

Summary of main tendencies

1. Development of main parameters of external economic environment in 1995 to 2006 showed a strong instability and weakening of positive effects on the Czech economy. The price of crude petroleum more than tripled, the growth of GDP in the EU in 2001-2006 in comparison with the period 1996-2000 slowed down by 1 p.p. on average per annum and CZK significantly strengthened, on average by more than 4% against EUR and by more than 5% against USD.
2. After accelerated growth of the economy in 2003-2005, GDP in the CR grew in 2006 by 6,1%, i.e. like in the previous year. From the aspect of medium-term (2001 to 2006) as well as long-term (1996 to 2006) development when the average growth rates were 4% and 2,9%, respectively, the growth in 2006 was highly above the average. Favourable internal conditions of economic growth prevailed. Production potential due to foreign direct investment proved to be supportive as well as relatively low prices of loan capital, employment growth, increased investment activity and acceleration of total factor productivity growth. In the second half of the analysed period monetary and fiscal policies were not of restrictive nature.
3. In a long term view, the development of the demand side of the economy in the period 1995-2006 showed balance between the average growth rates of GDP, consumption of households and investment oscillating around 3% p.a. Differences were reported for two five-year periods when in the second half of the 90's the growth was mainly driven by household consumption and from 2001 to 2006 by investment. In terms of international comparison of GDP by expenditure approach, the CR shows lower contribution of household consumption to GDP (around 50%) than the advanced countries (approximately 60%). Considering investment contribution to GDP, the development was just opposite (the CR contributed by about 30%, developed countries by about 20%). In 2006, the structure of GDP by expenditure approach showed only an intangible difference from the level of the above stated long-term averages.
4. Difference in long-term development of the supply side of the economy compared to advanced countries was in the contribution of industry and construction to gross value added, in 1995 – 2004 it stagnated around 35% and then it began to increase up to 40% in 2006. On the other hand, the contribution of services to the national economy dropped from 60% to 57%, widening the gap between the CR and the average of the EU countries where the contribution of services to GDP is about 70%. Faster growth of services output was impeded by a slow-down in new job creation, financial restriction for non-market branches (education, health care) and last, but not least, weak purchasing power of the population.
5. Weak point of the Czech economy development remains its high energy intensity. The average drop of energy intensiveness in 1995 to 2005 was 2% p.a. Although, from international comparison, the energy intensity remains still high and belongs to the highest in the EU. The main reasons for high energy intensity are the following: energy intensive technologies, high share of industry in the national economy structure and insufficient thermal insulation of buildings.
6. Contributions of main production factors – employment, fixed capital, labour productivity and capital to the GDP growth were, to a great extent, affected by the business cycle. The start-up of economic growth in the period 2000-2002 was attributed solely to the growth of investment and labour productivity. In 2003-2006, all four principal production factors contributed to the accelerated economic growth. Investment and labour productivity increased their contributions to GDP; a new feature was the contribution of the capital productivity and contribution coming from the resumed growth of employment in 2005 and 2006.
7. Macroeconomic imbalance in the period 1995 - 2006 was of cyclic character. Excessive satiation of the economy with credits and investment in the period 1994 - 1996 created a gap between savings and investment and resulted in external imbalance in form of an extra high deficit of the balance of payments current account which was between 6 up to 7% of GDP. The monetary and fiscal restriction applied in the period of recession 1997-1999 mitigated external imbalance. Growth phase of the economic cycle reported for the period 2000-2006 re-generated the increase of macroeconomic imbalance in form of double deficit, i.e. budget deficit and the balance of payments current account deficit. Although the public budget deficit in the period 1995-1996 showed a downward trend, in view of the robust economic growth it still remains high. On the other hand, in 2005 and 2006 the imbalance at the labour market was mitigated when the accelerated economic growth allowed for increase of employment and decrease of unemployment. The long-term unemployment rate which makes roughly a half of total unemployment, is still posing a problem. Macroeconomic framework of that period was formed by loosened fiscal and monetary policy.
8. In the period 1995 – 2006, economic level of the CR started to come closer to the EU25 average and in 2006 it reached 76%. Almost the whole progress in real convergence was reached in the period 2000 - 2006, when the CR was ranked to the countries showing the most rapid growth. The results was contributed to not only by acceleration of economic growth in the period 2003 - 2006 in the CR but also by the GDP slow-down in the EU Member States in the period 2001 - 2005 in comparison with the growth of economic

performance in the period 1996 - 2000. Similar rate of growth as for GDP per capita was recorded also for the convergence process of labour productivity per employee. In fact, nominal convergence experienced two-speed development. As early as in the first years of this decade, the inflation growth rates and interest rates levels came nearer to the EU15 average. On the other hand, no progress was recorded for convergence of public finance. The gap between the public finance deficit of the CR and the EU average did not narrow; in contrast, the trend to a significant growth of government debt strengthened. Yet, the international comparisons showed that in 2006 the CR as the only one of the new members of the EU was meeting the Maastricht criteria.

9. In a long-term view, the period 1995 - 2004 proved concordance of the development of economic performance and living standard characteristics. The differences began to appear in the period of accelerated dynamics of economic growth in the period 2004 - 2006 when the growth of household consumption and real wages began to fall behind the economic growth. In the period 1995 – 2006, the rate of gross domestic savings fell to one third of the previous year level. In the period 2001 – 2006, the conditions and manners of financing the growth of the living standard of population began to substantially change. People began to increasingly finance the consumption from their savings and consumer credits which in the years 2005 and 2006 rose on average by over 30% p.a. The rate of net population savings reached in the last years record low values.

10. From the long-term view the differentiation of wages in the Czech Republic gradually widened. Yet, according to international comparison made by OECD the CR belongs, along with Sweden, Finland and Slovenia, to countries with low wage differentiation which is proved by small wage differences in individual branches of the national economy and between business and non-business spheres. On the one hand, low level of wage differentiation allows for low level of poverty and social reconciliation but, at the same time, low level of wages and savings of the population can slow down the consumption of households in the future.

11. International comparisons of the state of health of the population revealed the suspension of convergence processes. The health expenditure/GDP ratio in the CR keeps 1 p.p. behind the EU average; similarly, the difference in life expectancy between the advanced countries and the Czech Republic began to stagnate. The Czech Republic belongs to the group of countries where a significant part of the population (in the CR almost 40%) live in the air polluted environment.