



CNB CZECH
NATIONAL
BANK

Annual
Report
2012



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Report
2012

CHARLES IV



JOHN
AMOS
COMENIUS



BOŽENA
NĚMCOVÁ



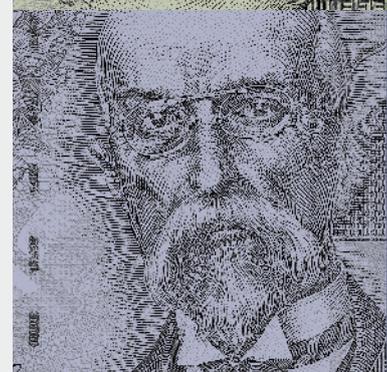
FRANTIŠEK
PALACKÝ



EMMY
DESTINN



TOMÁŠ
GARRIGUE
MASARYK



Mandate of the Czech National Bank

- **to maintain price stability,**
- **to oversee the stability of the financial system,**
- **to ensure smooth circulation of money and smooth payments,**
- **to support the balanced and smooth development of the Czech financial market.**

- Through monetary policy we seek to preserve price stability, i.e. low and stable inflation. Maintenance of stability of the financial system as a whole, which we pursue through macroprudential policy, is a necessary condition for the fulfilment of this objective. Through the joint action of monetary policy and macroprudential policy, we contribute to maintaining confidence in the value of the Czech koruna and safeguarding the stability of the macroeconomic environment.
- By supervising the financial market, issuing prudential rules and rules of conduct towards clients and conducting financial market operations we care for the stability and development of the financial system and protect its clients.
- By managing the interbank payment system and issuing banknotes and coins we ensure smooth payments and cash circulation.
- We act as the bank of the state and provide banking services to the state and the public sector.
- We administer the foreign exchange reserves.

I What we build on

INDEPENDENCE

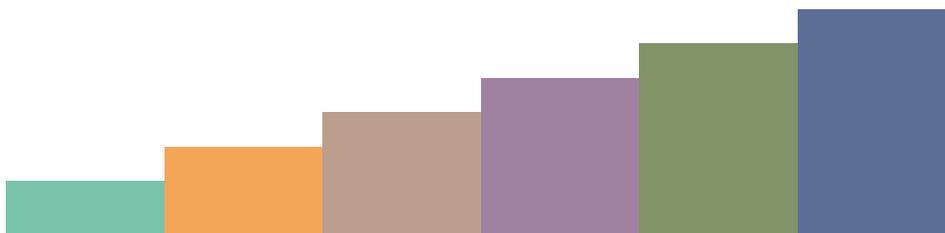
Broad independence of the central bank is a key condition for successful implementation of monetary policy, i.e. for sustained non-inflationary growth of the economy, as well as for objective supervision of the financial market.

OPENNESS AND CREDIBILITY

A high degree of independence must go hand in hand with a high degree of accountability to the public for fulfilling our objectives. We inform the public and their elected representatives regularly and openly about our objectives and their fulfilment and about our opinions, plans and predictions. This makes our actions comprehensible, predictable and therefore credible.

PROFESSIONALISM

Proficient and competent employees are vital if the CNB is to succeed in enhancing its reputation as a credible and open institution at home and on the international stage.



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The year at a glance

- Monetary-policy relevant inflation (headline inflation adjusted for the first-round effects of changes to indirect taxes) decreased gradually during 2012 and was close to the lower boundary of the tolerance band around the CNB's 2% target at the end of the year. This primarily reflected the anti-inflationary effect of the domestic economy. Headline inflation was above the upper boundary of the tolerance band for most of the year due to an increase in the reduced VAT rate in January 2012.
- Owing to a marked slowdown in external demand and generally subdued domestic demand amid ongoing fiscal consolidation, the Czech economy contracted by 1.2%. The external economy and domestic economy and their outlooks deteriorated mainly in the second half of the year.
- After having kept monetary policy rates unchanged for two years, the CNB lowered rates at the end of the first half of the year and decided to make another two cuts in the remainder of the year. The key interest rate thus fell from 0.75% to the technical zero level of 0.05% during 2012.
- In November 2012, the Bank Board announced that rates would be kept at technical zero over a longer horizon until inflation pressures increased significantly. The Board repeatedly communicated the option of using foreign exchange interventions if it became necessary to further ease monetary policy.
- In 2012, the CNB contributed to the development of the EU's ever-changing regulations in the financial market area and to changes in the regulatory framework in the Czech Republic.
- For preventive reasons, the CNB adjusted the extraordinary additional reporting duty applying to selected financial market institutions in the context of persisting tensions in foreign financial markets and the escalating euro area debt crisis.
- The Czech Republic joined a new IMF constituency comprising Central and Eastern European countries. This will give it the opportunity to appoint an Executive Director of the IMF Executive Board for only the second time ever.
- The Czech National Bank and the Ministry of Finance recommended that the Czech government should not set a target date for adopting the euro yet and should thus not attempt to enter ERM II during 2013.
- The Czech President appointed Mojmír Hampl and Vladimír Tomšík as CNB Vice-Governors for a second six-year term with effect from 1 December 2012.
- The CNB last year had the smallest workforce in its 20-year history. At the end of 2012 the central bank had 1,396 employees. Wage costs were cut as a result of reorganisation. Cost-saving and streamlining measures continued to be taken as part of the Bank Board's long-running drive to make the institution more efficient.



Governor's foreword



As in previous years, events in the foreign and domestic budget area were the most important factors for the Czech economy in 2012. The crisis in the euro area, which started in 2008 as a financial crisis and turned into a debt crisis in 2010, entered its fifth year. There were still no signs of the long-running problems in the euro area coming to an end in 2012. The rising financial market tensions observed at the end of 2011 intensified in the first half of 2012. This forced the European Central Bank into giving European banks another injection of liquidity in February and announcing a government bond purchase programme in September. This step helped to reduce the acute risks felt by the financial markets. Risk premia on government bonds of periphery economies started to decline after the programme was announced, and it seemed that this round of the crisis had been averted. The ECB was thus the most important stabilising factor outside the Czech Republic in 2012.

However, the budget deficit cuts made by most European governments took their toll during 2012 in the form of slowing economic growth. Weaknesses began to spill over increasingly from the periphery economies, which have been contracting for many quarters now, to core countries of the euro area. Although the ECB succeeded in averting the acute risks on the financial markets by intervening in determined fashion, public sector deleveraging exacerbated the overall economic weakness. The rising danger of the most indebted countries slipping into a downward spiral of budget cuts, deeper economic decline and more budget cuts due to deeper-than-expected decline sparked a heated debate about the appropriateness of the fiscal consolidation paths chosen. In addition, rising fatigue from the endless difficulties was

accompanied in some countries by major political tensions and, in the euro area as a whole, by signs of weakening solidarity between countries. Nonetheless, the euro area countries were probably close to bottoming out at the end of 2012 and will now start to recover gradually. However, this outlook is conditional on the risks not escalating again. The alternating waves of optimism and disillusionment we have seen since the crisis broke out indicate a need for sober reflection, all the more so because many European governments still have to make many painful interventions in their underperforming and inflexible economies. The institutions and basic mechanisms of the euro area will also have to undergo sweeping changes.

The budget situation was again the most important domestic factor for the Czech economy in 2012. As in some other European countries, the economic contraction in the Czech Republic was due to the correction of previous fiscal imbalances. The economy shrank by 1.2% for the year as a whole, with the only positive contribution coming from net exports. All components of domestic demand remained negative, reflecting investment uncertainty among businesses and a lack of consumer confidence among households.

Demand-pull inflationary pressures disappeared from the economy as a result of weakening external demand and falling domestic demand. Monetary-policy relevant inflation therefore fell steadily during 2012, reaching the lower boundary of the tolerance band around the CNB's inflation target at the year-end, although for most of the year headline inflation was above the upper boundary of the tolerance band due to a January increase in the reduced VAT

rate. The falling demand-pull inflation made the CNB lower its monetary policy interest rates at the end of the first half of the year, and two more cuts followed before the end of the year. The key two-week repo rate thus fell from 0.75% to a historical low of 0.05%.

An unprecedented monetary policy challenge arose in the second half of 2012. Whereas the forecasts compiled in the first half of the year had suggested just a minor fall in market interest rates by the end of 2012, the forecasts made in the second half of the year indicated a need for a greater interest rate reduction in 2013. As interest rates gradually approached their lower limit, the CNB started to analyse the options for using additional monetary policy instruments. The internal debate culminated in November 2012 with an announcement by the Bank Board that rates would be kept at technical zero over a longer horizon until inflation pressures increased significantly. To ease the monetary conditions the Board is ready to use tools other than interest rates, specifically foreign exchange interventions, to weaken the exchange rate of the koruna. To support the potential implementation of this plan, the Board ended the CNB's long-running programme of sales of income on international reserves.

Despite the economic downturn, domestic banks remained in good condition in 2012. The share of non-performing loans in their balance sheets remained stable and was far below any level representing a major risk. Our regular stress tests of banks constantly show that even in the event of highly implausible shocks, the capital adequacy ratio of the banking sector as a whole would remain above the required minimum and the necessary increase in the capital of individual financial institutions would represent just a fraction of a per cent of Czech GDP. The Czech financial system thus continued to act as an absorber of disturbances and shocks.

In July, the Czech Republic joined the new International Monetary Fund constituency of Central and Eastern European countries. Thanks to the new constituency, which started up at the beginning of November, the Czech Republic is for the first time in recent history represented at the level of second Alternate Executive Director in 2012–2014. This entitles it to hold the post of Executive Director for a two-year period in the future. We regard this as a significant achievement and a great honour for our country.

In a sense, 2012 was an extraordinary year for the Czech central bank. The CNB entered 2012 leaner and fitter after having made organisational changes in 2011 to streamline its operations. By the end of the year it had the smallest workforce in its 20-year history. Our cost-cutting drive also had the desired results, with operating costs reaching a 17-year low in 2012. Public confidence in the CNB, as expressed in opinion polls, remained at historical highs in 2012.

The Czech President appointed Vice-Governors Mojmír Hampl and Vladimír Tomšík for a second six-year term with effect from 1 December 2012, which I regard as a positive step. The Board thus had the same line-up for the entire year, testifying to a high degree of continuity in our work. I am glad to be able to conclude my foreword by saying that for us, 2012 was a successful and generally peaceful year.

Miroslav Singer
Governor





Bank Board

1



An era when the whole of Europe knew and recognised the Czech koruna as a symbol of stability, prosperity and civilisation. The “Father of his Country” laid the foundation stone of Czech statehood.

CHARLES IV

(14 May 1316, Prague – 29 November 1378, Prague)

Fluent in five languages, Charles was an unusually well educated and intelligent man. He used his power to consolidate the Bohemian state, which from then on became known as the Lands of the Bohemian Crown. As Holy Roman Emperor he also promulgated the most important imperial constitutional law, the Golden Bull of 1356, which remained in force until the Holy Roman Empire was dissolved in 1806. He founded Charles University in Prague, established Prague’s New Town and built Karlštejn Castle. He significantly expanded the territory of the Bohemian state, especially in the north-easterly direction.

Bank Board



The Bank Board is the supreme governing body of the Czech National Bank. It has seven members: the Governor, two Vice-Governors and four other members. Bank Board members are appointed and recalled by the President of the Czech Republic. They are appointed for a term of six years. No one may hold the position of Bank Board member more than twice.

Membership of the Bank Board is incompatible with the position of member of a legislative body, member of the Government and membership of the governing, supervisory or inspection bodies of other banks or commercial undertakings, and the performance of any independent gainful occupation, except for scientific, literary, journalistic, artistic and pedagogical activities and except for management of own assets. Membership of the Bank Board is incompatible with any activity which might cause any conflict of interest between the performance of this activity and membership of the Bank Board.

The Bank Board sets monetary policy, decides on fundamental monetary policy measures and approves monetary instruments and principles for CNB transactions. It decides on key measures relating to financial stability, financial market supervision and cash and non-cash money circulation. It sets the CNB's overall development strategy, approves plans of activities for individual areas of work of the bank and rules for the CNB's involvement in the activities of the EU, the European System of Central Banks (ESCB) and the European Systemic Risk Board (ESRB) and its cooperation with international financial institutions. It decides on the bank's organisational structure and the powers and responsibilities of the organisational units at its headquarters and branches. It also approves the CNB's budget and financial management principles. The Governor, or, in his absence, a Vice-Governor nominated by him, chairs the meetings of the Bank Board. The Bank Board acts by a simple majority of the votes cast.

< The Bank Board as of 31 December 2012

Pavel Řežábek, Eva Zamrazilová, Lubomír Lízal,
Vladimír Tomšík, Miroslav Singer, Mojmír Hampl, Kamil Janáček

The CNB in 2012

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To whomsoever you can do good, rejoice to do it, even though it were to the whole world. It is the property of excellent natures to minister and do good.

JOHN AMOS COMENIUS

(28 March 1592, south-eastern Moravia – 15 November 1670, Amsterdam)

Last Bishop of the Unity of the Brethren and one of the greatest Czech thinkers, philosophers and writers. Comenius was a renowned teacher and educational theorist and wrote many works on this subject. He was the sole creator of an original, philosophically based teaching system in the Czech Lands. He studied general educational theory and didactics, created a special language-teaching methodology and wrote innovative textbooks. Comenius is considered the founder of modern education and earned the title "Teacher of Nations".

The CNB in 2012

Monetary policy and statistics

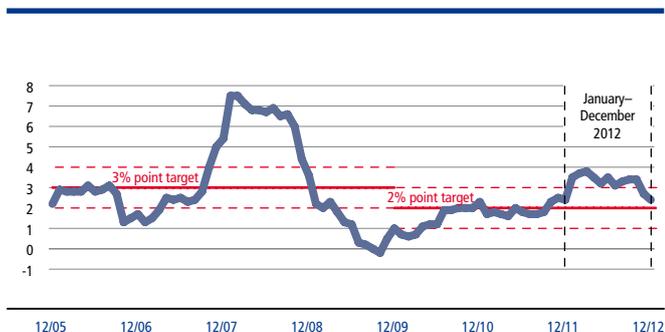
I Monetary policy and economic developments

The CNB's primary monetary policy objective by law is to maintain price stability. Since January 1998, the CNB has been achieving this under an inflation targeting regime in which it tries to keep inflation close to a declared target. Since the start of 2010, the CNB's inflation target in terms of the consumer price index has been set at 2% with a tolerance band of ± 1 percentage point.

Monetary-policy relevant inflation (i.e. headline inflation adjusted for the first-round effects of changes to indirect taxes) decreased gradually during 2012 and was close to the lower boundary of the tolerance band around the CNB's target at the year-end. This primarily reflected the anti-inflationary effect of the domestic economy. Headline inflation was above the upper boundary of the tolerance band for most of 2012 due to an increase in the reduced VAT rate in January, but returned inside the band at the end of the year. The inflation rate for 2012 as a whole was 3.3%. Owing to a marked slowdown in external demand and generally subdued domestic demand amid ongoing fiscal consolidation, the Czech economy contracted by 1.2%. Unemployment rose slightly and real wages fell. The exchange rate of the koruna was relatively stable despite the continuing euro area debt crisis and weakening domestic economic activity. The external economy and domestic economy and their outlooks deteriorated mainly in the second half of the year. Whereas the forecasts compiled in the first half of the year had implied just a minor fall in market interest rates by the end of 2012, those made in the second half indicated a need for a greater interest rate reduction in 2013. In 2012, the CNB's key interest rate was reduced in three steps to the technical zero level of 0.05%. In November, the CNB Bank Board announced that rates would be kept at this zero level over a longer horizon until inflation pressures increased significantly.

The Czech economy saw a surge in inflation above the upper boundary of the tolerance band at the start of the year. This rise in headline inflation was due mainly to an increase in the reduced VAT rate in January along with rising global commodity prices and import prices. By contrast, the domestic economy exerted downward pressure on prices, and core inflation (adjusted inflation excluding fuels) remained negative. This was because the Czech economy started to contract year on year and wage growth slowed. The contraction was mostly a result of falling household and government consumption and subdued investment in inventories.

Fulfilment of the inflation target (in %)



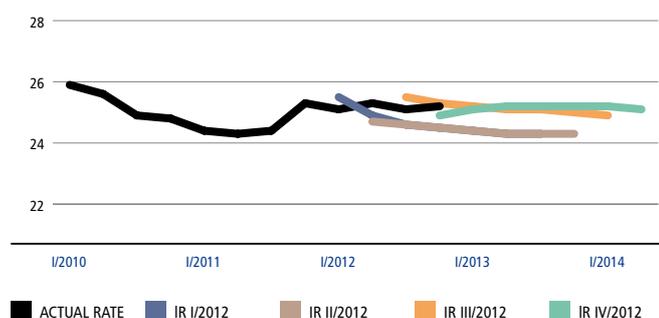
The macroeconomic forecasts made in the first half of 2012 were based on an expected slowdown in foreign economic activity in 2012 and a recovery in 2013. At the time, fiscal policy was expected to be only slightly restrictive in 2013. Under such conditions, economic activity was expected to bottom out after stagnating in 2012, and to rise by almost 2% in 2013. Given the persisting uncertainties, the baseline scenario of neither forecast assumed an increase in the two VAT rates in early 2013. Inflation was thus expected to fall below the target in 2013. The koruna-euro exchange rate was expected to appreciate slowly on the back of a recovery in external demand and expected renewal of long-term real convergence.

Consistent with the forecasts compiled in the first half of 2012 was a modest decline in market interest rates in the rest of 2012. The forecasts implied a rise in market rates starting in the second half of 2013. The slight decline in interest rates forecasted for 2012 was based primarily on expected low growth in domestic economic activity and wages and on low foreign interest rates. The interest rate growth forecasted in the longer term stemmed from an expected rise in interest rates abroad and a recovery of the domestic economy.

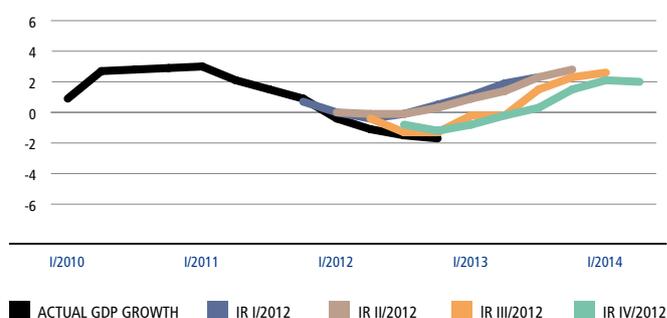
Both forecasts drawn up in the first half of last year were surrounded by a high degree of uncertainty. The main persisting risk was the future course of the euro area debt crisis and its impacts on the Czech economy. The risk of additional budgetary measures in the Czech Republic crystallised during the compilation of the Inflation Report II/2012 forecast, leading to the preparation of an alternative scenario. This scenario resulted in lower interest rates in 2013 and much slower economic growth amid higher headline inflation due to an increase in both VAT rates. The Bank Board decided to lower the key interest rate by 25 basis points to 0.50% with effect from 29 June, partly because of the likelihood of this scenario materialising.

The escalating debt crisis in the euro area and the domestic fiscal consolidation measures led to a deterioration in the growth prospects of the Czech economy in the second half of 2012. The growth forecast for 2013 fell from about 2% predicted in the first half of the year to almost zero in the Inflation Report IV/2012 forecast. At the same time, a lower outlook for foreign interest rates and domestic economic activity led to a reduction in the projected path of domestic interest rates and to the postponement of their expected return to growth to 2014.

Forecasts for the koruna-euro exchange rate



GDP forecasts



The forecasts in the second half of 2012 included a government-proposed 1 percentage point increase in both VAT rates as from January 2013. The forecasts assumed full pass-through of the tax changes to prices, but the second-round effects on inflation expectations and wages were not expected to be significant. For these reasons, in the second half of the year the headline inflation forecasts shifted from the lower half of the tolerance band around the CNB's target to slightly above the target, while the forecasts for monetary-policy relevant inflation were broadly unchanged and remained in the lower half of the tolerance band.

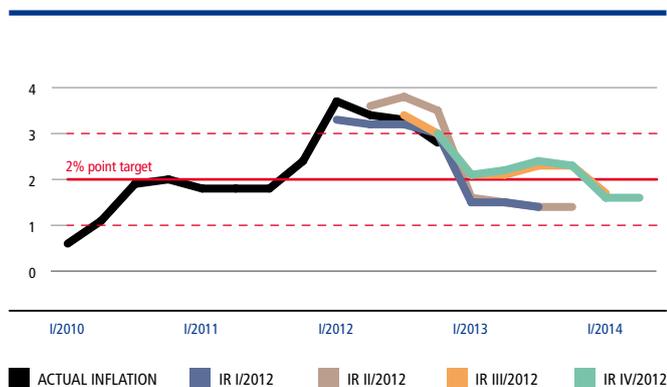
In the second half of 2012, the forecasts continued to be surrounded by numerous uncertainties. These included, for example, the impacts of the euro area debt crisis, the scope of domestic fiscal consolidation measures and their effects on the real economy, and the evolution of household consumption. Although these uncertainties did not lead to the preparation of an alternative scenario, the CNB compiled several sensitivity scenarios. In addition to the usual exchange rate sensitivity scenario, Inflation Report III/2012 contained a lower external demand sensitivity scenario and Inflation Report IV/2012 a higher fiscal multiplier sensitivity scenario.

The Bank Board continued to cut interest rates in the second half of the year. The key interest rate was lowered to 0.25% in late September and to the technical zero level of 0.05% in early November. In November, the CNB Bank Board also announced that the rates would be kept at technical zero over a longer horizon until inflation pressures increased significantly. At the same time the Board announced that it was ready to use monetary policy tools other than interest rates if a further easing was needed, specifically foreign exchange interventions to weaken the exchange rate of the koruna. The CNB also suspended its programme of sales of part of the investment income on international reserves, as a future conflict between such operations and monetary policy implementation could not be ruled out in a situation where monetary policy interest rates were at technical zero.

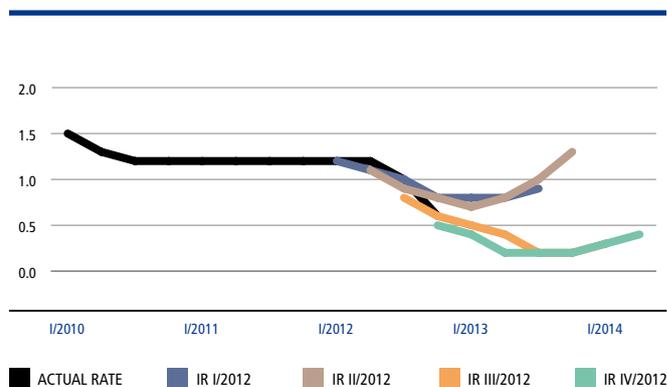
More detailed information on economic developments and monetary policy implementation can be found in the quarterly Inflation Reports available on the CNB website (*Monetary policy > Inflation reports*).

At the end of 2012, the CNB in cooperation with the Ministry of Finance prepared for the Government the regular *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. This document, which is available on the CNB website (*Monetary policy > Inflation reports >*

Inflation forecasts



Forecasts for 3M PRIBOR rates



Strategic documents > Euro area accession), resulted in a recommendation for the Czech government not to set a target date for adopting the euro yet and thus not to attempt to enter the ERM II during 2013. This recommendation was based on a whole range of factors. In the context of fiscal and other macroeconomic problems in the euro area, significant institutional changes are being made to the functioning of the monetary union. These changes are fundamentally changing the conditions and commitments arising from the Czech Republic's potential membership of the monetary union. As regards the preparedness of the Czech Republic itself to adopt the euro, it is necessary in particular to continue the public budget consolidation process and increase the flexibility of the labour market.

I Statistics

In 2012, CNB Statistics continued to provide a broad database for analytical activities and for the public. Significant efforts were devoted to methodological work and to the incorporation of new international standards into the statistics.

In partnership with the Czech Statistical Office (CZSO), the CNB launched preparatory work on the implementation into reporting of the new European System of National Accounts 2010 (ESA 2010) and the sixth edition of the IMF's Balance of Payments Manual. The two institutions formed a coordination committee to define common procedures so that compilation and publication of statistics in accordance with both international standards can start in the third quarter of 2014. This methodological work will remain a priority for the CNB's statisticians in 2013 and 2014.

Legislative activities connected with the preparation of an amendment to the Act on the CNB took up a great deal of time. This amendment, which regulates statistics and reporting in detail, is already in the final stage of the legislative process. Reporting duties will no longer be laid down in CNB provisions, and statistical reporting will be regulated only by decrees. Together with the amendment to the Act on the CNB, related decrees are under preparation stipulating the content, form and dates for submitting the information required from financial institutions and also for compiling the balance of payments. These activities also include the implementation of the ESA 2010 standard into Czech law.

Cooperation with Eurostat, the Ministry of Finance and the CZSO in the area of government financial statistics deepened further as a result of the CNB's use of Treasury accounting module data. This work was focused on the quality of data on the government deficit and debt

Work also continued on refining statistics, for example in the area of automated identification of confidential data to ensure systemic protection of individual respondents. Another important project was the automation of data collection for the international reserves statistics through the introduction of internal CNB reports.

As regards the CNB's unified approach to reporting institutions, coordination of data collection for statistical and supervisory purposes continued, for example, during the introduction of EBA reporting requirements. Preparations were also commenced for reporting to European institutions using the new SDMX format.

Financial stability

The Act on the CNB defines financial stability as one of the CNB's primary objectives. 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 main tool used to communicate the risks identified and their potential effects to the public is the Financial Stability Report. The CNB publishes this report on its website (*Financial stability > Financial stability reports*) and also provides information about its content at a press conference given by the CNB Governor and at a special public seminar. The report is submitted to the Chamber of Deputies (the lower house of the Czech Parliament) as required by law. Its conclusions are also discussed with the members of the Committee on National Economy, Agriculture and Transport of the Senate of the Czech Parliament.

The Financial Stability Report aims to identify new risks arising from domestic economic developments and the external environment. Another key objective is to assess the ability of the domestic financial system to withstand the impacts of sources of financial instability using stress tests of banks, insurance companies and pension funds. Financial Stability Report 2011/2012, published in June 2012, emphasised, as in the previous year, that despite the good starting position of the domestic financial sector, the decline in economic activity and the further development of negative feedback between public finances, the real economy and the financial sector in the euro area still pose risks to the sector's stability. A section containing macroprudential policy recommendations was added to the Financial Stability Report in 2012.

The manner in which financial stability issues are discussed within the CNB was changed during the year. The macrofinancial panels in which Bank Board members had, since 2009, been meeting with experts from key departments to discuss the current risk outlook were replaced by regular meetings on financial stability issues. Documents on the identification of risks to financial stability are discussed at these meetings.

The CNB in 2012 launched a quarterly Bank Lending Survey (BLS) providing information on developments on both the supply and demand sides of the bank credit market. The information is primarily qualitative and is obtained directly from banks that are major players in the credit market. The results of the BLS are published on the CNB website (*Monetary policy > Bank lending survey*).



Given the international nature of the financial market and its regulation, the CNB's work in the field of international cooperation, particularly within the European System of Financial Supervisors (ESFS), is gaining in importance. In the area of financial stability and macroprudential policy, the Governor and one other Bank Board member actively participate in the regular meetings of the General Board of the European Systemic Risk Board (ESRB) and CNB representatives are involved in the ESRB's Advisory Technical Committee (ATC) and working groups. The CNB is also represented in the Regional Consultative Group of the Financial Stability Board established by the G20.

Financial market supervision

By law, the CNB is the supervisor of the financial market in the Czech Republic. To the extent stipulated in legal rules, the CNB supervises entities operating on the financial market, analyses the evolution of the financial system, sees to the sound operation and development of the financial market in the Czech Republic and contributes to the stability of the Czech financial system as a whole. Detailed information is provided in regular Financial Market Supervision Reports available on the CNB website (*Supervision, regulation > Aggregate information on the financial sector > Financial market supervision reports*).

II Financial market regulation

New regulatory initiatives relating to the financial market are usually linked with changes to European law. In 2012, the CNB contributed to the development of the EU's ever changing regulations in the financial market area and to changes in the regulatory framework in the Czech Republic. It worked on the new legislation mainly in partnership with the Ministry of Finance. The CNB was actively involved in preparing several laws regulating the business of financial institutions and other entities subject to regulation and supervision. It also prepared a number of decrees and explanatory and methodological opinions interpreting the application of regulatory requirements pertaining to financial market participants.

The main legislative changes included an amendment to the Act on Bonds liberalising bond issuance, an amendment to the Act on Banks and the Act on Credit Unions, and a technical amendment to the Act on Retirement Savings and the Act on Supplementary Pension Savings removing the first shortcomings identified in the original wording of the laws and regulating the number and registration of pension product distributors. Other legislative changes included an amendment to the Act on Insurance Intermediaries, an amendment to the Act on Financial Conglomerates and a new Act on Investment Companies and Funds.

A draft amendment to the Act on the CNB (the part on financial market supervision) newly defines, among other things, the CNB's tasks in the macroprudential policy area. A new Act on Bureau-de-change Activity contains new regulatory and supervisory requirements relating to the provision of bureau-de-change services.

II European regulation

Work on new and amended European financial market regulations continued in 2012 at the level of the European Commission, the Council and the European Parliament. The CNB discussed the European Commission's proposals and prepared relevant opinions on an ongoing basis. CNB representatives actively promoted the CNB's positions on the above key topics in EU committees and working groups. The CNB was involved in the discussions on the proposed directive and regulation on capital requirements (CRD IV, CRR), where the main issues were the "flexibility package" (allowing member countries to tighten selected prudential requirements), the leverage ratio and the definition of capital.

In the capital market area, the CNB, among other things, prepared comments on a proposal for a directive on recovery and resolution of credit institutions and investment firms (CMD), on a regulation on OTC derivatives, central counterparties and trade repositories (EMIR), on a regulation on improving securities settlement in the EU and on central securities depositories, and on a proposal for a new directive and regulation on markets in financial instruments (MiFID, MiFIR). In the insurance area, the CNB commented on the proposed Omnibus II directive, which amends the Solvency II directive in respect of the establishment of the European Insurance and Occupational Pensions Authority (EIOPA) and defines areas in which the EIOPA is authorised to submit proposals for binding technical standards to the Commission.

II International cooperation

The European supervisory authorities – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB) – continued their work in 2012. As a result of the debt and banking crisis on international markets, a fundamental decision was made to instigate institutional and structural changes in the supervision of the EU banking sector.

Work on the transition to a future banking union began in the second half of 2012. The CNB has constantly campaigned for an arrangement that will allow it to retain the key powers it needs to achieve its objective of maintaining the stability of the financial system as a whole. Another CNB priority was to work to reduce the excessive European regulatory and administrative burden on national supervisors and financial institutions.

CNB representatives were actively involved in the work of the EBA, ESMA and EIOPA. The CNB was represented in all three supervisory authorities at board of supervisors, standing committee and working group level. In the first half of 2012, the CNB also had a representative on the EBA's Management Board.

CNB experts prepared numerous analyses and opinions on documents submitted for oral discussions as well as on documents circulated by the secretariats of European institutions for approval in written procedures. By making comments and suggestions, the CNB was actively involved in the preparation of proposals for binding technical standards and the creation of general guidelines and recommendations on financial market regulation and supervision.

The CNB worked in cooperation with the Joint Committee of the European Supervisory Authorities and the ESRB at the level of the General Council and the Advisory Technical Committee and its standing substructures. It was actively involved in the work of the Financial Stability Committee and the Payment and Settlement Systems Committee at the ECB. Key activities also included cooperation within the EU Council and its structures (the Ecofin Council, the Economic and Financial Committee, the Financial Services Committee and the Moneyval Committee) and within other international institutions and associations, notably the OECD Committee on Financial Markets, the Basel Committee on Banking Supervision, the International Organisation of Pension Supervisors (IOPS) and the International Organization of Securities Commissions (IOSCO).

The CNB also worked closely with financial market supervisors from Central and Eastern Europe, mainly in order to exchange information and coordinate the opinions of national supervisory authorities in the region. CNB representatives also regularly attended meetings of supervisory colleges for important banking groups and meetings of coordination committees for supervisors of insurance groups.

II Financial market supervision

The CNB supervises the financial market by means of both off-site surveillance (continuous monitoring of the stability of the individual supervised sectors) and on-site inspections.

Off-site surveillance consists in continuously monitoring the activity and financial performance of individual entities operating on the financial market and assessing the evolution of the market as a whole and its key segments. The CNB's supervisory work involves checking compliance with the relevant legal rules and compliance with prudential rules and regularly assessing the financial condition of individual regulated entities and the conduct of business rules.

Given the persisting problems in the global economy, the CNB concentrated on credit portfolio quality, provisioning, capital adequacy, liquidity and overall performance. For selected entities it extended the extraordinary reporting duty, increased the frequency of sending information and introduced a duty to report data on the structure of deposits and other financial liabilities on a weekly basis. Extraordinary monitoring of the situation of building societies also continued in the wake of changes to the terms and conditions for building savings schemes.

Off-site surveillance of insurance companies is based on regularly assessing the financial condition of insurance companies and their compliance with regulatory and prudential rules. As regards motor third party liability insurance, supervisors also focused on "open fleets", i.e. insurance contracts that cover multiple motor vehicles where there is no insurable interest between the insurance policy holder and the insured person.

In the area of private pension insurance, CNB supervisors continued to monitor pension funds' performance in accordance with the agreed principles of the prudential mechanism for safeguarding the financial stability of pension funds.

As regards the investment firms sector, the CNB continuously assessed compliance with information and disclosure duties. It inspected compliance with exposure limits following the introduction of a stricter limit for the exemption of exposures to foreign financial institutions from a group. It also checked capital adequacy calculations and guarantee fund contribution calculations.

Following the transposition of the payment services directive and the e-money directive, the CNB also supervised payment institutions, e-money institutions, small-scale payment service providers and small-scale e-money issuers. It focused mainly on monitoring compliance with the prudential rules and compliance with private law as laid down in the Payment System Act.

On-site inspections check compliance with the regulatory rules laid down in legal and implementing regulations. The inspections focus either on verifying all the relevant activities of the examined entity (comprehensive inspections) or on verifying selected areas thereof (partial inspections). In addition to conducting inspections, supervisors are responsible for approving advanced methods for calculating capital requirements. Given the interconnectedness of financial markets, the CNB is systematically stepping up its cooperation with regulators in other countries.

II Licensing, approval and authorisation activities in the financial market area

In 2012, the CNB conducted 54 administrative proceedings concerning regulated credit institutions (6 banks and 48 credit unions). The central bank granted no new licences to credit unions during the year. Its decision to withdraw the credit union licence of UNIBON – spořitelní a úvěrní družstvo was one of the most important events of 2012.

The CNB conducted 75 administrative proceedings and issued 63 administrative decisions in the insurance sector. The concentration of the life insurance sector continued to increase in 2012. The MetLife group (which took over Amcico pojišťovna, a.s. from AIG in 2010 after the latter was bailed out by the US government) strengthened its international position by taking over Aviva životní pojišťovna, a.s. Amcico pojišťovna and Aviva životní pojišťovna merged at the end of 2012 so that MetLife group could start operating on the Czech market as MetLife pojišťovna, a.s. in 2013. In connection with the pension reform, numerous insurance companies are seeking to extend their licences to cover brokering the sale of pension products.

The CNB conducted 261 administrative proceedings in the collective investment area. The largest number of these (116) concerned the approval of changes in the statutes of mutual funds. In all, 93 administrative proceedings were conducted in the pension funds sector. The CNB's licensing activities and the related administrative proceedings were concentrated mainly on the conversion of pension funds into pension management companies and the delicensing of participation and retirement funds under the ongoing pension reform in the Czech Republic.

In the sector of payment service providers and e-money issuers the CNB closed 10 administrative proceedings, most of them relating to licences of payment institutions. In the sector of handlers of domestic banknotes and coins, all three businesses carrying on such activities were granted new licences on request.

Number of financial market entities in liquidation	As of 31 Dec. 2011	Additions in 2012	Losses in 2012	As of 31 Dec. 2012
Banks	3	0	0	3
Credit unions	23	1	8	16
Management companies	7	0	1	6
Investment funds	20	1	2	19
Mutual funds	3	1	1	3
Total	56	3	12	47

The CNB conducted 149 administrative proceedings in the area of securities issues, securities registers and regulated markets. Most of the decisions (147) concerned the approval of prospectuses and amendments to prospectuses for the purposes of offers to the public or admission to trading on a regulated market. In the area of investment service providers, the CNB closed 1,739 administrative proceedings, most of which (1,720) related to the withdrawal of registration of investment intermediaries.

The CNB also monitored the process of liquidation of financial market entities, conducted oral proceedings with liquidators, provided consultations and opinions on liquidation processes and provided information and documentation to courts and law enforcement agencies on request.

II Enforcement

Enforcement is an important part of financial market supervision. It consists in investigating petitions for the opening of administrative proceedings, making decisions on the opening of administrative proceedings or the deferral of cases, and conducting first-instance administrative proceedings, within which fines and remedial measures are imposed, licences revoked and registrations cancelled. The CNB conducts administrative proceedings with both supervised institutions and institutions that provide services on the financial market without having the relevant licence.

Final decisions in the capital market area are published on the CNB website (*Financial market supervision > Conduct of supervision > Final administrative decisions*). Sanctions imposed on insurance intermediaries are entered in the Register of Insurance Intermediaries.

Statistics on administrative penalty proceedings conducted in 2012	No. of administrative penalty proceedings opened	No. of administrative penalty proceedings closed	Total fines imposed (in CZK thousands)
Supervision of credit institutions	5	8	100
Capital market supervision	37	29	17,465
Insurance supervision	47	41	2,250
Violation of forex regulations	33	34	2,787
Consumer protection	2	8	8,700
Payment system	3	0	0

II Central Credit Register

The Central Credit Register (CCR) is an information system administered by the CNB since 2002. It enables banks and foreign bank branches operating in the Czech Republic to share information on the credit commitments and payment discipline of businesses.

In 2012, the CCR's activity concentrated mainly on the CNB's involvement in international data sharing across the credit registers of EU countries. The CCR sends information abroad on non-residents and on Czech clients who have borrowed in a partner country. Foreign registers conversely send information on Czech clients who have borrowed abroad and on foreign clients who have borrowed in the Czech Republic.

Main operational characteristics of CCR	12/2009	12/2010	12/2011	12/2012
Number of registered debtors	497,726	539,540	576,583	609,503
of which: natural persons (entrepreneurs)	291,458	313,129	330,372	345,243
legal entities	206,268	226,411	246,211	264,260
Total volume of loans outstanding (CZK billions)	1,200	1,219	1,290	1,328
Number of CCR application users	2,245	2,362	2,569	2,767
Ad hoc credit commitment enquiries (thousands per year)	205	213	215	184
Number of enquiries on credit commitments of client in monthly reports (thousands per year)	3,038	3,640	3,198	3,843
Number of extracts made for clients (per year)	453	492	514	490

I Consumer protection

The CNB has been overseeing consumer protection on the financial market since 2008, and consumers have been contacting it with their complaints, suggestions and notifications over this period. The CNB received 1,177 complaints from members of the public in 2012. Most of these (542) concerned shortcomings in the activities of insurance companies and insurance intermediaries, usually insufficient provision of information on terminating policies and the related costs and on surrendering policies. In all, 317 complaints concerned shortcomings in the credit institutions segment. The largest number of complaints in this category related to the costs of products, in particular changes in price lists, as consumers often consider increases in fees by credit institutions to be unwarranted. A total of 39 complaints concerned the capital market. These usually related to alleged shortcomings arising from the management of entrusted funds and insufficient provision of information about the riskiness of trades offered. The remainder consisted of notifications falling outside the above categories, such as general enquiries or requests for information.

Where breaches of the consumer protection regulations are found, the CNB assesses the complaints as justified and deals with them directly with the supervised entity in order to remedy the shortcomings identified (65 cases in 2012). Alternatively, it can apply coercive measures by opening administrative proceedings and imposing penalties. The CNB dealt with two-thirds of the complaints by issuing written explanations, since the information that consumers had complained about was available in the product contract documentation or on the providers' websites. Where relevant, the CNB supplemented this information with reference to legal rules. The CNB assessed just under one-tenth of the complaints as unwarranted, as investigations revealed that consumers had not read all the product documentation properly.

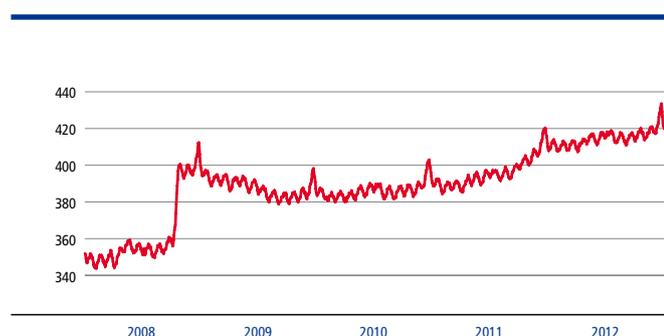
Currency and payments

I Currency in circulation

By law, the CNB has the exclusive right to put banknotes and coins, including commemorative coins, into circulation and to manage the circulation of currency.

The value of currency in circulation was CZK 422.7 billion on 31 December 2012, up by CZK 10.7 billion on a year earlier.

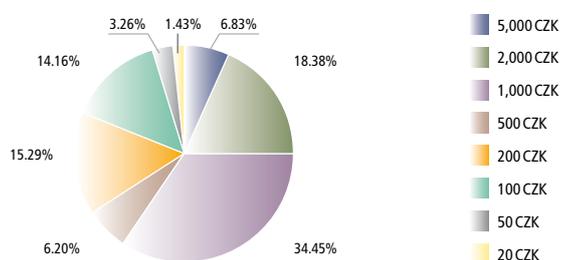
**Currency in circulation –
1 Jan. 2008 to 31 Dec. 2012** (in CZK billions)



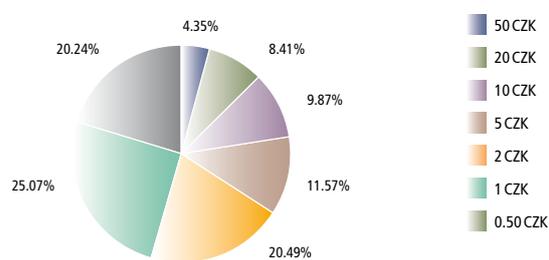
**Number of banknotes and coins in circulation
as of 31 December 2011 and 31 December 2012**

Denomination	2011		2012	
	CZK millions		millions of pieces	
CZK 5,000	124,915.3	123,858.1	25.0	24.8
CZK 2,000	124,666.5	133,290.6	62.3	66.6
CZK 1,000	123,681.3	124,939.0	123.7	124.9
CZK 500	10,399.6	11,233.3	21.4	22.5
CZK 200	10,600.4	11,087.0	53.0	55.4
CZK 100	5,028.1	5,133.7	50.3	51.3
CZK 50	606.9	591.6	12.1	11.8
CZK 20	104.2	104.1	5.2	5.2
Banknotes, total	400,302.3	410,237.3	353.0	362.6
CZK 50	3,614.6	3,935.3	72.3	78.7
CZK 20	2,952.8	3,043.6	147.6	152.2
CZK 10	1,729.4	1,786.8	172.9	178.7
CZK 5	1,006.4	1,046.9	201.3	209.4
CZK 2	709.8	741.7	354.9	370.9
CZK 1	434.7	453.7	434.7	453.7
CZK 0.50	183.3	183.1	366.5	366.2
Coins in circulation, total	10,630.9	11,191.2	1,750.3	1,809.7
Precious metal coins	1,019.5	1,280.4	1.9	2.0
Total	411,952.7	422,708.8	2,105.2	2,174.4

Structure of banknotes in circulation



Structure of coins in circulation



In all, 78.5 million banknotes, 67.2 million coins, 121,300 commemorative silver coins and 41,900 gold coins were produced in 2012. These banknotes and coins cost the CNB a total of CZK 386.7 million to produce.

Cash turnover at the CNB's branches amounted to CZK 1,398.6 billion in 2012, up by 1.4% year on year. The CNB's cash offices received 704.7 million banknotes and 403.4 million coins and issued 715.4 million banknotes and 464.2 million coins.

The CNB's branches processed 754.9 million banknotes and 433.7 million coins (compared to 704.9 million banknotes and 467.6 million coins in 2011). The CNB removed 11.9% of the total number of processed banknotes as unfit for further circulation (compared to 13.7% in 2011, when banks, members of the public and other entities sent damaged and unfit banknotes and coins to the CNB to an increased extent following the adoption of the Act on the Circulation of Banknotes and Coins).





In 2012, the CNB put into circulation five CZK 200 commemorative silver coins, one CZK 500 silver coin, two CZK 5,000 gold coins and one CZK 10,000 gold coin. After the Industrial Heritage Sites cycle ended, the central bank launched a new five-year cycle of gold coins entitled “Bridges in the Czech Republic” in 2011. The first two coins depicted the Gothic bridge in Písek and the Renaissance bridge in Stříbro. The coins issued in 2012 featured the Baroque bridge in Náměšť nad Oslavou and the Negrelli Viaduct in Prague. A special gold coin was struck to mark the 800th anniversary of the Golden Bull of Sicily.

I Non-cash payments

The CNB keeps the accounts of the state and operates systems for transferring interbank payments and settling short-term securities transactions. Non-cash payment transactions are executed through the Czech Express Real-Time Interbank Gross Settlement System (CERTIS), the Short-Term Bond System (SKD) and the Automated Banking Operations (ABO) System.

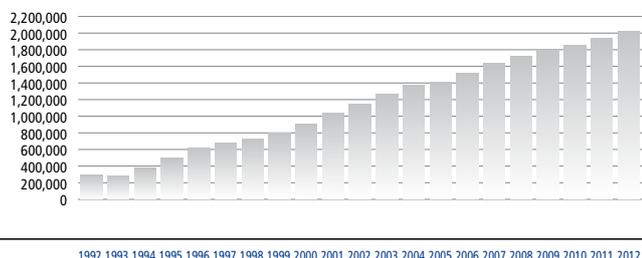
During 2012, the CNB actively assisted the Ministry of Finance in preparing an amendment to the Act on Budgetary Rules, which, with effect from 1 January 2013, closely interconnected the ABO system and the Ministry of Finance-operated Treasury system and will lead to a significant expansion in the number of entities required to hold accounts with the CNB.

The CNB responded to questions frequently asked by members of the finance community and the general public by publishing “Explanatory opinions on selected provisions of the Payment System Act” on the CNB website (in Czech only).

II CERTIS – interbank payment system

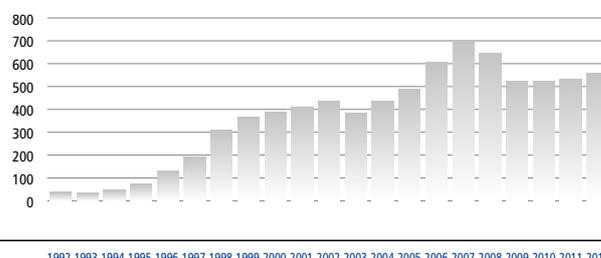
The CERTIS system processes interbank payments in the Czech Republic. Banks, credit unions and foreign bank branches are participants in this system. As of 1 December 2012, CERTIS comprised 48 direct participants (for which accounts are maintained in the system) and 6 third parties (for example, card payment clearing houses and securities clearing and settlement institutions).

Average daily number of transactions



Average daily turnovers

(in CZK billions)



CERTIS processed 510 million transactions in 2012 (up by 4.1% year on year) with a total value of CZK 140,610 billion (up by 4.2%). The system processed a daily average of 2.02 million transactions. The average daily value of the transactions was CZK 558 billion.

The above charts show the number of transactions processed and the volume of funds transferred in CERTIS since 1992.

II SKD – short-term securities settlement system

The short-term securities settlement system operated by the CNB is a separate register of securities and a securities settlement system.

As of 31 December 2012, SKD registered 153 owner accounts belonging to 105 clients (securities owners). The system records bonds issued by the CNB and government bonds issued by the Ministry of Finance.

The securities recorded in SKD are used, among other things, as collateral for intraday credit, which the CNB extends to banks for smooth accounting purposes within CERTIS. They are also used for the repo operations between the CNB and the Ministry of Finance for daily liquidity management of the Single Treasury Account.

Fifty transactions a day were processed in SKD on average in 2012. The average daily value of these transactions was CZK 148 billion.

II ABO – the CNB’s accounting and payment system

The CNB keeps the accounts of its clients and the internal accounts of the central bank in the ABO system. As of the end of 2012, the system had 40,541 accounts, 22,872 of which came under the Single Treasury Account, on which state budget revenues and expenditures and other financial operations of the state are realised.

Most clients use the ABO-K internet banking system to manage their accounts. The ABO-K system had 3,770 registered users at the end of 2012. It processes 160,000 transfer orders and 86,000 incoming payments on average every day. Users submit 99.3% of these orders through ABO-K and only 0.7% in writing.

ABO – average daily number of transactions



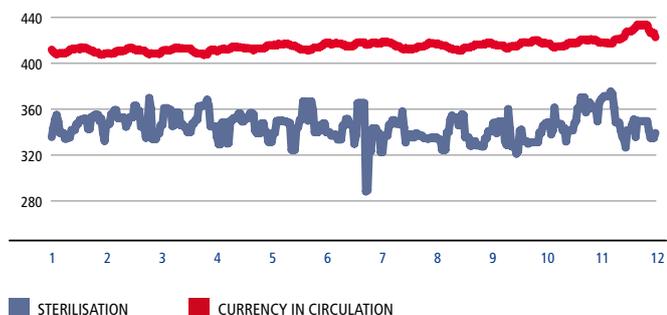
The above chart shows the average daily number of accounting transactions processed in 2012. The total number of transactions increased by 10% compared to 2011.

Financial market operations

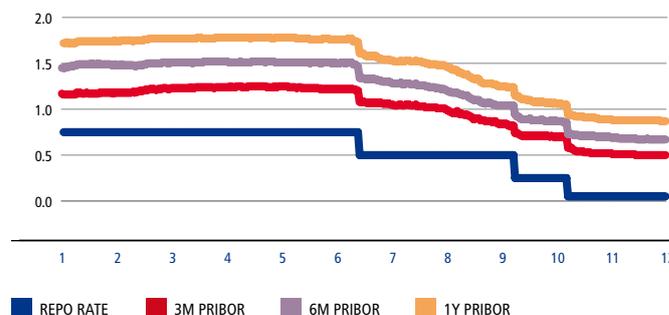
The CNB implements monetary policy by means of a system of monetary policy instruments. These instruments include open market operations, automatic facilities and reserve requirements. Open market operations play a pivotal role in steering short-term interest rates on the interbank market. The CNB Bank 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.

The CNB influences 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 main instrument for managing short-term interest rates is the repo, announced three times a week with a maturity of 14 days. Repos are used for absorbing excess liquidity from the banking sector. The liquidity absorbed is remunerated at the two-week repo rate at most.

Excess liquidity in 2012 (in CZK billions)



Interest rates in 2012



The CNB's instruments also include two "automatic" facilities – the marginal lending facility and the deposit facility. Under the lending facility, the CNB lends overnight funds to banks in the form of a repo operation at the Lombard rate. The deposit facility gives banks the option of making overnight deposits with the CNB at the discount rate. At the end of 2012, the two-week repo rate was lowered to a record low of 0.05% and the discount rate was cut to the same level. This led to a significant increase in the use of the deposit facility, with its volume rising at the expense of the amounts of liquidity sterilised through repo operations. The excess liquidity absorbed in the two types of monetary operations in 2012 ranged between CZK 288 billion and CZK 375 billion, the average being CZK 345 billion.

The CNB also executes collateral exchanges. These are technical operations in which the CNB usually exchanges a security settled in the Central Securities Depository for a security settled in the Short-term Bond System (SKD). The aim of these operations is to provide banks with securities that can be used, for instance, for obtaining intraday credit.

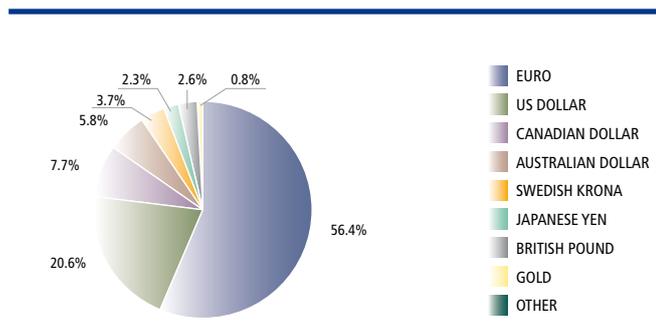
The CNB also has liquidity-providing instruments (two-week liquidity-providing repos and foreign exchange swaps) in its monetary policy toolkit. These were launched in autumn 2008 as a result of the outbreak of the crisis on foreign financial markets. Although banks did not use them actively in 2012, their very existence is important for the stability of the domestic financial market.

I International reserves management

International reserves are the CNB's foreign assets in convertible currencies. They are used mainly to support the CNB's independent monetary policy-making and as a source of foreign exchange liquidity for CNB clients. The CNB regularly publishes the size and structure of the reserves in the *Financial markets* section of its website. At the close of 2012, the international reserves totalled CZK 855 billion. The actively managed portfolio accounts for around 95% of the international reserves. The remainder consists of passively held assets – claims on the IMF in SDR (4%) and passively held gold (1%). The actively managed international reserves portfolio is invested in the euro, the US dollar, the Canadian dollar, the Australian dollar, the Swedish krona, the Japanese yen and the British pound.

The CNB invests the international reserves in compliance with the principles of its reserve management policy and subject to investment opportunities and the situation on the relevant markets. The largest part of the reserve portfolio is invested in debt securities issued by selected governments of advanced countries, selected government-guaranteed bonds or bonds issued

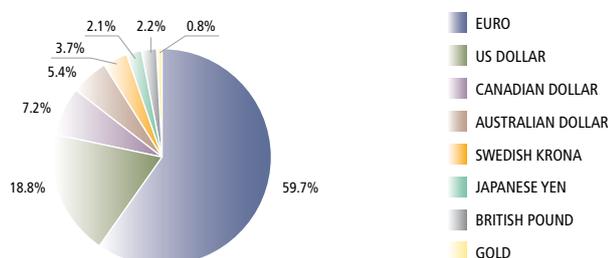
Currency structure of the actively managed portfolio (net of liabilities) as of 31 December 2012



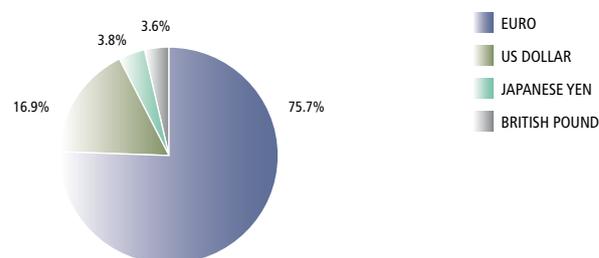
Investment allocation

As of	Government securities	Central banks	Agencies	Reverse repos	Covered bonds	BIS + multilateral institutions	Stocks
31 Dec. 2011	65.4%	0.0%	14.0%	7.0%	0.6%	2.7%	10.3%
31 Dec. 2012	55.0%	13.4%	7.2%	11.6%	0.4%	1.5%	10.8%

Currency structure of the fixed-income portfolio as of 31 December 2012



Currency structure of the equity portfolio as of 31 December 2012



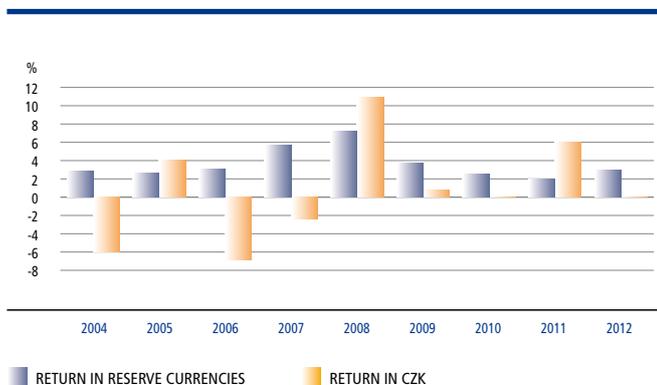
by top-rated multilateral institutions. Other instruments used for international reserves management include repos, reverse repos, deposits, specific covered bonds, shares, futures, and interest rate, currency and equity swaps. All derivative transactions are collateralised.

The international reserves recorded a year-on-year rise due mainly to external flows (+CZK 79.3 billion), which originate from purchases/sales of foreign currency from/to CNB clients and client deposits in foreign currency, and also due to portfolio returns (+CZK 22.2 billion). By contrast, the sale of returns (-CZK 21.2 billion) and the koruna's appreciation against most reserve currencies (-CZK 22.1 billion) fostered a decrease in the reserves. The individual portfolios recorded the following returns in 2012: euro 3.41%, US dollar 2.13%, Canadian dollar 0.99%, Swedish krona 1.79% and Australian dollar 5.35%. The weighted average of the return on the portfolios in reserve currencies was 2.96%.

BlackRock and State Street Global Advisors manage the equity portfolios, using the MSCI Euro, S&P 500, FTSE 100 and Nikkei 225 indices as benchmarks. A partial investment shift from the MSCI Euro to the Canadian (S&P TSX) and Australian (S&P ASX 200) stock indices was approved in 2012. This helped to achieve greater currency structure agreement between the equity portfolios and the interest-bearing instruments and hence more robust diversification.

The CNB provided three credit tranches totalling EUR 17.4 million in response to an IMF call in 2012 under a bilateral loan agreement signed in March 2010. One of the tranches drawn in 2010 was partially repaid ahead of schedule (a payment of EUR 10.8 million was made). As of the end of 2012, the total size of the loan since the contract began represented around 15.2% of the total credit line of EUR 1.03 billion. In 2012, the government and subsequently the CNB Bank Board approved a second bilateral loan to the IMF of EUR 1.5 billion. The Bank Board agreed to the loan on condition that that the Czech Parliament approves a state guarantee for the CNB's potential losses.

Comparison of the total return on international reserves in 2012 with previous periods



I The CNB as the bank of the state

The Czech National Bank provides banking services, i.e. maintains accounts and provides payment services, for the state and the public sector by law. The main clients of the CNB are state organisational units, the Czech Social Security Administration, the Labour Office of the Czech Republic, and revenue and customs offices. In 2012, the Czech National Bank also maintained accounts for business entities that receive subsidies from the state budget and for subsidised organisations and state funds, and also accounts connected to the budget of the European Union. The number of accounts maintained for these clients exceeded 26,000 at the end of 2012. They were used for 200,000 transactions a day on average.

The CNB has long been involved in the Integrated Treasury Information System (IISP) project. In 2012, it helped develop a fund reservation system for the budget expenditure of state organisational units, specifically verification of fund reservation for the execution of payment orders. This means in practice that payment orders of state organisational units which constitute non-cash state budget expenditure (i.e. expenditure excluding cash withdrawals, card payments and fees) are sent to the Ministry of Finance before being settled in the CNB’s accounting system. The Treasury budgetary system verifies whether funds have been reserved for such state budget expenditure, and the payment order is executed only after the reservation has been confirmed. Numerous entities successfully tested this reservation verification functionality in the second half of 2012, and all organisational units of the state have been using the system since 1 January 2013.

The CNB was also involved in preparing a major amendment to the Act on Budgetary Rules, which together with the coming into effect of other laws (the Act on Financial Administration and the Act on Customs Administration) ushered in the most extensive changes to the state accounting system since the early 1990s. As a result of these changes, the CNB terminated 12,000 existing accounts of revenue and customs offices and replaced them with 2,000 new accounts as of 1 January 2013. In the first quarter of 2013 it then progressively opened 7,000 accounts for municipalities, regions, voluntary associations of municipalities and certain other entities, for example public research institutions and public universities, in accordance with the amended Act on Budgetary Rules.

II Support for Treasury liquidity management

The CNB is responsible for the daily consolidation of individual Treasury accounts on the Single Treasury Account and works closely with the Ministry of Finance to continuously manage intra-day liquidity on this account. The Single Treasury Account is defined in the Act on Budgetary Rules, which specifies the accounts subject to consolidation. They include revenue and expenditure accounts of the state budget, revenue offices' accounts, state financial assets accounts, accounts of funds of state organisational units and Treasury liquidity management accounts. On 1 January 2013, the amended Act on Budgetary Rules significantly expanded the number of entities included in the Single Treasury Account and allowed summary accounts to be maintained in foreign currency. The Single Treasury Account is the main tool for efficient management of state liquidity and state budget balance financing, as it enables smoothing of the often large intraday fluctuations in state budget revenues and expenditures. Every morning, CNB and Ministry of Finance staff compile a daily estimate of Single Treasury Account revenues and expenditures. During the day, this estimate is compared with the actual flows of funds on Treasury accounts. If revenues are higher than expenditures, free liquidity is invested on the money market. Conversely, if expenditures are higher than revenues, the Ministry of Finance raises funds by selling T-bills on the money market. This results in efficient use of any free Treasury liquidity and guarantees coverage of all the state's current expenditures. Thanks to systemic liquidity management throughout the business day, the balance on the Single Treasury Account is maintained at just a few millions even though transactions worth billions of korunas are settled every day.

II Support for state debt financing

In the area of state debt management, the CNB organises and carries out primary sales of both short-term and long-term government bonds and administers such bonds for the Ministry of Finance. In 2012, the CNB organised 28 auctions of T-bills, with maturities of 3, 6, 9 and 12 months. Sales totalled CZK 248 billion (excluding purchases into the Ministry of Finance portfolio). In the area of long-term debt, the CNB organised 40 auctions of medium-term and long-term government bonds. Government bonds totalling CZK 165 billion were sold in these auctions.

As the administrator of government bond issues, the CNB in 2012 made coupon payments to government bond holders for 18 issues and payments of principal on two maturing issues, and organised coupon redemptions/payments for seven issues of government saving bonds.

Economic research

Economic research at the CNB creates an analytical and knowledge base for monetary policy-making, financial market supervision and maintaining financial stability, and furthers the professional development of the central bank's staff. Economic research also helps to develop the CNB's position within the ESCB and vis-à-vis the domestic and international academic community. Details on research activities can be found in the *Economic research* section of the CNB website.



In 2012, the central bank published 18 internationally reviewed articles in the CNB Working Paper Series and the CNB Research and Policy Notes Series and two issues of the Economic Research Bulletin. Prestigious journals such as the *International Journal of Central Banking* and *Labour Economics* published 10 research papers by CNB economists. Experts from foreign central banks, multilateral organisations and major universities collaborate with CNB economists on research projects. The relevance and quality of research outputs were assessed and internationally compared in the report *CNB Economic Research in 2012*.

Research project coordinators assist in the monetary policy-making process by preparing opinions on economic situation reports and the minutes and transcripts of monetary policy meetings. Topics raised during monetary policy discussions are taken into account when setting research priorities. Research project outputs are regularly used in CNB documents.

In 2012 the CNB held its eighth Research Open Day, at which the results of CNB economic research were presented to a broader professional audience. The Economic Research Department Award for the best research paper is regularly presented at this event. The CNB also organised two seminars jointly with the Czech Economic Society, the Centre for Economic Research and Graduate Education (CERGE-EI) and the Institute of Economic Studies at Charles University in Prague. The speakers were Philippe Aghion (Harvard University) and Martin Čihák (World Bank). The CNB was actively involved in the Eurosystem Macro-prudential Research Network (MaRs), which focuses on incorporating financial stability models and indicators into the decision-making processes of central banks. It was also involved in the new ESCB Competitiveness Research Network (CompNet), the objective of which is to develop a consistent analytical framework for assessing the competitiveness of individual European countries.

The Research Advisory Committee is an advisory body to the CNB Bank Board in the area of research. The Committee's main role is to draw up recommendations for the Bank Board's decisions on research projects. The members of the Committee include foreign experts. In 2012, the President of the Committee was CNB Governor Miroslav Singer and the Chairman (until the end of November) was CNB Board Member Lubomír Lízal, who was replaced by Board Member Kamil Janáček on 1 December.

European and international relations

II European Central Bank, European System of Central Banks and European Systemic Risk Board

Four times a year, the CNB Governor and Vice-Governor attend meetings of the General Council of the European Central Bank (ECB), where the governors of all the NCBs of the EU countries are represented. Documents concerning macroeconomic, monetary and financial developments around the world and in the EU and the functioning of countries in ERM II were discussed in 2012. The unconventional monetary policy measures of certain non-euro area countries and analyses of the EU's external imbalances were debated. In the discussion of the regular ECB's Convergence Report, the methodology for calculating the inflation criterion and the criterion on long-term interest rates (including the manner of application of the Excessive Imbalance Procedure) was also discussed. CNB representatives were actively involved in the work of the 13 committees of the European System of Central Banks (ESCB) and numerous sub-committees and working groups.

The CNB processed 149 documents in written consultations on European and national legislation and documents. In 42 cases the CNB made comments in the form of a Governor's letter to the President of the ECB. The CNB also consulted the ECB on an amendment to the Act on the CNB.

The European Systemic Risk Board (ESRB) continued to analyse systemic risks in the EU financial market and implement macroprudential tools in 2012. It dealt with proposals for anti-cyclical capital buffers in CRD IV/CRR, problem loans, bank financing and macro-prudential implications of the banking union. The ESRB's recommendations on bank financing and money market funds were approved. In June and December, the CNB fulfilled the reporting duty arising from recommendations issued by the ESRB in 2011. These recommendations related to lending in foreign currency and the macro-prudential mandate of national authorities. The CNB also processed 68 consultations and made comments in 29 cases.

II Relations with EU Council, EU Committee

The CNB has no direct representation in the EU Council except in some of its advisory bodies, such as the Economic and Financial Committee (EFC). Therefore, it works with the relevant government departments and contributes to the coordination of European issues through the EU Committee at the government level, the level of deputy ministers and the working level. At all these levels, the CNB actively commented on topics of relevance, especially in the areas of economic and monetary union and the financial markets. Priority attention was paid to the banking union and related measures (the establishment of the Single Supervisory Mechanism, changes in the voting of the EBA, crisis management in the banking sector, capital adequacy in CRD IV, etc.).

II International Monetary Fund

An IMF Article IV mission to the Czech Republic took place on 15–27 February 2012. The IMF's Executive Board discussed and approved a report on the Czech financial sector in July. This report confirmed that the financial sector was sound and supervision was functioning properly. It is available on the CNB website (*About the CNB > International relations, technical assistance > Relations with the IMF and the WB*).

In order to mobilise additional funds, the member states promised USD 430 billion in bilateral loans at the IMF's spring meeting. The first set of seven bilateral loan agreements was signed at the IMF/WB Annual Meetings in Tokyo in October. The Czech Republic will contribute EUR 1.5 billion to these credit facilities (for more details, see *International reserves management*).

The member states approved the provision of SDR 700 million to the poorest countries from a limited sale of gold. On 14 November 2012, the Czech government decided to contribute SDR 2.85 million to this initiative. An additional SDR 1.75 billion was approved by the IMF's Executive Board on 28 October 2012. General Director Christine Lagarde asked the Czech Republic to approve a contribution of SDR 7.37 million.

The process of ratifying the 2010 reform of IMF quotas and governance continued at national level. The government approved an increase in the Czech quota on 3 October 2012. The reform of quotas achieved the required majority on 9 November 2012.

Representatives of Austria, Belarus, the Czech Republic, Hungary, Kosovo, Slovakia, Slovenia and Turkey signed a constituency agreement for Central and Eastern European countries on 11 July 2012. The new constituency started up on 1 November 2012. For the first time in recent history, the Czech Republic is represented at the level of second Alternate Executive Director in 2012–2014. It will subsequently be entitled to hold the post of Executive Director for a two-year period in the future.

II CNB activities in other international organisations

The CNB Governor attended the regular meetings of central bank governors of the member countries of the Bank for International Settlements (BIS). The CNB was also represented at the regular meeting of vice-governors and at selected meetings of the Central Bank Governance Group and the Basel Consultative Group (BCG), which is part of the Basel Committee on Banking Supervision. At the expert level, the CNB was involved in the activities of the Working Party on Monetary Policy in Central and Eastern Europe. The CNB also regularly participates in the meetings of a number of OECD working bodies, particularly the Economic Policy Committee and the Committee on Financial Markets. CNB representatives also attended the annual meeting of the European Bank for Reconstruction and Development (EBRD).



I Foreign technical assistance

The CNB organised 38 events in 2012 to provide technical assistance to its foreign partners. Ten seminars were attended by 180 experts from 36 central banks and supervisory authorities, and 22 consultations took place for 143 participants from 16 central banks, mainly from Armenia, Azerbaijan, Indonesia, Kazakhstan, Montenegro, the Philippines, Russia, Serbia and Ukraine. The CNB also provided expert assistance in the form of consultations and lectures abroad. Within the ESCB, it continued to implement a project to prepare Serbia's central bank for ESCB entry in the area of monetary policy and operations. Together with the Deutsche Bundesbank the CNB is involved in a European Commission project for the central bank of Serbia in the field of human resource management.

In 2011 the CNB organised nine ESCB training events for a total of 128 participants (116 of whom were non-Czechs). Conversely, 42 CNB employees took part in ESCB events abroad.

Management and organisation

3



Božena Němcová respected national traditions while being independent-minded and progressive. She promoted Czech national pride through her ability to tell stories to simple folk.

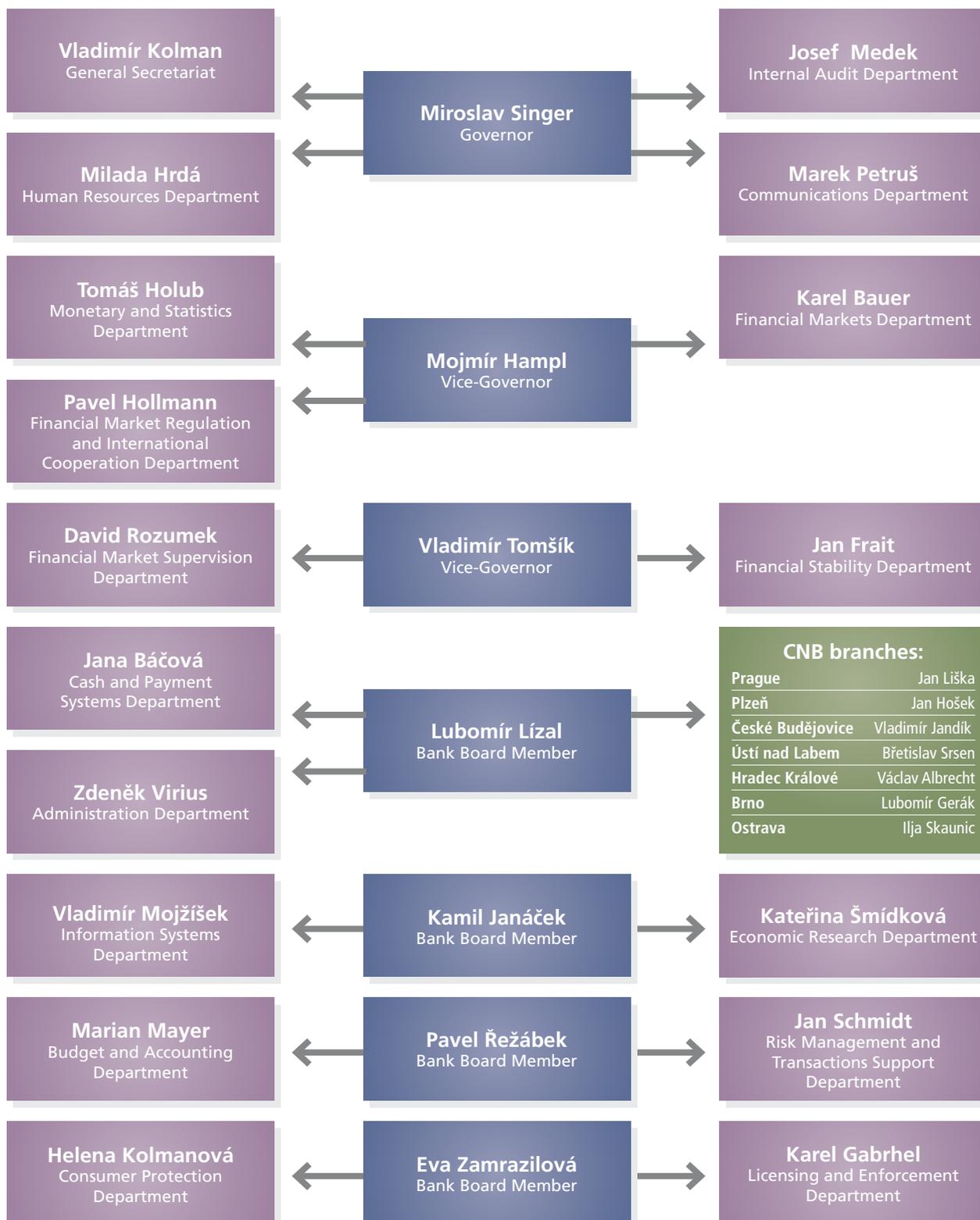
BOŽENA NĚMCOVÁ

(4 February 1820, Vienna – 21 January 1862, Prague)

Czech writer, considered the founder of modern Czech prose. Němcová's first published works were the poems *Ženám českým* (To Czech Women), *Moje vlast* (My Homeland) and *Slavné ráno* (A Glorious Morning). She was interested in folklore and folk traditions. Her greatest works consist of village-based short stories and longer prose as well as folk tales and fairy tales. Božena Němcová was a key literary figure of the final phase of the Czech National Revival movement. Her funeral was attended by thousands of people. She is buried in Vyšehrad Cemetery in Prague.

Management and organisation

Organisational chart as of 31 December 2012



The CNB's organisational structure consists of a headquarters in Prague and seven regional branches in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava.

The CNB has a two-tier management system. Fundamental decisions relating to the fulfilment of the CNB's primary objective, namely to maintain price stability, and other tasks corresponding to the CNB's responsibilities are taken by the Bank Board. 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.

II 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. In the event of a tie, the chairperson has the casting vote. The members of the Bank Board, in addition to collectively managing and deciding, oversee the activities performed by the CNB's organisational units according to a scheme defined by the Bank Board (see the organisational chart of the CNB).



The President of the Czech Republic appointed Mojmír Hampl and Vladimír Tomšík as CNB Vice-Governors for a second six-year term with effect from 1 December 2012. In this connection, the Bank Board decided to re-allocate the Bank Board members' responsibilities for overseeing the activities performed by the CNB's organisational units at its headquarters and branches (see the organisational chart of the CNB).



II Executive directors of departments and branches

These senior officers of the CNB carry out the decisions taken by the Bank Board and are responsible – subject to the CNB’s development strategy and plans for individual areas of the competence of the CNB – for the performance of the activities of the units they manage as defined in the Organisational Statute.

The executive directors set targets and tasks for the staff under them and perform the employer’s rights and duties under labour law in respect of those employees. Their powers and responsibilities relate not only to direct management activities, but also to methodological management activities in their competence, cooperation with other organisational units of the bank and with external partners in the Czech Republic and abroad, and to the submission of proposed solutions to issues of fundamental significance to the Bank Board.

II Headquarters

The organisational units of CNB headquarters are departments (subdivided into divisions). In their areas of competence defined in the CNB Organisational Statute, they are responsible for the implementation of the bank’s main and ancillary activities and for methodological management within the headquarters and in respect of branches. Coordination and advisory bodies – committees, commissions and project teams – are used to perform activities and implement Bank Board decisions that cover the areas of competence of more than one organisational unit and depend on close and efficient cooperation between them.

The competences of the CNB and its organisational units were extended and amended in 2012 on the basis of certain legal regulations and in order to rationalise and streamline the CNB’s activities.

A project team established by the Bank Board in June 2011 coordinated compliance with the CNB’s obligations under Act No. 111/2009 Coll., on Basic Registers, which took effect on 1 July 2012. This team was composed of the managers of all relevant organisational units. The Minister of the Interior awarded the CNB with the “Prize for Best Communication with the Basic Registers System” for its contribution to developing information and communication technology in the public sector for 2012. The Minister praised the CNB for its very active approach to joining the system and getting it up and running and also for its contribution to the testing and pilot operation of basic registers.

In connection with Act No. 426/2011 Coll., on Retirement Savings, and Act No. 427/2011 Coll., on Supplementary Pension Savings, the CNB adopted measures to extend financial market supervision to include the offering and intermediation of retirement savings and supplementary pension savings with effect from 1 January 2013.

The Bank Board defined the competence of the executive directors of the Financial Market Regulation and International Cooperation Department and the Financial Market Supervision Department to decide jointly on the need to incorporate the guidelines and recommendations issued by European supervisory authorities into the CNB’s work.

The Bank Board decided to re-organise the Cash and Payment Systems Department by reducing the number of divisions from three to two. It also clarified the responsibilities of the Financial Stability Department for preparing analyses and strategic proposals in the area of financial stability and macroprudential policy.



II Branches

The CNB's branches represent the bank in their regions of jurisdiction and are contact points for the CNB's relations with state and local authorities and legal and natural persons that have registered offices or residence addresses in the relevant region when dealing with the CNB under the relevant legal rules. This does not affect the right of the said entities to deal with the CNB's headquarters in Prague.

The main tasks of the CNB's branches include managing money reserves (with the exception of the branches in České Budějovice and Ústí nad Labem), maintaining accounts of the state budget and other CNB clients falling within their fields of competence, and making payments for them. To a specified extent they also perform supervision and foreign exchange inspections of financial market entities, including supervision in the area of consumer protection. They collect, check and process data for business surveys. They receive suggestions, enquiries and notifications from the public and deal with them within their defined areas of competence.

Human resources

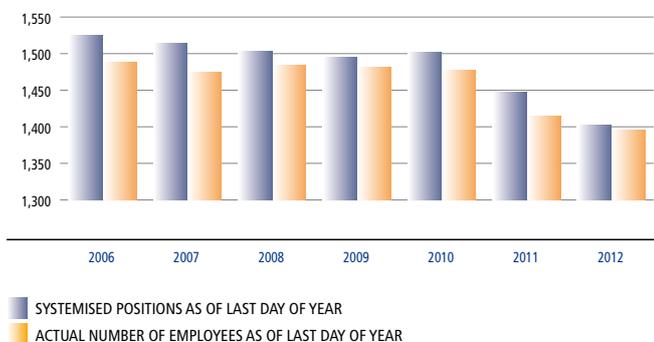
In human resource management, the CNB focuses on constantly raising the level of expertise and education of its staff and takes care to maintain an appropriate workforce composition, as this is crucial for maintaining the institution's tradition of credibility.

II Number of positions and employees

In 2012 the CNB was still experiencing the after-effects of the large-scale comprehensive reorganisation which took place in 2011. Its direct impacts were still being felt in the first months of the following year. Minor reorganisations took place according to the needs of the individual organisational units. These were aimed at streamlining activities and processes at the CNB, and also had the favourable effect of reducing the overall annual wage bill.

As of 31 December 2012, the CNB had 1,396 employees, down by 19 from the end of 2011. A total of 82 new employees were taken on during 2012. In all, 83 employees left the CNB, some of them retiring and some of them leaving as a result of organisational changes. The total staff turnover rate was 5.9%. As of 31 December 2012, the average length of employment at the CNB was 13.6 years, slightly higher than in 2011 (13.3 years).

Number of employees and number of positions



II Recruitment and selection

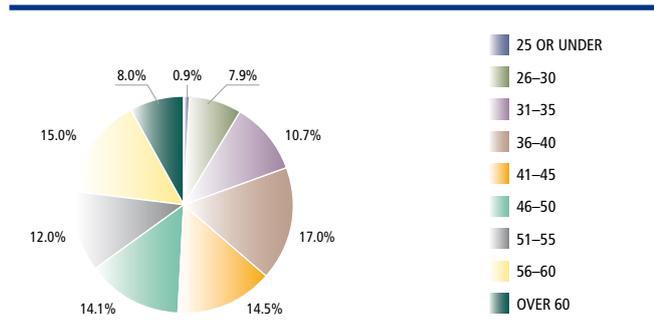
As the authority responsible for maintaining price stability and performing financial market supervision, the CNB systematically seeks skilled employees to perform these tasks well. To fill vacancies, it headhunts experienced experts as well as recruiting promising candidates whose potential it then develops to meet current requirements. To this end, it uses external selection procedures and directly contacts people who register an interest in working for the CNB. Advertising job offers in the daily press (e.g. *Hospodářské noviny* and *Mladá fronta Dnes*) and via specialised internet portals (e.g. *Jobs.cz*) has proved a successful way of finding new employees.

II Education, age and gender structure

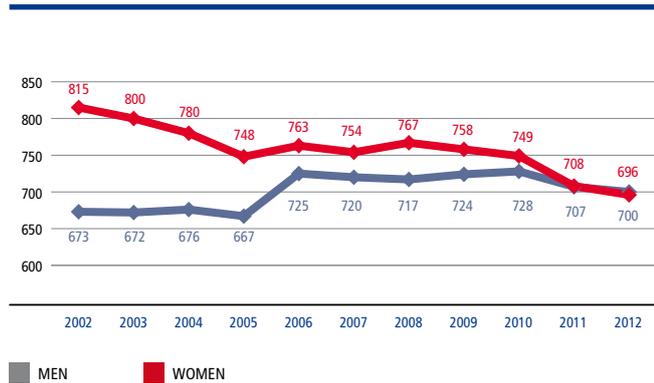
The CNB continues to promote equal opportunities for all its employees and applicants. This is reflected in the structure of its workforce. The nature of the CNB's objectives and tasks is reflected in the percentages of employees in individual education categories. In 2012, university graduates made up 53.9% of the total CNB workforce, while employees with higher vocational training or secondary school education ending with a school leaving exam (including vocational training ending with a school leaving exam) accounted for 36.5% and employees with vocational training without a school leaving exam or with basic education recorded a 9.6% share.

The age structure of employees has long been stable. All age groups are evenly represented. This ensures that working teams have optimal composition and minimises risks stemming from generational turnover. The average age of the CNB's workforce increased slightly to 45.03 years (from 44.88 years in 2011). The representation of men and women is also broadly balanced.

Age structure of employees as of 31 December 2012



Representation of men and women



II Incentive system

Together with staff assessments, which always take place at the end of the year and are linked to performance-related bonuses, the wage system is the basis for enhancing the quality and performance of employees. Regular feedback provided by managers within working teams is another integral part of the incentive system. Managers – as salary administrators of their divisions and departments – are motivated within the system to continuously streamline all activities and optimise all processes.

Personnel expenses, which comprise wage costs, including temporary sick leave payments, obligatory insurance contributions and other social expenses (pension insurance, health care and food allowances), training expenses and employee benefits, amounted to CZK 1,199 million in 2012, down by 3.2% from a year earlier. This decrease was mainly a result of a lower amount of wages and social expenses due to the year-on-year decline in the number of employees. The reorganisation which took place in 2011 and continued in early 2012 thus produced results in 2012.

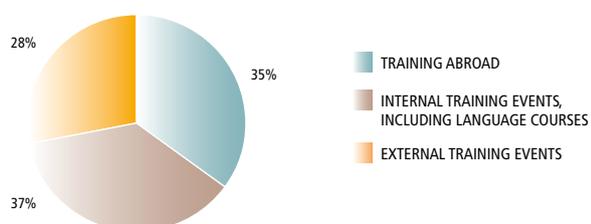
The salaries of Bank Board members were as follows (in CZK)

	Gross salary ¹	Net salary ²
Miroslav Singer	4,554,372	3,693,313
Mojmír Hampl	3,653,124	2,927,252
Vladimír Tomšík	3,632,574	2,858,137
Kamil Janáček	3,046,034	2,359,578
Lubomír Lízal	3,050,141	2,387,909
Pavel Řežábek	3,062,236	2,398,190
Eva Zamrazilová	3,088,015	2,460,314

1 – The gross salary comprises 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 tax discounts for dependent children for those Bank Board members who applied for the discount.

Structure of training expenses



II Professional development

Professional development is a key part of effective human resource management. The CNB's training system encompasses internal training organised by the CNB, training provided by domestic external organisations (including university studies) and training provided in other countries. Spending on staff training totalled CZK 27 million in 2012.

Internal training covered induction of new employees, specialist training and management training. Enhancing knowledge of individual areas of the CNB's work and providing information about new laws and regulations were emphasised. Following the adoption of the new Civil Code and the Act on Business Corporations, the CNB organised a series of lectures by the authors of these laws. Lecturers from major audit firms (Ernst&Young, KPMG) gave presentations at seminars for supervisory units. Likewise, experts from the CNB's supervisory units used these seminars as a way of sharing knowledge acquired at professional events abroad. Short-term external training events organised in the form of seminars and workshops were used to acquire information on new legislation and practices. Training of IT specialists also took the form of external training.

Training abroad is the foremost component of the training system in terms of both importance and the quality of the information and knowledge gained. Cooperation with partner central banks and attendance at training events organised by the International Monetary Fund, the Joint Vienna Institute and the Financial Stability Institute also play a significant role. Important training events included seminars and workshops in the fields of financial stability, economic modelling and financial market developments, and methodological training related to the introduction of new IMF statistical manuals. The CNB's active involvement in education within the European System of Central Banks continued not only in the form of attendance at training events, but also through seminars organised at the CNB for employees of other EU central banks. Seminars organised by the ESMA, EBA and EIOPA were important training events in the area of financial market regulation and supervision. Extension of knowledge and experience in the form of consultations and short-term exchange study visits between central bank staff and financial market regulatory and supervisory institutions in the EU was an important element of specialised training.

Language training at the CNB took various forms, in particular regular language training, intensive language courses and e-learning. The main goal was to enhance knowledge of specialised terminology and communication skills. Attention continued to be focused on meeting language skills requirements for professions for which such requirements are prescribed at the CNB. A total of 50% of employees proved their language skills by passing standardised language examinations.



Public relations

4

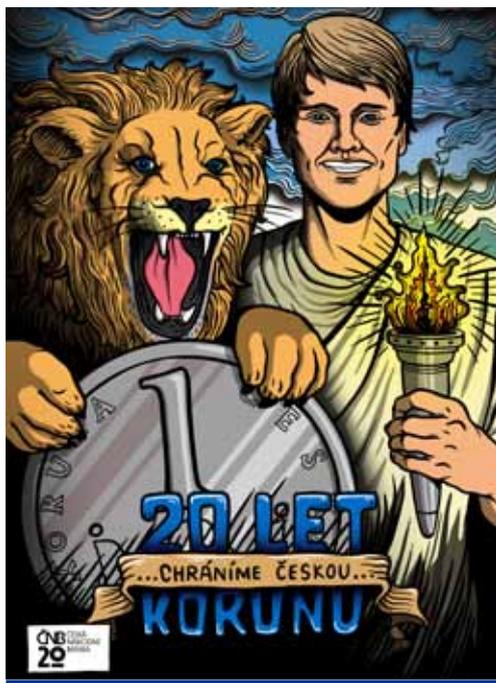


The “Father of the Nation” paved the way from the Austrian gulden to the Czech koruna and laid the foundations of Czech national consciousness.

FRANTIŠEK PALACKÝ

(14 June 1798, Hodslavice – 26 May 1876, Prague)

Czech historian, politician, writer and organiser of cultural and scientific life in 19th-century Prague. Palacký is considered the founder of modern Czech historiography and is known as “Father of the Nation”. In 1861 he was elected to the Bohemian Diet, and the same year he became the first Czech commoner to be made a life member of the Austrian Senate. In 1868 he laid the foundation stone of the National Theatre in Prague.



External communications

The 20th anniversary of the establishment of the Czech currency and the Czech National Bank was a focal point of communication with the public in 2012. The CNB became the central bank of the Czech Republic on 1 January 1993 upon the division of the former State Bank of Czechoslovakia. Although the independent Czech currency – the Czech koruna – existed *de jure* as from 1 January 1993, it started to circulate *de facto* only after the currency separation on 8 February 1993.

In 2012 the CNB launched a key project prepared for the 20th anniversary of the CNB and the Czech currency – an original and innovative interactive exhibition targeted mainly at higher-grade primary school pupils called *Twenty Years of Protecting the Czech Koruna*. This exhibition aims to show how the CNB has been looking after the Czech currency over the last 20 years. It represents another contribution of the central bank to enhancing the financial literacy of the Czech public and raising awareness of Czech money and its protective elements. In particular, it

is intended is to make schoolchildren think about the importance of money and economic concepts such as inflation, and to kindle their interest in mathematics and economics.

The exhibition consists of five interactive games presenting the central bank's main activities and its role in the economy in an entertaining way. The games are controlled by touching the screen or by body movements. Visitors can thus use their own hands to keep inflation at the target of 2% or manage money circulation, or to test their knowledge of the protective elements of banknotes.

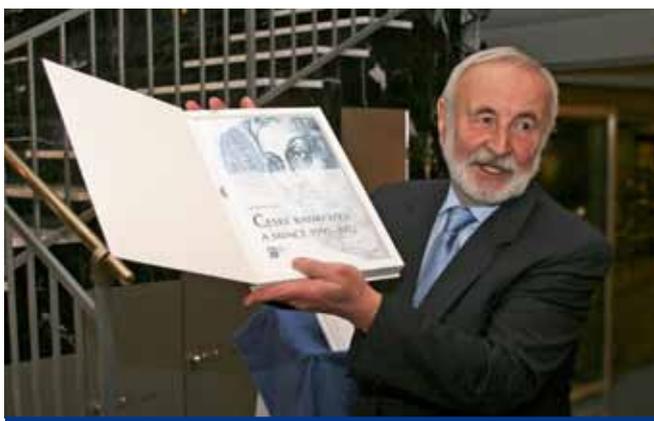
In 2012 the exhibition was shown in Ostrava and Brno. The plan for 2013 includes stops in Ústí nad Labem, Hradec Králové, Plzeň, České Budějovice and Prague. By mid-March 2013, a total of 10,000 visitors had played at being central bankers at the exhibition. This interactive exhibition is the centrepiece of the educational campaign *20 Years of Protecting the Czech Koruna*, which also includes the website www.chranimekorunu.cz and a dedicated Facebook page. In addition, between November 2012 and May 2013 school teams can compete to win a unique trip to the Czech Mint in Jablonec nad Nisou by collecting points while playing the interactive games directly at the exhibition or online.



The Lion and the Genius – figures from the sculpture located on the roof of the current CNB building at Na Příkopě street in Prague since the late 1930s – act as guides to the interactive exhibition. They personify the central bank's mission: the Lion is a strong and majestic symbol of physical protection of the Czech koruna, while the Genius is a wise and foresighted guardian of prices, financial stability and fair play on the financial market.

The Lion and the Genius also feature on the official CNB website www.cnb.cz, which is the central bank's primary means of on-line communication with the public. In 2012, the CNB website had 217,000 visitors and 1.4 million page loads a month on average (excluding exchange rate lists).

On the eve of its 20th anniversary, the CNB unveiled a special logo designed by Jan Solpera, which the public will see in the bank's official documents until the end of 2013.



The anniversary logo is inspired by graphic symbols of the Czech currency. The zero in the number 20 is suggestive of the circular shape of coins, and the rectangle below the number represents a bundle of banknotes. The 20th anniversary of Czech money is also celebrated in the publication *Czech Banknotes and Coins 1993–2012* written by the former director of the CNB Cash Department Leopold Sarga, which was launched at the end of October 2012.

In 2012 the CNB continued to inform the public openly and clearly about the fulfilment of its mandate. Through the website www.cnb.cz the public was informed about the results of the Bank Board's regular monetary policy meetings and was given up-to-date information about money circulation, financial stability and financial market supervision, exchange rates, consumer protection on the financial market and other topics. At press conferences given by Bank Board members the CNB provided information about monetary policy issues, the conclusions of the Financial Stability Report and statistics on counterfeit banknotes and coins seized in the Czech Republic the previous year. Recordings of all these events are available to the public on the CNB website and on YouTube.

The CNB is one of the most open and transparent central banks and uses the latest communication channels and technologies. In the area of social media, for example, the CNB in September 2009 became one of the first central banks in Europe to use Twitter, and since 2011 it has been active on YouTube. Since autumn 2012, it has been posting links to articles, videos, photos and other information about its activities on its official Facebook page. In early 2012, the CNB launched its first official mobile app, *Czech Money*, which enables users to view Czech banknotes and coins and their protective elements in detail on iOS mobile devices. In early 2013, the app was also made available to users of Android mobile devices.

Replies to queries and complaints from the public in the form of phone calls, e-mails and letters also form part of the CNB's day-to-day communication. Using the CNB Information Service the bank dealt with a total of 6,055 submissions (1,317 phone queries, 3,935 electronic submissions and 803 written submissions). Most calls were routed to an automated phone operator, available around the clock and to multiple callers. As a result, the number of phone calls dropped sharply compared to 2011, when it had reached almost 6,000.





The number of electronic submissions also decreased (by 562), as the receipt of such submissions was concentrated mainly in web forms. By contrast, the number of written submissions rose by more than 100.

Financial education

Financial education is an integral part of the CNB's communication with the general public. In 2012, particular attention was paid to the interactive educational exhibition *Twenty Years of Protecting the Czech Koruna*, which is targeted mainly at higher-grade primary school pupils. The CNB's website www.cnbprovsechny.cnb.cz gave the general public practical advice and other information on how to manage personal finances correctly. Previously launched activities of the central bank targeting teachers, pupils and senior citizens also continued, as did financial education projects organised by CNB branches in their regions, including cooperation with the Silesian University in Opava, the School of Business Administration in Karviná, and the Faculty of Economics and Administration at Masaryk University in Brno.

Exhibition

The CNB Exhibition, located in a former strong-room, celebrated its 11th birthday in 2011. More than 167,000 registered visitors, mostly school pupils and students, have visited the permanent exhibition *People and Money* since it opened. Modern audiovisual technology and 65 showcases provide a unique set of information about the history of money and monetary policy in the Czech Republic for experts and the general public alike. Thanks to its unique environment, the exhibition is used for hosting meetings with domestic and foreign official visitors, for filming interviews with the bank's representatives and for shooting TV programmes on economic topics. The exhibition is open Tuesday to Friday. Tours are organised at 9.00 a.m., 11.00 a.m. and 1.30 p.m. each day, and also at 4.00 p.m. on Thursday. More information is available in the *People and Money* section of the CNB website.

Special library

The CNB's special library provides services to CNB employees and to the wider economic community. It offers lending, advisory, reference and bibliographic information and research services (searches for information from all available information sources). Its highly specialised collection and access to numerous electronic sources allow users to obtain information in the fields of banking and economics in general, law and computer technology and to some extent in other areas as well. The library maintains and provides access to more than 69,000 publications and 700 periodicals, a large number of research reports and annual reports and other publications (bank documents, brochures, etc.). The electronic catalogue forms part of the T Series library information system and is integrated into the Single Information Gateway operated by the National Library of the Czech Republic. Internet access via both a wired connection and a secure wireless network is available to library users. 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. All information, including the electronic catalogue, is available in the *CNB special library* section of the CNB website. The library can also be contacted by e-mail at lib@cnb.cz.

Archive

The CNB Archive cares for the archive documents produced by the CNB and its legal predecessors. The archive collections offer a unique view of the political, economic, social and cultural history of the Czech lands and Central Europe. The CNB Archive also lends its documents for exhibitions, for example the joint exhibition of the National Technical Museum and the US Embassy in Prague called *Otto Petschek's Residence – Two Faces of an Entrepreneur's Villa*, which opened on 28 November 2012.

The CNB Archive's research room is open all year round subject to prior consultation. Anyone interested in obtaining information from, or studying in, the CNB Archive should email archiv@cnb.cz or visit the CNB website (*About the CNB > Archive of the CNB*).

Congress centre

The CNB Congress Centre, located in the listed building of the former Commodity Exchange, is a traditional venue for meetings between the CNB's top management and representatives of other central banks, deputies and senators of the Czech Parliament, representatives of financial market institutions, trade unions, analysts and journalists. The CNB's specialised units hold conferences, lectures, presentations, seminars, ECB committee and working group meetings, quarterly insurance intermediaries' examinations and various training sessions there. Thanks to its flexible spaces and modern technology, the Congress Centre is also one of Prague's most popular venues for external partners, who organise professional and social events there. For example, it hosted the 20th European Banking and Financial Forum, the conference of the Mont Pelerin Society for Czech Academia & Business and a three-day meeting of the Directors General of the National Statistical Institutes. More information is available on the CNB website (*About the CNB > Organisational structure > CNB headquarters building*).



Financial report

5



Initially underrated in her homeland, Emmy Destinn went on to conquer the world. Artistry, industry and a voice of gold together create a hard currency that no one will ever doubt.

EMMY DESTINN

(26 February 1878, Prague – 28 January 1930, České Budějovice)

World-famous Czech opera singer and polymath. Destinn debuted successfully in Berlin and ten years later was engaged by the New York Metropolitan Opera, where she sang opposite Enrico Caruso, among others. In 1918 she returned to the Czech stage to great acclaim. At the end of each concert she would sing the Czech national anthem as an expression of national pride.



(Translation of a report originally issued in Czech.)

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 2012 presented on the enclosed CD-ROM and our audit report dated 20 March 2013 stated the following:

"We have audited the accompanying financial statements of Česká národní banka, which comprise the balance sheet as at 31 December 2012, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. For details of Česká národní banka see Note 1 to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the Czech Republic, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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 and International Standards on Auditing as amended by 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 an 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 2012, and its financial performance for the year then ended in accordance with accounting principles generally accepted in the Czech Republic."

A member firm of Ernst & Young Global Limited
Ernst & Young Audit, s.r.o. with its registered office at Karlovo náměstí 10, 120 00 Prague 2,
has been incorporated in the Commercial Register administered by the Municipal Court
in Prague, Section C, entry no. 88504, under Identification No. 26704153.

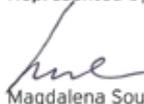


- II. We have also audited the consistency of the annual report with the financial statements described above. The management of Česká národní banka is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual 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 respects, 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 2012. Our work as auditors was confined to checking the annual report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. 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 financial statements described above.


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


Magdalena Soucek
Auditor, License No. 1291

20 March 2013
Prague, Czech Republic

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Balance sheet

(in CZK millions)

ASSETS	31 Dec. 2012	31 Dec. 2011
1. Gold	702	755
2. Receivables from the International Monetary Fund	55,335	57,337
3. Receivables from abroad, including securities	813,138	758,856
3.1. Deposits at foreign banks and financial institutions	110,768	71,767
3.2. Securities	607,114	634,315
3.3. Other receivables from abroad	95,256	52,774
4. Receivables from domestic banks	0	3,500
5. Fixed assets	4,182	4,413
5.1. Tangible fixed assets	4,145	4,390
5.2. Intangible fixed assets	37	23
6. Other assets	4,961	7,245
6.1. Other financial assets	3,999	3,883
6.2. Other	962	3,362
TOTAL ASSETS	878,318	832,106
LIABILITIES AND EQUITY	31 Dec. 2012	31 Dec. 2011
1. Notes and coins in circulation	422,707	411,953
2. Liabilities to the International Monetary Fund	42,697	44,830
3. Liabilities abroad	4,360	4,984
3.1. Loans from foreign banks	3,726	4,818
3.2. Other liabilities abroad	634	166
4. Liabilities to domestic banks	383,642	389,520
4.1. Loans received	241,902	328,046
4.2. Bank monetary reserves	44,301	50,317
4.3. Other liabilities to banks	97,439	11,157
5. Liabilities to the state and other public institutions	126,599	76,000
5.1. Liabilities to the state	122,768	70,906
5.2. Other liabilities	3,831	5,094
6. Provisions	219	229
7. Share capital	1,400	1,400
8. Funds	8,050	8,050
9. Revaluation reserve	8,048	12,239
10. Accumulated losses from previous periods	-126,410	-161,836
11. Net loss / profit for the period	2,846	35,425
12. Other liabilities	4,160	9,312
TOTAL LIABILITIES AND EQUITY	878,318	832,106

Balance sheet

(in CZK millions)

OFF-BALANCE SHEET		31 Dec. 2012	31 Dec. 2011
1.	Guarantees issued	158,085	158,120
2.	Issued loan commitments	21,960	22,984
3.	Receivables from spot, term and futures transactions	89,324	143,467
4.	Liabilities from spot, term and futures transactions	89,198	143,462
5.	Guarantees received	156,950	156,952
6.	Collateral received	108,177	77,841
INCOME STATEMENT		31 Dec. 2012	31 Dec. 2011
1.	Interest income and similar income	6,593	9,836
1.1.	Interest from fixed income securities	6,172	9,133
1.2.	Other	421	703
2.	Interest expense and similar expense	-2,360	-3,380
3.	Income from shares and other interests	2,628	1,277
4.	Fee and commission income	342	354
5.	Fee and commission expense	-81	-70
6.	Gains less losses from financial operations	-2,865	29,258
6.1.	Net foreign exchange gains / losses and foreign exchange spread	-21,277	29,818
6.2.	Other	18,412	-560
7.	Other operating income	3,191	438
7.1.	Income from money issue	618	239
7.2.	Other	2,573	199
8.	Other operating expense	-2,760	-354
8.1.	Expenses for production of notes and coins	-388	-276
8.2.	Other	-2,372	-78
9.	Administration expense	-1,528	-1,593
9.1.	Personnel expenses	-1,199	-1,238
9.1.1.	Wages and salaries	-840	-863
9.1.2.	Social and health security	-280	-290
9.1.3.	Training and employee benefits	-79	-85
9.2.	Other administration expenses	-329	-355
10.	Depreciation and amortisation of fixed assets	-314	-345
11.	Reversal of provisions for receivables and guarantees, income from receivables already written off	5	168
12.	Write offs, additions and utilisation of provisions for receivables and guarantees	-5	-164
13.	Net loss / profit for the period	2,846	35,425

The full version of the financial statements of the Czech National Bank as of 31 December 2012, including the notes thereto, is available on the CNB website (*About the CNB > Performance > Financial statements*) and on the attached CD-ROM.

The income and expense structure used in the following text corresponds to the main activities arising from Act No. 6/1993 Coll., on the CNB. In contrast to the structure of the standard financial statements, which give an overview of income and expenses primarily with regard to type, this approach provides information according to the purpose of the bank's expenditure. The following review of income and expenses lists the individual areas of the central bank's financial performance in 2012.

in CZK millions

	Expenses	Income	Net	y-o-y change
Monetary area	49,918	54,182	4,264	-33,008
monetary policy-making	2,178	3	-2,175	893
international reserves management	21,696	49,248	27,552	17,105
valuation changes	23,545	1,576	-21,969	-51,176
client operations	143	993	850	176
other operations	2,356	2,362	6	-6
Currency issuance and management	388	637	249	267
Operations	1,874	207	-1,667	162
Total	52,180	55,026	2,846	-32,579
Note: Operations include all personnel expenses, depreciation and amortisation, purchased services, energy consumption, etc.				

The Czech National Bank recorded a profit of CZK 2,846 million as at the end of 2012. The profit decreased year on year, mainly because of valuation changes. The domestic currency strengthened against most of the reserve currencies in which the central bank's international reserves are allocated. The koruna's exchange rate was affected mainly by the debt crisis in Europe and its impacts on financial markets. The effect of domestic factors was not as pronounced. The CNB's exchange rate loss was fully offset by income from international reserves management. The largest part of the income was generated by the equity portfolio, which recorded a strong recovery following a loss a year earlier. The bond portfolios increased owing to capital and interest income. Funds allocated on the money market generated lower returns. The profit was also due to a decrease in sterilisation costs associated with lower interest rates. The CNB changed its main monetary policy instruments three times in 2012. Policy interest rates were at historical lows at the close of the year.

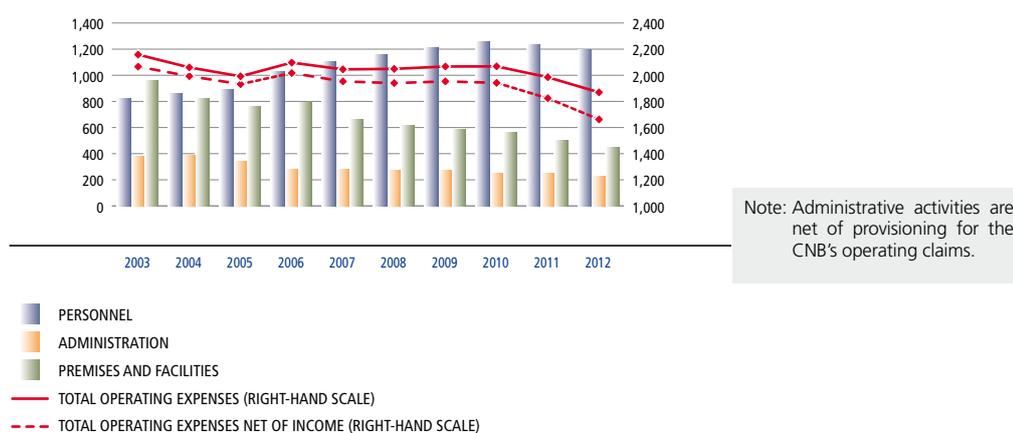
In the area of currency issuance and management, sales of numismatic material increased considerably owing to stronger demand for gold commemorative coins. The increase in sales fully offset expenditure on the preparation, protection and purchase of new banknotes and coins.

The ongoing drive for efficiency is reflected mainly in the bank's operational activities. The costs of numerous activities have long been stable or falling. Increased attention is being paid to streamlining all activities delegated to the CNB. The bank is constantly adopting organisational measures to optimise the number of jobs while maintaining the required quality of services and outputs. The number of people employed at the recorded a further year-on-year decline in 2012. This was reflected in a decrease in the bank's total personnel expenses.

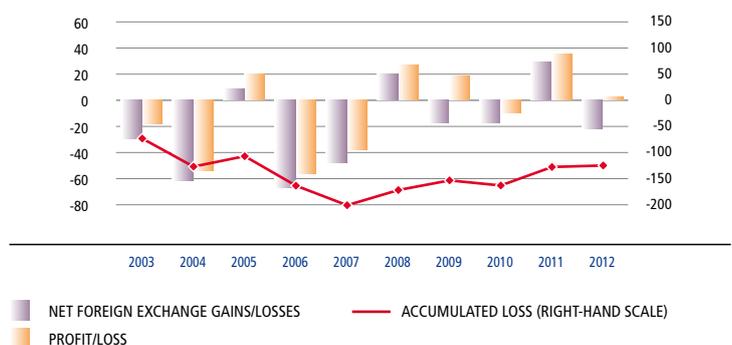
The CNB used its entire 2012 profit to reduce its accumulated losses. After this payment, the bank's balance sheet continues to show an accumulated loss of CZK 123.6 billion.

A more comprehensive analysis of the CNB's performance in 2012 is available on the CNB website (*About the CNB > Performance > Financial Reports*).

The CNB's operating expenses 2003–2012 (in CZK millions)



The CNB's performance 2003–2012 (in CZK billions)



Provision of information under Act No. 106/1999 Coll.



Money is just a ticket to independence, not a destination. But those who are paid for their work in foreign currency are not free. Anyone who plays a vital role in establishing their national currency and state should therefore be celebrated and immortalised.

TOMÁŠ GARRIGUE MASARYK

(7 March 1850, Hodonín – 14 September 1937, Láňy)

Teacher, politician, statesman and philosopher. Masaryk served as a deputy in the Austrian Imperial Council and as a university professor. In 1918 he became the first president of Czechoslovakia. He was hailed as President-Liberator for his key contribution to founding the independent state. To mark his 80th birthday, the Czechoslovak National Assembly passed a law called Lex Masaryk containing the phrase "Tomáš Garrigue Masaryk played a vital role in the establishment of the state". Masaryk was nominated 17 times for the Nobel Peace Prize (although only in ten nomination years).

Provision of information under Act No. 106/1999 Coll.

The CNB provides information pursuant to Act No. 106/1999 Coll., on Freedom of Information, as amended (hereinafter the "Act") by way of disclosure on the CNB website (www.cnb.cz) or to applicants on the basis of applications.

The CNB's procedure for complying with the duties ensuing from the Act, and in particular its procedure for accepting and dealing with applications for information in compliance therewith, is regulated by Czech National Bank Directive No. 55 of 13 December 2002, on the communication of the Czech National Bank, as amended.

A) INFORMATION PROVIDED IN 2012 ON THE BASIS OF APPLICATIONS:

1. Number of applications for information submitted in compliance with the Act: 26
2. Number of decisions refusing an application: 10
3. Number of appeals submitted against decisions: 6
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: 0
5. Number of exclusive licences granted, including justification of the need to grant exclusive licences: 0
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: 2
 - 6.1. A complaint about the CNB's action in dealing with the complainant's application for information about the result of a specific examination in an insurance company and an application for provision of specific findings and other additional information justifying the CNB's conclusion that it found no reason to open administrative proceedings against an insurance company. As the complaint referred to the Freedom of Information Act, it was dealt with as a complaint under Article 16a thereof, although previously the application had been dealt with outside the regime of this Act as the relevant prerequisites had not been fulfilled. The CNB Bank Board took over the matter and as the superior authority issued a decision in which it partially granted the application for information and partially refused the application with reference to the confidentiality duty pursuant to Article 11(3) of the Act.

6.2. A complaint about the CNB's action in dealing with the complainant's application for information on whether administrative proceedings were being conducted against specific financial market entities. The requested information was not provided to the complainant, as in the CNB's opinion provision thereof would have constituted a breach of the confidentiality duty. The refusal to provide information was justified on the basis of Articles 2(3) and 11(3) of the Act. An appeal was filed against the decision. In its decision on the appeal, the Bank Board overturned the decision and returned the matter to the first-instance administrative authority for reconsideration. The administrative proceedings had not been concluded as of the cut-off date of this report.

7. Other information relating to application of the Act: 0

B) INFORMATION PROVIDED BY WAY OF PUBLIC DISCLOSURE:

The CNB also publishes information in a manner allowing remote access pursuant to Article 3(2) of the Act and provides information pursuant to Article 5(1), (2) and (3) of the Act. The information is available on the CNB website (www.cnb.cz) and on notice boards at CNB headquarters and branches, in locations accessible to the public. Other information on the activities and responsibilities of the CNB is also published on the state administration web portal.

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Design:

Orbis Pictures Agency s.r.o.

Layout:

JEROME s. r. o.

Photography:

Charles IV, John Amos Comenius, Božena Němcová, František Palacký,
Emmy Destinn, Tomáš Garrigue Masaryk / © ČTK, 2013

Photography:

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