grew by 6.1% in Q4 2003. While the business sector balances strengthened, those of the household sector weakened. Debts as measured in relation to net wealth, assets or household incomes attained the highest level so far. Since the end of recession, i.e. since the end of 2001, the debts were expanding 4 times faster than assets. Housing investment rose at a rapid pace last year, specifically by 7.6 %. Consumers became more vulnerable towards potential shifts in the economic conditions. Open question remains, whether low savings levels and the extent of population indebtedness is going to slow down consumption expenditures.

¹ These and other data are based on the spring edition of World Economic Outlook, IMF, April 2004, which constituted the most current data available at the time of compiling this analysis.

- ***The pace of recovery in the euro area hindered by weak domestic demand***

Recovery in the euro area has been so far mostly supported by the external demand. Following the stagnation of the 1st half of 2003, annualized GDP rose by 1.5% in Q3 in real terms and by 1.3% in Q4. Sharp upturn in the world trade stimulated exports in spite of strong euro. Investment revived somewhat in Q4, but their growth is hampered by the exchange rate uncertainties and the corporate financial positions. Growth differences inside euro area are conditioned by the diversity of domestic demand, which is weakest in Germany and strongest in Greece, Ireland and Spain. Development is considerably affected by the real interest rate differentials. The growth of GDP is predicted at 1.7% in 2004 and 2.2 % in 2005. Factors serving as an impetus to growth should be strong foreign demand, rise in profitability, low yield spread of corporate bonds and sound financial balances of household sector. On the other hand, the development of consumer confidence and the rate of unemployment, which can impede the growth of consumption expenditures, can constitute potential risk factors. Further open question is whether the financial sector is going to be able and willing to extend credit.

In the euro area low inflation and stable interest rates are expected

In an economic environment signaling only gradual pick up of economic growth, declining inflation and strong currency, it is possible to expect for the interest rates to remain at a low level for a longer period of time. In the next six months however, a situation when the euro strengthens excessively and interest rates will have to be lowered again cannot be ruled out. Still, the European Central Bank is likely to tolerate slightly overvalued rate of euro in case it is convinced, that European and global economy is moving on a sustainable growth trajectory. The decline of inflation from 2.0 % in 2003 is expected to continue down to 1.4 % in 2004. Calculations of core inflation involving the deduction of food and energy products as the most volatile groups of production are nearing values around one percent, providing evidence of minimal demand side inflationary pressures.

- ***Growth of unemployment likely to cease while maintaining its differentiation among the EU countries***

At the beginning of the recessionary phase of the business cycle, the growth of unemployment was only mild as a consequence of higher share of employment in the more stable services sector. In 2003, the labour market resilience weakened and the unemployment rate went up by 0.5 p. p. to 8.8 %, having stabilized at this level in recent months. Highest unemployment was recorded in Spain (11.2 %), Italy (9.6 %) and Germany (9.6 %), the lowest in Netherlands (4.2 %), Austria (4.5 %) and Ireland (4.7 %) being the result of countries differences with respect to the flexibility of their labour market. Updated forecasts do not anticipate further growth of the rate of unemployment in 2004.

- ***Increasing tension in the budget area***

During the economic downturn the deficit of public finance rose to 2.2 % in 2002 in the euro area and 1.9 % in the EU. Further increases of deficits were planned for 2003 up to 2.5 % in the euro area and 2.3 % in the EU. During 2003, the budget deficits were revised upwards in France to 3.1 %, Germany to 3.6 %, downwards in Portugal below the 3 % line. Some countries intend to limit the effect of automatic stabilizers on the size of deficit. Among them, Germany, Ireland and Portugal lowered the cyclical component of the budget by 0.5 % of GDP. Budgets for 2004 are constructed based on the original policies. Three countries (France, Italy, Germany) should have budgets exceeding 3 %. Three other countries (Portugal, Netherlands and United States) should lie dangerously close to the Maastricht criterion or above it.

- ***Central European countries in transition show signs of growth acceleration***

Central European economies in transition experienced in 2003 higher rates of growth of GDP on average by 3 p. p. in comparison the EU countries. According to the IMF forecast, the economic growth is bound to climb from the average of 3.4 % in 2003 to 4.0 % in 2004, with the slowest growth occurring in the CR (3.0 %). In the same period, the growth of consumer prices is also expected to gain pace from 2.2 % to 4.2 %. The fastest growth of prices should materialize in Slovakia (by 7.8 %) and Hungary (by 7.1 %), the slowest in Poland (by 3.0 %) and in the CR (by 3.5 %). External imbalances in the form of current account of balance of payments deficits keep persisting. Macroeconomic convergence and connected processes such as a fast growth of credit issue and expansive fiscal policy supporting the imports constitute the background of this trend. These development tendencies are according to IMF sustainable in the short-run due to the low level of external debt, availability of adequate foreign exchange reserves as well as sufficient (even though diminished in

2003) inflow of foreign direct investment covering the current account deficits. This development is not expected to be sustainable in the medium term horizon, which would be linked to the risks of financial markets instability.

Table 1 World Economy Development

	2002	2003	Year-on-year change in %			
			Forecast		Previous forecast differential	
			2004	2005	2003	2004
GDP – world	3.0	3.9	4.6	4.4	0.6	0.6
High-income countries	1.7	2.1	3.5	3.1	0.3	0.6
USA	2.2	3.1	4.6	3.9	0.5	0.7
Euro area	0.9	0.4	1.7	2.3	-	-0.1
Germany	0.2	-0.1	1.6	1.9	-0.1	-
France	1.2	0.2	1.8	2.4	-0.3	-0.2
Italy	0.4	0.3	1.2	2.0	-0.1	-0.4
Spain	2.0	2.4	2.8	3.3	0.2	-
Japan	-0.3	2.7	3.4	1.9	0.7	1.9
Central and Eastern Europe	4.4	4.5	4.5	4.4	0.6	0.1
Russia	4.7	7.3	6.0	5.3	1.4	1.0
China	8.0	9.1	8.5	8.0	1.6	1.0
World trade (goods and services)	3.1	4.5	6.8	6.6	1.6	1.3
Consumer prices – high-income count.	1.5	1.8	1.7	1.7	-	0.4

Source: World Economic Outlook, IMF, April 2004

Table 2 Macroeconomic Development in Selected Central European Countries

	year-on-year change in %											
	Real GDP				Consumer prices				C.a. deficit/GDP			
	2002	2003	2004	2005	2002	2003	2004	2005	2002	2003	2004	2005
Central Europe	2.2	3.4	4.0	3.8	2.8	2.2	4.2	3.1	-3.6	-3.3	-3.4	-3.5
Czech Republic	2.0	2.9	3.0	3.4	1.8	0.1	3.5	3.0	-6.1	-6.5	-5.4	-4.8
Hungary	3.5	2.9	3.2	3.4	5.3	4.7	7.1	4.4	-4.1	-5.5	-5.3	-4.3
Poland	1.4	3.7	4.7	4.0	1.9	0.8	3.0	2.4	-2.6	-2.0	-2.3	-2.9
Slovakia	4.4	4.2	3.9	4.1	3.3	8.5	7.8	4.2	-8.0	-0.9	-2.9	-3.5
Slovenia	2.9	2.3	3.5	4.1	7.5	5.6	3.7	3.4	1.4	0.1	-0.6	-1.0

Source: World Economic Outlook, IMF, April 2004