



ANNUAL REPORT

2007

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I started the foreword of the previous CNB Annual Report by commenting on the integration of financial market supervision into the central bank in 2006. It was already clear back then that if we were to derive the maximum benefit for the domestic financial market and safeguard its development and stability, while reducing regulatory costs, the integration could not be just a one-off step in the institutional regulatory and supervisory set-up.

An intense debate therefore went on at the CNB last year as regards the optimal organisational structure for financial market supervision. As a result, the Bank Board took several decisions to change the existing sectoral set-up, which divided the supervision of credit institutions, the capital market and the insurance industry into a "functional model" as of 1 January 2008. Under this model, three new departments were established for the financial market as a whole, covering regulation and analysis, administrative proceedings, and off-site and on-site supervision. This organisational change is a necessary step towards harmonising the regulatory rules (in partnership with the Ministry of Finance, which is responsible for primary financial market legislation) and integrating supervisory practice across the financial market.

A document entitled *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market*, published at the end of last year, should help us to meet these challenges and increase the transparency and predictability of the regulator's actions, thereby furthering the development of the domestic financial market. This document, which originated at the initiative of the Financial Market Committee, formulates the basic goals, principles and rules that the CNB intends to implement in its regulatory and supervisory work. In this regard, I would like to express many thanks to the members of the CNB's Financial Market Committee and Appeals Committee. Both these advisory bodies provide the Bank Board with a valuable external perspective for its decision-making in the financial market supervision area.

From the macroeconomic point of view, I can only describe the past year as a success. The Czech economy built on the previous years' favourable trends, recording GDP growth of more than 6%. The related sizeable growth in employment and wages should not be overlooked either. Indeed, household consumption was the biggest contributor to the growth of the Czech economy in 2007.

The economic growth is undoubtedly very positive, although it could pose a risk from the perspective of the CNB's primary objective of maintaining price stability. This risk arises at a time of mounting expectations that demand growth might start pushing up prices. In such a situation, the Czech National Bank is left with no alternative other than to gradually tighten monetary policy by means of interest rates in order to dampen the rising domestic demand in an appropriate way. For this reason, interest rates were raised several times last year.

Furthermore, the situation was complicated by three additional factors. First, we saw a global increase in food prices, although this is very probably transitory. Second, government measures to stabilise public budgets had an impact – albeit a non-recurring one – on the price level. And third, there is still uncertainty about what overall impacts the US subprime mortgage crisis will have on the Czech Republic's main business partners. The first two factors may gradually lead to a rise in inflation expectations, and hence to a need to further tighten monetary policy, whereas a potential slowdown in the growth of our major trading partners' economies would have exactly the opposite effect. However, the prevailing view is that this indirect factor will have limited impacts on the Czech economy.

It is important to emphasise that despite the current heightened uncertainties, the CNB will do its utmost to ensure that low inflation remains a lasting feature of the Czech economy. In this respect, it is certainly worth mentioning that the Bank Board agreed in March last year to change the CNB's inflation target, as expressed by year-on-year growth in the consumer price index, from 3% to 2% with effect from January 2010. It also agreed to disclose the nominal voting of its members during monetary decision-making and the interest rate path consistent with the macroeconomic forecast. These two changes took effect in January this year.

Another major event in the monetary area was the approval of the *Updated Euro-area Accession Strategy*, a joint document of the Czech Government and the Czech National Bank. In its conclusion, the updated strategy states that the main obstacle to the fulfilment of the Maastricht criteria remains the unconsolidated state of public finances. This, coupled with the low flexibility of the economy, and especially the labour market, presents a risk to the operation of the Czech economy in the euro area. It therefore states that the euro adoption date will depend on how these problem areas are resolved.

The domestic financial sector is showing excellent resilience to the problems that have hit a number of financial institutions on global financial markets in the wake of the US subprime crisis. The direct impacts of this crisis on the Czech market have been negligible. This can be attributed to the minimum engagement of domestic financial institutions in structured investment instruments derived from risky mortgages and to the high liquidity of the domestic banking sector, which reduces banks' reliance on interbank loans. However, given the dominant ownership position of foreign capital in Czech institutions, we need to continue carefully monitoring the financial sector during the current global market unrest.

The positive tendencies in the Czech economy furthered the development of the domestic financial market. All the major sectors of the market experienced asset growth. The banking sector recorded a rise in assets of almost 20%, while maintaining its solvency ratio unchanged and achieving a 25% increase in profit on the previous year. Asset growth in the insurance sector mirrored the growth of the economy, while domestic mutual funds for the public showed a 10% increase. In the context of the planned pension reform, regulatory and analytical attention is also being focused on the increasingly important sector of pension funds, which need to be prepared for the segregation of policyholders' and shareholders' assets. Regulations have to be laid down for this sector to create a firm third pillar for the pensions of an ageing population.



Zdeněk Tůma
Governor

The CNB is the central bank of the Czech Republic and the supervisor of the Czech financial market. It is established under the Constitution of the Czech Republic and carries out its activities in compliance with Act No. 6/1993 Coll., on the Czech National Bank and other regulations. It is an entity governed by public law having its registered address in Prague. It is vested with the powers of an administrative authority to the extent stipulated by law. It manages the assets entrusted to it by the state independently and with due diligence. Interventions in its activities are only permissible on the basis of a law. Under Article 98 of the Constitution of the Czech Republic and Act No. 6/1993 Coll., on the Czech National Bank¹, the primary objective of the CNB is to maintain price stability. Achieving and maintaining price stability, i.e. creating a low-inflation environment in the economy, is the central bank's ongoing contribution to the creation of conditions for sustainable economic growth. Central bank independence is a prerequisite for having effective monetary instruments conducive to price stability. Ever since it came into being in January 1993, the CNB has had a high degree of independence from political structures in performing its statutory functions.

Without prejudice to its primary objective, the CNB also supports the general economic policies of the Government. In accordance with its primary objective, the CNB sets monetary policy, issues banknotes and coins and manages the circulation of currency, the payment system and settlements between banks. It also performs supervision of the banking sector, the capital market, the insurance industry, pension funds, credit unions and electronic money institutions, as well as foreign exchange supervision. As a central bank the CNB provides banking services to the state and the public sector. It maintains the accounts of organisations connected to the state budget, including revenue and customs authorities, the Czech Social Security Administration, labour offices, subsidised organisations, state funds and accounts connected to the budget of the European Communities. Under authorisation from the Ministry of Finance, the CNB conducts transactions relating to government securities.

The CNB as the integrated financial market regulatory and supervisory authority works to ensure the stability of the financial system and the safe and smooth development of the financial market in the Czech Republic. A stable financial system and a dynamically developing financial market, based, among other things, on sound and prospering financial institutions, contribute significantly to the long-term growth of the economy and are in the interests of businesses and the public alike. The principles of supervision are defined in a document entitled *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market* published on the CNB website. The document *Challenges for the Czech National Bank in 2005–2010* (motto: professionalism, transparency and efficiency), states that the CNB's mission is to continue fostering smooth development of the economy and thereby of society as a whole.



¹ Act No. 6/1993 Coll., on the Czech National Bank, as amended by Act No. 60/1993 Coll., Act No. 15/1998 Coll., and Act No. 442/2000 Coll., Ruling of the Constitutional Court No. 278/2001 Coll., Act No. 482/2001 Coll., Act No. 127/2002 Coll., Act No. 257/2004 Coll., Act No. 377/2005 Coll., Act No. 57/2006 Coll. and Act No. 62/2006 Coll., Act No. 230/2006 Coll., Act No. 160/2007 Coll. and Act No. 36/2008 Coll.

The CNB's high degree of independence goes hand in hand with a high degree of transparency. The public is kept informed about the CNB's primary monetary policy objective and about the nature of the inflation targeting regime through which this objective is fulfilled. The CNB also keeps the public informed about its inflation target, about its inflation forecasts and the risks attached to those forecasts, and about its monetary policy measures and the reasons for implementing them. To this end, the CNB issues quarterly Inflation Reports and also makes use of articles in the press and in professional journals, lectures, speeches by Bank Board members and so on.

The CNB issues a number of periodical publications (in both Czech and English): quarterly Inflation Reports, an Annual Report, an annual Financial Stability Report, and as from 2007, following the integration of the supervisory authorities into the CNB, also an annual Financial Market Supervision Report. A series of Working Papers is published in English. All CNB publications are available in electronic form on the CNB website. It is the central bank's main information channel and contains detailed information on the various areas of activity of the central bank. The CNB's website was redesigned in November 2007. The aim of the redesign was to create a clearer structure for this very extensive website and to liven up the site's rather conservative look.

As with commercial banks, the CNB's accounts are inspected by external auditors. The Supreme Audit Office is entitled to carry out inspections in the CNB in the area of expenditure on asset acquisition and the bank's operations. The Czech National Bank submits an annual financial report, including an external auditor's report, to the Chamber of Deputies for discussion.

In addition, financial data can be found in the CNB's Annual Report, which also contains basic information on organisation, monetary developments, financial market supervision and the bank's activities in other areas.



MANAGEMENT AND ORGANISATION



The CNB's organisational structure consists of a headquarters in Prague and seven branches in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava. The CNB has a two-tier management system. The Bank Board makes fundamental decisions relating to monetary policy, the development of core activities and the institutional development of the bank. Responsibility for implementing the Bank Board's decisions and the day-to-day running of the bank is delegated to the executive directors of departments and branches.

THE BANK BOARD

The Bank Board is the supreme governing body of the CNB and takes decisions as a collective body by a simple majority of the votes cast. It has seven members: the Governor, two Vice-Governors and four other Bank Board members. On the basis of a Bank Board decision, the Bank Board members oversee the CNB's core activities as performed by its departments and branches.

The Bank Board sets monetary policy and the instruments for implementing this policy, decides on the monetary policy measures and transactions of the CNB, approves key measures relating to financial market supervision and rules on appeals in administrative proceedings. It sets the CNB's overall development strategy and decides on the bank's organisational structure and the responsibilities of the organisational units at its headquarters and branches. The Bank Board also approves the CNB's budget and budgetary rules, defines the types, amounts and uses of the CNB's funds and approves the CNB's Annual Financial Report. It also approves Inflation Reports, Financial Stability Reports and Financial Market Supervision Reports.

SENIOR MANAGEMENT

The executive directors of the CNB's departments and branches are responsible – subject to the CNB's overall strategy – for effective performance of the tasks falling within their areas of competence and powers as set out in the Organisational Statute. Their competencies and responsibilities include in particular methodological and direct management activities, including presenting proposals for solutions to issues of fundamental significance at Bank Board meetings. They carry out the decisions adopted by the Bank Board and set targets for the staff under them. The executive directors also perform the employer's rights and duties under labour law in respect of employees. They are responsible for cooperation with other organisational units of the bank and with domestic and foreign partner institutions.

HEADQUARTERS

The fundamental units of methodological management are departments, and their areas of competence are set out in the Organisational Statute. The bank's main activities, including branch management, and ancillary and service activities are concentrated at headquarters. Activities are coordinated across individual areas by standing advisory bodies, committees and project teams. In the area of internal management and organisation, the CNB maintains a transparent and relatively flat organisational structure, applies an internal control system and internal control mechanisms (e.g. to keep the CNB's activities compliant with legal rules, internal rules and general ethical principles) and provides for efficient management of activities and processes.

In 2007, the Bank Board decided to switch to a new functional model of financial market supervision. With effect from 1 January 2008, the original Banking Regulation and Supervision Department, Capital Market Regulation Department and Insurance Companies Regulation and Supervision Department were replaced by a Financial Market Regulation and Analyses Department, a Licensing and Enforcement Department and a Financial Market Supervision Department. The responsibilities of the Monetary and Statistics Department for preparing reporting methodology and

for submitting motions for the opening of administrative enforcement proceedings in the field of the notification duty were redefined in connection with the new model of supervision. The integration of supervision also entailed transferring the methodological management of foreign exchange inspections (administrative proceedings, preparation of relevant regulations) from the Risk Management and Transactions Support Department to the new supervisory departments. The methodological support previously provided by CNB branches in the supervision of non-bank foreign exchange entities was transferred to the remit of the supervisory departments as a result of the application of the functional model of supervision.

Some sections of the Monetary and Statistics Department were renamed. The Economic Research Department was renamed the Economic Research and Financial Stability Department. The activities and responsibilities of some units were updated and revised, for example in the case of the Communications Department to deal with appeals under the Freedom of Information Act. The role of the Communications Department and other organisational units in publishing the CNB Gazette and CNB Bulletin was also revised. The Administration Department assumed responsibility for developing and running technical and security systems and the integrated premises management system, and the headquarters and branch systems were integrated. The Cash and Payment Systems Department's responsibilities regarding proceedings on administrative offences in the reproduction of money symbols and on administrative offences against money in circulation were revised, as were its responsibilities for preparing source documents for the Appeals Committee.

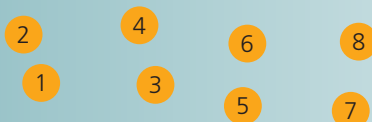
A new CNB Code of Ethics, based on the original one, took effect in October 2007. This Code forms part of the CNB's internal regulations, and the Ethics Committee established on its basis is acknowledged by the Organisational Statute as a special advisory and decision-making body in area of competence delegated to it.

BRANCHES

The CNB's branches represent the bank in the regions and are its contact points for relations with bank representatives, central and local authorities, financial authorities, the Czech Statistical Office, selected clients and other legal and natural persons. The CNB's branches are responsible mainly for managing money reserves and maintaining accounts of the state budget and other CNB clients falling within their fields of competence. They make cash and non-cash payments, conduct the accounting of the branch, issue tax documents and operate safe deposit boxes. To a specified extent the branches also conduct administrative proceedings, perform foreign exchange supervision, inspections of anti-money laundering measures and crisis management work falling within their fields of competence, and collect and process data on exchange office operations and regional data for business surveys. They receive and record inquiries, suggestions, notifications and announcements from the public and deal with them within their defined areas of competence. The CNB's branches located outside Prague are responsible for labour-law and social administration, for economic administrative activities and for the security and surveillance of the branch. The branch in Ústí nad Labem is responsible for central processing of statements and statistical data provided by non-bank institutions in compliance with their reporting duties. The České Budějovice branch organises special courses on the identification of suspected counterfeit or altered banknotes and coins and awards certificates to course participants. Part of the area of responsibility for insurance intermediaries was transferred from the original Insurance Companies Regulation and Supervision Department to the Plzeň branch with effect from 1 January 2008. In the foreign exchange supervision area, the responsibilities of the branches were extended to include the conduct of supervision of agreements on the remote provision of financial services. On 1 January 2008, the methodological management of this area was transferred to the Financial Market Supervision Department. The changes in the methodological management of branches were accompanied by revisions to their administrative departments' defined activities.

**The Bank Board**

1. Miroslav Singer, 2. Vladimír Tomšík, 3. Mojmír Hampl, 4. Robert Holman,
5. Zdeněk Tůma, 6. Pavel Řežábek, 7. Luděk Niedermayer

**Executive Directors of Departments**

1. Vilém Čermák, 2. Tomáš Hládek, 3. Jana Báčová, 4. Marian Mayer,
5. Pavlína Bolfová, 6. Zdeněk Virius, 7. Jan Schmidt, 8. Karel Bauer

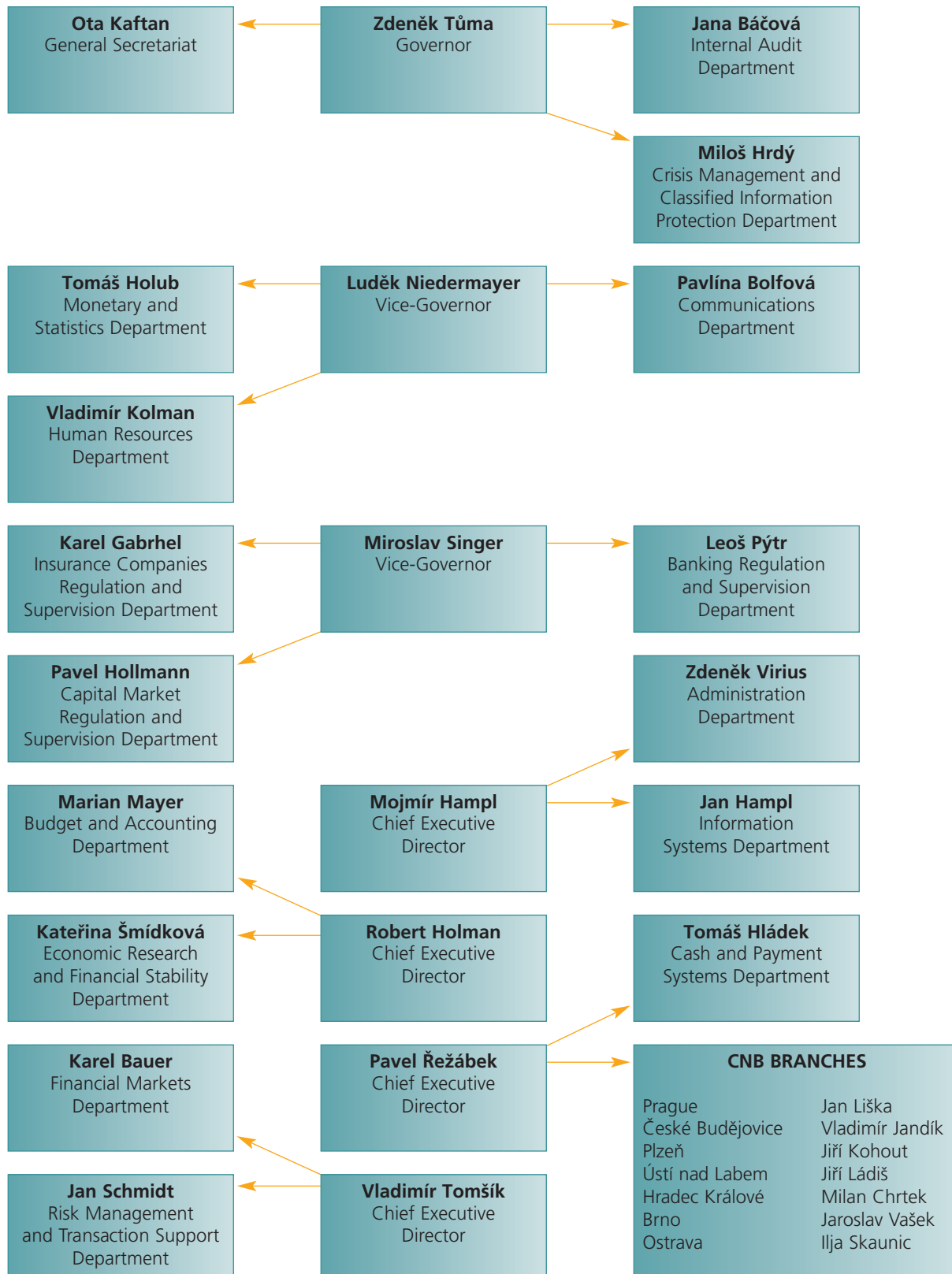
**Executive Directors of Departments**

1. Pavel Hollmann, 2. Leoš Pýtr, 3. Jan Hampl, 4. Vladimír Kolman,
5. Kateřina Šmídková, 6. Ota Kaftan, 7. Tomáš Holub, 8. Karel Gabrhel

**Executive Directors of Branches**

1. Milan Chrtěk (Hradec Králové branch),
2. Jiří Ládiš (Ústí nad Labem branch), 3. Jan Liška (Prague branch),
4. Vladimír Jandík (České Budějovice branch),
5. Jaroslav Vašek (Brno branch), 6. Jiří Kohout (Plzeň branch),
7. Ilja Skaunic (Ostrava branch)

ORGANISATIONAL CHART



THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

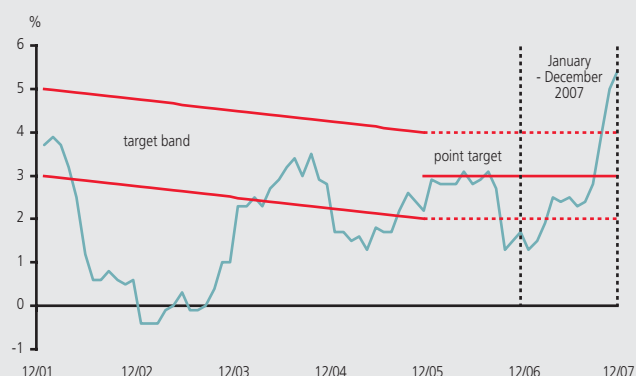


MONETARY POLICY AND ECONOMIC DEVELOPMENTS

The CNB's primary monetary policy objective is to maintain price stability. This is achieved within an inflation targeting regime in which the CNB tries to keep inflation close to a declared target. Since the start of 2006, the CNB's headline inflation target has been set at 3% with a tolerance band of ± 1 percentage point.

In the course of 2007, inflation gradually increased and thus converged towards the inflation target. In the final quarter, annual consumer price inflation picked up pace as a result of rising food prices and regulated prices and thus rose above the upper boundary of the tolerance band of the inflation target.

Fulfilment of the inflation target



Inflation in the Czech Republic and the EU



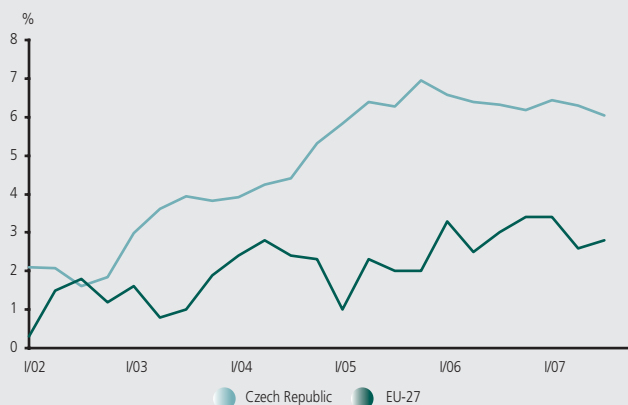
In the first four months of 2007, inflation as measured by the harmonised index of consumer prices (HICP) was below the inflation level in the EU countries, but in the remaining months (and particularly in the final quarter) it was considerably higher.

The rise in inflation in late 2007 can be viewed as a temporary swing caused by several one-off factors. Once these factors have subsided, inflation will fall back to low levels at the end of 2008 and the start of 2009, in line with the CNB's targets.

In 2007, consumer prices were affected in particular by food prices and regulated prices. Consumer price inflation continued to be affected by changes to indirect taxes and to a lesser extent also by adjusted inflation excluding fuels.

At roughly 6%, economic growth remained high in 2007. As in the previous five years, the Czech economy grew at a much faster pace than the EU economy as a whole. As in 2006, the growth was due mostly to gross fixed capital formation and household consumption. Net exports also contributed modestly. Overall, the real economy had an inflationary effect, as the GDP level exceeded its potential, while real wages dampened these inflationary pressures only slightly.

Gross domestic product growth in the Czech Republic and the EU



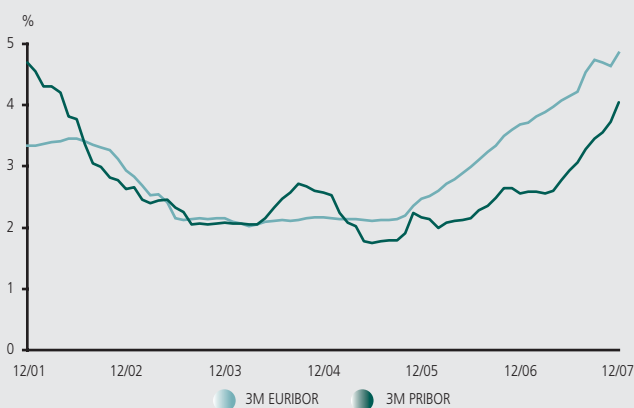
The unemployment rate in the Czech Republic and the EU



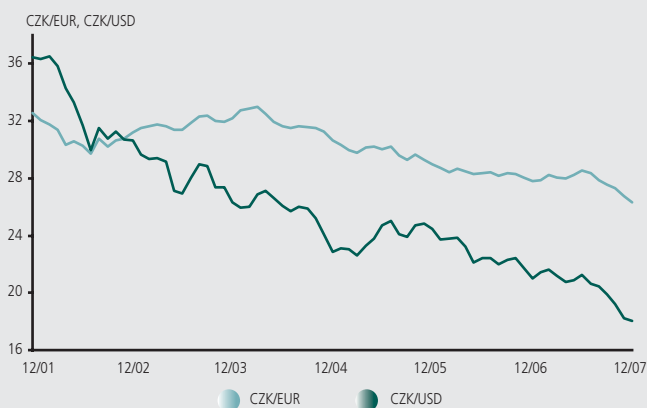
The continuing buoyant growth of the Czech economy was accompanied by growing labour demand, fostering conditions for rising employment. Some branches experienced shortages of workers in the required occupations. These shortages were only partially covered by inflows of foreign workers. The rising employment coupled with high job creation led to a sizeable decrease in unemployment (of more than 1.5 percentage points year on year). As in previous years, the unemployment rate was below the EU average and this difference widened further. Nominal and real wage growth was faster than in the previous year.

In 2007, as in the two previous years, domestic short-term interest rates (illustrated in the chart by 3-month interbank money market rates) remained lower than the corresponding euro area interest rates. This difference widened until April, but in the following months it gradually narrowed and in the final two months it fell below the December 2006 level.

Money market interest rates



Nominal exchange rate of the koruna against the euro and dollar



The nominal exchange rate of the koruna against the euro depreciated slightly in the first half of the year, but appreciated again in the remainder of the year, and particularly in the final two months. The koruna appreciated even more against the dollar. In addition to interest rates, the exchange rate of the koruna was affected by the global financial market turmoil in the second half of the year. The stronger

koruna-euro rate reduced the prices of imported commodities, thereby dampening the inflationary pressures. As in previous years, the CNB made no interventions in the foreign exchange market.

The January 2007 forecast revised the inflation outlook downwards slightly, mainly because of lower-than-expected inflation in the final quarter of 2006, expected lower growth in indirect taxes, appreciation of the koruna and a reduction in the estimated inflationary pressures from the real economy. By contrast, the remaining three forecasts of last year indicated an upswing in inflation in the following year, reflecting in particular an expected one-off increase in the price level as a result of tax changes and continuing rapid growth in regulated prices. Over time, the individual forecasts gradually shifted the expected inflation level up as far as the upper boundary of the tolerance band of the inflation target. According to the forecasts, after these effects unwind, inflation should gradually come down towards the inflation target in 2009. A shift in the inflation effects of the real economy from inflationary to slightly anti-inflationary should also foster declining inflation.

To keep monetary policy-relevant inflation (i.e. inflation to which monetary policy reacts) close to the point inflation target, it was therefore necessary – according to the January forecast – to keep interest rates unchanged initially and to gradually raise them later on. The ensuing forecasts spoke only about rising interest rates. In line with the forecasts and the balance of the risks identified by the Bank Board, monetary policy interest rates were raised in 2007 in four steps (at the May, July, August and November board meetings) by one percentage point overall.

More detailed information on economic developments and monetary policy management can be found in the quarterly Inflation Reports available on the CNB website (*Monetary policy – Inflation reports*).

In March, the CNB published a document entitled *The CNB's New Inflation Target and Changes in Monetary Policy Communication*. This dealt with the lowering of the inflation target from 3% to 2% as from January 2010 (a tolerance band of ± 1 percentage point was maintained) and increases in monetary policy transparency. 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 also change the frequency of the Bank Board's regular monetary policy meetings from monthly to eight a year. These changes are aimed in particular at bringing the inflation target into line with the usual practice in advanced countries and at further enhancing the transparency, clarity and predictability of monetary policy.

The Czech Republic's Updated Euro-Area Accession Strategy, a joint document of the CNB and the Czech Government, was published in August. This document responded to the postponement of the euro adoption date beyond the originally envisaged horizon of 2010. The document identified the unconsolidated state of public finances as the main obstacle to the fulfilment of the Maastricht criteria. This, coupled with the low flexibility of the economy, and especially the labour market, presents a risk to the operation of the Czech economy in the euro area and prevents it from reaping the benefits associated with adopting the euro. The document concludes that for these reasons it is not yet possible to set a new target date for euro adoption. In autumn 2007, the annual *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area* was drawn up jointly by the CNB and the Ministry of Finance and subsequently approved by the Government (both these documents are available on the CNB website: *Monetary policy – MP strategic documents*). This document resulted in a recommendation not to set a target date for adopting the euro yet and thus not to attempt to enter the ERM II during 2008.

FINANCIAL MARKET SUPERVISION

The CNB as the integrated supervisory authority

Since 2006, the Czech National Bank has been the integrated supervisor of the Czech financial market. In 2007, the CNB Bank Board decided that the existing management model, based on regulation and supervision of the individual segments of the financial services sector, would be replaced on 1 January 2008 by a model drawn up by the current supervisory departments. The new model will be organised according to the core supervisory activities, i.e. regulation, analysis, licensing, issuing consents, imposing penalties and the exercise of supervision itself, which involves on-site examinations and off-site surveillance. The new model should speed up the process of creating a single supervisory concept for all segments of the financial services sector, increase the effectiveness of supervision and regulation and support the implementation of the other values specified in the strategic document *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market*. The functional supervisory set-up at the CNB represents a further step in the integration of supervision of the Czech financial market, which started de facto on 1 April 2006 when the CNB took over additional supervisory powers from the former Czech Securities Commission, the Ministry of Finance's Office of State Inspection in the Insurance and Pension Scheme Industry and the Office for Supervision of Credit Unions. The CNB publishes more detailed information on the activities of the CNB as the financial market supervisory authority and on the evolution of the individual segments of the financial services sector in its regular *Financial Market Supervision Report*.

The CNB's competences as a supervisory authority

As regards supervision of credit institutions, the CNB supervised banks, branches of foreign banks, credit unions, electronic money institutions and other entities that issue electronic money under special legal rules. As for branches of foreign banks, primary responsibility for supervising these entities still lies, as in all countries of the European Union and the European Economic Area (EEA), with the supervisory authority in their country of origin (the home supervisor). The CNB's competences in respect of such branches are limited by the Act on Banks, and the CNB primarily monitors their liquidity.

In the insurance sector, the CNB supervised insurance and reinsurance companies and branches of insurance and reinsurance companies from third countries. As with credit institutions, primary responsibility for supervising branches of insurance and reinsurance companies from EU and EEA countries lies with their home supervisors.

Capital market participants² subject to CNB capital market supervision include investment firms, foreign investment firms providing investment services in the Czech Republic via branches, entities receiving and transmitting orders relating to investment instruments under the conditions laid down in the Securities Act, depositories, regulated market operators, entities engaged in securities settlement, printing houses authorised to print securities, and the central depository. In addition, they include institutional investors, i.e. banks trading in investment instruments on the capital market on their own account, investment companies, investment funds, pension funds and insurance companies, and also foreign entities authorised to carry on business in the same areas in the Czech Republic, other investors on the capital market, securities issuers, securities obligors, securities owners, and issuers and owners of other investment instruments.

² As in all EU and EEA countries, primary responsibility for supervising branches established by entities from these countries lies with the supervisory authority in their country of origin.

In the capital market area, the CNB performed supervision, made decisions on the rights, legally protected interests and obligations of legal entities and natural persons, checked compliance with the information duties of entities subject to CNB supervision, and carried on other activities to the extent stipulated in special legal rules³ regulating capital market undertakings, collective investment, bonds and company and pension fund rights.

The Czech financial market

The developments in 2007 were affected by the global market situation, which in July began to show the effects of the underestimated credit risk in the US subprime market. The credit spreads on a whole range of debt instruments subsequently widened and the ensuing months saw downgradings of some ratings and a reduction in the real value of structured financial instruments depending on how hard they were hit by the falls in cash-flow with regard to their underlying assets. The Czech National Bank closely monitored the exposures of Czech financial market participants to such risky assets and, based on information provided by the supervised entities, assessed the risk of the above situation impacting directly on the Czech financial market from the start of the crisis as insignificant.

The credit institutions sector, comprising banks, branches of foreign banks and credit unions, plays the key role in the Czech financial market. This sector is dominated by foreign capital, with foreign investors directly or indirectly controlling about 98% of the total assets of banks and foreign bank branches. The share of credit unions in the sector's assets is very low (less than 1%).

As of 31 December 2007, a total of 23 banks and building societies and 14 foreign bank branches were offering banking services to clients in the Czech Republic. In 2007, the total assets of the banking sector rose by CZK 585 billion (18.6%) to CZK 3,737 billion.⁴ This sizeable growth on the asset side was due mainly to a continued expansion in lending. Loan demand was particularly strong in the household sector (up by 35.1% year on year), but the largest exposure in terms of volume is still recorded for non-financial corporations (up by 17.2% year on year).

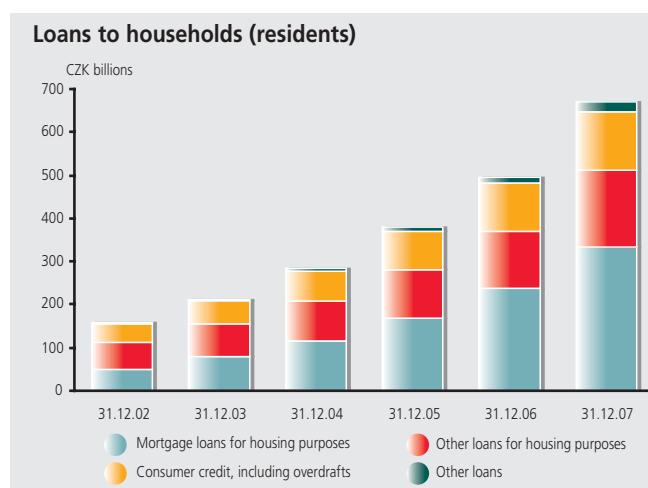
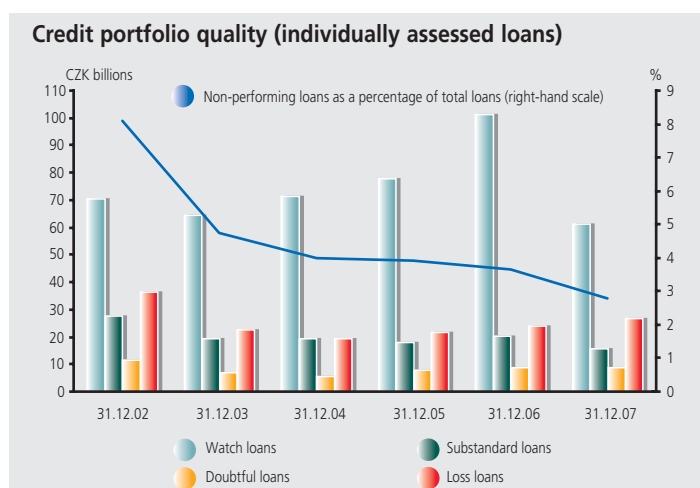
Sectoral breakdown of claims (in CZK millions)

	31 Dec. 2002	31 Dec. 2003	31 Dec. 2004	31 Dec. 2005	31 Dec. 2006	31 Dec. 2007
Residents and non-residents, total	892,371	950,766	1,010,309	1,178,670	1,413,084	1,785,838
Residents	850,468	907,461	969,194	1,118,659	1,338,650	1,669,557
Non-financial corporations	433,883	428,318	459,502	525,350	634,876	744,011
Financial corporations	67,438	83,000	81,126	96,932	99,754	147,120
General government	167,734	158,731	114,877	81,463	67,630	57,482
Households	178,622	235,568	311,837	412,895	530,805	707,848
Households – trades	21,552	24,678	28,530	33,361	35,923	39,059
Households – individuals	157,070	210,891	283,307	379,535	494,882	668,789
Non-profit institutions						
serving households	2,792	1,845	1,852	2,019	5,586	13,096
Non-residents	41,904	43,305	41,115	60,011	74,433	116,281

³ In particular: Act No. 6/1993 Coll., on the Czech National Bank, as amended; Act No. 15/1998 Coll., on Supervision in the Capital Market Area and on the Amendment of Other Acts, as amended; Act No. 256/2004 Coll., on Capital Market Undertakings, as amended; Act No. 189/2004 Coll., on Collective Investment, as amended; Act No. 190/2004 Coll., on Bonds, as amended; Act No. 513/1991 Coll., The Commercial Code, as amended; Act No. 42/1992 Coll., on Private Pension Insurance and the Amendment of Some Acts Related to its Introduction, as amended.

⁴ All figures are based on unaudited results as of 31 December 2007.

The quality of loans provided by banks and foreign bank branches developed positively in 2007. The share of non-performing loans (i.e. substandard, doubtful and loss loans) decreased by 0.9 percentage point year on year to 2.8%. Although the absolute volume of problem loans has started rising again in the last three years, its rate of growth is lower than that of the total loan portfolio. Non-performing loans totalled CZK 51.3 billion at the end of 2007.



Turning to the banking sector's funding sources, the largest growth was recorded for client deposits, which rose by CZK 357 billion (or 17%). Demand deposits grew at a faster pace (21%) than time deposits (13%), accounting for the bulk (53%) of the total volume of client deposits. Regulatory capital increased by CZK 25.6 billion (13%) to CZK 221.3 billion at the end of 2007. Capital adequacy saw only a slight increase to 11.5%.

The banking sector generated a record net profit of CZK 47.1 billion in 2007, representing a year-on-year rise of 24%. Growing credit exposures and rising interest rates fostered a positive trend in banks' interest profit, which rose by CZK 13.3 billion (19%) year on year to CZK 84.9 billion. Profit from fees and commissions grew by more than CZK 2.7 billion (8.4%) to CZK 35.6 billion. Administrative expenses rose by CZK 3.9 billion (7.1%) to CZK 59.6 billion. Impairment charges increased by CZK 1.6 billion to CZK 6.9 billion. Write-offs fell by CZK 0.5 billion to CZK 7.9 billion. The number of employees⁵ in the Czech banking sector increased by 714 last year to 38,708.

Banking sector indicators

	31 Dec. 2002	31 Dec. 2003	31 Dec. 2004	31 Dec. 2005	31 Dec. 2006	31 Dec. 2007
No. of banks and foreign bank branches	37	35	35	36	37	37
Total assets (CZK billions)	2,481.1	2,527.7	2,635.6	2,954.4	3,151.8	3,736.8
Liabilities to clients (CZK billions)	1,608.2	1,665.9	1,731.8	1,919.6	2,102.2	2,459.2
Net profit (CZK billions)	30.4	30.2	32.9	39.1	38.0	47.1
Administrative expenses (CZK billions)	47.0	47.5	48.8	51.8	55.7	59.6
Capital adequacy (%)	14.3	14.5	12.6	11.9	11.4	11.5
Non-performing loans to client loans (%)	8.1	4.8	4.0	3.9	3.7	2.8
Recalculated no. of employees	39,202	39,072	38,500	37,199	37,894	38,708
No. of banking units	1,722	1,670	1,785	1,825	1,877	1,862
No. of ATMs	2,254	2,572	2,750	3,005	3,281	3,357

⁵ This is the average number of employees in the given year converted into full-time equivalents (for example, a half-time employee is calculated as half an employee).

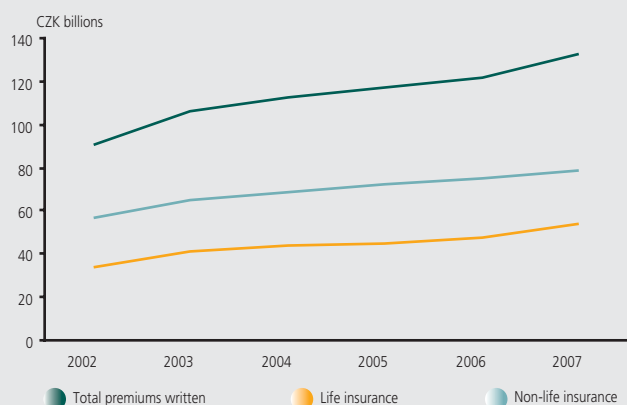
A total of 19 credit unions with valid licences were also operating on the financial market.⁶ Their assets totalled about CZK 9 billion as of 31 December 2007, up by around 31% year on year. This increase was mainly due to a rise in loans of CZK 1.1 billion (about 27%). The four largest credit unions still account for roughly 70% of the sector's total assets.

As of 31 December 2007, there were 34 domestic insurance companies (life, non-life and universal) operating on the Czech market (one more than in the previous period), along with 18 branches of foreign insurance companies (two more than in the previous period).⁷ As for capital origin, 22 insurance companies are controlled by foreign capital and 12 by domestic capital. Of the foreign shareholders, those from the Netherlands accounted for the largest share (25.6%) of the total registered capital of Czech insurance companies.

The rate of growth of premiums written increased to 8.8% in 2007, almost double the previous year's figure (4.3%). In 2006, gross domestic product had grown by 6.1% in real terms, i.e. faster than premiums written. In 2007, the situation was just the opposite (real GDP grew by 6.6%⁸). The positive trend in premiums written is due to buoyant growth in the life insurance area, where premiums written increased by 14.6% in 2007 (compared to 5.1% a year earlier). Non-life insurance recorded a modest rise in growth, from 3.8% in 2006 to 5.1%; the growth rate of premiums written in this area has been broadly stable since 2004.

In 2007, the share of life insurance in total premiums written increased by 2.1 percentage points compared to the previous period, reaching a historical high of 40.8%. However, this share is still lower than in advanced EU countries.

Gross premiums written



Rate of growth of premiums written



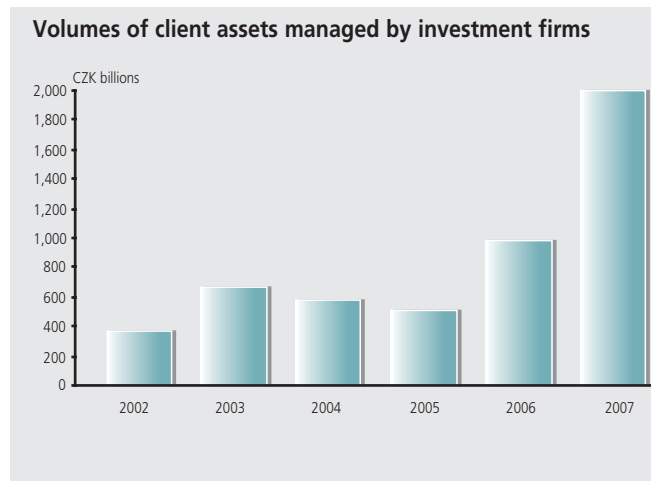
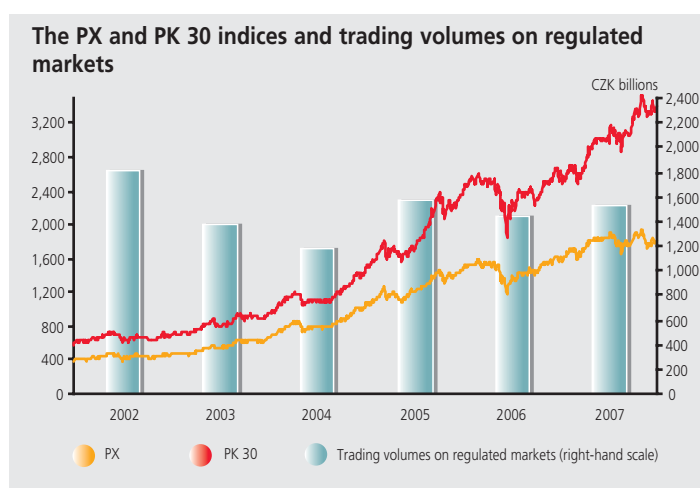
Following an amendment to the Act on Collective Investment, there was a rise in interest in 2007 in establishing new open-end mutual funds, real estate funds and funds for qualified investors. Out of the active domestic collective investment undertakings and pension funds, a total of 18 investment companies, 7 investment funds and 121 open-end mutual funds, 38 of them standard funds and 83 special

⁶ In the first half of 2007, one credit union had its licence withdrawn due to shortcomings identified in its activities during an on-site examination.

⁷ These figures do not include the Czech Insurers' Bureau.

⁸ According to preliminary CZSO data.

funds, were subject to supervision as of the end of 2007. The total assets of domestic mutual funds for the public rose by 10.3% in 2007, to CZK 174 billion. At the end of 2007, the CNB registered 44 investment firms (13 of them banks) and 14 foreign entities from EU countries providing investment services in the Czech Republic via a branch (11 of them banks). In the regulated markets area, 85 issuers of listed securities were operating under the CNB's supervision.



As of 1 January 2008, the pension fund sector consisted of ten entities. The sector's book profit grew by 6.5% to CZK 4.4 billion and its total assets rose by 15% to CZK 167.2 billion. The average return credited to pension planholders may thus be around 2.3%. Planholders' funds in pensions funds' liabilities grew by 19% in 2007. Assuming that the pension funds' profits are distributed in compliance with Act No. 42/1994 Coll., these planholders' funds should total CZK 166.2 billion as of 31 December 2007, which represents a year-on-year increase of CZK 26.3 billion. The balance of funds received and paid out by the pension fund sector was CZK 22.3 billion in 2007, while investment in securities in real terms in pension funds' assets grew by CZK 13.9 billion to CZK 144.2 billion and the balance in respect of receivables, deposits and cash was CZK 6.8 billion, with the final volume of assets of this type amounting to CZK 16 billion at the end of 2007.

Use of the Central Credit Register

The Central Credit Register (CCR) has served banks as credit risk mitigation tool since 2002. The next phase of development of the CCR was prepared in 2007. The proposed changes are based primarily on banks' requests and on the experience of administering the system at the CNB. The aim is to optimise and stabilise the CCR's functions, to address direct communication between bank information systems and the CCR, to update the existing modules and to create new ones. Other plans included changing the client and claim registration process, preparing for international exchange of data and for using the data in banking supervisory practice, incorporating banks' requests for changes to the analytical module's functions, extending the CCR administration functions, and modifying the training environment. The project will be implemented in three phases and completed by 2010.

As of 31 December 2007, a total of 407,000 clients, with claims amounting to CZK 1,105 billion, were recorded in the CCR. Banks routinely exercise their right to monitor the credit exposures of all their clients on a monthly basis. In 2007, the CNB noted a significant rise in banks' interest in directly implementing CCR outputs in their internal lending process and credit risk management systems.

International cooperation

CNB employees continued to be actively involved in various forms of international cooperation in 2007. Along with market globalisation and the integration of financial market supervision, the CNB ever more frequently formulates and communicates to international institutions its unified opinions on common financial market issues.

Bilateral cooperation with foreign partner supervisors continued in 2007. A major impetus for developing such cooperation is the obligation to assess special approaches together with foreign partners in line with the Basel II requirements as implemented in the relevant EC directives. Such assessment relates mainly to credit and operational risks. Bilateral cooperation under international agreements such as Memoranda of Understanding (MoU) was supplemented with regular contacts with foreign partners as and when necessary. As for multilateral cooperation, the CNB was actively involved in the work of a number of committees and working groups of the European Commission, the European Central Bank, the Bank for International Settlements and other international organisations. Of great importance for financial market supervision in the Czech Republic and for cooperation with the supervisory authorities of EU Member States was the CNB's active involvement in the Lamfalussy Level 3 committees, i.e. the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and in the working groups and subgroups established by these committees. Working in these committees gives the CNB new opportunities to shape the European legislation and obtain new instruments to better perform its main tasks in the financial market supervision area.

Following negotiations commenced in 2006, the CNB became a signatory to the International Organization of Securities Commissions (IOSCO) Multinational Memorandum of Understanding and started to cooperate with specific jurisdictions. IOSCO's vision is to cooperate together to promote high standards of regulation in order to maintain just, efficient and sound capital markets. Within IOSCO, the CNB is mainly involved in the European Regional Committee and the Emerging Markets Committee.

At the beginning of 2007 the CNB became a member of the International Organisation of Pension Supervisors (IOPS). Thanks to this membership, the Czech Republic has access to detailed information about pension systems in the individual member states of this organisation. CNB representatives participated in the work of its Technical Committee, which focuses on conducting studies comparing various aspects of private pension schemes across the member countries. Its outputs cover, for example, licensing standards, on-site and off-site examinations, cross-border cooperation issues, alternative investment risk management, corporate governance and guarantee schemes within the sector. In 2007, the CNB also actively monitored the work of IAIS (International Association of Insurance Supervisors) working committees and subcommittees on individual standards and recommendations and participated in various surveys organised by the IAIS.

Financial market regulation

Several acts amending and regulating business activities on the financial market were adopted in 2007. These amendments, which to varying extents involved the Act on Banks, the Act on Credit Unions, the Capital Market Undertakings Act and the Payment System Act, had a significant effect on the conduct of financial market supervision.

A comprehensive CNB Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, implementing European directives 2006/48/EC

and 2006/49/EC, known as Basel II, and the relevant Act No. 120/2007 Coll., introduced a change in regulation across sectors. The decree implements the new capital adequacy framework in the Czech Republic and also lays down some other prudential rules for financial market participants. In addition to its primary aim, i.e. the transposition of Basel II, this decree represents a major contribution from the point of view of the conceptual objectives of the integration of financial market supervision into the CNB. The concentration of additional regulated areas involving additional types of regulated entities in this single implementing legal regulation has made it possible to avoid repetition of identical or similar texts and at least partially unify any terminological differences across the segments of the financial market. With Decree No. 123/2007 Coll., the principle of equal treatment of all relevant segments is starting to be gradually implemented (identical requirements apply to banks, credit unions and investment firms). The realisation of the plan to implement Basel II essentially in a single implementing decree and also to integrate the related existing regulations into it, contributed greatly to optimising the content, structure and extent of the regulations for banks, credit unions and investment firms. Another factor helping to unify the regulation of banks and credit unions was the publication of decrees stipulating certain requirements for the governance of banks and credit unions in the area of money laundering and terrorism financing prevention.

There were no major changes in the regulation of the insurance sector in 2007. However, Decree No. 251/2007 Coll. amended Decree No. 582/2004 Coll., implementing certain provisions of the Act on Insurance Intermediaries and Independent Loss Adjusters. Technical changes were made in the area regulating communication between the CNB and insurance intermediaries, and new institutions authorised to provide training programmes for insurance intermediaries and loss adjusters were registered. In the course of the year, the CNB, the Ministry of Finance and representatives of the Czech Insurance Association worked together to prepare a new insurance act. A comments procedure took place at the end of the year and after the comments had been taken on board a bill was submitted to the Government for discussion. The Solvency II project, representing a new approach to insurance regulation focusing primarily on risk identification and management, entered the next preparatory phase. In July 2007, the European Commission adopted a draft directive, which was passed on to the EU Council and the European Parliament for discussion. The CNB worked closely with the Ministry of Finance during discussions in the Commission's working group as well as during the subsequent discussions in the Council's financial services working group. The third round of the Quantitative Impact Study (QIS3) – aimed at calibrating the capital requirement calculation – took place in 2007 under Solvency II. Twelve Czech insurance companies contributed to the study. CEIOPS working groups then assessed the study, which revealed that Czech insurance companies' results do not differ markedly from the European average.

As regards the capital markets, no fundamental changes were made to the collective investment legislation in 2007, although certain implementing regulations were amended. Decree No. 241/2007 Coll. amended Decree No. 603/2006 Coll., on the disclosure duties of a collective investment fund and an investment company, and Decree No. 115/2007 Coll., stipulating details for fulfilling the duties of a depository of a collective investment fund, replaced the previous Decree No. 256/2004 Coll., stipulating details for fulfilling the duties of a depository. In the period under review, the CNB also worked on the preparation of a major amendment to the Capital Market Undertakings Act (transposing MiFID and the Transparency Directive). A minor amendment to this act took effect during work on this transposition amendment. This concerned the revenues of the Guarantee Fund of Investment Firms and addressed the financing of the Fund from the state budget.

An amendment to the Commercial Code in the takeover bids area was also planned in 2007 (a new act on takeover bids, partial changes in the squeeze-out area,

transposition of the takeover bids directive) and the CNB worked closely with the Ministry of Justice on a draft law on takeover bids. In the private pension scheme area, the CNB was involved in working groups organised by the Ministry of Finance focusing on standardising the regulatory framework for this segment of the financial market, whose current situation derives from laws adopted in 1994.

The legislative process regarding the drafting of a new Act on Certain Measures against Money Laundering, which transposes the relevant EU directive, will affect all segments. The CNB was heavily involved in preparing this amendment and also began preparing an implementing decree setting out more detailed rules for banks and other financial institutions. This act is being accompanied among other things by an amendment to the Foreign Exchange Act imposing new duties on foreign exchange entities in connection with money laundering, including a requirement to be licensed or registered with the CNB and a requirement to prove the trustworthiness of individuals. Derivatives transactions can now be executed only under the Capital Market Undertakings Act. Here, too, the text of the amendment was formulated in close cooperation with the CNB, which also prepared the preliminary text of the implementing decree in 2007.

Financial market inspection work

In the area of supervision of banks and credit unions, a total of 14 on-site inspections were carried out in 2007 (seven in banks and seven in credit unions). These inspections concentrated on credit, market and operational risk management (including information system risk management), and on money laundering prevention and overall assessment of internal control systems. These inspections focused on either all or just some of the above areas. One specialised extraordinary on-site inspection was conducted in 2007.

In the insurance sector, a total of eight on-site inspections were commenced in 2007. Four of them were comprehensive, while two focused only on non-life insurance and the remaining two on financial placements and risk management in relation to the investment activities of supervised entities. By the end of 2007, inspection reports had been submitted to the responsible representatives of five insurance companies. The remaining three inspections continued into 2008.

After assessing the insurance companies' approach to the shortcomings detected and evaluating the adequacy and effectiveness of the proposed measures, and taking account of the number and seriousness of the inspection findings, the CNB commenced administrative proceedings against three entities. In one case, together with the commencement of administrative proceedings the CNB issued a precautionary measure prohibiting the insurance company from concluding policies and expanding its existing liabilities in areas for which it did not have a permit from the supervisory authority. The CNB decided in the administrative proceedings to impose on all three entities concerned the obligation to prepare and submit a schedule of measures to eliminate the shortcomings detected.

A total of 7 on-site inspections were carried out in collective investment and pension funds, three of which concerned the internal operations of investment companies and four concerned risk assessment of pension funds and compliance with the rules for the management of assets entrusted to third parties and the rules for calculating the real value of assets. As regards investment services, nine on-site examinations were undertaken in investment firms, four of which were comprehensive, and one on-site inspection was carried out in the public markets area. Transactions executed on regulated markets were monitored on a daily basis, and work started on a new capital market monitoring information system project. Compliance with the duty of issuers' directors to report transactions in an issuer's securities was also checked.

Turning to off-site surveillance, the CNB monitored compliance with the information duties of entities subject to its supervision and whether the information provided to the CNB by these entities met all the requirements placed on them. The CNB then assessed this information and used it in performing its mandate for financial market supervision, namely to ensure the stability of the financial system and the sound and smooth development of the Czech financial market.

Licensing and sanction activities in the financial market area

In the area of credit institutions, 18 prior consents to the acquisition of qualifying holdings in banks, one change (extension) to a licence and one consent to a bank merger were issued. In 2007, one new foreign bank branch operating under the single banking licence exercised the right of any bank having a licence from an EU country to expand its business across the entire EU area, either by establishing a branch or by cross-border provision of services not having the character of permanent economic activity. In addition, one medium-sized bank was converted into a foreign bank branch on 1 January 2008. The number of institutions that had notified the CNB of provision of cross-border services in the Czech Republic increased to 198 in 2007. Two institutions with a banking licence granted by the CNB reported that they were providing services outside the Czech Republic under the freedom to provide services.

In administrative proceedings, CNB Banking Supervision issued one decision to withdraw a credit union licence, due to serious shortcomings detected during an on-site inspection. Penalties for breach of the delivery obligation by credit unions were imposed in ten cases. Outside administrative proceedings, the CNB issued 34 decisions relating to the approval of external auditors, 30 decisions relating to shareholder structures prior to general meetings, 2 decisions on the inclusion of subordinated debt in the capital of a bank or a credit union, 4 decisions on the investment of another membership contribution in a credit union, and so on. 20 decisions concerned consents in relation to assessments of compliance with the conditions for discharging the office of member of a credit union body or senior officer of a credit union. Opinions on nominees for managerial posts were issued in 9 cases.

In the insurance sector, a total of 100 administrative proceedings were opened in 2007, 89 of which were closed by administrative decision. The CNB granted authorisation to carry on insurance activities to one company, and four companies were granted authorisation to expand their activities. In administrative proceedings concerning applications for prior consent to change a member of a statutory or supervisory body or a proctor, consent was granted for 91 persons and denied for one person in 2007. Prior consent to acquire or increase qualifying holdings was granted in 6 cases. The CNB also approved a merger of one insurance company with its subsidiary and one transfer of an insurance portfolio. It also granted one consent to the creation of another technical provision and one consent to a different financial placement structure.

A large number of insurance companies and branches of insurance companies from EU and EEA Member States declared their intention to provide services temporarily in the Czech Republic. The CNB received announcements from foreign regulators regarding the notifications of 82 insurance companies and regarding the termination of activities in the Czech Republic of 5 insurance companies. The number of notified insurance companies thus reached 478. A gradual increase in the number of notified entities can also be expected in the future, both through the establishment of branches and through cross-border service provision. Notified entities providing cross-border insurance services are affecting the competitive environment on the non-life insurance market in particular.

A total of 1,479 funds or sub-funds managed by 64 foreign investment companies or SICAVs⁹ from seven EU countries had made notifications in the collective investment area by the end of 2007. CNB authorisation had also been granted to 20 foreign special funds. The intention to provide investment services in the Czech Republic without establishing an organisational unit had been notified by 518 non-bank entities from 17 EU countries. During the year, two such licences became null and void under the legislation, owing to changes in objects of business.

A total of 294 decisions were issued in the area of collective investment and pension funds concerning the approval of directors, the approval of changes to statutes, changes to depositories, and licences to establish investment companies and mutual funds. The CNB permitted the establishment of one new pension fund and a merger of two other pension funds. The CNB furthermore issued 160 decisions in the investment services area, mostly relating to the extension or withdrawal of investment firm licences, broker's licences, prior consents to the discharge of office of director of an investment firm, or consents to the acquisition of a qualifying holding.

In the regulated market area, the CNB extended the licence of the OTC market operator and settlement system operator RM-Systém to include trading in foreign securities. Consents were also issued for changes in the rules of the UNIVYC and RM-Systém settlement systems. Proceedings to grant a central securities depository licence continued. A total of 9 administrative proceedings were conducted in the field of regulated market supervision and 276 administrative proceedings were conducted in the area of securities issues, 191 of which concerned the approval of documents connected with securities issues (bond issue conditions and securities prospectuses), 9 concerned takeover bids, 8 concerned the information duties of issuers of listed securities and 68 concerned the application of the squeeze-out principle; the proportion of squeeze-out consents was about 67%. Notifications of managers' transactions undertaken by directors of issuers and shares in voting rights were also verified. As regards sanction procedures, 56 administrative or offence proceedings were conducted in 2007. During the period under review, a total of 44 decisions took effect and fines amounting to CZK 12.86 million were imposed.

Financial intermediaries

At the end of 2007, 13,365 entities (most of them natural persons) were registered with the CNB as investment intermediaries. Thirty-nine rounds of broker examinations took place, with 394 participants. As of 31 December 2007, the CNB registered a total of 1,917 entities holding a broker's licence.

In 2007, the CNB recorded a total of 14,541 legal/natural persons in the Register of Insurance Intermediaries and Independent Loss Adjusters¹⁰, 94 of which were insurance agents and 60 insurance brokers. As of the end of 2007, a total of 67,529 insurance intermediaries were entered in the register, 5,226 of them foreign. Following a change to the CNB Organisational Manual, responsibility for registering insurance intermediaries was transferred to the Plzeň branch on 1 January 2008.

⁹ SICAV - société d'investissement à capital variable (investment company with variable capital).

¹⁰ The Register of Insurance Intermediaries is available on the CNB website at <http://ispoz.cnb.cz>.

FOREIGN EXCHANGE SUPERVISION

Under powers contained in Act No. 219/1995 Coll., the Foreign Exchange Act, as amended, the Czech National Bank is also responsible for regulation and supervision in the foreign exchange area. These activities include issuing foreign exchange licences, in particular for cash sales of foreign currency, non-cash foreign currency transactions and provision of financial services, and overseeing compliance with the relevant legal rules.

In the foreign exchange area, the Czech National Bank thus mainly regulates and supervises the activities of money changers and non-bank foreign exchange entities offering non-cash conversion of foreign currency or intermediation of payments abroad and accepting payments from abroad.

The number of applications for foreign exchange licences submitted last year and the way in which they were dealt with is shown in the following table:

Number of foreign exchange licence applications ¹¹			
CNB units	No. of applications submitted	Approvals (positive decisions)	Refusals (negative decisions)
PRAGUE	17	12	6
ČESKÉ BUDĚJOVICE	2	2	0
PLZEŇ	2	2	0
ÚSTÍ NAD LABEM	2	2	0
HRADEC KRÁLOVÉ	1	1	0
BRNO	6	6	0
OSTRAVA	1	0	0
DEPARTMENT 620	7	2	1
TOTAL	38	27	7

More detailed information regarding individual foreign exchange licence holders is available on the CNB website (*Financial market supervision – Foreign exchange supervision – Complete list of foreign exchange licences from the register of foreign exchange entities*).

The number and orientation of the on-site inspections carried out by foreign exchange supervisors in 2007 are shown in the following table:

On-site foreign exchange inspections in 2007								
CNB units	Total	Completed			By orientation			
		With violation of forex regulations found	Without violation of forex regulations found	Official record only	Licences	Forex licences for sale	Other forex licences	Other (notification duty, unauthorised business)
PRAGUE	166	94	65	7	125	28	9	4
ČESKÉ BUDĚJOVICE ¹²	40	29	8	3	22	18	3	0
PLZEŇ	43	33	9	1	36	4	2	1
ÚSTÍ NAD LABEM	56	47	7	2	44	10	2	0
HRADEC KRÁLOVÉ	55	37	2	16	48	2	3	2
BRNO	51	33	10	8	30	17	4	0
OSTRAVA	40	24	2	14	23	14	2	1
DEPARTMENT 620	0	0	0	0	0	0	0	0
TOTAL	451	297	103	51	328	93	25	8

¹¹ Two of the total number of foreign exchange licence applications were withdrawn, and two proceedings were not completed in 2007 and are thus carried over into 2008.

¹² The České Budějovice branch conducted 43 on-site inspections. However, three inspections had not been completed as of 31 December 2007.

Where it finds that the foreign exchange regulations have been contravened, the CNB imposes remedial measures or is authorised to impose penalties in administrative proceedings. A total of 37 administrative proceedings opened due to suspicion of violation of the foreign exchange regulations were definitively closed in 2007. The fines imposed in 2007 totalled CZK 1,220,000. These fines constitute revenues to the state budget.

In 2007, as in previous years, most of the foreign exchange offences were due to breaches of the conditions for cash purchases/sales of foreign currency in return for Czech currency. These included in particular incorrectly made out and labelled deductions for foreign currency sales and purchases, insufficient identification of clients in transactions exceeding CZK 100,000, and failure to fulfil the reporting duty. The offence of unauthorised offering, performance or intermediation of foreign exchange trading (cash or non-cash) was identified in 6 cases.

CURRENCY IN CIRCULATION AND THE PAYMENT SYSTEM

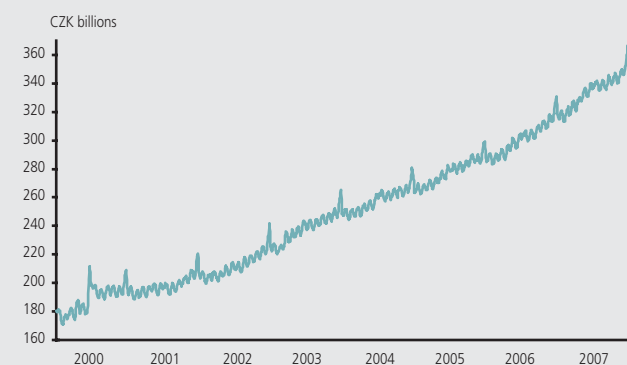
Currency in circulation

Currency in circulation amounted to CZK 353.7 billion as of 31 December 2007. The total volume of currency in circulation increased by CZK 32.2 billion, or 10%, in 2007. The rate of growth of currency in circulation was lower than in 2006, but was above the long-term average of 9.4%.

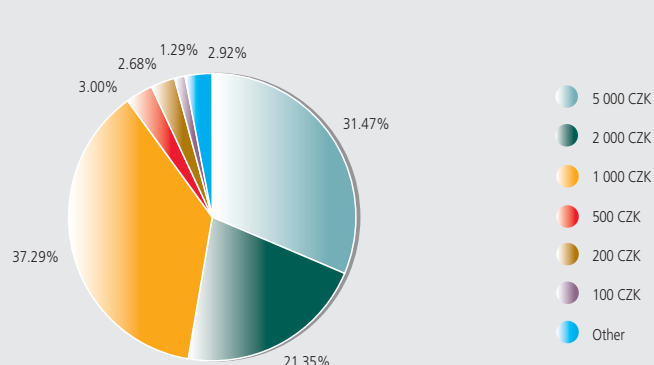
The numbers of both banknotes and coins in circulation rose more slowly than currency in circulation in koruna terms. The number of banknotes rose by 8.2% and the number of coins by 6.3% in 2007. Nevertheless, the numbers of banknotes and coins in circulation rose by 25.7 million and 98.5 million respectively. As of 31 December 2007, a total of 340.7 million banknotes and 2,686.3 million coins were in circulation. The total number of banknotes and coins thus exceeded 3 billion. However, 1.1 billion of these were ten-heller and twenty-heller coins, which are no longer legal tender but can still be exchanged at the CNB.

At the end of 2007, the average value of a banknote in circulation was CZK 1,012 and that of a coin in circulation (excluding ten-heller and twenty-heller coins) was CZK 2.98.

Currency in circulation – 1 Jan. 2000 to 31 Dec. 2007



Structure of currency in circulation



Cash turnover at the CNB's branches amounted to CZK 1,511 billion in 2007, up by 6.7% year on year. More than 2.6 billion banknotes and coins were accepted or paid out at the CNB's branches in 2007.

The CNB put into circulation a new version of the CZK 2,000 banknote in July 2007. The new note has a number of updated and new protective elements, some of them visible to the naked eye for the general public and others detectable by special authentication devices and tools for professionals. The first modifications were made to the 1999 version of the CZK 2,000 note. That was eight years ago, and most central banks deem it necessary to upgrade a note's counterfeit protection after such a time.

In 2007, the CNB put into circulation two more gold coins from the Industrial Heritage Sites cycle, featuring Ševčiny Mine at Příbram – Březové Hory (in May) and the Water Mill at Slup (in October). In addition, four commemorative silver coins were issued, marking the 550th anniversary of the foundation of Jednota bratrská (Unitas Fratrum), the 650th anniversary of laying of the foundation stone of Charles Bridge in Prague (this coin featured in the international Europe 2007 project), the 100th anniversary of the birth of opera singer Jarmila Novotná, and the 50th anniversary of the launch of the first Earth satellite. A total of 96,250 commemorative silver coins were produced last year (41,600 in normal quality and 54,650 in proof quality), along with 15,800 commemorative gold coins (4,400 in normal quality and 11,400 in proof quality). The overall nominal values of the silver and gold coins were CZK 19.3 million and CZK 39.5 million respectively.

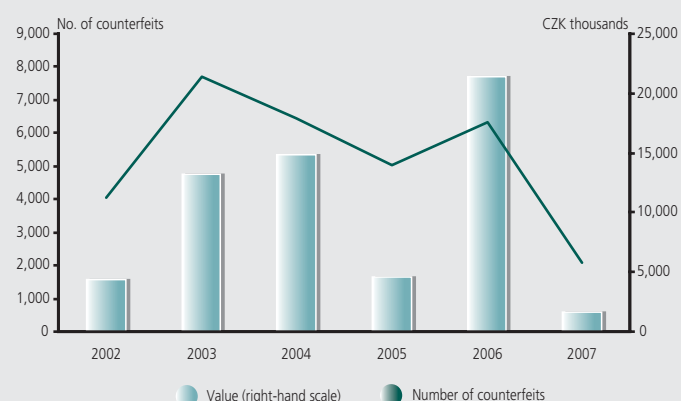


Counterfeit recognition training, counterfeits

As in previous years, training programmes were held in 2007 for sellers of foreign currency, who, under CNB Decree No. 434/2002 Coll., implementing Article 9(3) of Act No. 219/1995 Coll., the Foreign Exchange Act, are required to present a certificate demonstrating that they have completed a course on counterfeit recognition. In all, 425 people attended these courses in 2007, and a total of 2,472 people have attended the courses since the statutory duty came into existence.

In 2007, a total of 3,524 counterfeit and altered banknotes and coins and 112,192 imitations of banknotes and coins of all currencies, denominations and versions were seized in the Czech Republic. The total quantity of counterfeits identified was lower than in 2006, largely because the Czech police seized only 249 banknotes and coins prior to circulation, which is 4,595 less than in 2006. The upward trend in counterfeit euros and the downward trend in counterfeit US dollars continued into 2007. No counterfeit banknotes and coins of the former national currencies of the countries that adopted the euro in 2002 were seized in 2007.

Counterfeit Czech banknotes



The non-cash payment system

By law, the CNB operates the non-cash payment system, i.e. it maintains the accounts of banks and the accounts of the state and arranges interbank payments and settles short-term securities transactions. Non-cash payment transactions are executed through the CERTIS, SKD and ABO systems. The CNB also drafts legal rules in the payment systems area and is involved in the preparation of European legislation.

The CERTIS system

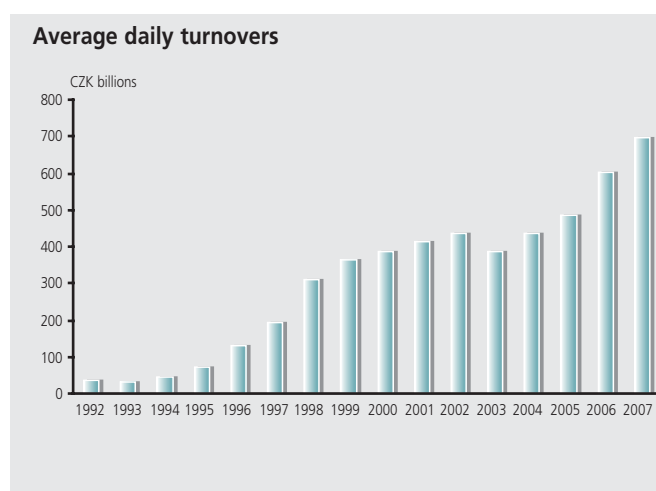
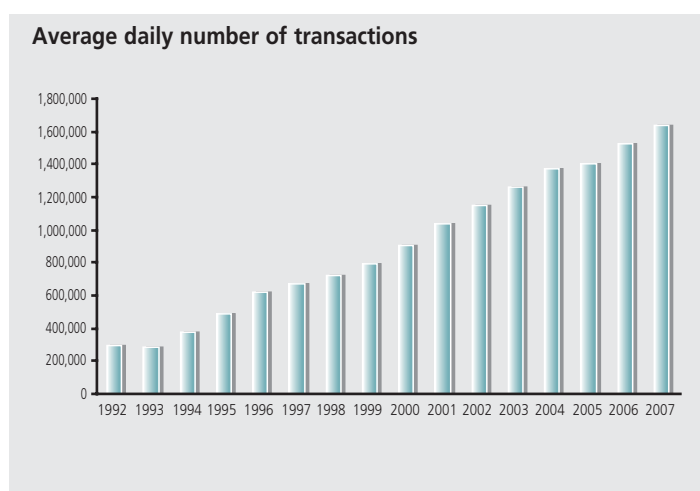
The CERTIS system processes interbank payments in the Czech Republic. Banks, credit unions and foreign bank branches are direct participants in this system. As of 31 December 2007, the system comprised 40 direct participants and 7 third parties – for example, card payment clearing houses and securities clearing and settlement institutions.

On 1 November 2006, the CERTIS system was transferred from a mainframe platform to a server environment. Its functionality remained intact. The purpose of this transfer was to modernise the equipment, reduce costs and increase the

system's performance. As a result, the fees paid by system participants were reduced on 1 January 2007.

CERTIS processed 411 million transactions in 2007 (up by 7.6% year on year), representing a total value of CZK 174,854 billion (up by 15.4%). The system processed a daily average of 1.64 million transactions. The average daily value of the transactions was CZK 697 billion.

The following charts show the number of transactions processed and the volume of funds transferred in the CERTIS system in the last 16 years.



SKD – the short-term securities settlement system

The short-term securities settlement system (SKD) operated by the CNB is a separate register of securities and a settlement system for the securities recorded therein. In SKD, records are kept of the securities issued by the Czech Republic (the Ministry of Finance) with maturities of up to one year, the short-term securities issued by the CNB with maturities of up to six months, and other bonds with maturities of up to one year.

The SKD system is being modified to incorporate changes in the legal and tax areas. The CNB also monitors developments in EU settlement systems, particularly with regard to the connection of such systems to TARGET2, the proposed Target2Securities single settlement system and the CCBM2 collateral management system, which will become relevant as the Czech Republic prepares to adopt the euro.

As of 31 December 2007, a total of 152 owner accounts – belonging to 110 clients (securities owners) – were registered in SKD. In all, 20 agents and 4 custodians use the system.

Agents are banks that provide securities settlement services to their securities owner clients. They have direct interactive access to the SKD system. Custodians administer securities accounts owned by persons other than custodians, i.e. customers of custodians.

The securities recorded in SKD are used mainly as collateral for intraday credit, which the CNB extends to banks for accounting purposes within CERTIS and for the needs of the CNB's repo operations.

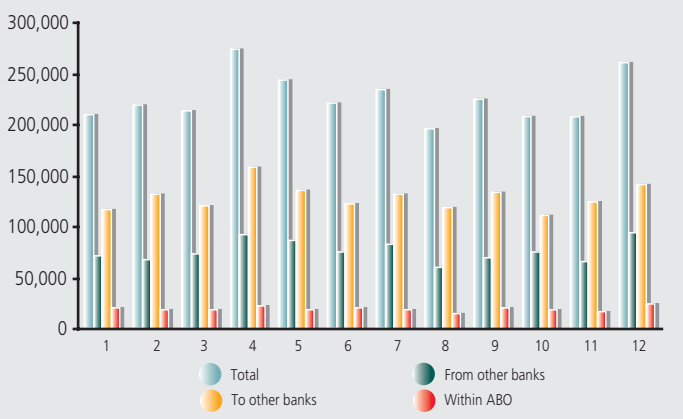
ABO – the CNB's accounting and payment system

As of 31 December 2007, the ABO system maintained 41,107 live accounts, 9,078 of which were internal accounts, 3,962 employees' accounts and 28,067 accounts of legal entities. As regards the accounts of legal entities, 23,842 fall into the regulated Treasury accounts category. The other accounts are mostly owned by state institutions, as well as banks, foreign financial institutions, etc.

The development of the ABO system continued in 2007 within the ABO5 project. This project involves the preparation of new functions in the ABO-K internet banking application, the integration of foreign payment entries into the ABO and a number of other minor adjustments and improvements.

The following chart shows the number of transactions processed in 2007. A modest increase was recorded compared to 2006 – the total number of items rose by 2.9%.

ABO – Daily average number of items



Legislation

In 2007, the CNB was actively involved in formulating and discussing the draft directive on payment services in the internal market in the working groups of the European Commission and worked with the Ministry of Finance on finding a compromise wording of the directive within the structures of the EU Council.

The directive on payment services in the internal market was adopted by the European Parliament and the EU Council in the second half of 2007 and was published in the Official Journal of the EU on 5 December 2007 under number 2007/64/EC. Its transposition into the Member States' national legislation, scheduled for 1 November 2009, should produce a unified legal framework for payment service provision across the EU.

The Czech National Bank and the Ministry of Finance prepared a public consultation document on the transposition of the directive on payment services in the internal market into Czech law. This document can be found on the websites of both institutions. It is intended to gather opinions, comments and suggestions from bank and non-bank providers of payment services, clients (including consumers) and finance professionals. These comments will be incorporated into the new act.

PREPARATIONS FOR INTRODUCING THE EURO IN THE CZECH REPUBLIC

A National Coordination Group (NCG) responsible for the technical, institutional and legislative arrangements for the introduction of the euro was established in the Czech Republic in February 2006 under a government resolution. At the same time, six working groups were set up for the individual changeover areas (the financial sector, the non-financial sector and consumer protection, public finances and public administration, legislation, information technology and statistics, and communication). The management of the whole process was delegated to the Ministry of Finance.

The CNB's role in the NCG is significant, as many of the tasks associated with the changeover will fall within the direct competence of the central bank. The CNB is represented in the leadership of the NCG, as a CNB board member is a vice-chairman of the NCG and is also the head of the Financial Sector Working Group. The CNB – jointly with the Ministry of Finance – also chaired the Communication Working Group, and it has representatives as members of all the other working groups at the expert level.

In the first phase of its work, the NCG formulated a recommendation for the choice of optimum changeover scenario for the Czech Republic (approved by the Government in October 2006) and prepared the first version of the National Changeover Plan (April 2007). The CNB and the Financial Sector Working Group played a major role in the preparation of both documents.

The Plan contains an overview of the technical, legislative and institutional steps that need to be taken in connection with the adoption of the single currency. The CNB will be responsible mainly for the introduction of euro banknotes and coins and the non-cash euro, the adjustment of payment systems, and cooperation with the financial sector in this process. It will also play a significant role in communication with the public. The Czech Republic's Updated Euro-area Accession Strategy, discussed by the Government in August 2007, does not set a target date, so the National Plan does not give specific start dates for the individual steps, but only states the estimated periods of time needed to implement them.

The central bank's main tasks in the changeover process are covered in more detail in the CNB's October 2007 document *Updated Tasks Relating to the Introduction of the Euro in the Czech Republic*, which can be found on the CNB website (www.cnb.cz).

The Czech National Bank and the Ministry of Finance are also jointly involved in a technical assistance project with the central bank of Belgium. In December 2007, the CNB organised a lecture by representatives of the Slovenian central bank on the technical preparations for the changeover and on issues of higher inflation after joining the euro area.

CNB representatives also attend meetings of the European Commission's working group for technical and organisational issues relating to euro adoption (PAN II) and the working group for communication (DirCom). Valuable information and experience can be gained here from the existing euro area members and from other EU Member States at more advanced stages of preparation for the changeover.

FINANCIAL MARKET OPERATIONS

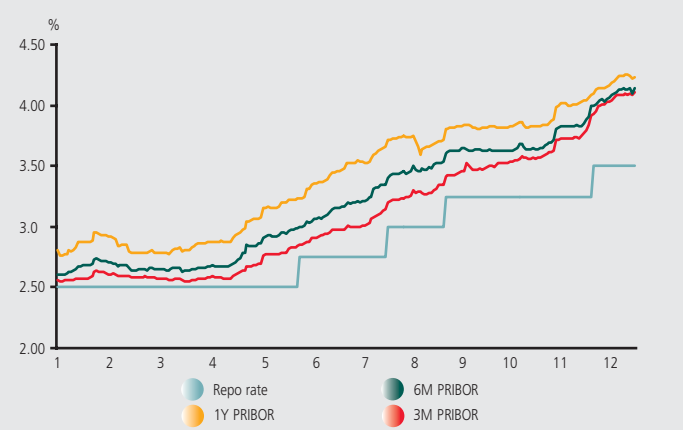
The CNB implements monetary policy by means of a system of monetary policy instruments consisting of financial market operations, automatic facilities and reserve requirements. Financial market operations play a pivotal role in steering interest rates, managing the liquidity of the banking system and signalling the monetary policy stance. The CNB Bank Board sets three interest rates: the two-week repo rate, the discount rate and the Lombard rate. The main monetary policy rate is the two-week repo rate. By setting this interest rate, the CNB influences the short end of the yield curve. The discount and Lombard rates provide the floor and ceiling respectively for short-term interest rates on the money market. Changes in the repo rate (set half-way between the above two rates) are accompanied by symmetrical changes in the discount and Lombard rates.

The Bank Board decided to raise the two-week repo rate by 0.25 percentage point four times in 2007. The repo rate was changed to 2.75% with effect from 1 June, to 3.00% with effect from 27 July, to 3.25% with effect from 31 August, and to 3.50% with effect from 30 November.

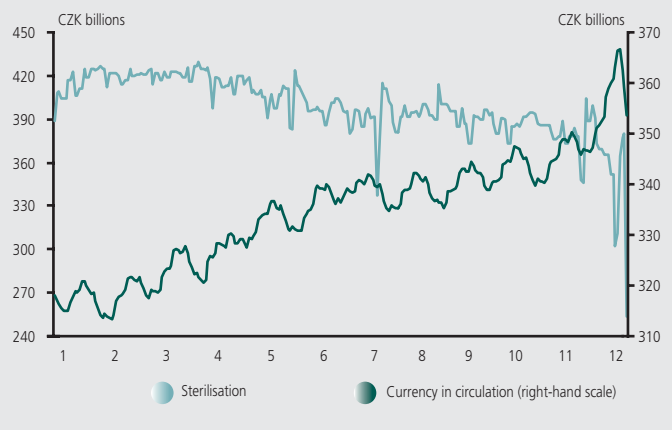
The CNB manages the liquidity of the banking sector through money market operations so as to maintain an optimum liquidity level for compliance with the reserve requirement. This ensures that short-term interest rates are stable at the desired level. The decision-making on the central bank's money market operations is based on a daily analysis and forecast of banking sector liquidity and on the money market situation.

In 2007, the main instrument for managing short-term interest rates was again the two-week repo, announced on a regular basis three times a week. Given the persistent excess liquidity in the Czech banking system, the CNB used these operations to absorb excess reserves (unlike for example the ECB, which provides liquidity). The liquidity absorbed is remunerated at the repo rate at most. The excess liquidity absorbed in monetary operations in 2007 varied between CZK 254 billion and CZK 430 billion, the average being CZK 399 billion. The average amount of liquidity absorbed fell by approximately CZK 43 billion relative to the 2006 average.

Interest rates in 2007



Excess liquidity in 2007



This decrease was due mainly to steady growth in currency in circulation (see the chart). Another factor reducing the sterilisation volume was the continuing sell-off of a portion of the returns on the international reserves. The volume of returns sold totalled EUR 770 million in 2007. A gradual rise in the reserve requirement

of around CZK 5.5 billion also helped to reduce the sterilisation volume. The fall in the sterilisation volume was counteracted by interest paid on monetary operations, which totalled CZK 12.5 billion. Of this, interest paid to banks was CZK 11.4 billion and interest paid on the required reserves was CZK 1.2 billion.

The large decline in the sterilisation volume at the end of the year (of around CZK 165 billion compared to the end of November) was due mainly to seasonal effects. There was an increase in state fixed-purpose funds with the CNB, since they are not allowed to be short-term invested in the market over the end of the year (around CZK 135 billion), and the growth rate of currency in circulation rose in connection with Christmas. These factors are short-term and closely linked with the end of the calendar year, and their effect gradually abates during January.

The CNB's instruments also included two "automatic" facilities – the marginal lending facility and the deposit facility. Under the lending facility, the CNB lends overnight funds to banks against eligible collateral in the form of securities. Such loans are charged interest at the Lombard rate. The Lombard rate thus provides a ceiling for short-term interest rates. The CNB accepts CNB-issued bills, bonds issued and unconditionally guaranteed by the Czech Republic and koruna securities issued or unconditionally guaranteed by EU governments and selected multilateral issuers as collateral. The deposit facility gives banks the option of making overnight deposits with the CNB at the discount rate. The discount rate provides a floor for short-term interest rates. The minimum volume for these operations is CZK 10 million. Fine-tuning operations (ad hoc repos and reverse repos under market conditions) are used only rarely. In 2007, the CNB continued issuing its own bills, which it used as collateral for open market operations. In addition, CNB bills are used by banks as collateral against intraday credit from the CNB. Such credit is provided to ensure the smooth running of the payment system at CNB Clearing. The CNB charges no interest on such credit. There is automatic spillover into the marginal lending facility in the event of non-repayment of intra-day credit at the end of the day.

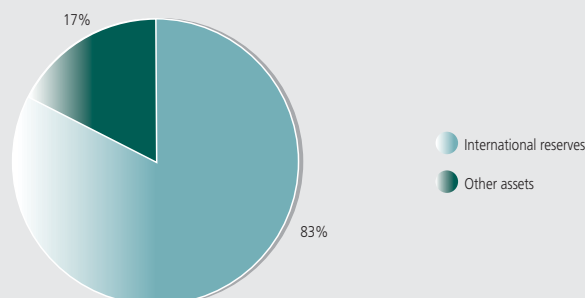
Management of the CNB's international reserves in 2007

International reserves are the Czech National Bank's foreign assets in convertible currencies. They comprise deposits in foreign banks, securities, gold, the reserve position with the IMF and other reserve assets. At the end of 2007, the international reserves represented approximately 83% of the CNB's assets, and the return on these reserves was the CNB's most significant revenue item.

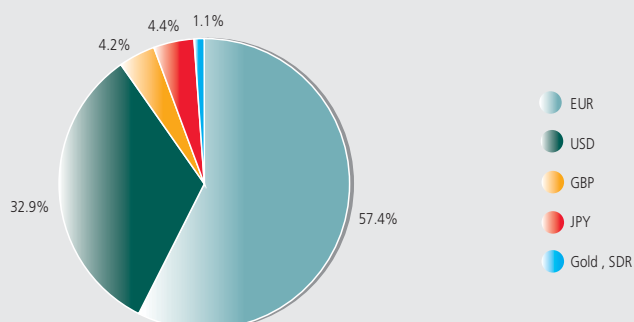
The CNB holds international reserves to support its independent monetary and exchange rate policy-making. In addition, the international reserves provide a source of foreign exchange liquidity for CNB clients, to whom the CNB sells foreign currency in exchange for koruna. The volume of the reserves is published regularly in the Financial Markets section of the CNB website.

In managing the international reserves, the CNB aims to attain maximum and stable returns subject to compliance with the stipulated liquidity restrictions and market and credit risk limits. Portfolio managers invest the international reserves in particular instruments in compliance with the principles of the CNB's reserve management policy and subject to investment opportunities and the situation on the financial markets. The largest part of both portfolios is invested in securities issued by the governments of OECD countries, government-guaranteed securities, or securities issued by eligible agencies and multilateral institutions with maturities of more than one year. At the same time, a large part of both portfolios is invested in credit instruments with the highest rating – AAA.

Share of international reserves in CNB balance sheet assets



Monetary allocation as of 31 Dec. 2007



The CNB's international reserves amounted to CZK 631 billion at the end of 2007. The decline in the reserves in koruna terms was mainly due to the appreciation of the koruna against the dollar (13%, or roughly CZK 36 billion) and the euro (3.2%, or roughly CZK 12 billion). The volume of the reserves was also affected by positive income on investment activities, the sell-off of previous returns in exchange for koruna, and external flows. No foreign exchange interventions were made in 2007.

In euro terms, the market value of the international reserves was EUR 23.7 billion (an annual decrease of EUR 199 million) and in dollar terms it rose by USD 3.4 billion to USD 34.8 billion. Besides the aforementioned factors, the market value of the international reserves (expressed in these terms) was also affected by the euro-dollar exchange rate.

At the end of 2007, the international reserves were allocated as follows: 57.4% EUR, 32.9% USD, 4.4% JPY, 4.2% GBP and 1.1% SDR and gold. The changes in the allocation of the international reserves were only minor and were due chiefly to the gradual transfer of a portion of the dollar portfolio into the euro portfolio (see the decision to reallocate the international reserves below).

Currency diversification of part of the dollar reserves into JPY and GBP is being executed by means of currency forwards in order to achieve the required structure (80% USD, 10% GBP and 10% JPY). The return on the GBP and JPY positions forms part of the return on the dollar portfolio. The diversification effects of the exposure to other currencies stabilise the returns on the dollar reserve portfolio.

Overall, the international reserves consist of two main portfolios. Foreign exchange risk may not be accepted when managing these portfolios. The parameters defining the interest rate risk assumed – portfolio duration in particular – are also set separately for each portfolio. The duration set in 2007 continued to be based on the requirement that the euro portfolio should not record a loss in any moving twelve-month period and the dollar portfolio should not record a loss in any moving 36-month period. In 2007, the average duration was around 2.3 years for the euro portfolio and 3.6 years for the dollar portfolio.

The rate of return on the reserve portfolios is measured both in absolute terms and relative to benchmark portfolios. Measuring the relative rate of return indicates how successful the strategies implemented by the portfolio managers were relative to the benchmark portfolios.

The rate of return on the dollar portfolio was 8.4% and that on the euro portfolio 3.6% in 2007. The relative rate of return (i.e. the difference between the rate of

return on the actual portfolio and that on the benchmark) was 0.15 basis point for the dollar portfolio, which is around USD 0.2 million in absolute terms, and 0.63 basis point for the euro portfolio, or around EUR 1.1 million in absolute terms. The rate of return on the gold portfolio, including valuation changes, amounted to 14.2% due to a large increase in the gold price. The price of gold increased by almost 32% last year. The overall rate of return on the international reserves in 2007, measured as a weighted average of all portfolios, was 5.72% (up by 2.7 percentage points compared to 2006). The weighted average of the return on the portfolios in koruna terms, i.e. including exchange rate gains and losses, was -2.33% due to the koruna appreciation (-6.86% in 2006).

Decision to reallocate the international reserves

In mid-2007, the Bank Board decided to extend the range of foreign currency instruments in which the CNB invests its international reserves. Starting in 2008 H2, the investment portfolio is to be gradually reallocated so that investments in stock indices represent 10% of the total international reserves at the four-year horizon. This measure is based on the fact that the volume of international reserves has exceeded the level necessary to provide for monetary policy objectives. This opens up the possibility of focusing more on portfolio management based on risk diversification and return. The inclusion of stock indices as a new class of assets is motivated by the higher expected return on the invested funds, which, thanks to the diversification effect, will not affect – or may even reduce – market risk. Full replication of the stock indices of the major world economies (the S&P 500, the FT-SE 100, the Nikkei 225 and the MSCI Euro¹³) was selected as the most appropriate investment instrument. This will be performed using a combination of direct purchases and derivatives for the selected indices. In terms of exchange rate risk, these investments will be allocated so that they reflect the overall currency structure of the international reserves. Management of the stock portfolios will be delegated to selected external managers. Complementary internal management will create exposures to the relevant stock indices using swaps.

In July 2007, a decision was also adopted on the total targeted volume of the dollar part of the reserves. The aim is to change the size of the dollar portfolio to USD 10 billion as of 1 January 2012. This decision was made in order to gradually prepare the central bank's balance sheet for euro area entry. The decision started to be implemented in September 2007 and currently involves the gradual sale of dollars in exchange for euros.

ECONOMIC RESEARCH

The objective of the research work at the CNB is to expand the knowledge base for monetary policy-making and for maintaining financial stability. Research at the CNB is carried out across the bank's organisational units and is coordinated by a specialised department. After a comprehensive review process, the research results are disseminated to the economics community through the publication of research papers and an information bulletin, and by organising seminars. Many research papers have also been published in prestigious international or regional journals. The economic research contributes to the development of the central bank's human capital and helps to build the CNB's position within the ESCB. All relevant information relating to economic research activities and documents is made available to the public in the *Economic Research* section of the CNB website.

¹³ Following a change in the MSCI EMU Large Cap.

The economic research must be of a high standard and, equally importantly, relevant to the central bank. The preparation of opinions on the situation reports on economic developments, which are a fundamental internal input for the CNB Bank Board's decisions on policy interest rates, remained an integral part of the research work at the CNB. These opinions ensure that the usual analytical activities are subject to internal review, thereby fostering better decision-making. The preparation of such opinions also includes the subsequent writing of the minutes of the Bank Board meetings on monetary policy issues, which are published on the CNB website shortly after each meeting. Full transcripts from the meetings are published six years later. Transcripts from 1998–2001 were prepared for publication last year and can now be found on the CNB's website. The involvement of research workers in the monetary policy decision-making process enables economic research findings to be taken into account during the monetary policy discussions, which, in turn, influence research projects in the future. The relevance of the research activities of CNB economists can also be illustrated by their use in the regular Financial Stability Report and in the annual Analyses of the Czech Republic's Current Economic Alignment with the Euro Area, which assess the preparedness of the Czech economy for adopting the euro.

The CNB Bank Board's advisory body for economic research is the Research Advisory Committee, whose members include leading foreign experts. The Committee's main role is to provide a foundation for the Bank Board's decisions on research projects. The line-up of the Committee changes regularly. In 2007, Iain Begg from the European Institute at the London School of Economics became an external member, replacing Aleš Bulíř (International Monetary Fund). Niccolò Batini (International Monetary Fund), Stephen G. Cecchetti (Brandeis University), Carsten Detken (European Central Bank) and László Halpern (Hungarian Academy of Sciences) continued their work for the Committee. The President of the Committee is the Governor of the CNB Zdeněk Tůma. Its new chairman is Chief Executive Director Robert Holman. The internal members of the Committee are the Executive Directors of the CNB's Economic Research Department, Monetary and Statistics Department, Financial Market Regulation and Analyses Department, Financial Market Supervision Department and Risk Management and Transactions Support Department, together with four research project coordinators.

The CNB publishes two research paper series: CNB Working Papers and CNB Research and Policy Notes. The research papers usually present the results of projects recommended by the Research Advisory Committee and approved by the Bank Board. A total of 19 research papers were published in 2007, i.e. more than in the previous year. This number is comparable with other inflation-targeting central banks in small open economies. In addition to research papers, two issues of the Economic Research Bulletin were published. The first one focused on financial stability and the second on fiscal policy.

The quality of research at the CNB is also illustrated by the fact that CNB economists rank high among Czech authors as regards the number of publications in refereed journals. In the IDEAS international rankings of specialised literature, the CNB is among the top 5% of research institutions dealing with transition economics. The large number of CNB economists who attended the Annual Congress of the European Economic Association also deserves a mention. In 2007, the CNB bestowed the third ERD Award for best research paper, which was won jointly by Kamil Galuščák and Daniel Münich and by Roman Horváth.

The CNB also organises public seminars and conferences. It held its third Research Open Day in May 2007. As in previous years, the CNB, the Czech Economic Society and CERGE-EI (The Centre for Economic Research and Graduate Education of Charles University – The Economics Institute of the Academy of Sciences of the Czech Republic) organised three "big" seminars, featuring lectures by Carl Walsh (University of California), Lars Svensson (Princeton University and Sveriges Riksbank) and Pedro Portugal (Banco de Portugal).



One example of the CNB's international research cooperation is the active involvement of its economists in the Wage Dynamics Network (WDN), which studies numerous aspects of the labour market. This project network is coordinated by the ECB and involves economists from the ECB and national central banks as well as leading external experts.

FINANCIAL STABILITY

Maintaining financial stability is defined as one of the CNB's primary objectives in the Act on the Czech National Bank. The CNB defines financial stability as a situation where the financial system operates with no serious failures or undesirable impacts on the present and future development of the economy as a whole, while showing a high degree of resilience to shocks.

The financial market turbulence that started in summer 2007 has increased the relevance of financial stability analyses and the need for regular cooperation in this area with other national and international authorities. CNB experts participate in official EU structures (Banking Supervision Committee, Working Group on Macro-Prudential Analysis, Working Group on Banking Developments, EFC Financial Stability Table, Lamfalussy committees etc.), but regular cooperation has also been established on a regional basis, for example in the area of stress testing. The topical issues in 2007 included the adverse developments on key financial markets in H2, resulting from the reassessment of credit risk on the US mortgage market, and the persisting uncertainty with regard to the extent and allocation of the losses in the financial system in both the USA and Europe. However, the impact of these events on the Czech financial sector was negligible.

The CNB's aim with regard to financial stability is to foster a level of resilience of the system that minimises the risk of financial instability. To fulfil this objective, the CNB uses the instruments available to it under the Act on the CNB. Financial stability monitoring requires identification of the main sources of risk and vulnerability of the financial system. These include inefficient allocation of funds and incorrect assessment or inadequate management of risk. Financial stability analyses deal above all with the development of the financial sector as a whole. They stress the link between financial sector developments and macroeconomic developments at home and abroad, the relationships with the development of those economic sectors to which the financial sector is most exposed (above all non-financial corporations and households), developments in asset prices (financial assets, real estate), the functioning of the financial infrastructure and the settings

of the regulatory framework. Thus, financial stability analyses are complementary to the two other areas of analytical work at the CNB, namely monetary and macroeconomic analyses and supervisory analyses.

In order to maintain financial stability, the CNB focuses on prevention and broad communication with the public regarding the potential risks and factors posing a threat to financial stability. The Financial Stability Report is an integral part of such communication. This report, published annually since 2004, aims to assess developments in the past year and to identify potential risks to the stability of the Czech financial system in the period ahead. The CNB has a legal obligation to submit this report to the Chamber of Deputies (the lower house of the Czech Parliament). The 2006 Financial Stability Report, published in June 2007, assessed the developments in the previous period as very positive. However, it warned that risks existed in relation to the US economy, growth in the indebtedness of Czech households and overly optimistic expectations regarding the outlook for the Czech economy. The 2007 report will be published in June 2008. It will be made available in electronic form in both Czech and English in the *Financial Stability* and *Publications* sections of the CNB website.

Financial stability research publications also serve as a channel of communication with professional economists. The results can be found in research publications on the CNB website, in articles and papers published in professional journals and in the thematic articles of the Financial Stability Report.

STATISTICS

In 2007, CNB statisticians continued to provide source information for monetary policy, financial stability analyses, other CNB analytical activities and the public. They also continued to prepare for the adoption of the euro by harmonising the national statistics with EU standards. The harmonised statistics are also of undoubted importance for the creation of the national statistics, as they generate high-quality, internationally comparable indicators. CNB statisticians were involved in European statistical structures, where they discussed new user requirements and formulated procedures for statistical data coverage. Involvement in international structures is also extensive. CNB representatives attend the meetings of the ESCB Statistics Committee and its six standing working groups. As the ECB shares responsibility for statistics with the European Commission, CNB staff are also involved in two Eurostat committees and five Eurostat working groups. The standards and requirements applied to euro area countries do not become formally binding until euro adoption, but they include an obligation to provide retrospective time series as from EU entry. Therefore, CNB statisticians are monitoring the requirements placed on euro area countries and are gradually preparing, compiling and publishing the statistics prescribed by the EU and ECB legislation.

In addition to harmonisation with EU standards, the CNB statistics also took into account many requirements of domestic users. In line with the principle of minimising the reporting burden, the CNB discussed these requirements with professional associations (e.g. the Czech Banking Association and the Czech Capital Market Association) in order to create an optimal reporting structure. The task of reducing the reporting burden and streamlining the statistical work was also aided by the signing of a Memorandum of Understanding between the Czech Statistical Office (CZSO) and the CNB. This facilitates the exchange of information and defines a procedure for this process. Following preparations in 2006, integrated reporting to the CNB – combining the regulatory and statistical requirements on all regulated financial institutions – was put into practice in 2007.

Money and banking statistics

The range of harmonised and non-harmonised data published was further extended in 2007. The former category includes statistics of other financial intermediaries, where factoring companies were included, and statistics on securities issued. The latter category is represented by detailed breakdowns by sector and industry, especially for the purposes of financial stability, as well as new industry concentration indicators. The money statistics (monetary and credit aggregates and interest rate statistics) can now be considered standard outputs.

Balance of payments statistics

There was a substantial change in the source data used to compile international services trade statistics. Together with the CZSO, the CNB assessed the results of a pilot project to collect information directly from enterprises. The results proved to be sufficiently robust and reliable to allow further use of these sources. Consequently, the time series on services exports and imports were revised as from the Czech Republic's accession to the EU. The change of data source allows the CNB to rescind two decrees governing the use of payment codes in international bank payments. Alongside the quarterly releases, the monthly publication of the main balance of payments items is now a standard tool for analytical work.

Financial accounts statistics

The CNB launched the publication of stock data from the quarterly financial accounts. These summary statistics provide comprehensive information on financial assets and liabilities in individual economic sectors, the financial relations between them, and the relationship between the domestic economy and the rest of the world. The financial accounts are an integral part of the national accounts. Therefore, coordination with the CZSO is being stepped up, especially in the areas of consistency with the national accounts and primary data sharing, which reduces the reporting burden.

THE CNB AS THE BANK OF THE STATE

The CNB provides banking services for the state and the public sector under Act No. 6/1993 Coll., on the Czech National Bank, as amended, and Act No. 218/2000 Coll., on Budgetary Rules and on the Amendment of Some Related Acts (The Budgetary Rules), as amended. It maintains the revenue and expenditure accounts of state organisational units connected to the state budget, revenue and customs offices, the Czech Social Security Administration, labour offices, subsidised organisations, state funds and businesses that receive subsidies from the state budget, and accounts connected to the budget of the European Communities. At the end of 2007, the CNB maintained 27,000 such accounts. The CNB is also responsible for the non-cash payment of state social benefits. For example, 11.3 million transactions relating to state social benefits, 9.2 million health insurance and employment policy contributions and 2.3 million transactions connected with VAT administration were recorded on these accounts in 2007.

Support for treasury liquidity management

Approximately since 2000, the CNB has been working in close partnership with the Ministry of Finance on a Treasury development project in the Czech Republic, under which it is currently responsible for the "Payment System" sub-project.

Under agreements on the performance of Treasury activities, the CNB created financial tools for the Ministry of Finance enabling automated provision of

information on the intra-day Treasury balance. The CNB also launched a new system for setting budget limits for Treasury expenditure accounts, which gives budget chapter administrators direct access to information. Following a change to the relevant provisions of the Act on Budgetary Rules, budget chapter administrators will be able to set budget limits directly via the Internet.

The CNB is also responsible for the daily consolidation of state sector funds¹⁴ on an aggregate Treasury account and works closely with the Ministry of Finance on continuously managing intra-day liquidity on this account, including drafting recommendations for daily lending or investment operations. Current-day expenditures and their coverage by funds on the state accounts are continuously compared in the CNB's payment and settlement system (ABO) so that maximum use can be made of any temporary free liquidity. In the event of any temporary mismatch between revenues and expenditures, either additional funds are obtained to finance expenditures through sales of T-bills on the financial market, or surplus Treasury funds are invested in bills (T-bills or CNB bills). In this way, Treasury funds are used in the most effective way possible and so debt service costs are minimised. The target balance on the aggregate Treasury account continued to decline moderately during 2007, reaching levels around CZK 9 million at the close of the year (the daily average balance on the aggregate Treasury account was roughly CZK 11.5 million last year).

Support for state debt financing

The CNB acts as a fiscal agent for state debt management on behalf of the Ministry of Finance. In practice, this chiefly involves organising primary sales of government bonds and providing expert consultations. In line with the Ministry of Finance's strategy of extending the average maturity of the national debt, debt issued in the area of medium-term and long-term koruna bonds saw further growth, rising by CZK 97.8 billion to CZK 687.2 billion. Conversely, the volume of T-bill issues fell further to CZK 82.2 billion (a decrease of CZK 7.4 billion compared to 2006).

In 2007, the CNB organised 23 auctions of T-bills on behalf of the Ministry of Finance. These bills had maturities ranging from 3 months to 1 year and totalled CZK 175.8 billion. Of this amount, bills with a face value of around CZK 115.8 billion were purchased by direct participants in the auctions. The remainder were purchased by the issuer and placed in its portfolio to be used later on as collateral in financial market operations to bridge short-term liquidity shortages. The bills were sold by Dutch auction. The investors at the T-bill auctions were particularly interested in bills with short maturities. At the end of 2007, the outstanding volume of T-bills (including bills held in the issuer's portfolio) was around CZK 122.2 billion.

The CNB organised 25 primary auctions of medium- and long-term bonds on behalf of the Ministry of Finance, totalling CZK 177.9 billion. The Ministry of Finance reopened existing issues and made new benchmark issues of government bonds with maturities of 5, 10 and 15 years and the first-ever 50-year government bond. However, investor demand for the 50-year bond was very low (traders purchased only 40% of the volume offered). In March, the Ministry of Finance also started buying bonds that were not underwritten into its own portfolio. Overall, it purchased bonds worth CZK 28.7 billion, of which CZK 10.0 billion in government bonds purchased above and beyond the volume offered at auction (the 50-year bond). Two issues, with maturities of 3 and 7 years and a total face value of CZK 43 billion, were also redeemed in 2007.

¹⁴ Accounts subject to consolidation are defined in Act No. 218/2000 Coll., on Budgetary Rules. Above all, they include revenue and expenditure accounts of the state budget, state financial assets accounts, revenue offices' accounts, Treasury liquidity management accounts and, since October 2005, the reserve fund accounts of organisational units of the state.

EUROPEAN AND INTERNATIONAL COOPERATION, FOREIGN TECHNICAL ASSISTANCE

Since 1 May 2004, the CNB has been a full member of the European System of Central Banks (ESCB). Following the accession of Bulgaria and Romania on 1 January 2007, the ESCB comprises the European Central Bank (ECB) and the 27 National Central Banks (NCBs) of the EU.

The CNB Governor regularly attends meetings of the ECB General Council – one of the ECB's three decision-making bodies (along with the Governing Council and the Executive Board), which meets four times a year and where the governors of all the NCBs of the EU countries are represented. In 2007, an extraordinary teleconference was held to discuss and adopt the ECB's Convergence Reports prepared at the request of Cyprus and Malta. Important issues discussed at the regular meetings of the General Council included macroeconomic, monetary and financial developments around the world and in the EU and a document on the evolution of banking structures. Financial market developments related to the US mortgage market and other topics were also discussed.

As in previous years, CNB representatives were involved in the ESCB's 13 committees and numerous working groups. The major issues discussed included counterfeits of euro banknotes and coins, preparations for the second series of euro banknotes, the TARGET2 project, open issues regarding the convergence of the new EU members towards the euro area, information on the banking sector situation in various EU countries, the reform of IMF quotas, and statistical matters.

More than 80 documents were prepared in written consultations and written procedures at the CNB in 2007. In seven cases, the CNB made comments in the form of a Governor's letter to the President of the ECB.

Written consultations represent the Member States' duty to consult the ECB on any draft legislation falling within its fields of competence. This duty applies to the CNB as well as to other state authorities in the Czech Republic. On the other hand, the central banks are entitled to comment on the opinions issued by the ECB on new European and national legal regulations concerning the fields of competence of the ESCB/ECB.

The Czech side twice initiated consultations to evaluate the harmonisation of national law with European law. The Ministry of Industry and Trade consulted the ECB on some provisions of the Consumer Protection Act pertaining to the Czech National Bank. The Ministry of Finance consulted the ECB on an amendment of certain provisions of Act No. 2/1969 Coll., on the Establishment of Ministries and other Central Government Authorities of the Czech Republic, as amended.

The CNB's representation in bodies linked either to the Council of the European Union or to the European Commission also plays an important role. The CNB Governor attends the informal meetings of ECOFIN held twice a year in the country that holds the Presidency of the Council of the European Union. The main topics at the 2007 meetings in Berlin and Porto included the economic situation, financial stability, public finance quality and reform of the IMF. A CNB vice-governor also attends the meetings of the Economic and Financial Committee (EFC), which acts in an advisory capacity to the Council of the European Union. Among other things, the Committee discussed the Convergence Reports of the European Commission and the ECB, financial stability and financial services issues. The CNB is also actively involved in the work of the EFC Sub-Committee on International Monetary Fund Matters (SCIMF). In 2007, the Sub-Committee focused on the reform of member quotas and sustainable financing of this organisation; in particular, the need to link the new financing mechanism on the income side with a review of the expenditure side was stressed.

The most important domestic platform for coordination of policies towards the EU is the government-level EU Committee, which began work in early 2007 in response to the need to institutionalise the debate on key political issues related to the Czech Republic's membership of the EU and connected with the Czech Republic's presidency of the EU Council in the first half of 2009. The CNB is involved in this committee at governor level. Inputs for the meetings of the government-level committee are always discussed in advance in the working-level committee, where the CNB is represented by a vice-governor. Both committees assist primarily in forming and approving positions, instructions and mandates for the Czech Republic's representatives in the Council of the European Union and its working groups. The CNB submits a report on its relations with the ESCB/ECB to the Committee twice a year.

Within the CNB, the Coordination Meeting for EU Issues, chaired by a vice-governor, is used to coordinate activities and discuss European issues.

The International Monetary Fund and World Bank Group

An Article IV consultation with the IMF took place on 8–20 September 2006. The IMF's assessment of economic developments in the Czech Republic was generally positive. Economic growth was still robust, but was likely to slow in 2008. External debt was low and the modest current account deficit was comfortably financed by direct investment flows. While the koruna had appreciated in the second half of the year, it was broadly in line with fundamentals.

According to the IMF, a further monetary policy tightening would be needed and would depend on the degree of koruna appreciation and the second-round effects of indirect tax and energy price increases. The CNB's high credibility and recent steps to enhance transparency of policy communication should serve to anchor inflation expectations. This would also facilitate the transition to the lower inflation target of 2% from 2010.

The IMF experts also felt that despite the better-than-budgeted public finance outcome in 2007, the government should maintain the originally targeted changes in 2008. The government's public finance reform was heading in the right direction, but was only a first step and would not be sufficient to deliver medium- and long-term stabilisation. Reform of the pension and health insurance systems would be essential for sustainable and stable public budgets. Fiscal policy could also benefit from labour market reforms.

In connection with the phasing-out of technical assistance for the Czech Republic, it was agreed that the World Bank would launch the first stage of an integrated financial market supervision financing project. To that end, a World Bank mission visited the Czech Republic in June 2007 in order to analyse the possibilities of financing of such supervision by supervised entities on the Czech financial market. The CNB arranged meetings between the members of the mission and the representatives of public authorities, financial institutions' interest groups and financial market participants. The assessment of the first stage of the project will be handed over to the Czech National Bank in 2008 Q1.

Bank for International Settlements

As in the previous period, the CNB Governor attended the regular meetings of central bank governors of BIS countries held every two months, where strategic issues relating to the international financial system and financial market stability are discussed. In addition, CNB Bank Board members attended the BIS Annual General Meeting in June 2007. Within the Basel Committee on Banking Supervision (BCBS), a CNB representative attended the meetings of the International Liaison Group (ILG).

The Organisation for Economic Cooperation and Development

CNB representatives regularly attended the meetings of the Economic Policy Committee and the Committee on Financial Markets. These working bodies of the OECD discussed topical economic issues such as the financial market turbulence, population ageing, financial sector reform in OECD countries and other major economies and pension system developments.

The CNB was also actively involved in the preparation of the regular review of economic developments in the Czech Republic, which the Economic and Development Review Committee started in 2007 H2. The review will be discussed in March 2008 in Paris and published in the Czech Republic in April. The presentation of the review will be attended by the Secretary-General of the OECD. In addition to assessing overall economic developments, this review is focused on evaluating the recently launched public finance reform. In the same committee, CNB representatives also regularly act as examiners in the discussion of the economic review for Finland.

During 2007, a comprehensive assessment was conducted of the activities and efficiency of all working bodies of the OECD, in which the CNB was also involved. It was also decided in 2007 to renew the process of OECD enlargement to include Russia, Chile, Estonia, Slovenia and Israel.

The European Bank for Reconstruction and Development

The Czech Republic's "graduation" from EBRD operations was completed at the close of 2007. The Czech Republic's intention to graduate from new EBRD operations was approved by the Government in May 2006 and confirmed in a letter sent by the Czech Minister of Finance to the EBRD President in March 2007. The Czech Republic's decision to graduate from new EBRD operations was approved by the EBRD Board of Directors on 23 October 2007 with effect from the end of 2007. The EBRD's Prague office closed in November 2007. In connection with the graduation, the EBRD's London headquarters hosted an exhibition on the cooperation between the Czech Republic and the EBRD from the start of the economic transformation process to graduation. This exhibition met with a very positive response.

The EBRD had operated in the Czech Republic from 1992, providing financing amounting to EUR 1.1 billion for 103 projects totalling EUR 4.7 billion (around CZK 130 billion). Financial sector projects accounted for 48%, corporate sector projects for 40% and infrastructure projects for 12% of this total. The EBRD focused mainly on projects supporting foreign investment in the Czech Republic. In mid-2007, the EBRD's active portfolio in the Czech Republic totalled EUR 369 billion.

The EBRD is interested in continued cooperation with Czech entities after graduation. This is evidenced by the fact that the exchange of information between the EBRD and the Czech business sector as regards cooperation with the EBRD on third markets and their incorporation into EBRD development programmes intensified significantly in 2007. The first step in facilitating regional cooperation between Czech companies and the EBRD in third countries is the Memorandum of Understanding between the Czech Republic and the EBRD signed by the Czech Minister of Finance and the EBRD President in October 2007. It offers symbolic confirmation of the intention of both parties to continue and further develop their cooperation.

The graduation process also included a decision of the Czech Republic to get involved in the donor activities carried out through the EBRD. In addition to a donation of EUR 500,000 provided by the Czech Republic to the Western Balkans Fund in 2006, the Government approved the creation of a Czech Donor Fund amounting to EUR 1.5 million, which will be used for EBRD technical cooperation projects contracted solely to Czech companies.

Foreign technical assistance

Over the past decade, the Czech National Bank has become a sought-after institution in the area of foreign technical assistance (FTA). The foundations for the CNB's technical assistance were laid in 2002, when an FTA programme designed mainly for countries of South-East Europe and the former Soviet Union was prepared for the first time.

A total of 34 projects, including 8 seminars, were held within this programme in 2007, attended by 136 people from 30 central banks. The interest in consultations was strong; a total of 21 consultations took place at the CNB for experts from the central banks of Albania, Armenia, Belarus, Botswana, China, Croatia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Serbia, Slovakia, South Africa and Ukraine. CNB staff also provided technical assistance in the form of consultations or lectures at central banks and international organisations (the Joint Vienna Institute and the central banks of Kyrgyzstan, Macedonia, Armenia, Mongolia and Albania). In addition, the CNB made two financial contributions to international organisations. The total amount spent by the CNB directly on such assistance under the relevant budget item was CZK 757,000.



The CNB's activities in this area are mutually beneficial and enriching. CNB experts also take part in missions of the IMF and other international organisations. Opportunities to become involved in joint EU-funded projects with other central banks (e.g. a banking supervision project for the central bank of Egypt) are opening up. This activity of the CNB is valued not only by the seminar and consultation participants themselves, but also by the BIS in Basel, which monitors the technical assistance provided by central banks.

As regards technical assistance from abroad, a twinning project for the CNB to develop a system for monitoring and analysing financial stability in the Czech Republic, prepared in partnership with Deutsche Bundesbank, was successfully implemented. This project was assessed by the European Commission as the most successful in the history of the assistance received by the Czech Republic from the EU since 1991. Furthermore, a joint twinning project was launched with the Ministry of Finance in the area of the Czech Republic's preparations for the euro.

In recent years, the CNB, which was a net recipient of foreign technical assistance in the first half of the 1990s, has become largely a provider of foreign technical assistance and is thus repaying its "transformation debt".

TECHNOLOGY AND SECURITY

Computing and communication systems

The CNB's information systems and technological environment represent a necessary condition for the performance of the central bank's activities and the fulfilment of its mission. Reliable, safe, economically sound and accessible technology forms the basis for the CNB's analytical, forecasting, regulatory, inspection and decision-making activities.

In addition to having its own infrastructure, the CNB is also linked through communication channels and application logic to all major entities operating on the Czech financial market and therefore can fully use and share this information potential.

As in previous years, the CNB continued cutting its investment and operational costs while maintaining the safe and sound operation of information systems. No IT failure affecting the CNB's activities was recorded in 2007.

The next phase of the integration of IT activities was implemented. The functionality of the CNB's back-up centre and interbank payment security were comprehensively checked and confirmed following major technological changes. The introduction of chip card technology for safer authentication of information system users at the CNB proved beneficial. Audits and security checks of the CNB's system environment were carried out.

A total of 18 new information systems supporting virtually all the areas of activity of the CNB were developed and implemented in the course of the year. Regular replacement of system environment elements continued, focusing on enhancing performance, accessibility, efficiency and security.

The CNB launched a printing strategy to significantly reduce and streamline the use of printing devices at the bank. This should aid service support by reducing the number and types of devices and concentrating printing functions into higher performance devices, thereby reducing total operating expenses.

Last year saw continuing collaboration with the ECB on joint ESCB projects and on ensuring the smooth running of the systems operated by the CNB.

The CNB's crisis management system

Continuity of the CNB's activities is vital to the smooth running of the Czech financial market. Any disruption, even for just a moment, could cause serious economic damage. The CNB therefore has in place a crisis management system intended to eliminate potential security risks. The system is connected to the national crisis management system. Crisis management issues at the CNB are the responsibility of the Crisis Management and Classified Information Protection Department.

The CNB creates the right environment and plans measures for dealing with emergencies. This process is formally laid down in the CNB's Crisis Plan and set out in detail in the Plan's implementing documentation. Last year, the Crisis Plan and the list of critical activities of the CNB were updated. This update took account of information obtained from exercises and tests of the implementing documentation.

Testing receives considerable attention at the CNB, as it is only through testing that planned measures become functional, effective and reliable tools for dealing with real-life emergencies. A practical test of the CNB's new back-up facility at Zličín was a milestone for CNB crisis management in 2007. During the exercise, the CNB's

most important information systems were restored from the back-up centre and the routine operations of selected CNB organisational units were run from the back-up centre. The test was evaluated as a success and confirmed the back-up centre's ability to safeguard the continuity of the CNB's critical activities.

The CNB also met the Ministry of the Interior's requirement to update the list of critical financial market infrastructure entities. These entities currently comprise Komerční banka, Československá obchodní banka, Česká spořitelna and Česká pojišťovna.

Another significant event last year was the implementation of security risk management at the CNB. Under this project, a security risk management system was established across the CNB's organisational units. At the same time, a risk assessment methodology was introduced and a risk reporting procedure was defined. This procedure generates a report for the Bank Board on the security situation at the CNB for the relevant year.

To sum up, we can confidently say that the crisis management system at the CNB contributes significantly to maintaining a high-quality security culture. A modern organisation needs such a culture in order to be resilient and operate successfully.

THE CNB AND THE PUBLIC



EXTERNAL COMMUNICATIONS

The CNB's communication strategy underwent no major changes in 2007. The provision of as much relevant information as possible to all the CNB's target groups is a constant feature of the central bank's work. The CNB's communication with the public in 2007 was active, transparent and cooperative. An opinion poll conducted by STEM confirms that the CNB has chosen the right approach to communicating with the public. This poll revealed that 74% of the population trust the central bank. According to STEM, the CNB enjoys the long-term support of the vast majority of the population.

The most visible change in CNB communications in 2007 was the launch of the bank's new website, which was transformed in terms of structure, function and design. The project began in 2006 and was implemented throughout most of 2007. The new CNB website was put into trial operation at the start of October 2007 and fully replaced the original outdated version in mid-November. The many user-friendly innovations include the location of the exchange rates of the koruna against the euro and the dollar on the home page, and an interactive calendar where users can click on a particular date to reveal information about the data releases and the activities of the CNB and its representatives scheduled for that day. The number of items in the main menu has also been reduced significantly. The main sections now have introductory texts, which should help visitors to find their way around the site more easily. The new, more user-friendly CNB website also meets relatively strict accessibility criteria for disabled users. The new-look site remains the CNB's most important publication channel for all target groups.

The CNB is paying increasing attention to dealing with questions, suggestions and complaints relating to the bank's responsibilities submitted by the public in writing, in electronic form or by phone. A Green Line and a contact e-mail address (info@cnb.cz) have been in operation since 2006. In 2007, the CNB replied to 536 written submissions, 3,850 Green Line calls and more than 2,600 e-mail enquiries from the public. This represents an increase in submissions of around 40% on average compared to 2006. Suggestions from the public are also a valuable source of information for the CNB, and especially for its financial market supervisory units.

Electronic forms for submitting routine applications and applications for information under Act No. 106/1999 Coll. were added to the CNB's new website in November 2007. The central bank made it easier for the public to prepare and submit applications, and this was reflected almost immediately in a sharp rise in their number.



EXHIBITION

The CNB Exhibition is one of the main channels through which the central bank communicates with the public. It provides visitors with a unique set of information about the development of money and monetary policy in the Czech Republic, concentrated in one location. In 2007, the exhibition had more than 15,000 visitors. Since it opened in 2002, more than 91,000 visitors have passed through its doors, most of them secondary school pupils.

Teachers and school governors are increasingly aware of the exhibition, and a visit to the permanent exhibition *People and Money* is becoming a regular part of the tuition they provide, especially in schools specialising in economics. The exhibition is in such high demand that booking periods of more than one year are not unusual. Even some foreign universities book tours of the exhibition as part of their students' study trips to the Czech Republic.

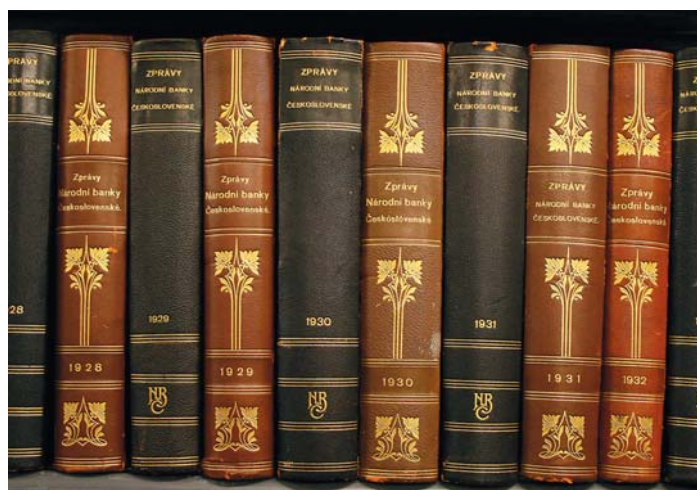
The CNB Exhibition is also a valuable source of information for collectors and for employees of commercial banks and investment companies, for example. Official visits of guests of the CNB's management, participants of courses and seminars organised by the CNB for other central banks and participants of working meetings are also significant. The exhibition also hosted a press conference to present the new CZK 2000 banknote to the public. During the summer holidays the exhibition is visited mainly by foreign tourists, visitors from outside Prague or those for whom no suitable or free date could be found during the school year. Thanks to its completeness, clarity and attractive setting, the exhibition is used by television crews and journalists.



The latest commemorative silver and gold coins from the new Industrial Heritage Sites cycle (Ševčiny Mine at Příbram – Březové Hory, and the Water Mill at Slup) were added to the exhibition as the year progressed. A showcase containing examples of counterfeit current banknotes is a centre of interest. Visitors particularly enjoy the opportunity to test their ability to distinguish between genuine and counterfeit notes. The European Union showcase was also changed. The map displaying the Member States was extended to include Bulgaria and Romania. The visitors can also now admire the national side of the euro coins of the new EMU member, Slovenia. The surging price of gold on world markets boosted interest in the showcase containing one tonne of fine gold in eighty bars from the CNB's gold reserves, giving its spot price in Czech korunas and US dollars. Further information is available on the CNB website at http://www.cnb.cz/cz/expozice_cnb/.

SPECIAL LIBRARY

The CNB's special library provides services to CNB employees and to finance and banking professionals. The specialised collection comprises literature on economics, law, computer technology, politics and history, as well as encyclopaedias, language textbooks and biographies of prominent personalities. A collection of current books and periodicals is deposited in the reading room and is freely accessible to all users. Overall, the library maintains and provides access to more than 51,000 publications, i.e. about 38,000 books and 13,000 study texts, annual reports and research reports and 1,300 periodicals (including documents of central banks, the International Monetary Fund, the World Bank, the European Central Bank and other major international institutions). In 2007, the library acquired 1,960 books, 1,904 study texts, research reports and annual reports and about 8,000 periodicals and other publications. The library's major acquisitions include archive issues of the *American Economic Review* (1962–2000), the *Journal of Economic Perspectives* (1987–2000) and the *Journal of Economic Literature* (1969–1997), which were donated to the library in 2007.



The mission of the library is to provide lending, advisory, reference, bibliographic and information and research services to the public. The library continued to provide access to the Internet and to bibliographic, full-text and numerical databases in the period under review. The proportion of electronic periodicals and access to various databases increased, while that of printed periodicals decreased. Cataloguing of archive collections previously unavailable to users in the library's electronic catalogue was launched in 2007. These archives contain various publications (annual reports and research and study papers) from domestic and foreign banks and economic documents dating in particular from the First Republic of Czechoslovakia.

In 2007, the library registered more than 5,000 active readers, who made 17,623 visits and borrowed 31,787 publications.

The library is open Monday to Thursday from 9 a.m. to 5 p.m. and Friday from 9 a.m. to 3 p.m. Further information is available on the library's website http://www.cnb.cz/cz/knihovna_cnb/ or directly from its online catalogue at <http://sd.ruk.cuni.cz/tinweb/cnbanka/k6>. Books can be reserved, borrowing periods extended, etc. by e-mailing lib@cnb.cz.

CONGRESS CENTRE

The CNB's Congress Centre, which is located in the former Commodity Exchange on Senovážné Square, is used primarily for the needs of the bank. It is a venue for meetings between the CNB's top management and representatives of central banks of other states, deputies and senators of the Parliament of the Czech Republic, financial market representatives, trade unions, financial analysts and journalists. Specialised units of the CNB hold conferences, lectures, presentations, insurance intermediaries' examinations and press conferences there. Last year, the Congress Centre hosted working meetings of ECB and ESCB committees and working groups – for example the Information Technology Committee, the Working Group on External Statistics and the Working Group on Statistical Information Management – and the international Wage Dynamics Network conference.

The premises are used not only by the CNB, but are also rented out to other institutions. The European Banking and Financial Forum took place as usual at the Congress Centre. Another significant event was the international conference "New Challenges for Economics in a Globalised World" organised by the Institute of Finance and Administration, at which the inaugural František Vencovský prize, named after a leading Czech economist and student of Karel Engliš, was awarded to talented young economists. Another event worth mentioning was the "Future of Regional Funding and Employment Policy" conference organised by the *Ano pro Evropu* (Yes to Europe) association, attended by EU commissioners Danuta Hübner and Vladimír Špidla.



The Congress Centre is also used for major social gatherings. In 2007, these included the official ceremony to commemorate the 70th anniversary of the opening of Prague Airport and a meeting of disabled students supported by *Nadace Charta 77 – Konto Bariéry* and their supporters. The Large Congress Hall's excellent acoustics have made it popular with music lovers. Concerts of the Prague Spring and Young Prague international music festivals are performed here regularly.



Traditionally, the CNB's cultural activities also include exhibitions of photographs in the foyer of the Congress Centre. An exhibition entitled *Golden Collection – Part III* was organised in 2007, consisting of photographs lent by the National Museum of Photography in Jindřichův Hradec. Also highly interesting was an exhibition of works by students of the Institute of Creative Photography, Faculty of Arts and Science, Silesian University in Opava, which is the second-oldest, and the biggest (in terms of number of students), of the six university departments offering separate photography courses in the Czech Republic. The exhibition year ended with the opening of an exhibition of photographs entitled *EGYPT* by Martin Frouz, picture editor of the Czech-language edition of National Geographic.



Further information is available on the CNB website at www.cnb.cz/ocnb_sidlo_kcentrum.php.

THE CNB AND ITS PEOPLE



The basis of the CNB's success is human capital, which the CNB strives constantly to improve:

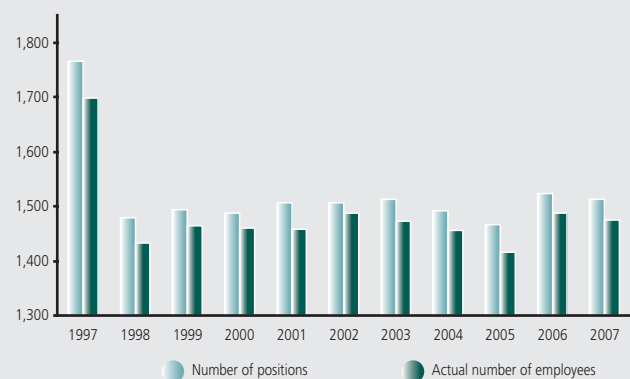
...The human resources area is of key significance, since successful fulfilment of the challenges in the period ahead will depend on the quality, knowledge and motivation of each member of staff. Up until now, personnel work has focused on acquiring people with the required qualifications in areas of central banking in the market economy. It has also been necessary to stabilise central bank staffing in the competitive environment of the developing commercial banking sector. The target for the future is to develop the professionalism of CNB staff members and motivate them to cope with a qualitatively different period of CNB operation...

(Challenges for the Czech National Bank in the Years Ahead)

Number of employees

At the end of 2007, the CNB had 1,474 employees, down by 210 compared to ten years ago. The increase in the number of employees caused by the integration of the state financial market supervisory institutions into the CNB in 2006 was offset by an internal personnel audit conducted in the headquarters and all branches of the CNB. The number of positions, which declined by 10 year on year, and the number of employees were thus both roughly the same as in 2003.

Number of positions and actual number of employees



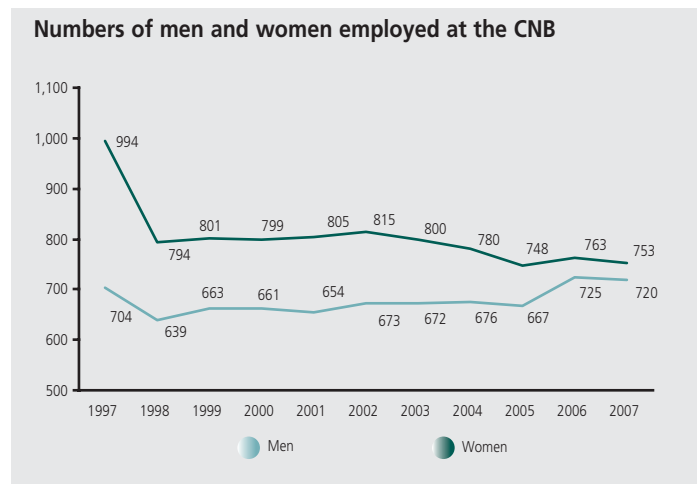
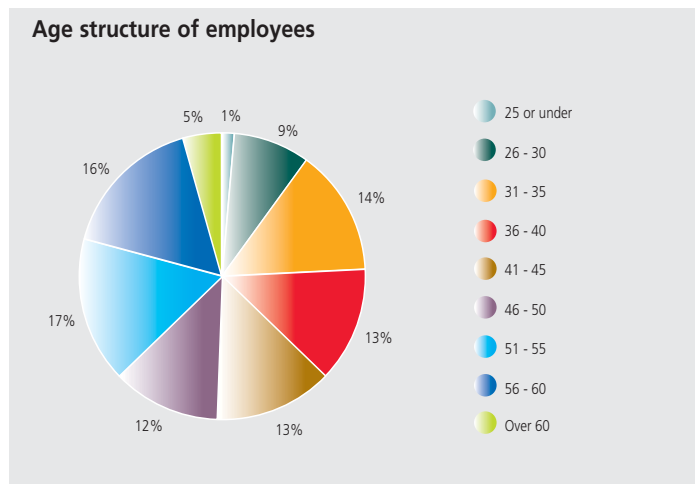
In 2007, a total of 93 new employees were taken on and 106 persons terminated their employment, of whom 28 retired. The number of employees who left the bank in 2007 as a result of the personnel audit in CNB branches and other organisational changes was 33. The recruitment of new employees generally takes the form of headhunting and written job applications, directly approaching selected students in their final years at university, and job advertisements, tenders and selection procedures. Employment is preceded by a demanding interview with the applicant to verify his or her professional qualifications and personal attributes.

Level of education of CNB employees

As of 31 December 2007, university graduates made up 47% of the total CNB workforce, while employees with secondary school education (ending with a school leaving exam) and higher vocational training recorded a 40% share. The remaining 13% had basic education or vocational training (without a school leaving certificate).

Age structure and proportion of men and women

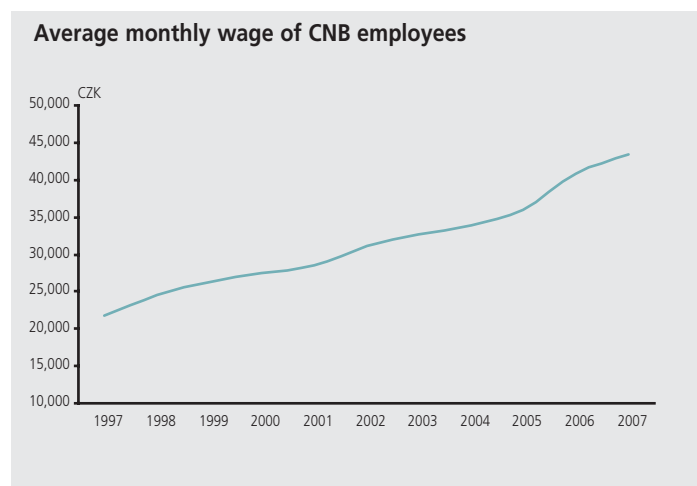
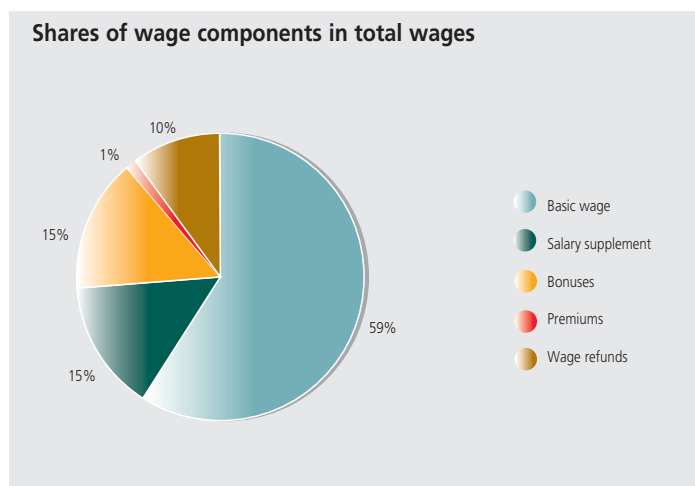
Disregarding the extreme age ranges (i.e. 25 years or under, and over 60 years), the age structure of CNB's employees is balanced, with all age groups evenly represented. The average age of the CNB's employees as of 31 December 2007 was 44.5 years.



The ratio between men and women employed at the CNB has gradually been equalising and has stabilised at approximately 49:51 since the fundamental reorganisation of the CNB in 1998.

The CNB's salary system

The main component of the CNB's salary system is the basic wage, which is based on a sliding scale. In 2007, another component was the salary supplement, amounting to 25% of the basic wage, which was intended to compensate CNB employees in part for the increased duties and limits imposed on them by the Labour Code beyond the framework of their general basic duties. Employees can be given performance-related bonuses.



Personnel expenses totalled CZK 1,105 million in 2007, up by 7.6% on a year earlier. A total of CZK 773 million was paid in salaries, i.e. 7.2% more than in 2006.

The average monthly wage was CZK 43,441. The average annual wage increased by 6.4%. Statutory insurance payments amounted to CZK 275 million. Training expenses were CZK 34 million and other social expenses CZK 23 million. The largest part of these expenses (CZK 17 million) comprised life insurance and pension scheme contributions provided to employees.

The salaries of Bank Board members were as follows:

	Gross salary in CZK ¹⁾	Net salary in CZK ²⁾
Zdeněk Tůma	4,157,202	2,537,507
Luděk Niedermayer	3,638,621	2,222,951
Miroslav Singer	3,525,354	2,149,558
Mojmír Hampl	2,938,139	1,810,665
Robert Holman	2,955,356	1,822,409
Pavel Řežábek	2,955,792	1,810,668
Vladimír Tomšík	2,924,589	1,784,902

1) The gross salary comprises the basic wage, the salary supplement (25% of the basic wage), holiday pay, performance-related bonuses and bonuses for working on non-working days.

2) The net salary is the gross salary net of state health insurance contributions, social security contributions, state employment policy contributions and income tax and tax discounts for the taxpayer and dependent children.

Staff training

Staff training is one of the CNB's human resource management priorities. It encompasses internal training organised within the CNB, training provided by domestic external organisations (including university studies), language training and training provided in other countries.

Language training was focused on further enhancing employees' language skills, especially in the area of specialised terminology and communication. The CNB offered selected seminars to employees of other central banks as part of the ESBC Open Training Activities.

As for training abroad, the CNB continued working with partner central banks. Courses and seminars organised by international banking and financial institutions continued to play a major role in specialised training. The proportion of training events held within the European System of Central Banks increased, especially in the field of communication and management skills (soft skills). In 2007, financial market regulatory and supervisory staff attended pilot seminars organised by the CEBS, CESR and CEIOPS across the individual sectors of financial market regulation and supervision in the EU.

The structure of the internal training events saw an increase in the proportion of specialised courses in financial market regulation and supervision offered in the CNB's annual catalogue of training events.

Employees remain interested in preparing for international certification such as ACCA, CIA and CFA.

An important part of staff training is the expansion of knowledge and experience in the form of exchange study visits to other central banks, usually lasting between 2 weeks and 3 months. Eleven employees undertook such visits in 2007.

FINANCIAL REPORT



INDEPENDENT AUDITOR'S REPORT

To the Bank Board of Česká národní banka:

- I. We have audited the financial statements of Česká národní banka as at 31 December 2007 presented on the enclosed CD-ROM and our audit report dated 29 February 2008 stated the following:

"We have audited the accompanying financial statements of Česká národní banka which comprise the balance sheet as at 31 December 2007, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. For details on Česká národní banka see Note 1 to the financial statements.

Management's Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the Czech Republic. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors, International Standards on Auditing and implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

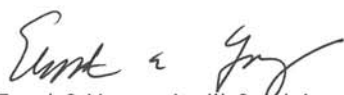
Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Česká národní banka as at 31 December 2007, and its financial performance for the year then ended in accordance with accounting principles generally accepted in the Czech Republic."

- II. We have also audited the consistency of the annual report with the above-mentioned financial statements. The management of Česká národní banka is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respect, with the financial statements. We have checked that the accounting information presented in the annual report in section 5 "Financial report" is consistent with that contained in the audited financial statements as at 31 December 2007. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit, the accounting information presented in the annual report is consistent, in all material respects, with the above-mentioned financial statements.

A handwritten signature in black ink, appearing to read 'Ernst & Young'.

Ernst & Young Audit & Advisory, s.r.o., člen koncernu
License No. 401
Represented by Partner

A handwritten signature in black ink, appearing to read 'Magdalena Souček'.

Magdalena Souček
Auditor, License No. 1291

29 February 2008
Prague, Czech Republic

FINANCIAL STATEMENTS

BALANCE SHEET

in CZK millions	31 Dec. 2007	31 Dec. 2006
1. Gold	809	816
2. Receivables from International Monetary Fund	24,209	26,614
3. Receivables from abroad, including securities	719,681	729,455
3.1. Deposits at foreign banks	48,928	120,413
3.2. Loans provided to foreign banks	4,992	522
3.3. Securities	665,645	608,436
3.4. Other receivables from foreign countries	116	84
4. Receivables from domestic banks	9	27
5. Receivables from clients	100	92
6. Fixed assets	5,519	5,885
6.1. Tangible fixed assets	5,473	5,803
6.2. Intangible fixed assets	46	82
7. Other assets	6,183	6,676
7.1. Prepayments and accrued income	33	27
7.2. Other financial assets	2,687	2,816
7.3. Other	3,463	3,833
TOTAL ASSETS	756,510	769,565
1. Currency in circulation	353,703	321,495
2. Liabilities to International Monetary Fund	22,162	23,765
3. Liabilities to foreign countries	97,366	81,626
3.1. Loans from foreign banks	96,962	81,134
3.2. Other liabilities to foreign countries	404	492
4. Liabilities to domestic banks	279,197	331,789
4.1. Bank monetary reserves	21,421	30,611
4.2. Repo operations	241,530	297,811
4.3. Other liabilities	16,246	3,367
5. Deposits from clients	29,798	40,133
6. Liabilities to the state	152,359	118,979
7. Provisions	208	240
8. Share capital	1,400	1,400
9. Funds	8,087	8,123
10. Revaluation reserve	6,655	-1,440
11. Accumulated losses from previous periods	-162,133	-105,748
12. Net profit / loss for the period	-37,507	-56,385
13. Other liabilities	5,215	5,588
TOTAL LIABILITIES	756,510	769,565

OFF BALANCE SHEET

in CZK millions	31 Dec. 2007	31 Dec. 2006
1. Guarantees issued	161,505	161,583
2. Receivables from spot, term and option transactions	115,248	110,479
3. Liabilities from spot, term and option transactions	115,710	110,434
4. Guarantees received	157,006	157,007
5. Collateral accepted	139,965	105,581
6. Values taken into custody and values in own custody	925	1,119

INCOME STATEMENT		
in CZK millions	31 Dec. 2007	31 Dec. 2006
1. Interest income and similar income	31,968	27,906
1.1. Interest from fixed income securities	27,427	22,207
1.2. Other	4,541	5,699
2. Interest expense and similar expense	-16,914	-14,269
3. Income from shares and other interests	47	46
4. Fee and commission income	490	436
5. Fee and commission expense	-47	-37
6. Gains net losses from financial operations	-50,889	-69,874
6.1. Net foreign exchange losses / gains and foreign exchange spread	-47,183	-65,999
6.2. Other	-3,706	-3,875
7. Other operating income	149	411
7.1. Income from money issue	46	327
7.2. Other	103	84
8. Other operating expense	-293	-281
8.1. Expenses for production of notes and coins	-264	-193
8.2. Other	-29	-88
9. Administrative expenses	-1,545	-1,533
9.1. Personnel expenses	-1,105	-1,027
9.1.1. Wages and salaries	-773	-722
9.1.2. Social and health security	-275	-253
9.1.3. Training and other expenses	-57	-52
9.2. Other administration expenses	-440	-506
10. Depreciation and amortisation of fixed assets	-480	-535
11. Release of specific and general provisions for receivables and guarantees, income from receivables already written off	12	1,383
12. Write offs, additions and utilisation of specific and general provisions for receivables and guarantees	-5	-38
13. Net loss / profit for the period	-37,507	-56,385

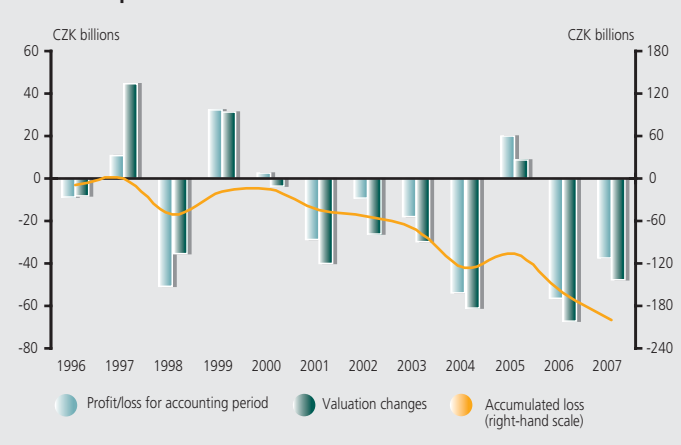
The notes to the financial statements are available on the CNB website, on the attached CD-ROM and from the CNB's Budget and Accounting Department, Na Příkopě 28, Praha 1

At the end of 2007, the Czech National Bank recorded the largest accumulated loss in its balance sheet in its history. This was due to several factors. In the past, for example, there was the resolution of the consequences of the division of the State Bank of Czechoslovakia's balance sheet and the CNB's involvement in the banking sector consolidation programme. These two factors encumbered the bank's finances with aggregate costs of about CZK 95 billion. Recently, the CNB's performance has been affected mainly by foreign exchange losses, generated as a result of the large proportion of foreign exchange assets in the bank's balance sheet (95%) and the appreciation of the koruna.

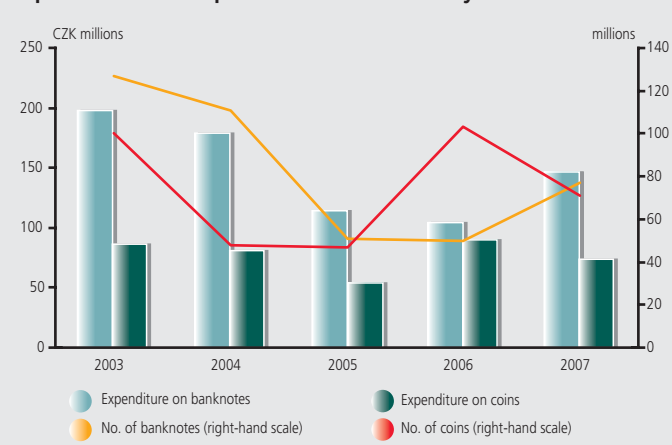
The gradual appreciation of the domestic currency reflects the real convergence of the domestic economy towards the level achieved in the advanced countries. The current level of international reserves exceeds the standard benchmark of commensurate size and is largely due to the conversion of government privatisation revenues and foreign exchange interventions performed in the past in response to strong inflows of foreign investment, which the CNB did not want to let pass through fully into the exchange rate. A partial decline in the accumulated loss is being fostered by measures taken in connection with the reassessment of the international reserves management strategy, such as the increase in the rate of return on reserve holdings and the process of selling off returns on the reserves. This process is being spread over a long period of time, i.e. it is being performed gradually and in regular steps, paying due regard to the potential impact on the exchange rate of the domestic currency.

The primary objective of the CNB is to maintain price stability. Monetary policy-making is fully subordinated to this. Monetary operations affect the bank's performance, hence the latter is not and cannot be an indicator of the true quality of performance, despite efforts to be efficient. The Czech National Bank made a loss of CZK 37,507 million in 2007, but expenses and income arising from monetary operations accounted for 94% of this figure.

The CNB's performance 1996–2007



Expenditure on the purchase of Czech money 2003–2007



Performance in the international reserves management segment is influenced by market developments. Markets were affected in 2007 by the US subprime crisis and subsequently by the credit crunch. This notwithstanding, the CNB managed to increase its income in year-on-year terms, recording net income of CZK 24,313 million at the end of 2007. Net of capital gains from the revaluation of securities in the bank's portfolios (revaluation gains are recorded on the capital accounts, i.e. off the bank's income statement), the result can be considered exceptionally successful. This is also evidenced by the relative rate of return (the weighted average return on managed portfolios), which amounted to 5.72% p.a., up by 2.70 percentage points on a year earlier. From the aggregate point of view, i.e. including foreign exchange losses (CZK 47,665 million), the CNB recorded a loss of CZK 15 billion in respect of international reserves management.

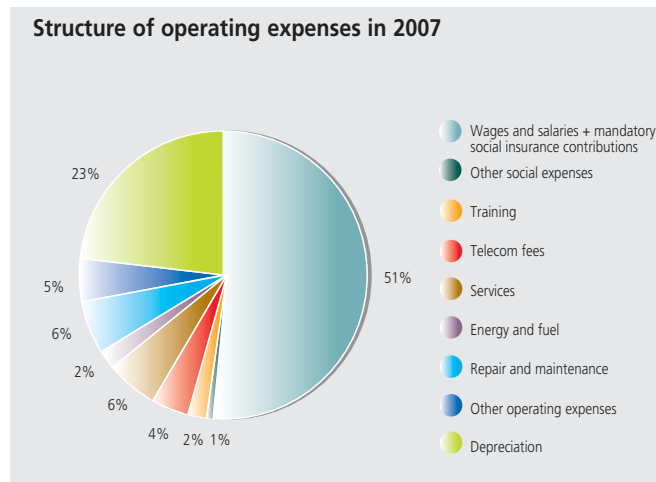
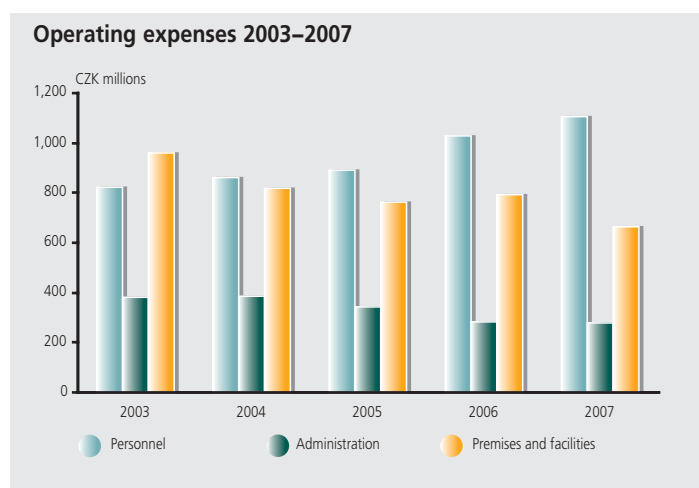
Open market operations, conducted in the form of repo operations, and remuneration of banks' minimum reserve holdings brought a loss of CZK 12,514 million. Their year-on-year growth was due in part to higher interest rates. The long-running decline in excess liquidity, which the CNB sterilises by means of repos, had a positive effect (in the sense of a smaller year-on-year rise in expenses).

In relation to its clients, the CNB recorded a profit. This included fees and interest received and paid, which the bank charged on operations with its clients and when providing services relating to the interbank payment system and the registration and settlement of short-term bond transactions.

A steady rise in money in circulation and the need to replenish the central bank's money stocks, which had previously been reduced owing to the then planned euro adoption date in the Czech Republic, affected the annual growth in currency circulation and management expenses. The finalisation of the project to upgrade Czech banknotes and the preparations for production and the creation of the proofs also played a significant role. In 2007, the CNB purchased 77 million banknotes from its suppliers, at a cost of CZK 147 million. It paid CZK 74 million for base metal coins and silver and gold commemorative coins, of which CZK 37 million was spent on 70 million base metal coins. Expenditure on the preparation and protection of banknotes and coins (the development of new security features) was CZK 43 million. Banknote and coin issuance income totalled CZK 46 million, linked primarily with the sale of numismatic material (silver and gold commemorative coins).

In 2007, the bank's performance was affected for the first time by full-year operating expenses for integrated financial market supervision. The integration of financial market supervision into the central bank on 1 April 2006 generated a sizeable increase in personnel expenses (wages including obligatory insurance contributions)

and other operating expenses, such as software application support. Despite the rising personnel expenses, total operating expenses declined by 2.5% year on year in 2007, i.e. by CZK 54 million in absolute terms. In particular, there was a decline in total depreciation (of about CZK 55 million) due to a higher rate of depreciation of tangible and intangible assets, as well as a decrease in repair and maintenance expenses (especially for information technology and security equipment) and also a fall in rents linked with the construction of the bank's back-up centre.



Personnel expenses, i.e. wages including obligatory insurance contributions, training expenses and other social expenses in the areas of health care and food, were 7.6% higher than a year earlier. They accounted for 54% of total operating expenses, i.e. CZK 1,105 million.

Administration expenses of CZK 238 million consisted mainly of purchased services amounting to CZK 117 million, which include software support, legal and advisory services, cleaning services, auditing services etc. A significant year-on-year rise in expenses was recorded for legal services provided by external providers, while spending on software support services dropped considerably, resulting in an overall decline in expenditure on purchased services. Administration expenses also included, for example, telecommunication and data charges (CZK 80 million), made up mainly of payments for the CNB's branch WAN, Reuters and Bloomberg charges, and internet fees. The charges for Reuters and Bloomberg went down slightly.

Expenditure on the operation of premises and equipment was CZK 665 million, consisting mainly of asset depreciation (CZK 480 million) and asset repair and maintenance expenses (CZK 118 million), for example repair and maintenance of information technology, security equipment and CNB premises. Compared to 2006, there was an overall decline of CZK 127 million, mainly due to depreciation of computer technology and software and also to repair and maintenance of information technology and security equipment.

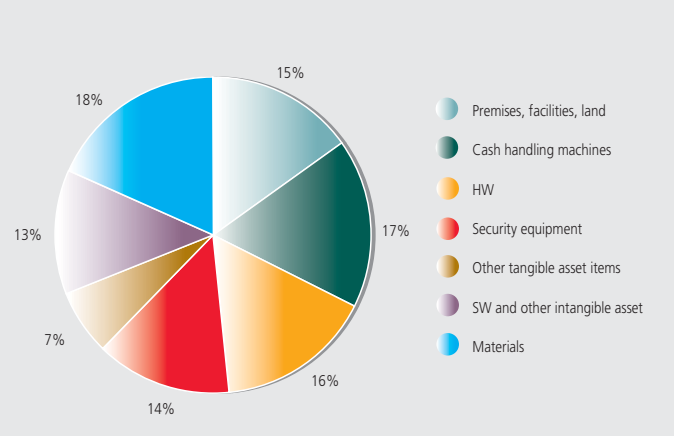
Operating income totalled CZK 95 million, with income relating to financial market supervision and premises rental receipts accounting for the largest part.

The CNB spent CZK 143 million on asset acquisition in 2007, of which CZK 100 million was spent on tangible assets and CZK 24 million on purchases of materials, while CZK 19 million was invested in intangible assets. The volume of expenditure was 47% lower than in 2006.

Asset acquisition costs 2003–2007



Asset acquisition structure in 2007



From the long-term perspective, the largest expenditure item is cash storage, handling and processing equipment, which needs to be upgraded depending on its physical and moral useful life and the date when it was put into service. The accelerating rate of such upgrading recently is also due to a rising volume of cash processing. The next upgrading phase is currently underway.

In previous years, significant amounts were spent on buildings, in particular the construction of the CNB's back-up centre in Prague–Zličín. Expenses in this area decreased considerably after the centre was completed in 2006. No new CNB premises are planned in the longer term. Expenses in this area will thus be channelled mainly into smaller-scale projects in existing buildings and the upgrading of equipment.

Significant amounts were also spent on the acquisition of computer technology, both hardware and software. This area was also significantly affected by the construction of the CNB's back-up centre.

Expenses for the acquisition of materials (packing materials for banknotes and coins, office supplies, maintenance materials, forms, etc.) have been flat in recent years. A slight decline was recorded in 2007, reflecting lower purchase prices for banknote and coin packing materials achieved in tenders.

PROVISION OF INFORMATION UNDER
ACT NO. 106/1999 COLL.



The Czech National Bank's procedure for complying with the duties ensuing from Act No. 106/1999 Coll., on Freedom of Information, as amended (hereinafter the "Act"), and in particular its procedure for dealing with applications for information in compliance therewith, is internally regulated by Czech National Bank Directive No. 55 of 13 December 2002, on the communication of the Czech National Bank, as amended by Amendment No. 4 of 1 November 2007.

Under the Act, the CNB provides information to applicants on the basis of applications or by way of public disclosure.

A) Information provided in 2007 on the basis of applications:

1. Number of applications for information under the Act:
Fifteen
2. Number of decisions refusing an application:
One
3. Number of appeals against decisions:
None
4. Transcript of the relevant parts of each court judgement concerning the examination of the legality of an obliged entity's decision refusing an application for information and an overview of all expenses incurred by the obliged entity in connection with court proceedings on rights and obligations under this Act, including its own staff expenses and legal representation costs:
None
5. Number of exclusive licences granted, including justification of the necessity to grant exclusive licences:
None
6. Number of complaints submitted under Article 16a, reasons for their submission and a brief description of the manner in which they were dealt with:
None
7. Other information relating to the application of the Act:
Most written, e-mail and telephone applications for information received in 2007 concerned information whose provision went beyond the scope of the existing interpretation of the Act. In 2007, the CNB answered 536 written and 2,572 e-mail enquiries from the public.

B) Information provided by way of public disclosure:

The Czech National Bank publishes and continuously updates information in a manner allowing remote access. The information disclosed pursuant to Articles 5(1) and 5(2) of the Act is provided on notice boards at CNB headquarters and branches, in locations accessible to the public, and also on the CNB website (www.cnb.cz/en). A wide range of other information on the activities and responsibilities of the CNB is also published on the state administration web portal.

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115 03 Prague 1
CZECH REPUBLIC

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COMMUNICATIONS DEPARTMENT
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Fax: +420 22441 2179

<http://www.cnb.cz>

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CZECH NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS FOR
THE YEAR ENDED 31 DECEMBER 2007

2007

(Translation of a report originally issued in Czech - see Note 1 to the financial statements.)

INDEPENDENT AUDITOR'S REPORT

To the Bank Board of Česká národní banka:

We have audited the accompanying financial statements of Česká národní banka which comprise the balance sheet as at 31 December 2007, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. For details on Česká národní banka see Note 1 to the financial statements.

Management's Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the Czech Republic. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

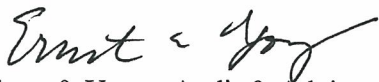
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors, International Standards on Auditing and implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

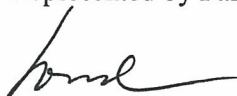
In our opinion, the financial statements present fairly, in all material respects, the financial position of Česká národní banka as at 31 December 2007, and its financial performance for the year then ended in accordance with accounting principles generally accepted in the Czech Republic.



Ernst & Young Audit & Advisory, s.r.o., člen koncernu

License No. 401

Represented by Partner



Magdalena Souček

Auditor, License No. 1291

29 February 2008

Prague, Czech Republic

		IKF						Year		Identification number							
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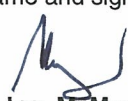
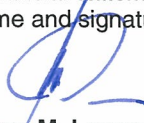
Name of bank: **CZECH NATIONAL BANK**

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BALANCE SHEET

as at 31 December 2007
(CZK million)

Date of preparation	Governor's stamp and signature	Person responsible for accounting Name and signature	Person responsible for financial statements Name and signature
29 February 2008	  doc. Ing. Z. Tůma, CSc. ČESKÁ NÁRODNÍ BANKA Na Příkopě 28, 115 03 Praha 1	 Ing. M. Mayer Tel.: 224 414 326	 Ing. M. Lorenc Tel.: 224 414 461

CZECH NATIONAL BANK

BALANCE SHEET

AS AT 31 DECEMBER 2007

		31 December 2007			31 December 2006
	Note	Gross CZK million	Provision CZK million	Net CZK million	CZK million
ASSETS					
1. Gold	3	809	0	809	816
2. Receivables from the International Monetary Fund	4	24,209	0	24,209	26,614
3. Receivables from abroad, including securities	5	719,681	0	719,681	729,455
3.1. Deposits at foreign banks		48,928	0	48,928	120,413
3.2. Loans provided to foreign banks		4,992	0	4,992	522
3.3. Securities		665,645	0	665,645	608,436
3.4. Other receivables from abroad		116	0	116	84
4. Receivables from domestic banks	6	23	(14)	9	27
5. Receivables from clients	7	8,685	(8,585)	100	92
6. Fixed assets	8	11,343	(5,824)	5,519	5,885
6.1. Tangible fixed assets		10,357	(4,884)	5,473	5,803
6.2. Intangible fixed assets		986	(940)	46	82
7. Other assets	9	7,268	(1,085)	6,183	6,676
7.1. Prepayments and accrued income		33	0	33	27
7.2. Other financial assets		2,687	0	2,687	2,816
7.3. Other		4,548	(1,085)	3,463	3,833
TOTAL ASSETS		772,018	(15,508)	756,510	769,565

The accompanying income statement, off-balance sheet and notes are an integral part of the financial statements.

CZECH NATIONAL BANK

BALANCE SHEET

AS AT 31 DECEMBER 2007

	<u>Note</u>	<u>31 December 2007</u>	<u>31 December 2006</u>
		CZK million	CZK million
LIABILITIES AND EQUITY			
1. Currency in circulation	10	353,703	321,495
2. Liabilities to the International Monetary Fund	4	22,162	23,765
3. Liabilities abroad	11	97,366	81,626
3.1. Loans from foreign banks		96,962	81,134
3.2. Other liabilities abroad		404	492
4. Liabilities to domestic banks	12	279,197	331,789
4.1. Banks' minimum reserves		21,421	30,611
4.2. Repo transactions		241,530	297,811
4.3. Other liabilities		16,246	3,367
5. Deposits from clients	13	29,798	40,133
6. Liabilities to the state	15	152,359	118,979
7. Provisions	16	208	240
8. Capital	17	1,400	1,400
9. Funds	17	8,087	8,123
10. Securities valuation differences	17	6,655	(1,440)
11. Accumulated losses from previous periods	17	(162,133)	(105,748)
12. Net (loss) / profit for the period	17	(37,507)	(56,385)
13. Other liabilities	18	<u>5,215</u>	<u>5,588</u>
TOTAL LIABILITIES AND EQUITY		<u>756,510</u>	<u>769,565</u>

The accompanying income statement, off-balance sheet and notes are an integral part of the financial statements.

CZECH NATIONAL BANK**OFF-BALANCE SHEET****AS AT 31 DECEMBER 2007**

	<u>Note</u>	<u>31 December 2007</u>	<u>31 December 2006</u>
		CZK million	CZK million
OFF-BALANCE SHEET			
1. Guarantees issued	27	161,505	161,583
2. Receivables from spot, term and option transactions	22	115,248	110,479
3. Liabilities from spot, term, option and reverse repo transactions	22	115,710	110,434
4. Guarantees received	27	157,006	157,007
5. Collateral received	27	139,965	105,581
6. Values taken into custody and values in own custody	27	925	1,119

The accompanying income statement, balance sheet and notes are an integral part of the financial statements.

		IKF						Year		Identification number							
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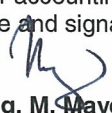
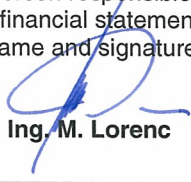
Name of bank: **CZECH NATIONAL BANK**

Sorting code:

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INCOME STATEMENT

for the year ended 31 December 2007
(CZK million)

Date of preparation	Governor's stamp and signature	Person responsible for accounting Name and signature	Person responsible for financial statements Name and signature
29 February 2008	 doc. Ing. Z. Tůma, CSc.  ČESKÁ NÁRODNÍ BANKA Na Příkopě 28, 115 03 Praha 1	 Ing. M. Mayer Tel.: 224 414 326	 Ing. M. Lorenc Tel.: 224 414 461

CZECH NATIONAL BANK

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2007

	<u>Note</u>	<u>2007</u> CZK million	<u>2006</u> CZK million
1. Interest income and similar income	19	31,968	27,906
1.1. Interest from fixed income securities		27,427	22,207
1.2. Other		4,541	5,699
2. Interest expense and similar expense	19	(16,914)	(14,269)
3. Income from shares and other interests		47	46
4. Fee and commission income		490	436
5. Fee and commission expense		(47)	(37)
6. Gains less losses from financial operations	20	(50,889)	(69,874)
6.1. Net foreign exchange gains / (losses) and foreign exchange spread		(47,183)	(65,999)
6.2. Other		(3,706)	(3,875)
7. Other operating income		149	411
7.1. Income from money issue		46	327
7.2. Other		103	84
8. Other operating expense		(293)	(281)
8.1. Expenses for production of notes and coins		(264)	(193)
8.2. Other		(29)	(88)
9. Administration expense	21	(1,545)	(1,533)
9.1. Personnel expenses		(1,105)	(1,027)
9.1.1. Wages and salaries		(773)	(722)
9.1.2. Social and health security		(275)	(253)
9.1.3. Training and other expenses		(57)	(52)
9.2. Other administration expenses		(440)	(506)
10. Depreciation and amortisation of fixed assets	8	(480)	(535)
11. Reversal of specific and general provisions for receivables and guarantees, income from receivables already written off	16	12	1,383
12. Write offs, additions and utilisation of specific and general provisions for receivables and guarantees	16	(5)	(38)
13. Net (loss) / profit for the period		<u>(37,507)</u>	<u>(56,385)</u>

The accompanying balance sheet, off-balance sheet and notes are an integral part of the financial statements.

		IKF						Year		Identification number							
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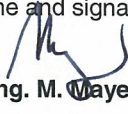
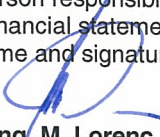
Name of bank: **CZECH NATIONAL BANK**

Sorting code:

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NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2007
(CZK million)

Date of preparation	Governor's stamp and signature	Person responsible for accounting Name and signature	Person responsible for financial statements Name and signature
29 February 2008	 doc. Ing. Z. Tůma, CSc.  ČESKÁ NÁRODNÍ BANKA Na Příkopě 28, 115 03 Praha 1	 Ing. M. Mayer tel.: 224 414 326	 Ing. M. Lorenc tel.: 224 414 461

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

1 GENERAL INFORMATION

The Czech National Bank (hereinafter “the Bank” or “the CNB”) is the central bank of the Czech Republic (hereinafter “the CR”). The Bank was established on 1 January 1993 following the dissolution of the State Bank of Czechoslovakia to form the Czech National Bank and the National Bank of Slovakia. The Bank was established on the basis of Act No. 6/1993 Col. as amended, The Czech National Bank Act (hereinafter “the CNB Act”). The Bank is a legal entity governed by public law and is not registered in the Commercial Register. The Bank operates from its headquarters in Prague and from seven branches around the CR (Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava). The registered office of the CNB is at Na Příkopě 28, Prague 1, Czech Republic, and its identification number is 48136450.

The primary objective of the Bank is to maintain price stability. Without prejudice to its primary objective, the Bank also aims to support the general economic policies of the Government which lead to sustainable economic growth and the general economic policies of the European Union. The Bank acts in accordance with the principle of an open market economy.

In accordance with its primary objective, the Bank sets the monetary policy, issues bank notes and coins, manages the circulation of currency and inter-bank clearing and the settlement system, including the maintenance of this system to ensure its fluency and efficiency, supervises the institutions operating on the financial market (banks, credit unions, electronic money institutions, investment firms and issuers of securities, insurance companies and pension funds) and ensures the safe functioning and development of the financial system in the CR. The Bank also manages foreign currency reserves and performs other activities as defined by the CNB Act and by other legislation.

When pursuing its objectives, the Bank cooperates with the central banks of other countries, the authorities supervising the banks and financial markets of other countries, and with international financial organisations and international organisations involved in the supervision of banks and financial markets.

Based on the European Community foundation agreement and based on the Protocol about the Statute of the European System of Central Banks and the European Central Bank (hereinafter “the Statute”), the Bank is a part of the European Central Banks System and is obligated to follow the regulations set by the Statute in the extension of requirements for those European Union member states which have not yet accepted the euro as their national currency.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

(1)

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

When carrying out its business, the Bank is independent of any instruction given by the President of the CR, the Czech Parliament, the Czech Government, administrative authorities, European Union authorities, Governments of other European Union member states or other authorities and its relationship to the Chamber of Deputies of the Czech Parliament is defined by the law. The Bank and the Government communicate with each other about the principles and measures of monetary and general economic policy.

The supreme management body of the Bank is the Bank Board of the CNB. The Bank Board has seven members. The members include the Governor of the Bank, two Vice-Governors of the Bank, and four other Bank Board members. The members of the Bank Board are appointed and recalled by the President of the CR. The members of the Bank Board are appointed for a period of six years. The Bank Board sets the monetary rules and instruments for their implementation and decides about the primary monetary-political measures of the Bank.

There were no changes in the Bank Board in 2007. As at 31 December 2007, the members of the Bank Board were as follows:

Mr. Zdeněk Tůma	Governor	until 12 February 2011
Mr. Luděk Niedermayer	Vice-Governor	until 26 February 2008
Mr. Miroslav Singer	Vice-Governor	until 12 February 2011
Mr. Mojmír Hampl	Head Manager	until 30 November 2012
Mr. Robert Holman	Head Manager	until 12 February 2011
Mr. Pavel Řežábek	Head Manager	until 12 February 2011
Mr. Vladimír Tomšík	Head Manager	until 30 November 2012

The statutory representative of the Bank is the Governor. In the event of the Governor's absence, a Vice-Governor is appointed by him to represent the Bank.

The Bank uses its income to cover the necessary costs of its operations. Pursuant to the CNB Act, the Bank's profit, if any, is allocated to its reserve fund and other funds created from profit, and for other uses within the Bank's budget. Any remaining profit is transferred to the state budget. Accumulated losses are expected to be covered by future profits; however, this depends on a number of factors, the outcome of which is not certain. The Bank Board is monitoring the situation so that appropriate action, consistent with the Bank's statutory objectives, can be taken should it be necessary.

The CNB submits its annual report on its operations to the Chamber of Deputies of the Czech Parliament within three months after the calendar year-end.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Explanation Added for Translation into English

These financial statements are presented on the basis of accounting principles and standards generally accepted in the Czech Republic. Certain accounting practices applied by the Bank that conform with generally accepted accounting principles and standards in the Czech Republic may not conform with generally accepted accounting principles in other countries.

2 ACCOUNTING POLICIES

(a) Basis of preparation

The financial statements, comprising a balance sheet, income statement and accompanying notes including statement of changes in equity, are prepared in accordance with the Act on Accounting, decree No. 501/2002 Coll. issued by the Ministry of Finance of the CR and Czech Accounting Standards for financial institutions. The financial statements are prepared under the historical cost convention as modified by the revaluation of derivatives and available-for-sale financial instruments to fair values. The financial statements are prepared according to the principles of presentation and disclosure determined by the management of the CNB to be appropriate, bearing in mind the needs and requirements for reporting of central banks. The financial statements of the CNB are prepared to give a true and fair view of its financial position, financial transactions and the results of its operations. The financial statements are rounded to millions of Czech Crowns (hereinafter "million CZK") unless otherwise stated.

(b) Foreign currencies and Special Drawing Rights

Transactions in foreign currencies are translated into CZK at the foreign exchange rate effective at the transaction date. Assets and liabilities denominated in foreign currencies are translated to CZK at the exchange rate effective as at the balance sheet date. All resulting realised and unrealised foreign exchange gains and losses are recognised in the income statement in the gains less losses from financial operations except for foreign exchange gains and losses from capital instruments in available-for-sale portfolio which are recognised in equity (see Note 2(d)).

(c) Gold and other precious metals

Gold and other precious metals are valued at historical cost. Deposits and securities denominated and payable in gold, which the CNB holds to maturity, are included in the gold balance and valued at historical cost. Interest income resulting from the interest bearing securities and deposits denominated in gold is accrued into the income statement.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(d) Securities

The Bank holds foreign debt securities, which are reported in receivables from abroad, and shares in subsidiaries or associates, which are recognized in other financial assets.

Foreign debt securities are purchased in relation to the foreign currency reserves administration, in accordance with predefined rules set by the Bank Board. They consist of money market and capital market securities. Interests represent participations reflecting CNB membership of these institutions.

The Bank classifies all securities held in its portfolio as available-for-sale, i.e., no securities are classified as at fair value through profit or loss, held to maturity or ownership interests.

Securities and interests are initially recognized at cost which includes expenses incurred in connection with their acquisition. Interest income on debt securities is accrued based on the difference between the purchase price and the nominal value using effective interest rate method considering also coupon payments if relevant (amortised cost).

As at 31 December, available-for-sale securities are measured at fair value. Gains and losses arising from changes in the fair value are recognized directly in equity until the financial asset is derecognized or impaired. In such case the cumulative gain or loss previously recognized in equity is recognized in the income statement.

The fair value is determined as the bid / mid market value quoted by a relevant stock exchange or other active public market. In other cases the fair value is estimated by:

- the share on the issuer's equity or the historical cost less impairment in the absence of any other measure;
- the risk adjusted net present value of cash flows for debt securities and notes.

Interest, dividends and foreign exchange differences on debt securities are recognized in the income statement. Foreign exchange differences on shares and ownership interests are recognized in equity.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(e) Repo transactions and securities lending

Securities borrowed or purchased under the purchase and resell agreements are not recognised on the balance sheet. Securities lent or sold under those agreements are retained in their original portfolio. The underlying cash-flows are recorded as received or provided loans and borrowings, respectively, on a settlement date basis. The value of securities received under reverse repo transactions or under securities lending contracts is reported off balance sheet in collateral received.

Foreign debt securities are deposited with foreign depositories and used in an automatic lending scheme operated by a depository or an agent. As part of the lending scheme, securities are lent to third parties through repo transactions and cash received as securities collateral is reinvested through repo transactions or in deposits or short-term bonds. The agent guarantees that all securities lent will be secured by sufficient collateral and cash collateral will be invested in line with CNB rules ensuring risk mitigation. Securities lent as part of the lending scheme continue to be carried on the CNB balance sheet at the original carrying amount. Received collateral is recorded off balance sheet and measured at the current fair value of investment instruments.

(f) Currency in circulation

Notes and coins in circulation represent the liability of the Bank from the issue of currency. The expenses for the production of notes and coins are expensed as incurred.

(g) Membership quota at the International Monetary Fund

The membership quota at the International Monetary Fund (hereinafter the "IMF") is denominated in Special Drawing Rights (hereinafter the "SDR") and is translated to CZK at the rate advised by the IMF on a yearly basis.

(h) Issued securities

The amount of treasury bills issued by the Bank is presented in the balance sheet after offsetting against treasury bills repurchased by the Bank. The Bank repurchases the whole issued amount of treasury bills and uses the treasury bills only as collateral in repo transactions with domestic banks (see Note 14).

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(i) Derivative financial instruments

Derivative financial instruments are initially recognised on the balance sheet at cost and subsequently are re-measured at their fair value. Fair values of futures are obtained from quoted market prices, in other cases the market value is derived from discounted cash flow models. Fair values of derivatives are presented in other assets or in other liabilities when they are positive or negative respectively. The Bank does not apply hedge accounting. Changes in the fair value of derivatives are included in the gains less losses from financial operations. Receivables and liabilities arising from derivative transactions are reported off balance sheet and remeasured to reflect exchange rate movements.

(j) Interest income and expense

Interest income and expense are accrued using a linear yield method for loans and deposits. Interest income for available-for-sale securities is calculated using an effective interest rate method derived from purchase price. Accrued interest is recorded together with underlying assets and liabilities.

The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the instrument to its net carrying amount.

Interest income on non-performing loans is also accrued and included in the related loan balance. Such amounts are considered in estimating the specific provisions for non-performing loans. Interest income also includes interest earned on securities. Penalty interest income recognition is suspended in case of a debtor's default and excluded from interest income until received. Non-interest earning assets, such as long-term receivables are not discounted.

(k) Fee and commission income

Fee and commission income from the maintenance of current accounts and other services are generally recognised on an accrual basis when the service has been provided, usually monthly. One-off fees are recognised immediately in the income statement when the service is provided.

(l) Receivables

Receivables originated by the Bank are stated at nominal value less specific provisions for impairment, if any. Irrecoverable receivables are written off upon completion of bankruptcy proceedings against the debtor or on debtor's liquidation.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(m) Liabilities to the state

The CNB serves the Czech state by maintaining a system of income and expense accounts and other current and deposit accounts for the state and its organization units and other entities pursuant to Section 33 of Act No. 218/2000 Coll., on budgetary rules. The Bank also provides regular banking services on these accounts. Most account balances are connected to the Single Treasury Account and accordingly, these liabilities represent state funds deposited with the CNB.

(n) Provisions

Provisions are created when the Bank has a present obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Additions to provisions are recognised in the income statement, their utilisation is recognised together with expenses or losses, for which purpose they were created in the income statement. Reversal of provisions in case they are no longer necessary is recognised into income. Movements in provision accounts denominated in foreign currencies arising from revaluations to exchange rates prevailing as at the balance sheet date are recognised or charged, as appropriate, to exchange rate differences.

(o) Specific provisions for impairment

Specific provisions are deducted from the nominal value of each receivable originated by the Bank. The amount of specific provisions for classified receivables and assets at risk is based on appraisals of these assets at the balance sheet date after taking into consideration the present forced sale value of collateral.

Specific provisions and provisions are not discounted for the effects of expected timing of cash flows.

When a loan is deemed to be not collectable, it is written off and the related provision for impairment is reversed. Subsequent recoveries are credited to the current period income statement if previously written off.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(p) Tangible and intangible fixed assets

Tangible and intangible fixed assets are recorded at cost, which includes value added tax (hereinafter "VAT") unless the VAT is fully recoverable, and are depreciated / amortised by applying the straight-line basis of depreciation over the estimated useful lives.

If usage of intangible fixed assets is limited by contract, the intangible fixed assets are amortised over the contractual period. Low value tangible fixed assets with a unit cost of more than CZK 2,000 and not exceeding CZK 40,000, as well as low value intangible fixed assets with a unit cost not exceeding CZK 60,000, are treated as fixed assets and are fully depreciated / amortised upon the inception of use. Land, art and art collections are not depreciated.

Estimated useful lives of the tangible and intangible fixed assets are as follows:

Buildings and constructions	30 years
Furniture and fittings	5 – 6 years
Motor vehicles	4 years
Office equipment and computers	3 – 4 years
Software	3 – 4 years
Other intangible assets	6 years

In the case of a change in the annual depreciation or amortisation rate or classification or valuation of the property, the depreciation charge is modified in the month of the change; depreciation or amortisation charged before that date is not adjusted.

Repairs and maintenance expenditures are charged to expenses as incurred. Improvement expenditures exceeding CZK 40,000 per unit in one year are included in the cost of the property.

(q) Value added tax

The Bank is registered for VAT. In accordance with the VAT Act, the CNB claims the full amount of input VAT in respect of received taxable supplies used only for taxable supplies liable to VAT, where the input VAT is fully recoverable.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(r) Income tax and profit transfer to the state budget

The Bank is exempt from income tax in accordance with Section 17(2) of Act No. 586/92 Coll. on Income Taxes, as amended. As a result, the Bank does not account for current or deferred tax. The income of the Bank is used to cover necessary operating expenses. Profit after allocations to funds and other usage (e.g. budgeted compensation of accumulated losses from previous periods) is transferred to the state budget.

(s) Staff costs, pensions and social fund

Staff costs are included in Administration expense and they also include the Bank Board emoluments.

The Bank does not administer its own pension fund but operates defined contribution schemes for its employees, administrated by commercial pension funds. Contributions paid by the Bank are accounted for directly as an expense.

The CNB creates a social fund to finance the social needs of its employees and the employees' programme. The allocation to the social fund is not recognised in the income statement, but as a transfer between funds. Similarly, the usage of the social fund is recognised as a decrease of the fund.

(t) Cash flow statement

As the Bank is the central bank of the CR, the management of the Bank is of the opinion that inclusion of a cash flow statement would not provide further significant information to the users of these financial statements.

(u) Date of accounting transaction

Accounting transactions are recognized or charged into income for the period to which they relate. Purchases and sales of foreign currencies and securities are accounted for as at the trade date off balance sheet; they are recognized on the balance sheet as at the settlement date. Credit transactions, including repo transactions, are accounted for as at the settlement date.

(v) Other off-balance-sheet assets and liabilities

In compliance with accounting procedures for banks, other off-balance-sheet assets and liabilities are recorded off balance sheet. Off-balance-sheet items are carried at face value or estimated value; carrying amount is used if neither face value nor estimated value can be determined.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

(w) Subsequent events

The effects of events which occurred between the balance sheet date and the date of compilation of the financial statements by the Bank Board are reflected in the financial statements in the case that these events provide further evidence of conditions which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date but prior to the compilation of the financial statements which are indicative of conditions that arose subsequent to the balance sheet date, the effects of these events are disclosed, but are not themselves reflected in the financial statements.

3 GOLD

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Gold at cost	<u>809</u>	<u>816</u>

As at 31 December 2007, the Bank held gold bullion, minted gold coins and other unminted gold stock, including gold deposits, of 429 thousand oz of gold, i.e., 13.3 t (31 December 2006: 433 thousand oz of gold, i.e., 13.5 t).

Gold as at 31 December 2007 included a foreign bank deposit of CZK 341 million denominated in gold; gold as at 31 December 2006 included a gold bond of CZK 283 million.

The total market value of gold as at 31 December 2007 was CZK 6,432 million (31 December 2006: CZK 5,691 million).

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

4 RECEIVABLES FROM AND PAYABLES TO IMF

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Membership quota at IMF	22,526	24,111
Deposits in IMF	<u>1,683</u>	<u>2,503</u>
Total receivables from IMF	<u>24,209</u>	<u>26,614</u>
Liability to IMF	13,955	15,381
Current account with IMF	<u>8,207</u>	<u>8,384</u>
Total payables to IMF	<u>22,162</u>	<u>23,765</u>

The membership quota at the IMF is denominated in SDR and financed by bills of exchange payable on request issued by the Czech Government and endorsed by the CNB.

5 RECEIVABLES FROM ABROAD INCLUDING SECURITIES

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Current accounts with banks	35	45
Deposits	<u>48,893</u>	<u>120,368</u>
Total deposits at foreign banks	48,928	120,413
Total loans provided to foreign banks	4,992	522
Treasury bills and other discounted securities	138,943	129,300
Bonds and other coupon securities	<u>526,702</u>	<u>479,136</u>
Total securities	665,645	608,436
Cash in foreign currencies and other cash values	116	84
Total other receivables from abroad	116	84
Total receivables from abroad including securities	<u>719,681</u>	<u>729,455</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007**

Foreign banks are banks with residence abroad. Foreign banks do not include branches of foreign banks resident in the Czech Republic.

Treasury bills and other discounted securities

Treasury bills and other discounted securities can be analysed as follows:

	Fair value 31 December 2007 CZK million	Fair value 31 December 2006 CZK million
Treasury bills	45,232	41,834
Other discounted securities	<u>93,711</u>	<u>87,466</u>
Total treasury bills and other discounted securities	<u>138,943</u>	<u>129,300</u>

Bonds and other coupon securities

Bonds and other coupon securities can be analysed as follows:

	Fair value 31 December 2007 CZK million	Fair value 31 December 2006 CZK million
State bonds	303,182	281,918
Other foreign bonds	<u>223,520</u>	<u>197,218</u>
Total bonds and other coupon securities	<u>526,702</u>	<u>479,136</u>

Of the total securities portfolio of CZK 665,645 million as at 31 December 2007, treasury bills and other discounted securities and bonds and other coupon securities with a fair value of CZK 99,478 million were granted as collateral in repo transactions. Treasury bills and other discounted securities and bonds and other coupon securities with a fair value of CZK 90,648 million were lent under the securities lending scheme. Of the total securities portfolio of CZK 608,436 million as at 31 December 2006, bonds with a total value of CZK 102,484 million were lent through the automatic lending scheme.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

6 RECEIVABLES FROM DOMESTIC BANKS

	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
Non-performing loans	14	14
Loans provided by European Investment Bank (hereinafter the "EIB") funds	<u>9</u>	<u>27</u>
	23	41
Specific provisions against receivables from domestic banks (Note 16)	<u>(14)</u>	<u>(14)</u>
Total net receivables from domestic banks	<u><u>9</u></u>	<u><u>27</u></u>

Loans from the EIB

From the loans received from the EIB, the Bank granted loans in foreign currencies to commercial banks in the CR. Loans were received and provided in the same amount, have the same maturity date and are not secured (see Note 11). The CNB earns a margin on these loans.

7 RECEIVABLES FROM CLIENTS

	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
Standard loans	100	92
Loss loans net value	<u>0</u>	<u>0</u>
Total receivables from clients	<u><u>100</u></u>	<u><u>92</u></u>

Loss loans can be analysed as follows:

	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
Loss loans of former banks	8,585	8,588
Specific provisions (Note 16)	<u>(8,585)</u>	<u>(8,588)</u>
Net book value	<u><u>0</u></u>	<u><u>0</u></u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

8 TANGIBLE AND INTANGIBLE ASSETS

Tangible fixed assets

<u>Cost</u>	<u>31 December 2006</u>	<u>Additions</u>	<u>Disposals</u>	<u>31 December 2007</u>
	CZK million	CZK million	CZK million	CZK million
Land	188	1	0	189
Buildings	6,967	13	0	6,980
Technical equipment	2,500	36	(164)	2,372
Furniture and fittings	328	4	(4)	328
Other	445	16	(6)	455
Tangible assets				
in the course of construction	8	79	(73)	14
Advance payments for tangible assets	<u>0</u>	<u>22</u>	<u>(3)</u>	<u>19</u>
Total cost	<u>10,436</u>	<u>171</u>	<u>(250)</u>	<u>10,357</u>
<u>Accumulated depreciation</u>				
Buildings	(1,921)	(237)	0	(2,158)
Technical equipment	(1,995)	(165)	164	(1,996)
Furniture and fittings	(306)	(8)	4	(310)
Other	<u>(411)</u>	<u>(15)</u>	<u>6</u>	<u>(420)</u>
Total accumulated depreciation	<u>(4,633)</u>	<u>(425)</u>	<u>174</u>	<u>(4,884)</u>
Net book value	<u>5,803</u>			<u>5,473</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Intangible fixed assets

	<u>31 December 2006</u>	<u>Additions</u>	<u>Disposals</u>	<u>31 December 2007</u>
<u>Cost</u>	CZK million	CZK million	CZK million	CZK million
Software	1,276	18	(320)	974
Other intangible assets	12	0	(1)	11
Intangible assets not yet put into use	0	19	(18)	1
Total cost	<u>1,288</u>	<u>37</u>	<u>(339)</u>	<u>986</u>
<u>Accumulated amortisation</u>				
Software	(1,201)	(52)	320	(933)
Other intangible assets	<u>(5)</u>	<u>(3)</u>	<u>1</u>	<u>(7)</u>
Total accumulated amortisation	<u>(1,206)</u>	<u>(55)</u>	<u>321</u>	<u>(940)</u>
Net book value	<u>82</u>			<u>46</u>

The Bank did not provide any fixed tangible or intangible assets as collateral and does not hold any fixed assets under finance lease contracts.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****9 OTHER ASSETS**

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Prepaid expenses	33	27
Other financial assets	2,687	2,816
Advances in relation to the Agreement and indemnity letter (Note 29)	2,943	2,946
Other precious metals	14	7
Positive fair value of foreign currency forwards (Note 22)	386	766
Positive fair value of interest rate swaps (Note 22)	32	0
Margin account including fair value of futures (Note 22)	28	22
Other operating receivables	<u>1,145</u>	<u>1,180</u>
	7,268	7,764
Specific provisions against other operating receivables (Note 16)	<u>(1,085)</u>	<u>(1,088)</u>
Total other assets	<u>6,183</u>	<u>6,676</u>

Other financial assets include CNB's share in the European Central Bank (hereinafter only the "ECB"), the Bank for International Settlement (hereinafter the "BIS") and SWIFT. In line with Article 29 of the Statute, the membership share in the ECB of 1.3880% (totalling EUR 5.6 million) was calculated as at 31 December 2007 based on the population and gross domestic product.

The BIS and SWIFT shares are non-tradable and their holding results from the participation of the CNB in these institutions. The ECB and SWIFT shares are measured at cost. The BIS shares are measured at CNB's share on the paid-up portion of BIS net assets (or equity) reduced by 30%, which reflects the valuation of shares used by the BIS.

In addition, other financial assets include shares of former banks acquired by the CNB during the consolidation of the banking sector. The Bank did not incur any losses in this connection. The shares are measured at fair value, which based on the Bank's estimate approximates zero.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****10 CURRENCY IN CIRCULATION**

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Notes in circulation	344,936	313,279
Coins in circulation	<u>8,767</u>	<u>8,216</u>
Total currency in circulation	<u>353,703</u>	<u>321,495</u>

11 LIABILITIES ABROAD

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Repo transactions	96,953	81,107
Loans from the EIB (Note 6)	<u>9</u>	<u>27</u>
Total loans from abroad	96,962	81,134
Other liabilities abroad	<u>404</u>	<u>492</u>
Total liabilities abroad	<u>97,366</u>	<u>81,626</u>

12 DUE TO DOMESTIC BANKS

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Banks' minimum reserves	21,421	30,611
Repo transactions	241,530	297,811
Short-term deposits received	12,670	0
Other liabilities to domestic banks	<u>3,576</u>	<u>3,367</u>
Total liabilities to domestic banks	<u>279,197</u>	<u>331,789</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****Banks' minimum reserves**

Obligatory minimum reserves represent deposits of the banks in the CR held at the CNB which banks cannot dispose with. The CNB pays interest equal to the CZK two-week repo interest rate on these deposits, which was 3.5% p.a. as at 31 December 2007 (2006: 2.5% p.a.). Obligatory minimum reserves are defined as 2% of received deposits and loans from non-banking clients or selected issued securities.

Other liabilities to domestic banks

Other liabilities to domestic banks represent deposits for handling cash and deposits used for inter-bank money transfers.

13 DEPOSITS FROM CLIENTS

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Current accounts	9,954	9,079
Term deposits	1,826	16,849
Deposits of local government bodies	14,058	11,303
Other deposits	<u>3,960</u>	<u>2,902</u>
Total deposits from clients	<u>29,798</u>	<u>40,133</u>

14 ISSUED DOMESTIC SECURITIES

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Treasury bills issued by the Bank	<u>700,000</u>	<u>700,000</u>
Of which:		
- held by the Bank	418,790	406,756
- used in repo transactions (carrying amount)	281,210	293,244
Total issued domestic securities	<u>0</u>	<u>0</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****15 LIABILITIES TO THE STATE**

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
State funds' accounts	4,301	9,299
State assets denominated in CZK	133,571	102,801
State assets denominated in foreign currency	<u>14,487</u>	<u>6,879</u>
Total liabilities to the state	<u>152,359</u>	<u>118,979</u>

16 PROVISIONS, SPECIFIC PROVISIONS AND WRITE-OFFS

The Bank created specific provisions and provisions for assets at risk:

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Specific provisions		
Non-performing loans due from domestic banks (Note 6)	14	14
Classified loans to clients (Note 7)	8,585	8,588
Other (Note 9)	<u>1,085</u>	<u>1,088</u>
Total specific provisions	<u>9,684</u>	<u>9,690</u>
Provisions		
Guarantees for clients	<u>208</u>	<u>240</u>
Total provisions	<u>208</u>	<u>240</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****Specific provisions**

The movements in the specific provisions can be analysed as follows:

	Amounts due <u>from banks</u>	Classified <u>loans</u>	<u>Other</u>	<u>Total</u>
	CZK million	CZK million	CZK million	CZK million
As at 1 January 2006	14	8,740	1,084	9,838
Addition	0	0	4	4
Utilisation	0	(17)	0	(17)
Reversal	<u>0</u>	<u>(135)</u>	<u>0</u>	<u>(135)</u>
As at 31 December 2006	<u>14</u>	<u>8,588</u>	<u>1,088</u>	<u>9,690</u>
Addition	0	0	1	1
Reversal	<u>0</u>	<u>(3)</u>	<u>(4)</u>	<u>(7)</u>
As at 31 December 2007	<u>14</u>	<u>8,585</u>	<u>1,085</u>	<u>9,684</u>

Provisions

The movements in provisions can be analysed as follows:

	<u>CF</u>	<u>Other</u> <u>guarantees</u>	<u>Total</u>
	CZK million	CZK million	CZK million
As at 1 January 2006	3,815	282	4,097
Addition	0	6	6
Utilisation	(3,815)	0	(3,815)
Reversal	<u>0</u>	<u>(48)</u>	<u>(48)</u>
As at 31 December 2006	<u>0</u>	<u>240</u>	<u>240</u>
Addition	0	4	4
Reversal	0	(5)	(5)
Exchange rate differences	<u>0</u>	<u>(31)</u>	<u>(31)</u>
As at 31 December 2007	<u>0</u>	<u>208</u>	<u>208</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Česká Finanční, s.r.o. (hereinafter "CF") was wound up without liquidation by the take over of net assets by Česká konsolidační agentura on 31 August 2006. Following the settlement of costs and losses resulting from assets taken over within the Consolidation program, the provision to the Guarantee for CF, created in the past, was reversed in 2006.

Reversal of specific and general provisions for loans and guarantees, income from receivables already written off may be analysed as follows:

	<u>2007</u>	<u>2006</u>
	CZK million	CZK million
Reversal of specific provisions	7	135
Reversal of provisions	5	48
Income from receivables already written off	<u>0</u>	<u>1,200</u>
	<u>12</u>	<u>1,383</u>

Income from receivables already written off in 2006 represents partial compensation from Ministry of Finance of the CR for losses incurred on the dissolution of the State Bank of Czechoslovakia.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

17 EQUITY

Changes in equity during 2007 and 2006 were as follows:

	<u>Capital</u>	<u>Funds</u>	<u>Accumulated losses</u>	<u>Securities valuation differences</u>	<u>Profit/(loss) for the period</u>	<u>Equity</u>
	CZK million	CZK million	CZK million	CZK million	CZK million	CZK million
Balance as at						
1 January 2006	1,400	8,044	(125,670)	(433)	19,957	(96,702)
Transfer to accumulated losses	0	0	19,957	0	(19,957)	0
Acquisition of fixed assets						
acquired free of charge	0	75	0	0	0	75
Allocation to funds	0	35	(35)	0	0	0
Use of social fund	0	(31)	0	0	0	(31)
Securities valuation differences	0	0	0	(1,007)	0	(1,007)
Loss for the year 2006	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(56,385)</u>	<u>(56,385)</u>
Balance as at						
31 December 2006	<u>1,400</u>	<u>8,123</u>	<u>(105,748)</u>	<u>(1,440)</u>	<u>(56,385)</u>	<u>(154,050)</u>
Transfer to accumulated losses	0	0	(56,385)	0	56,385	0
Allocation to funds	0	0	0	0	0	0
Use of social fund	0	(36)	0	0	0	(36)
Securities valuation differences	0	0	0	8,095	0	8,095
Loss for the year 2007	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(37,507)</u>	<u>(37,507)</u>
Balance as at						
31 December 2007	<u>1,400</u>	<u>8,087</u>	<u>(162,133)</u>	<u>6,655</u>	<u>(37,507)</u>	<u>(183,498)</u>

Funds

The major part of funds is represented by the General reserve fund of CZK 7,773 million existing at both year ends, which can be used to cover accumulated losses, increase share capital or for any other purpose approved by the Bank Board of the CNB.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007**

The Social fund of CZK 7 million as at 31 December 2007 (31 December 2006: CZK 9 million) is used for coverage of the social needs of employees and the employees' programme of the CNB. Allocations to the Social fund are performed each year from the profit of the previous year. If the CNB achieved a loss in the previous year, the allocation to the Social fund is made from the Special reserve fund.

18 OTHER LIABILITIES

	<u>31 December 2007</u> CZK million	<u>31 December</u> <u>2006</u> CZK million
Negative fair value of foreign currency forwards (Note 22)	745	541
Advance received in relation to the State Guarantee (Note 29)	2,956	2,955
Liabilities to the European Union	1,220	1,768
Other liabilities	<u>294</u>	<u>324</u>
Total other liabilities	<u>5,215</u>	<u>5,588</u>

Liabilities to the European Union include funds from the EU budget to be used by the Czech Republic.

Other liabilities totalling CZK 294 million include liabilities of CZK 60 million owing to social security and health insurance premiums. The Bank has no liabilities to social security and health insurance authorities that would be overdue.

19 INTEREST INCOME, NET

	<u>2007</u> CZK million	<u>2006</u> CZK million
Interest income and similar income	31,968	27,906
Interest expense and similar expense	<u>(16,914)</u>	<u>(14,269)</u>
Interest income, net	<u>15,054</u>	<u>13,637</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****Interest income and similar income**

	<u>2007</u>	<u>2006</u>
	CZK million	CZK million
Interest on treasury bills and other discounted securities	13,789	5,097
Interest on coupon bonds	<u>13,638</u>	<u>17,110</u>
Total interest on securities	<u>27,427</u>	<u>22,207</u>
Interest on inter-bank deposits	4,499	5,581
Interest on receivables from the clients	4	36
Other interest	<u>38</u>	<u>82</u>
Total other interest income	<u>4,541</u>	<u>5,699</u>
Total interest income and similar income	<u>31,968</u>	<u>27,906</u>

Interest expense and similar expense

	<u>2007</u>	<u>2006</u>
	CZK million	CZK million
Interest on liabilities to the state	159	131
Interest on liabilities to banks	16,629	13,998
Interest on liabilities to clients	<u>126</u>	<u>140</u>
Total interest expense and similar expense	<u>16,914</u>	<u>14,269</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****20 GAINS LESS LOSSES FROM FINANCIAL OPERATIONS**

Gains less losses from financial operations can be analysed as follows:

	<u>2007</u>	<u>2006</u>
	CZK million	CZK million
Foreign exchange losses	(47,665)	(66,994)
Foreign exchange spread	<u>482</u>	<u>995</u>
Net foreign exchange losses and foreign exchange spread	(47,183)	(65,999)
Realised gain from sales of securities	1,467	353
Realised loss from sales of securities	(4,006)	(4,204)
Net losses from currency forwards	(1,156)	(12)
Net losses from interest futures	<u>(11)</u>	<u>(12)</u>
Total gains less losses from financial operations	<u>(50,889)</u>	<u>(69,874)</u>

The foreign exchange spread represents the difference between the bid or ask foreign exchange rate and the mid foreign exchange rate used for purchases and sales of the cash and non-cash of the Bank's clients.

21 ADMINISTRATION EXPENSES

The administration expenses can be analysed as follows:

	<u>2007</u>	<u>2006</u>
	CZK million	CZK million
Wages and salaries	773	722
Social security and health insurance	275	253
Training and other expense	<u>57</u>	<u>52</u>
Total personnel costs	<u>1,105</u>	<u>1,027</u>
Rent	2	17
Other	<u>438</u>	<u>489</u>
Total other administration expenses	<u>440</u>	<u>506</u>
Total administration expenses	<u>1,545</u>	<u>1,533</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Staff statistics

	<u>2007</u>	<u>2006</u>
Average number of employees	1,465	1,458
Of which: Number of members of the Bank Board	7	7

22 FINANCIAL RISKS

Liquidity risk

The Bank monitors and manages the structure and duration of its foreign currency reserves in compliance with the mission of the Bank. The table in Note 23 analyses and categorises the assets and liabilities of the Bank into the relevant maturity bands based on the period from the balance sheet date to the contractual maturity date.

Interest rate risk

The Bank takes on exposure resulting from fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Changes in interest rates result in a change in the market value of securities held in the portfolio of the Bank. The rules for investing foreign currency reserves are aimed at limiting the losses resulting from changes in interest rates. The table in Note 24 summarises the Bank's exposure to interest rate risks.

The table lists the Bank's interest bearing assets and liabilities at carrying amounts, categorised by the earlier of contractual, re-pricing or maturity dates.

Currency risk

The Bank takes on exposure resulting from fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. Most of the assets and liabilities denominated in foreign currency are made up of foreign currency reserves which support the CNB's ability to perform intervention and insure against a Balance of Payments crisis, and result from performing the Bank's currency policy. Due to the necessity to keep foreign currency reserves, the CNB cannot reduce the risk of the strengthening of the Czech currency against major foreign currencies. The table in Note 25 summarises the Bank's exposure to the currency risk. The table lists the Bank's foreign currency-denominated assets and liabilities at carrying amounts, categorised by currency.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****Credit risk**

The Bank manages the levels of credit risk it undertakes during the management of foreign currency reserves by placing limits on the amount of risk accepted in relation to one borrower or group of borrowers and to geographical segments. Such risks are monitored on a revolving basis and are subject to an annual, or more frequent, review. The geographical concentrations of assets and liabilities are stated in Note 26.

Spot transactions and derivative financial instruments

The receivables and payables from spot, forward and option transactions can be analysed as follows:

<u>Off-balance sheet receivables:</u>	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
- from future transactions	8,769	224
- from interest rate swap transactions	3,417	0
- from unsettled spot transactions	2,352	12,014
- from forward transactions	56,240	59,554
- from option transactions (Note 27)	<u>44,470</u>	<u>38,687</u>
	<u>115,248</u>	<u>110,479</u>
 <u>Off-balance sheet payables:</u>		
- from future transactions	8,769	224
- from interest rate swap transactions	3,417	0
- from unsettled spot transactions	2,352	12,008
- from forward transactions	56,702	59,515
- from option transactions (Note 27)	<u>44,470</u>	<u>38,687</u>
	<u>115,710</u>	<u>110,434</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007**

The Bank has outstanding currency forwards as at the balance sheet date hedging the movement of foreign exchange rates:

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Off-balance sheet receivables from forward transactions	56,240	59,554
Off-balance sheet payables from forward transactions	56,702	59,515
Positive fair value (Note 9)	386	766
Negative fair value (Note 18)	745	541

All currency forwards mature in 2008.

The foreign currency forwards do not fulfil the criteria for hedge accounting required by the Czech accounting rules, so they are treated as trading derivatives. Gains and losses from the change of the fair value of these foreign currency forwards are recorded in the gain less loss from financial operations (Note 20).

The Bank has outstanding futures as at the balance sheet date:

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Off-balance sheet receivables and payables from futures transactions	8,769	224
Net gain/(loss) from change in fair values of futures transactions open at the year-end	16	(12)

Gains or losses from change in fair values of futures transactions are settled daily against cash on margin account reported within other assets.

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Net gain/(loss) from change in fair values of futures transactions open at the year-end	16	(12)
Cash on margin account	<u>12</u>	<u>34</u>
Margin account including settled change in fair value of futures (Note 9)	<u>28</u>	<u>22</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.
(28)

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

23 LIQUIDITY RISK

As at 31 December 2007	Up to <u>1 month</u> CZK mil.	1-3 <u>months</u> CZK mil.	3-12 <u>months</u> CZK mil.	1-5 <u>years</u> CZK mil.	Over <u>5 years</u> CZK mil.	Un- <u>specified</u> CZK mil.	<u>Total</u> CZK mil.
Assets							
Gold	809	0	0	0	0	0	809
Receivables from IMF	0	0	0	0	0	24,209	24,209
Treasury bills and other discounted securities	48,480	47,374	43,089	0	0	0	138,943
Bonds and other coupon securities	16,366	50,384	70,817	233,680	155,455	0	526,702
Deposits, loans and other receivables from foreign countries	54,036	0	0	0	0	0	54,036
Receivables from domestic banks	0	0	9	0	0	0	9
Receivables from clients	0	0	0	4	96	0	100
Fixed assets	0	0	0	0	0	5,519	5,519
Other assets	<u>520</u>	<u>0</u>	<u>33</u>	<u>0</u>	<u>2,943</u>	<u>2,687</u>	<u>6,183</u>
Total assets	<u>120,211</u>	<u>97,758</u>	<u>113,948</u>	<u>233,684</u>	<u>158,494</u>	<u>32,415</u>	<u>756,510</u>
Liabilities and equity							
Currency in circulation	0	0	0	0	0	353,703	353,703
Liabilities to IMF	0	0	0	0	0	22,162	22,162
Liabilities abroad	97,357	0	9	0	0	0	97,366
Liabilities to domestic banks	279,197	0	0	0	0	0	279,197
Deposits from clients	28,086	0	392	231	1,089	0	29,798
Liabilities to the state	152,359	0	0	0	0	0	152,359
Provisions	0	0	0	0	0	208	208
Equity	0	0	0	0	0	(183,498)	(183,498)
Other liabilities	<u>2,259</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>2,956</u>	<u>5,215</u>
Total liabilities and equity	<u>559,258</u>	<u>0</u>	<u>401</u>	<u>231</u>	<u>1,089</u>	<u>195,531</u>	<u>756,510</u>
Net liquidity gap	<u>(439,047)</u>	<u>97,758</u>	<u>113,547</u>	<u>233,453</u>	<u>157,405</u>	<u>(163,116)</u>	<u>0</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

As at 31 December 2006	Up to <u>1 month</u> CZK mil.	1 - 3 <u>months</u> CZK mil.	3 - 12 <u>months</u> CZK mil.	1 - 5 <u>years</u> CZK mil.	Over <u>5 years</u> CZK mil.	Un- <u>specified</u> CZK mil.	<u>Total</u> CZK mil.
Assets							
Gold	533	0	283	0	0	0	816
Receivables from IMF	0	0	0	0	0	26,614	26,614
Treasury bills and other discounted securities	45,537	37,713	46,050	0	0	0	129,300
Bonds and other coupon securities	24,054	36,666	42,199	228,676	147,541	0	479,136
Deposits, loans and other receivables from foreign countries	121,019	0	0	0	0	0	121,019
Receivables from domestic banks	0	10	10	7	0	0	27
Receivables from clients	0	0	0	5	87	0	92
Fixed assets	0	0	0	0	0	5,885	5,885
Other assets	<u>565</u>	<u>323</u>	<u>27</u>	<u>0</u>	<u>2,945</u>	<u>2,816</u>	<u>6,676</u>
Total assets	<u>191,708</u>	<u>74,712</u>	<u>88,569</u>	<u>228,688</u>	<u>150,573</u>	<u>35,315</u>	<u>769,565</u>
Liabilities and equity							
Currency in circulation	0	0	0	0	0	321,495	321,495
Liabilities to IMF	0	0	0	0	0	23,765	23,765
Liabilities abroad	80,393	1,216	10	7	0	0	81,626
Liabilities to domestic banks	331,789	0	0	0	0	0	331,789
Deposits from clients	39,564	0	340	229	0	0	40,133
Liabilities to the state	118,979	0	0	0	0	0	118,979
Provisions	0	0	0	0	0	240	240
Equity	0	0	0	0	0	(154,050)	(154,050)
Other liabilities	<u>2,258</u>	<u>355</u>	<u>5</u>	<u>14</u>	<u>0</u>	<u>2,956</u>	<u>5,588</u>
Total liabilities and equity	<u>572,983</u>	<u>1,571</u>	<u>355</u>	<u>250</u>	<u>0</u>	<u>194,406</u>	<u>769,565</u>
Net liquidity gap	<u>(381,275)</u>	<u>73,141</u>	<u>88,214</u>	<u>228,438</u>	<u>150,573</u>	<u>(159,091)</u>	<u>0</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

24 INTEREST RATE RISK

As at 31 December 2007	Up to <u>1 month</u> CZK mil.	1 - 3 <u>months</u> CZK mil.	3 - 12 <u>months</u> CZK mil.	1 - 5 <u>years</u> CZK mil.	Over <u>5 years</u> CZK mil.	<u>Insensitive to</u> <u>interest rate</u> CZK mil.	<u>Total</u> CZK mil.
Assets							
Gold	0	0	0	0	0	809	809
Receivables from IMF	0	0	0	0	0	24,209	24,209
Treasury bills and other discounted securities	48,480	47,374	43,089	0	0	0	138,943
Bonds and other coupon securities	25,089	50,397	70,813	228,069	152,334	0	526,702
Deposits, loans and other receivables							
from foreign countries	54,036	0	0	0	0	0	54,036
Receivables from domestic banks	0	0	9	0	0	0	9
Receivables from clients	0	0	0	4	96	0	100
Fixed assets	0	0	0	0	0	5,519	5,519
Other assets	<u>553</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>5,630</u>	<u>6,183</u>
Total assets	<u>128,158</u>	<u>97,771</u>	<u>113,911</u>	<u>228,073</u>	<u>152,430</u>	<u>36,167</u>	<u>756,510</u>
Liabilities and equity							
Currency in circulation	0	0	0	0	0	353,703	353,703
Liabilities to IMF	0	0	0	0	0	22,162	22,162
Liabilities abroad	97,357	0	9	0	0	0	97,366
Liabilities to domestic banks	279,197	0	0	0	0	0	279,197
Deposits from clients	28,086	1,712	0	0	0	0	29,798
Liabilities to the state	152,359	0	0	0	0	0	152,359
Provisions	0	0	0	0	0	208	208
Equity	0	0	0	0	0	(183,498)	(183,498)
Other liabilities	<u>2,259</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>2,956</u>	<u>5,215</u>
Total liabilities and equity	<u>559,258</u>	<u>1,712</u>	<u>9</u>	<u>0</u>	<u>0</u>	<u>195,531</u>	<u>756,510</u>
Net interest sensitivity gap	<u>(431,100)</u>	<u>96,059</u>	<u>113,902</u>	<u>228,073</u>	<u>152,430</u>	<u>(159,364)</u>	<u>0</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

As at 31 December 2006	Up to <u>1 month</u> CZK mil.	1 - 3 <u>months</u> CZK mil.	3 - 12 <u>months</u> CZK mil.	1 - 5 <u>years</u> CZK mil.	Over <u>5 years</u> CZK mil.	<u>Insensitive to</u> <u>interest rate</u> CZK mil.	<u>Total</u> CZK mil.
Assets							
Gold	0	0	0	0	0	816	816
Receivables from IMF	0	2,671	0	0	0	23,943	26,614
Treasury bills and other discounted securities	45,537	37,713	46,050	0	0	0	129,300
Bonds and other coupon securities	73,493	184,863	220,780	0	0	0	479,136
Deposits, loans and other receivables							
from foreign countries	121,019	0	0	0	0	0	121,019
Receivables from domestic banks	0	10	10	7	0	0	27
Receivables from clients	0	0	0	5	87	0	92
Fixed assets	0	0	0	0	0	5,885	5,885
Other assets	<u>465</u>	<u>323</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>5,888</u>	<u>6,676</u>
Total assets	<u>240,514</u>	<u>225,580</u>	<u>266,840</u>	<u>12</u>	<u>87</u>	<u>36,532</u>	<u>769,565</u>
Liabilities and equity							
Currency in circulation	0	0	0	0	0	321,495	321,495
Liabilities to IMF	0	0	0	0	0	23,765	23,765
Liabilities abroad	80,393	1,216	10	7	0	0	81,626
Liabilities to domestic banks	331,789	0	0	0	0	0	331,789
Deposits from clients	39,565	568	0	0	0	0	40,133
Liabilities to the state	118,979	0	0	0	0	0	118,979
Provisions	0	0	0	0	0	240	240
Equity	0	0	0	0	0	(154,050)	(154,050)
Other liabilities	<u>181</u>	<u>354</u>	<u>5</u>	<u>14</u>	<u>0</u>	<u>5,034</u>	<u>5,588</u>
Total liabilities and equity	<u>570,907</u>	<u>2,138</u>	<u>15</u>	<u>21</u>	<u>0</u>	<u>196,484</u>	<u>769,565</u>
Net interest sensitivity gap	<u>(330,393)</u>	<u>223,442</u>	<u>266,825</u>	<u>(9)</u>	<u>87</u>	<u>(159,952)</u>	<u>0</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

25 CURRENCY RISK

As at 31 December 2007

	<u>CZK</u>	<u>EUR</u>	<u>USD</u>	<u>JPY</u>	<u>Other</u>	<u>Total</u>
	CZK mil.	CZK mil.	CZK mil.	CZK mil.	CZK mil.	CZK mil.
Assets						
Gold	0	0	0	0	809	809
Receivables from IMF	22,162	0	0	0	2,047	24,209
Treasury bills and other discounted securities	0	50,455	88,488	0	0	138,943
Bonds and other coupon securities	0	306,775	219,927	0	0	526,702
Deposits, loans and other receivables from foreign countries	0	39,471	14,422	1	142	54,036
Receivables from domestic banks	0	9	0	0	0	9
Receivables from clients	100	0	0	0	0	100
Fixed assets	5,509	0	0	0	10	5,519
Other assets	<u>3,354</u>	<u>248</u>	<u>43</u>	<u>0</u>	<u>2,538</u>	<u>6,183</u>
Total assets	<u>31,125</u>	<u>396,958</u>	<u>322,880</u>	<u>1</u>	<u>5,546</u>	<u>756,510</u>
Liabilities						
Currency in circulation	353,703	0	0	0	0	353,703
Liabilities to IMF	22,162	0	0	0	0	22,162
Liabilities abroad	404	28,806	68,156	0	0	97,366
Liabilities to domestic banks	279,197	0	0	0	0	279,197
Deposits from clients	28,583	1,091	124	0	0	29,798
Liabilities to the state	137,873	14,485	1	0	0	152,359
Provisions	0	0	208	0	0	208
Other liabilities	<u>4,968</u>	<u>246</u>	<u>0</u>	<u>0</u>	<u>1</u>	<u>5,215</u>
Total liabilities	<u>826,890</u>	<u>44,628</u>	<u>68,489</u>	<u>0</u>	<u>1</u>	<u>940,008</u>
Net assets/(liabilities)	(795,765)	352,330	254,391	1	5,545	(183,498)
Net off-balance sheet assets / (liabilities)	<u>0</u>	<u>238</u>	<u>(52,993)</u>	<u>26,771</u>	<u>25,522</u>	<u>(462)</u>
Net foreign exchange position	<u>(795,765)</u>	<u>352,568</u>	<u>201,398</u>	<u>26,772</u>	<u>31,067</u>	<u>(183,960)</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

As at 31 December 2006

	<u>CZK</u>	<u>EUR</u>	<u>USD</u>	<u>JPY</u>	<u>Other</u>	<u>Total</u>
	CZK mil.	CZK mil.	CZK mil.	CZK mil.	CZK mil.	CZK mil.
Assets						
Gold	0	0	0	0	816	816
Receivables from IMF	23,765	0	0	0	2,849	26,614
Treasury bills and other discounted securities	0	72,075	57,225	0	0	129,300
Bonds and other coupon securities	0	260,511	218,625	0	0	479,136
Deposits, loans and other						
receivables from foreign countries	0	41,807	79,163	1	48	121,019
Receivables from domestic banks	0	27	0	0	0	27
Receivables from clients	92	0	0	0	0	92
Fixed assets	5,875	0	0	0	10	5,885
Other assets	<u>3,747</u>	<u>263</u>	<u>0</u>	<u>0</u>	<u>2,666</u>	<u>6,676</u>
Total assets	<u>33,479</u>	<u>374,683</u>	<u>355,013</u>	<u>1</u>	<u>6,389</u>	<u>769,565</u>
Liabilities						
Currency in circulation	321,495	0	0	0	0	321,495
Liabilities to IMF	23,765	0	0	0	0	23,765
Liabilities abroad	492	5,088	76,046	0	0	81,626
Liabilities to domestic banks	331,789	0	0	0	0	331,789
Deposits from clients	23,841	16,255	37	0	0	40,133
Liabilities to the state	112,100	6,878	1	0	0	118,979
Provisions	240	0	0	0	0	240
Other liabilities	<u>3,866</u>	<u>1,722</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>5,588</u>
Total liabilities	<u>817,588</u>	<u>29,943</u>	<u>76,084</u>	<u>0</u>	<u>0</u>	<u>923,615</u>
Net assets/(liabilities)	(784,109)	344,740	278,929	1	6,389	(154,050)
Net off-balance sheet assets / (liabilities)	<u>17</u>	<u>(16)</u>	<u>(57,355)</u>	<u>27,387</u>	<u>30,012</u>	<u>45</u>
Net foreign exchange position	<u>(784,092)</u>	<u>344,724</u>	<u>221,574</u>	<u>27,388</u>	<u>36,401</u>	<u>(154,005)</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

26 CREDIT RISK AND CONCENTRATION OF LIABILITIES

Geographical concentrations of assets

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Czech Republic	10,398	10,352
Germany	170,382	119,184
France	84,709	84,680
Italy	24,551	57,538
Other Eurozone countries	143,502	116,652
Switzerland	21,936	23,757
Great Britain	88,685	90,386
Other European countries	12,509	6,243
USA and Canada	192,943	239,999
Japan	2	2
Other countries	<u>6,893</u>	<u>20,772</u>
	<u>756,510</u>	<u>769,565</u>
Of which:		
Central governments	341,697	360,212
Government agencies	107,201	31,858
Securities hedged by other assets (pfandbriefs)	96,650	76,499
Commercial banks	58,177	171,375
BIS	<u>17,708</u>	<u>8,132</u>
	<u>621,433</u>	<u>648,076</u>

Geographical concentrations of liabilities

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Czech Republic	635,762	662,433
Eurozone countries	1,230	5,623
Other European countries	28,801	1,217
USA and Canada	<u>90,717</u>	<u>100,292</u>
	<u>756,510</u>	<u>769,565</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007****27 OTHER OFF-BALANCE SHEET ITEMS**

Issued guarantees	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
Clients	231	267
In relation to the Agreement and indemnity letter (Note 29)	157,006	157,007
For deposits held by IPB (Note 29)	268	309
Consolidation of the banking sector – sale of part of the business of Agrobanka Praha a. s.	<u>4,000</u>	<u>4,000</u>
Total issued guarantees	<u>161,505</u>	<u>161,583</u>

The identified need for provisions for expected losses on the guarantees issued to clients was CZK 208 million as at 31 December 2007 (2006: CZK 240 million) (Note 16).

Received guarantees	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
From the Ministry of Finance of the CR in relation to the State Guarantee (Note 29)	<u>157,006</u>	<u>157,007</u>
Total guarantees received	<u>157,006</u>	<u>157,007</u>

Off-balance sheet receivables and payables from option transactions	<u>31 December 2007</u> CZK million	<u>31 December 2006</u> CZK million
The agreement about the sale option resulting from the sale of part of business of Agrobanka Praha a.s. (Note 22)	<u>44,470</u>	<u>38,687</u>

Receivables and payables from option operations are made up of the notional value of options issued in 1998 in favour of GE Capital International Holdings Corporation in connection with the sale of part of the business of Agrobanka Praha a.s. to GE Capital Bank. This option maturity expires on 22 June 2008.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Collateral received

The Bank received collateral in relation to reverse repo transactions and agreements on securities lending in the amount of CZK 48,287 million as at 31 December 2007 (31 December 2006: CZK 0).

The Bank recognized off balance sheet liabilities in relation to investments of collateral received as part of securities lending agreements in the amount of CZK 91,678 million as at 31 December 2007 (31 December 2006: CZK 105,581 million).

Assets held in custody

The Bank has not received any financial assets from third parties to be held in custody in 2007 and 2006.

In the off-balance sheet the Bank recognizes other assets taken into custody from clients and banks, assets in own custody and other carrying amounts.

In the off-balance sheet, the Bank recognizes at carrying amounts the assets not reflected in the balance sheet which it received in connection with the fulfilment of the Bank's functions, especially in the field of currency. These items (particularly realized and unrealized designs of tender, legal and non-valid foreign and domestic tender and their counterfeits) are important for archiving and documentary needs of the Bank and, mainly, for study and comparative purposes during protecting currency.

28 CONTINGENCIES AND COMMITMENTS

CNB charges against income the amounts it pays for the reasonable operating costs of Česká konsolidační agentura acknowledged by the Bank. These payments are effected in accordance with addenda No. 1 to the agreement on the payment of operating costs and losses related to assumed assets that are incurred in connection with the fulfilment of the Consolidation Programme concluded on 29 June 2000. These costs were CZK 1 million in 2007. The Bank does not recognize any provisions against these contingencies and commitments as they are immaterial.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

Lawsuits

Pursuant to its role in supporting and maintaining the stability of the banking sector, the CNB or third parties are defendants in several lawsuits. The negative results of these lawsuits could impact the operations of the Bank. Based on consultation with external law firms and internal analyses, the CNB does not consider it probable that the outcome of these legal cases will result in any material outflow of CNB resources and, therefore, has not recognised any provisions.

29 CONSOLIDATION OF THE BANKING SECTOR

Investiční a Poštovní banka, a.s.

In June 2000, the CNB declared forced administration in Investiční a Poštovní banka, a.s. (hereinafter "IPB"). On 16 June 2000, the CNB issued a guarantee for deposits held by IPB (hereinafter "the Guarantee for Deposits") covering all commitments resulting from deposits received by IPB and from bonds issued by IPB, including accrued interest, as at 16 June 2000. Liabilities with a fixed maturity date were guaranteed until the maturity date and liabilities without a fixed maturity date were guaranteed until June 2003.

The Guarantee for Deposits is regularly updated in the CNB off-balance sheet based on an assessment of the liabilities covered by the Guarantee for Deposits performed by CSOB. The balance of the Guarantee for Deposits in the off-balance sheet of the CNB as at 31 December 2007 was CZK 268 million (31 December 2006: CZK 309 million).

The forced administrator of IPB concluded a contract with CSOB regarding the sale of the business on 19 June 2000. Based on this agreement, CSOB took over the assets and liabilities of IPB. On 19 June 2000, the CNB and CSOB concluded the Agreement and indemnity letter (hereinafter the "Indemnity Letter") in which the CNB irrevocably and unconditionally undertook to pay to CSOB certain losses and to indemnify CSOB for certain costs related to the transaction.

On 23 June 2000, the Czech Government issued a State guarantee in which it undertook to refund certain losses incurred by the CNB in connection with the CSOB indemnification based on the Indemnity Letter (hereinafter "the State Guarantee"). The state guarantee covers losses incurred by the CNB resulting from the indemnification of CSOB's losses (damages) arising from unrecorded liabilities relating to IPB that were transferred to CSOB.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK**NOTES TO FINANCIAL STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2007**

On 6 November 2002, the CNB obtained a unilateral binding declaration from CSOB according to which all claims for compensations under the Indemnity Letter from the CNB will be made by CSOB and will be settled by the CNB by 31 December 2016; the maximum amount of the compensation is CZK 160 billion. Based on this declaration, the CNB expects the maximum compensation from the State Guarantee to be of the same amount.

The CNB received a Binding Representation from CSOB on 28 June 2004. A final List of Claims is enclosed with this Binding Representation. The CNB accepted this Binding Representation on 28 June 2004. This does not mean that the CNB accepted or approved the individual claims in the enclosure; however, further claims not included in the Binding Representation may not be brought by CSOB.

The advances and final payments to CSOB and potential amounts covered under the Indemnity Letter can be analysed as follows:

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Total potential claims under the Indemnity Letter	160,000	160,000
Advances paid to CSOB (Note 9)	(2,943)	(2,946)
Foreign exchange differences	(13)	(9)
Settlement to CSOB	<u>(38)</u>	<u>(38)</u>
Total potential future claims under the Indemnity Letter	<u>157,006</u>	<u>157,007</u>

The advances and final payments received from the State Guarantee and available State Guarantee can be analysed as follows:

	<u>31 December 2007</u>	<u>31 December 2006</u>
	CZK million	CZK million
Total State Guarantee received	160,000	160,000
Advances received from the State Guarantee (Note 18)	(2,956)	(2,955)
Final settlement from the State Guarantee	<u>(38)</u>	<u>(38)</u>
State Guarantee receivables at year end (Note 29)	<u>157,006</u>	<u>157,007</u>

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.

CZECH NATIONAL BANK

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FOR THE YEAR ENDED 31 DECEMBER 2007

The CNB has not recognised a provision for these claims as the volume of claims settled so far which were not covered by the State Guarantee has been marginal. In addition, the CNB is currently not able to assess reliably the expected outcome of legal proceedings or the amount of damages, if any, which may be incurred by CSOB, then claimed from the CNB, which would not be covered by the State Guarantee and would, therefore, become an expense of CNB.

30 RELATED PARTY TRANSACTIONS

Related parties and parties with special relations to the Bank are members of the Bank Board, other senior management and their relatives.

CNB grants members of the Bank Board and senior management in accordance with internal rules the services consisting of maintaining deposit and fixed term accounts and special purpose loans, especially for housing. These loans are financed from special reserve fund set aside from the profits of previous periods of the CNB. The loans to the members of the Bank Board and senior management are provided under the same conditions as loans to other employees.

31 SUBSEQUENT EVENTS

In connection with the termination of the mandate of Vice-Governor Mr. Luděk Niedermayer, the President of the Czech Republic, Mr. Vaclav Klaus, appointed a new Head Manager and member of the Bank Board, Ms. Eva Zamrazilová, effective as of 1 March 2008. The current Head Manager, Mr. Mojmír Hampl, was appointed CNB Vice-Governor effective as of the same date.

At its meeting of 21 February 2008, the Bank Board approved the write-off of the CNB receivable from Pozemní stavby Zlín – Group, a. s. arising from a penalty imposed for the reconstruction of the headquarters building amounting to CZK 1,057 million and the corresponding release of the specific provision to income.

The CNB's management is not aware of any other subsequent events that would have a material impact on the 2007 financial statements.

The accompanying income statement, balance sheet and off-balance sheet are an integral part of the financial statements.