

1. External environment

The economy of the EU represents the main component of external environment for the Czech economy. The overview of the macroeconomic development in the EU is focused on (1) current trends, (2) comparison of economic growth in the EU and the USA, (3) indication of causes of low economic growth in the EU, (4) description of anticipated economic development, and (5) priorities of economic policy in the future.

- **Revival set back**

GDP in the EU15 grew by 2.4% in 2004, which was close to its potential. After a strong economic growth in the first half of the year, there was a slowdown in the second half of the year. Among underlying causes were the weakening growth of world trade, high oil prices and appreciation of the *euro*, which affected exports unfavourably. A positive feature was accelerating growth of domestic demand. Investment and private consumption recorded a slight revival. However, business cycle surveys in the first months of 2005 suggested that the strength of the revival should not be overestimated.
- **Gap from growth of the US economy**

A comparison of key economic indicators between the USA and the EU spanning the years 1991-2004 showed better results for the USA in the development of both GDP and all its components on the side of demand such as household consumption, investment and net export. The reasons were better utilisation of labour pool (higher employment rate), faster growth of investment and higher labour and capital productivity.

Table 1 Comparison of key economic indicators for the USA and the EU

Y-o-y change in %, constant prices

	Avrg. of 1991-2000	2000	2004
GDP – USA	3.3	3.7	4.4
EU15	2.1	3.6	2.4
Domestic demand – USA	3.6	4.4	4.9
EU15	1.9	3.2	2.3
Private consumption – USA	3.5	4.7	3.8
EU15	2.0	3.1	1.7
GFCF – USA	6.2	6.2	8.8
EU15	2.0	4.9	2.8
Exports of goods and service – USA	7.1	8.7	8.5
EU15	6.6	11.8	5.7

Source: Statistical Annex of European Economy, European Commission, 2005

- **There are more causes of low growth**

The causes of low dynamics of economic growth in the EU can be explained by a broader range of factors, among them are:

 - EU member states are not sufficiently attractive for inward flows of foreign direct investment, which results in reduced dynamics of gross fixed capital formation;
 - outsourcing in form of winding up domestic production, which is substituted by imports from countries with a lower costs level, has a negative effect on employment and growth;
 - application of macroeconomic restrictions also during recession (in the downward stage of business cycle) indicates insufficient use of the system of analyses monitoring the development of a potential product, and deviations of the movement of the economy from a potential product;
 - the volatility of exchange rate weakened the contribution of net export to GDP growth and reduced investment activities connected with export performance of the EU economy;
 - low elasticity of the labour market reducing the utilisation of labour pool, which slows down the implementation of progressive structural changes between industries and sectors;
 - insufficient development of the sector of services caused mainly by the protection of domestic markets;

- ageing of population, which reduces economic performance by deteriorating the age structure of workers;
- slow progress of structural reforms which reduces availability of financial resources for the development of infrastructure projects, particularly in the area of transport.

• **Acceleration of growth not expected until 2006**

With regard to less favourable external economic conditions, the forecast of GDP growth in 2005 was lowered to 2% for the EU and 1.6% for the Euro-zone, but acceleration to 2.3% and 2.1%, respectively, is expected in 2006. The growth should be boosted by domestic demand, whereas net export is not supposed to contribute to GDP growth. The rate of growth of investment should speed up, supported by historically low real interest rates and improvements of companies' balance sheets and profit margins. Accelerating investment should be accompanied by a moderate growth of private consumption.

Among the risks of the forecast are global imbalance (the current account of the balance of payments in the USA should move around 6%) and development of prices in world commodity markets, in particular oil prices. The development of private consumption will be sensitive to the development of real incomes. Neither ruled out is deterioration of competitiveness, which would slow down economic performance.

Table 2 Forecast of the economic development in the Euro-zone

Y-o-y change in %, constant prices

	2004	2005	2006
GDP	2.0	1.6	2.1
Private consumption	1.3	1.6	1.8
Total investments	2.1	2.8	3.7
Employment	0.6	0.7	0.9
Unemployment rate	8.8	8.8	8.5
Inflation	2.1	1.9	1.5
Government budget (% GDP)	2.7	-2.6	-2.7
Government debt (% GDP)	71.3	71.7	71.9
Current account of balance of payments (% GDP)	0.6	0.6	0.6

Source: Economic forecasts, European Commission, spring 2005

• **Priorities of growth-promoting policy**

The Directive on EU economic policy in 2005-2008 brings some changes in the accent, structure and conception of its implementation. Among the main priorities are questions of economic growth and job creation. Justification of this priority rests on the need to respond to the process of population ageing by a growth-promoting policy which will make possible sustainable growth of economic performance. In order to make the growth of economic potential sustainable, all the key sources of growth should be motivated such as higher utilisation of labour pool, widening of productive investment activities and increasing productivity of factors of production, i.e. labour and fixed capital. Also long-term factors of growth, i.e. innovation activities and higher qualifications of the labour force, should be supported.

A new feature of setting economic policy should be integration of macro- and micro-policy. In this framework, the role of micro-policy should be strengthened. Among priorities are enlargement and widening of the internal market, openness of markets and creation of a more attractive business environment.