

INFLATION REPORT / APRIL

7  
2007



# INFLATION REPORT / APRIL

---



<b>TABLES IN THE TEXT</b>	<b>2</b>
<b>CHARTS IN THE TEXT</b>	<b>3</b>
<b>BOXES AND ANNEXES CONTAINED IN PAST INFLATION REPORTS</b>	<b>5</b>
<b>ABBREVIATIONS USED</b>	<b>6</b>
<b>FOREWORD</b>	<b>7</b>
<b>I. SUMMARY</b>	<b>8</b>
<b>II. INFLATION DEVELOPMENTS</b>	<b>10</b>
<b>II.1 PAST INFLATION DEVELOPMENTS</b>	<b>10</b>
BOX 1 The new consumer basket as from January 2007	12
<b>II.2 FULFILMENT OF THE INFLATION TARGET</b>	<b>12</b>
<b>III. INFLATION FACTORS</b>	<b>15</b>
<b>III.1 THE EXTERNAL ENVIRONMENT</b>	<b>15</b>
<b>III.2 THE MONETARY CONDITIONS</b>	<b>18</b>
III.2.1 Interest rates	18
III.2.2 The exchange rate	19
<b>III.3 THE BALANCE OF PAYMENTS</b>	<b>20</b>
III.3.1 The current account	20
III.3.2 The capital account	21
III.3.3 The financial account	21
<b>III.4 MONETARY DEVELOPMENTS</b>	<b>22</b>
III.4.1 Money	22
III.4.2 Credit	23
BOX 2 Financing of non-financial corporations	24
<b>III.5 DEMAND AND OUTPUT</b>	<b>26</b>
III.5.1 Domestic demand	26
III.5.2 Net external demand	29
III.5.3 Output	30
III.5.4 Financial performance of non-financial corporations	31
<b>III.6 THE LABOUR MARKET</b>	<b>32</b>
III.6.1 Employment and unemployment	32
III.6.2 Wages and productivity	34
<b>III.7 IMPORT PRICES AND PRODUCER PRICES</b>	<b>35</b>
III.7.1 Import prices	35
III.7.2 Producer prices	36
<b>IV. THE MACROECONOMIC FORECAST AND ITS ASSUMPTIONS</b>	<b>39</b>
<b>IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST</b>	<b>39</b>
<b>IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST</b>	<b>39</b>
<b>IV.3 THE MESSAGE OF THE FORECAST</b>	<b>41</b>
BOX 3 The application of escape clauses to indirect tax changes	43
<b>IV.4 EXPECTATIONS OF ECONOMIC AGENTS</b>	<b>44</b>
<b>ANNEX</b>	
<b>THE CNB'S NEW INFLATION TARGET AND CHANGES IN MONETARY POLICY COMMUNICATION</b>	<b>45</b>
<b>MINUTES OF THE CNB BANK BOARD MEETINGS</b>	<b>48</b>
MINUTES OF THE BOARD MEETING ON 1 MARCH 2007	48
MINUTES OF THE BOARD MEETING ON 29 MARCH 2007	49
MINUTES OF THE BOARD MEETING ON 26 APRIL 2007	50
<b>ANNEX OF STATISTICAL TABLES</b>	<b>53</b>

Table I.1	The Czech economy continued to grow at a fast pace in 2006 Q4	8
Table II.1	Categories with subdued inflation or falling prices still prevailed in the consumer basket	10
Table II.2	The main factors underlying the forecast error were lower-than-expected adjusted inflation excluding fuels and the first-round impacts of changes to indirect taxes	13
Table II.3	The external economic recovery, foreign interest rates and the price of oil were all higher than forecasted	13
Table II.4	The koruna-euro exchange rate was stronger than expected	14
Table III.1	The current account deficit increased mainly as result of a deterioration of the income balance	20
Table III.2	M1 growth slowed	23
Table III.3	Loans to corporations and households continued rising rapidly	23
Table III.4	Household consumption and gross fixed capital formation contributed the most to domestic demand growth	26
Table III.5	The rapid growth in consumer durables and capital goods production continued	30
Table III.6	Rapid profit growth continued in 2006 Q4	31
Table III.7	Corporations' higher material cost-output ratio was offset by a lower personnel cost-output ratio	31
Table III.8	Average nominal wage growth rose slightly in 2006 Q4	34
Table III.9	Prices fell in the majority of import categories, but the number of categories with rising prices increased	36
Table IV.1	Economic growth will remain solid in the euro area in 2007 and 2008	39
Table IV.2	Growth in employment will slacken	42
Table IV.3	Household consumption will significantly contribute to economic growth	42
Table IV.4	Consumer prices will be significantly influenced by administrative measures	42
Table IV.5	Inflation expectations were above the CNB's target at the one-year horizon	44

Chart I.1	Inflation was below the lower boundary of the tolerance band of the inflation target in 2007 Q1	8
Chart I.2	The inflation forecast lies in the upper half of the tolerance band of the inflation target at the monetary policy horizon	9
Chart I.3	Excluding the first-round impacts of indirect tax changes, the inflation forecast lies in the lower half of the tolerance band at the monetary policy horizon	9
Chart II.1	Annual inflation increased overall in 2007 Q1	10
Chart II.2	Consumer price inflation was most affected by food and housing prices	10
Chart II.3	The share of market prices in consumer price inflation increased in 2007 Q1 compared to the previous quarter	10
Chart II.4	Food price inflation rose sharply in 2007 Q1	11
Chart II.5	Except for fuel prices, prices of non-food commodities were fairly stable	11
Chart II.6	Falling gas prices accounted for most of the slowdown in regulated price inflation	11
Chart II.7	Inflation in the Czech Republic was lower than in the EU countries in 2007 Q1	11
Chart II.8	Actual inflation in 2007 Q1 was significantly lower than the October 2005 forecast	13
Chart III.1	The dollar-euro exchange rate depreciated at the end of March 2007 to its lowest level since March 2005	15
Chart III.2	The price of Brent crude oil rose to USD 68.4 a barrel in the last week of March	15
Chart III.3	In the euro area, economic growth increased in 2006 Q4 but inflation remains below 2%	15
Chart III.4	GDP growth accelerated to 6.5% in 2006 Q4 in the 12 new EU Member States	16
Chart III.5	In 2007 Q1, HUF and SKK appreciated while PLN depreciated slightly	17
Chart III.6	The CNB left its key interest rates unchanged in Q1	18
Chart III.7	Market interest rates were little changed in Q1	18
Chart III.8	Interest rate differentials vis-à-vis the euro and the dollar continued to fluctuate in negative values	18
Chart III.9	Ex ante real interest rates on new loans decreased slightly	19
Chart III.10	The koruna's appreciation against the euro halted in 2007 Q1	19
Chart III.11	The year-on-year appreciation of the nominal effective exchange rate slowed in 2007 Q1	19
Chart III.12	The annual moving total of the trade surplus increased in 2006 Q4	20
Chart III.13	The annual moving total of the income deficit increased in 2006 Q4	21
Chart III.14	Firms registered in Luxembourg were the largest foreign investors in the Czech Republic in 2006	21
Chart III.15	Portfolio investment recorded a net inflow in 2006 Q4	21
Chart III.16	The CNB's international reserves increased only slightly in dollar terms in 2007 Q1	22
Chart III.17	Money supply growth was in line with the high nominal GDP growth	22
Chart III.18	Deposits of households and non-financial corporations continued to grow rapidly, while deposits of non-monetary financial institutions fell	23
Chart III.19	Loans for house purchase remained the fastest-growing	25
Chart III.20	Short-term interest rates on new loans for house purchase increased in 2006 Q4, while long-term rates were mostly flat	25
Chart III.21	Interest rates on new consumer credit mostly fell	26
Chart III.22	Economic growth slowed in 2006 Q4, but remained high	26
Chart III.23	GDP growth in 2006 Q4 was driven by domestic demand	26
Chart III.24	Household consumption growth picked up pace significantly in 2006 Q4, exceeding 5%	27
Chart III.25	Consumer confidence was fluctuating at high levels for most of 2006 and at the start of 2007	27
Chart III.26	The continuing rapid investment growth was again driven largely by technological investment	27

Chart III.27	But investment in buildings remained a significant component of the total investment volume	28
Chart III.28	Government final consumption expenditure showed renewed growth in 2006 Q4	28
Chart III.29	The net export deficit increased year on year in 2006 Q4	29
Chart III.30	Imports rose faster than exports in 2006 Q4	29
Chart III.31	Manufacturing was the biggest contributor to the high GDP growth in 2006 Q4	30
Chart III.32	Rapid growth in industrial production was achieved amid high productivity growth	30
Chart III.33	Business confidence was generally high in 2006 and at the start of 2007	30
Chart III.34	The contribution of the services sector to gross value added growth in 2006 was again lower than that of industry	31
Chart III.35	The profit-equity ratio reached its highest level since 1997	32
Chart III.36	The continuing buoyant economic growth was accompanied by rising employment	32
Chart III.37	The numbers of employees and entrepreneurs rose in 2006 Q4	32
Chart III.38	Employment rose primarily in industry and market services	33
Chart III.39	The rising number of vacancies fostered a fall in unemployment	33
Chart III.40	The decline in the number of unemployed people gradually deepened during 2006	33
Chart III.41	The number of the long-term unemployed decreased in 2006 Q4, but the long-term unemployment rate remained high	33
Chart III.42	Wages rose fastest in industry and construction	34
Chart III.43	Productivity growth slowed in 2006 Q4, but remained relatively high	34
Chart III.44	Annual growth in nominal unit wage costs has been edging up since the start of 2006	35
Chart III.45	Producer price inflation increased in most of the monitored sectors in 2007 Q1	35
Chart III.46	Import prices were generally falling year on year at the start of 2007	35
Chart III.47	Falling or modestly rising world prices of energy-producing materials coupled with appreciation of the koruna-dollar exchange rate led to a sharp fall in mineral fuel import prices	36
Chart III.48	Producer prices in the metal processing industry contributed most to the rise in industrial producer price inflation	36
Chart III.49	Within industry, producer prices in the metal processing industry recorded the highest growth	37
Chart III.50	Most branches of industry recorded a rise in inflation in 2007 Q1	37
Chart III.51	Producer prices in primary processing of oil products continued falling year on year in 2007 Q1	37
Chart III.52	The rapid rise in agricultural producer prices was caused by rising prices of crop products	38
Chart III.53	Construction work price inflation accelerated in 2007 Q1, while market services price inflation slowed	38
Chart IV.1	The real economy will generate moderate inflation pressures at the forecast horizon	41
Chart IV.2	GDP growth will gradually slow	41
Chart IV.3	The inflation forecast lies in the upper half of the tolerance band of the inflation target at the monetary policy horizon	42
Chart IV.4	Excluding the first-round impacts of indirect tax changes, the inflation forecast lies in the lower half of the tolerance band at the monetary policy horizon	43

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002-2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
The Balassa-Samuelson effect	(Annex)	April 2002
The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002
The financial conditions of the Czech Republic's accession to the EU	(Box)	January 2003
Implications of the unexpectedly slow growth in regulated prices	(Box)	January 2003
The Czech Republic and the euro - Draft accession strategy	(Annex)	January 2003
Fiscal consolidation and its effect on economic growth	(Annex)	January 2003
Price deregulation in the period of transformation of the Czech economy	(Box)	April 2003
Revisions to the March 2003 GDP figures	(Box)	April 2003
Credit to households	(Box)	July 2003
The withdrawal of 10- and 20-heller coins and its possible impact on prices	(Box)	July 2003
Indirect taxes and the inflation forecast	(Box)	July 2003
Changes to the methodology for surveying inflation expectations	(Box)	July 2003
ERM II and the exchange-rate convergence criterion	(Annex)	July 2003
Use of the output gap indicator at the CNB	(Box)	October 2003
Monetary policy in the CNB's macroeconomic forecast	(Box)	October 2003
The Czech Republic's euro-area accession strategy	(Annex)	October 2003
Short-run food price prediction methods	(Box)	January 2004
Monetary conditions	(Box)	April 2004
The CNB's inflation target from January 2006	(Annex)	April 2004
The exchange rate in the CNB's forecasting system	(Box)	July 2004
The CNB has fully integrated into the European System of Central Banks	(Annex)	July 2004
Petrol prices and their impact on inflation in the Czech Republic	(Box)	October 2004
Indicators of households' financial situation	(Box)	October 2004
GDP data revision	(Box)	October 2004
The structure of lending	(Box)	January 2005
Uncertainty regarding the evolution of public finances in 2005 and 2006	(Box)	January 2005
Inflation expectations in the CNB's modelling system	(Box)	January 2005
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of alignment of the Czech economy with the euro area	(Annex)	January 2005
The transmission of external cost shocks into domestic prices in 2003-2005	(Box)	April 2005
The effect of the exchange rate on inflation	(Box)	April 2005
The Czech National Bank's position on the revision of the Stability and Growth Pact	(Annex)	April 2005
The effect of EU accession on prices and inflation expectations	(Box)	July 2005
Foreign trade in the first year after the Czech Republic's accession to the EU	(Box)	July 2005
Financial flows between the Czech Republic and the European Union	(Box)	July 2005
The effect of world energy prices on consumer prices	(Box)	October 2005
The performance of large non-financial corporations 1998-2004	(Box)	October 2005
Potential output in the CNB's forecasting system	(Box)	October 2005
Fiscal policy in the CNB's modelling system	(Box)	January 2006
Assessment of the fulfilment of the Maastricht Convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	January 2006
Implications of household debt for consumption	(Box)	April 2006
Effective indicators of external developments	(Box)	July 2006
Oil and petrol prices in the CNB forecast	(Box)	July 2006
The role of monetary aggregates in the CNB's forecasts	(Box)	October 2006
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	October 2006
Employment of foreign nationals	(Box)	January 2007
The extension of the core prediction model to include the effect of real wages	(Box)	January 2007
The new consumer basket as from January 2007	(Box)	April 2007
Financing of non-financial corporations	(Box)	April 2007
The application of escape clauses to indirect tax changes	(Box)	April 2007
The CNB's new inflation target and changes in monetary policy communication	(Annex)	April 2007

ARA	Amsterdam–Rotterdam–Antwerp	ILO	International Labour Organization
BCPP	Prague Stock Exchange	IMF	International Monetary Fund
ČEZ	České energetické závody, a power utility company	ISAE	Information System on Average Earnings
ČMZRB	Czech-Moravian Guarantee and Development Bank	IRS	interest rate swap
CNB	Czech National Bank	LFS	Labour Force Survey
COICOP	Classification of Individual Consumption by Purpose	LIBOR	London Interbank Offered Rate
CPI	consumer price index	M1, M2	monetary aggregates
ČSOB	Československá obchodní banka	MFIs	monetary financial institutions
CZK	Czech koruna	MLSA	Ministry of Labour and Social Affairs
CZ-NACE	Industrial Classification of Economic Activities	NBS	National Bank of Slovakia
CZSO	Czech Statistical Office	NCG	net credit to government
ECB	European Central Bank	NDA	net domestic assets
EIB	European Investment Bank	NEAs	net external assets
ERM II	Exchange Rate Mechanism	NPISHs	non-profit institutions serving households
ESA	European System of National Accounts	OMFIs	other monetary financial institutions
EU	European Union	O/N	overnight
EUR	euro	PLN	Polish zloty
EURIBOR	Euro Interbank Offered Rate	PPI	producer price index
FDI	foreign direct investment	PRIBID	Prague Interbank Bid Rate
Fed	Federal Reserve System (the central banking system in the USA)	PRIBOR	Prague Interbank Offered Rate
FRA	forward rate agreement	(1W, 1M, 1Y)	(one-week, one-month, one-year)
GDP	gross domestic product	repo rate	repurchase agreement rate
GFS	Government Finance Statistics	SFAOs	state financial assets operations
HICP	Harmonised Index of Consumer Prices	SITC	Standard International Trade Classification
HUF	Hungarian forint	SKK	Slovak koruna
		USD	US dollar
		VAT	value added tax

In 1998, the Czech National Bank switched to direct inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of quarterly Inflation Reports.

Sections II and III of this pivotal document provide information on monetary and economic developments over the past quarter.

Section IV moves the focus of attention from the past to the future. It acquaints readers with the forecast for the Czech economy drawn up at the start of the quarter by the CNB's Monetary and Statistics Department. The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy as transparent, comprehensible, predictable and therefore reliable as possible. The Czech National Bank is convinced that reliable monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current balance of risks and uncertainties of the forecast. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not correspond to the message of the forecast. Information on the Bank Board's discussions over the past three months and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

This Inflation Report was approved by the CNB Bank Board on 3 May 2007. The annex to this Inflation Report is a document entitled "The CNB's new inflation target and changes in monetary policy communication".

Unless stated otherwise, the sources of the data contained in this Inflation Report are the CZSO or the CNB. All the Inflation Reports published to date are available on the CNB website at <http://www.cnb.cz/>.

**CHART I.1**  
**Inflation was below the lower boundary of the tolerance band of the inflation target in 2007 Q1**

(annual percentage changes in CPI)



**TABLE I.1**  
**The Czech economy continued to grow at a fast pace in 2006 Q4**

(annual percentage changes unless otherwise indicated)

	12/06	01/07	02/07	03/07
Consumer price inflation	1.7	1.3	1.5	1.9
Industrial producer price inflation	2.6	2.8	3.2	3.6
Money supply growth (M2)	9.9	10.1	10.6	-
3M PRIBOR <sup>a)</sup> , (in per cent)	2.6	2.6	2.6	2.6
CZK/EUR exchange rate <sup>a)</sup> , (level)	27.78	27.84	28.23	28.06
State budget balance since January <sup>b)</sup> , (CZK bn)	-97.6	5.0	-6.7	11.3
GDP growth at constant prices <sup>c)</sup>	5.8	-	-	-
Unemployment rate <sup>d)</sup> , (in per cent)	7.7	7.9	7.7	7.3

a) average level for the month

b) incl. SFAOs, end-of-month position

c) figure for the quarter ending with the given month

d) registered unemployment (MLSA), end of month position

Inflation remained below the lower boundary of the tolerance band of the CNB's inflation target in 2007 Q1 (see Chart I.1). The Czech economy grew at a fast pace in Q4 and throughout 2006 (see Table I.1), although the rate of growth gradually decreased as the year progressed. Employment growth rose modestly and the unemployment rate declined compared to the previous quarter. Money market interest rates were stable during 2007 Q1. The koruna's exchange rate depreciated against both major world currencies in this period.

Annual consumer price inflation in 2007 Q1 was similar to that in the previous quarter. Inflation remained below 2%. As in the previous quarter, it declined in the first month and gradually increased in the remaining months. The slight pick-up in annual consumer price inflation was due mainly to growth in food prices, although this was largely offset by slower growth in the category of housing, water, energy and fuels. The contribution of regulated prices decreased, while that of market prices increased.

Annual GDP growth continued to moderate slightly in 2006 Q4. The Czech economy grew at a rate of more than 6% for the whole of 2006, the same as the previous year. However, the growth structure gradually changed in the course of 2006. Foreign trade had been the main source of growth in 2005, but in 2006 it was replaced primarily by household final consumption expenditure, fixed investment and inventories. This trend continued into Q4. The growth contributions of household and government final consumption expenditure increased, the contribution of fixed investment was approximately stable and the contributions of inventories and foreign trade declined.

The labour market continued to be significantly affected by the rapid, albeit gradually slowing, growth of the economy. Annual employment growth picked up pace modestly in 2006 Q4 compared to the previous quarter, but was slower than in H1. The unemployment rate fell month on month and year on year in 2007 Q1. Annual growth in nominal and, in particular, real wages accelerated in Q4. This was mostly due to the business sector, as in the non-business sector nominal wage growth slackened and real wage growth rose only slightly.

Interest rates on the money market were relatively stable in 2007 Q1. The rise in rates in the second half of January, the subsequent decline at the beginning of February and the renewed rise in the second half of March were all within the range of 0.1–0.2 percentage point depending on maturity. Interest rates were affected by a shift in market expectations towards a later and more moderate monetary policy tightening. This shift primarily reflected the evolution of inflation, although comments made by CNB board members, which were viewed by the market as confirmation of interest rate stability in the coming months, also played a role.

The koruna's exchange rate depreciated against both the euro and, to a lesser extent, the dollar in 2007 Q1. The koruna lost value particularly in January, when negative sentiment about the Central European region and a change in expectations regarding interest rates led to a relatively sharp depreciation of the koruna against both currencies. In the second half of March, however, the koruna regained some of its January losses. After the publication of favourable preliminary data on the January balance of payments, the koruna's exchange rate started to appreciate slightly. Further impulses for the appreciation of the koruna were provided by the appreciation of Central European currencies following the revaluation of the central rate of the Slovak koruna and by the depreciation of the dollar, reflecting less favourable data on economic activity in the United States.

The monetary policy decision-making of the CNB Bank Board in 2007 Q1 was based on the inflation forecast discussed by the Board at its meeting on 25 January 2007 and published in the January Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at roughly the 12–18 month horizon, i.e. in the first half of 2008. According to the forecast,

headline inflation should be in the upper half of the tolerance band of the inflation target in this period. Inflation adjusted for the first-round effects of changes to indirect taxes, to which monetary policy does not react, was in the lower half of the tolerance band of the inflation target at the monetary policy horizon, gradually moving upwards towards the target. Consistent with the baseline scenario was broad interest rate stability initially and then a gradual rise in nominal interest rates.

The Bank Board left monetary policy interest rates unchanged in 2007 Q1, in line with the macroeconomic forecast. The Bank Board's decisions were unanimous in all three months of the first quarter. The Bank Board assessed the risks of forecast as being roughly balanced overall. The main downside risk to inflation, according to the Bank Board, was the lower-than-forecasted inflation in the course of Q1, which resulted, among other things, from a change in the consumer basket structure. The main upside risk, according to the Bank Board, was higher-than-expected economic growth in the euro area and correspondingly higher euro interest rates. The Bank Board assessed the future evolution of public budgets and the koruna's exchange rate as two-sided risks.

Section IV of this Inflation Report describes the CNB's new forecast. New data on domestic economic activity and the labour market situation confirm that the real economy is moderately inflationary. The real marginal cost gap, which captures the inflation pressures from the real economy, will remain roughly at its current value until the end of 2007, then its inflationary effect will weaken somewhat. Its first component – the output gap – will have a modest inflationary effect at the forecast horizon, the same as at present. Its second component – the real wage gap – closed in late 2006/early 2007. In the outlook its effect on inflation will initially be neutral and then turn slightly anti-inflationary again as a result of nominal wage stickiness and rising inflation.

The inflation forecast has been increased slightly compared to the January Inflation Report. The revision is due chiefly to a forecast of higher import prices in the next few quarters and higher inflation pressures from the real economy in the longer term. The rise in inflation will be driven by adjusted inflation excluding fuels and changes to indirect taxes on cigarettes. At the monetary policy horizon, i.e. in 2008 Q2 and Q3, inflation will be in the upper half of the tolerance band of the inflation target.

The mechanism of caveats applies as usual to the first-round effects of changes to indirect taxes, whose impact at the monetary policy horizon is pronounced. Adjusted for these effects, inflation to which monetary policy reacts is slightly below the inflation target at the monetary policy horizon. Consistent with the macroeconomic forecast and its assumptions is a gradual rise in interest rates over the entire forecast horizon.

Along with the baseline scenario, an alternative scenario was drawn up simulating the impacts of the implementation of the government's planned fiscal reform and the introduction of environmental taxes on 1 January 2008. Headline inflation in the alternative scenario will increase by roughly 1 percentage point at the beginning of 2008 as a result of growth in indirect taxes. However, inflation adjusted for the changes to indirect taxes will change only slightly and the monetary policy response will, therefore, be only moderate.

The annex to this Inflation Report is a document entitled "The CNB's new inflation target and changes in monetary policy communication" published by the CNB on 8 March 2007. The CNB has announced a new inflation target as annual consumer price index growth of 2% (with a tolerance band of  $\pm 1\%$ ), effective from January 2010. Starting from 2008 the CNB will publish the forecast-consistent interest rate path in numerical form, as a fan chart, and the votes cast by the board members on interest rate changes by name. In 2008 the CNB will change the frequency of the Bank Board's regular monetary policy meetings from monthly to eight meetings a year.

CHART I.2

**The inflation forecast lies in the upper half of the tolerance band of the inflation target at the monetary policy horizon**  
(annual percentage changes in CPI)

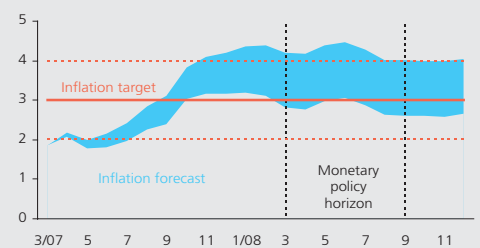
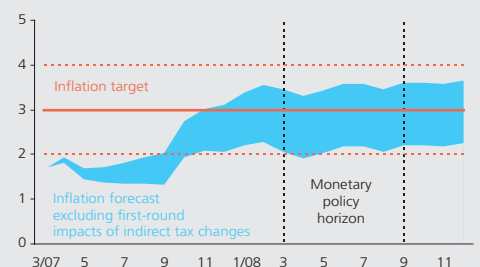
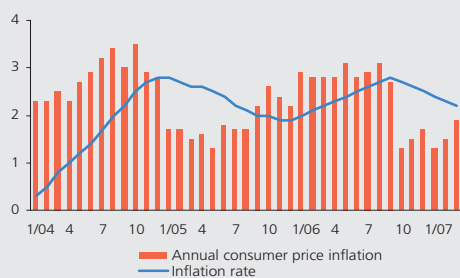


CHART I.3

**Excluding the first-round impacts of indirect tax changes, the inflation forecast lies in the lower half of the tolerance band at the monetary policy horizon**  
(annual percentage changes)



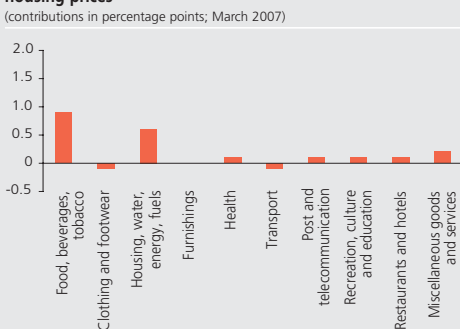
**CHART II.1**  
Annual inflation increased overall in 2007 Q1  
(percentages)



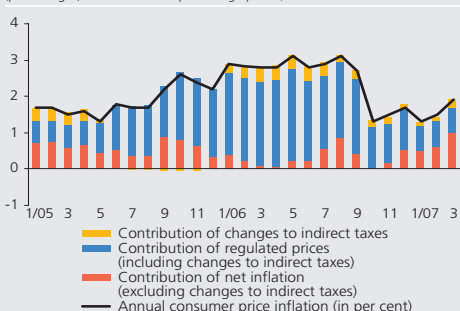
**TABLE II.1**  
Categories with subdued inflation or falling prices still prevailed in the consumer basket  
(annual percentage changes)

	12/06	1/07	2/07	3/07
CONSUMER PRICES	1.7	1.3	1.5	1.9
of which:				
food and non-alcoholic beverages	1.9	2.7	3.0	3.3
alcoholic beverages and tobacco	0.9	1.7	3.4	5.3
clothing and footwear	-4.6	-3.8	-2.7	-1.8
housing, water, electricity, gas and other fuels	3.9	2.2	2.2	2.3
furnishings, household equipment and routine maintenance of the house	-0.7	-0.6	-0.7	-0.5
health	5.6	4.8	4.6	3.7
transport	-0.7	-1.0	-2.0	-0.6
communication	2.9	2.0	3.9	3.8
recreation and culture	0.4	0.8	0.5	0.7
education	2.5	2.6	2.6	2.7
hotels and restaurants	2.6	2.4	2.3	2.4
miscellaneous goods and services	2.1	2.0	2.2	2.4

**CHART II.2**  
Consumer price inflation was most affected by food and housing prices  
(contributions in percentage points; March 2007)



**CHART II.3**  
The share of market prices in consumer price inflation increased in 2007 Q1 compared to the previous quarter  
(percentages; contributions in percentage points)



## II.1 PAST INFLATION DEVELOPMENTS

Annual inflation increased overall in 2007 Q1.<sup>1</sup> In January it fell noticeably below the level it reached at the end of 2006 Q4 (by 0.4 percentage point to 1.3%), but in February it started returning to higher figures. Annual inflation stood at 1.9% in March, 0.2 percentage point higher than in December 2006. The inflation rate decreased in 2007 Q1 to stand at 2.2% in March.

The pick-up in annual consumer price inflation in 2007 Q1 was due mainly to a relatively sharp increase in food prices.<sup>2</sup> Consumer price inflation increased in another four categories of the consumer basket – communication, recreation and culture, education and miscellaneous goods and services. A significant moderation of the price decline in the clothing and footwear category also acted in the same direction. The inflationary effect of the price changes in these categories was largely offset by a noticeable slowdown in inflation in housing. Nevertheless, inflation in the housing category remained a significant factor underlying annual consumer price inflation, as shown in Chart II.2.

Weakening external cost pressures stemming from the evolution of prices of energy-producing materials on world markets remained a significant factor for domestic prices in 2007 Q1. Prices of oil on world markets started falling year on year at the beginning of 2007, which, amid a persisting year-on-year appreciation of the koruna, led to a marked decline in import prices of mineral fuels. However, this was accompanied by continuing rapid growth in prices of some other major energy and raw material inputs, most notably electricity and metals. This "contrary" trend in input prices passed through to producers' costs. Producer prices in industry continued rising. The continuing upward trend in prices involved most industrial branches, but branches with subdued price growth still prevailed overall. Agricultural producer price inflation rose significantly. Construction price inflation also rose, whereas market services price inflation slowed.

By the CNB's estimation the economy has been exceeding the potential, non-accelerating inflation level of output since 2005 Q4, but no clear signals have yet been recorded that the real economy is generating strong inflation pressures. Although consumer demand continued growing during 2006, the evolution of consumer prices in the first three months of 2007 did not suggest any noticeable across-the-board upward pressures on prices. According to the latest figures for March, annual goods price inflation was generally modest (1%), while prices of durable goods continued falling amid continuing appreciation of the exchange rate of the koruna. Only food prices showed rapid growth. Growth in services prices was more pronounced, although it stayed in line with the previous four quarters (3.4% year on year in March). Developments on the labour market suggested a gradual weakening of the anti-inflationary pressures. Nominal unit wage cost growth, however, has so far been subdued, being most affected by the personnel cost-output ratio in the services sector.

Under these circumstances, market prices – driven primarily by the growth in food prices – were the main source of the 1.9% annual consumer price inflation in March 2007. The contribution of prices of non-food commodities<sup>3</sup> was less significant. Conversely, the share of regulated prices in consumer price inflation fell markedly thanks to favourable prices of imported energy sources. These changes in

<sup>1</sup> Measured by annual growth in consumer prices. In January 2007, the CZSO started calculating inflation using a new consumer basket where the weights of individual items are derived from data on household consumption in 2005 (see the Box 1 *The new consumer basket as from January 2007*). The revision of the consumer basket does not change the data published for the period until December 2006.

<sup>2</sup> i.e. prices of food, non-alcoholic beverages, alcoholic beverages and tobacco.

<sup>3</sup> Consolidated category of market prices of non-food commodities (= adjusted inflation), comprising other tradable commodities (excluding food and fuels), non-tradable commodities and fuels.

the annual consumer price inflation structure compared to the previous quarters are shown in Chart II.3.

Annual food price inflation rose quite significantly in 2007 Q1 (from 1.6% in December 2006 to 4.1% in March)<sup>4</sup>. This was due in particular to higher prices of tobacco products, non-alcoholic beverages and oils. The rise in tobacco product prices (of 9.6% year on year in March) resulted from the delayed start of sale of cigarettes with increased excise duty from April 2006. This time shift was due to the fact that producers and suppliers had stocked up in advance with products with prices valid prior to the increase in duty. Another significant factor underlying the higher food price inflation in Q1 was a sizeable annual rise in prices of agricultural products of vegetable origin, which fed through to bread prices (of 11.6%). Prices of vegetables and potatoes, which display considerable volatility, also rose substantially.

Growth in prices of non-food commodities – unlike food prices – was generally very modest and relatively stable. Their annual growth did not exceed 0.4% in Q1. Chart II.5 shows that the continuing relative stability of inflation in this category was a result of a long-running combination of falling prices of other tradable assets<sup>5</sup> and rising prices of non-tradable assets.

Prices of tradable commodities have been recording an annual decline since 2001. This long-term phenomenon is a result of several factors mentioned in the January Inflation Report. Prices of these commodities are influenced mainly by the external competitive environment, which affects domestic prices via import prices of consumer goods. Import prices of consumer goods are currently predominantly falling as a result of the persisting year-on-year appreciation of the koruna-euro and koruna-dollar exchange rates combined with relatively low prices of many consumer products on foreign markets. A long-running decline in prices has been recorded particularly in the categories of clothing and footwear and household equipment and furnishings. Prices of other non-tradable commodities (primarily services), which are affected solely by the domestic competitive environment, continued to display growth. However, during 2007 Q1 this growth gradually accelerated in year-on-year terms, reaching 2.9% in March.

Fuel prices, which tend to respond to changes in oil prices on global markets with a relatively short lag, thus remained the most volatile component of non-food commodity prices. The declining fuel prices during 2007 Q1 (by 3.2% in March) were a response to the slowing year-on-year growth and subsequent year-on-year fall in oil prices on global markets, which, coupled with the annual appreciation of the koruna-dollar exchange rate, led to a sharp fall in import prices of mineral fuels and subsequently to price cuts by domestic fuel producers.

Annual growth in regulated prices slowed sharply in 2007 Q1 (to 4.2% in March; see Chart II.6). The main reason was a decrease of 4.2% in prices of natural gas for households in January 2007. Growth in prices of electricity and heat for households slowed, too. At the same time, however, regulated rents were raised (by 8.4% year on year in March), as were water supply and sewerage collection charges and prices of social services.

Turning to international comparisons, annual HICP inflation in the Czech Republic stayed below that in the EU countries in the first quarter of 2007. According to the latest Eurostat figures for March, annual HICP inflation in the EU countries was 2.2%, exceeding that in the Czech Republic by 0.1 percentage point.

4 Consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

5 Excluding food and fuels.

CHART II.4

**Food price inflation rose sharply in 2007 Q1**  
(annual percentage changes)

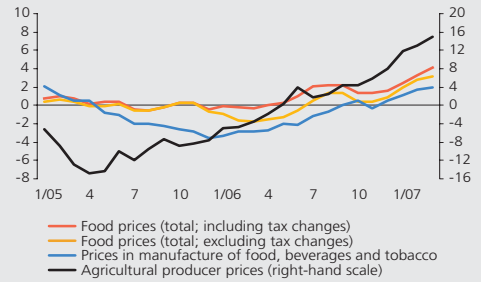


CHART II.5

**Except for fuel prices, prices of non-food commodities were fairly stable**  
(annual percentage changes)

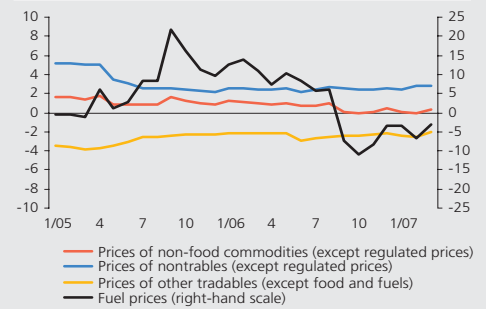


CHART II.6

**Falling gas prices accounted for most of the slowdown in regulated price inflation**  
(annual percentage changes)

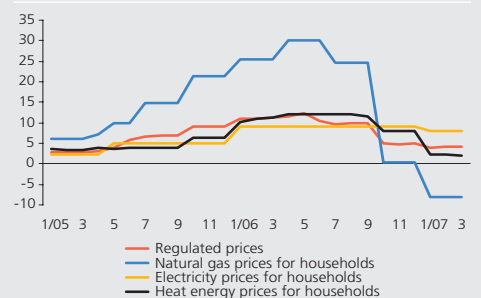


CHART II.7

**Inflation in the Czech Republic was lower than in the EU countries in 2007 Q1**  
(annual percentage changes)

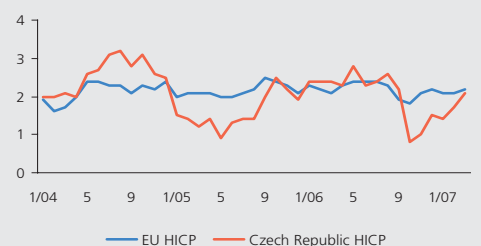


TABLE 1 (Box)

The changes in weights reflect developments in the consumption behaviour of Czech households

(COICOP groups; weights in %)

	Constant weights		Recalculated weights	
	of 1999 old basket	of 2005 new basket	in 12/06 old basket	in 1/07 new basket
TOTAL	100	100	100	100
Breakdown:				
Food and non-alcoholic beverages	19.8	16.3	18.1	16.4
Alcoholic beverages, tobacco	7.9	8.2	7.6	8.2
Clothing and footwear	5.7	5.2	3.7	4.8
Housing, water, energy, fuel	23.6	24.8	29.0	25.7
Furnishings, households equipment and maintenance	6.8	5.8	5.3	5.6
Health	1.4	1.8	1.7	1.8
Transport	10.1	11.4	9.3	10.9
Post and telecommunication	2.3	3.9	2.7	3.8
Recreation and culture	9.6	9.9	9.0	9.8
Education	0.5	0.6	0.5	0.6
Restaurants and hotels	7.4	5.8	7.9	5.9
Miscellaneous goods and services	5.0	6.3	5.2	6.3

TABLE 2 (Box)

The weight of regulated prices in the consumer basket has fallen, while the weight of adjusted inflation has risen

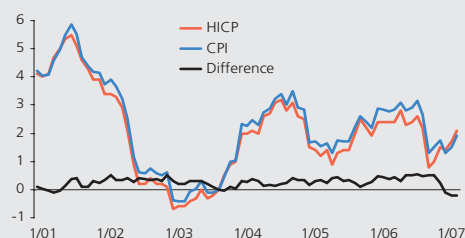
(weights in %)

	Constant weights		Recalculated weights	
	of 1999 old basket	of 2005 new basket	in 12/06 old basket	in 1/07 new basket
TOTAL	100	100	100	100
Breakdown:				
regulated prices	17.9	16.4	22.2	17.3
food prices	27.7	24.4	25.7	24.6
adjusted inflation excl. fuels	51.3	55.1	49.3	54.3
fuel prices	3.0	4.0	2.8	3.7
cigarettes	3.3	4.1	3.4	4.2
net inflation	82.1	83.6	77.8	82.6
adjusted inflation	54.4	59.2	52.1	58.1
nontradable other goods	27.2	32.2	31.4	32.5
tradable other goods	27.2	26.9	20.7	25.6
tradable other goods excl. fuels	24.2	22.9	17.9	21.8

CHART 1 (Box)

Since January 2007 annual HICP inflation has been higher than annual CPI inflation

(percentages; difference in percentage points)



## BOX 1

## The new consumer basket as from January 2007

In January 2007, as part of its regular revisions, the CZSO switched to a new consumer basket used to calculate the consumer price index (see Table 1). The selection of the individual items and their weights was revised. The new weighting scheme (constant weights) is based on data on household consumption in 2005; the new base period is December 2005. The revision of the consumer basket has no effect on the inflation data published up until December 2006. When analysing the effects of the switch to the new consumer basket, one has to take into consideration the fact that price movements themselves give rise to continuous changes in the weights of the individual items and expenditure categories for calculation of the index using the Laspeyres index formula (so-called recalculated weights). Compared with the previous revisions (1995 and 2001), the latest revision of the consumer basket can be described as more moderate. This is due both to some stabilisation of consumer habits and to the partial continuous revision of the previous consumer basket and the replacement of its components.

The revision of the consumer basket led to a decline in the weights of regulated prices and food prices, while the weights of adjusted inflation excluding fuels and fuel prices increased (see Table 2). Within adjusted inflation excluding fuels the weight of tradable items (expressed in recalculated weights) increased. This change to the consumer basket structure affected the CNB's inflation analysis and forecast both technically and fundamentally. Comparison of the current situation with previous forecasts is not straightforward, since the new consumer basket was not available at the time the forecasts were prepared. According to CNB analyses, the change in the weighting scheme could, other things being equal, lead to rather lower-than-expected headline inflation in the future. The inflation figures for 2007 Q1 are in line with this expectation.

The change to the consumer basket also evidently gave rise to a change in the relationship between inflation as measured by the national consumer price index (CPI) and inflation as measured by the harmonised index of consumer prices (HICP) as from January 2007. Between 2004 and 2006 annual consumer price inflation measured by the CPI was always higher than that measured by the HICP, the average difference being 0.3 percentage point. Higher HICP inflation than CPI inflation has been observed since January (Chart 1). This change in trend is in line with the aforementioned lower CPI inflation caused by the changes to the consumer basket.

## II.2 FULFILMENT OF THE INFLATION TARGET

Headline inflation was below the lower boundary of the tolerance band of the CNB's inflation target in 2007 Q1 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

To assess the effect of monetary policy on the fulfilment of the inflation target one needs to analyse retrospectively the forecasts and the Bank Board's decisions based thereon in the relevant period. As monetary policy is focused on hitting the inflation target at the 12–18 month horizon, the key period for the fulfilment of the inflation target in 2007 Q1 is roughly from July 2005 to March 2006. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a

comparison of the forecast drawn up in October 2005, i.e. approximately in the middle of the aforementioned period, with inflation in 2007 Q1.

According to the October 2005 forecast, headline inflation was expected to rise gradually and be slightly above the inflation target at the monetary policy horizon (see Chart II.8). The significant expected inflation factors were regulated prices of energy for households, the price impacts of the increases in indirect taxes on cigarettes, and a rise in adjusted inflation excluding fuels. The real economy was expected to have an anti-inflationary effect over the entire forecast horizon, amid a temporarily tighter exchange rate component of the real monetary conditions and weak external demand. The interest rate component of the real monetary conditions was expected to have a moderately easy effect over the entire forecast horizon.

Actual inflation was lower than the October forecast over the entire period. In 2007 Q1, an anti-inflationary deviation was recorded for adjusted inflation excluding fuels and the first-round effects of the changes to indirect taxes on cigarette prices and, to a lesser extent, also for fuel prices (see Table II.2). Food prices and regulated prices increased year on year in 2007 Q1 by more than had been expected. However, the contribution of regulated prices to the non-fulfilment of the forecast was negative, owing to a reduction of the weight of this price category in the consumer basket during the revision of the basket.

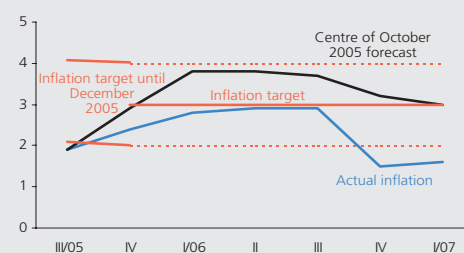
Exogenous factors had a more marked inflationary effect overall in 2007 Q1 than forecasted. Oil prices and external economic activity, inflation and interest rates were relatively significant upside factors (see Table II.3). The lagged and lower growth in cigarette prices resulting from the increases in indirect taxes on tobacco products in July 2005 and April 2006 had the opposite effect.

Consistent with the October 2005 forecast was a gradual rise in interest rates. In October 2005, monetary policy interest rates were raised by 0.25 percentage point in line with the forecast. In the period that followed, however, rates were not raised to the same extent as forecasted in October 2005. Between July 2005 and March 2006, domestic nominal and real interest rates were lower on average than the October forecast, whereas foreign interest rates were higher. The nominal koruna-euro exchange rate was substantially stronger than forecasted. Since the forecast was drawn up, the perceived level of equilibrium real interest rates has decreased and the estimate of the rate of equilibrium real appreciation has increased. As a result of these changes, the exchange rate component is, other things being equal, viewed as easier, and the interest rate component as tighter, than evaluated in the October forecast. Consequently, the average setting of the interest rate component of the real monetary conditions in the key period for the most recent consumer price developments was broadly in line with the October forecast, while the exchange rate component of the real monetary conditions was easier. According to the current view, the monetary policy setting as expressed by the real monetary conditions index was thus easier in this period than predicted by the October 2005 forecast.

When assessing the fulfilment of the inflation forecast, one needs to take into account changes in the CNB's view of the workings of the economy. The most fundamental change since October 2005 is an extension of the core prediction model to include the effect of real wages on inflation. This change also partially contributed to an overall shift in the view of the equilibrium paths of the real exchange rate, real interest rates and the non-accelerating inflation level of output. The view of the formation of inflation expectations was also changed in connection with the extension of the core prediction model. The description of economic developments in the Czech Republic's major trading partners had also earlier been changed and is now approximated by effective developments in the euro area instead of Germany.

**CHART II.8**
**Actual inflation in 2007 Q1 was significantly lower than the October 2005 forecast**

(annual percentage changes)


**TABLE II.2**
**The main factors underlying the forecast error were lower-than-expected adjusted inflation excluding fuels and the first-round impacts of changes to indirect taxes**

(annual percentage changes; contributions in percentage points)

	October 2005 forecast	2007 Q1 outturn	Contribution to total difference a)
CONSUMER PRICES	3.0	1.6	-1.4
Breakdown into contributions:			
regulated prices	3.5	4.1	-0.1(c)
first-round impacts of changes to indirect taxes	0.4	0.1	-0.3
food prices b)	1.8	2.7	0.2
fuel prices b)	-3.2	-4.5	-0.1
adjusted inflation excl. fuels b)	2.9	0.4	-1.2

a) owing to rounding, the sum of the contributions need not be equal to the total difference  
 b) excluding the first-round impacts of changes to indirect taxes  
 c) the negative contribution of regulated prices despite the higher-than-expected regulated price inflation is due to the change in weights in the consumer basket as from January 2007

**TABLE II.3**
**The external economic recovery, foreign interest rates and the price of oil were all higher than forecasted**

		IV/05	I/06	II/06	III/06	IV/06	I/07
GDP in Germany a)	p	1.3	1.3	1.1	1.4	1.4	1.5
	o	1.1	2.4	2.3	2.6	3.5	-
GDP in euro area a), d)	p	1.3	2.5	2.5	2.7	3.4	-
	o	1.3	2.5	2.5	2.7	3.4	-
CPI in Germany b)	p	1.7	1.5	1.6	1.6	2.1	2.2
	o	2.2	2.0	2.0	1.6	1.3	1.7
CPI in euro area b), d)	p	2.2	2.0	2.0	1.7	1.5	-
	o	2.2	2.0	2.0	1.7	1.5	-
1Y EURIBOR (percentages)	p	2.2	2.2	2.2	2.3	2.4	2.5
	o	2.6	3.0	3.3	3.6	3.9	4.1
USD/EUR exchange rate (levels)	p	1.24	1.24	1.25	1.26	1.28	1.28
	o	1.19	1.20	1.26	1.27	1.29	1.31
Oil prices - Ural c)	p	56.8	53.5	51.5	50.6	50.5	50.6
	o	53.3	57.6	65.0	65.4	56.5	52.8
Oil prices - Brent c), d)	p	56.9	62.0	69.8	70.2	59.6	58.1
	o	56.9	62.0	69.8	70.2	59.6	58.1

p - prediction, o - outturn

a) at constant prices; annual percentage changes; seasonally adjusted

b) annual percentage changes

c) USD/barrel

d) no comparison with the prediction is given, as the indicator was not tracked in the October 2005 forecast

Any revisions made to economic indicators since the forecast was drawn up also have an effect on the fulfilment of the forecast. GDP revisions, especially those made to the national accounts in March 2006, markedly increased the estimate of GDP growth in 2004 and 2005. In the absence of any observed inflation pressures from the real economy, and given the anti-inflationary effect of real wages in 2005 and 2006, the revision of the national accounts generated an increase of up to one percentage point in the estimated rate of growth of the potential, non-accelerating inflation level of output. The new consumer basket as from January 2007, which decreased the weight of items and sub-aggregates where prices have long been rising faster (e.g. regulated prices) and increased the weight of items whose prices have long been rising more slowly (e.g. adjusted inflation excluding fuels), contributed significantly to the non-fulfilment of the inflation forecast in 2007 Q1.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the October 2005 forecast was drawn up can be summed up in the following way. The real marginal cost gap, which in the core prediction model approximates the overall inflation pressures from the real economy, has been positive since 2006 Q2 and its inflationary effect on the economy is gradually strengthening. This is mainly due to the closure of the real wage gap in late 2006/early 2007. The inflationary effect of the output gap has remained stable recently, thanks mainly to the recovery abroad and a positive contribution of fiscal policy, despite the broadly neutral monetary conditions. Adjusted inflation excluding fuels was low over the entire period despite greater-than-expected inflation pressures from the real economy, as the unexpected appreciation of the koruna exchange rate had a strong anti-inflationary effect (see Table II.4). The first-round effects of the changes to indirect taxes on cigarettes have so far materialised with little intensity and with a lag. Given fulfilment of the forecasts for the other components, annual headline inflation was below the lower boundary of the tolerance band of the inflation target in 2007 H1.

In addition to the forecast itself, an assessment of the risks associated with this forecast by the board members is of importance for the Bank Board's decisions on monetary policy rates. At its meetings between July 2005 and March 2006 (see the relevant minutes) the Bank Board initially assessed the risks of the forecasts drawn up in this period as roughly balanced, but from November 2005 onwards the Board viewed the risks of the forecasts systematically, albeit with varying intensity, as being on the downside. However, the monetary policy decisions of the CNB Bank Board remained in line with the forecasts in this period. One can say with the benefit of hindsight that the upside effect of some factors was clearly outweighed by the markedly stronger exchange rate. The setting of interest rates broadly in line with the forecasts thus led to an excessively tight monetary policy in the key period. This fact also contributed to the undershooting of the inflation target in 2007 Q1.

**TABLE II.4**  
The koruna-euro exchange rate was stronger than expected

		IV/05	I/06	II/06	III/06	IV/06	I/07
3M PRIBOR	p	2.1	2.3	2.5	2.9	3.2	3.3
(percentages)	o	2.1	2.1	2.1	2.4	2.6	2.6
CZK/EUR exchange rate	p	29.7	29.7	29.8	29.8	29.7	29.7
(levels)	o	29.3	28.6	28.4	28.3	28.0	28.0
Real GDP	p	4.6	4.9	3.9	3.7	3.9	-
(annual perc. changes)	o	6.7	6.4	6.2	5.9	5.8	-
Inflation pressures	p <sup>a)</sup>	-0.5	-0.7	-0.8	-0.6	-0.5	-0.4
from the real economy	o <sup>b)</sup>	-0.3	-0.3	-0.1	0.0	0.3	0.5

p - prediction, o - outturn

a) output gap as a percentage of GDP

b) real marginal cost gap; estimate based on the CNB's April 2007 forecast

**III.1 THE EXTERNAL ENVIRONMENT**

In 2006 Q4, economic growth in the euro area outpaced that in the United States. The dollar's exchange rate depreciated in 2007 Q1 to USD 1.34/EUR at the end of March. Oil prices rose during the quarter, with the price of Brent crude oil exceeding USD 68 a barrel in March.

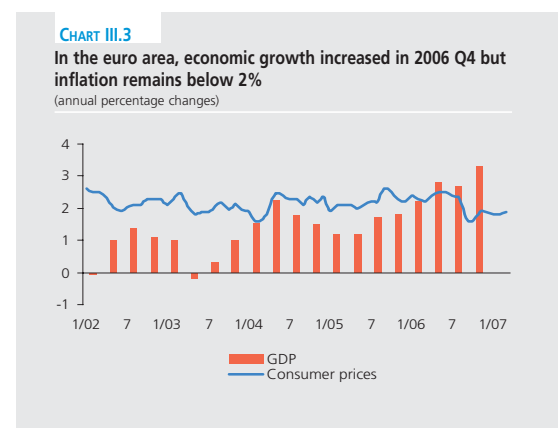
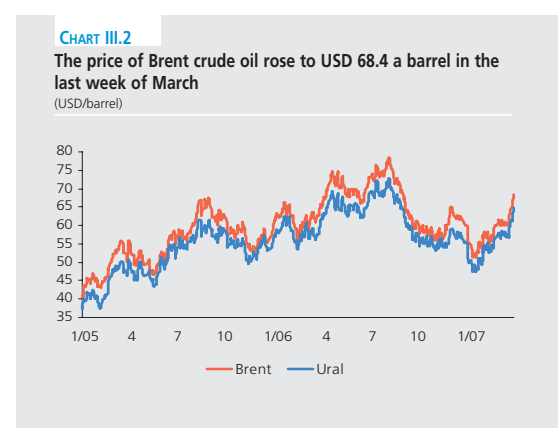
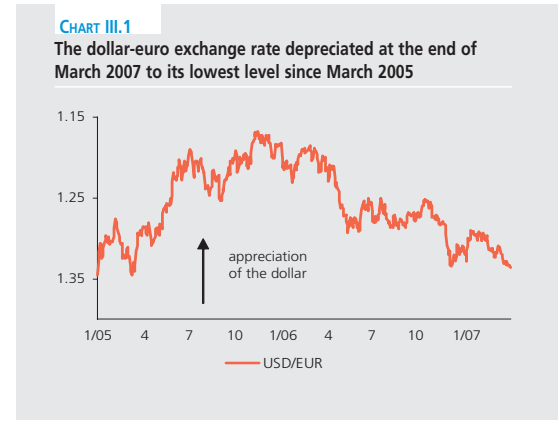
In 2006, the US economy maintained the previous year's relatively high growth rate and grew by 3.3%. Compared to 2005, fixed investment growth declined to 3%, whereas the contributions of the government and the external sector increased. Annual economic growth decreased by 0.6 percentage point in 2006 H2 compared to H1, owing to a sizeable reduction in investment, which even recorded a year-on-year decline in 2006 Q4. This was due to a fall in the residential property market, which turned from a source of economic growth into its brake during H2. The rate of growth of GDP increased very slightly in 2006 Q4 compared to the previous quarter, to 3.1%. The negative effect of falling investment was offset by higher consumer, government and external demand. The signals from the US economy are generally mixed. The weak investment demand is being accompanied by low growth in industry and a decline in employment in manufacturing industries. By contrast, employment in services and total employment both rose year on year in 2007 Q1. The seasonally adjusted data on unemployment in March decreased compared to the previous two months and to the previous year. Wage growth was high as well, the hourly wage increasing by more than 4% in 2007 Q1. The external imbalance decreased slightly in 2006 Q4. The current account deficit fell by USD 27 billion year on year and exports maintained high growth of more than 9% amid a decline in import growth.

The US public budgets recorded a year-on-year improvement. The deficit for the first five months of the fiscal year 2006/2007 was USD 162 billion, down by USD 56 billion from the previous year. In February 2007, consumer and producer price inflation both increased as a result of higher food and energy prices caused by the very cold weather in this month. Core inflation also rose by 0.1 percentage point to 2.7%. In 2007 Q1, the Fed left its key rate unchanged at 5.25%. According to Fed representatives, their attention remains focused mainly on inflation, despite the slowdown in economic growth. Inflation pressures persist as a result of very high capacity utilisation, growing employment, falling unemployment and rapid nominal wage growth.

In 2006, economic growth in the euro area almost doubled compared to 2005, reaching 2.6%, the highest level since 2000. There was a pick-up in growth of all components of domestic demand, in particular investment, which rose by 2 percentage points to 4.5%, and an improvement was also recorded for net exports. In 2006 Q4, GDP growth rose by 0.5 percentage point to 3.3%, with the euro area economy growing faster in that period than the US economy. Increases were recorded by all components of domestic and external demand.

The rapid economic growth in the euro area was reflected in a substantial rise in employment and a decline in the unemployment rate, which fell by almost 1 percentage point year on year in Q1. Thanks to low wage and unit wage cost growth the competitiveness of the euro area did not deteriorate despite the appreciation of the nominal euro-dollar exchange rate, and there was a year-on-year improvement in the trade balance and the current account balance, which improved by EUR 20 billion in Q4 compared to the previous year.

In 2006, the fiscal deficit-to-GDP ratio in the euro area as a whole fell by 0.4 percentage point from the previous year to 2.1%. The better public budget result was chiefly due to faster GDP growth. Except for Italy, all the euro area countries to which the excessive deficit procedure was applied met their targets. In 2006, the



average public debt-to-GDP ratio decreased below 70% for the first time. Annual consumer price inflation fell sharply in September and October 2006 thanks to lower energy prices (see Chart III.3). In the subsequent five months to March 2007, however, it rose slightly again to just below the 2% level as a result of growth in food prices and a VAT rise in Germany. The lower energy prices also affected producer prices, whose rate of growth dropped to 2.9% in February. At its March meeting, the ECB raised its key rate by 0.25 percentage point to 3.75%. Although consumer price inflation had remained below the 2% level in the previous seven months, the bank tightened its monetary policy because of inflation pressures, which, in its opinion, pose a risk to price stability in the medium term. According to the ECB, M3, which increased by 10.2% year on year in February due to high demand for loans, is rising too fast.

Economic growth in Germany rose sharply in 2006 to almost 3%, from less than 1% in 2005. Household and government consumption rose only modestly, but fixed investment saw strong growth and the improvement in net imports was truly impressive. The biggest GDP growth recorded last year was in Q4. Export growth far exceeded import growth, which slowed slightly. Domestic demand growth also accelerated substantially. The strong external and investment demand was reflected in high growth in industrial production, which fluctuated around 8% in 2007 Q1. The positive evolution of the German economy passed through to a marked decline in the unemployment rate, which fell by more than 2 percentage points year on year. The high competitiveness of the economy was due, among other things, to relatively low wage growth (less than 2%); thanks to this, growth in labour costs moved around the 1% level. The current account and trade surpluses widened further in Q1 compared to the previous year. The VAT increase in January 2007 had already generated a rise in consumer price inflation at the end of 2006, although its impact was much smaller than had been expected. By contrast, industrial producer price inflation decreased markedly in January and February to about 3%.

In 2006 Q4, economic growth in the countries of the Central European region remained higher than in the euro area. Economic growth accelerated in Slovakia and Poland, but slowed in Hungary, which also had the highest inflation.

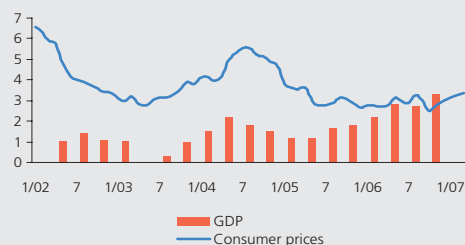
GDP growth in Poland increased markedly last year to almost 6%. Fixed investment growth in particular rose from 6% in 2005 to a sizeable 17%. Personal consumption also grew significantly, rising by more than 3 percentage points to 5%. By contrast, government consumption growth decreased and net exports deteriorated. The fastest economic growth (of more than 6%) in 2006 came in Q4. This growth was mostly due to a pick-up in investment growth to almost 20%. Household consumption maintained high growth of more than 5% thanks to rapid growth in wages and employment. The strong household consumption and external demand growth is being accompanied by sizeable increases in industrial production, which reached 15% at the start of 2007. With labour productivity growth high, the strong growth in nominal and real wages does not currently pose any threat to price stability. Unemployment is still quite high, despite a 3% annual decrease in the unemployment rate.

Inflation in Poland edged up at the start of 2007, reaching 2.4% in March. Previously, however, it had been fluctuating below the 2% level for 18 months. The Polish central bank left its key rate unchanged at 4% during 2007 Q1. The rate has been at this level for more than a year despite high GDP, wage and money supply growth. The minutes of the meeting of the Polish central bank's Monetary Policy Committee held at the end of March indicate some shift in sentiment among the Committee members and hint at the possibility of a monetary policy tightening in the event of a further acceleration of economic growth and wage growth.

CHART III.4

#### GDP growth accelerated to 6.5% in 2006 Q4 in the 12 new EU Member States

(annual percentage changes)



Economic growth in Hungary slowed slightly to 3.9% in 2006 compared to the previous year. All components of domestic demand deteriorated, with government consumption and investment even decreasing in absolute terms. The economic growth was driven solely by external demand, with export growth far outpacing import growth. A similar situation can be seen in 2006 Q4. Economic growth in that period was the slowest all year. Household consumption was flat, while the other components of domestic demand decreased. By contrast, an improvement was recorded for net exports, which remained the sole driver of aggregate demand. Annual industrial output growth was above 10% at the start of 2007 and thanks to it the rise in unemployment was only moderate. The external imbalance is decreasing and the current account deficit narrowed to 5.8% of GDP in Q4 thanks to an improved trade and services balance.

Annual consumer price inflation in Hungary increased sharply in 2007 Q1 compared to the previous quarter, reaching 9% in March. However, this is no cause for concern for the central bank, as the increase was almost exclusively due to price deregulation (heating for households, medicines, doctors' fees, gas and transport prices). During this period, the Hungarian central bank left its key rate unchanged at the high level of 8%.

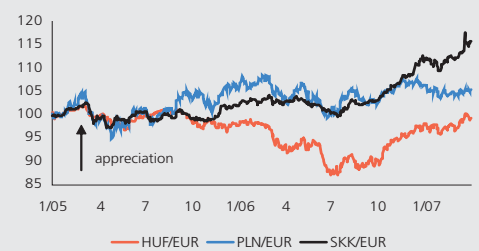
Economic growth in Slovakia increased by 2 percentage points in 2006 compared to the previous year, to 8.3%. This growth was driven mainly by external demand. Exports rose by 23%, while imports grew 8 percentage points slower. Net exports improved considerably, contributing more than 5 percentage points to the GDP growth. Household consumption growth was strong as well, reaching 6%. It was buoyed by strong real wage growth and a decline in the unemployment rate of 2.5 percentage points year on year. The sharp growth of the Slovak economy is mostly due to large investments in the car and electrical engineering industries. These fostered industrial output growth of more than 16% in 2007 Q1. Nominal and real wage growth is high, but poses no inflationary risk thanks to rapid growth in labour productivity. In 2006, however, both the trade balance and the current account ran very large deficits. The sizeable foreign investment generated a sizeable trade deficit of SKK 92 billion (5.6% of GDP). The current account deficit was SKK 130 billion (almost 8% of GDP).

Thanks to lower growth in energy prices and regulated prices, consumer price inflation in Slovakia fell considerably in the first quarter of this year to stand at 2.7% in March. Midway through this month, the central rate of the Slovak koruna in ERM II was revalued from SKK 38.45/EUR to SKK 35.44/EUR. In response to this measure, the koruna strengthened by more than 3%, from around SKK 34/EUR to SKK 32.7/EUR (see Chart 5). The NBS regards this level as strongly overvalued and it succeeded in weakening the koruna's exchange rate to SKK 33.3/EUR through a combination of foreign exchange interventions (amounting to EUR 1.4 billion) and verbal interventions and by refusing the full demand for repo tenders and subsequently increasing the money supply. At the end of the month the NBS lowered its key rate from 4.75% to 4.5%. This was a tough decision to make, however, since the bank viewed the appreciation of the Slovak koruna as excessive, but concerns still exist about the inflationary risks and non-fulfilment of the Maastricht criterion.

CHART III.5

**In 2007 Q1, HUF and SKK appreciated while PLN depreciated slightly**

(average for January 2005 = 100)



## III.2 THE MONETARY CONDITIONS

According to the CNB's calculations, the settings of the real monetary conditions in 2007 Q1 can be characterised as roughly neutral. The interest rate component was slightly tight, whereas the exchange rate component was neutral to slightly easy.<sup>6</sup> The evolution of the two components of the monetary conditions in 2007 Q1 is described in more detail below.

### III.2.1 Interest rates

The CNB left its key interest rates unchanged in 2007 Q1. With effect from 29 September 2006, the 2W repo rate is 2.5%, the Lombard rate 3.5% and the discount rate 1.5%. Market interest rates showed no clear trend. They rose gradually in January, declined by roughly the same amount from the start of February onwards, and increased modestly again in the middle of March.

The rise in rates at the start of the year was due to two main factors – a weakening koruna and developments on foreign financial markets. The later downward correction was caused by several factors. These included a stabilisation of the koruna exchange rate, the minutes of the January meeting of the CNB Bank Board, and the publication of inflation figures (lower than expected both by analysts and by the CNB). The comments made by CNB Board members were also viewed by the market as confirmation of interest rate stability in the coming months. An important external factor was a decline in interest rates with longer maturities connected with the fall on world stock markets and the release of less favourable data on the US economy.

Interest rates grew slightly again in the second half of March after the turbulence on international financial markets subsided. Overall, money market interest rates were flat in 2007 Q1, with rates with longer maturities increasing by 0.2 percentage point at most. PRIBOR spot quotations and FRA forward quotations at the end of March 2007 indicated that financial market participants expected a further monetary policy tightening to occur in 2007 Q3 at the earliest.

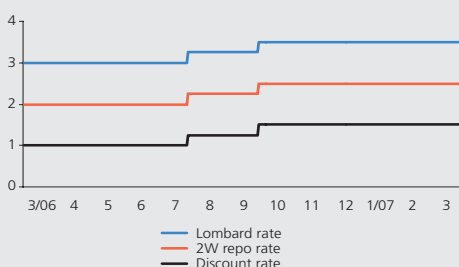
The PRIBOR yield curve gradually shifted to a lower yield level during 2007 Q1, although only at its longer end and to a minimal extent. Its positive slope thus decreased slightly. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.29 percentage point in March. Unlike the money market curve, the IRS yield curve moved upwards, but the changes were also small. The slope of the curve remained positive. In March, the average 5Y-1Y spread was 0.59 percentage point and the 10Y-1Y spread 0.96 percentage point.

The interest rate differential on the money market (PRIBID/CZK-LIBOR/EUR or LIBOR/USD) was affected by changes in key rates and movements in interbank market rates. The ECB raised its refinancing operations rate by 0.25 percentage point to 3.75% during Q1, while the Fed left its key O/N rate at 5.25%. The negative interest rate differential vis-à-vis euro rates thus widened, whereas that vis-à-vis dollar rates was unchanged.

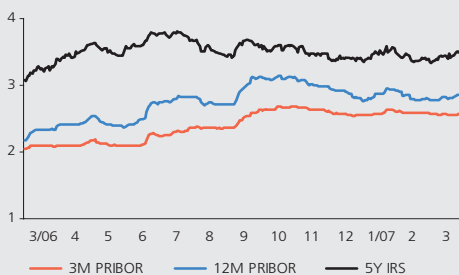
Seven auctions were held on the primary government bond market, with original maturities of 3Y-30Y and a total volume of CZK 43.1 billion. Most auctions met

<sup>6</sup> However, the current effect of monetary policy on economic activity and inflation also depends on the settings of the monetary conditions in previous quarters. The accumulated effect of the monetary conditions is assessed as easy. This accumulated easy monetary policy setting in turn co-determines the starting conditions of the forecast.

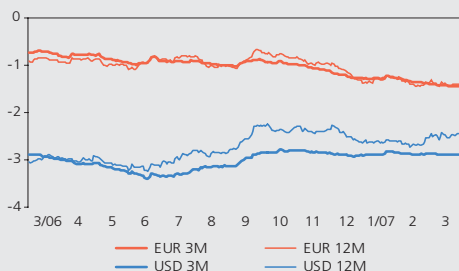
**CHART III.6**  
The CNB left its key interest rates unchanged in Q1  
(percentages)



**CHART III.7**  
Market interest rates were little changed in Q1  
(percentages)



**CHART III.8**  
Interest rate differentials vis-à-vis the euro and the dollar continued to fluctuate in negative values  
(percentage points)



with sufficient interest, but some were negatively affected by the publication of the issuance schedule for 2007 Q2. The planned volume of government bond issues on the domestic market was quite a lot higher than expected by market participants.

Nominal interest rates on new loans were 6.1% and rates on new time deposits 2.1% in February. Real interest rates<sup>7</sup> are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices have long been higher than expected industrial producer price indices, despite the gap having narrowed in 2007 Q1. Real rates on new loans were 4.1% in February, while real rates on time deposits were -0.9%.

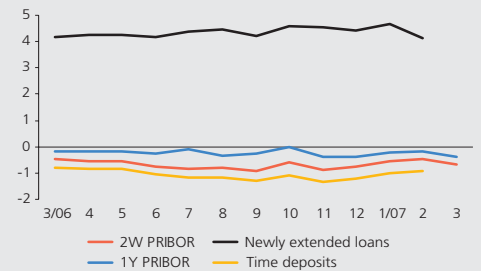
### III.2.2 The exchange rate

The average exchange rate of the koruna against the euro in 2007 Q1 was CZK 28.04/EUR, which represents a year-on-year appreciation of 2.0% (in quarter-on-quarter terms it was unchanged). The modest appreciation trend, still visible the previous year, thus came to a halt. After depreciating in January and February, the exchange rate appreciated again slightly in March. The weakening of the koruna against the euro in January was due to negative sentiment about the Central European region and a change in expectations regarding CNB interest rates, with the prospect of stability or a decline in rates. Whereas the other currencies of the Central European region, particularly the Slovak koruna, gradually corrected their January losses, the Czech koruna remained at a weaker level. The different evolution of the Czech koruna was probably due to the persisting negative interest rate differential against the other currencies in the region. After the publication of favourable economic indicators at the start of March, the koruna again started to appreciate modestly. This appreciation was simultaneously aided by a weakening of the dollar caused primarily by less favourable data on the US economy and the revaluation of the central rate of the Slovak koruna (see Chart III.10).

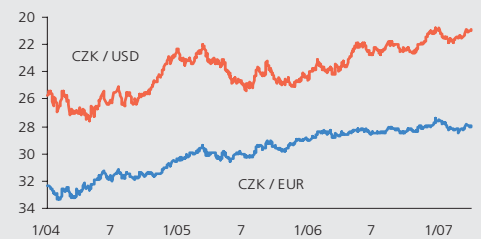
In 2007 Q1, the average exchange rate of the koruna against the dollar was CZK 21.39/USD, which represents a year-on-year appreciation of 10.1% (and a quarter-on-quarter appreciation of 1.7%). The previous year's appreciation trend thus continued. As it did against the euro, the koruna first depreciated in January and the first half of February and then started to appreciate again. The weakening of the koruna against the dollar was generated by mostly favourable data from the USA, which allayed concerns about interest rate cuts by the Fed in the near future. At the same time, an increase in US bond yields led to an outflow of short-term capital from the entire Central European region. By contrast, generally negative US economic results and falling yields led to a renewed koruna appreciation in the second half of the quarter.

The nominal effective exchange rate of the koruna strengthened by 2.0% year on year in 2007 Q1. Compared to the previous quarter, the extent of its appreciation decreased by 2.5 percentage points. The moderating year-on-year appreciation was chiefly due to a slower strengthening of the koruna against the euro and also to a faster depreciation of the Czech koruna against the Slovak koruna. Owing to the evolution of the nominal exchange rate of the koruna and continuing lower domestic inflation compared to that abroad, the annual appreciation of the real effective rate deflated by the PPI moderated as well (to 1.6% in January to February). The slowest year-on-year appreciation was recorded by the real effective exchange rate deflated by the CPI (1.1% in January to February) – see Chart III.11.

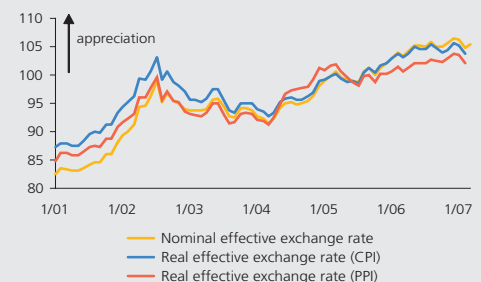
**CHART III.9**  
Ex ante real interest rates on new loans decreased slightly (percentages)



**CHART III.10**  
The koruna's appreciation against the euro halted in 2007 Q1



**CHART III.11**  
The year-on-year appreciation of the nominal effective exchange rate slowed in 2007 Q1 (year 2000 = 100)



<sup>7</sup> Ex ante real interest rates: nominal interest rates on loans are deflated by the industrial producer price indices forecasted by the CNB each month; nominal interest rates on deposits and PRIBOR rates are deflated by the consumer price indices expected by financial market participants each month.

### III.3 THE BALANCE OF PAYMENTS

#### III.3.1 The current account

The current account ended 2006 in a deficit of CZK 133.8 billion, or 4.2% of GDP. In year-on-year terms this meant a rise in deficit of CZK 56.7 billion. Although the current account deficit grew back to the average level observed in 2000–2004, it recorded a substantial shift in structure thanks to favourable trade balance developments. The widening of the overall deficit was mainly due to an increase in the income deficit, so paradoxically it primarily reflects the favourable economic trend in the Czech Republic, as mirrored in high foreign direct investment income. The current transfers balance also deteriorated. The output surplus (goods and services balance) was meanwhile almost unchanged in year-on-year terms (see Table III.1).

The trade surplus amounted to CZK 44.4 billion in 2006, recording a further modest year-on-year increase (of CZK 5.8 billion). The impact of the positive effects of foreign capital inflows, relocation of production to the Czech Republic and relatively high external demand was largely offset by unfavourable price effects, strong aggregate domestic demand growth and continuing appreciation of the koruna-euro exchange rate (see Chart III.12). The increase in surplus was due exclusively to favourable developments at constant prices amid a modest lead of export growth over import growth. The sole category to make a more significant contribution to the trade balance improvement was machinery and transport equipment, whose surplus increased by CZK 62 billion year on year, mainly thanks to a favourable result in the road vehicles subcategory. By contrast, the growth in the overall surplus was strongly dampened by a widening of the deficit in the mineral fuels category (of almost CZK 29 billion year on year). As physical imports of oil and gas increased by less than one per cent overall, the widening of the deficit in the mineral fuels category was essentially a result of large increases in their import prices. Another factor acting towards a moderation of the overall surplus was a narrowing of the surplus in the category of manufactured goods classified by material, primarily due to rising prices of nonferrous metals.

From the geographical perspective, the trade balance improvement was again due primarily to an increase in the trade surplus with the EU-25 – of CZK 56 billion year on year to CZK 328 billion. The largest surpluses were as usual recorded in trade with Germany (CZK 83.8 billion) and Slovakia. By contrast, the biggest deficit was recorded in trade with China (CZK 118.8 billion, a deterioration of CZK 31.9 billion due chiefly to rising imports of machinery components). Trade with Russia also continued to show a high deficit.

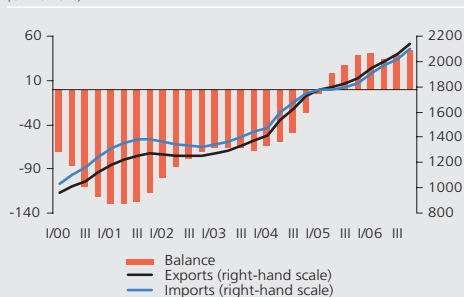
In Q4, the balance of trade ended in a surplus of CZK 6.6 billion. Unlike in the previous three quarters, the year-on-year improvement of CZK 5.4 billion was a result of favourable price effects. The overall impact of developments in physical volume was unfavourable, owing to high domestic demand.

The balance of services ended 2006 in a surplus of CZK 12.5 billion, which, however, represented a year-on-year decrease of CZK 7.8 billion. This decrease was caused by less favourable developments in all three sub-balances (transport, travel and other services). The moderation of the overall surplus was, however, mostly due to a wider deficit on other services. This widening was chiefly due to a decline in receipts from services between affiliated enterprises, whose sizeable increase in 2005 seems to have been a one-off phenomenon, and also to extraordinarily high expenditure on other business services at the end of the year. This is why the total surplus decreased to CZK 1.2 billion in Q4, despite strong growth in receipts from other services, which probably reflected positive changes on the supply side associated with foreign investment inflows into the services sector.

**TABLE III.1**  
The current account deficit increased mainly as result of a deterioration of the income balance  
(CZK billions)

	2003	2004	2005	2006
<b>A. CURRENT ACCOUNT</b>	<b>-160.6</b>	<b>-167.3</b>	<b>-77.1</b>	<b>-133.8</b>
Trade balance	-69.8	-26.4	38.6	44.4
Balance of services	13.2	12.5	20.3	12.5
Income balance	-119.9	-157.8	-155.7	-183.4
Current transfers	15.8	4.3	19.7	-7.2
<b>B. CAPITAL ACCOUNT</b>	<b>-0.1</b>	<b>-14.0</b>	<b>4.9</b>	<b>8.6</b>
<b>C. FINANCIAL ACCOUNT</b>	<b>157.1</b>	<b>183.7</b>	<b>154.8</b>	<b>111.6</b>
Direct investment	53.5	101.8	279.6	104.3
Portfolio investment	-35.7	59.4	-81.2	-26.9
Financial derivatives	3.9	-3.2	-2.8	-6.3
Other investment	135.5	25.7	-40.8	40.5
<b>D. ERRORS AND OMISSIONS</b>	<b>16.5</b>	<b>4.5</b>	<b>10.3</b>	<b>15.6</b>
<b>E. CHANGE IN RESERVES</b>	<b>-12.9</b>	<b>-6.8</b>	<b>-92.9</b>	<b>-2.1</b>
(- = increase)				

**CHART III.12**  
The annual moving total of the trade surplus increased in 2006 Q4  
(CZK billions)



The income deficit reached CZK 183.4 billion in 2006, representing a year-on-year deterioration of CZK 27.7 billion (see Chart III.13). Its main components were outflow of dividends and estimated reinvested earnings on the debit side. The widening of the total deficit was mostly due to an increase in the deficit on dividends (including interest) under direct investment income, which rose by CZK 30.2 billion year on year to CZK 96.1 billion. At the same time, the deficit on compensation of employees widened as well, owing to faster growth in expenditure on foreigners working in the Czech Republic. The rise in the total income deficit was counteracted by growth of the surplus on income on other investment, in particular income on the CNB's foreign exchange reserves and interest income of commercial banks on foreign deposits, and a moderation of the reinvested earnings deficit.

Current transfers recorded a deficit of CZK 7.2 billion, deteriorating by CZK 26.9 billion year on year. The annual decline in receipts was largely due to base effects connected with a one-off transaction relating to damages paid to ČSOB by the Slovak Republic (CZK 19.4 billion). The increase in transfers abroad was mainly associated with private transfers and EU budget-related transfers included under current transfers.

**III.3.2 The capital account**

The capital account recorded a surplus of CZK 8.6 billion in 2006 (a year-on-year improvement of CZK 3.8 billion). The comparatively large annual growth in revenues was associated primarily with higher income from EU funds and emission allowance trading. The surplus was significantly moderated by an increase in expenditure due to the inclusion of a write-off of a claim against Iraq (roughly CZK 4 billion).

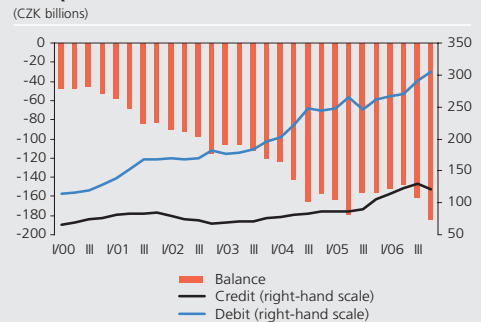
**III.3.3 The financial account**

In 2006, the financial account showed a surplus of CZK 111.6 billion, or 3.5% of GDP. This represented a year-on-year fall in surplus of CZK 43.2 billion. The direct investment surplus was still its largest component. The annual decrease in the total surplus was linked primarily with a moderation of the net inflow of direct investment, resulting from an absence of major sales of assets to non-residents. By contrast, a decrease in the total surplus was counteracted by a substantial change in other investment flows and a decline in the net outflow of portfolio investment.

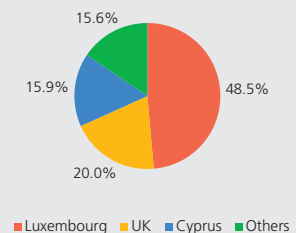
Direct investment recorded a surplus of CZK 104.3 billion, representing a sizeable year-on-year decline in net inflow of CZK 175.3 billion. The total FDI inflow amounted to CZK 134.7 billion and was about half that recorded in 2005. The largest FDI item was reinvested earnings of non-residents (CZK 82.1 billion), whose estimated volume increased slightly year on year. The moderation of the overall FDI inflow was chiefly due to base effects relating to large sales of assets to non-residents amounting to almost CZK 150 billion. In 2006 it was also partially affected by a one-off decline in investment in equity capital as a result of accounting operations decreasing the equity of two major foreign-owned companies in the Czech Republic. With regard to industries, the foreign capital inflow (of CZK 52.6 billion) was channelled primarily into real estate and trade. By territory, the biggest investors were Luxembourg, the United Kingdom and Cyprus (see Chart III.14). Czech direct investment abroad amounted to CZK 30.4 billion thanks mainly to ČEZ acquisitions and an estimated rise in reinvested earnings.

The net outflow of portfolio investment in 2006 was CZK 26.9 billion, compared to CZK 81.2 billion in 2005. The year-on-year decrease in the overall deficit resulted from a recovery in non-residents' demand for Czech equity securities and a

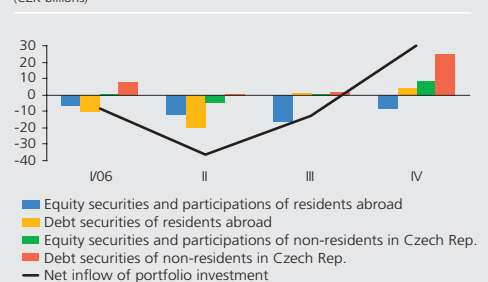
**CHART III.13**  
The annual moving total of the income deficit increased in 2006 Q4



**CHART III.14**  
Firms registered in Luxembourg were the largest foreign investors in the Czech Republic in 2006



**CHART III.15**  
Portfolio investment recorded a net inflow in 2006 Q4



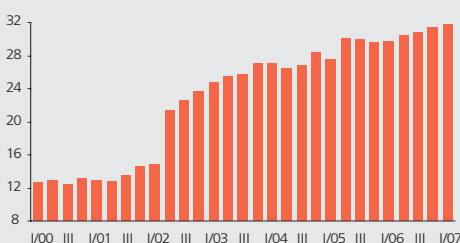
simultaneous fall in residents' interest in foreign debt securities. The outflow of capital moderated to CZK 68.4 billion. Roughly two-thirds of this outflow was linked with a rise in holdings of foreign shares and about one-third was attributable to bonds. Although the negative interest rate differential of the Czech koruna vis-à-vis major world currencies increased in 2006, residents' interest in foreign debt securities decreased year on year. The inflow of portfolio investment from abroad was CZK 41.5 billion. Its increase of about CZK 40 billion was a result of a change in flows of equity securities, with a marked decline in holdings of shares in 2005 turning to moderate share purchases in 2006. The increased interest in shares was probably associated with the favourable financial results of domestic companies. The level of investment in debt securities was almost unchanged in year-on-year comparison. 2006 Q4 saw a significant foreign issue of bonds of a domestic corporation, which had a major effect on the overall portfolio investment balance in that quarter. By contrast to the net outflow observed in the first three quarters, Q4 ended in a sizeable net inflow (see Chart III.15).

Financial derivatives transactions generated a CZK 6.3 billion decrease in the financial account surplus. Their turnover was still low compared to the other financial account items.

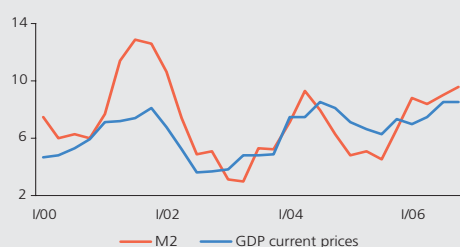
Other investment recorded a net capital inflow of CZK 40.5 billion in 2006 (by contrast, a net outflow of CZK 40.8 billion had been posted in 2005). The year-on-year change was due exclusively to a strong outflow of banking sector capital being replaced by an inflow. The net inflow of capital of commercial banks reached CZK 29.2 billion, largely owing to a decline in short-term assets. Other contributors to the overall net inflow were the government sector and, to a very small extent, the corporate sector. Foreign funds obtained by the government amounted to CZK 14.5 billion. In year-on-year terms, however, this meant a decrease in drawings on foreign funds of more than one-half. The reason was the inception of a new long-term liability for the lease of fighter aircraft in the base period and a concurrent decrease in the volume of de-blocking operations and lower borrowing from the EIB in 2006. Net drawings on foreign loans by corporations fell to CZK 1.0 billion owing to a more pronounced rise in funds provided abroad.

The CNB's international reserves rose by CZK 8.6 billion to CZK 665.2 billion in 2007 Q1. This was due mostly to exchange rate differences. In dollar terms, the reserves rose by just USD 0.2 billion to USD 31.6 billion in the same period (see Chart III.16).

**CHART III.16**  
The CNB's international reserves increased only slightly in dollar terms in 2007 Q1  
(USD billions)



**CHART III.17**  
Money supply growth was in line with the high nominal GDP growth  
(annual percentage changes)



### III.4 MONETARY DEVELOPMENTS

The money supply continued to grow relatively fast in 2006 Q4. The main contributor to this growth remained highly liquid money, although its rate of growth slowed. The low level of interest rates and the growth of the economy were reflected in a high rate of growth of loans to corporations and households. Given the still low debt ratios of these two sectors by comparison with the euro area, further growth in lending can be expected going forward.

#### III.4.1 Money

Annual M2 growth increased to 10.6%. The rise was due to the low level of interest rates and was consistent with the robust economic growth (see Chart III.17). This is also evidenced by rapid growth in domestic loans to corporations and households, which was the main source of M2 growth. Especially recently, partial indicators of

the appropriateness of the M2 growth suggest the possibility of a gradual slightly inflationary effect in the medium term.

70% of the M2 growth was again due to the liquid money included in M1. However, year-on-year M1 growth slowed in the period under review, while growth in quasi money picked up pace (see Table III.2). Within M1, this was visible in overnight deposits. By contrast, currency in circulation accelerated further in line with the buoyant growth in household consumption. As regards the structure of quasi money, the growth rate of short-term deposits with agreed maturity recorded an increase. Deposits redeemable at notice continued to grow relatively fast. This trend gradually began to be affected by growth in the spreads between rates on time deposits and rates on overnight deposits following the increase in key monetary policy interest rates in 2006 Q3. However, demand for money continued to focus on the short-term and relatively liquid components of M2, in line with the cyclical position of the economy and the still relatively low opportunity costs of holding liquid money.

Deposits of households and non-financial corporations contributed to M2 growth (see Chart III.18). In the case of households, growth in deposits has been steadily picking up pace for some time. By contrast, deposits of non-monetary financial institutions fell.

### III.4.2 Credit

Annual growth in loans to corporations<sup>8</sup> and households remained relatively high in February, at 20.3% (see Table III.3). It was affected mainly by the easy cumulative effect of the interest rate component of the real monetary conditions and the buoyant economic growth. Loans to corporations accounted for the largest part of total loans (around 60%), while the share of loans to households was roughly 40%. However, the contribution of loans to households to the growth in lending was around 60%. The ratio of total loans to GDP increased by 4 percentage points to 40% in 2006, rising by 1 percentage point to 23% for corporations and by 3 percentage points to 17% for households. So far this ratio has been much lower than in the euro area (127%), hence further growth can be expected as part of the convergence process.

Annual growth in loans to non-financial corporations picked up in 2006 Q4 and in January, but slowed to 18.7% in February. The February slowdown was recorded for both short-term and long-term loans. Long-term loans grew the fastest in the period under review, in line with gross fixed capital formation. Loans to the machinery and equipment rental sector, manufacturing, services and construction remained the main contributors to the increase in loans. Domestic borrowing in korunas was supported by the negative differentials between domestic and euro area interest rates. However, the demand of corporations for domestic loans in foreign currency increased in the period under review, owing to the appreciation of the exchange rate. Nonetheless, the share of foreign currency loans remained low (10.7%). The increase in loans to corporations in Q4 was due chiefly to loans to domestic corporations and, to a lesser extent, loans to foreign-owned corporations. The share of loans to domestic corporations in total loans to corporations was 74% and that of loans to foreign-owned corporations was 26%. Foreign-owned corporations also used their own funds to finance the development of their economic activities (see Box 2 for details on the financing of non-financial corporations).

**TABLE III.2**  
**M1 growth slowed**

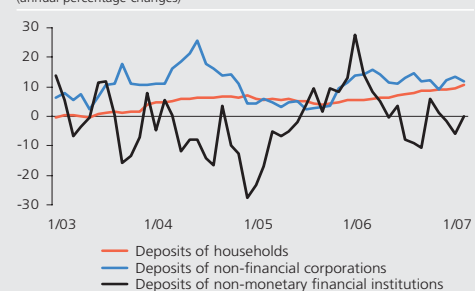
(quarterly averages and end-of-month stocks; annual percentage changes)

	III/06	IV/06	1/07	2/07	Share in M2, % 2/07
M1	16.5	15.2	14.3	13.6	56.6
Currency in circulation	11.4	11.4	11.6	12.1	13.4
Overnight deposits	18.2	16.4	15.2	14.0	43.2
M2-M1 (quasi money)	0.6	2.8	5.0	7.0	43.4
Deposits with agreed maturity	-4.9	-2.5	1.4	3.6	30.9
Deposits redeemable at notice	19.3	19.5	18.3	18.6	12.0
Repurchase agreements	5.4	8.0	-41.7	-19.0	0.5
M2	9.0	9.6	10.1	10.6	100.0

**CHART III.18**

**Deposits of households and non-financial corporations continued to grow rapidly, while deposits of non-monetary financial institutions fell**

(annual percentage changes)



**TABLE III.3**

**Loans to corporations and households continued rising rapidly**

(quarterly averages and end-of-month stocks; annual percentage changes)

	III/06	IV/06	1/07	2/07	Share in total loans, % 2/07
Non-financial corporations	16.9	19.4	20.0	18.7	49.1
Loans up to 1 year	11.1	12.5	10.6	9.7	18.2
Loans over 1 year and up to 5 years	15.6	15.1	19.5	20.0	12.0
Loans over 5 years	24.6	30.8	30.9	28.0	18.9
Households	32.2	30.3	29.7	30.1	42.5
Consumer credit	27.4	25.1	23.3	24.2	8.5
Loans for house purchase	33.7	33.1	32.3	32.3	29.4
Other loans	32.2	22.7	26.5	27.9	4.6
Non-monetary financial institutions	2.2	-5.9	-8.2	-8.2	8.4
Total loans	20.8	20.6	20.7	20.3	100.0

<sup>8</sup> Loans to corporations comprise loans to non-financial corporations and non-monetary financial institutions.

CHART 1 (Box)

The financing structure of monitored corporations has been fairly stable in the past four years

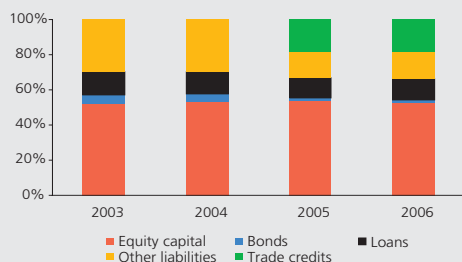


CHART 2 (Box)

Growth in corporations' own funds has been affected primarily by rising returns on sales (pre-tax profit-sales ratios in per cent)

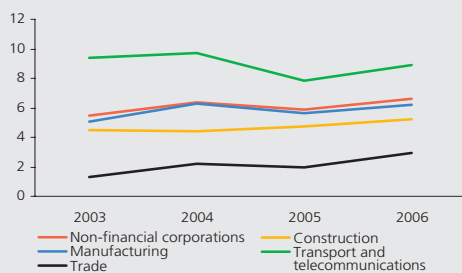


CHART 3 (Box)

The corporate debt indicator increased slightly overall in 2006 (external funds-equity capital ratio in per cent)

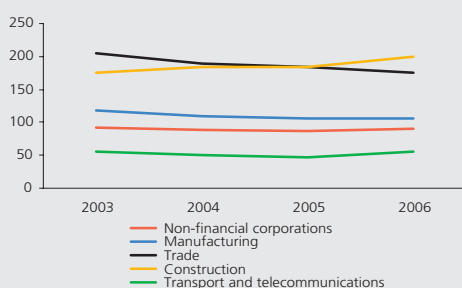
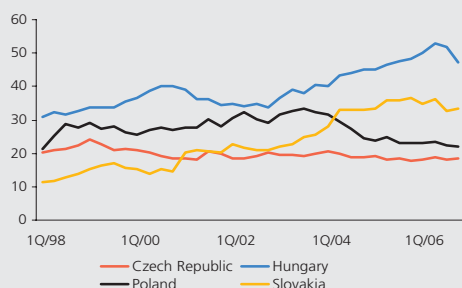


CHART 4 (Box)

The share of foreign currency loans in loans to corporations has long been stable in the Czech Republic (percentages)



## BOX 2

### Financing of non-financial corporations

Corporate financing is an important component of monetary policy transmission. Real corporate financing costs are included in the real monetary conditions index in the core prediction model. This box uses new data for 2006 and analyses the evolution of financing of non-financial corporations.

According to the financial results of non-financial corporations with 100 employees or more, the structure of financing of large corporations has remained broadly unchanged for the last four years. The ratios of internal and external funds to total liabilities are relatively balanced (roughly 53% and 47%). However, the annual rate of increase of internal funds picked up by 2.5 percentage points to 11% in 2006, while that of external funds rose by 8.9 percentage points to 15%. Within external funds (see Chart 1), corporations used mostly trade credits (around 18%), other liabilities and reserves (around 15%), but also drew financial loans (around 12%). Financing through bond issues was negligible (around 2%). By international comparison, the structure of corporate financing in the Czech Republic was roughly similar to that in Hungary and Poland in 2006. Within the financing structure in the Czech Republic, the share of funds of domestic companies in total funds declined, whereas the share of funds of foreign-owned companies rose.<sup>9</sup> This was in line with the contributions of these companies to economic activity.

The companies monitored achieved their best results ever in 2006 as regards return on equity and return on sales, which increased by 0.7 percentage point to 6.6%<sup>10</sup> (see Chart 2). The corporate debt ratio, expressed as the ratio of external funds to equity capital, rose by around 4 percentage points to 91%<sup>11</sup> in 2006 (see Chart 3). Taking into account financial loans and bonds only, the debt ratio increased by 0.4 percentage point to 26.3%.

Companies drew loans both in the Czech Republic and abroad. The estimated share of domestic loans was around 65% and that of foreign loans around 35%. Since the beginning of 2005 annual growth in domestic loans has exceeded growth in foreign loans (around 17% and 2% respectively in 2006 Q3) as a result of the negative interest rate differential between domestic and euro area rates. Within domestic financial loans, koruna loans were more prevalent than foreign currency loans. Despite the appreciation of the koruna and expectations of further appreciation, the demand of corporations for foreign currency loans has been stable around 20% for the last four years. The share of foreign currency loans in total loans in the Czech Republic was similar to that in Poland, slightly lower than in Slovakia and significantly lower than in Hungary (see Chart 4). A positive dependence between the interest rate differential and the share of foreign currency loans was visible across all these countries.

So far, the stable structure of corporate financing in the Czech Republic has not indicated any significant changes in the effect of the monetary policy transmission mechanism. The effect of monetary policy is affected by the structure of financing in the sense that it is weakened by the high shares of

<sup>9</sup> In foreign-owned companies, the share of equity capital, loans (financial loans and trade credits) and other liabilities increased in particular. In the sample of companies monitored in 2006, domestic companies accounted for 70% and foreign-owned ones for 30%.

<sup>10</sup> An increase in profitability was recorded for foreign-owned companies and domestic public companies.

<sup>11</sup> The debt ratio was 79% in domestic companies and 106% in foreign-owned companies.

trade credits and other liabilities in total funds (30% and 60% of total external funds respectively) and by the share of foreign-owned companies. These companies recorded the highest debt relative to their internal funds, with foreign loans accounting for the majority of their debt (an estimated 67%). Consequently, they are sensitive to the euro area real interest rate and to the interest rate differential. Higher growth in domestic koruna loans in the Czech Republic indicates a higher sensitivity of domestic companies in particular to changes in the domestic real interest rate, as 98% of new loans to corporations are granted at a floating rate or with an initial rate fixation of up to 1 year.

The real interest rate on new koruna loans granted to non-financial corporations was relatively low at 2.0% (see Chart 5). It was roughly 1 percentage point lower by comparison with the euro area in 2006. Its evolution was broadly in line with real financial market rates, with a closer link recorded for short-term interest rates (i.e. with an interest rate fixation of up to 1 year) than for long-term ones.

Annual growth in loans to households slowed slightly in 2006 Q4 and early 2007 to stand at 30.1% in February.<sup>12</sup> The rate of growth was 32.3% for loans for house purchase and 24.2% for consumer credit (see Chart III.19). The rapid growth in loans for house purchase was fuelled by the low interest rates, uncertainty surrounding changes to the VAT rate on construction work, and rent deregulation. Consumer credit contributed partly to the higher growth in household consumption in 2006 Q4. Alongside other factors, its effect was visible in a further – albeit slower – decline in the saving rate. However, consumption accelerated mainly as a result of faster real gross disposable income growth. Growth in consumer credit granted by non-bank financial institutions rose to 18% in 2006 Q4. This was due mainly to credit granted by financial leasing companies.

The ratio of total household debt (with banks and non-banks) to annual gross disposable income rose by around 7 percentage points to 40.7% in 2006. In the case of loans for house purchase, the increase was roughly 5 percentage points to 23.9%. Interest costs grew at a similar rate as household debt, but their ratio to gross disposable income was relatively low (1.6%). Households' balance sheets were affected more by the impact of loan repayments, whose average ratio to net money income was 4.3% per capita in 2006. Consumer credit was the most risky from MFIs' perspective; the volume of classified consumer loans rose in proportion to total consumer credit. These loans increase the sensitivity of households' balance sheets to potential shocks, with potential knock-on effects on consumption. Analyses suggest that any interest rate rise could be reflected in consumption to a rather limited degree, but a more pronounced effect can be expected in the case of low-income households.

The overall interest rate on new loans to non-financial corporations and households rose by 0.3 percentage point to 6.1% between October 2006 and February 2007. Short-term and long-term interest rates moved in line with financial market interest rates. Growth in short-term interest rates (i.e. those with an initial rate fixation of up to 1 year) on new loans for house purchase was slightly higher in 2006 Q4 than the rise in money market interest rates (see Chart III.20). However, these rates

CHART 5 (Box)

The real interest rate on new loans to corporations has reached a low level

(percentages; new business)

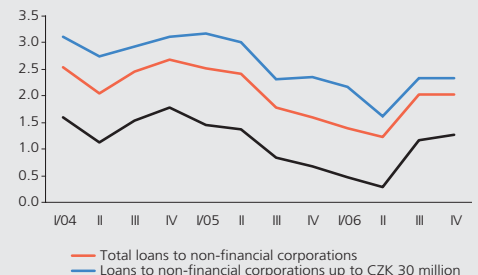


CHART III.19

Loans for house purchase remained the fastest-growing

(annual percentage changes)

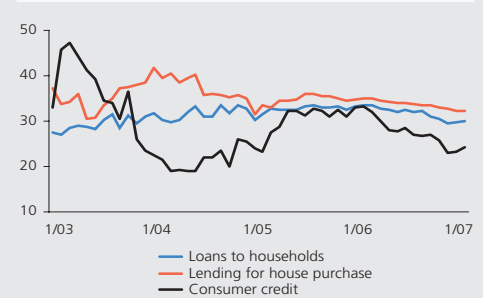
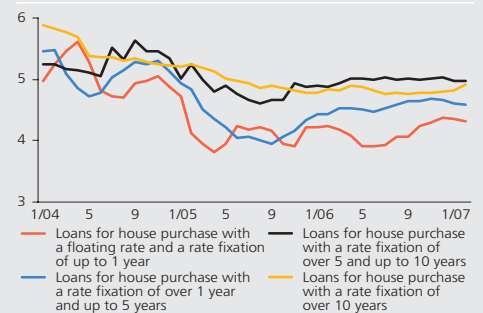


CHART III.20

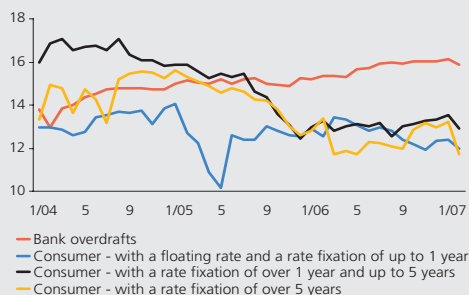
Short-term interest rates on new loans for house purchase increased in 2006 Q4, while long-term rates were mostly flat

(percentages)

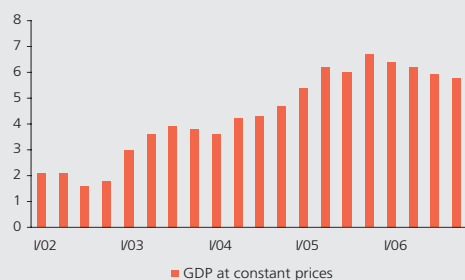


<sup>12</sup> This figure relates solely to MFI loans to households, whose absolute volume is around CZK 557 billion. The volume of loans granted by non-bank institutions is around CZK 117 billion (the share of financial leasing and hire-purchase companies being roughly one-half). Loans for house purchase accounted for around CZK 401 billion, consumer credit for around CZK 213 billion and other loans for around CZK 60 billion of the total volume of loans to households.

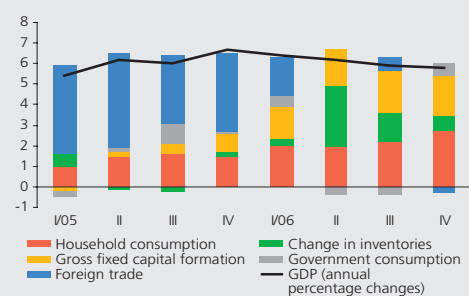
**CHART III.21**  
Interest rates on new consumer credit mostly fell  
(percentages)



**CHART III.22**  
Economic growth slowed in 2006 Q4, but remained high  
(annual percentage changes)



**CHART III.23**  
GDP growth in 2006 Q4 was driven by domestic demand  
(annual percentage changes; contributions in percentage points)



**TABLE III.4**  
Household consumption and gross fixed capital formation  
contributed the most to domestic demand growth  
(annual percentage changes; CZK billions)

	IV05	II/06	III/06	IV/06
GROSS DOMESTIC PRODUCT	6.4	6.2	5.9	5.8
A. FINAL CONSUMPTION EXPENDITURE	3.6	2.3	2.5	4.6
household consumption	4.1	4.3	4.3	5.4
government consumption	2.4	-1.9	-1.8	2.6
non-profit institutions serving households	4.5	5.5	5.7	3.0
B. GROSS CAPITAL FORMATION <sup>a)</sup>	7.4	16.7	13.0	11.1
gross fixed capital formation	6.8	7.0	8.0	7.6
C. NET EXPORTS OF GOODS AND SERVICES (balance in CZK billions, constant 2000 prices)	8.2	-10.3	-13.0	-27.7
imports of goods and services	16.4	11.3	10.9	18.1
exports of goods and services	18.4	10.9	11.7	17.4

a) gross fixed capital formation, change in inventories and net acquisition of valuables

subsequently fell slightly. The evolution of rates on new loans to non-financial corporations was similar to that of money market rates. Short-term rates on new consumer credit were mostly flat or falling (see Chart III.21). Long-term interest rates on new loans for house purchase remained almost unchanged over the period under review, while the 5Y IRS rate declined. Moreover, rates fixed for more than five years were flat throughout 2006. Long-term rates on new consumer credit tended to decline. Rates on new loans to non-financial corporations followed a similar trend.

### III.5 DEMAND AND OUTPUT

Economic growth remained buoyant but recorded a further slight slowdown in 2006 Q4 (see Chart III.22). According to the CZSO's preliminary estimate, annual growth in real GDP was 5.8% in 2006 Q4, 0.1 percentage point lower than in the previous quarter. GDP growth in 2006 as a whole was 6.1%. By the CNB's estimation, the economy has been slightly exceeding the potential, non-accelerating inflation level of output since 2005 Q4.

During 2006, a decrease in the contribution of external trade and an increase in the share of domestic demand were apparent in the GDP growth structure. These changes are shown in Chart III.23. By 2006 Q4, GDP growth was already being driven exclusively by domestic demand. Its contribution to output growth was most affected by consumption expenditure of households, which is showing a long-term upward trend. The rising propensity of households to consume was due mainly to high consumer confidence and relatively low interest rates. Also high was the contribution of fixed investment, the continuing rise of which was consistent with the current phase of the business cycle and was fostered above all by foreign capital inflows, easy monetary policy in the recent past and favourable growth in corporations' own funds in the previous period. The share of change in inventories in economic growth was less significant in Q4 than in the previous two quarters, and the contribution of government consumption was even lower. Only the contribution of foreign trade was negative in 2006 Q4, although real exports grew rapidly, testifying to the continuing strong export performance of the Czech economy. However, import growth was faster, its high growth in 2006 Q4 being affected by the buoyant domestic demand.

On the supply side of the economy, manufacturing, which had seen major structural changes in the previous period, was again the largest contributor to GDP growth in 2006 Q4. The contribution of the services sector, where market services grew the fastest, was lower than that of industry. Gross value added growth in construction picked up. By contrast, gross value added in agriculture continued to fall year on year.

#### III.5.1 Domestic demand

Annual growth in total final consumption expenditure increased significantly in 2006 Q4, reaching 4.6%. This increase was due chiefly to a rise of 5.4% in households' consumption expenditure, as government expenditure rose much more slowly and the contribution of expenditure by non-profit institutions was insignificant. The largest increase (11.1%) was recorded by gross capital formation, whose contribution to domestic demand growth was identical to that of household consumption. Its rapid growth was due to a strong increase in gross fixed capital formation (7.6%) as well as additions to inventories, which were higher than a year earlier.

**Consumer demand**

Annual household consumption growth continued its long-running gradual upward trend during 2006, reaching 5.4% in Q4. As shown in Chart III.24, household consumption expenditure growth was at a three-year high. In 2006 as a whole, real household consumption increased by 4.6%, up by 1.8 percentage points compared to 2005. This was in line with the results of a CZSO survey indicating that consumer confidence had been strong for most of 2006, reaching historical highs in some months. The continuing favourable evolution of consumer confidence in 2007 Q1 suggested that households' higher propensity to consume might continue into 2007 (see Chart III.25).

As in the first three quarters of 2006, households' consumer expenditure rose 1.2 percentage points faster than their disposable income. Households dealt with this situation by saving less from their disposable income and by borrowing. This was evidenced by an annual decrease in gross saving of almost 10% in absolute terms and an annual decrease in the gross saving rate of 0.9 percentage point to 5.6% (see Chart III.24). Consumer credit growth slowed slightly in 2006 Q4, but remained strong above 20% (see section III.4 *Monetary developments*).

However, gross disposable income<sup>13</sup> remained the main source of financing of households' rising final consumption expenditure. Its annual rate of increase rose by 0.3 percentage point to 5.6% in nominal terms (4.2% in real terms) in 2006 Q4. Wages and salaries – the largest component of household income in terms of volume – contributed most to the growth in household income, rising by 6.5% year on year in 2006 Q4. The contribution of operating surplus and mixed income was also important; its annual growth rate increased significantly in 2006 Q4 to almost double the figure recorded for 2006 as a whole. By contrast, annual growth in social benefits<sup>14</sup> slowed gradually during 2006 and stood at 5.4% in Q4. However, income from the above-mentioned sources was "drained off" to a larger extent than in the previous year by rising current expenditure, with interest paid on loans rising the fastest (50% year on year in Q4).

The view of the causes of households' continuing higher propensity to consume remains unchanged from the January Inflation Report. It was due probably to the still relatively strong consumer confidence, reflecting positive perceptions of the present and future economic situation, but also the favourable conditions for borrowing supported by the easy interest rate component of the monetary conditions in the recent past, the long-running decline in prices of many durable consumer goods and increased demand for household equipment connected with new housing construction.

**Investment demand**

Fixed investment continued to grow rapidly (by 7.6%) in 2006 Q4. As regards the investment structure, the trends of the previous quarters of 2006 continued. Annual investment growth was still being driven predominantly by technological investment (see Chart III.26).<sup>15</sup> Investment in transport equipment, which grew by almost 30%, again recorded the largest contribution to the total increase in

CHART III.24

**Household consumption growth picked up pace significantly in 2006 Q4, exceeding 5%**  
(annual percentage changes)

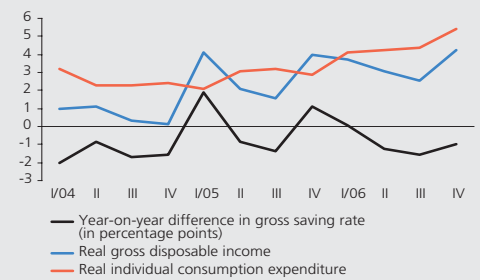


CHART III.25

**Consumer confidence was fluctuating at high levels for most of 2006 and at the start of 2007**  
(2005 average = 100)

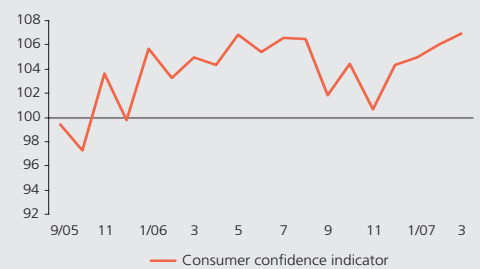
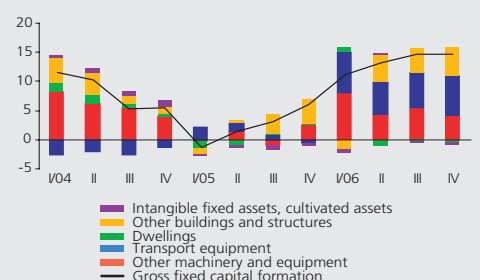


CHART III.26

**The continuing rapid investment growth was again driven largely by technological investment**  
(annual changes in CZK billions)

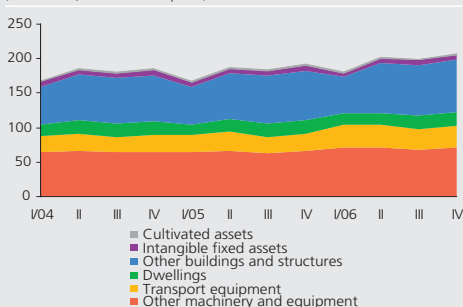


<sup>13</sup> Disposable income = current income (wages and salaries, gross operating surplus and mixed income, property income, social benefits etc.) - current expenditure (payments of taxes, interest, social contributions, non-life insurance premiums, etc.).

<sup>14</sup> i.e. social benefits other than social transfers in kind.

<sup>15</sup> Technological investment comprises transport equipment and other machinery and equipment.

**CHART III.27**  
**But investment in buildings remained a significant component of the total investment volume**  
 (CZK billions, constant 2000 prices)



investment. According to the statistics for large non-financial corporations,<sup>16</sup> this investment went mainly into transport, communications and storage<sup>17</sup> and industry. The contribution of investment in other machinery and equipment, which rose by 6.2%, was also relatively significant.

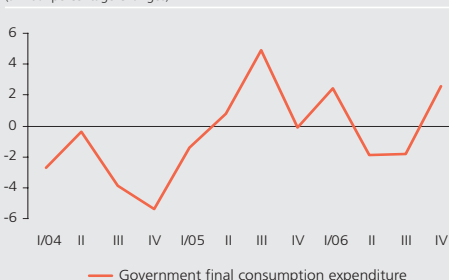
The share of construction investment in total fixed investment growth was much lower than that of technological investment, despite the fact that construction activity remained buoyant thanks to the very favourable winter weather conditions.<sup>18</sup> As in 2006 Q3, one of the reasons for this phenomenon was an increasing number of buildings under construction, reflecting high demand for construction work, more new housing starts and a lack of special construction capacity for completing work. These factors manifested themselves above all in a continuing moderate decline in investment in dwellings. By contrast, investment in other buildings and structures continued to rise rapidly (by 6.9% year on year), hence also contributing to the strong investment growth in Q4. There was no major change in the structure of total investment in the last quarter of 2006 compared to the last three years. The investment continued to be channelled mostly into machinery and equipment and other buildings and structures (see Chart III.27). The share of investment in transport equipment remained relatively low, despite recording a very high rate of increase.

Only partial changes in the structure of investment by kind and some other indicators<sup>19</sup> suggested that the shares of the individual sectors in total investment also remained largely unchanged. Continuing very strong growth in government sector investment expenditure (30.8% at current prices) indicated that the contribution of government to total investment growth was again relatively significant in 2006 Q4. This assumption was supported by data on the rather high share of civil engineering structures<sup>20</sup> in new construction, which reached around 40% for the whole of 2006.

Investment in fixed capital in the non-financial corporations sector, which accounts for more than half of the total investment volume, went mainly into technological investment in 2006 Q4. This seems to have been closely related to the realisation of large investments, the development of transport and probably also the upgrading of transport equipment in some branches. Investment in this sector was fostered not only by foreign capital inflows, but also by the relatively low level of interest rates, the favourable evolution of own funds, and current and expected demand.

Investment in dwellings, which primarily concerns the household sector, declined for the third consecutive quarter (by 1.9% in 2006 Q4). One of the main reasons for this was probably the aforementioned increase in the number of flats under construction.<sup>21</sup> Given the relatively high growth in the number of housing starts (13.7% in Q4) and the persisting favourable conditions for mortgage loan provision, investment in dwellings can probably be expected to recover in the near future.

**CHART III.28**  
**Government final consumption expenditure showed renewed growth in 2006 Q4**  
 (annual percentage changes)



### Government demand

Following two quarters of annual real decline, general government expenditure on final consumption rose again by 2.6% in 2006 Q4. At 6.4%, its growth at current prices was higher.

<sup>16</sup> Corporations with 100 employees or more.

<sup>17</sup> Especially in public non-financial corporations.

<sup>18</sup> For example, construction output recorded annual real growth of 15.4% in December 2006.

<sup>19</sup> The CZSO only publishes data on the structure of investment by kind, so the analysis of total investment by economic sector is based on partial indicators.

<sup>20</sup> Civil engineering structures include roads, motorways, bridges and tunnels.

<sup>21</sup> In 2006 Q4, annual growth in the number of flats under construction was 8.7%.

Government demand is affected above all by the state budget, which represents the main part of the government sector's performance. Although total state budget revenue rose noticeably (by 7.5% year on year) in 2006 Q4 following a moderate drop in Q3, the increase in total expenditure was higher (10.8%). As a result, the state budget deficit widened by almost CZK 17 billion to CZK 98.8 billion compared to the same period a year earlier.

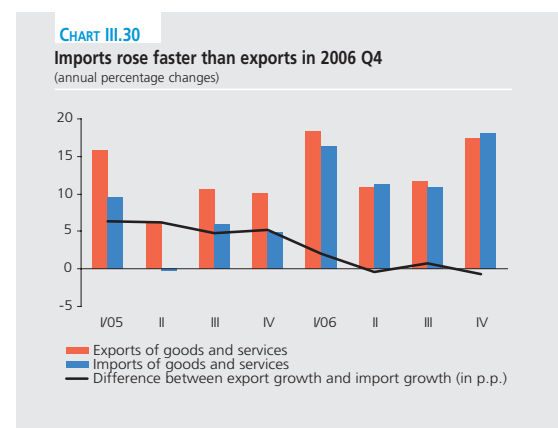
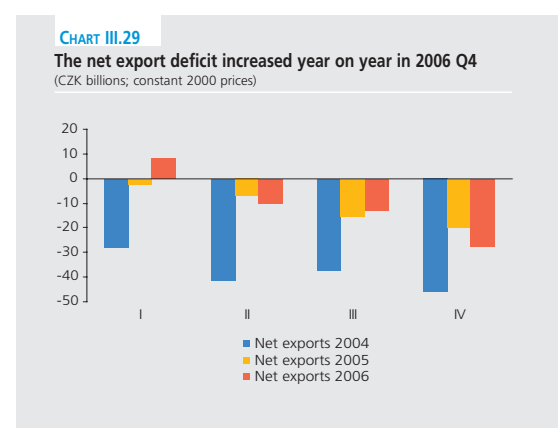
The pick-up in annual state budget revenue growth was aided significantly by renewed growth in excise duty collection (up by 25% year on year), caused by the "lagged" sale of tobacco products with a higher duty rate. Other tax revenue was flat or slightly falling. The increase in state budget revenue was also supported by higher inflows of non-investment subsidies from EU funds at the close of the year. On the other hand, the relatively strong growth in state budget expenditure, which had begun in the previous quarter, continued into 2006 Q4. The annual increase in expenditure was due chiefly to other non-investment expenditure (up by 25.1%), reflecting dynamic growth in current expenditure. However, public wage expenditure, which also has a direct impact on government demand, fell by around 1.4% year on year in 2006 Q4. Large increases were also recorded for transfers to reserve funds, social security and health insurance funds (19.5%) and budgetary and subsidised organisations (31.2%), which, however, do not directly affect government demand. The analysis of the expenditure side of the state budget in 2006 Q4 suggests that government demand started to support aggregate demand growth in the Czech economy.

**III.5.2 Net external demand**

The annual decline in negative net exports of goods and services,<sup>22</sup> visible particularly during 2005, was replaced by a sizeable increase of CZK 7.9 billion to CZK -27.7 billion in 2006 Q4. This change occurred amid a marked annual rise in foreign trade turnover, as growth in both exports and imports accelerated by comparison with the previous quarter. Export growth increased by 5.7 percentage points to 17.4%, but import growth recorded an even stronger pick-up (of 7.2 percentage points to 18.1%). Import growth thus overtook export growth again, and, unlike in the previous quarter, the contribution of net exports to GDP growth was negative (see Chart III.23).

The annual deterioration in net exports was fostered mainly by the trade deficit, which widened by CZK 4.7 billion after nine quarters of decline. This was due mainly to a large increase in goods imports (of 18.5%), which, as in the previous quarters, primarily reflected higher demand for investment imports and imports for intermediate consumption of corporations linked with the buoyant growth in aggregate domestic demand and additional collaboration imports. Although rapidly growing goods exports (18.1%) acted towards a reduction in the trade deficit, they did not fully offset the strong import growth. The continuing rapid growth in goods exports was due to the launching of export-oriented production facilities (especially in the car and electrical engineering industries), transfers of production from Europe and Asia to the Czech Republic and favourable external demand.

Services imports also rose unusually fast in 2006 Q4 (by 14.9%), as a result of high growth in imports of other services. At the same time, services exports also picked up significantly, owing to a considerable rise in exports of other services. Nevertheless, the services deficit widened in 2006 Q4, contributing to the overall deterioration in net exports.



22 At constant 2000 prices.

To sum up, we can say that high growth in aggregate demand, connected with a substantial pick-up in total import growth, was the key factor affecting net exports in 2006 Q4. Nonetheless, the buoyant growth in total exports continued, supported by favourable supply-side changes and higher external demand.

CHART III.31

### Manufacturing was the biggest contributor to the high GDP growth in 2006 Q4

(contributions in percentage points; constant 2000 prices; selected branches)

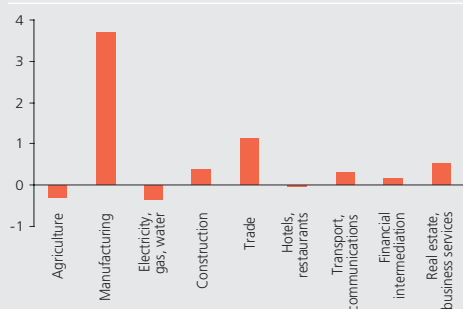


CHART III.32

### Rapid growth in industrial production was achieved amid high productivity growth

(annual percentage changes)

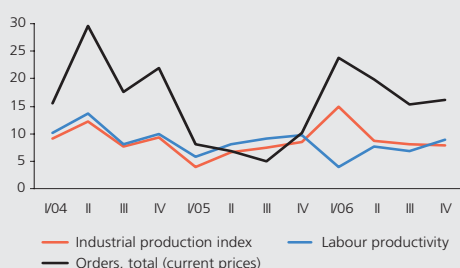


CHART III.33

### Business confidence was generally high in 2006 and at the start of 2007

(average 2005 = 100)



TABLE III.5

### The rapid growth in consumer durables and capital goods production continued

(annual percentage changes)

	9/06	10/06	11/06	12/06
Industrial production, total	5.5	12.6	7.6	3.0
Intermediate goods	4.0	12.1	3.6	0.6
Capital goods	11.6	20.7	15.5	8.9
Consumer durables	15.8	19.1	34.5	24.3
Consumer non-durables	-6.9	5.1	-2.7	-2.7
Energy	4.2	-0.7	2.8	-3.3

### III.5.3 Output

In 2006 Q4, gross value added on the supply side of the economy confirmed a continuation of the trends observed in the previous quarters of 2006. Annual growth in gross value added at basic prices slowed only very moderately compared to the previous quarter, amounting to 6.1%. The sectoral breakdown of economic growth remained broadly unchanged. The buoyant growth in gross value added was again mostly due to manufacturing (around 60%), where production continued to expand apace in some branches. The contribution of trade, amounting to around 18%, was also significant. The contributions of the other branches did not exceed 10%, and six branches recorded an annual decline in gross value added.<sup>23</sup>

Growth in gross value added in manufacturing remained in double figures in 2006 Q4. Such high growth has been observed since the end of 2004. In Q4, value added rose by 12.8% and its share in total annual growth in value added at basic prices was almost unchanged compared to 2006 Q3. However, its development continued to be very mixed across the individual branches, as suggested by data on the evolution of book value added in monitored large financial corporations.<sup>24</sup> According to these statistics, growth in value added at current prices was concentrated in four branches – manufacture of basic metals and fabricated metal products, manufacture and repair of machinery and equipment, manufacture of electrical and optical equipment, and manufacture of transport equipment. These branches also accounted for most of the total volume of value added. The main factors underlying the continuing rapid growth in value added in the above branches were structural changes supported by foreign capital, which affected output growth at new production and assembly facilities,<sup>25</sup> and significant shifts in demand in some branches.

Although the continuing strong economic growth was also fuelled by output growth in other branches of manufacturing (for example, manufacture of wood and wood products), the share of these sectors in total value added was less significant, hence their contribution to growth was less pronounced.<sup>26</sup> The generally fast growth in value added in industry as a whole was achieved amid a rise in the industrial production index of 7.8%, supported, as in the previous three quarters, by higher employment and rapid productivity growth. The strong export activity of industrial producers continued, as indicated by direct real export growth of 11.6% and its almost 50% share in total sales of industrial corporations. The ongoing structural changes within branches and demand developments affected the structure of production by use. In particular, production of consumer durables continued to increase very rapidly (see Table III.5). Production of capital goods also rose rapidly. The overall picture of the situation in industry is illustrated by the business confidence trend shown in Chart III.33, indicating positive perceptions of the present and future economic situation by businesses in this sector.

In the services sector, trade was the biggest contributor to the growth in value added in 2006 Q4, recording the highest increase in value added in both absolute and

<sup>23</sup> Agriculture and forestry, fishing, electricity, gas and water supply, hotels and restaurants, education and private households employing staff.

<sup>24</sup> Corporations with 100 employees or more.

<sup>25</sup> Particularly in the car and electrical engineering industries.

<sup>26</sup> Only four branches of manufacturing recorded an annual decline in gross value added.

relative terms (6.8% year on year). The contributions of market services in real estate and business services and in transport were also more significant. Although the contribution of the services sector to the growth in total gross value added was considerably smaller than that of industry, the services sector still generated the largest volume of value added. However, from the longer-term perspective, the share of services and some other branches in value added is gradually decreasing, whereas the share of industry is showing the opposite trend. These changes are evidenced by the data for 1995–2006, when the share of industry in value added increased by 7 percentage points to 36%. By contrast, the share of services dropped by around 4 percentage points in the same period to 56%, and the shares of agriculture and construction declined as well. Such changes can be largely attributed to extensive restructuring of industry, on focused primarily export production.

### III.5.4 Financial performance of non-financial corporations <sup>27</sup>

The financial results in the large non-financial corporations sector in 2006 Q4 confirmed the trends observed in previous quarters of 2006, i.e. buoyant growth in volume indicators, favourable return on equity and a sizeable increase in profits. In 2006 Q4, profit generation rose by 32.6% year on year, amid a rise in output of 18% and improvements in all profitability indicators. Book value added per employee increased by 10.8%. These results were achieved amid roughly the same increase in the number of employees as in 2006 Q3. 63% of the monitored corporations contributed to the profit generation.

As in 2006 Q3, corporations generated profit in an environment of weakening external cost pressures stemming from prices of oil and natural gas on world markets. Their import prices started falling year on year at the end of 2006 Q3 and subsequently fostered lower producer prices in oil product processing industries. On the other hand, however, prices of electricity rose apace, solid fuels (coal) recorded renewed price growth, and prices of imported intermediate goods also continued to show relatively rapid growth. Import prices of some metals also rose.<sup>28</sup> Overall, these effects were reflected in a year-on-year increase in the material cost-output ratio (of 1.1 percentage point), which was slightly higher than in the previous quarter.

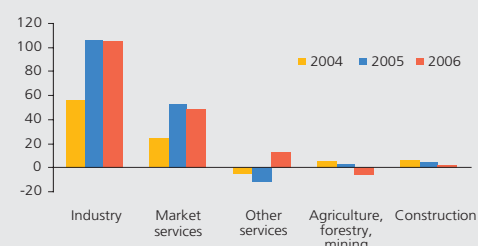
Corporations offset the increasing material cost-output ratio by slower growth in personnel costs and depreciation. The reduction in the personnel cost-output ratio was aided significantly by buoyant productivity growth in a number of branches, which was accompanied by slower wage growth (for more details see section III.6 *The labour market*). The employment of workers with lower wage demands also helped reduce the personnel cost-output ratio in some branches. However, a continuing rise in producer price inflation in most sectors of non-financial corporations<sup>29</sup> suggested that corporations, given the favourable demand conditions, were probably gradually incorporating the accumulated rise in costs into their prices. The high profit growth, accompanied by a noticeable upswing in inflation in some branches, simultaneously indicated that the growth in prices was largely a response to higher growth in demand than in costs.

In 2006, the key corporate performance ratios – the profit-equity and profit-sales ratios – recorded their highest levels since 1997. In 2006 Q4, the profit-equity ratio rose by 0.7 percentage point year on year, to 3.8%. This marked increase was due mostly to the profit-sales ratio, although increases were also recorded by the asset

**CHART III.34**

**The contribution of the services sector to gross value added growth in 2006 was again lower than that of industry**

(annual changes in CZK billions; constant prices)


**TABLE III.6**

**Rapid profit growth continued in 2006 Q4**

	Q4		Annual changes	
	2005	2006	CZK billions	%
Total income	1,376.1	1,589.9	213.8	15.5
Output excl. profit margin	900.1	1,062.3	162.2	18.0
Total expenses	1,311.2	1,503.8	192.6	14.7
Cost of sales	692.6	829.3	136.7	19.7
Depreciation	53.8	56.4	2.6	4.9
Personnel costs	141.0	155.1	14.1	10.0
Book value added	254.0	288.0	34.0	13.4
Pre-tax profit	64.9	86.1	21.2	32.6

**TABLE III.7**

**Corporations' higher material cost-output ratio was offset by a lower personnel cost-output ratio**

(percentages; percentage points; CZK thousands)

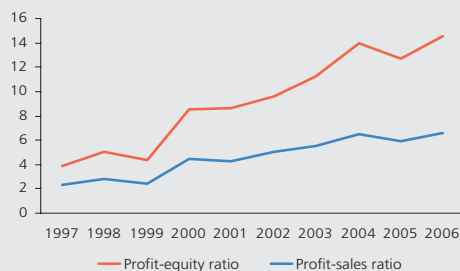
	2006 Q4 %		Change in p.p. against 2005 Q4	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	5.7	5.7	0.8	0.7
Profit-equity ratio	3.8	3.4	0.7	0.3
Profit-sales ratio	6.1	6.1	0.8	0.6
Asset turnover ratio	32.1	29.9	0.6	0.0
Financial leverage	190.6	187.3	3.7	0.7
Material cost-output ratio	78.1	78.9	1.1	1.2
Personnel cost-output ratio	14.6	10.8	-1.1	-0.9
Ratio of personnel costs to value added	53.9	48.6	-1.7	-1.0
	CZK thousands per month		Annual percentage changes	
Book value added per employee	60.1	65.2	10.8	9.6

<sup>27</sup> Assessment based on figures for non-financial corporations with 100 employees or more. These corporations account for roughly 50% of the total assets and liabilities of the non-financial corporations sector and approximately two-thirds of the value added in that sector.

<sup>28</sup> For more details see section III.7 *Import prices and producer prices*.

<sup>29</sup> Especially in industry; for more details see section III.7 *Import prices and producer prices*.

**CHART III.35**  
The profit-equity ratio reached its highest level since 1997  
(percentages)



turnover ratio and, for the first time in several years, leverage,<sup>30</sup> indicating the degree of use of external funds. This was also evidenced by rapid growth in external funds within total assets (15.4%), amid an overall increase in liabilities of 12.9%, reflected in a relatively large rise in interest expenses. Analyses of profit generation over the past eight years at the same time show that the main factor underlying profit generation in the non-financial corporations sector was more efficient capital utilisation as measured by the profit-equity ratio. Although the increase in net quantitative capitalisation was relatively low, it included investment laying the groundwork for higher productivity growth and better output quality.

Unlike in the previous quarters of 2006, the buoyant profit growth in Q4 was attributable to non-financial corporations in all the monitored forms of ownership. This was reflected, among other things, in a significant reduction in the differences in profit-equity ratios observed in previous quarters. Profits and profit-equity ratios again grew fastest in foreign-owned corporations (by 34.2% year on year and an increase to 4.7% respectively). Profit growth in public corporations and domestic private corporations also reached double figures (23.9% and 34.3% respectively), while their profit-equity ratios rose to 2.6% and 3.4% respectively.

### III.6 THE LABOUR MARKET

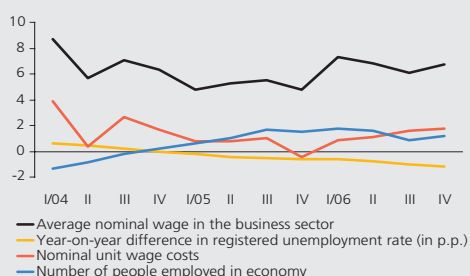
In 2006 Q4, the labour market saw continuing growth in labour demand amid still buoyant economic growth. However, a gradual slight slackening of economic growth partly led to slower employment growth compared to the first half of 2006. Ongoing structural changes in the economy fostered rising employment especially in industry and market services. The increasing employment and a rising number of vacancies generated a further decline in the unemployment rate, which was predominantly cyclical in nature. Despite this, relatively high long-term unemployment persisted, reflecting the problem of the professional and skills structure of the unemployed. Nominal unit wage costs continued to rise gradually.

#### III.6.1 Employment and unemployment

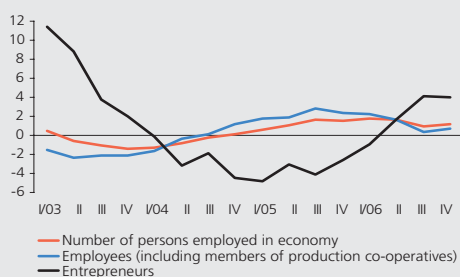
Annual employment growth edged up to 1.2% in 2006 Q4 compared to Q3, but was lower than in the first half of 2006. As in Q3, the number of entrepreneurs grew faster than the number of employees<sup>31</sup> (by 4% and 0.7% respectively). The continuing recovery in growth in the number of entrepreneurs was recorded mainly in market services and some branches of manufacturing. In absolute terms, employees and entrepreneurs contributed roughly equally to the total increase in the number of the employed, and entrepreneurs still accounted for less than one-fifth of total employment.

The rise in employment was mainly due to the sectors that were the main sources of economic growth in 2006 – manufacturing and market services. Although the largest increase in the number of the employed was recorded in manufacturing (50,600 people, or 3.8%), the employment growth rate in this sector has gradually decreased since the beginning of the year. The reasons underlying the rising employment in manufacturing remain the same as in previous quarters. In particular it is closely linked with foreign direct investment, the development of related

**CHART III.36**  
The continuing buoyant economic growth was accompanied  
by rising employment  
(annual percentage changes; percentage points)



**CHART III.37**  
The numbers of employees and entrepreneurs rose in  
2006 Q4  
(annual percentage changes; source: LFS)



<sup>30</sup> Financial leverage = total assets / equity capital

<sup>31</sup> Including members of production co-operatives.

activities and favourable domestic and external demand. Within market services, employment in real estate, renting and numerous other business activities continued to grow relatively rapidly (an increase of 25,100 people, or 8.2%), indicating growing demand for various services at a time of continuing buoyant economic growth. However, employment growth slackened in this sector as well in 2006. In Q4, labour demand continued to be met partly by the employment of foreign nationals, albeit to a lesser extent than in 2005.<sup>32</sup>

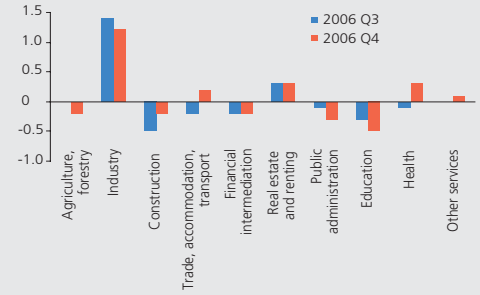
The increase in employment was not across the board in nature. In some branches, strong competition and changes in demand exerted strong downward pressures on costs through job cuts. The annual decline in the number of people employed continued particularly in financial intermediation, agriculture, education,<sup>33</sup> public administration and construction.<sup>34</sup> Overall, the shares of the main sectors in total employment were little changed, with the most people still working in the tertiary sector (56.4%). The share of the secondary sector (39.9%) still exceeded the figures recorded by all other EU-25 countries. This is mainly due to high employment in manufacturing, reflecting the ongoing restructuring of the production base in this sector.

A rising number of vacancies, which are a potential source of increasing employment, provided evidence of continuing growth in labour demand. The slope of the Beveridge curve in Chart III.39 shows that higher labour demand began to contribute more significantly to reducing registered unemployment at the start of 2006 Q2. At the start of 2006, growth in the number of vacancies was influenced to a larger extent by new penalties imposed on employers who fail to report vacancies to labour offices.

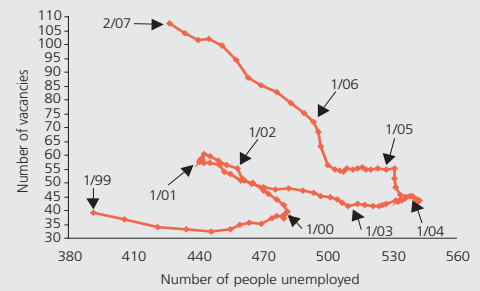
In 2006 Q4, the rising employment continued to be accompanied by declining unemployment, as shown in Chart III.40. The registered unemployment rate fell annually by 1.1 percentage points to 7.5%.<sup>35</sup> According to unemployment analyses, the cyclical component of registered unemployment continued to decline. This observation is supported by data on a higher number of placed applicants and a lower number of reported unemployed in the final months of 2006.<sup>36</sup> The decline in the seasonally adjusted unemployment rate was also partly due to the exclusion of unemployed people from the labour office register as a result of penalties.<sup>37</sup> Under these circumstances, the decline in the number of unemployed people was higher than the increase in the employed in Q4, as shown in Chart III.40.

Although the number of the long-term unemployed also declined, they still account for more than a half of all the unemployed (54.5%). The problem of long-term unemployment persisted mainly among people with only basic education.<sup>38</sup> The gradual improvement in the situation on the labour market for cyclical reasons thus did not lead to any substantial narrowing of the skills and professional gaps

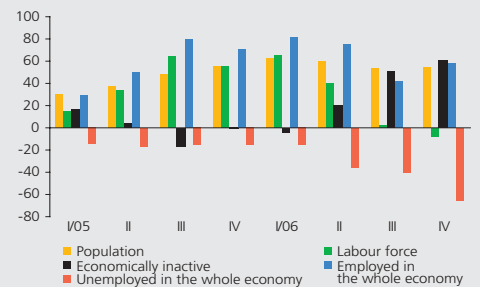
**CHART III.38**  
Employment rose primarily in industry and market services  
(contributions in percentage points)



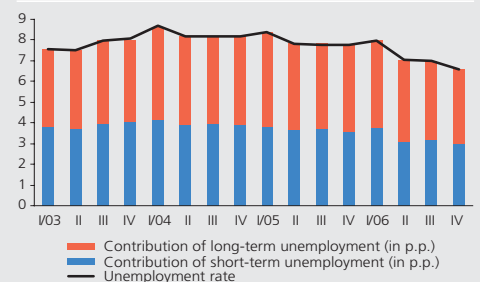
**CHART III.39**  
The rising number of vacancies fostered a fall in unemployment  
(seasonally adjusted numbers in thousands)



**CHART III.40**  
The decline in the number of unemployed people gradually deepened during 2006  
(annual changes in thousands of persons)



**CHART III.41**  
The number of the long-term unemployed decreased in 2006 Q4, but the long-term unemployment rate remained high  
(percentages; percentage points, source: LFS)



32 According to Labour Force Survey (LFS) data, foreign nationals seem to be employed most of all in the age group of 30–44 years, where growth in population, labour force and employment can be observed.  
 33 Employment declined particularly in pre-primary and primary education.  
 34 Analyses of employment in construction should take into account that fact that the survey is conducted entirely in dwellings. According to MLSA figures, however, there was an increase in the number of employed foreign nationals, who are largely accommodated in facilities other than dwellings (for example, in workers' hostels). It is possible, therefore, that there was no decline in the number of people employed in construction.  
 35 According to LFS data, the general unemployment rate (ILO) recorded an eight-year low (6.6%) and, by international comparison, was lower than average in the EU and EU-15 countries.  
 36 Except in December for the number of placed persons.  
 37 Persons who refuse to co-operate with labour offices, accept a job offer, etc. are excluded from the register.  
 38 According to the CZSO, 70.3% of unemployed people with basic education were long-term unemployed in 2006 Q4.

between the supply of, and demand for, labour in 2006 Q4. At the same time, the problem of the regional distribution of unemployment persisted, remaining broadly unchanged compared to the previous quarter.

### III.6.2 Wages and productivity

Annual growth in the average nominal wage in the national economy increased slightly in 2006 Q4, to 6.2%. Thanks to lower annual inflation, the average real wage picked up more significantly, rising by 4.6% year on year. Overall, average nominal wages grew faster in 2006 than in 2005; their year-on-year growth increased by 1.3 percentage points to 6.5%. The wage growth remained very mixed across sectors and branches. According to the CZSO, inter-industry wage differentiation showed a year-on-year increase in 2006 Q4.<sup>39</sup>

During 2006 as a whole, average nominal wage growth was most affected by wages in the business sector. More than three-quarters of employees in the monitored organisations work in this sector, and wages grew considerably faster here than in the non-business sector, rising by 6.7% in Q4 and 6.8% in 2006 as a whole. The relatively rapid increase in wages in the business sector, where wages are limited primarily by profits and competition, was aided by continuing buoyant growth in output and productivity in the manufacturing sector. In Q4, average nominal wage growth was 6.6% in industry and even higher in construction (6.8% year on year).<sup>40</sup> By contrast, wage growth in services was below average, amid relatively low productivity growth. Annual growth in mean and median hourly earnings<sup>41</sup> was lower than that in 2006 Q3 (5.9% and 4% respectively), suggesting that, according to CZSO statistics, the increase in the average monthly wage was achieved with a higher number of hours worked.

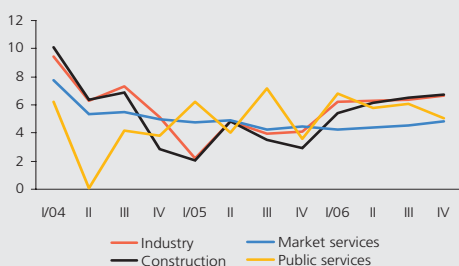
In the non-business sector, where wages depend mainly on legislative decisions made by the government and the capacities of the budget, the average nominal wage growth slowed in 2006, reaching just 4.4% in 2006 Q4 (5.4% in 2006 as a whole). The slower average wage growth in the non-business sector in Q4 was mainly due to public administration, defence and compulsory social security, where average wage growth moderated to 2.9%. By contrast, wages in education and health and social care recorded above-average increases (of 6.9% and 6.4% respectively).

The most important factor as regards inflation, though, is how wages develop in relation to productivity indicators. Annual growth in whole-economy productivity gradually slowed in 2006, reaching 3.9% in Q4. This was mainly due to the lower GDP growth rate, which was not accompanied by correspondingly slower employment growth.<sup>42</sup> More moderate productivity growth was observed in all the monitored industries except construction. Nonetheless, annual productivity growth in industry was still in double figures (10.5% in Q4). The continuing fast productivity growth in industry was significantly aided by investment in new production equipment, facilitated primarily by foreign capital. Services recorded far lower annual productivity growth than industry and construction.

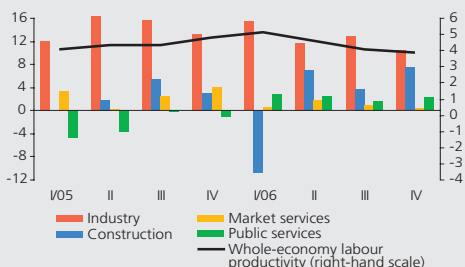
**TABLE III.8**  
Average nominal wage growth rose slightly in 2006 Q4  
(annual percentage changes)

	I/06	II/06	III/06	IV/06
Average wage in monitored organisations				
nominal	7.0	6.6	6.0	6.2
real	4.1	3.6	3.0	4.6
Average wage in business sector				
nominal	7.3	6.8	6.1	6.7
real	4.4	3.8	3.1	5.1
Average wage in non-business sector				
nominal	5.9	5.9	5.4	4.4
real	3.0	2.9	2.4	2.9
Whole-economy labour productivity	5.2	4.6	4.1	3.9
Nominal unit wage costs	0.8	1.1	1.6	1.7

**CHART III.42**  
Wages rose fastest in industry and construction  
(annual percentage changes)



**CHART III.43**  
Productivity growth slowed in 2006 Q4, but remained relatively high  
(annual percentage changes)



<sup>39</sup> The coefficient of variation of average wages (by CZ-NACE category) increased by 0.9 percentage point to 34.3%.

<sup>40</sup> The data on growth in average wages in individual branches of industry are calculated from the volume of wages and the number of employees according to the national accounts.

<sup>41</sup> Source: MLSA; ISAE data.

<sup>42</sup> Annual employment growth also moderated compared to the first half of 2006, although expected domestic and external demand was apparently not yet generating any need to make marked changes in employment.

The slower growth in whole-economy productivity, which was accompanied by faster average wage growth, resulted in a further upturn in annual nominal unit wage cost growth in 2006 Q4. Nominal unit wage costs are an indicator of potential inflationary pressures arising from wage developments (see Chart III.44). However, this upturn was only moderate, not exceeding 2% (1.7%). Nominal unit wage costs continued to show mixed structural trends, largely due to the scope for productivity gains and demand in individual sectors. The biggest increase in nominal unit wage costs was recorded, as usual, by services, where the scope for offsetting rising costs by boosting productivity is limited. By contrast, nominal unit wage costs in industry continued to decline year on year (by 3.6%). It is possible that employment of foreign workers with low wage demands helped to maintain the still relatively big lead of productivity growth over average wage growth in industry. Overall, then, the gradual growth in nominal unit wage costs continued into 2006 Q4. As regards a build-up of potential inflationary pressures, however, the growth was still moderate and related mainly to the services sector.

**III.7 IMPORT PRICES AND PRODUCER PRICES**

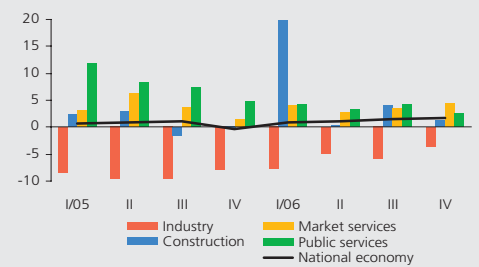
A continuing slowdown in the growth of world prices of energy-producing materials at the beginning of 2007 fostered a further easing of the external cost pressures on domestic inflation. Prices of imported energy-producing materials fell sharply amid continuing annual appreciation of the koruna (especially the koruna-dollar exchange rate), which contributed in particular to a decline in producer prices in primary oil product processing industries. At the same time, however, growth in prices of some other imported inputs picked up and prices of some important domestic inputs (particularly electricity) also grew fairly quickly. This contrary trend in the prices of inputs fed through to producer costs. Overall, producer price inflation picked up in 2007 Q1 and concerned most branches. An increase was also recorded for agricultural producer price inflation, exclusively due to a significant rise in crop product prices. Construction work price inflation also increased. Only prices of market services in the business sector grew at a slower rate than in the previous quarter. Overall, prices in the production sector thus indicated a gradual rise in inflationary pressures (see Chart III.45).

**III.7.1 Import prices**

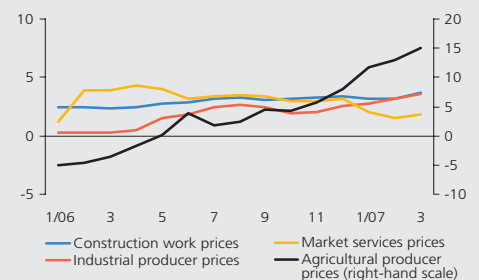
Import prices, which are an important factor of domestic inflation, recorded a further annual decline at the beginning of 2007. According to the latest figures for February, they declined by 1.3%, 0.5 percentage point less than at the end of 2006 Q4. Chart III.46 shows that the annual decline in prices was mainly attributable to import prices of mineral fuels and "other" imports.<sup>43</sup>

The gradual slowdown in the high growth of prices of energy-producing materials on world markets, apparent with slight fluctuations throughout 2006, switched to an annual decline in January 2007. These prices started to rise again in February, although the growth was only small, amounting to 1.4% (see Chart III.47).<sup>44</sup> The slowing growth in world prices of oil culminated in an annual decline in January, which continued into February (4%). Growth in prices of natural gas moderated much more slowly, so natural gas prices were still rising relatively quickly in February (7.6%). The aforementioned trend in world prices of energy-producing materials and the relatively pronounced annual appreciation of the koruna-dollar exchange

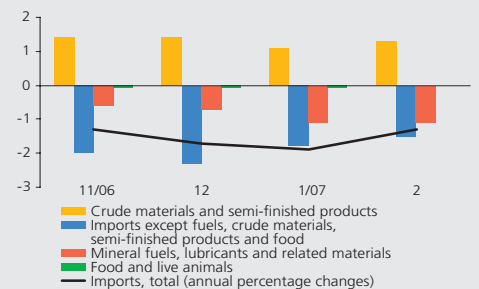
**CHART III.44**  
Annual growth in nominal unit wage costs has been edging up since the start of 2006  
(annual percentage changes)



**CHART III.45**  
Producer price inflation increased in most of the monitored sectors in 2007 Q1  
(annual percentage changes)



**CHART III.46**  
Import prices were generally falling year on year at the start of 2007  
(annual percentage changes; contributions in percentage points)



<sup>43</sup> Prices of imports excluding mineral fuels, crude materials, semi-manufactures and food.

<sup>44</sup> As measured by the CZSO index of world oil and natural gas prices.

CHART III.47

**Falling or modestly rising world prices of energy-producing materials coupled with appreciation of the koruna-dollar exchange rate led to a sharp fall in mineral fuel import prices**  
(annual percentage changes)

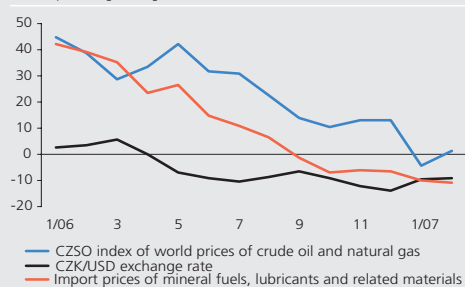


TABLE III.9

**Prices fell in the majority of import categories, but the number of categories with rising prices increased**  
(annual percentage changes)

	11/06	12/06	1/07	2/07
IMPORTS, TOTAL	-1.3	-1.8	-1.9	-1.3
of which:				
food and live animals	-1.2	-2.1	-1.5	-0.7
beverages and tobacco	-4.8	-3.9	-3.5	-3.8
crude materials except fuels	-3.6	-2.3	1.2	3.6
mineral fuels and related products	-5.9	-6.4	-10.0	-10.7
animal and vegetable oils	-2.8	-1.6	5.2	9.9
chemicals and related products	-1.1	-0.9	0.8	2.7
manufactured goods classified by material				
machinery and transport equipment	7.7	6.6	5.1	6.1
miscellaneous manufactured articles	-3.4	-4.2	-3.7	-3.7
miscellaneous manufactured articles	-5.5	-5.7	-4.3	-2.5

rate resulted in a decline in koruna import prices of mineral fuels since the end of 2006 Q3. According to the latest figures for February 2007, they decreased by 10.7% year on year (see Table III.9).

Prices of other imported raw materials showed the opposite trend to prices of energy-producing materials.<sup>45</sup> Their long-running annual decline gradually moderated in 2006 and turned into an annual increase in January (3.6% in February). This was probably due also to iron ore, which is an important component of imports of other raw materials<sup>46</sup> and prices of which had recorded an annual decline in previous quarters. World prices of other metals continued to show exceptionally high growth, which, however, moderated considerably at the beginning of 2007 according to the CZSO world price index (from 58.6% in December 2006 to 36.1% in February).

Prices of commodities with a high degree of processing<sup>47</sup> also recorded an overall slowdown in their annual decline at the beginning of 2007. However, the structural trends remained mixed, as this group included commodities with both falling and rising prices. The most significant category – machinery and transport equipment – continued to record an annual decline in prices in February, which amounted to 3.7%. Prices in the category of miscellaneous manufactured articles fell even more sharply at the start of 2007, although their decline gradually eased to 2.5% in February. By contrast, import prices of manufactured goods (including intermediate products) continued to record fast growth (of 6.1% in February). At the start of 2007, rapid annual growth was also recorded by import prices of natural oils, which showed an upturn after a long period of annual decline. Renewed inflation was also seen in the category of chemical products (see Table III.9).

Although the overall annual decline in import prices was little changed in the first two months of 2007 compared to the previous quarter, some structural changes in trend were apparent. The falling or only moderately rising world prices of energy-producing materials in the first two months of 2007 and the persisting "dampening effect" of the still high annual appreciation of the koruna-dollar exchange rate fostered lower external cost pressures on domestic inflation. On the other hand, renewed growth in three import categories (consisting mainly of raw materials) and continuing fast growth in prices of manufactured goods signalled a potential build-up of inflationary pressures among some producers, most notably in industry. Import prices thus indicated opposing potential impacts stemming from prices of imported inputs on producer costs and subsequently on domestic prices.

### III.7.2 Producer prices

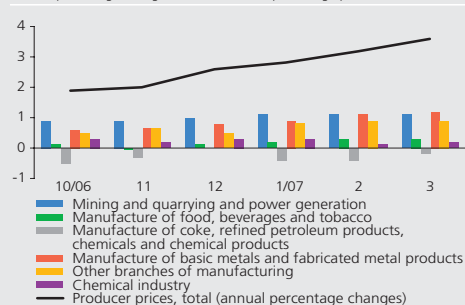
#### Industrial producer prices

The gradual pick-up in industrial producer price inflation observed since October 2006 continued into 2007 Q1 (to 3.6% in March). This was mainly due to producer prices in the manufacture of metals and fabricated metal products and in other manufacturing industries.<sup>48</sup>

According to the latest figures for March, the largest contributor to the overall annual increase in industrial producer prices was the metal processing industry

CHART III.48

**Producer prices in the metal processing industry contributed most to the rise in industrial producer price inflation**  
(annual percentage changes; contributions in percentage points)



<sup>45</sup> Excluding mineral fuels.

<sup>46</sup> Iron ore is not included in the CZSO world price index.

<sup>47</sup> This category consists mainly of machinery and transport equipment, manufactured goods, miscellaneous manufactured articles and chemicals and related products.

<sup>48</sup> This includes manufacture of machinery and equipment, electrical and optical equipment, transport equipment, rubber and plastic products, other non-metallic mineral products, wood products, pulp, paper, textiles and textile products, and leather products.

(see Chart III.48). Price growth picked up gradually and in March reached the highest levels in the industry sector (8.6% year on year; see Chart III.49). The rise was mainly due to increased external demand for products of this branch, accompanied by high prices of such products.<sup>49</sup> This was also evidenced by high real growth in exports of metal products in 2006 Q4 and at the start of 2007. Overall annual industrial producer price inflation was also considerably affected by rapidly increasing producer prices in the electricity, gas and water supply industry. Their prices increased further in 2007 Q1 (annually to 7.5% in March), primarily due to a marked rise in prices of gas fuels and electricity prices.<sup>50</sup> Prices in mining and quarrying, which consists mainly of coal mining, also continued to increase (by 3.7% overall). The growth in producer prices in coal mining was a further one percentage point higher in March. The contribution of these two "energy" branches to producer price inflation was only slightly lower in March than that of prices in the metal processing industry.

In 2007 Q1, annual producer price inflation also picked up in the other branches of manufacturing, which accounted for around one-quarter of the 3.6% increase in industrial producer prices. A closer look at the structure reveals that most branches contributed to the continuing upward trend in prices, with some branches seeing relatively fast growth in prices. The fastest-growing prices were recorded in the wood processing industry, where prices increased by 7.7%, according to the latest figures for March. Only the transport equipment manufacturing industry and the aforementioned manufacture of coke and refined petroleum products recorded annual declines in producer prices. Very moderate inflation, not exceeding 1%, persisted only in the textile and leather industry.

Faster growth was also recorded in prices in the food industry, which significantly affect consumer prices of food. They increased by 1.9% in March, an increase of 1.4 percentage points compared to December 2006. They were affected by several factors as described in detail in the section *Agricultural producer prices*. Prices in this industry were also partly affected by the previous year's low base.

Producer prices in the manufacture of coke and refined petroleum products, which usually react to import prices with a relatively short lag, showed a decline in 2007 Q1. According to the latest figures for March, prices in this industry recorded an annual decline of 2.9%.

Overall, industrial producer prices in 2007 Q1 indicated a continuing rise in annual inflation. This was evident in most branches. The causes of the continuing upward trend in prices in this sector can be seen mainly in the prices of inputs of both domestic and foreign origin. Although import prices of oil and primary oil processing products showed a year-on-year decline, a number of other imported and domestic inputs (particularly energy and solid fuels) recorded a rise in inflation or saw renewed price growth after a previous decline. At a time of favourable domestic demand, producers gradually passed the rising costs through to their prices. However, mixed rates of price growth across the individual industries suggest that the cost pressures were different in individual industries, depending on the production intensity for each raw material, the level of competition,<sup>51</sup> the market position and other factors. Overall, industrial producer prices suggested that the upward cost pressures on prices had increased in the business sector.

CHART III.49

#### Within industry, producer prices in the metal processing industry recorded the highest growth

(annual percentage changes)

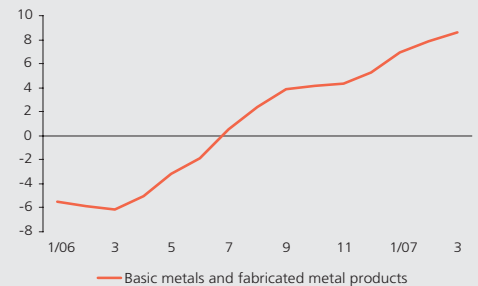


CHART III.50

#### Most branches of industry recorded a rise in inflation in 2007 Q1

(annual percentage changes; selected branches)

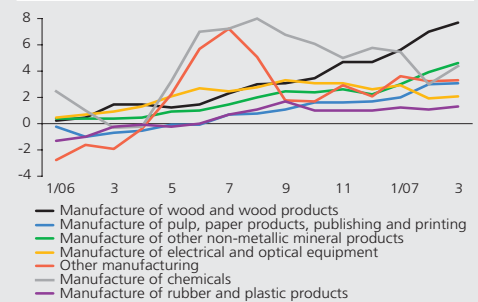
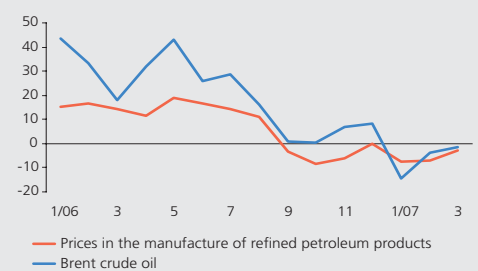


CHART III.51

#### Producer prices in primary processing of oil products continued falling year on year in 2007 Q1

(annual percentage changes)



<sup>49</sup> According to detailed CZSO analyses, the most significant increases in 2007 Q1 were recorded for prices of non-ferrous metals, including fabricated metal products, and cast-iron and steel pipes (of 23.1% and 16.7% respectively).

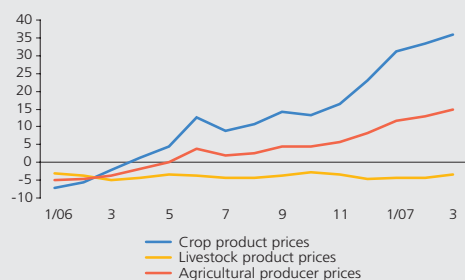
<sup>50</sup> Prices of gas fuels increased by 10.7% year on year in 2007 Q1, while prices of electricity, including distribution, rose by 9.3%.

<sup>51</sup> The effect of this factor was apparent, for example, in the textile and leather industry, where weak price growth indicated a strong influence of foreign competition, in particular from China.

CHART III.52

The rapid rise in agricultural producer prices was caused by rising prices of crop products

(annual percentage changes)



### Agricultural producer prices

The annual increase in agricultural producer price inflation, which began in 2006 Q2, continued into 2007 Q1. According to the latest figures for March, prices in this sector recorded a significant increase of 15%. As in previous quarters, this growth was due to crop product prices (see Chart III.52). By contrast, livestock product prices continued to fall year on year.

The continuing annual rise in growth in crop product prices (from 23.1% in December 2006 to 36.2% in March) was again due to several factors at the start of 2007. One major contributor to this strong price increase was a large annual rise in potato prices (of 115.8% in March), observed already in the previous quarter. Prices of cereals, the most significant commodity in the agricultural producer price index, continued to grow strongly (by 39.1% in March). This trend reflects an upswing in prices of cereals after the 2006 harvest, which was average from the long-term perspective, but much lower than the above-average harvests in 2004 and 2005. Prices of oil crops, fruit and vegetables also recorded rapid growth.

Livestock product prices continued falling year on year in 2007 Q1 (by 3.3% in March), in line with previous quarters of 2006, as shown in Chart III.52. This decline was again apparent in most major items of livestock production. The causes of the mostly falling livestock product prices remain the same as in previous quarters, in particular the persisting annual appreciation of the koruna exchange rate, falling prices in some EU countries and increasing imports of these commodities from EU Member States.

### Other producer prices

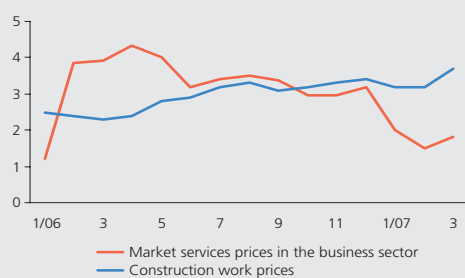
Annual construction work price inflation increased at the end of 2007 Q1 (to 3.7% in March), thus continuing the gradual upward trend observed since 2006 Q2. This rise is mainly due to persisting high demand for construction work, as indicated by significant real growth in the volume of construction work in 2006 and the first two months of 2007 (for details see section III.5 *Demand and output*). Annual growth in prices of inputs in construction production also increased. In Q1, its growth rate again exceeded that of construction work (4.7% in March).

By contrast, market services price inflation in the business sector recorded a sizeable decline in 2007 Q1, falling to 1.8% in March (see Chart III.53). This was mainly due to an annual moderation in the growth rate of prices in real estate, renting and other business services (from 4.7% in December 2006 to 2.8% in March)<sup>52</sup> and also in financial intermediation. By contrast, inflation increased in freight transport and storage, and especially in road freight transport (to 2.5% in March). However, inflation remained highest in the less significant category of other services, which includes sewerage collection charges, whose rate of growth remained at 5.5% in Q1.

CHART III.53

Construction work price inflation accelerated in 2007 Q1, while market services price inflation slowed

(annual percentage changes)



<sup>52</sup> The fastest growth in this category was recorded by prices for advertising (3.4% year on year in 2007 Q1) and in architectural and engineering consultancy (4.8%).

#### IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams, and market outlooks. The current forecast is based on the March Consensus Forecasts data and the market information effective on the survey date. Effective developments in the euro area are used to proxy for developments in the Czech Republic's major trading partner economies. The CNB forecast uses the outlook for prices of Brent crude oil as an indicator of energy-producing material prices. In addition, the outlook for petrol prices on the ARA markets is used in forecasting fuel prices. Compared to the previous forecast, expectations regarding future external developments have shifted towards higher economic growth and slightly higher interest rates. On the other hand, expected prices of energy products have decreased. This is reflected in a decline in expected external inflation as well.

The new reference scenario assumes 1.8% growth in the effective indicator of consumer prices in the euro area this year. Compared to the January forecast this is a downward shift, mostly due to a revision of the inflation impacts of the VAT change in Germany. Expected inflation for 2008 remains unchanged at 1.7%. The VAT increase in Germany should not exert upward pressures on import prices in the Czech Republic. This effect is therefore adjusted for in the forecast. The reference scenario of the April forecast assumes that growth in the effective indicator of producer prices in the euro area will slow from 2.1% in 2007 to 1.9% in 2008. Owing to the favourable developments in the euro area economies in 2006, the analysts have again significantly revised their outlook for economic growth this year and in 2008. Economic growth in the euro area in effective terms should reach 2.2% in both years (see Table IV.1).

This year, oil prices have so far risen gradually from the low levels recorded in January. However, this rise was lower than expected by the market at the time the January forecast was formulated. The new market outlook for oil prices has thus shifted downwards, with prices expected to rise moderately from an average of USD 58.1 a barrel in 2007 Q1 to USD 64 a barrel at the end of 2007 and to USD 66 a barrel at the end of 2008. Petrol prices on the ARA market should progress similarly, rising as high as USD 660 a ton in summer 2008 with seasonal fluctuations.

A decline in demand on the residential property market in the United States fostered further depreciation of the dollar. The March Consensus Forecasts slightly revised the future dollar-euro exchange rate towards a weaker dollar, especially in the longer term. In 2007 and 2008, the dollar's exchange rate should be roughly stable around USD 1.31/EUR with a modest appreciation tendency. The implied one-year EURIBOR trajectory has shifted slightly upwards owing to higher economic growth in the euro area countries. The average annual rate should be 4.1% this year and 4.0% in 2008.

#### IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the effects of domestic fiscal policy are an important input to the forecast. The April forecast has revised the estimate of the public finance deficit in 2007 and 2008. This is due to the preliminary public budgets result in 2006, according to which the general government deficit under ESA 95 methodology was 2.9% of GDP, whereas the January forecast had predicted a deficit of 3.5% of GDP. The estimate of the deficit for 2007 and 2008 has been decreased by 0.5 percentage point, i.e. to 3.5% of GDP in 2007 and to 3.4% of GDP in 2008. However, this revision has had no major effect on the estimate of the fiscal impulse, which approximates the effect of fiscal policy on economic demand, since the adjustments were made mostly in non-

**TABLE IV.1**  
Economic growth will remain solid in the euro area in 2007 and 2008

	II/07	III/07	IV/07	I/08	II/08	III/08	IV/08
Brent crude oil prices (USD/barrel)	61.2	63.0	64.2	64.9	65.4	65.7	65.8
ARA petrol prices (USD/t)	615.3	608.0	566.0	574.0	658.5	644.9	607.0
GDP in euro area <sup>a)</sup>	2.2	2.2	1.9	2.3	2.2	2.1	2.0
Producer prices in euro area <sup>a)</sup>	2.1	1.6	1.9	2.0	1.9	1.9	1.9
Consumer prices in euro area <sup>a)</sup>	1.7	1.8	1.9	1.8	1.6	1.6	1.6
USD/EUR exchange rate	1.32	1.32	1.32	1.31	1.31	1.31	1.31
1Y EURIBOR (in per cent)	4.1	4.1	4.0	4.0	4.0	4.0	4.0

a) effective indicator; annual percentage changes

demand items of public budget revenues and expenditures. The estimate of the fiscal impulse in 2006–2008 thus remains virtually unchanged and characterises fiscal policy as having a pro-growth effect in 2006 and 2007 and a neutral to slightly pro-growth effect in 2008. It still holds true that no sizeable additional fiscal stimulus is expected from the inflow of money from EU funds at the forecast horizon. Similarly, the baseline scenario of the forecast does not take into account the implementation of fiscal reforms or the introduction of environmental taxes; the effects of these planned steps are captured in the alternative scenario.

Another factor determining the message of the forecast is an assumption regarding the equilibrium values of key macroeconomic variables, especially real interest rates, the real exchange rate, real wages and the non-accelerating inflation level of output. The current position of the economy in the business cycle and the current settings of the monetary conditions are derived from these assumptions. The evolution of the equilibrium values also provides a framework for the fundamental orientation of the forecast. Among other things, an analysis of past and present developments in economic activity, inflation, wages, the exchange rate and interest rates is used to determine the starting conditions of the forecast and the equilibrium variables. This analysis draws on the linkages between these variables as perceived by the CNB's prediction model.

Two changes were made to the CNB's prediction model as part of the April forecast. Following the recent announcement of a decrease in the inflation target as from 1 January 2010, the inflation target has been lowered to 2% in the model starting from 2010 Q1. At the same time, an assumption has been applied that inflation expectations will start adjusting gradually to this new target in 2008 and 2009. Starting with this forecast, the real exchange rate calculation method has been changed as well. The real exchange rate is now calculated adjusted for changes to indirect taxes both in the Czech Republic and abroad. This adjustment is based on the assumption that these tax changes should not affect competitiveness across economies. Inflation continues to be adjusted for tax effects, as in the past, in the calculation of real wages, real interest rates and inflation to which monetary policy reacts.

Following the changeover to the new consumer basket and as a result of the adjustment of the real exchange rate for tax effects, the estimated rate of equilibrium real appreciation has been lowered slightly, particularly at the forecast horizon. This estimate at the forecast horizon lies between 3.0% and 3.5% with a gradually declining tendency. Owing to an increase in the outlook for foreign interest rates against a background of lower inflation and higher economic growth, the estimated foreign real equilibrium interest rate has been increased. The domestic real equilibrium interest rate is unchanged at just under 1%. Following the release of the GDP growth estimate for 2006 Q4 and the revision of the data for 2006 Q2 and Q3, the estimate of the current growth rate of the potential, non-accelerating inflation level of output has been increased to around 5.5%. The non-accelerating inflation level of output will also be growing at approximately the same pace at the forecast horizon. In the long run, its growth rate is converging to the 5% level. Equilibrium real wages are rising at the forecast horizon at a somewhat slower rate than the non-accelerating inflation level of output.

The model uses real marginal costs to proxy for inflation pressures from the real economy. These costs consist of the costs arising from the increasing volume of production (the "output gap") and wage costs (the "real wage gap"). The estimate of past inflation pressures from the real economy is unchanged compared to the January forecast. The estimate of the effect of the real economy as a whole also remained unchanged for 2007 Q1, although a minor change was made to the structure of real marginal costs. The higher-than-expected growth in real wages resulting from the lower inflation at the end of 2006 and at the start of 2007 led

to faster closure of the negative real wage gap, whereas the positive output gap is assessed as somewhat less open. The overall effect of the real economy is thus still estimated as slightly inflationary, with the output gap currently having an inflationary effect and the real wage gap a neutral effect.

The inflationary pressures from the volume of production, approximated by the output gap, stem from the strong GDP growth of about 6% in the last two years against a background of potential output growth of just under 5% on average. The negative output gap closed at the end of 2005 and was in positive figures in 2006. The contribution of net exports to economic growth decreased considerably in 2006, with household consumption and investment becoming significant engines of growth. Government consumption was flat in 2006 and thus made no contribution to the growth in domestic demand.

The pressures from real wages had an opposite, anti-inflationary, effect in the past two years. However, the sharp decline in inflation at the turn of this year amid flat nominal wage growth generated a rise in real wages, which thus converged to their equilibrium level. The real wage gap closed in 2007 Q1, hence real wages are currently having a neutral effect on inflation.

Consumer price inflation was below the January forecast in the first two months of 2007 Q1, and almost reached the forecasted level in March. The prediction of the effects of the changes to regulated prices and taxes materialised, and the deviation from the fuel price prediction was also negligible. Growth in food prices was higher than expected, whereas adjusted inflation excluding fuels was lower. The deviation from the prediction for food price inflation was linked with higher growth in agricultural producer prices than forecasted in January. The opposite deviation from the prediction for adjusted inflation excluding fuels was caused solely by developments in January and was most probably associated with the change to the consumer basket.

The current settings of the real monetary conditions, which affect the future course of the business cycle, are assessed as roughly neutral overall, with both components of the monetary conditions being close to neutral. On average, the exchange rate component is assessed as neutral to slightly easy and the interest rate component as slightly tight in 2007 Q1.

### IV.3 THE MESSAGE OF THE FORECAST

The aforementioned information on domestic and external economic developments obtained since the January forecast was drawn up has partially changed the forecast for the Czech economy. Pressures from the real economy – captured by the real marginal cost gap – will be slightly inflationary over the entire forecast horizon (see Chart IV.1). The real marginal cost gap will remain at its current value throughout this year, but its inflationary effect will weaken in 2008.

The first component of real marginal costs – the output gap – will fluctuate close to its current value over the entire forecast horizon. The output gap will remain inflationary, primarily because of easing monetary conditions, especially in the exchange rate component. Fiscal policy will also contribute to higher economic growth this year. By contrast, external demand will continue to act towards closure of the output gap. Under these assumptions, real GDP growth will be 5.7% this year and slow to 5.3% in 2008 (see Chart IV.2).

Turning to the components of future economic growth, household consumption will play the most significant role. It will grow by 5.6% this year. This high rate of

CHART IV.1

The real economy will generate moderate inflation pressures at the forecast horizon

(percentages)

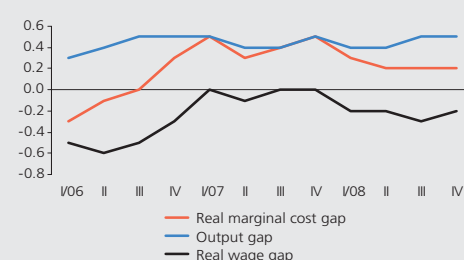
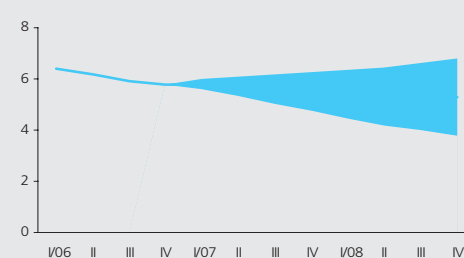


CHART IV.2

GDP growth will gradually slow

(annual percentage changes; seasonally adjusted)



**TABLE IV.2**  
Growth in employment will slacken  
(annual percentage changes)

	2007	2008
Real gross disposable income of households	5.7	3.9
Total employment	0.7	0.1
Unemployment rate (in per cent) <sup>a)</sup>	6.4	6.3
Labour productivity	4.9	5.3
Average nominal wage	6.7	7.1
Average nominal wage in business sector	7.1	7.7
Current account deficit (ratio to GDP in per cent)	-3.6	-3.2
M2	9.8	8.5

a) ILO methodology

**TABLE IV.3**  
Household consumption will significantly contribute to economic growth  
(annual percentage changes)

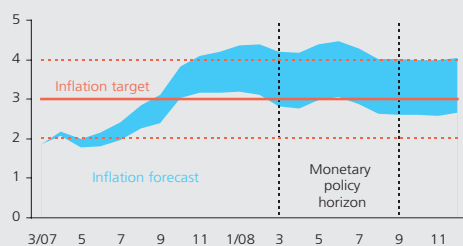
	2007	2008
GROSS DOMESTIC PRODUCT	5.7	5.3
Household consumption	5.6	4.1
Government consumption	1.0	0.9
Gross fixed capital formation	7.9	7.9
Imports of goods and services	12.1	12.7
Exports of goods and services	12.7	13.2
Net exports of goods and services (in CZK bn, at constant prices)	-33.2	-23.1

**TABLE IV.4**  
Consumer prices will be significantly influenced by administrative measures  
(annual percentage changes)

	II/07	III/07	IV/07	I/08	II/08	III/08	IV/08
CONSUMER PRICES	2.0	2.5	3.6	3.7	3.6	3.4	3.3
Breakdown into contributions:							
regulated prices	3.9	4.1	5.4	5.1	4.7	4.4	4.4
indirect taxes <sup>a)</sup>	0.3	0.9	1.1	0.9	0.9	0.6	0.4
food prices <sup>b)</sup>	3.1	1.5	1.9	1.4	1.1	1.3	1.6
fuel prices <sup>b)</sup>	-6.2	-8.8	1.4	7.5	4.1	5.8	6.5
adjusted inflation excl. fuels <sup>b)</sup>	0.8	1.5	1.9	2.4	2.7	2.8	2.8

a) contributions in percentage points  
b) excluding changes to indirect taxes

**CHART IV.3**  
The inflation forecast lies in the upper half of the tolerance band of the inflation target at the monetary policy horizon  
(annual percentage changes in CPI)



growth will be supported by rapid growth in real wages and growth in social transfers linked with legislative changes to family allowances and changes in the social benefit system. Growth in consumption will also be supported by continuing employment growth, although to a lesser extent than before (see Table IV.2), and by the slightly easy effect of the interest rate component of the monetary conditions. Owing to a further decrease in employment growth and an unwinding of the effect of social transfers from the previous year, amid a neutral interest rate component of the monetary conditions, the rate of growth of real consumer spending will decline to roughly 4% in 2008.

Growth in gross fixed capital formation will also be an important source of economic growth (see Table IV.3). Private investment will continue to be supported primarily by further growth in external demand and inflow of foreign direct investment. Its growth will continue to be encouraged by the easy real monetary conditions. Gross fixed capital formation will grow by roughly 8% in 2007 and 2008.

The forecast still assumes a growth trend in export performance, connected with FDI inflow and related changes on the supply side of the economy. A slightly easier effect of the real exchange rate and a more optimistic outlook for external demand will lead to a rise in real export growth by comparison with the January forecast. The rate of real export growth will be around 13% in both 2007 and 2008. Real import growth will lag only slightly behind export growth in these years. Relatively robust domestic demand growth coupled with a high import intensity of exports will result in year-on-year real import growth of roughly 12% in 2007 and just under 13% in 2008.

The second component of the real marginal cost gap – the real wage gap – will have a roughly neutral effect on inflation this year and will turn slightly anti-inflationary in 2008. This will be due to rising inflation, which amid relatively sticky nominal wage growth will lead to a fall in real wage growth. The forecast expects the average nominal wage in the business sector to grow by 7.1% in 2007 and 7.7% in 2008.

In the remainder of 2007, the exchange rate of the koruna against the euro will be close to its current levels. The depreciation pressures stemming from the negative interest rate differential vis-à-vis other currencies and from the higher domestic inflation than in other countries will be balanced by long-term equilibrium appreciation of the real exchange rate. This long-term effect will start prevailing in the course of 2008 and a trend of moderate nominal appreciation of the exchange rate will be renewed.

The April inflation forecast is slightly higher than the October forecast over most of the forecast horizon. This revision reflects the moderately inflationary signals arriving from the Czech and external economies in the last quarter and from the indicators of future inflation. The revision of the outlook is due chiefly to the forecast of higher import prices over the coming quarters and higher inflation pressures from the real economy in the longer run. Beyond the monetary policy horizon, inflation expectations decrease owing to the effect of the new inflation target and the inflation forecast moves below the level predicted in January. This year, the pick-up in inflation will be driven by adjusted inflation excluding fuels and changes to indirect taxes on cigarettes (see Table IV.4). Headline inflation should reach 3.7% at the close of the year. In 2008 H1 inflation will remain roughly at this level, and in H2 it should fall towards 3% owing to the unwinding of the effects of the indirect tax changes and to lower inflation expectations. At the end of 2008, headline inflation should stand at 3.3%. At the monetary policy horizon, i.e. in 2008 Q2 and Q3, inflation will be in the upper half of the tolerance band of the inflation target (see Chart IV.3).

In the coming years, inflation will be significantly affected by growth in regulated prices and the impacts of tax changes stemming from the need to harmonise excise duties on tobacco products with EU regulations. The average contribution of these administrative effects to annual inflation will be 1.5 percentage points at the monetary policy horizon. The mechanism of caveats applies as usual to the first-round effects of changes to indirect taxes, whose impact at the monetary policy horizon is pronounced (for more details see Box 3 *The application of escape clauses to indirect tax changes*). Adjusted for these effects, inflation to which monetary policy reacts is slightly below the inflation target at the monetary policy horizon.

Consistent with the macroeconomic forecast and its assumptions is a gradual rise in nominal interest rates over the entire forecast horizon.

The uncertainties and risks associated with the baseline scenario of the forecast and identified during its preparation are viewed as broadly balanced. However, the economy would diverge from the baseline scenario in the event of implementation of the government's fiscal reforms and the introduction of environmental taxes on 1 January 2008. Therefore, an alternative scenario was drawn up quantifying their potential effects on the inflation forecast and other relevant variables based on information on the prepared reforms available in mid-April 2007.

Should the government's reforms be implemented, the raising of the 5% VAT rate to 9% and the introduction of environmental taxes would temporarily increase inflation by 1 percentage point. This estimate assumes roughly 80% pass-through of the higher VAT rate to prices for customers. At the same time, inflation expectations would start to edge up, although this effect would be depressed by slower growth in domestic demand as a result of a decreasing public budgets deficit. The inflation outlook adjusted for the first-round effects of the changes to indirect taxes would consequently change only slightly and the monetary policy reaction could be only moderate.

### BOX 3 The application of escape clauses to indirect tax changes

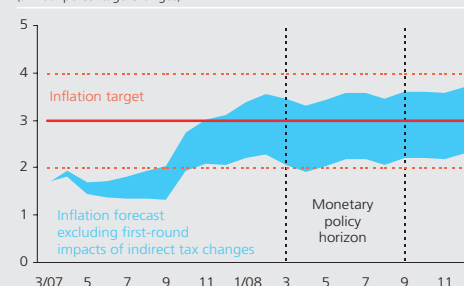
In applying its strategy of flexible inflation targeting, the CNB regards its inflation target as a medium-term one from which actual inflation may deviate temporarily. If the economy is affected by a strong exogenous shock which causes the inflation forecast to deviate from the target, the CNB need not react to the first-round effects of the shock. It may apply an exemption ("escape clause") from its obligation to hit the inflation target and accept the deviation of the inflation forecast and subsequently actual inflation from the target caused in this way.

The main reason for applying escape clauses is the fact that the CNB also takes into account the effect of monetary policy on economic stability when meeting the inflation target. Strict elimination of a deviation of actual inflation from the inflation target by means of changes to monetary policy interest rates could lead to undesirable destabilisation of the economy, especially in the case of short-term shocks and supply-side shocks.<sup>53</sup>

Significant changes in the level and structure of indirect tax rates are a specific type of exogenous shock. Since the switch to headline inflation targeting, step changes in

CHART IV.4

Excluding the first-round impacts of indirect tax changes, the inflation forecast lies in the lower half of the tolerance band at the monetary policy horizon (annual percentage changes)



<sup>53</sup> The principle of stabilisation of the economy is also incorporated into the reaction function of the CNB's core prediction model. If a shock is expected, however, it is best to apply the escape clause and adjust the strength of the reaction to the specific shock, as the model reaction function involves an average reaction to all types of shock.

indirect taxes have therefore been included in the range of situations that may lead to the application of escape clauses. The Czech Republic's membership of the European Union entailed harmonisation changes to indirect taxes before accession. Gradual harmonisation of excise duties on tobacco products is currently under way.<sup>54</sup> The individual harmonisation steps are announced in advance and are included in the CNB forecast. The inflation forecasts are thus subject to the effect of indirect tax changes to a relatively large degree. The CNB applies escape clauses ("the mechanism of caveats" is used in the main text of the Inflation Report) to rule out any reaction to the first-round effects of such changes.<sup>55</sup> In practice, the first-round effects have been subtracted from headline inflation since July 2003, when the effect of taxes was significant for the first time. The CNB has reacted to the deviation of inflation adjusted for the first-round effects of indirect tax changes from the target and has focused on hitting the target for inflation adjusted in this way.

According to the April forecast, the contribution to headline inflation of the first-round effects of the changes to excise duty on cigarettes will be 0.7 percentage point at the monetary policy horizon. The application of the escape clause to these first-round effects means that the CNB will allow headline inflation to rise into the upper half of the tolerance band of the inflation target at the monetary policy horizon. If the CNB did not apply the escape clause, implied monetary policy rates for the next quarter would be higher by roughly 0.3 percentage point.

Similarly, the CNB would apply an escape clause in the case of implementation of the proposed fiscal reform, which includes an increase in the lower VAT rate from 5% to 9%, and the introduction of environmental taxes (see the alternative scenario of the April forecast). In that case, inflation would be above the target at the monetary policy horizon.

#### IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The CNB monitors the inflation expectations of three sectors (the financial market, corporations, households) at the one-year and three-year horizons. Future inflation expected by financial market participants at the one-year horizon remained slightly above the CNB's target of 3%. Analysts predict that the main inflation factors will be demand-pull inflationary pressures and administrative changes to prices (excise duty on tobacco products, deregulation of rents, electricity, heat supply, water supply and sewerage collection charges). The exchange rate of the koruna remains the most substantial downside factor, although its effect should be weaker than in the past. The inflation expectations of corporations are unchanged and remain consistent with the inflation target. The inflation outturns expected by households rose slightly. Their expectations are still a relatively long way above the inflation target.

At the three-year horizon, the inflation expectations of the financial market are below the CNB's inflation target of 3%. Corporations exceed this level only slightly. The highest inflation has long been expected by the household sector.

In Q1, interest rates expected by financial analysts were almost unchanged at all the monitored maturities. The interest rate path consistent with the aforementioned CNB forecast was slightly above the expectations of financial market analysts in the near future. At the longer horizon, it was higher.

TABLE IV.5

Inflation expectations were above the CNB's target at the one-year horizon (percentages)

	3/06	12/06	1/07	2/07	3/07
<b>CONSUMER PRICES</b>					
1Y horizon:					
Financial market	2.5	3.3	3.1	3.0	3.2
Corporations	2.7	3.0			3.0
Households	4.1	4.9			5.0
3Y horizon:					
Financial market	2.4	2.7	2.6	2.6	2.5
Corporations	2.9	2.9			3.1
Households	6.2	6.5			6.8
<b>1Y PRIBOR</b>					
1Y horizon:					
Financial market	2.8	3.4	3.3	3.3	3.4

<sup>54</sup> Besides the effect of EU membership, some changes to indirect taxes have been and probably will be brought about by the purely domestic needs of national fiscal policy.

<sup>55</sup> The first- and second-round effects of changes to indirect taxes were defined in the box *Indirect taxes and the inflation forecast* in the July 2003 Inflation Report.

## **THE CNB'S NEW INFLATION TARGET AND CHANGES IN MONETARY POLICY COMMUNICATION**

At its meeting on 8 March 2007, the CNB Bank Board approved the CNB's new inflation target, a reduction in the number of monetary policy meetings of the Board, and several changes in monetary policy communication.

The CNB announces the new inflation target as annual consumer price index growth of 2% (with a tolerance band of  $\pm 1\%$ ), effective from January 2010.

Starting from 2008 the CNB will publish the following new information:

- the forecast-consistent interest rate path in numerical form, as a fan chart;
- the votes cast by the board members on interest rate changes by name.

In 2008 the CNB will change the frequency of the Bank Board's regular monetary policy meetings from monthly to eight meetings a year.

### **The CNB's inflation target from January 2010**

The current target of the Czech National Bank (CNB) of 3% was announced in March 2004 and took effect in January 2006. It was set marginally above the price stability level declared by the European Central Bank (ECB) for the euro area and also above the inflation target levels of most central banks in advanced countries (mostly 2.0% or 2.5%). This target level reflected some specific features of a transforming economy converging towards the advanced countries. On declaring the target, the CNB announced that it would remain in effect until the Czech Republic enters the euro area, at which point monetary policy decision-making will transfer to the ECB.

However, the postponement – towards the end of last year – of the euro adoption date beyond the originally considered horizon of 2010 established a longer-term perspective for the operation of the inflation targeting system in the Czech Republic. It offers space for considerations about whether the current inflation target corresponds ideally to the understanding of price stability and the expected evolution of the Czech economy beyond 2010.

The process of equilibrium real appreciation of the Czech koruna can be expected to continue gradually slowing as some of its underlying factors unwind. By 2010 the process of deregulation of most prices and the harmonisation of indirect taxes should have been completed, so these administrative effects will not be exerting significant upward pressures on inflation in the Czech Republic. The improvement in the terms of trade and changes in the structure of relative prices are also likely to slow compared to the current trend; these factors are also fostering real appreciation of the koruna. Correspondingly, the need to keep open a positive inflation differential as one of the channels for raising the Czech price level to the level of the advanced countries will gradually subside. The existing trend moreover confirms that the Czech economy is capable of achieving high rates of growth while maintaining a low level of inflation and a moderate trend of appreciation of the nominal exchange rate of the koruna. Prices of tradable commodities are showing downward flexibility thanks to a combination of subdued wage growth and high labour productivity growth in industry. The change in the structure of relative prices, which is usual for a converging economy, can thus proceed with no problem even amid low overall inflation.

Given the gradual stabilisation of the structure of consumption and the completion of the main "transformation" changes in the quality of consumer goods, the extent of statistical over-estimation in the measurement of inflation can also be expected

to decrease gradually. Lower measured inflation should also be fostered by the fact that the new consumer basket in use since January this year increases the weight of tradable unregulated commodities, i.e. goods whose prices are, in the long term, rising only slowly or even falling in the Czech Republic and on world markets.

The inflation expectations of financial market participants are anchored at low levels and at the three-year horizon are just below the CNB's current target. In this situation it is appropriate to move the inflation target to a lower level in line with the practice in advanced countries. The inflation targeting regime has accrued sufficient credibility for the new target to anchor inflation expectations effectively; this, in turn, will make the target easier to achieve. The CNB will allow inflation to gradually decline to the new inflation target level sufficiently in advance (roughly one year) in order for inflation to be close to the target as of its effective date. Analyses suggest that lowering the target sufficiently in advance will have very low real economic costs and does not necessitate a higher nominal interest rate level in the short run; in the longer run, by contrast, nominal rates will on average be lower thanks to the lower targeted inflation.

**After considering all the above facts, the CNB announces the new inflation target as annual consumer price index growth of 2%, effective from January 2010.** As before, the CNB will strive to ensure that actual inflation does not differ from the target by more than one percentage point on either side.

The CNB continues to view its inflation targets as medium-term ones from which actual inflation may deviate temporarily as a result of exogenous shocks. Changes to indirect taxes are one such shock; monetary policy does not react to the first-round effects of such changes and concentrates only on their second-round effects.

#### **Publication of the forecast-consistent interest rate path**

One of the key materials for monetary policy decision-making is the CNB's regular macroeconomic forecast. The forecast is drawn up by the CNB's Monetary and Statistics Department after consultations with the Bank Board, and its message is described in detail in the Inflation Report. The CNB forecast is based on the assumption of an active central bank which steers inflation towards the inflation target by means of changes in interest rates. Up to now this part of the forecast – the "forecast-consistent interest rate path" – has been described only verbally, and not numerically.

**Starting from 2008 the CNB will publish the forecast-consistent interest rate path in numerical form, as a fan chart.** This step will further enhance the transparency of the CNB forecast and the Bank Board's monetary-policy considerations, and will give external observers a better understanding of the inflation forecast and CNB monetary policy.

In no event, however, should this path be understood as a commitment of the CNB regarding the future evolution of rates. Owing to the arrival of new information after the preparation of the forecast, and to board members' different views of economic developments than as outlined in the Monetary and Statistics Department's forecast, the actual interest rate path can deviate from the forecasted path. As with the forecast of the other main variables, this uncertainty surrounding the future interest rate path will be illustrated in a fan chart.

### **Publication of the votes cast by the board members by name**

Since the very start of inflation targeting, the CNB has been gradually increasing the level of transparency and accountability associated with the Bank Board's monetary policy decision-making. Since 1998, the minutes of the Board's monetary policy meetings have been published on the CNB website and in the Inflation Report. Since mid-2000 the minutes have included a record of the ratio of the votes cast, and for over a year now this voting ratio has also been disclosed straight after the monetary policy meeting at a news conference. In 2001 the Board also decided to publish the Situation Reports on Economic and Monetary Developments – the main reference material for the Board's monetary policy discussions – together with the full minutes of these discussions, with a six-year time delay. The first set of these documents will be published in January 2008.

**The disclosure, as from the start of 2008, of the votes cast by the board members on interest rate changes by name will represent a further move towards increased transparency in monetary policy-making.** This step towards the model used by a number of central banks in other countries will allow experts and the general public to better identify the opinions of each board member and thus better understand the decisions of the Board as a whole. It will give the board members more freedom to express their views in public. Increasing the board members' individual accountability for their own voting will enhance the principle of majority decision-making at board level. This collective decision-making will continue to reflect the natural diversity of the board members' expert opinions on economic and monetary developments.

### **Reduction of the number of regular monetary policy meetings to eight a year**

In recent years the Czech economy has stabilised close to its equilibrium level. Inflation, too, has stabilised at low values and inflation expectations are firmly anchored. Consequently, the situation does not require such frequent changes in interest rates as in the early stages of inflation targeting. **In 2008 the CNB will change the frequency of the Bank Board's regular monetary policy meetings from monthly to eight meetings a year.** Numerous major central banks around the world apply a similar system.

The CNB still reserves the right to decide on monetary policy issues outside the framework of the regular monetary policy meetings. As before, however, it will only exercise that right in exceptional cases.

The regular monetary policy meetings will be timed to optimally reflect the schedule for the publication of key macroeconomic indicators and inputs to the CNB forecast. The CNB will publish the specific calendar of monetary policy meetings for 2008 this autumn.

**MINUTES OF THE BOARD MEETING ON 1 MARCH 2007**

Present at the meeting:

Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), M. Hampl (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director)

The meeting began with a presentation of the February situation report summarising the newly available economic data and the associated risks of the January forecast. The balance of risks was being tilted towards the upside primarily by the nominal exchange rate of the koruna together with the overall effect of new data on expected economic activity and interest rates in the euro area. The downside factors included lower-than-forecasted oil price inflation and the new figures on inflation in the Czech Republic in January 2007. Adjusted inflation excluding fuels had recorded the largest downward deviation compared to the January forecast. However, the downside effect of the January inflation had been made more difficult to assess by a change in the consumer basket structure. Without this change, inflation in January would probably have recorded only a very small deviation from the forecast.

The majority of the board members agreed on the overall assessment of the January forecast risks as being balanced. The opinion was also expressed, however, that the risks to inflation were skewed slightly to the upside overall. It was said that a specific risk of the forecast was the lower January inflation linked with the change in the consumer basket. The opinion was expressed that inflation calculated on the basis of the new consumer basket structure could not be automatically viewed as a forecast risk, as the forecast had been prepared using a different consumer basket structure. The new consumer basket structure might then imply lower measured inflation in the long term. On the other hand, however, it was said that the lower-than-expected inflation, even though resulting from a change in the basket structure, was a downside risk of the forecast, or a risk of non-fulfilment of the inflation target. The change in the consumer basket structure was only temporarily reducing the statistical deviation necessarily arising when measuring inflation at constant weights in the consumer basket. In this context, it was also said that monetary policy, *ceteris paribus*, should react to lower inflation. However, there was a consensus on the need for a longer time period to correctly assess the affect of the change in the consumer basket on inflation.

The nominal exchange rate was identified as an upside risk to inflation. Its level so far in the first quarter had been weaker than assumed in the forecast. However, it was said that given the volatility of the nominal rate this risk should be assessed guardedly. At the same time, it was emphasised that the financial markets' expectations were still on the appreciation side. The reasons for the observed depreciation of the nominal rate were also discussed in this context.

Another upside risk to inflation mentioned was expected developments abroad, where the primary upside factors included a rise in interest rates in the euro area, leading to a widening of the negative interest rate differential, and also an increase in expected economic growth. In the context of the assessment of external developments it was said that the higher economic growth combined with the lower expected inflation perhaps suggested growth in potential output without the need to tighten monetary policy. The accelerating money supply growth was also identified as a potential medium-term upside risk to inflation. On the other hand, however, it was said that consumer credit growth was slowing.

In addition to the aforementioned fall in inflation in January, the lower-than-forecasted evolution of oil and oil product prices and external inflation in general was identified as a potential downside risk to inflation. The opinion was also expressed that the observed improvement in the terms of trade might be reflected in a deterioration of net exports at constant prices and thus also in expected GDP growth.

At the close of the meeting, the Board decided unanimously to leave the two-week repo rate unchanged at 2.50%.

**MINUTES OF THE BOARD MEETING ON 29 MARCH 2007**

Present at the meeting:

Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), M. Hampl (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director)

The March meeting of the Bank Board opened with a presentation of the situation report, which focused above all on summarising the January forecast and assessing its risks. The risks of the January forecast were assessed as balanced overall. Recent inflation figures, which had been lower than forecasted, were identified as a moderate downside risk. A role had been played by the new definition of the consumer basket and lower-than-expected inflation in a number of segments. Only food prices had risen faster than forecasted. Economic growth had been in line with the forecast. Private consumption had grown faster, whereas investment had risen more slowly and the contribution of net exports to economic growth had been lower. The external environment was assessed as favourable. Higher expectations regarding economic growth and interest rates in the euro area were presented as a moderate upside risk. The Board had been informed that future fiscal developments were a major uncertainty of the upcoming April forecast.

After the presentation, the Board went on to discuss the newly available information and the risks of the January forecast. The Board agreed that the forecast risks were balanced and there were no strong arguments for either a rise or a cut in interest rates. In this regard, the March situation report led to a view of economic developments which was very similar to that ensuing from the February report. The Board then turned to a discussion of upside and downside risks to inflation.

The rising share of household consumption in GDP was mentioned as a moderate upside risk. The Board agreed that growth driven by consumption could affect inflation in a different way than growth driven by net exports and investment. Opinions were expressed that a more optimistic outlook for euro area growth and expectations of further ECB interest rate increases – together with their implications for domestic exchange rate developments – were moderate upside risks. However, it was also said several times that growth in the euro area could be in line with its potential (non-inflationary) growth and that a number of other factors, e.g. the lower-than-expected oil prices, were an argument against viewing the external environment as an upside risk. It was said that the acceleration of growth in some cost indices could also be assessed as a moderate upside risk. The opinion was also expressed that domestic inflation was more volatile than foreign inflation and therefore rapid responses of monetary policy to both upward and downward deviations of inflation from the forecast were to be avoided.

According to the Board, moderate downside risks included above all the observed incomplete pass-through of cost shocks into inflation. It was said repeatedly that deregulation of rents would not have to pass through into inflation to the extent assumed in the January forecast. Opinions were also expressed that increases in indirect taxes would not have to affect consumer prices to the full extent. In this context, the board members drew attention to the experience of other countries, for example Germany, as well as the past experience of the Czech Republic with incomplete pass-through of cost shocks into inflation. It was also said that in some cases past pick-ups in cost indices had also failed to pass through into domestic inflation to the full extent. During the discussion of downside risks it was also said that the moderate decline in inflation expectations for 2010 could already reflect the change in the target announced at the beginning of the month. The new target could help anchor inflation expectations at a lower level.

The Board also discussed signals for inflation ensuing from the labour market. It was said that the decline in unemployment and some indications from the corporate sector suggested that the labour market would not be able to accommodate further economic growth easily. Workforce shortages could therefore increase pressures on inflation. In this context, however, opinions were also expressed that aggregate data had not suggested such a situation so far and wage pressures were not particularly visible in data on wages. It was also said that wage developments appropriate to the economic situation were important for further non-inflationary growth.

The Board also turned its attention to the effect of the planned public finance reform on the economy. A consensus was reached that its effect could become one of the major uncertainties of the April forecast.

At the close of the meeting, the Board decided unanimously to leave the two-week repo rate unchanged at 2.50%.

**MINUTES OF THE BANK BOARD MEETING ON 26 APRIL 2007**

Present at the meeting:

Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director)

The meeting opened with a presentation of the April situation report and the new forecast for inflation and economic developments. The forecast took into consideration changes in the international environment, most notably the improving outlook for euro area economic growth, expectations of moderately higher rates in the euro area and the lower outlook for oil prices and external inflation. According to the forecast the Czech economy had been fluctuating above the non-accelerating inflation level of output for six quarters. The growth structure had changed, with consumption and investment now being the engines of economic growth. Export and import growth rates were converging. Wages had ceased to be anti-inflationary. CPI inflation had stayed low in the first quarter and was slightly below the values forecasted in January. Adjusted inflation also remained low. The exchange rate component of the monetary conditions was neutral to slightly easy, while the interest rate component was slightly restrictive given the low inflation expectations. The monetary conditions were broadly neutral overall.

The growth outlook remained very good, the GDP growth forecast for 2007–2008 being 0.4–0.5 percentage point higher than in January. Pressures from the real economy would remain moderately inflationary at the forecast horizon. Growth in food prices and import prices would also be moderately inflationary compared to the January forecast. The inflation forecast was rising slightly in the near future compared to January, but as in the January forecast it lay in the upper half of the tolerance band of the inflation target at the monetary policy horizon. The prediction for inflation adjusted for the first-round impacts of changes to taxes, which is the key indicator for monetary policy decisions, was also rising slightly in the near future. Consistent with the macroeconomic forecast and its assumptions was a gradual rise in nominal interest rates over the entire forecast horizon.

After the presentation of the April situation report, the Board discussed the new forecast. It was said repeatedly that by comparison with January the April forecast suggested the build-up of a number of moderate inflationary factors, none of which alone presented a serious inflation risk, but the build-up of which was becoming an important factor in the decision on rates. However, it was also said repeatedly that the economic developments in 2007 Q1, which had seen atypical weather conditions, did not necessarily have sufficient information content to distinguish between short-term fluctuations and trends, hence it was too early to talk of a build-up of inflationary factors. In this context, the opinion was also expressed that the January and April economic outlooks did not differ greatly from each other. It was also said that current inflation was below the inflation target and the fact that it was measured using a new index was not relevant, as the new index had brought the consumer basket structure more into line with reality. It was also said that adjusted inflation, which chiefly reflects demand pressures in the economy, remained low.

The Board moved on to discuss the aforementioned factors and to assess the extent to which they could be described as inflationary. It was said that the external environment – for instance the increase in the euro area growth estimate, but also the latest data on higher oil prices than expected in the forecast – could become an inflationary factor. It was also said that the data on higher oil prices were out of line with the estimates of some analysts, who by contrast were pointing to increasing production capacities. It was also said that the inflation outlook for the euro area was more favourable than in January. The Board then discussed the extent to which the ongoing deregulation of rents and other administrative measures, including potential future measures associated with the planned fiscal reform, would impact on prices. It was said repeatedly that these factors might affect inflation expectations and subsequently pass through to wages and prices. But it was also repeatedly pointed out that this pass-through need not be significant and that this effect might be counteracted by the income effect and also the substitution effect via slowing consumption. The Board agreed that the planned reform could become an important factor for decision-making.

The Board then discussed the rate of economic growth and the link between the strong growth and the labour market. The Board agreed that the growth of the Czech economy would remain robust. The opinion was expressed that the growth estimate presented in the forecast might be too conservative given that a number of

complementary indicators – such as retail wages and supply indicators – were suggesting faster growth in 2008 rather than the slowdown signalled by the forecast. It was also said that utilisation of production capacities was higher than in past years. In the context of the high rate of growth it was repeatedly said that current developments on the labour market would be relevant to future inflation. It was said several times that unemployment was coming down fairly rapidly and that this might signal the onset of wage inflation pressures. However, it was also said several times that strong competition, inflow of labour from abroad, capitalisation of labour and growing mobility on the labour market were putting the brakes on these pressures. It was also said that the fall in the unemployment rate was not surprising given the current rate of economic growth.

The Board also discussed the link between household consumption and other economic variables. Some of the board members pointed out that the growth structure was changing and that the role of private consumption was increasing. The relationship between interest rate changes and households' financial balances and the relationship between higher nominal incomes and the property market were discussed. It was also said that the favourable weather in the first quarter of this year had contributed to the rise in consumption. This was viewed as a supporting argument for the need to assess the inflationary factors over a longer period than three months.

At the close of the meeting, the Board decided by a majority vote to leave the CNB two-week repo rate unchanged at 2.50%. Four members voted in favour of this decision, and two members voted for increasing rates by 0.25 percentage point.



Table 1a	Inflation development	54
Table 1b	Inflation development	55
Table 2	Consumer prices	56
Table 3	Consumer prices – tradables and nontradables	57
Table 4	Inflation expectations of selected economic sectors for 12 months ahead	58
Table 5	Harmonised index of consumer prices	59
Table 6	Monetary survey	60
Table 7	Interest rates on interbank deposits	61
Table 8	FRA rates, IRS rates	62
Table 9	Nominal and real interest rates (ex post approach)	63
Table 10	Real interest rates (ex ante approach)	64
Table 11	Koruna interest rates (stock of business)	65
Table 12	Balance of payments	66
Table 13	International investment position	67
Table 14	External debt	68
Table 15	Exchange rates	69
Table 16	Public finances	70
Table 17	Capital market	71
Table 18	CNB monetary policy instruments	72
Table 19	Macroeconomic aggregates	73
Table 20	Labour market	74
Table 21	Producer prices	75
Table 22	Ratios of key indicators to GDP	76

Table 1a

INFLATION DEVELOPMENT												annual percentage changes	
2003	1	2	3	4	5	6	7	8	9	10	11	12	
Consumer prices	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0	
Regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3	
(contribution to consumer price inflation)	-0.07	-0.15	-0.16	0.29	0.31	0.32	0.08	0.09	0.08	0.24	0.24	0.27	
Influence of indirect tax growth on unregulated prices													
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Net inflation	-0.4	-0.2	-0.2	-0.5	-0.4	0.0	-0.2	-0.1	0.0	0.3	0.9	1.0	
(contribution to consumer price inflation)	-0.32	-0.17	-0.15	-0.38	-0.30	-0.01	-0.19	-0.10	-0.01	0.20	0.70	0.77	
of which: prices of food, beverages and tobacco	-4.1	-3.8	-3.5	-3.5	-2.8	-1.0	-0.9	-0.9	-0.1	0.6	2.5	2.7	
(contribution to consumer price inflation)	-1.06	-1.06	-0.97	-0.94	-0.76	-0.28	-0.22	-0.22	-0.04	0.16	0.66	0.70	
adjusted inflation	1.5	1.7	1.5	1.1	0.9	0.5	0.1	0.2	0.0	0.1	0.1	0.1	
(contribution to consumer price inflation)	0.74	0.89	0.82	0.56	0.46	0.27	0.04	0.12	0.02	0.04	0.04	0.06	
Inflation rate (annual moving average)	1.5	1.1	0.8	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.1	
<b>2004</b>													
Consumer prices	2.3	2.3	2.5	2.3	2.7	2.9	3.2	3.4	3.0	3.5	2.9	2.8	
Regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4	
(contribution to consumer price inflation)	1.01	0.99	0.96	0.63	0.49	0.49	0.49	0.47	0.46	0.90	0.89	0.89	
Influence of indirect tax growth on unregulated prices													
(contribution to consumer price inflation)	0.35	0.35	0.35	0.39	0.61	0.68	0.72	0.73	0.76	0.76	0.76	0.76	
Net inflation	1.2	1.2	1.4	1.5	2.0	2.1	2.5	2.6	2.3	2.1	1.6	1.5	
(contribution to consumer price inflation)	0.96	0.92	1.15	1.21	1.63	1.71	2.02	2.11	1.81	1.71	1.28	1.20	
of which: prices of food, beverages and tobacco	2.8	2.8	3.2	3.3	3.4	2.7	3.8	4.2	3.0	2.2	0.7	0.9	
(contribution to consumer price inflation)	0.75	0.75	0.83	0.86	0.89	0.71	1.00	1.10	0.78	0.59	0.18	0.25	
adjusted inflation	0.4	0.3	0.6	0.6	1.4	1.9	1.9	1.9	1.9	2.1	2.1	1.8	
(contribution to consumer price inflation)	0.21	0.17	0.32	0.35	0.74	1.00	1.02	1.02	1.03	1.12	1.10	0.96	
Inflation rate (annual moving average)	0.3	0.5	0.8	1.0	1.2	1.4	1.7	2.0	2.2	2.5	2.7	2.8	
<b>2005</b>													
Consumer prices	1.7	1.7	1.5	1.6	1.3	1.8	1.7	1.7	2.2	2.6	2.4	2.2	
Regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8	9.0	9.0	9.0	
(contribution to consumer price inflation)	0.61	0.60	0.61	0.66	0.83	1.21	1.38	1.41	1.41	1.87	1.87	1.87	
Influence of indirect tax growth on unregulated prices													
(contribution to consumer price inflation)	0.35	0.35	0.35	0.31	0.09	0.02	-0.02	-0.03	-0.06	-0.06	-0.05	0.00	
Net inflation	0.9	0.9	0.7	0.8	0.6	0.7	0.4	0.4	1.1	1.0	0.8	0.4	
(contribution to consumer price inflation)	0.72	0.75	0.59	0.68	0.46	0.53	0.35	0.35	0.89	0.80	0.65	0.32	
of which: prices of food, beverages and tobacco	0.4	0.6	0.4	-0.1	-0.1	0.2	-0.6	-0.6	-0.2	0.3	0.3	-0.7	
(contribution to consumer price inflation)	0.11	0.17	0.12	-0.02	-0.03	0.04	-0.15	-0.17	-0.05	0.07	0.08	-0.17	
adjusted inflation	1.1	1.1	0.9	1.3	0.9	0.9	0.9	1.0	1.8	1.4	1.1	0.9	
(contribution to consumer price inflation)	0.61	0.59	0.47	0.69	0.49	0.48	0.50	0.52	0.94	0.74	0.57	0.49	
Inflation rate (annual moving average)	2.8	2.7	2.6	2.6	2.5	2.4	2.2	2.1	2.0	2.0	1.9	1.9	
<b>2006</b>													
Consumer prices	2.9	2.8	2.8	2.8	3.1	2.8	2.9	3.1	2.7	1.3	1.5	1.7	
Regulated prices	11.0	11.0	11.2	11.5	12.4	10.5	9.7	9.8	9.8	4.9	4.8	4.9	
(contribution to consumer price inflation)	2.27	2.28	2.30	2.37	2.55	2.19	2.02	2.06	2.05	1.08	1.07	1.08	
Influence of indirect tax growth on unregulated prices													
(contribution to consumer price inflation)	0.21	0.34	0.39	0.39	0.39	0.39	0.39	0.21	0.21	0.21	0.21	0.16	
Net inflation	0.5	0.3	0.1	0.1	0.3	0.3	0.7	1.1	0.5	0.1	0.2	0.7	
(contribution to consumer price inflation)	0.40	0.23	0.08	0.09	0.22	0.24	0.55	0.88	0.43	0.06	0.17	0.54	
of which: prices of food, beverages and tobacco	-1.0	-1.6	-1.8	-1.5	-1.3	-0.6	0.5	1.3	1.4	0.4	0.4	0.9	
(contribution to consumer price inflation)	-0.25	-0.41	-0.47	-0.39	-0.34	-0.15	0.13	0.34	0.35	0.12	0.12	0.25	
adjusted inflation	1.2	1.2	1.0	0.9	1.1	0.7	0.8	1.0	0.1	-0.1	0.1	0.5	
(contribution to consumer price inflation)	0.65	0.64	0.55	0.48	0.56	0.39	0.42	0.54	0.08	-0.06	0.05	0.29	
Inflation rate (annual moving average)	2.0	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8	2.7	2.6	2.5	
<b>2007</b>													
Consumer prices	1.3	1.5	1.9										
Regulated prices	3.9	4.3	4.2										
(contribution to consumer price inflation)	0.66	0.72	0.70										
Influence of indirect tax growth on unregulated prices													
(contribution to consumer price inflation)	0.10	0.11	0.21										
Net inflation	0.7	0.8	1.3										
(contribution to consumer price inflation)	0.53	0.62	1.00										
of which: prices of food, beverages and tobacco	2.0	2.8	3.2										
(contribution to consumer price inflation)	0.49	0.68	0.79										
adjusted inflation	0.1	-0.1	0.4										
(contribution to consumer price inflation)	0.04	-0.06	0.21										
Inflation rate (annual moving average)	2.4	2.3	2.2										

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												
	monthly percentage changes											
2003	1	2	3	4	5	6	7	8	9	10	11	12
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	0.03	0.06	0.03	0.23	-0.01	0.01	0.00	0.00	0.01	-0.09	0.00	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	0.55	0.14	-0.13	-0.03	-0.04	0.05	0.03	-0.11	-0.49	0.22	0.39	0.20
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	0.22	-0.05	-0.05	0.04	0.10	0.16	-0.44	-0.25	0.16	0.18	0.42	0.22
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	0.33	0.18	-0.07	-0.06	-0.14	-0.11	0.47	0.15	-0.65	0.03	-0.03	-0.02
<b>2004</b>												
Consumer prices	1.8	0.2	0.1	0.0	0.4	0.2	0.4	0.0	-0.8	0.5	-0.1	0.1
Regulated prices	3.7	0.2	0.0	-0.5	-0.7	0.0	0.0	-0.1	0.0	1.6	0.0	0.0
(contribution to consumer price inflation)	0.76	0.04	0.01	-0.10	-0.15	0.00	0.00	-0.03	0.01	0.34	-0.01	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.00	0.00	0.04	0.23	0.07	0.04	0.01	0.03	0.00	0.00	0.00
Net inflation	0.9	0.1	0.1	0.0	0.5	0.1	0.4	0.0	-1.0	0.2	0.0	0.2
(contribution to consumer price inflation)	0.74	0.09	0.10	0.03	0.37	0.12	0.33	-0.01	-0.78	0.12	-0.04	0.12
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1	0.3	0.5	-0.1	-0.6	-0.6	-0.6	0.0	0.0	1.1
(contribution to consumer price inflation)	0.26	-0.05	0.02	0.07	0.14	-0.03	-0.15	-0.15	-0.16	-0.01	0.01	0.28
adjusted inflation	0.9	0.3	0.1	-0.1	0.4	0.3	0.9	0.3	-1.2	0.2	-0.1	-0.3
(contribution to consumer price inflation)	0.48	0.14	0.08	-0.04	0.23	0.14	0.48	0.14	-0.63	0.13	-0.05	-0.16
<b>2005</b>												
Consumer prices	0.7	0.2	-0.1	0.1	0.2	0.6	0.3	0.0	-0.3	0.9	-0.3	-0.1
Regulated prices	2.2	0.2	0.1	-0.2	0.1	1.8	0.8	0.0	0.0	3.7	0.0	0.0
(contribution to consumer price inflation)	0.48	0.04	0.01	-0.05	0.02	0.39	0.16	0.00	0.01	0.78	0.00	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	-0.06	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05
Net inflation	0.3	0.2	-0.1	0.1	0.2	0.2	0.2	0.0	-0.3	0.1	-0.2	-0.3
(contribution to consumer price inflation)	0.26	0.13	-0.06	0.11	0.15	0.19	0.17	-0.01	-0.26	0.05	-0.20	-0.20
of which: prices of food, beverages and tobacco	0.5	0.0	-0.1	-0.2	0.5	0.2	-1.3	-0.7	-0.2	0.4	0.1	0.1
(contribution to consumer price inflation)	0.12	0.01	-0.02	-0.06	0.12	0.05	-0.33	-0.17	-0.04	0.11	0.02	0.03
adjusted inflation	0.3	0.2	-0.1	0.3	0.1	0.3	0.9	0.3	-0.4	-0.1	-0.4	-0.4
(contribution to consumer price inflation)	0.14	0.11	-0.04	0.17	0.03	0.14	0.50	0.16	-0.21	-0.06	-0.22	-0.23
<b>2006</b>												
Consumer prices	1.4	0.1	-0.1	0.1	0.5	0.3	0.4	0.2	-0.7	-0.5	-0.1	0.2
Regulated prices	4.1	0.2	0.2	0.1	0.9	0.1	0.0	0.2	0.0	-0.9	0.0	0.0
(contribution to consumer price inflation)	0.89	0.04	0.03	0.02	0.21	0.02	0.00	0.04	-0.01	-0.21	-0.01	0.01
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.16	0.13	0.05	0.00	0.00	0.00	0.00	-0.18	0.00	0.00	0.00	0.00
Net inflation	0.4	-0.1	-0.3	0.2	0.4	0.3	0.6	0.4	-0.9	-0.4	-0.1	0.2
(contribution to consumer price inflation)	0.33	-0.05	-0.21	0.12	0.28	0.20	0.47	0.31	-0.69	-0.31	-0.09	0.16
of which: prices of food, beverages and tobacco	0.2	-0.6	-0.3	0.1	0.7	0.9	-0.2	0.2	-0.1	-0.5	0.1	0.6
(contribution to consumer price inflation)	0.04	-0.15	-0.08	0.02	0.17	0.23	-0.05	0.05	-0.03	-0.13	0.03	0.15
adjusted inflation	0.5	0.2	-0.2	0.2	0.2	-0.1	1.0	0.5	-1.2	-0.4	-0.2	0.0
(contribution to consumer price inflation)	0.29	0.10	-0.12	0.10	0.12	-0.03	0.53	0.26	-0.65	-0.19	-0.12	0.01
<b>2007</b>												
Consumer prices	1.0	0.3	0.3									
Regulated prices	3.2	0.6	0.0									
(contribution to consumer price inflation)	0.54	0.10	0.01									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.10	0.14	0.15									
Net inflation	0.4	0.1	0.2									
(contribution to consumer price inflation)	0.36	0.05	0.15									
of which: prices of food, beverages and tobacco	1.2	0.2	0.1									
(contribution to consumer price inflation)	0.30	0.04	0.02									
adjusted inflation	0.1	0.0	0.2									
(contribution to consumer price inflation)	0.06	0.01	0.13									

CNB calculation based on CZSO data

Table 2

CONSUMER PRICES														percentage changes; average for 2005 = 100
Group	Constant 2005 weights in per mille	Months												Average since start of year
		1	2	3	4	5	6	7	8	9	10	11	12	
<b>Total - 2004</b>	1,000.0	-2.5	-2.3	-2.3	-2.3	-1.8	-1.6	-1.3	-1.3	-2.1	-1.6	-1.6	-1.6	-1.9
Food and non-alcoholic beverages	162.6	1.3	1.0	1.1	1.4	1.0	1.0	0.3	-0.6	-1.3	-1.3	-1.2	0.5	0.3
Alcoholic beverages and tobacco	81.7	-3.6	-3.5	-3.4	-2.8	-1.2	-0.6	-0.3	-0.1	-0.2	-0.3	-0.4	-0.8	-1.4
Clothing and footwear	52.4	6.9	6.0	6.0	6.1	6.2	6.2	4.7	3.7	4.1	5.4	5.6	5.6	5.5
Housing, water, electricity, gas and other fuels	248.3	-4.4	-4.1	-4.0	-4.4	-4.7	-4.7	-4.4	-4.3	-4.1	-2.9	-2.9	-2.9	-4.0
Furnishings, household equipment and routine maintenance of the house	58.1	3.0	2.8	2.7	2.7	2.2	2.2	1.9	1.7	1.5	1.4	1.2	1.1	2.0
Health	17.9	-9.4	-9.1	-8.7	-8.4	-6.5	-6.2	-6.0	-5.8	-5.4	-6.0	-6.3	-6.3	-7.0
Transport	114.1	-2.3	-2.3	-1.3	-1.3	-0.1	-0.6	-0.9	-1.0	-1.7	-1.2	-1.5	-3.0	-1.4
Communications	38.7	-5.1	-6.0	-6.0	-6.1	-7.2	-7.3	-7.4	-8.5	-8.7	-7.4	-7.5	-7.6	-7.1
Recreation and culture	98.6	-3.5	-2.3	-3.3	-3.9	-3.4	-2.0	3.3	5.2	-2.1	-2.6	-3.0	-3.1	-1.7
Education	6.2	-4.2	-3.8	-3.9	-3.9	-3.6	-3.7	-3.7	-3.7	0.7	0.9	0.9	0.9	-2.3
Hotels, cafés and restaurants	58.4	-8.1	-7.9	-7.6	-7.4	-3.7	-3.4	-3.3	-3.2	-2.4	-2.0	-1.8	-1.7	-4.4
Miscellaneous goods and services	63.0	-2.8	-2.1	-1.6	-1.7	-0.7	-0.4	-0.3	-0.4	-0.5	-0.6	-0.4	-0.4	-1.0
<b>Total - 2005</b>	1,000.0	-0.9	-0.7	-0.8	-0.7	-0.5	0.1	0.3	0.3	0.1	0.9	0.7	0.6	0.0
Food and non-alcoholic beverages	162.6	0.8	0.8	0.7	0.5	1.2	1.4	-0.4	-1.3	-1.5	-1.0	-0.8	-0.4	0.0
Alcoholic beverages and tobacco	81.7	0.1	0.3	0.2	-0.2	-0.2	0.0	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1	0.0
Clothing and footwear	52.4	2.4	1.2	1.0	1.3	1.3	1.1	-0.6	-2.0	-1.9	-1.3	-1.1	-1.4	0.0
Housing, water, electricity, gas and other fuels	248.3	-1.0	-0.9	-0.7	-0.9	-0.9	-0.8	-0.4	-0.3	-0.2	2.0	2.0	2.0	0.0
Furnishings, household equipment and routine maintenance of the house	58.1	0.8	0.6	0.5	0.3	0.2	0.0	-0.2	-0.3	-0.5	-0.5	-0.6	-0.7	0.0
Health	17.9	-2.5	-2.0	-1.6	-1.1	0.3	1.1	1.1	1.3	1.8	0.9	0.6	0.6	0.0
Transport	114.1	-4.0	-4.2	-3.8	-1.3	-1.2	-0.4	1.1	1.2	4.9	4.4	2.6	0.5	0.0
Communications	38.7	-7.6	-8.2	-8.2	-8.3	-8.4	5.9	6.2	6.2	5.6	5.6	5.4	5.4	0.0
Recreation and culture	98.6	-1.3	0.1	-1.1	-2.1	-1.7	-1.1	4.1	6.1	-1.1	-0.1	-0.6	-0.7	0.0
Education	6.2	-1.9	-1.2	-1.1	-1.1	-1.1	-1.2	-1.2	-1.2	2.1	2.7	2.7	2.7	0.0
Hotels, cafés and restaurants	58.4	-1.1	-0.6	-0.4	-0.2	-0.2	-0.2	-0.4	-0.4	0.6	0.9	0.9	0.9	0.0
Miscellaneous goods and services	63.0	-0.4	0.1	0.1	0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.1	0.1	0.0
<b>Total - 2006</b>	1,000.0	2.0	2.1	2.0	2.1	2.6	2.8	3.3	3.5	2.8	2.2	2.2	2.3	2.5
Food and non-alcoholic beverages	162.6	0.4	0.2	0.0	0.2	0.9	2.3	2.0	1.2	1.0	0.3	0.4	1.5	0.9
Alcoholic beverages and tobacco	81.7	0.9	1.1	1.1	0.9	1.3	1.1	1.2	1.2	1.2	1.3	1.5	0.8	1.1
Clothing and footwear	52.4	-3.7	-4.8	-5.1	-4.9	-5.1	-5.6	-7.6	-8.0	-7.6	-6.8	-6.4	-5.9	-6.0
Housing, water, electricity, gas and other fuels	248.3	5.8	6.1	6.1	6.3	6.4	6.5	6.6	6.6	6.6	6.0	6.0	6.0	6.3
Furnishings, household equipment and routine maintenance of the house	58.1	-0.9	-0.9	-1.1	-1.1	-1.2	-1.4	-1.6	-1.6	-1.6	-1.6	-1.4	-1.4	-1.3
Health	17.9	1.7	2.0	2.8	3.1	4.2	4.9	4.9	7.2	7.5	6.9	6.3	6.3	4.8
Transport	114.1	0.2	0.4	0.2	1.7	2.9	2.8	3.6	3.8	2.8	1.0	0.0	-0.2	1.6
Communications	38.7	6.0	4.0	4.0	1.7	7.3	7.3	8.1	8.7	8.5	8.7	8.5	8.5	6.8
Recreation and culture	98.6	0.7	1.8	0.7	0.1	0.4	0.3	5.5	8.1	1.0	0.2	-0.5	-0.3	1.5
Education	6.2	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	5.2	5.2	5.2	5.2	3.5
Hotels, cafés and restaurants	58.4	1.6	1.9	2.0	2.2	2.4	2.5	2.7	2.9	3.1	3.2	3.3	3.5	2.6
Miscellaneous goods and services	63.0	0.9	1.4	1.6	1.8	1.8	1.8	2.1	2.1	2.1	2.2	2.2	2.2	1.9
<b>Total - 2007</b>	1,000.0	3.3	3.6	3.9										3.6
Food and non-alcoholic beverages	162.6	3.1	3.2	3.3										3.2
Alcoholic beverages and tobacco	81.7	2.6	4.6	6.5										4.6
Clothing and footwear	52.4	-7.3	-7.3	-6.8										-7.1
Housing, water, electricity, gas and other fuels	248.3	8.2	8.5	8.6										8.4
Furnishings, household equipment and routine maintenance of the house	58.1	-1.5	-1.6	-1.6										-1.6
Health	17.9	6.6	6.7	6.7										6.7
Transport	114.1	-0.8	-1.6	-0.4										-0.9
Communications	38.7	8.1	8.0	7.9										8.0
Recreation and culture	98.6	1.5	2.3	1.4										1.7
Education	6.2	5.2	5.3	5.3										5.3
Hotels, cafés and restaurants	58.4	4.0	4.2	4.4										4.2
Miscellaneous goods and services	63.0	2.9	3.6	4.0										3.5

Source: CZSO

Table 3

**CONSUMER PRICES - TRADABLES AND NONTRADABLES**

annual percentage changes

	1	2	3	4	5	6	7	8	9	10	11	12
<b>2003</b>												
Fuel prices	6.1	10.5	11.4	1.9	-0.5	-1.1	-0.6	0.7	-2.5	-2.9	-2.7	-2.0
Other tradables excluding food and fuel prices	-2.3	-2.5	-2.6	-2.7	-2.7	-2.9	-3.0	-3.0	-2.9	-2.7	-2.8	-2.7
Prices of tradables excluding regulated prices	4.0	4.1	3.9	3.9	3.8	3.3	2.4	2.5	2.5	2.4	2.5	2.4
Prices of non-food commodities excluding regulated prices	1.5	1.7	1.6	1.1	0.9	0.5	0.1	0.2	0.1	0.1	0.1	0.1
Prices of tradables - food	-4.1	-3.8	-3.6	-3.5	-2.8	-1.1	-0.8	-0.8	-0.2	0.6	2.5	2.7
Prices of nontradables - regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
<b>2004</b>												
Fuel prices	1.0	-1.9	-0.3	2.0	11.0	14.2	13.7	12.8	10.5	14.4	13.7	8.9
Other tradables excluding food and fuel prices	-2.6	-2.4	-2.2	-2.3	-2.6	-2.6	-2.6	-2.6	-2.9	-2.9	-2.7	-2.8
Prices of tradables excluding regulated prices	3.3	3.3	3.4	3.4	5.2	5.9	5.9	5.9	6.4	6.4	6.3	6.3
Prices of non-food commodities excluding regulated prices	0.9	0.8	1.1	1.1	2.5	2.9	3.0	2.9	3.0	3.2	3.1	2.9
Prices of tradables - food	3.2	3.2	3.5	3.8	3.6	3.1	4.4	4.9	3.7	3.0	1.4	1.6
Prices of nontradables - regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4
<b>2005</b>												
Fuel prices	-0.4	-0.6	-1.2	6.1	1.1	2.7	8.2	8.3	21.6	16.1	11.4	9.8
Other tradables excluding food and fuel prices	-3.4	-3.6	-3.8	-3.7	-3.4	-3.1	-2.6	-2.6	-2.4	-2.3	-2.3	-2.3
Prices of tradables excluding regulated prices	5.2	5.2	5.0	5.0	3.5	3.1	2.6	2.6	2.6	2.4	2.3	2.2
Prices of non-food commodities excluding regulated prices	1.6	1.6	1.4	1.8	0.8	0.8	0.8	0.9	1.7	1.3	1.0	0.8
Prices of tradables - food	0.8	1.0	0.8	0.2	0.4	0.4	-0.4	-0.5	-0.2	0.3	0.3	-0.5
Prices of nontradables - regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8	9.0	9.0	9.0
<b>2006</b>												
Fuel prices	12.5	13.9	10.9	7.3	10.4	8.3	5.7	6.0	-7.5	-10.8	-8.4	-3.4
Other tradables excluding food and fuel prices	-2.1	-2.1	-2.1	-2.1	-2.1	-2.9	-2.7	-2.6	-2.4	-2.4	-2.3	-2.1
Prices of tradables excluding regulated prices	2.6	2.5	2.4	2.4	2.5	2.2	2.4	2.6	2.5	2.4	2.4	2.5
Prices of non-food commodities excluding regulated prices	1.2	1.2	1.0	0.9	1.0	0.7	0.8	1.0	0.1	-0.1	0.1	0.5
Prices of tradables - food	-0.1	-0.2	-0.3	0.1	0.3	1.0	2.1	2.2	2.2	1.3	1.3	1.6
Prices of nontradables - regulated prices	11.0	11.0	11.2	11.5	12.4	10.5	9.7	9.8	9.8	4.9	4.8	4.9
<b>2007</b>												
Fuel prices	-3.5	-6.7	-3.2									
Other tradables excluding food and fuel prices	-2.4	-2.6	-2.0									
Prices of tradables excluding regulated prices	2.5	2.8	2.9									
Prices of non-food commodities excluding regulated prices	0.1	-0.1	0.4									
Prices of tradables - food	2.4	3.3	4.1									
Prices of nontradables - regulated prices	3.9	4.3	4.2									

CNB calculation based on CZSO data

Table 4

INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS FOR 12 MONTHS AHEAD				annual percentage changes
	Financial market	CPI	Businesses	Households
1/03	2.5	—	—	—
2/03	2.4	—	—	—
3/03	2.5	—	2.1	4.3
4/03	2.6	—	—	—
5/03	3.7	—	—	—
6/03	3.2	—	2.6	1.7
7/03	3.3	—	—	—
8/03	3.2	—	—	—
9/03	3.1	—	2.6	3.1
10/03	3.0	—	—	—
11/03	3.1	—	—	—
12/03	3.3	—	2.9	4.2
1/04	2.9	—	—	—
2/04	3.2	—	—	—
3/04	3.0	—	3.3	4.9
4/04	2.8	—	—	—
5/04	2.6	—	—	—
6/04	2.7	—	3.1	4.9
7/04	2.8	—	—	—
8/04	2.8	—	—	—
9/04	3.0	—	3.1	1.7
10/04	2.8	—	—	—
11/04	2.8	—	—	—
12/04	2.8	—	3.2	1.5
1/05	2.8	—	—	—
2/05	2.6	—	—	—
3/05	2.6	—	2.7	3.8
4/05	2.5	—	—	—
5/05	2.4	—	—	—
6/05	2.3	—	2.7	3.8
7/05	2.4	—	—	—
8/05	2.5	—	—	—
9/05	2.5	—	2.8	5.2
10/05	2.7	—	—	—
11/05	2.8	—	—	—
12/05	2.6	—	2.8	4.6
1/06	2.5	—	—	—
2/06	2.5	—	—	—
3/06	2.5	—	2.7	4.1
4/06	2.6	—	—	—
5/06	2.6	—	—	—
6/06	2.8	—	2.9	5.9
7/06	2.9	—	—	—
8/06	3.1	—	—	—
9/06	3.2	—	3.0	5.0
10/06	3.1	—	—	—
11/06	3.4	—	—	—
12/06	3.3	—	3.0	4.9
1/07	3.1	—	—	—
2/07	3.0	—	—	—
3/07	3.2	—	3.0	5.0

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES	annual percentage changes				
	2003 12	2004 12	2005 12	2006 12	2007 3
European Union (25 countries)	1.9	2.4	2.1	2.2	2.2
European Union (15 countries)	1.8	2.2	2.2	2.1	
Belgium	1.7	1.9	2.8	2.1	1.8
Czech Republic	0.9	2.5	1.9	1.5	2.1
Denmark	1.2	0.9	2.2	1.7	1.9
Germany	1.0	2.3	2.1	1.4	2.0
Estonia	1.2	4.8	3.6	5.1	5.6
Greece	3.1	3.1	3.5	3.2	2.8
Spain	2.7	3.3	3.7	2.7	2.5
France	2.4	2.3	1.8	1.7	1.2
Ireland	3.0	2.4	1.9	3.0	2.9
Italy	2.5	2.4	2.1	2.1	2.1
Cyprus	2.2	3.9	1.4	1.5	1.4
Latvia	3.5	7.4	7.1	6.8	8.5
Lithuania	-1.3	2.8	3.0	4.5	4.8
Luxembourg	2.4	3.5	3.4	2.3	2.4
Hungary	5.6	5.5	3.3	6.6	9.0
Malta	2.4	1.9	3.4	0.8	0.5
Netherlands	1.6	1.2	2.0	1.7	1.9
Austria	1.3	2.5	1.6	1.6	1.9
Poland	1.6	4.4	0.8	1.4	2.4
Portugal	2.3	2.6	2.5	2.5	2.4
Slovenia	4.7	3.3	2.4	3.0	2.6
Slovakia	9.4	5.8	3.9	3.7	2.1
Finland	1.2	0.1	1.1	1.2	1.6
Sweden	1.8	0.9	1.3	1.4	1.6
United Kingdom	1.3	1.7	1.9	3.0	

Source: Eurostat

Table 6

MONETARY SURVEY	position at month-end in CZK billions				
	2003 12	2004 12	2005 12	2006 12	2007 2
<b>Total assets</b>	1,766.1	1,844.1	1,992.1	2,188.6	2,215.0
Net external assets (NEAs)	821.5	863.3	1,076.4	972.7	1,011.9
NEAs of CNB	687.5	634.1	724.7	659.1	680.0
NEAs of OMFIs	134.0	229.3	351.7	313.5	331.9
Net domestic assets	944.5	980.8	915.8	1,215.9	1,203.1
Domestic loans	1,145.6	1,147.0	1,166.6	1,423.0	1,444.0
Net credit to government (NCG) (including securities)	354.0	257.5	99.1	136.8	131.8
NCG to central government (including securities)	408.7	312.4	163.0	206.9	224.7
NCG to other government (including securities)	-54.8	-54.9	-64.0	-70.1	-92.8
Loans to corporations and households (excluding securities)	791.6	889.4	1,067.5	1,286.2	1,312.2
Loans to corporations (excluding securities)	554.1	574.2	649.7	745.6	755.2
Loans to households (excluding securities)	237.5	315.2	417.8	540.6	557.0
Other net items (including securities and capital)	-201.1	-166.2	-250.8	-207.1	-240.9
Holdings of securities	16.6	18.8	14.4	13.6	14.0
Issued securities	-51.6	-74.9	-119.1	-121.8	-125.4
<b>Liabilities</b>					
Monetary aggregate M2	1,766.1	1,844.1	1,992.1	2,188.6	2,215.0
Monetary aggregate M1	902.8	962.3	1,087.3	1,239.8	1,253.2
Currency in circulation	221.4	236.8	263.8	295.3	296.8
Overnight deposits	681.4	725.6	823.5	944.5	956.4
Overnight deposits - households	372.1	410.8	456.6	529.3	552.6
Overnight deposits - corporations	309.3	314.7	367.0	415.2	403.8
M2-M1 (quasi money)	863.3	881.8	904.8	948.8	961.8
Deposits with agreed maturity	666.4	675.3	671.4	674.9	684.6
Deposits with agreed maturity - households	439.8	458.6	445.1	433.6	441.5
Deposits with agreed maturity - corporations	226.6	216.7	226.3	241.3	243.1
Deposits redeemable at notice	185.6	198.8	224.1	265.6	266.6
Deposits redeemable at notice - households	182.3	194.6	220.6	260.8	262.6
Deposits redeemable at notice - corporations	3.2	4.2	3.6	4.8	4.0
Repurchase agreements	11.3	7.6	9.3	8.4	10.5
<b>Annual percentage changes</b>					
M1	14.6	6.6	13.0	14.0	13.6
M2	6.9	4.4	8.0	9.9	10.6
Loans to corporations and households	9.3	12.4	20.0	20.5	20.3
M2-M1 (deposits)	-0.1	2.1	2.6	4.9	7.0
<b>Annual percentage growth rates</b>					
M1	15.5	8.3	13.1	14.7	13.8
M2	8.1	5.8	8.1	10.6	10.9
Loans to corporations and households	11.8	15.3	20.8	21.6	20.7
M2-M1 (deposits)	1.2	3.3	2.6	5.7	7.3

Table 7

INTEREST RATES ON INTERBANK DEPOSITS					percentages
	2003	2004	2005	2006	2007
	12	12	12	12	3
<b>1. Average PRIBOR <sup>1)</sup></b>					
- 1 day	1.98	2.49	2.00	2.48	2.49
- 7 day	2.02	2.51	2.04	2.51	2.52
- 14 day	2.03	2.51	2.04	2.51	2.52
- 1 month	2.04	2.53	2.05	2.52	2.54
- 2 month	2.06	2.55	2.10	2.54	2.55
- 3 month	2.08	2.57	2.17	2.56	2.56
- 6 month	2.13	2.67	2.33	2.67	2.65
- 9 month	2.22	2.76	2.44	2.79	2.73
- 12 month	2.30	2.85	2.53	2.89	2.81
<b>2. Average PRIBID <sup>1)</sup></b>					
- 1 day	1.88	2.39	1.90	2.38	2.39
- 7 day	1.92	2.41	1.94	2.41	2.42
- 14 day	1.93	2.41	1.94	2.41	2.42
- 1 month	1.94	2.43	1.95	2.42	2.44
- 2 month	1.96	2.45	2.00	2.44	2.45
- 3 month	1.98	2.47	2.07	2.46	2.46
- 6 month	2.03	2.57	2.23	2.57	2.55
- 9 month	2.12	2.66	2.34	2.69	2.63
- 12 month	2.20	2.75	2.43	2.79	2.71

1) Commercial banks quoting their rates daily on the interbank deposit market

Table 8

<b>FRA RATES</b>						percentages; monthly averages
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>	<b>3</b>
3 * 6	2.23	2.74	2.46	2.71	2.73	
3 * 9	2.36	2.81	2.57	2.83	2.82	
6 * 9	2.47	2.85	2.66	2.92	2.89	
6 * 12	2.64	2.92	2.74	3.02	2.96	
9 * 12	2.77	2.97	2.79	3.08	3.00	
9*12 - 3*6 spread	0.55	0.24	0.33	0.37	0.27	
6*12 - 3*9 spread	0.28	0.12	0.17	0.19	0.14	

<b>IRS RATES</b>						percentages; monthly averages
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>	<b>3</b>
1Y	2.41	2.82	2.56	2.86	2.84	
2Y	2.98	3.06	2.82	3.09	3.04	
3Y	3.38	3.27	3.00	3.21	3.20	
4Y	3.69	3.45	3.13	3.31	3.33	
5Y	3.93	3.62	3.25	3.40	3.43	
6Y	4.13	3.77	3.33	3.46	3.52	
7Y	4.29	3.89	3.40	3.52	3.60	
8Y	4.43	4.00	3.46	3.58	3.68	
9Y	4.54	4.09	3.52	3.63	3.74	
10Y	4.64	4.17	3.58	3.68	3.81	
15Y	4.97	4.40	3.78	3.83	4.02	
20Y	5.11	4.54	3.88	3.89	4.11	
5Y - 1Y spread	1.52	0.80	0.69	0.54	0.59	
10Y - 1Y spread	2.23	1.35	1.02	0.82	0.96	

Table 9

NOMINAL AND REAL INTEREST RATES (ex post approach)											percentages	
	Nominal rates				Real rates based on CPI				Real rates based on PPI			
	PRIBOR 2W	1Y	client rates new loans	time deposits	PRIBOR 2W	1Y	client rates new loans	time deposits	PRIBOR 2W	1Y	new client loans	
1/03	2.7	2.6	4.1	2.2	3.2	3.0	4.5	2.6	3.6	3.5	5.0	
2/03	2.5	2.4	3.9	2.1	2.9	2.8	4.3	2.5	3.2	3.2	4.6	
3/03	2.5	2.4	3.9	2.0	2.9	2.8	4.3	2.5	2.9	2.8	4.3	
4/03	2.5	2.4	3.9	2.0	2.6	2.5	4.0	2.1	3.2	3.2	4.7	
5/03	2.5	2.4	4.0	2.0	2.5	2.4	4.0	2.0	3.3	3.3	4.8	
6/03	2.5	2.3	3.8	1.9	2.2	2.0	3.5	1.6	3.4	3.2	4.8	
7/03	2.3	2.2	3.5	1.7	2.4	2.3	3.6	1.8	2.9	2.9	4.2	
8/03	2.0	2.1	3.3	1.8	2.1	2.2	3.4	1.9	2.4	2.5	3.7	
9/03	2.0	2.2	3.6	1.7	2.0	2.2	3.6	1.7	2.0	2.2	3.6	
10/03	2.0	2.2	3.7	1.7	1.6	1.8	3.3	1.3	2.1	2.3	3.8	
11/03	2.0	2.2	3.5	1.8	1.0	1.2	2.5	0.7	1.6	1.8	3.1	
12/03	2.0	2.3	3.7	1.7	1.0	1.3	2.6	0.7	1.1	1.4	2.7	
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	3.1	-0.9	0.4	0.7	3.9	
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5	
3/04	2.0	2.3	5.1	1.5	-0.5	-0.2	2.6	-1.0	-0.1	0.2	3.0	
4/04	2.0	2.3	5.4	1.5	-0.3	0.0	3.0	-0.8	-1.6	-1.4	1.6	
5/04	2.0	2.5	5.4	1.5	-0.7	-0.2	2.6	-1.2	-2.7	-2.3	0.5	
6/04	2.1	2.8	5.3	1.6	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8	
7/04	2.3	3.0	5.7	1.7	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5	
8/04	2.3	3.0	6.0	1.7	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9	
9/04	2.5	3.1	5.9	1.8	-0.5	0.1	2.9	-1.2	-5.1	-4.5	-1.9	
10/04	2.5	3.0	6.0	1.8	-1.0	-0.4	2.4	-1.6	-5.6	-5.1	-2.4	
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0	
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5	
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0	
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1	
3/05	2.2	2.1	5.6	1.7	0.7	0.6	4.1	0.2	-3.9	-4.0	-0.7	
4/05	2.0	2.1	5.9	1.6	0.4	0.4	4.2	0.0	-3.4	-3.4	0.2	
5/05	1.8	1.8	5.7	1.4	0.5	0.5	4.3	0.1	-2.1	-2.1	1.6	
6/05	1.8	1.8	5.3	1.4	0.0	0.0	3.4	-0.4	-0.9	-0.9	2.5	
7/05	1.8	1.8	5.3	1.4	0.1	0.1	3.6	-0.3	-0.2	-0.2	3.3	
8/05	1.8	1.9	5.3	1.4	0.1	0.2	3.5	-0.3	0.7	0.8	4.1	
9/05	1.8	1.9	5.1	1.5	-0.4	-0.3	2.8	-0.7	0.8	0.9	4.1	
10/05	1.8	2.2	5.6	1.5	-0.8	-0.4	2.9	-1.1	1.5	1.9	5.3	
11/05	2.0	2.6	5.4	1.7	-0.4	0.2	2.9	-0.7	2.0	2.6	5.4	
12/05	2.0	2.5	5.5	1.7	-0.2	0.3	3.2	-0.5	2.3	2.8	5.8	
1/06	2.0	2.4	5.5	1.7	-0.8	-0.5	2.6	-1.2	1.7	2.1	5.2	
2/06	2.0	2.2	5.5	1.7	-0.8	-0.6	2.6	-1.1	1.7	1.9	5.2	
3/06	2.0	2.3	5.5	1.7	-0.8	-0.5	2.6	-1.1	1.7	2.0	5.2	
4/06	2.0	2.4	5.6	1.7	-0.8	-0.4	2.7	-1.0	1.5	1.9	5.1	
5/06	2.0	2.4	5.6	1.7	-1.0	-0.6	2.4	-1.3	0.5	0.9	4.0	
6/06	2.0	2.6	5.5	1.7	-0.8	-0.2	2.6	-1.0	0.2	0.7	3.6	
7/06	2.0	2.8	5.7	1.7	-0.9	-0.1	2.7	-1.2	-0.1	0.7	3.5	
8/06	2.3	2.7	5.8	1.9	-0.8	-0.3	2.7	-1.2	-0.4	0.0	3.1	
9/06	2.2	2.9	5.8	1.9	-0.4	0.2	3.0	-0.8	-0.2	0.5	3.3	
10/06	2.5	3.1	6.1	2.0	1.2	1.8	4.7	0.7	0.6	1.2	4.1	
11/06	2.5	3.0	6.0	2.0	1.0	1.5	4.4	0.5	0.5	1.0	3.9	
12/06	2.5	2.9	5.9	2.0	0.8	1.2	4.1	0.3	-0.1	0.3	3.2	
1/07	2.5	2.9	6.1	2.1	1.2	1.5	4.8	0.7	-0.3	0.1	3.3	
2/07	2.5	2.8	6.1	2.1	1.0	1.3	4.5	0.6	-0.7	-0.4	2.8	
3/07	2.5	2.8	—	—	0.6	0.9	—	—	-1.0	-0.8	—	

Note: real rates = nominal rates deflated by annual index (CPI/PPI) in given month.

Starting from January 2004, the methodology for new loans and time deposits was changed. Newly drawn credits were replaced by newly extended loans.

Table 10

REAL INTEREST RATES (ex ante approach)													percentages
	Real rates expected by financial markets				Real rates expected by businesses				Real rates expected by households				
	PRIBOR	client rates			PRIBOR	client rates			PRIBOR	client rates			
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	
1/03	0.2	0.1	1.6	-0.3	—	—	—	—	—	—	—	—	
2/03	0.1	0.0	1.4	-0.3	—	—	—	—	—	—	—	—	
3/03	0.0	-0.1	1.3	-0.4	0.4	0.3	1.7	-0.1	-1.7	-1.9	-0.4	-2.2	
4/03	-0.1	-0.2	1.3	-0.6	—	—	—	—	—	—	—	—	
5/03	-1.2	-1.2	0.3	-1.6	—	—	—	—	—	—	—	—	
6/03	-0.7	-0.9	0.6	-1.2	-0.1	-0.3	1.2	-0.6	0.8	0.6	2.1	0.2	
7/03	-1.0	-1.0	0.2	-1.5	—	—	—	—	—	—	—	—	
8/03	-1.1	-1.1	0.1	-1.4	—	—	—	—	—	—	—	—	
9/03	-1.0	-0.9	0.5	-1.3	-0.6	-0.4	1.0	-0.8	-1.0	-0.9	0.5	-1.3	
10/03	-0.9	-0.8	0.6	-1.2	—	—	—	—	—	—	—	—	
11/03	-1.0	-0.8	0.4	-1.3	—	—	—	—	—	—	—	—	
12/03	-1.2	-1.0	0.4	-1.5	-0.8	-0.6	0.7	-1.1	-2.1	-1.8	-0.5	-2.4	
1/04	-0.9	-0.6	2.5	-1.4	—	—	—	—	—	—	—	—	
2/04	-1.2	-0.8	1.8	-1.7	—	—	—	—	—	—	—	—	
3/04	-1.0	-0.7	2.1	-1.5	-1.2	-1.0	1.8	-1.8	-2.8	-2.5	0.2	-3.3	
4/04	-0.8	-0.5	2.5	-1.3	—	—	—	—	—	—	—	—	
5/04	-0.6	-0.1	2.7	-1.1	—	—	—	—	—	—	—	—	
6/04	-0.6	0.1	2.6	-1.1	-1.0	-0.3	2.2	-1.5	-2.7	-2.0	0.4	-3.2	
7/04	-0.5	0.2	2.8	-1.1	—	—	—	—	—	—	—	—	
8/04	-0.5	0.2	3.1	-1.1	—	—	—	—	—	—	—	—	
9/04	-0.5	0.1	2.9	-1.2	-0.6	0.0	2.8	-1.3	0.8	1.4	4.2	0.1	
10/04	-0.3	0.2	3.1	-1.0	—	—	—	—	—	—	—	—	
11/04	-0.3	0.1	3.2	-1.0	—	—	—	—	—	—	—	—	
12/04	-0.3	0.0	3.2	-0.9	-0.7	-0.3	2.8	-1.3	1.0	1.3	4.5	0.3	
1/05	-0.3	-0.1	3.3	-0.9	—	—	—	—	—	—	—	—	
2/05	-0.3	-0.3	3.3	-0.8	—	—	—	—	—	—	—	—	
3/05	-0.4	-0.5	2.9	-0.9	-0.5	-0.6	2.8	-1.0	-1.5	-1.6	1.8	-2.0	
4/05	-0.5	-0.4	3.3	-0.9	—	—	—	—	—	—	—	—	
5/05	-0.6	-0.6	3.2	-0.9	—	—	—	—	—	—	—	—	
6/05	-0.5	-0.5	2.9	-0.8	-0.9	-0.9	2.5	-1.2	-2.0	-2.0	1.4	-2.3	
7/05	-0.6	-0.6	2.9	-0.9	—	—	—	—	—	—	—	—	
8/05	-0.7	-0.6	2.7	-1.0	—	—	—	—	—	—	—	—	
9/05	-0.7	-0.6	2.5	-1.0	-1.0	-0.9	2.2	-1.3	-3.3	-3.2	-0.1	-3.6	
10/05	-0.9	-0.5	2.8	-1.1	—	—	—	—	—	—	—	—	
11/05	-0.7	-0.2	2.5	-1.1	—	—	—	—	—	—	—	—	
12/05	-0.5	-0.1	2.8	-0.9	-0.8	-0.3	2.6	-1.1	-2.5	-2.0	0.8	-2.8	
1/06	-0.5	-0.1	3.0	-0.8	—	—	—	—	—	—	—	—	
2/06	-0.5	-0.3	2.9	-0.8	—	—	—	—	—	—	—	—	
3/06	-0.5	-0.2	2.9	-0.8	-0.7	-0.4	2.7	-1.0	-2.0	-1.7	1.4	-2.3	
4/06	-0.6	-0.2	2.9	-0.9	—	—	—	—	—	—	—	—	
5/06	-0.6	-0.2	2.9	-0.9	—	—	—	—	—	—	—	—	
6/06	-0.8	-0.2	2.6	-1.0	-0.8	-0.3	2.5	-1.1	-3.7	-3.2	-0.4	-3.9	
7/06	-0.9	-0.1	2.7	-1.2	—	—	—	—	—	—	—	—	
8/06	-0.8	-0.3	2.7	-1.2	—	—	—	—	—	—	—	—	
9/06	-0.9	-0.3	2.5	-1.3	-0.8	-0.1	2.7	-1.1	-2.7	-2.0	0.7	-3.0	
10/06	-0.6	0.0	2.9	-1.1	—	—	—	—	—	—	—	—	
11/06	-0.9	-0.4	2.5	-1.3	—	—	—	—	—	—	—	—	
12/06	-0.8	-0.4	2.5	-1.2	-0.5	-0.1	2.8	-0.9	-2.3	-1.9	0.9	-2.7	
1/07	-0.6	-0.2	3.0	-1.0	—	—	—	—	—	—	—	—	
2/07	-0.5	-0.2	3.0	-0.9	—	—	—	—	—	—	—	—	
3/07	-0.7	-0.4	—	—	-0.4	-0.1	—	—	-2.4	-2.1	—	—	

Note: real rates = nominal rates deflated by inflation expected by selected economic sectors according to the CNB statistical survey.  
Starting from January 2004, the methodology for new loans and time deposits was changed. Newly drawn credits were replaced by newly extended loans.

Table 11

KORUNA INTEREST RATES (stock of business)	percentages				
	2003 12	2004 12	2005 12	2006 12	2007 2
<b>Koruna interest rates on loans provided by banks to residents:</b>					
<b>Households and non-profit institutions serving households (S.14+S.15) - total</b>	8.24	7.96	7.20	6.80	6.71
- maturity up to 1 year	11.21	12.82	12.96	13.75	13.66
- maturity over 1 year and up to 5 years	10.17	12.40	11.43	11.35	11.34
- maturity over 5 years	6.65	6.39	5.96	5.84	5.79
<b>for consumption - total</b>	13.83	14.89	13.88	13.59	13.45
- maturity up to 1 year	14.26	15.48	16.22	17.31	17.10
- maturity over 1 year and up to 5 years	13.86	15.17	14.94	14.67	14.51
- maturity over 5 years	13.21	13.45	11.85	11.93	11.86
<b>for house purchase - total</b>	6.31	5.93	5.24	4.91	4.88
- maturity up to 1 year	6.24	4.48	4.29	5.39	6.01
- maturity over 1 year and up to 5 years	7.05	6.57	6.22	6.15	6.12
- maturity over 5 years	6.09	5.89	5.19	4.88	4.85
<b>other - total</b>	7.80	7.50	7.09	6.87	6.75
- maturity up to 1 year	8.49	8.96	9.09	9.52	9.55
- maturity over 1 year and up to 5 years	8.02	7.63	7.17	7.74	7.80
- maturity over 5 years	7.02	6.58	5.79	5.51	5.42
<b>Non-financial corporations (S.11) - total</b>	4.53	4.75	4.20	4.45	4.52
- maturity up to 1 year	4.08	4.35	3.84	4.23	4.35
- maturity over 1 year and up to 5 years	4.64	4.68	4.18	4.38	4.41
- maturity over 5 years	5.14	5.39	4.72	4.74	4.79
<b>Koruna interest rates on deposits accepted by banks from residents:</b>					
<b>Households and non-profit institutions serving households (S.14+S.15) - total</b>	1.30	1.41	1.25	1.28	1.27
overnight	0.50	0.52	0.40	0.41	0.42
with agreed maturity - total	2.02	2.13	1.92	1.96	1.94
- with agreed maturity up to 2 years	0.96	1.37	1.03	1.49	1.52
- with agreed maturity over 2 years	2.90	2.69	2.50	2.31	2.28
redeemable at notice - total	1.26	1.63	1.71	1.97	1.98
- redeemable at notice up to 3 months	1.67	2.14	2.27	2.34	2.34
- redeemable at notice over 3 months	0.98	1.12	0.81	1.00	1.00
<b>Non-financial corporations (S.11) - total</b>	0.85	1.21	0.91	1.18	1.26
overnight	0.64	0.68	0.52	0.72	0.80
with agreed maturity - total	1.50	2.08	1.64	2.09	2.10
- with agreed maturity up to 2 years	1.49	2.05	1.61	2.08	2.10
- with agreed maturity over 2 years	3.04	3.12	2.47	2.28	2.27
redeemable at notice - total	1.17	1.60	1.14	1.64	1.62
- redeemable at notice up to 3 months	1.14	1.49	1.07	1.53	1.51
- redeemable at notice over 3 months	1.32	2.26	1.64	2.21	2.21

Table 12

<b>BALANCE OF PAYMENTS <sup>1)</sup></b>						in CZK millions
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005 <sup>2)</sup></b>	<b>2006 <sup>2)</sup></b>	
	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	
<b>A. Current account</b>						
Balance of trade <sup>3)</sup>	-136,378.1	-160,614.6	-167,348.2	-77,070.4	-133,763.7	
exports	1,254,394.0	1,370,930.0	1,722,657.0	1,868,585.8	2,143,997.6	
imports	1,325,717.0	1,440,723.0	1,749,095.0	1,829,961.8	2,099,603.6	
Services	21,850.8	13,236.7	12,539.3	20,303.1	12,513.6	
credit	231,131.1	219,151.1	248,535.1	258,889.7	265,484.3	
transport	56,560.5	60,556.3	72,308.9	78,763.0	78,153.7	
travel	96,289.2	100,310.1	107,231.8	111,839.3	113,125.0	
others	78,281.4	58,284.7	68,994.4	68,287.4	74,205.6	
debit	209,280.3	205,914.4	235,995.8	238,586.6	252,970.7	
transport	29,332.8	33,725.7	38,603.0	43,135.9	44,236.5	
travel	51,549.3	54,419.2	58,398.0	57,777.6	60,015.4	
others	128,398.2	117,769.5	138,994.8	137,673.1	148,718.8	
Income	-115,615.0	-119,858.4	-157,772.9	-155,700.6	-183,431.3	
credit	66,790.1	75,508.3	87,040.1	105,728.7	121,355.9	
debit	182,405.1	195,366.7	244,813.0	261,429.3	304,787.2	
Current transfers	28,709.1	15,800.1	4,323.4	19,703.1	-7,240.0	
credit	46,709.0	46,976.7	46,777.3	74,528.5	62,994.9	
debit	17,999.9	31,176.6	42,453.9	54,825.4	70,234.9	
<b>B. Capital account</b>						
credit	-119.4	-82.2	-14,017.0	4,853.3	8,630.4	
debit	221.0	198.2	5,608.2	5,525.2	14,269.5	
debit	340.4	280.4	19,625.2	671.9	5,639.1	
<b>Total A + B</b>	<b>-136,497.5</b>	<b>-160,696.8</b>	<b>-181,365.2</b>	<b>-72,217.1</b>	<b>-125,133.3</b>	
<b>C. Financial account</b>						
Direct investment	347,827.4	157,093.5	183,659.9	154,767.4	111,611.3	
abroad	270,930.2	53,500.3	101,776.3	279,630.5	104,307.1	
equity capital and reinvested earnings	-6,759.3	-5,815.7	-26,067.3	449.0	-30,370.0	
other capital	-5,376.8	-3,124.6	-20,260.0	-4,262.8	-29,228.4	
in the Czech Republic	-1,382.5	-2,691.1	-5,807.3	4,711.8	-1,141.6	
equity capital and reinvested earnings	277,689.5	59,316.0	127,843.6	279,181.5	134,677.1	
other capital	270,061.0	59,350.4	121,482.9	262,471.8	117,628.4	
other capital	7,628.5	-34.4	6,360.7	16,709.7	17,048.7	
Portfolio investment	-46,748.7	-35,719.1	59,380.4	-81,243.8	-26,882.5	
assets	-75,602.1	-83,892.7	-63,897.3	-82,095.7	-68,383.5	
equity securities	-7,807.9	5,630.5	-30,109.2	-35,342.4	-43,559.2	
debt securities	-67,794.2	-89,523.2	-33,788.1	-46,753.3	-24,824.3	
liabilities	28,853.4	48,173.6	123,277.7	851.9	41,501.0	
equity securities	-9,035.7	30,133.5	19,558.6	-36,408.9	5,758.0	
debt securities	37,889.1	18,040.1	103,719.1	37,260.8	35,743.0	
Financial derivatives	-4,281.7	3,860.1	-3,208.0	-2,798.6	-6,323.5	
assets	-15,458.4	7,083.7	-15,565.8	-2,860.9	-10,899.8	
liabilities	11,176.7	-3,223.6	12,357.8	62.3	4,576.3	
Other investment	127,927.6	135,452.2	25,711.2	-40,820.7	40,510.2	
assets	133,121.8	67,071.3	-30,507.4	-114,430.6	-35,522.5	
long-term	28,711.4	1,141.3	20,434.2	-16,338.0	-6,060.0	
CNB	—	—	-184.9	-176.3	—	
commercial banks	5,271.7	-999.9	505.0	-24,641.7	-10,715.5	
government	25,333.6	5,714.3	22,790.7	14,056.5	4,983.6	
other sectors	-1,893.9	-3,573.1	-2,676.6	-5,576.5	-328.1	
short-term	104,410.4	65,930.0	-50,941.6	-98,092.6	-29,462.5	
commercial banks	122,163.8	44,971.2	-34,248.5	-87,137.0	24,770.1	
government	-2,237.4	2,193.8	92.9	9.4	—	
other sectors	-15,516.0	18,765.0	-16,786.0	-10,965.0	-54,232.6	
liabilities	-5,194.2	68,380.9	56,218.6	73,609.9	76,032.7	
long-term	2,853.8	26,361.6	36,550.9	49,022.1	51,095.2	
CNB	-20.2	-20.4	-20.5	-19.1	-18.1	
commercial banks	-8,059.2	-5,038.0	-1,410.8	311.1	12,733.4	
government	-1,517.2	10,304.7	10,296.1	20,809.1	9,550.3	
other sectors	12,450.4	21,115.3	27,686.1	27,921.0	28,829.6	
short-term	-8,048.0	42,019.3	19,667.7	24,587.8	24,937.5	
CNB	-24.3	-21.4	843.7	5,060.1	-4,147.6	
commercial banks	-3,871.2	37,899.4	-15,344.5	14,808.8	2,369.2	
government	—	—	—	—	—	
other sectors	-4,152.5	4,141.3	34,168.5	4,718.9	26,715.9	
Total A + B + C	211,329.9	-3,603.3	2,294.7	82,550.3	-13,522.0	
<b>D. Net errors and omissions, valuation changes</b>	5,615.1	16,506.7	4,487.5	10,301.3	15,596.4	
<b>Total A + B + C + D</b>	<b>216,945.0</b>	<b>12,903.4</b>	<b>6,782.2</b>	<b>92,851.6</b>	<b>2,074.4</b>	
<b>E. Change in reserves (- increase)</b>	<b>-216,945.0</b>	<b>-12,903.4</b>	<b>-6,782.2</b>	<b>-92,851.6</b>	<b>-2,074.4</b>	

1) Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993

2) Preliminary data

3) In accordance with customs statistics methodology in force since 1 July 2000

Table 13

INTERNATIONAL INVESTMENT POSITION						in CZK millions
	2002	2003	2004	2005 <sup>1)</sup>	2006 <sup>1)</sup>	
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	31 Dec.	
<b>Assets</b>	1,579,922.9	1,537,284.6	1,549,333.7	1,875,403.8	1,894,747.4	
Direct investment abroad	44,397.1	58,581.5	84,087.4	88,772.7	105,600.0	
- equity capital	39,472.1	50,965.5	70,664.0	80,061.1	96,510.0	
- other capital	4,925.0	7,616.0	13,423.4	8,711.6	9,090.0	
Portfolio investment	274,344.7	343,968.7	372,237.6	467,808.5	531,990.4	
- equity securities	86,464.7	47,337.7	76,121.3	146,957.6	202,122.7	
- debt securities	187,880.0	296,631.0	296,116.3	320,850.9	329,867.7	
Financial derivatives	31,213.2	24,129.5	39,695.3	42,556.2	53,456.0	
Other investment	515,356.2	419,090.0	417,071.9	549,564.4	547,063.3	
long-term	179,639.6	157,598.6	118,432.7	136,314.1	129,684.5	
- CNB	280.9	468.4	600.0	3,184.5	2,993.8	
- commercial banks	67,966.9	66,121.3	58,137.8	83,231.1	87,666.1	
- government	97,156.8	79,483.9	48,574.9	38,408.5	29,894.6	
- other sectors	14,235.0	11,525.0	11,120.0	11,490.0	9,130.0	
short-term	335,716.6	261,491.4	298,639.2	413,250.3	417,378.8	
- CNB	376.7	98.8	71.7	71.1	131.3	
- commercial banks	213,815.4	161,150.2	184,588.0	273,879.1	233,927.5	
of which: gold and foreign exchange	163,032.9	115,884.8	128,119.8	198,042.8	166,580.8	
- government	2,324.5	102.4	9.5	0.1	0.0	
- other sectors	119,200.0	100,140.0	113,970.0	139,300.0	183,320.0	
CNB reserves	714,611.7	691,514.9	636,241.5	726,702.0	656,637.7	
- gold	4,653.8	4,784.3	4,253.9	5,526.8	5,690.9	
- SDR	137.1	238.7	118.0	289.8	346.0	
- reserve position in the IMF	7,081.5	11,949.9	9,137.5	4,447.7	2,324.6	
- foreign exchange	686,516.1	674,451.8	622,606.4	716,315.2	648,192.1	
- other reserve assets	16,223.2	90.2	125.7	122.5	84.1	
<b>Liabilities</b>	1,977,177.7	2,064,768.3	2,374,328.4	2,710,646.3	2,928,764.2	
Direct investment in the Czech Republic	1,165,529.1	1,161,783.6	1,280,594.8	1,491,564.0	1,617,053.0	
- equity capital	1,013,102.9	1,009,391.8	1,121,842.3	1,316,101.8	1,433,723.0	
- other capital	152,426.2	152,391.8	158,752.5	175,462.2	183,330.0	
Portfolio investment	201,120.0	223,620.4	381,019.4	437,806.0	487,994.5	
- equity securities	128,097.7	140,788.6	208,872.1	220,495.8	241,594.8	
- debt securities	73,022.3	82,831.8	172,147.3	217,310.2	246,399.7	
Financial derivatives	22,671.9	19,448.3	31,806.1	31,868.4	36,444.7	
Other investment	587,856.7	659,916.0	680,908.1	749,407.9	787,272.0	
long-term	326,321.3	360,279.2	373,456.4	417,645.7	448,883.2	
- CNB	114.5	96.1	70.2	47.8	27.2	
- commercial banks	63,541.0	58,056.3	52,020.8	51,639.8	62,263.6	
- government	9,475.8	22,456.0	32,065.4	52,322.1	61,236.4	
- other sectors	253,190.0	279,670.8	289,300.0	313,636.0	325,356.0	
short-term	261,535.4	299,636.8	307,451.7	331,762.2	338,388.8	
- CNB	44.2	22.8	866.5	5,926.5	1,779.0	
- commercial banks	176,196.2	208,534.0	185,025.2	201,315.7	193,934.8	
- government	—	—	—	—	—	
- other sectors	85,295.0	91,080.0	121,560.0	124,520.0	142,675.0	
<b>Net investment position</b>	-397,254.8	-527,483.7	-824,994.7	-835,242.5	-1,034,016.8	

1) Preliminary data

Table 14

<b>EXTERNAL DEBT</b>						in CZK millions
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005<sup>1)</sup></b>	<b>2006<sup>1)</sup></b>	
	<b>31 Dec.</b>	<b>31 Dec.</b>	<b>31 Dec.</b>	<b>31 Dec.</b>	<b>31 Dec.</b>	
<b>Debt in convertible currencies</b>	813,305.2	895,139.6	1,011,807.9	1,142,180.3	1,217,001.7	
of which:						
Long-term	498,833.8	535,995.9	667,327.6	783,533.1	844,844.5	
by debtor						
- CNB	114.5	96.1	70.2	47.8	27.2	
- commercial banks	80,063.7	73,276.4	64,346.5	65,418.9	76,426.6	
- government	47,701.3	69,029.9	147,729.1	221,003.4	246,569.8	
- other sectors	370,954.3	393,593.5	455,181.8	497,063.0	521,820.9	
by creditor						
- foreign banks	230,589.8	251,535.3	269,081.3	276,594.3	304,855.9	
- government institutions	1,747.2	—	—	9,636.0	9,555.5	
- multilateral institutions	69,894.7	83,779.6	84,862.4	105,187.7	109,106.6	
- suppliers and direct investors	118,829.4	109,287.9	143,301.2	170,586.6	170,625.0	
- other investors	77,772.7	91,393.1	170,082.7	221,528.5	250,701.5	
Short-term	314,471.4	359,143.7	344,480.3	358,647.2	372,157.2	
by debtor						
- CNB	44.2	22.8	866.5	5,926.5	1,779.0	
- commercial banks	177,474.4	210,017.0	188,495.9	202,616.9	196,648.2	
- government	761.0	710.0	3,334.6	1,102.4	350.0	
- other sectors	136,191.8	148,393.9	151,783.3	149,001.4	173,380.0	
by creditor						
- foreign banks	168,200.7	218,436.1	202,372.6	197,820.7	192,668.8	
- multilateral institutions	—	—	861.3	5,918.8	1,768.2	
- suppliers and direct investors	112,256.8	105,563.9	98,611.3	102,235.6	123,495.0	
- other investors	34,013.9	35,143.7	42,635.1	52,672.1	54,225.2	
<b>Debt in non-convertible currencies</b>	—	—	—	—	—	
of which:						
- long-term	—	—	—	—	—	
- short-term	—	—	—	—	—	
<b>Total external debt</b>	813,305.2	895,139.6	1,011,807.9	1,142,180.3	1,217,001.7	
of which:						
- long-term	498,833.8	535,995.9	667,327.6	783,533.1	844,844.5	
- short-term	314,471.4	359,143.7	344,480.3	358,647.2	372,157.2	
<b>Total long-term debt</b>	498,833.8	535,995.9	667,327.6	783,533.1	844,844.5	
of which:						
- IMF loans	—	—	—	—	—	
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	207,325.2	222,120.9	272,202.1	322,498.4	324,907.2	
- liabilities of entities with majority private capital	291,508.6	313,875.0	395,125.5	461,034.7	519,937.3	

1) Preliminary data

Table 15

**EXCHANGE RATES**

in CZK; foreign exchange market rates

<b>A. NOMINAL RATE</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
	<b>1 - 12</b>	<b>1 - 12</b>	<b>1 - 12</b>	<b>1 - 12</b>	<b>1 - 3</b>
<b>CZK exchange rate against selected currencies</b>					
- annual/quarterly averages					
1 EUR	31.84	31.90	29.78	28.34	28.04
1 USD	28.23	25.70	23.95	22.61	21.39
100 SKK	76.75	79.69	77.15	76.16	81.64
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>
- monthly averages					
1 EUR	32.31	30.65	28.98	27.78	28.06
1 USD	26.32	22.87	24.44	21.02	21.19
100 SKK	78.57	78.81	76.51	79.44	82.99
	<b>31 Dec.</b>	<b>31 Dec.</b>	<b>30 Dec.</b>	<b>29 Dec.</b>	<b>30 Mar.</b>
- last day of the month					
1 EUR	32.41	30.47	29.01	27.50	28.00
1 USD	25.65	22.37	24.59	20.88	21.02
100 SKK	78.71	78.63	76.57	79.86	83.98

<b>B. NOMINAL EFFECTIVE RATE</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
					<b>3</b>
CZK nominal effective exchange rate (percentages)					
(2005=100)					
weights - foreign trade turnover	94.0	94.3	100.0	104.6	105.4
weights - foreign trade turnover SITC 5-8	93.8	94.2	100.0	105.0	105.7

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2005, 23 countries which account for around 90% of the Czech Republic's foreign trade were selected. The weights were processed in two alternatives:

Alternative I, used by the IMF, applies to the Czech Republic's entire foreign trade turnover

Alternative II, used by the European Central Bank, applies to only four commodity groups of the Czech Republic's foreign trade

<b>C. REAL EFFECTIVE RATE</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
					<b>2</b>
CZK real effective exchange rate (percentages)					
(2005=100)					
a) industrial producer prices					
weights - foreign trade turnover	93.1	95.8	100.0	102.0	102.0
weights - foreign trade turnover SITC 5-8	92.6	95.5	100.0	102.3	102.5
b) consumer prices					
weights - foreign trade turnover	95.4	95.3	100.0	104.3	103.8
weights - foreign trade turnover SITC 5-8	94.7	94.9	100.0	104.7	104.4

Source: CZSO - consumer prices and industrial producer prices of the Czech Republic  
Monthly IMF publication - International Financial Statistics - and the CNB's own calculations

Table 16

PUBLIC FINANCES						in CZK billions
	2003	2004	2005	2006	2007	
	1 - 12	1 - 12	1 - 12	1 - 12	1 - 3	
<b>STATE BUDGET</b>						
<b>Total revenue</b>	699.7	769.2	866.5	923.1	242.0	
Tax revenue	667.5	716.7	770.4	801.6	208.7	
Taxes on income, profits and capital gains	172.9	180.7	195.0	187.1	48.2	
Domestic taxes on goods and services	198.4	223.2	250.4	266.1	69.1	
- value-added taxes	125.6	140.4	146.8	153.5	39.2	
- excises	72.9	82.8	103.6	112.6	29.9	
Taxes on property	8.8	10.4	8.1	8.5	2.4	
Social and health security contributions and payroll taxes	272.4	293.3	311.2	333.7	86.7	
Non-tax and capital incomes and received subsidies	32.2	52.5	96.1	121.5	33.3	
<b>Total expenditure</b>	808.7	862.9	922.8	1020.6	230.7	
Current expenditure	745.4	796.8	840.8	912.1	220.6	
Capital expenditure	63.3	66.1	82.0	108.5	10.1	
Public budgets (balance in IMF GFS methodology)	-127.7	-89.4	0.6	-148.9	—	
state budget	-104.9	-65.0	-61.1	-107.0	11.3	
local budget	-2.9	-8.9	7.8	-3.9	—	
state financial assets	—	—	—	—	—	
state funds	6.9	-11.7	-0.5	-6.6	—	
Land Fund	-0.1	0.2	1.6	0.2	—	
National Property Fund	-27.4	-4.2	51.5	-29.9	—	
health insurance companies	0.1	0.2	0.5	0.6	—	
others	0.6	0.0	0.8	-2.3	—	

Table 17

<b>CAPITAL MARKET</b>						last day of the month in points
<b>A. STOCK MARKET INDICES</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>	
<b>BCPP</b>						
PX	659.1	1,032.0	1,473.0	1,588.9	1,712.2	
PX-GLOB	816.9	1,232.7	1,811.3	1,987.4	2,127.4	
<b>RM-SYSTÉM</b>						
PK-30	947.5	1,443.5	2,365.0	2,595.3	2,689.1	

On 20 March 2006, the Prague Stock Exchange's PX 50 and PX-D indices were replaced by a single index called the PX. Calculation of both the original indices was terminated on Friday, 17 March 2006. The new main PX index carries on from the PX 50 and takes over its history.

						in CZK millions
<b>B. TRADE VOLUMES</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>	
<b>BCPP</b>						
Monthly trade volumes	98,640.0	90,610.5	96,160.5	112,400.0	140,639.1	
of which:						
a) shares	28,296.0	46,210.3	56,180.3	58,915.7	101,232.5	
b) bonds	70,344.0	44,400.2	39,980.2	53,484.3	39,406.6	
<b>RM-SYSTÉM</b>						
Monthly trade volumes	1,103.0	335.8	286.7	523.0	750.2	
of which:						
a) shares	1,082.5	332.7	220.9	440.2	748.3	
b) units	3.7	3.1	0.0	1.1	1.9	
c) bonds	16.8	0.0	65.8	81.7	0.0	

Table 18

CNB MONETARY POLICY INSTRUMENTS						
	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)		
				Banks	Building societies and ČMZRB	
<b>1999</b>						
18 January	8.75	—	—	—	—	—
28 January	—	—	—	5.0	—	—
29 January	8.00	—	—	—	—	—
12 March	7.50	6.0	10.0	—	—	—
9 April	7.20	—	—	—	—	—
4 May	6.90	—	—	—	—	—
25 June	6.50	—	—	—	—	—
30 July	6.25	—	—	—	—	—
3 September	6.00	5.5	8.0	—	—	—
5 October	5.75	—	—	—	—	—
7 October	—	—	—	2.0	—	2.0
27 October	5.50	5.0	7.5	—	—	—
26 November	5.25	—	—	—	—	—
<b>2000</b>	No changes made					
<b>2001</b>						
23 February	5.00	4.0	6.0	—	—	—
27 July	5.25	4.25	6.25	—	—	—
30 November	4.75	3.75	5.75	—	—	—
<b>2002</b>						
22 January	4.50	3.50	5.50	—	—	—
1 February	4.25	3.25	5.25	—	—	—
26 April	3.75	2.75	4.75	—	—	—
26 July	3.00	2.00	4.00	—	—	—
1 November	2.75	1.75	3.75	—	—	—
<b>2003</b>						
31 January	2.50	1.50	3.50	—	—	—
26 June	2.25	1.25	3.25	—	—	—
1 August	2.00	1.00	3.00	—	—	—
<b>2004</b>						
25 June	2.25	1.25	3.25	—	—	—
27 August	2.50	1.50	3.50	—	—	—
<b>2005</b>						
28 January	2.25	1.25	3.25	—	—	—
1 April	2.00	1.00	3.00	—	—	—
29 April	1.75	0.75	2.75	—	—	—
31 October	2.00	1.00	3.00	—	—	—
<b>2006</b>						
28 July	2.25	1.25	3.25	—	—	—
29 September	2.50	1.50	3.50	—	—	—

Table 19

<b>MACROECONOMIC AGGREGATES</b>		in CZK millions; annual percentage changes; constant 2000 prices				
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	
	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	
<b>Gross domestic product</b>						
- in CZK millions	2,285,488	2,367,818	2,467,615	2,617,608	2,776,379	
- percentages	1.9	3.6	4.2	6.1	6.1	
<b>Final consumption</b>						
- in CZK millions	1,709,342	1,817,625	1,832,424	1,873,847	1,934,630	
- percentages	3.5	6.3	0.8	2.3	3.2	
of which:						
Households						
- in CZK millions	1,187,163	1,258,158	1,290,086	1,326,376	1,386,828	
- percentages	2.2	6.0	2.5	2.8	4.6	
Government						
- in CZK millions	509,591	545,999	528,767	534,005	535,717	
- percentages	6.7	7.1	-3.2	1.0	0.3	
Non-profit institutions						
- in CZK millions	12,586	13,362	14,576	15,104	15,809	
- percentages	-0.9	6.2	9.1	3.6	4.7	
<b>Gross capital formation</b>						
- in CZK millions	720,002	709,600	768,013	780,361	875,866	
- percentages	4.6	-1.4	8.2	1.6	12.2	
of which:						
Fixed capital						
- in CZK millions	686,128	689,117	721,822	731,246	784,926	
- percentages	5.1	0.4	4.7	1.3	7.3	
Changes in inventories						
- in CZK millions	30,435	15,642	43,266	46,734	88,304	
Acquisitions less disposals of valuables						
- in CZK millions	3,439	4,841	2,925	2,381	2,636	
- percentages	33.0	40.8	-39.6	-18.6	10.7	
<b>Foreign trade</b>						
of which:						
Exports of goods						
- in CZK millions	1,354,163	1,479,795	1,820,657	2,031,968	2,361,982	
- percentages	5.9	9.3	23.0	11.6	16.2	
Exports of services						
- in CZK millions	222,147	212,807	231,549	236,721	242,785	
- percentages	-15.7	-4.2	8.8	2.2	2.6	
Imports of goods						
- in CZK millions	1,489,963	1,623,393	1,943,966	2,054,029	2,370,249	
- percentages	4.6	9.0	19.7	5.7	15.4	
Imports of services						
- in CZK millions	231,687	235,915	253,370	248,900	261,830	
- percentages	7.7	1.8	7.4	-1.8	5.2	
<b>Final domestic demand</b>						
- in CZK millions	2,395,470	2,506,742	2,554,246	2,605,093	2,719,556	
- percentages	3.9	4.6	1.9	2.0	4.4	
<b>Aggregate domestic demand</b>						
- in CZK millions	2,429,344	2,527,225	2,600,437	2,654,208	2,810,496	
- percentages	3.8	4.0	2.9	2.1	5.9	
<b>Gross domestic product at current prices</b>						
- in CZK millions	2,464,432	2,577,110	2,781,060	2,970,261	3,204,086	
- percentages	4.8	4.6	7.9	6.8	7.9	

Source: CZSO

Table 20

<b>LABOUR MARKET</b>						annual percentage changes
<b>A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	
	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>
Current income	6.4	5.9	4.9	4.6	6.2	
of which:						
- gross operating surplus and mixed income	2.4	7.7	5.7	0.1	2.5	
- compensation of employees	8.5	5.5	5.7	6.3	6.7	
- property income	-0.9	5.3	-1.0	4.0	12.3	
- social benefits other than social transfers in kind	8.0	3.6	3.4	5.1	6.7	
- other current transfers	4.1	10.9	2.2	3.9	8.4	
Current expenditure	8.4	9.5	7.5	4.6	7.0	
of which:						
- property income	15.1	21.3	12.4	4.0	28.1	
- current taxes on income, wealth, etc.	8.2	12.1	7.7	1.9	-0.3	
- social contributions	8.9	7.2	8.3	6.5	7.4	
- other current transfers	4.7	12.5	2.8	-0.1	10.8	
Gross disposable income	5.6	4.3	3.6	4.7	5.8	
Change in net equity of households in pension funds reserves	22.6	15.4	29.1	11.1	19.6	
Individual consumption expenditure	3.5	6.5	5.6	4.5	7.0	
Gross saving	31.8	-15.5	-17.8	7.7	-10.2	
Gross saving rate	9.90	8.03	5.89	6.06	5.14	
(gross saving/gross disposable income - ratio in per cent)						

<b>B. AVERAGE WAGES</b>						annual percentage changes
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	
	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>	<b>Q1 - 4</b>
Whole-economy nominal wage	7.0	6.4	6.2	5.3	6.4	
Business sector	6.3	5.5	6.3	5.3	6.7	
Non-business sector	9.8	9.8	5.7	5.7	5.4	
Whole-economy real wage	5.1	6.3	3.3	3.3	3.8	
Business sector	4.4	5.4	3.4	3.3	4.1	
Non-business sector	7.9	9.7	2.8	3.7	2.8	

Note: including data for the Ministry of Defence and the Ministry of the Interior and an estimate for intelligence services not included in the survey.

<b>C. UNEMPLOYMENT</b>						end of period
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>3</b>	
Registered job applicants (thousands)	542.4	541.7	510.4	448.5	430.5	
Unemployment rate (percentages) <sup>1)</sup>	—	9.5	8.9	7.7	7.3	

1) Unemployment rate calculated according to the new methodology from 1 July 2004

Source: CZSO

Table 21

PRODUCER PRICES	percentage changes				
	2003	2004	2005	2006	2007 3
<b>Industrial producer prices</b>					
a) previous period = 100	0.1	0.6	0.0	0.2	0.5
b) same period of previous year = 100	-0.3	5.7	3.0	1.6	3.6
c) average for 2005 = 100	-8.2	-3.0	0.0	1.5	4.2
<b>Construction work prices</b>					
a) previous period = 100	0.2	0.4	0.2	0.3	0.6
b) same period of previous year = 100	2.2	3.7	3.0	2.9	3.7
c) average for 2005 = 100	-6.1	-2.6	0.2	3.1	5.7
<b>Agricultural producer prices</b>					
a) previous period = 100	0.6	0.2	-0.4	0.7	0.2
b) same period of previous year = 100	-2.9	8.1	-9.2	1.1	15.0
c) average for 2005 = 100	2.1	10.4	0.0	1.1	11.8
<b>Market services prices</b>					
a) previous period = 100	0.0	0.2	0.1	0.3	1.1
b) same period of previous year = 100	1.6	2.3	1.9	3.3	1.8
c) average of 2005 = 100	-1.9	0.4	0.0	3.3	5.1

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP	percentage ratios				
	2002	2003	2004	2005	2006
Public budgets balance	-0.5	-5.0	-3.2	0.0	-4.6
Public debt	18.0	21.5	23.7	25.7	27.4
Debt in convertible currencies	33.0	34.7	36.4	38.5	38.0
Trade balance <sup>1)</sup>	-2.9	-2.7	-1.0	1.3	1.4
Current account balance	-5.5	-6.2	-6.0	-2.6	-4.2
M2	67.0	68.5	66.3	67.1	68.3

Note: ratio = indicator/GDP at current prices

1) Source: CZSO



**Issued by:**  
CZECH NATIONAL BANK  
Na Příkopě 28  
115 03 Prague 1  
CZECH REPUBLIC

**Contact:**  
COMMUNICATIONS DEPARTMENT  
Tel.: +420 22441 3494  
Fax: +420 22441 2179

<http://www.cnb.cz>

**Produced by:** Studio Press  
**Design:** Jerome s.r.o.