

## IV. Czech industry is changing

The recent development of the Czech industry can be viewed as breaking in many respects. In the new decade the growth is driven by other sectors than those dominating in terms of produced volumes and revenues in the 1990's. The Czech industry is now "lighter", shifted towards sectors with higher value added, with exports gaining ground. An essential feature is the accelerating dynamics – direct export revenues have been growing fastest, reaching double-digit rates year-on-year in the long term. In the period of last few years increases in labour productivity are higher than increases in average wages. Imposing are company profits: in 2006 they were up 30.7% and reached CZK 237.1 billion (8.4 billion euros) in large enterprises (more than 100 employees) and potential of growth seems far from being exhausted.

In comparison with the 1990's, the Czech industry at the turn of the decade of the new millennium is healthier, more focused on production that consumes less energy, less devastating to the environment, exporting more than half of the production and producing more value added. And the structure keeps changing.

### Persons employed in industry are increasing

Employment in industry has been increasing. After the period of structural changes ended and in the conditions of relatively high unemployment rates, certain industrial sectors started to take on new employees roughly from mid-2005. Now industry gives work to nearly one third of all employees in the national economy, i.e. nearly 1.3 million. The segment of foreign-controlled enterprises alone has absorbed well above half million people and its share in employment in industry continues growing and reached 45% of all persons employed in industry in the first quarter of 2007 (compared to 41.3% a year earlier).

On top of these persons, tens of thousands of agency workers are working in industry. In the first quarter of 2007 they were 40 thousand workers, of which most in the car industry (10.5 thousand), manufacture of electrical and optical equipment (10 thousand) and metallurgy (6 thousand).

### Revenues amounting to annual GDP

One third of persons employed in the national economy are working with roughly 150 thousand industrial enterprises (natural persons and legal entities). They sell their products for approx. CZK 3 400 billion, i.e. 120 billion euros annually, which is the value of the Czech Republic's nominal GDP. More than 450 enterprises achieved sales in excess of a billion (CZK). The segment of small and medium enterprises is gaining importance in the economic structure of the Czech Republic; its revenues make up nearly two-fifths (46.8 billion euros) of total industrial revenues.

The strong growth of company revenues is amazing for two reasons, which can be documented by the year 2006: firstly, the increase was not generated by increasing numbers of enterprises because the number of enterprises remained actually the same year-on-year. This holds for both large enterprises employing more than 100 persons (increase by 0.1%) and smaller enterprises employing between 20 and 100 persons (increase by 1%). The second commendable aspect is the lasting strong capability of export even though CZK has been strengthening against the euro and US dollar for a long time.

The growth rate of revenues is roughly the same in large and small enterprises: in 2006 revenues from sale of own goods and services grew by 18.1% year-on-year in enterprises with more than 100 employees, i.e. just the same rate as in enterprises employing 20–100 persons. Difference between the two groups was, however, in the rate of profits.

### Very high profitability

In comparison to the 1990's, profits achieved in the Czech industry in last years are very high. Also annual profit increases are commendable – in 2006 pre-tax profit in enterprises over 100 employees grew by 30.7% and reached CZK 237.1 billion (8.4 billion euros). Trade margin in enterprises with 20–60 employees stood at CZK 45.1 billion (1.6 billion euros) and grew by 10.6% year-on-year.

Good profit figures in the entire industry were recorded also in the previous three years. While in 2002 there were 127 151 active enterprises making profit in the Czech industry, this set of enterprises remained principally the same in 2005 – 127 532 enterprises made profit. However, due to a decreasing number of employees the book value added per employee grew most sharply. Using this parameter, in 2002 one employee produced CZK 483 thousand (17 thousand euros) and in 2005 already CZK 633 thousand (22.3 thousand euros). Just in three years the book value added per employee rose by nearly a third (+31.1%).

Such an improvement in output and financial situation of industrial enterprises had an impact on return on equity. While in 2002 ROE was 8.94%, in other words the 100% return would have taken 11 years under this rate, in 2005 ROE increased to 11.83%, i.e. the 100% return would need 8.5 years.

## **Productivity two steps ahead of wages**

Another remarkable aspect of the Czech industry development is related to wages, productivity and employment. The average monthly wage in April 2007 exceeded CZK 20 thousand, i.e. 720 euros (average monthly wage in 2006 was CZK 19 388, i.e. 680 euros). According to the data, the average monthly nominal wage was CZK 21 260. The rate of growth is very high. The data say that in the first quarter of 2007 wages in industry rose by 8.0% year-on-year on average, in April by 9.0% and in July by 9.4%; these rates are highly above the long-term average (+6.0% annually in the 2000–2005 period). The number of persons employed has been increasing faster – while in 2002–2005 employment shrank by 1.1% annually on average, in January–April 2007 it grew by 2.4% year-on-year and in July 2007 by 2.6% (i.e. +29.9 thousand employed persons).

Compared to wage increases, the average rates of labour productivity are by a third higher and more accelerating in the last period. In 2000–2005 productivity grew by 8.2% annually on average (wages by 6% annually), in the first quarter of 2007 productivity rose by 9.4% and the average wage by 8.0%. In April and July 2007 was labour productivity higher by 11.5% and 9.5% year-on-year respectively. Productivity is growing faster than wages despite the high rates of the latter.

## **Exports, exports...**

More than half of the industrial production is exported, in the manufacturing industry well above one half. The percentage has increased sharply since 2000. In 2000 direct export revenues made up over one third (37.5%) of the total industrial revenues, in 2006 already 48.5%. In manufacturing direct export participated in respective total revenues by 43.8% in 2000 and by 53% in 2006. As far as industrial sectors are concerned, exports are pulled by car industry in particular. Exports by sectors producing office machines and computers grew sharply too, but they are more or less of a complementing nature in the conditions of the Czech Republic. These exports follow the pattern “cheap purchase of attractively priced components in dollars ⇒ assembling ⇒ profitable sale abroad in euros”. Company profits are generated, besides the trade margin, by exchange gains (favourable trend of EUR/USD exchange rates).

## **... controlled by foreign investors**

The strong wave of foreign investors coming in the Czech Republic especially in the late 1990's and the first years of the new decade took place together with strong investment imports. Acquired plants were furnished with machinery and equipment which were to serve the export of the future production, which came true. Already in 2000 foreign-controlled enterprises accounted for 63.4% of the total direct export revenues. In 2006 the share was 75.2%. The participation of foreign-controlled enterprises in export revenues of the Czech industry thus exceeded three quarters.

The share of foreign-controlled enterprises in total industrial revenues is lower, which proves that domestic enterprises are substantially more focused on the Czech market. In spite of this, the share of foreign investors in this field more than doubled in a short period of time. While the share was a quarter (25.3%) in 2000, it rose to more than half (58.6%) in 2006. The prevailing part of incomes from industrial production in the Czech Republic goes to foreign investors, and they are the main driving force of both industrial production and external trade.

## **Shift towards a “lighter” structure**

Structural changes are behind the changes in the Czech industry. While in 2000 metallurgy was dominating with a 16.2% share in the total revenues of manufacturing, in 2006 the first position was occupied by the car industry with a 20.4% share. This sector is among those which markedly increased their share (+4.5 p.p.), just like the manufacture of plastic products (+2.2% to 6.6% of total revenues) which is closely linked to car production. The strongest growth was recorded in the manufacture of electrical and optical equipment where the share in revenues of manufacturing rose by 7.1 p.p. to 15.7%. Just this made the so far “heavy” structure of the Czech industry “lighter”.

The Czech industry benefits from a stable energy sector (energy distribution networks in the Czech Republic are among the most stable ones across Europe).

## **Sources of growth are not yet exhausted**

Sources of continuing industrial growth are still open. The rate of growing orders, especially in certain sectors of the manufacturing industry, has been accelerating thanks to economic recovery in west Europe. This holds in particular for new external orders which account for 60% of total orders. While in 2001–2005 new industrial orders in the Czech Republic grew by 15.9% annually on average, the growth in the first quarter of 2007 was 15.0%. What may be hopeful for the future is a good shape of the German economy and European economy as major markets for Czech industrial exports. In spite of a slight slowdown of GDP in Germany in the second quarter of 2007 affecting the year-on-year rate of total industrial new orders in the Czech Republic (+8.6% in July 2007), conclusions that the business cycle in industry has just peaked and the downward trend begins are not yet on the agenda.

**Expansion of industry in the Czech Republic**

(change in % against 2000 average = 100, unless otherwise stated)

	2001	2002	2003	2004	2005	2006	1H2007
Industrial production index	6.7	8.7	14.7	25.7	34.0	49.0	61.0
Manufacturing production index	7.4	9.6	15.5	27.9	37.6	54.2	66.9
Direct export revenues	13.5	27.8	37.7	68.4	79.9	100.3	x
Averag nominal wage	6.3	13.3	20.1	28.7	34.7	42.7	x
Average number of employees (y-o-y change)	0.5	-2.9	-3.4	-0.3	0.0	1.7	x
New orders (y-o-y change)	34.1	7.1	8.9	21.1	7.5	19.7	x
Average nominal wage (y-o-y change)	6.3	6.0	5.7	7.0	4.7	6.0	x