

# 1. External Economic Environment

The most important parameters of external economic environment affecting the development of the Czech economy in the period 1995-2006 included economic growth in the EU, oil prices and exchange rate trends.

- **Slight acceleration of global economic growth**

In 2006, according to preliminary estimates, the global economic growth moderately accelerated while some development trends were maintained and some changed. The process when less advanced countries benefited from advantages of globalisation to narrow the gap between their economic growth and that of advanced countries, continued. This is proved by double-digit growth reported for countries such as China or India or high growth dynamics between 5 and 7% in the countries with medium level of economic output including the Czech Republic. The changes in differentiation of economic growth in the main global regions took place when the growth of GDP in the USA slowed down and in the EU speeded up.

This development was due to various reasons. The slow-down of American economic growth was related mainly to the price rise of loan capital which resulted into the increase of consumer prices and prices of housing. An important negative role is attributed to problems appearing in external economic relations due to high dependence of the US on energy source prices accompanied by weakening of USD.

- **Acceleration of GDP growth in EU15 in 2006 I**

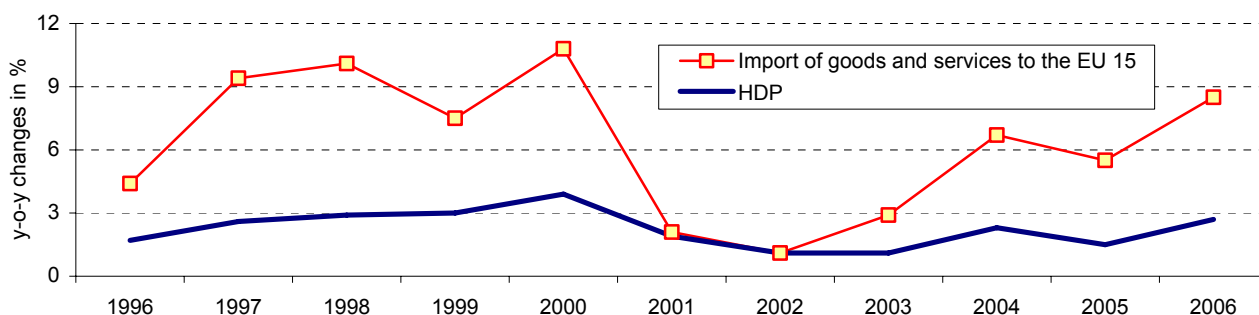
Economic growth in the EU15 showed a long-term slow-down. While in the period 1996-2000 the GDP annual growth was 2.8%, in the period 2001-2006 the annual growth dropped to only 1.8%. After a few mere signs of economic growth in 2004 the growth took place in 2006. GDP increased by 2.7% in 2006 and hit the record since 2000. To the main pillars of growth belonged exports and investment. In capital investment the domestic investments are losing their leading role which they had in the past. A certain start-up of growth was recorded for household consumption. Eurostat reports an estimated annual economic growth by more than 2% also in the period 2007 and 2008.

**Table 1 Development of GDP and its components in EU15 and in Germany**

	y-o-y changes in %				
	1996	2006	1996-2000	2001-2006	1996-2006
<b>EU15</b>					
GDP	1.7	2.7	2.8	1.8	2.2
Aggregate domestic demand	1.4	2.5	2.9	1.8	2.3
Household consumption					
Gross fixed capital formation	2.1	4.9	4.6	1.9	3.1
Net exports	18.7	28.3	-6.7	2.1	-2.0
<b>Germany</b>					
GDP	1.0	2.7	2.0	1.0	1.4
Aggregate domestic demand	0.4	1.6	1.8	0.0	0.8
Household consumption	1.6	0.7	1.8	0.3	1.0
Gross fixed capital formation	-0.5	5.6	2.4	-0.8	0.6
Net exports	131.8	19.8	38.7	25.5	31.3

Source: Eurostat

**Graph 1 EU15 – GDP and imports development**



Source: Eurostat

- **Acceleration of German economy was pulled by investment and exports**

Due to intense business relations the business cycle development in Germany is one of the important external conditions of the Czech economy. German economy accelerated mainly due to investment and exports. Certain slow-down is however expected due to the planned increase of VAT which should contribute to public finance consolidation. On the other hand, the growth should be stimulated by household consumption which is expected to grow due to decreasing unemployment and growing real income. The pro-growth effect should be brought also by increased competitiveness in production markets, especially in network industries.
- **In 2007, global economic slow-down is expected**

Forecasts of economic growth in 2007 are derived mainly from specific features of economic cycle movements in the US and EU. The main role should be played again by the US economy development which represents the main driving force of global economic growth. Further slow-down is expected due to development of financial conditions, i.e. interest rates which are in the long term above the average. This development can weaken the import performance of the EU countries and thus slow down its economic growth.
- **Long-term oil price growth**

In the period 1995 - 2006 the oil price continued to grow. In 2006, the oil price was 3times higher than in 1995. Whilst in the period 1996 - 2000 the oil price rose by 19% per annum on average, in the period 2001 - 2006 the average growth rate was 14% per annum.
- **Oil price instability in 2006**

In 2006, oil price fluctuation in global market continued. Causes included: on the supply side the shifts in production at the main oil producers were recorded mainly due to geopolitical reasons. On the other hand, a significant growth of demand for energy sources was recorded in the countries with high growth dynamics of industrial production (e.g. China and India). Very important for the global economy was that most countries were able to mitigate adverse impacts of price shocks in commodity markets on the inflation and economic growth. An important role in this field was played not only by an adequate stricter monetary policy curbing the growth of demand by increasing of interest rates but also by non-igniting the upward spiral of wages and prices due to moderate wage policy.

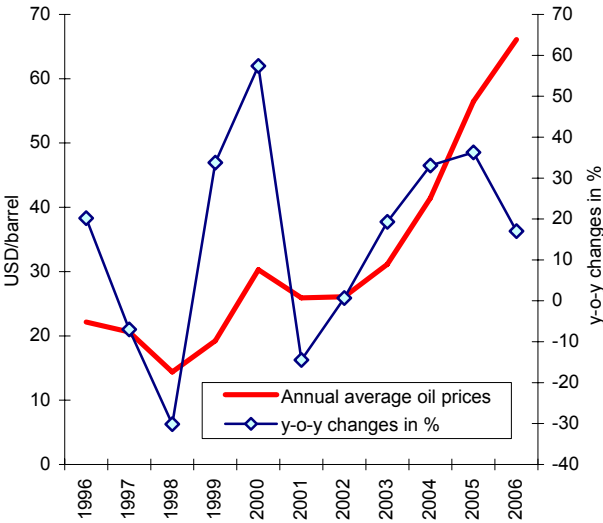
In response to the oil price growth which started to narrow the price gap to renewable sources, the countries showed an increased interest in the support of clean energy sources. Energy policy goals more reflect efforts aimed at reduction of energy dependence on external sources. The instruments supporting these goals included: taxes, subsidies and emission permit system.
- **Acceleration of global trade**

Dynamics of global external trade speeded up in 2006. This development was driven mainly by transition economies which reached two-digit growth rates of exports dominated by industrial products. High rates of growth of external trade were recorded although terms of trade in countries importing energy sources were becoming worse.
- **Strengthening of CZK continued**

In the period 2000 - 2006 CZK strengthened markedly. The average rate of CZK strengthening to USD was in the period 2001 - 2006 8.5% p.a. and to EUR 3.7% p.a. In 2006 CZK strengthened dynamically, by nearly 5% against EUR and more than 5% against USD.
- **Impact of changes in external environment on the Czech economy**

Long-term trends in development of parameters of external economic environment when the oil price grew, the GDP growth in Europe slowed down and the CZK weakened competitiveness, apparently reduced the positive effect of external conditions on the Czech economy. In 2006, certain balance was reached between favourable and adverse effects of the changes in external environment due to significant revival of economic growth in the EU which contributed to the dynamic growth of exports.

Graph 2 Oil price development



Graph 3 Development of exchange rates of CZK to EUR and USD

