

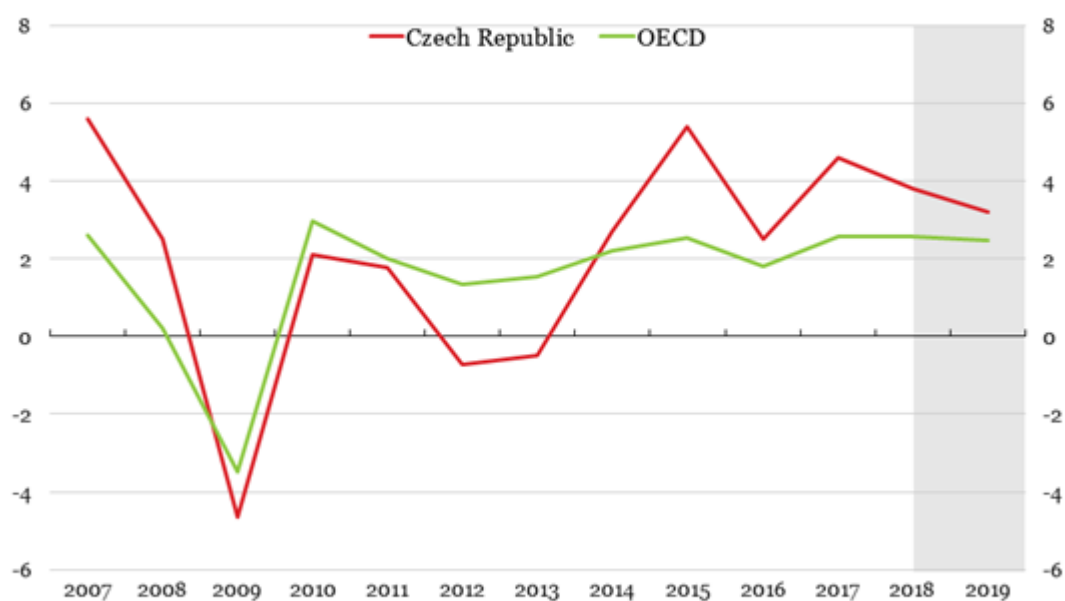
# **The Czech economy is thriving but labour shortages will limit growth**

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Growth, driven by both internal and external demand, has been accelerating since 2013 and at 4.6% in 2017 it was more balanced than in previous years. Household consumption is supported by income growth, a declining savings rate as confidence is high, and by rising credit. Going forward, private investment is projected to increase thanks to favourable credit conditions, and greater withdrawal of European Structural and Investment Funds. Moreover, the relative higher cost of labour than capital should stimulate physical capital investment. Also, high housing demand and prices will continue to drive housing investment. However, growth will slow down in 2018 mainly due to labour supply constraints, but at 3.8%, growth will remain above its potential.

**Figure 1. The economy is thriving**

Real GDP growth, year on year per cent changes



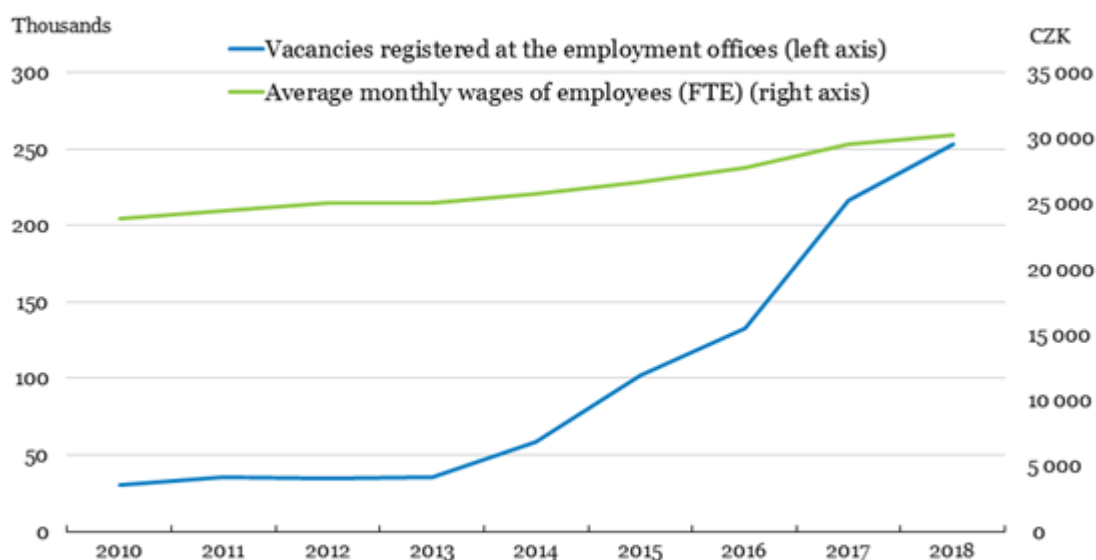
Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

Inflation picked up strongly in 2017 reaching on average 2.5% after three years of being around 0.5%. Inflation will remain above the 2% target of the Central Bank, driven by high wage growth, strong household consumption and increasing oil prices. The current account has been positive in the last four years contributing to foreign reserve accumulation. However, after the exit from the exchange rate floor policy in April 2017, reserves (as a percent of GDP) started to decrease and the koruna to appreciate. As wages and inflation are rising, monetary policy should raise interest rates further at a gradual pace.

The fiscal position is strong but will be challenged by an ageing population. The primary balance increased to 2.3% in 2017 and has been in surplus for three years in a row. Therefore, debt-to-GDP is decreasing rapidly and at 35% of GDP in 2017 is one of the lowest in the OECD (Maastricht definition). According to new measures announced by the newly elected government, there is a risk of fiscal policy becoming pro-cyclical. In view of signs of overheating economy, fiscal

policy should avoid being pro-cyclical. Some fiscal space is also needed to prepare for the rise in future ageing-related spending.

**Figure 2. Wages are rising due to labour market shortages**



*Note:* 2017-preliminary; vacancies refer to numbers registered at the end of the respective year and for 2018 at the end of the first quarter, preliminary.

The lack of workers is becoming the main bottleneck to higher growth. The unemployment rate fell further in 2017 and at below 2.4% is among the lowest in the OECD. Until recently, labour shortages driven by demographic changes and high employment were partly offset by higher economic activity rates. However, the economy is facing constraints on the labour market and vacancies registered at employment offices increased more than seven-fold, from 30 803 in end 2010 to almost 267 000 in April 2018. Increasing labour productivity would sustain wage growth and help to cope with labour shortages. Providing workers with the right skills and training, as well as strengthening the effectiveness of R&D and innovation policies will be crucial to generate sustainable productivity gains and achieve inclusive growth.

## References:

OECD (2018), [OECD Economic Surveys: CZECH REPUBLIC 2018](#), OECD Publishing, Paris.