



ANNUAL REPORT 2017

CNB CZECH
NATIONAL
BANK

The graphic design of the CNB's 2017 Annual Report acquaints readers with the appearance of the Hypšman extension, which is one of the buildings of the CNB's headquarters and was partly renovated in 2017.

ANNUAL REPORT 2017

The mandate of the CNB

- **to maintain price stability,**
- **to maintain financial stability and see to the sound operation of the financial system in the Czech Republic,**
- **to issue banknotes and coins, manage the circulation of currency and administer clearing between banks,**
- **to supervise the entities operating on the financial market.**

- Through *monetary policy* we seek to preserve price stability, i.e. low and stable inflation. Through *macroprudential policy* we foster financial stability and resilience of the financial system, which are necessary conditions for the maintenance of price stability. 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 and creating prudential rules and rules of conduct towards clients* we protect the clients of persons and institutions carrying on business on the financial market.
- By *managing the interbank payment system and issuing banknotes and coins* we ensure smooth payments and cash circulation.
- As the *bank of the state*, we provide banking services to the state and the public sector.
- In line with our primary objective, we *manage international reserves with professional care*.
- We are a *part of the European System of Central Banks (ESCB)* and contribute to the fulfilment of its objectives and tasks.

— 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 low-inflation 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.

— PROFICIENCY

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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2017 at a glance

- The main monetary policy event of the year was the exit from the CNB's exchange rate commitment. In line with its previous communications, the Bank Board took this step in early April when the conditions for sustainable fulfilment of the CNB's inflation target in the future had been met. The koruna subsequently appreciated against the euro only gradually and with no major swings in either direction.
- Inflation was in the upper half of the tolerance band around the CNB's target throughout the year. Easy monetary policy coupled with rising external demand supported economic growth, which reached 4.6%. Increasing labour shortages led to a surge in wage growth.
- The robust fulfilment of the inflation target enabled the CNB to lift interest rates from "technical zero". The Bank Board increased the key monetary policy interest rate first in August and again in November by a total of 0.45 percentage point to 0.5%.
- The domestic financial sector maintained its high resilience to shocks and its ability to withstand very adverse economic developments. However, there was an increase in risks associated with the conduct of financial institutions, firms and households in the favourable phase of the economic and financial cycle. The CNB responded to these risks by deploying macroprudential policy tools, specifically by adjusting its recommendation on the provision of mortgage loans and by raising the countercyclical capital buffer rate.
- In December 2016, after the new Consumer Credit Act took effect, the CNB gradually started supervising the entire consumer credit market, including non-bank companies, which are required under the new Act to obtain authorisation from the CNB to carry on business.
- The President of the Czech Republic appointed Oldřich Dědek and Marek Mora as members of the CNB Bank Board with effect from 13 February 2017. They replaced Lubomír Lízal and Pavel Řežábek, whose mandates expired on 12 February.
- The Human Resources Department was restructured as of 31 January. On 1 February, a large part of its work was taken over by the General Secretariat, where a new Human Resources Division was created. Some activities were transferred to the Budget and Accounting Department and the Administration Department. The EU and International Organisations Division was simultaneously transferred from the General Secretariat to the Financial Market Regulation and International Cooperation Department.
- In December, the Bank Board decided to elevate the Financial Stability Department to multi-divisional department status as of 1 January 2018.
- In the *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*, the CNB together with the Ministry of Finance recommended that the Czech government should not set a target date for adopting the euro and thus should not attempt to enter ERM II during 2018.



Governor's foreword



The main event for the CNB in 2017 was the exit from the exchange rate commitment and the gradual return of monetary policy to normal. The success of the exchange rate commitment, which was in place from 7 November 2013 to 6 April 2017, has been assessed in domestic and foreign analyses, and I am sure that interest in this topic will persist. However, we can already say that for the Czech economy the commitment delivered what the CNB had expected: first it broke the spiral of deflationary expectations and weakened the strong disinflationary pressures, and then it contributed to an economic recovery and job creation. As a result, it accelerated the return of inflation to our inflation target.

Despite all these demonstrable benefits, we could not have regarded the commitment as a clear success if the exit had been followed by a period of excessive volatility of the koruna exchange rate or other macroeconomic variables. Although we were standing by to use our instruments to deal with any major swings, in the event none of the potential risks materialised and the exit went smoothly. Following a relatively short period of slightly increased volatility, the exchange rate stabilised and, with only a few interruptions, the koruna appreciated gradually against the euro for the rest of the year. This success was due to our predictable policy based on open communication, although I admit that a bit of good luck also contributed to the successful exit. However, this changes nothing about the fact that the

gloomy predictions made by the CNB's critics did not materialise and that the smooth exit capped off the overall success of this unconventional monetary policy instrument, which had been in place for almost three and a half years. This is amply illustrated by the praise we have received from experts and the general public. I am sure that our experience with the use of the exchange rate as an unconventional monetary policy instrument, including the way we discontinued it, will be interesting and useful to other central banks in the future.

Persisting inflation pressures resulting from rapid growth in wages and the economy as a whole in a situation of relatively gradual appreciation of the koruna allowed us to start returning monetary policy to normal in the second half of the year. By this, I mean a return to the use of interest rates as our main monetary policy instrument. We made the first rate increase in early August, becoming the first central bank in Europe and the third among the advanced economies to raise interest rates again after many years. A second rate hike followed in early November. Although the return to equilibrium interest rates will continue in the years ahead, we can say that from the monetary policy perspective it was in 2017 that we laid the foundations for definitively overcoming the consequences of the 2008–2013 crisis.

Thanks to the rate increases, our monetary policy began to move back into line with our macroprudential policy, which we had started tightening in previous years due to growing signs of overheating in some parts of the economy. We were particularly concerned about the rapid growth in residential property prices and increasing amounts of mortgages being provided. The increasingly intensive use of macroprudential instruments in a rising number of countries is one of the consequences of the financial crisis. This confirms the adage that every cloud (the financial crisis) has a silver lining (the introduction of more sophisticated tools to prevent it from recurring). I consider it very useful that we have two sets of complementary and mutually reinforcing instruments to influence our economy in a countercyclical way and deliver financial stability. At a time when monetary policy remained "bound" to zero interest rates and the exchange rate commitment owing to persisting low inflation, our ability to start reducing the risks of overheating in certain financial market segments proved extremely useful.

Even so, we regard it as important to push through the conversion of certain macroprudential tools from the "soft" form of mere recommendations for banks into a form enforceable by law. This specifically concerns our credit indicators for managing risks connected with the provision of loans secured by property. As this wish of ours remained unheard by Czech lawmakers in 2017 due to the approaching elections to the Chamber of Deputies, we will seek its legislative enactment again. If we are to bear full responsibility for the stability of the financial sector, it is vital to put in place the necessary legal preconditions, and that includes enforceable instruments.

This Annual Report describes the most important material, organisational, operational and personnel changes that took place at the CNB in 2017. Those changes were aimed at responding actively to an evolving environment, at meeting the latest domestic and foreign challenges and at enhancing the professionalism and transparency of this institution. I believe that the actions and decisions we made in 2017 have further strengthened the credibility that we have long enjoyed with the public.



Jiří Rusnok
Governor



The Commodity Exchange, which today forms part of the CNB's headquarters complex, was expanded in 1928–1929 with the addition of a functionalist extension sensitively designed by the architect Bohumil Hypšman (aka Hübschmann). The extension contains a new Exchange Hall connected with the original premises in a T-shape. When all the halls were linked up, a room with a floor area of 1,250 m² was created. This made it the largest hall in Prague. The statues above

the entrance outside the building were removed and replaced with a rectangular travertine portal. A modern sculpture – an allegorical female figure holding a sickle and a sheaf of wheat, designed by Jaroslav Horejc – was placed where the old and new buildings met. The new facades were given a functionalist look, which, however, fully respected the principles of the original Neo-Renaissance building.

I. THE BANK BOARD



The Bank Board



The Bank Board as of 31 December 2017

Back: Oldřich Dědek, Vladimír Tomšík, Vojtěch Benda, Marek Mora, Tomáš Nidetzký
Front: Jiří Rusnok, Mojmír Hampl

The Bank Board is the supreme governing body of the CNB. 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 or member of the governing, supervisory or inspection bodies of other banks or commercial undertakings, and the performance of any independent gainful occupation, except for management of own assets and scientific, literary, journalistic, artistic and pedagogical activities. 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 and macroprudential policy and the instruments for implementing them in line with the CNB's primary objective, namely to maintain price stability, and in line with the task of maintaining financial stability. It decides on fundamental monetary and macroprudential policy measures and lays down principles for CNB transactions. In addition, it decides on key measures relating to financial market supervision, resolution on the financial market and cash and non-cash money circulation. It sets the CNB's overall development strategy 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 for 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. In the event of a tie, the chairperson has the casting vote.

Oldřich Dědek and Marek Mora became members of the CNB Bank Board with effect from 13 February 2017. They replaced Lubomír Lízal and Pavel Řežábek, whose mandates expired on 12 February 2017.





The CNB special library was relocated to another part of the Hypšman extension during the renovation in 2017. The two rooms it vacated were incorporated into the CNB Congress Centre, making the latter more attractive for internal purposes and especially to external organisations. The new premises are multifunctional enough to be used not only for press conferences given by CNB representatives and for lectures,

training courses and seminars, but also as a venue for large conferences and as meeting rooms or additional training rooms in the Commodity Exchange. This expansion of the Congress Centre into the former premises of the special library is a milestone in the centre's existence, as it allows the CNB to host major multi-day conferences requiring multiple supporting rooms for lectures and separate meetings.



II. THE CNB IN 2017

The CNB in 2017

— MONETARY POLICY AND ECONOMIC DEVELOPMENTS

The primary monetary policy objective as laid down in the Act on the CNB is to maintain price stability. Since January 1998, this has been achieved under an inflation targeting regime in which the CNB tries to keep inflation close to a declared target. Since 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. This target is in line with the practice of advanced economies.

Inflation was in the upper half of the tolerance band around the CNB's target throughout 2017. Still easy monetary policy coupled with rising external demand supported economic growth, which accelerated to 4.6%. Record-low unemployment and the highest number of job vacancies in history led to a surge in wage growth.

The conditions for sustainable fulfilment of the CNB's inflation target were met, enabling the Bank Board – in line with its previous communications – to exit the exchange rate commitment, which it did in early April 2017. The koruna subsequently appreciated against the euro only gradually and with no major swings in either direction. The CNB thus did not intervene on the foreign exchange market after the commitment ended and was able to raise its monetary policy rates twice in the second half of 2017.

The key input to the Bank Board's decision-making is the forecast of future economic developments drawn up by the Monetary Department. The forecasts are published together with a description and assessment of economic and monetary developments in the quarterly *Inflation Reports* (IRs), which are available on the CNB website (*Monetary policy > Inflation reports*). The first forecast of 2017, published in February, indicated that inflation would increase further into the upper half of the tolerance band around the CNB's target and return to it from above in the first half of 2018. According to this forecast, economic growth and wage growth were expected to accelerate further, while the unemployment rate was predicted to continue decreasing gradually. The February forecast assumed that the exchange rate commitment would be ended in mid-2017. At its February meeting, the Bank Board stated that the CNB would not discontinue the use of the exchange rate as a monetary policy instrument before the second quarter of 2017 and that it considered it likely that the commitment would be discontinued around the middle of 2017. The forecast expected the koruna to firm against the euro following the exit from the commitment. However, this outlook did

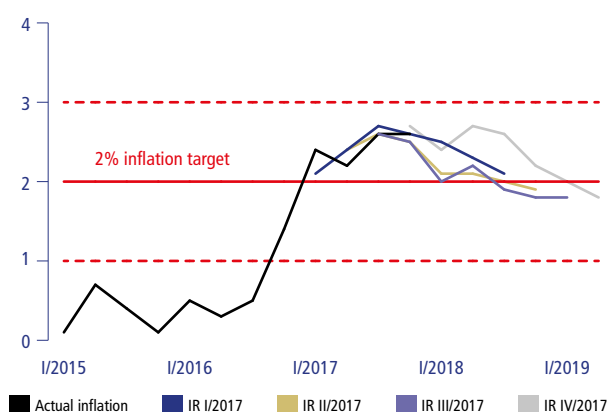
Fulfilment of the inflation target

(in %)



Inflation forecasts

(in %)



not take into account that the appreciation of the koruna could be strongly dampened by market “overboughtness”, i.e. by past hedging of exchange rate risk by exporters before the exit from the exchange rate commitment and by the closing of koruna positions by financial investors.

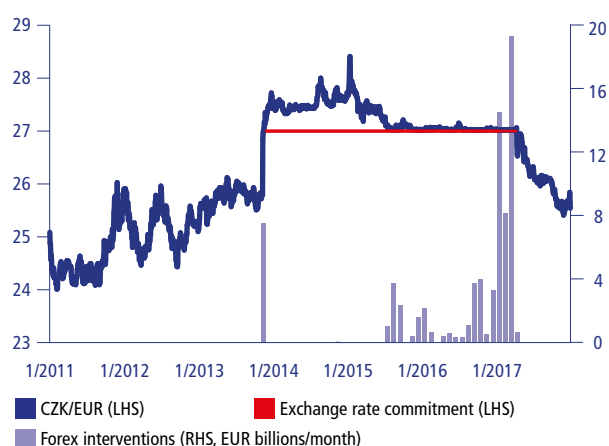
On the basis of a thorough assessment of the available macroeconomic data, analyses and forecasting scenarios, the Bank Board stated at an extraordinary meeting on 6 April 2017 that the conditions for sustainable fulfilment of the CNB’s inflation target in the future had been met and discontinued the exchange rate commitment. This was the first step towards a gradual moderation of the expansionary nature of the monetary conditions. However, the Bank Board announced that there would be a time delay between the end of the commitment and an interest rate increase. On exiting the exchange rate commitment, the Bank Board also warned that the koruna exchange rate could fluctuate in either direction in the short term and that its evolution was a significant uncertainty of the February forecast valid at the time. At the same time, it communicated that the CNB stood ready to use its instruments to mitigate potential excessive exchange rate fluctuations if needed.

The koruna-euro exchange rate strengthened only modestly straight after the commitment ended and followed a moderate appreciating trend in the rest of 2017 as well. By the end of the year, it was about 5.5% firmer than at the beginning. The appreciation was dampened by market overboughtness and there were no major exchange rate swings in either direction. As a result, the CNB did not have to intervene in the foreign exchange market. In early 2017, however, the volume of interventions had been high: the CNB had bought a total of EUR 42.5 billion between January and the exit in April. Over the entire duration of the commitment, it had intervened to the tune of EUR 76 billion.

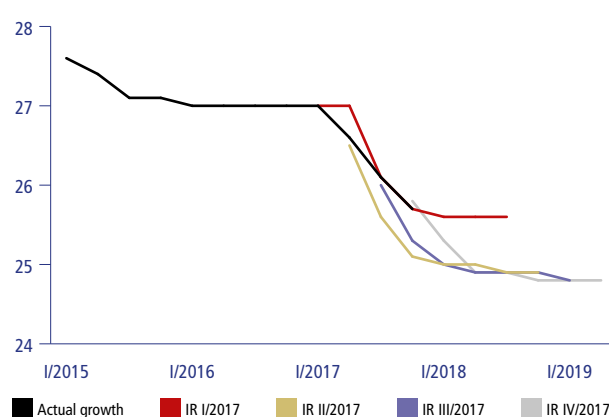
The CNB received recognition from the international economic community for the way it had exited the exchange rate commitment. Governor Jiří Rusnok was named Central Bank Governor of the Year in Europe for 2018 by The Banker, which praised the way in which the commitment had been ended without inducing market shocks. Another reason given by the judges was the subsequent return to conventional monetary policy. Jiří Rusnok was also named Central Bank Governor of the Year for Central and Eastern Europe 2017 by GlobalMarkets – the newspaper of record at the annual meetings of the International Monetary Fund (IMF) and the World Bank – for the smooth exit from the exchange rate commitment, including the careful preparation and effective communication of this move, and for the CNB’s financial stability policy.

The May forecast shifted the inflation path downwards, mainly on account of a stronger koruna. The earlier exit from the exchange rate commitment than assumed by the previous forecast, coupled with changes in the outlooks for foreign variables, had led to the koruna appreciating

The koruna-euro exchange rate and the CNB’s interventions



The koruna-euro exchange rate forecast



THE CNB IN 2017

earlier and faster against the euro. This was taken into account in the May forecast. The prediction for the real economy was little changed. Consistent with the forecast was an increase in domestic market interest rates in the third quarter of 2017 and later also in 2018. It was expected that the rate increase would be strongly dampened until around mid-2018 by the ongoing quantitative easing by the European Central Bank (ECB). At its monetary policy meetings during the second quarter, the Bank Board stated that interest rate increases would be conditional on the evolution of all key macroeconomic variables, including the exchange rate of the koruna. In line with the assumption of the forecast and its previous communications, the Bank Board decided to leave the key monetary policy rate at technical zero in the second quarter.

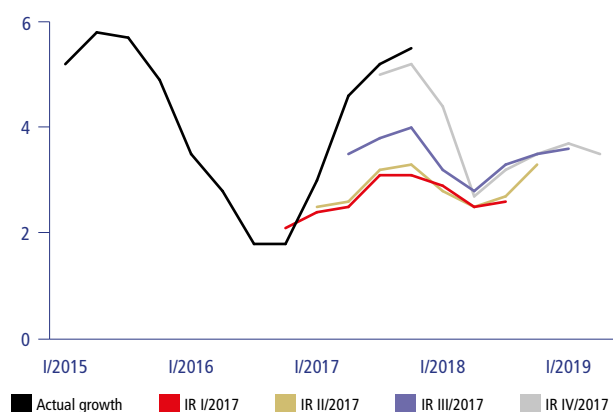
As economic developments in the second and third quarters of 2017 were in line with the message of the May forecast, the next forecast (drawn up in August) saw no major changes. The only exception was an increase in the forecast for wage growth and, in turn, economic growth. Consistent with the forecast was an increase in domestic market interest rates in the third quarter of 2017 and later also in the following two years. As in the previous forecasts, a faster return of interest rates to their long-run neutral level was hampered by the ECB's ongoing quantitative easing. After discussing this forecast, the Bank Board decided at its August meeting to raise the key monetary policy rate by 20 basis points to 0.25%. This rate thus rebounded from technical zero after almost five years. The exchange rate of the koruna reacted to the interest rate hike only to a limited extent.

A further acceleration in wage growth and GDP growth led to an upward revision of these variables in the November forecast. The stronger inflationary effect of the domestic economy and a higher outlook for administered prices were reflected in higher forecasts for inflation and interest rates. The exchange rate forecast for the following few quarters shifted to weaker levels. This was linked with persisting market overboughtness, which had been only partly taken into account in the previous forecast. After discussing the November forecast, the Bank Board decided to increase its key rate further to 0.50%.

At the end of 2017, 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*. The document again resulted in a recommendation not to set a target date for adopting the euro yet and thus not to attempt to enter ERM II during the following year. This recommendation was based on a whole range of factors. The economic situation in the euro area itself still cannot be assessed as sufficiently stabilised despite the observed improvement. Low enforceability of fiscal rules is a long-standing problem. However, the preparedness of the Czech Republic itself to adopt the euro has improved in recent years, although some shortcomings persist, especially as regards incomplete real convergence and public finance sustainability.

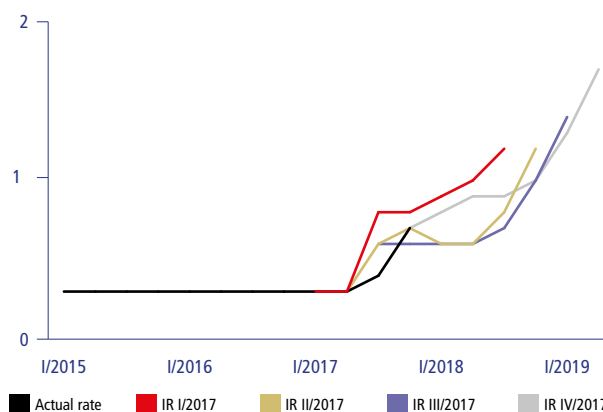
GDP growth forecasts

(in %)



3M PRIBOR forecasts

(in %)



— FINANCIAL STABILITY

Maintaining financial stability and seeing to the sound operation of the financial system in the Czech Republic are among the CNB's objectives. The CNB identifies, monitors and assesses risks jeopardising the stability of the financial system. By means of its powers, it prevents or mitigates these risks, thus creating macroprudential policy and contributing to the resilience of the financial system and the maintenance of financial stability. The CNB provides information about the conduct of this policy on its website (*Financial stability > Macroprudential policy*).

The main tool used to communicate with the public in the financial stability area 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 Governor and at a special seminar. In accordance with the law, it also submits the report to the Chamber of Deputies. The Financial Stability Report above all aims to identify new risks arising from domestic economic developments and the external environment. Another key objective is to assess to what extent the domestic financial system would be able to withstand the impacts of adverse economic shocks using stress tests. The Financial Stability Report is an underlying document for the spring Bank Board meeting on financial stability issues. For the similar autumn meeting, CNB experts regularly draw up an update to the Financial Stability Report. This update, however, had not previously been published. Given the increasing public interest in macroprudential policy, the Bank Board decided to disclose the information contained in the update in a publication called *Risks to financial stability and their indicators*. At the end of January 2018, the CNB published the information from the update to the Financial Stability Report discussed by the Bank Board in December 2017.

In Financial Stability Report 2016/2017, issued in June 2017, the CNB stated that the Czech financial sector had maintained a high level of resilience to possible shocks. Stress test results had proved the ability of supervised financial institutions to withstand even very adverse economic developments. This was due mainly to sufficient capital adequacy, large liquidity buffers and prudent risk management by financial institutions. As regards potential sources of risks to financial stability in the future, there was a further increase in cyclical risks, due mainly to rising optimism of financial institutions and their clients, which was reflected in strong growth in demand for loans. The CNB's mandate also requires it to react by applying macroprudential tools as soon as risks to financial stability emerge. Back in 2014, the CNB introduced a requirement for all banks in the Czech Republic to create a capital conservation buffer equal to 2.5% of their common equity. For five systemically important banks, the CNB sets a systemic risk buffer of 1%–3% of common equity. In 2017, the CNB reacted to the continuing shift of the domestic financial cycle to a phase of stronger recovery by raising the countercyclical capital buffer rate. At the Bank Board's May meeting on financial stability issues, it was decided to increase this rate from 0.5% to 1.0% of banks' exposures in the Czech Republic. At its December meeting, the Bank Board, taking into account banking sector vulnerability indicators and other factors, decided to increase this rate further to 1.25% with effect from 1 January 2019.

Financial Stability Report 2016/2017 identified the risk of a continued price spiral between property prices and property purchase loans. A reduction of the ceiling for the loan-to-value (LTV) ratio (the ratio of the amount of a loan to the value of collateral), which took effect in April 2017, helped to dampen this risk. More specifically, the upper limit for individual loans was lowered to 90% and the aggregate limit for loans with an LTV of 80%–90% was newly set at 15%. The scope of the *Recommendation on the management of risks associated with the provision of retail loans secured by residential property* was extended to include other loans provided to consumers who already have a mortgage loan and to cover all credit providers. In line with an IMF recommendation, the CNB promoted an amendment to the Act on the CNB in cooperation with the Ministry of Finance. The bill should empower the CNB to set binding upper limits on certain risk indicators now subject

THE CNB IN 2017

to the above Recommendation. However, the Chamber of Deputies did not discuss the amendment before the end of the parliamentary term, so the CNB will seek to have it enacted in a new round of the legislative process. The current settings of the individual macroprudential tools are available on the CNB website (*Financial stability > Macroprudential policy*).

At the EU level, the Governor and a Vice-Governor attend the regular meetings of the General Board of the European Systemic Risk Board (ESRB). CNB representatives are involved in the ESRB Advisory Technical Committee and its working groups. In 2017, the CNB contributed mainly to the work of teams dealing with risks associated with capital buffers. Cooperation within the European Central Bank (ECB) continued via the Financial Stability Committee (FSC), in which the CNB is active primarily in providing data sources for financial stability analyses in the EU. The CNB is also involved in the Regional Consultative Group of the Financial Stability Board (FSB) established by the group of twenty most important economies of the world (G20). Last year, this group focused on global risks to financial stability and the impacts of post-crisis regulations.

The CNB is one of the most active national macroprudential authorities in the EU as regards the use of tools aimed at ensuring banking sector resilience and mitigating existing and potential sources of risks to financial stability. The CNB's decisions in this area – alongside the successful exit from the exchange rate commitment – were mentioned upon the presentation of both international awards bestowed on Governor Jiří Rusnok last year (see the section *Monetary policy and economic developments*).

— FINANCIAL MARKET SUPERVISION

The CNB performs supervision of the financial market in the Czech Republic. To the extent stipulated in legal rules, it supervises entities operating on the financial market, lays down rules for their business to safeguard the stability of the financial system, and systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with those rules. The CNB is part of the European System of Financial Supervision (ESFS) and works in cooperation with the European Systemic Risk Board (ESRB) and the European Supervisory Authorities for the banking industry (EBA), insurance and occupational pensions (EIOPA) and securities and markets (ESMA). The CNB provides detailed information about financial market supervision in its annual Financial Market Supervision Report, which is available on its website (*Supervision, regulation > Aggregate information on the financial sector > Financial market supervision reports*).

— FINANCIAL MARKET REGULATION

Last year, the CNB was actively involved in preparing financial market laws, mainly in partnership with the Ministry of Finance. It also constructively influenced the ongoing process of creation of EU financial legislation. It prepared implementing decrees and issued a series of explanatory and methodological opinions interpreting the application of regulatory requirements pertaining to financial market participants. A complete and up-to-date list of the CNB's decrees, provisions of a general nature, official information and opinions relating to the financial market can be found on its website (*Supervision, regulation > Legislation*).

In the area of capital market regulation, an amendment to the Capital Market Undertakings Act was adopted with effect from 3 January 2018, transposing into Czech law above all the Markets in Financial Instruments Directive (MiFID II). The main changes included stricter rules of conduct towards clients and rules for the activities of investment intermediaries. The requirements

for the expertise of persons involved in the distribution of investment instruments were also strengthened through the introduction of professional examinations. Directly applicable EU legal acts also resulted in a number of changes. The CNB established a working group for implementing new rules and dealing with any ambiguities.

In early 2017, the Government submitted to the Chamber of Deputies an amendment to the Act on Banks and an amendment to the Act on Credit Unions. The amendments included changes in the regulation of governance systems connected with the Capital Requirements Directive (CRD IV), rules for the conversion of banks into foreign bank branches and changes in the calculation of the settlement shares of credit union members. At the same time, the Government submitted to the Chamber of Deputies an amendment to the Recovery and Resolution Act which, for example, extended the options of the moratorium on the fulfilment of a bank's obligations and simplified the procedures concerning the protection of competition during resolution. Due to elections, however, the Chamber of Deputies did not discuss these proposals, so the legislative process should recommence in 2018.

A key task in the area of insurance regulation was the preparation of a new Act on Insurance and Reinsurance Distribution transposing the Insurance Distribution Directive (IDD) into Czech law. The main objective of the draft is to enhance the transparency and quality of the insurance distribution market, which is burdened with a large number of registered entities. The proposal clarifies the requirements for the expertise of intermediaries and conduct towards clients, and in particular strengthens the provision of objective information to clients and prevents the sale of unsuitable products. The CNB actively commented on the draft and a number of its suggestions were taken on board by the Ministry of Finance and the Government. The draft act was submitted to the Chamber of Deputies in early January 2018.

An important legislative change was the adoption of a new Payment System Act transposing the recast Payment Services Directive (PSD2) into Czech law. Its main objective is to enhance the safety of payments and define rules for some previously unregulated services (payment initiation and provision of information on payment accounts).

During 2017, the CNB also worked on proposals to amend the Act on Bureau-de-change Activity, which it had initiated on the basis of its supervisory practice. As the CNB is not entitled to propose laws, in late 2016 it contacted the Ministry of Finance, which opened a public consultation on this topic in April 2017. Its evaluation was published in August 2017. The CNB is proposing above all the right of a consumer to withdraw from (cancel) an exchange, consistent implementation of the single exchange rate list rule and the inclusion of most fees in the exchange rate. The CNB expects the Ministry of Finance to submit a draft amendment to the Act on Bureau-de-change Activity to the Government during 2018.

— EUROPEAN REGULATION

Intensive work on European financial market regulations continued in 2017 at the level of the European Commission, the EU Council and the European Parliament. As the number of legal acts issued as directly applicable regulations increases, the importance of the CNB being actively involved in the drafting of European legislation also rises. The CNB prepared opinions on proposals for new legislation on an ongoing basis and its representatives actively promoted the CNB's positions in EU committees and working groups.

Throughout the year, the CNB participated in discussions in an EU Council working group focused on the European Commission's proposals to reduce risk in the banking sector. A draft amendment to the directive and regulation on capital requirements (CRD IV/CRR) changes the rules for calculating capital requirements for market and counterparty risks and introduces a binding leverage ratio or net stable funding ratio as part of the mandatory liquidity standard. Provisions

distributing the impact of the new IFRS 9 financial reporting standard on regulatory capital over time and phasing in the limits on large foreign currency exposures to central governments and central banks were agreed. These changes took effect on 1 January 2018. The main aims of the proposed changes to the Bank Recovery and Resolution Directive (BRRD) are to harmonise the insolvency rankings of bank creditors, to harmonise the introduction of the moratorium on the fulfilment of banks' obligations and to implement the international standard for capital usable during bank resolution into the European legislation. Partial harmonisation of the insolvency ranking of bank creditors came into force in December 2017.

The year 2017 saw the publication of a number of legal rules to which the CNB contributed as part of its activities in the European Supervisory Authorities or by commenting on the instructions of the Ministry of Finance for Council meetings. They included regulations of the European Commission implementing and amending the directive and regulation on markets in financial instruments (MiFID II/MiFIR), an amendment of a regulation governing the calculation of capital requirements for some asset classes of insurance and reinsurance companies, and a new regulation on securitisation and a related amendment of the CRR. Work continued on an amendment of the Anti-Money Laundering Directive (AML). In particular, the amendment aims to address virtual currencies and introduce national central account registers.

In December 2017, the European Commission published a proposal for a new regulatory framework for investment firms, to which the CNB contributed as part of the EBA's activities. The proposal significantly lowers the regulatory burden on most investment firms, as only the largest systemically important investment firms would be subject to the regulatory framework for credit institutions.

In addition, the CNB was actively involved in the preparation of numerous other implementing measures and guidelines, including those relating to PSD2.

— INTERNATIONAL COOPERATION ON THE FINANCIAL MARKET

In 2017, the CNB was involved in the debate about the completion of the banking union, specifically the debate on the legislative package to reduce risk in the banking sector which the European Commission had submitted in November 2016. Within the package, proposals concerning the insolvency ranking of unsecured debt instruments and the implementation of IFRS 9 were prioritised and approved. With reference to the EU Council's conclusions of June 2016, the CNB opposed the European Commission's proposal for rapid adoption of political agreements on risk sharing. The CNB emphasised that such agreements should be preceded by sufficient risk reduction and the introduction of effective risk controls. It also advocated other priorities in this area, specifically the prevention of moral hazard and respect for the integrity of the internal market.

The CNB was actively involved in the work of the European Supervisory Authorities at board, expert committee and working group level. In September 2017, the European Commission published a legislative proposal for fundamental changes to the regulation establishing the European Systemic Risk Board and the regulation establishing the European Supervisory Authorities. As the current model for the functioning of the European System of Financial Supervision has proven successful in practice, the CNB was against most of the changes. It voiced fundamental disagreement with proposals in the area of the management of the European Supervisory Authorities and their funding by supervised entities. Moreover, it rejected the introduction of new powers of the European Supervisory Authorities as regards the creation of single supervisory plans, delegation and outsourcing.

In 2017, the CNB was involved in nine supervisory colleges for European banking groups, acting as consolidating supervisory authority in one case. As in 2016, the colleges focused, for example, on the assessment of the risk profiles of supervised entities and on internal models. In addition, the CNB cooperated in 13 supervisory colleges for European insurance groups. The discussions

focused on group internal models, the implementation of the requirements of the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and risk assessments of supervised entities, among other topics.

— LICENSING, APPROVAL AND AUTHORISATION ACTIVITIES IN THE FINANCIAL MARKET AREA

As the financial market supervisory authority, the CNB issues authorisations (licences) to the majority of service providers on the financial market. In this context, it also issues other permissions or approvals, for example approvals of securities prospectuses and approvals of the publication of takeover bids. In these cases, the CNB acts as an administrative authority.

Numbers of administrative licensing proceedings for selected categories of supervised entities

Categories of financial entities ¹⁾	No. of administrative proceedings continuing from 2016	No. of administrative proceedings opened in 2017	No. of administrative proceedings closed in 2017	No. of supervised entities as of 31 December 2017
Credit institutions	7	24	21	57
Insurance sector (insurance and reinsurance companies and Czech Insurers' Bureau)	4	5	7	51
Pension management companies and funds	0	8	7	44
Management companies and investment funds	15	115	107	381
Investment firms	10	30	24	67
Payment institutions and electronic money institutions	5	8	9	37
Processors of domestic banknotes and coins	0	0	0	5
Non-bank consumer credit providers	8	103	14	5
Securities issuers and market infrastructure	8	39	45	115
Accredited entities ²⁾	14	16	26	36
Bureaux de change	4	58	56	1,014

1) Including branches of foreign companies.

2) Accredited entities are entities accredited to organise examinations of supplementary pension savings and consumer credit distributors.

THE CNB IN 2017

In April 2017, a banking licence was granted to a branch from a third country, i.e. a country outside the EU. The licence was issued to the Industrial and Commercial Bank of China. Raiffeisen Bank a.s. purchased the business of ZUNO Bank, pobočka ČR, which then ceased to exist. At the close of 2017, the CNB opened proceedings on the transformation and granting of a banking licence to a credit union and on a licence for a branch from a third country.

Two insurance companies left the market in 2017 – Adria Way (following the transfer of its portfolio of insurance policies to UNIQA a.s.) and ING pojišťovna (following the transfer of its portfolio of insurance policies to NN životná poisťovňa a.s.).

At the end of 2017, the CNB was supervising 159,235 insurance intermediaries, 7,046 investment intermediaries, 26,448 tied agents under the Capital Market Undertakings Act, 254 consumer credit intermediaries, 24,049 tied agents under the Consumer Credit Act and many other types of financial entities.

Securities of 18 issuers were newly admitted to trading on a regulated market during 2017. By contrast, securities of 16 issuers, ten of which had been redeemed, were excluded from trading.

POWER EXCHANGE CENTRAL EUROPE, a.s., terminated its activities as a regulated market operator on 31 December 2017. This took the number of such entities down to two. The number of multilateral trading facility operators (three) and the number of operators of settlement systems with settlement finality (two) remained unchanged from the previous year. There is still one central depository.

— FINANCIAL MARKET SUPERVISION

In its supervisory work, the CNB continuously monitored the activity and financial performance of individual financial market entities and assessed the evolution of the market as a whole and its segments. Financial market supervision in the areas of prudence, conduct of business, consumer protection and AML/CFT took the form of both off-site surveillance and on-site inspections. Intensive cooperation with partner supervisory authorities in other countries remained a supervisory priority for the CNB.

The CNB's supervision of banks, credit unions and, under a simplified regime, foreign bank branches, was concentrated on the credit portfolio quality, capital adequacy, liquidity and overall performance of banks and their consolidated groups. The CNB also prepared comprehensive evaluations of the risk profiles of individual credit institutions on a regular basis and assessed the quality of resolution plans.

During on-site inspections, the CNB examined the functioning of governance systems, especially credit, market and liquidity risk management systems, internal capital systems, internal auditing and compliance, the provision of payment and investment services to clients, communication with clients and procedures for entering into and terminating contractual relationships. Supervisors are paying increasing attention to cyber risks. Following an amendment of the Act on Credit Unions, supervisors increasingly focused on measures taken by credit unions to implement that amendment.

The CNB, in cooperation with some banks, continued to implement the joint project of stress testing in selected banks, which is performed annually. The aggregated results of these stress tests confirmed the good resilience of domestic banks. Their capital adequacy ratio stayed above the regulatory minimum by a sufficient margin even in an adverse scenario.

Prudential supervision of insurance companies is based mainly on regularly assessing the financial condition and solvency situation of the supervised insurance companies and assessing compliance with control system requirements. One of the main factors affecting the focus and priorities of supervision of insurance companies was the entry into effect of the Solvency II regulatory framework in the second half of 2016.

As regards non-life insurance, supervisors focused on premium adequacy in vehicle liability insurance. In life insurance, supervisors mainly verified the compliance of insurance companies' approaches to setting technical provisions with the Solvency II requirements. The CNB has also long paid great attention to approving internal models for determining capital requirements. Supervisors also monitored the preparedness of insurance companies for the new requirements of the regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs). The CNB also focused on external distribution network quality control and procedures for terminating insurance policies with clients, for handling complaints and for claims and loss adjustment. Supervision also covered consumer protection, in particular when offering and promoting insurance products.

In addition to testing the resilience of banks, the CNB regularly conducts stress tests to assess the resilience of the insurance sector to adverse scenarios of future economic developments. The CNB conducted its own stress tests in 2017, which newly included most domestic insurance companies. The aggregated results proved that the insurance sector as a whole is also sufficiently capitalised and able to absorb major changes in risk factors.

CNB supervision in the area of pension management companies and the funds managed by them was concentrated on assessing their capital position, their capital management, the ability of transformed funds to cover liabilities with assets, compliance with the rules in the management of assets of transformed and participation funds and follow-up control mechanisms. The results of stress tests performed by the CNB for the pension management company sector also showed that the sector is able to meet its capital requirements.

On 1 December 2016, after the new Consumer Credit Act took effect, the CNB gradually started supervising the entire consumer credit market, including non-bank companies. In 2017, the CNB investigated 128 consumer credit-related complaints from the public regarding credit institutions and received 150 complaints about consumer credit providers. The complaints about banks mainly concerned the justifiability of charging fees for early repayment of consumer credit for housing, shortcomings in consumer credit advertisements and failure to provide complete information when consumer credit was agreed. The complaints about non-bank providers mainly concerned disadvantageous terms and conditions for agreed credit, procedures for recovering amounts due and unethical conduct by providers' representatives. The CNB also dealt with several complaints about unauthorised consumer credit providers. On-site examinations in accredited entities, i.e. institutions authorised to verify the competence of persons involved in providing consumer credit, were commenced in 2017.

The CNB also supervises investment services providers, in particular non-bank investment firms, management companies, autonomous investment funds and foreign investment firms having branches in the Czech Republic. Off-site surveillance in the area of prudence mainly involved assessing information obtained from financial statements, annual reports, auditors' reports, supervised entities' websites and other sources in the public domain. The CNB investigated 168 conduct of business-related complaints from the public, most of which concerned foreign investment firms. Investment losses and the distribution and purchases of foreign funds were the most frequent subjects of complaints.

THE CNB IN 2017

As regards payment services, the CNB focused primarily on off-site surveillance, but also commenced on-site inspections based on its findings. Its attention was directed mainly at payment institutions and small-scale payment service providers. The CNB received 43 complaints from the public about the activities of non-bank payment service providers in 2017. A large part of them related to the unsolicited sending of credit cards.

CNB supervision of bureaux de change was focused primarily on compliance with the information duty to clients and with anti-money-laundering and anti-terrorist financing measures. A total of 294 complaints from the public concerned bureau-de-change activities. Most of them expressed dissatisfaction with exchange rates or fees, often resulting from a lack of clarity as regards the information published by bureaux de change on their terms and conditions for changing money.

The CNB's on-site inspections in financial product distributors were focused mainly on compliance with the rules for the conduct of business when dealing with clients. The most frequent shortcomings in this area were found in the provision of information to clients before the conclusion of contracts and the recording of the content of communications with clients. The CNB obtained 330 complaints from the public about the activities of financial product distributors. Most of them related to inappropriate intermediation of life insurance. The public pointed out shortcomings in the provision of information and unauthorised business in investment intermediation. Most of the complaints regarding consumer credit intermediaries pointed to out-of-date information entered in the register.

— ENFORCEMENT

As regards the enforcement area in 2017, the CNB investigated petitions for the opening of administrative proceedings, made decisions on the opening of administrative proceedings or the deferral of cases, and conducted first-instance administrative proceedings, within which it imposed fines and remedial measures, revoked licences and cancelled registrations. In addition to conducting administrative proceedings with supervised entities, the CNB conducted administrative proceedings with entities that provide financial services without having the relevant licence in financial market sectors where the law enables penalties to be imposed for the carrying on of unauthorised business. Final decisions in the CNB supervision area for which publication is prescribed by law are published on the CNB website (*Supervision, regulation > Conduct of supervision > Final administrative decisions*). Sanctions imposed on insurance intermediaries are entered in the Register of Insurance Intermediaries.

Statistics on administrative penalty proceedings

Area of imposition of penalty	No. of administrative penalty proceedings continuing from 2016	No. of administrative penalty proceedings opened in 2017	No. of administrative penalty proceedings closed in 2017	Total fines imposed (in CZK thousands)
Supervision of credit institutions	3	1	4	2,650
Supervision of insurance companies	10	30	34	1,120
Capital market supervision	28	28	38	16,830
Violation of the Act on Bureau-de-change Activity	5	19	15	2,045
Consumer protection	1	2	1	1,500
Payment system	2	10	10	5,880
Circulation of banknotes and coins	0	11	9	2,730
Act on the CNB	0	0	0	0
Consumer credit	0	5	3	150
Act on Certain Measures against Money Laundering and Terrorist Financing	0	1	1	80
Financial market supervision, total	49	107	115	32,985

— RESOLUTION PROCEDURES

The CNB became a financial market resolution authority in 2016. In 2017, the CNB's activities in the resolution of banks, credit unions and some investment firms were based again on two main principles: first, that resolution-related costs should be borne not by the state (or taxpayers) but by private individuals (primarily the institution's shareholders and creditors), and second, that resolution should only be applied if it is in the public interest. As part of its planning activities, the CNB worked with banks themselves, for which it plans resolution procedures, and with the Ministry of Finance and foreign institutions such as the Single Resolution Board (SRB) and the European Banking Authority (EBA).

In 2017, the CNB focused on new challenges in the area of resolution planning. These primarily included the definition of critical functions separately for each bank. Critical functions are those provided by banks without which the national economy would function only with difficulty or the financial stability of the state would be disrupted. They must therefore be protected. Some critical functions may only be provided by banks (deposit-taking and payments with irrevocable settlement). For others, banks are the most important provider on the market (e.g. lending and financial market and securities infrastructure-related services).

The CNB continued to work in cooperation with the Single Resolution Board in Brussels. Resolution strategy agreements have now been reached with some cross-border banks with major subsidiaries in the Czech Republic. Such strategies may be centralised or decentralised, depending mainly on the internal organisation and interconnectedness of the group. The agreed strategy will be reflected in the resolution plan and will affect the use of resolution instruments and the amount, type, placement and potential subordinatedness of the minimum requirement for own funds and eligible liabilities (MREL). In the event of resolution, the CNB will be able to write down the MREL or convert it to cover losses and to meet other resolution objectives so that the bank remains viable and continues to provide critical functions.

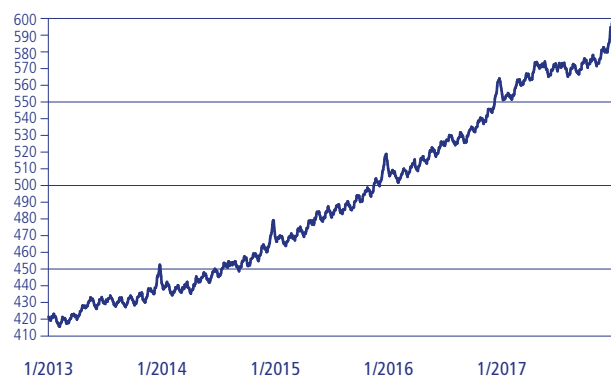
— CURRENCY AND PAYMENTS

— CURRENCY IN CIRCULATION

Under the Act on the CNB, 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 rose by CZK 37.2 billion in 2017. This is the fourth largest annual increase in the history of the independent Czech currency. Currency in circulation amounted to CZK 593.9 billion as of 31 December 2017. CZK 2,000 banknotes accounted for almost 40% of the value of currency in circulation; CZK 5,000, CZK 2,000 and CZK 1,000 banknotes together accounted for more than 90% of currency in circulation.

Currency in circulation –
1 January 2013 to 31 December 2017 (in CZK billions)



Structure of banknotes and coins in circulation as of 31 December 2017

Denomination	CZK millions	Percentage of total	Millions of pieces	Percentage of total
CZK 5,000	155,464.1	26.2%	31.1	6.7%
CZK 2,000	236,509.0	39.8%	118.3	25.7%
CZK 1,000	144,807.4	24.4%	144.8	31.4%
CZK 500	20,985.4	3.5%	42.0	9.1%
CZK 200	12,477.2	2.1%	62.4	13.6%
CZK 100	6,204.0	1.0%	62.0	13.5%
Banknotes, total	576,447.1	97.0%	460.6	100.0%
CZK 50	6,260.9	1.1%	125.2	6.7%
CZK 20	3,927.4	0.7%	196.4	10.6%
CZK 10	2,245.4	0.4%	224.5	12.1%
CZK 5	1,323.7	0.2%	264.7	14.2%
CZK 2	948.0	0.2%	474.0	25.5%
CZK 1	573.5	0.1%	573.5	30.9%
Coins, total	15,278.9	2.6%	1,858.4	100.0%
Precious metal coins	2,128.5	0.4%	2.6	100.0%
TOTAL	593,854.5	100.0%	2,321.6	

The number of banknotes in circulation rose by 15 million in 2017. CZK 1 to CZK 50 coins saw an increase of 100.7 million, the largest since 1995.

In all, 75.1 million banknotes, 95.7 million coins (including those for annual sets), 119,000 commemorative silver coins and 21,000 gold coins were produced in 2017. These banknotes and coins (including gold and silver commemorative coins) cost the CNB a total of CZK 450.1 million to produce.

THE CNB IN 2017

The CNB destroyed 80.4 million banknotes evaluated as unfit for recirculation due to wear or damage. Only 2.7 million coins accepted from circulation were rejected as unfit for further circulation. The significantly lower number of unfit coins than unfit banknotes is due mainly to the material used, which makes coins much more resistant to wear and tear.

Cash turnover at the CNB's cash offices amounted to CZK 1,392.2 billion in 2017, up by CZK 40.6 billion, or 3%, on a year earlier. The CNB's cash offices received 704 million banknotes and 357 million coins from circulation and issued 731.2 million banknotes and 458.1 million coins.

The CNB put new precious metal coins into circulation in 2017: six CZK 200 commemorative silver coins, one CZK 500 commemorative silver coin and two CZK 5,000 commemorative gold coins.



— SUPERVISION OF COMPLIANCE WITH THE ACT ON THE CIRCULATION OF BANKNOTES AND COINS

Cash circulation, together with the related rights and duties of the CNB, banks, legal entities and natural persons, is regulated by the Act on the Circulation of Banknotes and Coins. In 2017, the CNB opened a total of 16 inspections focusing on compliance with duties under this act:

- six inspections of banks, during which on-site inspections were conducted in 53 branches. A total of 243 mystery shopping inspections were conducted in banks, focusing on the exchange of damaged banknotes. In addition, 17 banknote processing machines and 41 deposit ATMs were tested.
- two inspections of handlers of domestic banknotes and coins, during which in-site inspections were conducted in four cash-handling centres and 39 banknote processing machines were tested.
- three inspections of persons authorised by the CNB to organise special courses, during which a total of 13 special courses, or 13 lecturers, were inspected.
- five inspections of operators of anonymous devices (retail chains), during which 229 self-service cash registers and 20 banknote processing machines were inspected in 54 shops.

Five inspections commenced in 2016 and 14 inspections commenced in 2017 had been completed as of 31 December 2017.

— NON-CASH PAYMENTS

In the area of non-cash payments, the CNB keeps the accounts of the state and operates systems for transferring interbank payments and settling short-term securities transactions. These 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.

The CERTIS system is used to maintain accounts of banks, the SKD system records bonds owned by banks, investment firms and other entities, and the ABO system maintains accounts of state organisational units and other state organisations and legal entities connected to the state budget. In order to execute state budget payments, the ABO system is closely linked to the Integrated Treasury Information System operated by the Ministry of Finance.

All state budget expenditure must be clearly linked with the reservation of funds in the state budget. State organisational units transmit payment orders together with information on the reservation of funds in the Integrated Treasury Information System to the CNB. The CNB verifies this reservation before executing the payment order.

Other clients for which the CNB maintains accounts include state funds, subsidised organisations established by state organisational units, the Railway Transport Route Administration and health insurance companies. All these organisations' accounts have been held exclusively at the CNB since 2017.

The entities whose accounts for the receipt of subsidies from the state budget are held at the CNB include self-governing territorial divisions and voluntary municipal organisations, regional councils of cohesion regions, public research institutions and public universities, as well as other legal entities with the approval of the Ministry of Finance.

To manage their accounts, clients use internet banking services or visit the CNB's branches in Brno, Hradec Králové, Ostrava and Prague or its regional offices in České Budějovice, Plzeň and Ústí nad Labem.

THE CNB IN 2017

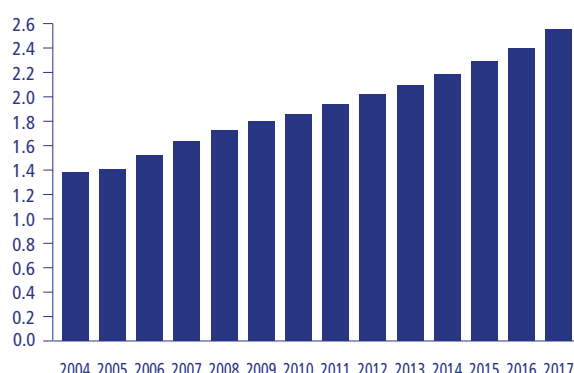
— CERTIS – INTERBANK PAYMENT SYSTEM

The CNB uses the CERTIS system to process interbank payments in the Czech Republic. Banks, credit unions and foreign bank branches are participants in this system. As of 31 December 2017, CERTIS had 46 direct participants with their own accounts and six third parties (for example, card payment clearing houses and securities clearing and settlement institutions).

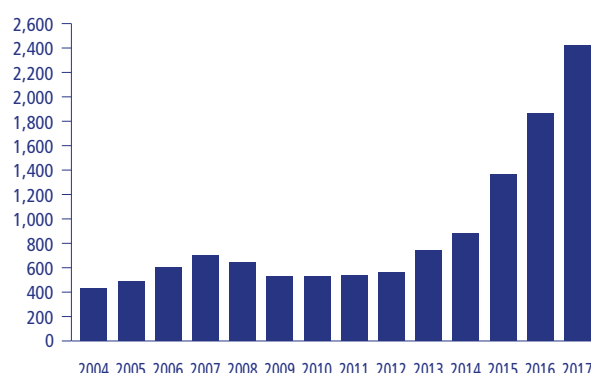
CERTIS processed 638 million transactions in 2017 (up by 5.8% year on year) with a total value of CZK 605,457 billion (up by 28.8%). Almost 2.6 million transactions were processed on average daily, with daily turnovers averaging CZK 2,422 billion.

The following charts show the average daily number of transactions executed and the amount of funds transferred in CERTIS since 2004.

CERTIS – average daily number of transactions (in millions of transactions)



CERTIS – Average daily turnovers (in CZK billions)



— SKD – SHORT-TERM SECURITIES SETTLEMENT SYSTEM

The CNB also operates the SKD system, which is a separate register of securities and a securities settlement system.

As of 31 December 2017, a total of 82 asset accounts – belonging to 53 clients (securities owners) and 10 custodians (securities managers) – were registered in SKD. 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 the intraday credit that the CNB extends to banks for smooth accounting purposes within CERTIS. The CNB also uses it for repo operations and the Ministry of Finance for daily liquidity management of the single treasury account. On average, 76 transactions a day were processed in SKD in 2017. The average daily value of these transactions was CZK 502 billion.

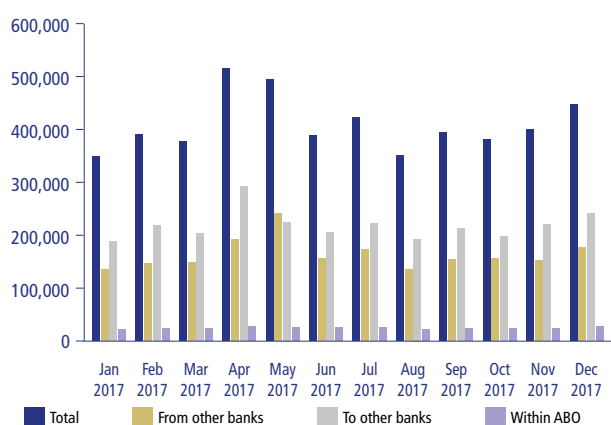
— ABO – THE CNB'S ACCOUNTING AND PAYMENT SYSTEM

The CNB keeps its internal accounts and the accounts of its clients in the ABO system. At the end of 2017, it maintained 22,393 accounts, of which 3,186 internal accounts, 3,172 employee accounts (for current CNB employees and pensioners) and 16,035 accounts of legal entities. The vast majority of the accounts of legal entities – 15,450 – are Treasury accounts in the Czech currency and 225 Treasury accounts in the euro. Treasury accounts are used for state budget revenues and expenditure and other financial operations of the state.

Most clients use the CNB's internet banking to manage their accounts. In all, 10,386 users were registered in the system as of the end of 2017.

The following chart shows the average daily numbers of accounting transactions processed in each month of 2017. The ABO system processes more than 900,000 transactions a day on peak days. Compared to 2016, the total number of transactions increased by 26.8%, due mainly to the inclusion of accounts of health insurance companies, which have been maintaining all their accounts at the CNB since 2017. The number of client orders rose by 11.3%.

ABO – average daily number of transactions



— SUPERVISION OF PAYMENT AND SETTLEMENT SYSTEMS

Another of the CNB's objectives under the Act on the CNB is to contribute to the safety, soundness and efficiency of payment and settlement systems and the development thereof. The CNB fulfils this objective as part of its oversight of payment and settlement systems. In 2017, the CNB focused mainly on the cyber resilience of systemically important financial infrastructures in the Czech Republic. In line with the recommendations issued by the Bank for International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) in June 2016, the CNB analysed the cyber resilience of the CERTIS system, the SKD system and the Central Securities Depository Prague. The results of this analysis were favourable. In addition to checking the systems' technological condition, the analysis verified the existence of an overall cyber resilience strategy, including a training programme for responsible employees.

— STATISTICS

The CNB compiles and publishes statistics for the needs of monetary policy, financial market supervision, financial stability and the CNB's other tasks. These statistics are available in the *Statistics* section of the CNB website. In 2017, the bank continued to provide regular national and harmonised statistics and also engaged in the development of individual statistics.

As regards macroeconomic statistics, the CNB focused mainly on cooperation in the assessment of the quality of macroeconomic imbalance indicators in EU countries. Since 2011, these have been part of the set of measures used to regulate economic developments in order to prevent or correct macroeconomic imbalances. In coordination with the European Central Bank (ECB) and Eurostat, the CNB produced and published on its website detailed methodologies for the balance of payments and international investment position statistics and the quarterly financial accounts statistics. Another important topic was ensuring data consistency between statistics, as there are still minor methodological differences and various timetables for revising external statistics data and financial and non-financial accounts data. In 2017, the CNB started to harmonise the financial account statistics with the annual national accounts statistics and the international investment position. In the field of government finance statistics, the CNB expanded its cooperation with the Ministry of Finance in the use of data from the Central Accounting System. Following a pilot project, the CNB in partnership with the ECB continued to build the government debt service statistics.

The development of monetary and financial statistics consisted mainly in the expansion of harmonised banking and non-banking statistics within the European System of Central Banks (ESCB). Milestone events included the completion of a compilation system for deriving harmonised flow statistics on insurance companies and the commencement of reporting to the ECB. As regards the balance sheet statistics of monetary financial institutions, the CNB expanded reporting to the ECB in the areas of capital and reserves. It extended the publication of statistics on banks' and building societies' interest rates to include new housing credit indicators. The CNB also started to publish partial lists of insurance companies and institutions relevant for payment statistics. Within the ESCB, it was also involved in the completion of a new regulation governing the production of harmonised pension fund statistics. Collection and compilation of data in accordance with this regulation should start in 2019. The CNB also joined an ECB initiative and began working on a revised payment statistics regulation.

The CNB continued to implement the AnaCredit project in cooperation with the ECB and with the involvement of the Czech Banking Association. The CNB plans to join the harmonised collection of granular credit data fully at the end of 2018. Detailed information is available in the *Statistics > AnaCredit* section of the CNB website. The project to expand the system for storing and administering reference data on institutions (RIAD) is also continuing. This project will extend the system to include credit counterparties collected in the AnaCredit system. As regards the Central Credit Register, progress was made on modernising the system thanks to the development of new output formats for bank users in 2017.

The CNB made extensive changes to current reporting in the field of supervisory statistics in 2017. These changes arose mainly from directly applicable European legislation and ensuing requirements for reporting by financial market entities (see the *Statistics > Supervisory statistics* section of the CNB website). In the case of reporting by credit institutions, the CNB significantly modified the data collected in line with new international accounting standards for the classification and valuation of financial instruments. Reporting by capital market undertakings (investment firms and trading and settlement systems) also underwent major changes due to the implementation of the single reporting framework in accordance with the EU directive and regulation on markets in financial instruments (MiFID II/MiFIR). The CNB also introduced changes to reporting by payment institutions linked with the new payment services directive. In the other segments of supervisory statistics, especially those relating to insurance companies, it focused on enhancing data quality and presentation to users.

Turning to the Central Register of Accounts (CRA), after the approval of the relevant law the CNB implemented a technical solution to commence timely collection of “primary” data from credit institutions. It prepared an implementing decree which was promulgated in the Collection of Laws on 26 January 2017. Collection of data from credit institutions commenced on 1 July 2017 in line with the agreed schedule. The CRA database was successfully filled before the end of 2017 and the system went into full operation on 1 January 2018 (see the *Statistika > Centrální evidence účtů* section of the CNB website – in Czech only).

As regards information systems and technology supporting mass data processing, the CNB continued to develop the new SDAT data collection system, which will serve as a unified interface for submitting statistical and supervisory data to the CNB. The bank also introduced changes to the information system for registration and licensing activities in accordance with amendments to the Capital Market Undertakings Act and the Payment System Act. Following these legislative changes, the CNB added new categories to its online lists of regulated and registered entities.

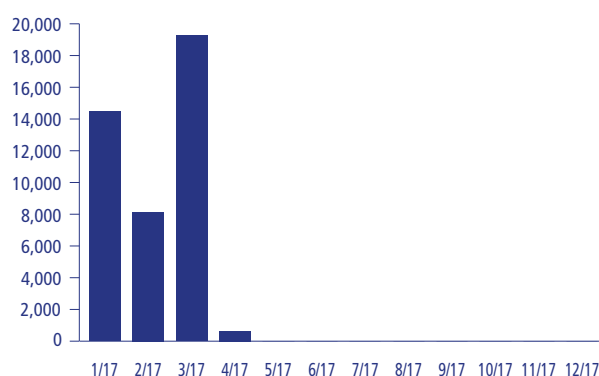
— FINANCIAL MARKET OPERATIONS

The CNB continued to use the exchange rate as an additional monetary policy instrument in early 2017. This consisted in a commitment to intervene if needed to weaken the koruna against the euro so that its exchange rate was kept close to CZK 27 to the euro. The Bank Board decided to discontinue the exchange rate commitment on 6 April 2017. The foreign exchange interventions conducted in 2017 amounted to EUR 42.5 billion (approximately CZK 1,149 billion). The interventions peaked in March in connection with the expected exit from the exchange rate commitment. After that, the CNB did not undertake any foreign exchange operations aimed at affecting the koruna's exchange rate. The rate therefore moved entirely freely. Foreign exchange interventions were the main factor affecting growth in koruna liquidity.

The main monetary policy instruments included interest rate operations (repo operations and automatic facilities), foreign exchange interventions and reserve requirements. The Bank Board sets three interest rates: the repo rate, the discount rate and the Lombard rate. The main monetary

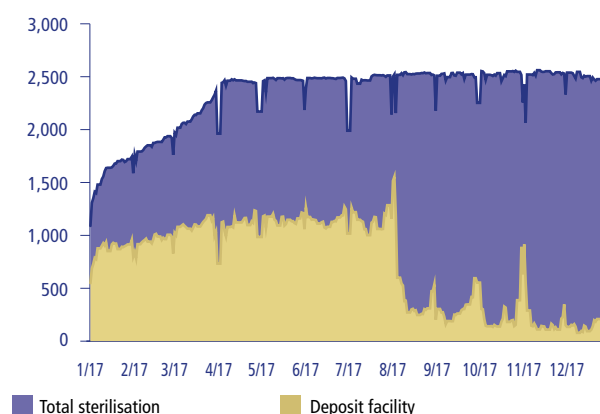
Size of forex interventions

(in EUR millions)



Excess liquidity

(in CZK billions)



THE CNB IN 2017

policy rate is the two-week (2W) repo rate. The discount and Lombard rates provide the floor and ceiling respectively for short-term interest rates on the money market. The CNB increased the repo rate and the Lombard rate twice in 2017, in August and November. It left the discount rate at 0.05% for the entire year. The increase in the spread between the repo rate and the discount rate led to greater use of repo operations and less use of the deposit facility.

The CNB's monetary policy instruments also include two "automatic" facilities – the marginal lending facility and the deposit facility. Under the lending facility, the CNB lends funds to banks overnight 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. Banks used the deposit facility a great deal during 2017, as the discount rate was equal to the repo rate. Recourse to the lending facility was rare.

The total average amount of excess liquidity absorbed was CZK 2,321 billion. Of this, the CNB absorbed 32% on average through the deposit facility and 68% through repo operations.

The CNB executed collateral exchanges with banks. In these technical operations, the CNB usually exchanged a security settled in the Central Securities Depository for a security settled in the Short-term Bond System (SKD). The aim of these operations was not to affect the banking sector's excess liquidity, but to provide liquid securities to banks, for instance for obtaining intraday credit.

The CNB's toolkit still contains two-week liquidity-providing repo operations and foreign exchange swaps. The CNB launched them in October 2008 as a result of the outbreak of the financial crisis and their existence is important for the stability of the domestic financial market. Although commercial banks did not use these instruments actively in 2017, the CNB considers it appropriate to keep them available.

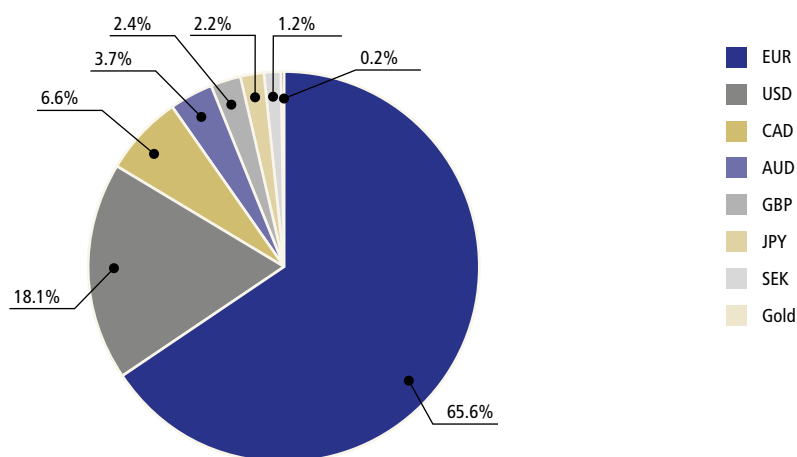
— INTERNATIONAL RESERVES MANAGEMENT

The CNB manages its international reserves, which are made up of foreign assets in selected convertible currencies. These assets are used mainly to support the CNB's independent monetary policy-making and as a source of foreign exchange liquidity for CNB clients. At the end of 2017, the reserves totalled CZK 3,151 billion, equivalent to EUR 123.6 billion or USD 148.0 billion. International reserves form the bulk of the CNB's assets – they accounted for almost 98% of the CNB's total assets at the end of 2017. The size and structure of the reserves are published regularly in the *Financial markets* section of the CNB website.

The market value of the international reserves recorded a year-on-year rise of 43% in koruna terms. This was due mainly to settled foreign exchange interventions (CZK +1,175.1 billion), followed by portfolio returns (CZK +33.4 billion) and purchases of foreign currency from clients and foreign currency deposits (CZK +23.4 billion). By contrast, the appreciation of the koruna against most reserve currencies resulted in a decline in reserves (CZK -286.7 billion). The reserves increased only in euro, which is the CNB's transaction and intervention currency. As a result, the percentage share of the euro in the currency structure of reserves increased. To preserve the diversification role of the US dollar in the CNB's reserve portfolio, it was decided to shift part of the increase in euro assets into the dollar.

The CNB actively invests most of its international reserves in accordance with its reserves management principles. The principles take into account the function performed by the international reserves and pay due regard to security, liquidity and returns. The largest part of the reserve portfolio is invested in debt securities issued by selected governments of several advanced countries, selected government-guaranteed bonds or bonds issued by top-rated multilateral institutions. Other instruments used for international reserves management include shares, repos,

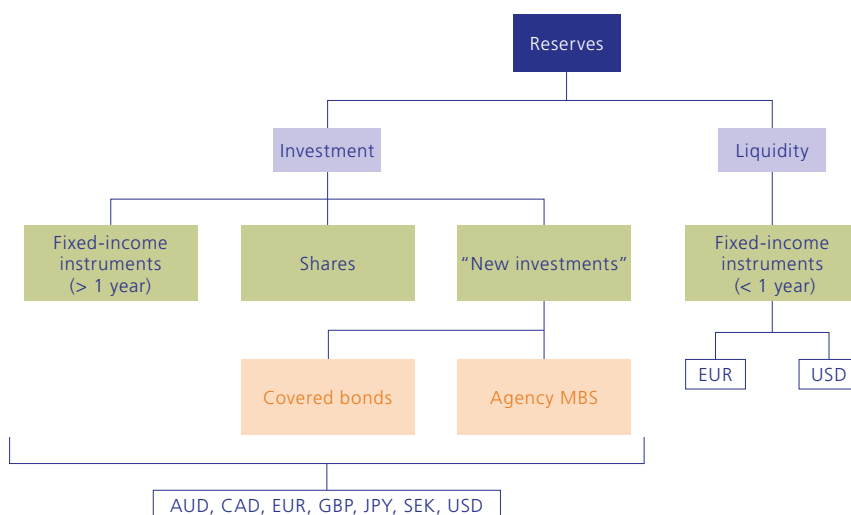
Currency structure of the actively managed portfolio (net of liabilities) as of 31 December 2017



specific covered bonds, deposits with central banks, futures and interest rate, currency and equity swaps. All creditor positions vis-à-vis private counterparties are backed by financial collateral.

The concept of tranching was introduced in 2017 in response to the almost five-fold increase in the international reserves during the three and a half years of the exchange rate commitment. This tranching consists in dividing the reserve portfolio into two parts (tranches) and re-setting the risk and yield parameters. The liquidity tranche, which accounted for 47% of the reserves at the end of 2017, contains fixed-income investment instruments with a residual maturity of up to one year in euros and US dollars, which, if necessary, can easily be converted into money. The remaining 53% of the reserves made up the investment tranche. It contains financial instruments which bear higher risk (such as bonds with longer maturities and shares) but at the same time make it possible to generate higher returns in the longer run. It was decided to extend the range of investment instruments in the investment tranche to include European covered bonds and specific mortgage-backed securities (MBS) guaranteed by selected US agencies.

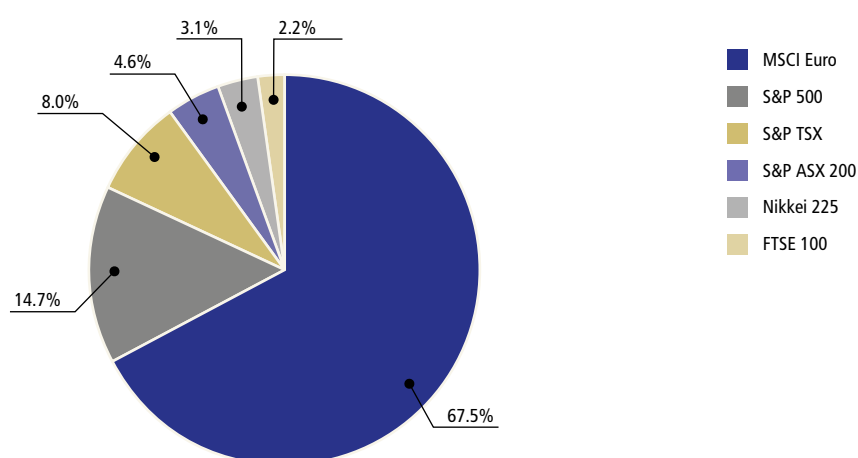
Division of the international reserves into the liquidity and investment tranches



THE CNB IN 2017

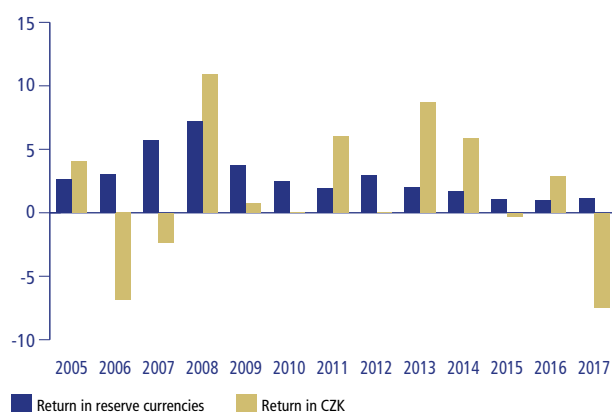
Most of the international reserves are managed in internal portfolios made up of fixed-interest money and capital market instruments. The equity portfolios managed by BlackRock and State Street Global Advisors account for around 10% of the reserves and are invested on the following markets using the relevant benchmark indices: European (MSCI Euro), US (S&P 500), UK (FTSE 100), Japanese (Nikkei 225), Canadian (S&P TSX) and Australian (S&P ASX 200). Both companies that manage the CNB's equity portfolios follow the Global Investment Performance Standards.

Structure of the equity portfolio as of 31 December 2017



The individual reserve portfolios recorded the following returns in 2017 (as measured in the portfolio currency): euro 0.37%, US dollar 3.15%, Canadian dollar 0.55%, Swedish krona -0.21% and Australian dollar 3.75%. The weighted average of the return on the portfolios in reserve currencies was 1.13%. However, the appreciation of the koruna against most reserve currencies resulted in a negative koruna return of -7.45%, since a strengthening of the koruna means revaluation of foreign currency items to a lower value (for example, one euro was accounted for at CZK 27.02 at the start of 2017 and CZK 25.54 at the end of 2017).

Comparison of the total return on international reserves in 2017 with previous periods



Gold and the part of the claim on the International Monetary Fund (IMF) that has been paid or is maintained in a foreign currency make up a small part of the reserves. The non-koruna financial position vis-à-vis the IMF, which amounted to SDR 766 million at the end of 2017, decreased during the year due to a fall in the reserve tranche of more than SDR 33 million; SDR holdings remained almost unchanged. The zero drawdown of the bilateral loan to the IMF was unchanged as well. Part of the gold held by the CNB was used for coin production in 2017. The CNB thus had 9.4 tonnes of gold at the end of 2017.

— THE CNB AS THE BANK OF THE STATE

The Czech National Bank provides banking services for the state and the public sector under the Act on the Czech National Bank and the Act on Budgetary Rules, i.e. it maintains accounts and provides payment services and services relating to liquidity management of the single treasury accounts.

In 2017, the CNB continued to work with the Ministry of Finance in managing Treasury liquidity, safeguarding the smooth operation of the payment system and streamlining those processes. As of 31 December 2017, the CNB maintained 15,400 accounts for the state and the public sector. A total of 380,000 transactions took place on the Treasury accounts on average per day. Treasury clients now almost exclusively use internet banking. Only 0.3% of orders are in paper form.

— SUPPORT FOR TREASURY LIQUIDITY MANAGEMENT

Government sector deposits on accounts at the CNB are very difficult to forecast, as they are strongly affected by fluctuations in state budget revenues and expenditure (due, for example, to tax collection deadlines). However, their volatility has been minimised by the introduction of the single treasury accounts.

There are two single accounts: koruna-denominated and euro-denominated. The koruna-denominated single treasury account includes, for example, state budget revenue and expenditure accounts, state financial assets and liabilities accounts, revenue and customs offices' accounts, state funds accounts and the National Fund accounts. The euro-denominated single treasury account includes above all the funds of the National Fund, euro debt service funds and foreign funds of state organisational units. The CNB is responsible for the daily consolidation of these entities' accounts on the single accounts.

Virtually all the account balances of government entities in the single treasury accounts system are monitored and managed during the day so that current expenditures are covered and free funds are used effectively. The CNB – acting on behalf of the Ministry of Finance – invests any end-of-day surplus on these accounts on the financial market. Conversely, the CNB – again acting on behalf of the Ministry of Finance – covers any end-of-day shortfall by borrowing from banks. The daily balances on the single treasury accounts are maintained at CZK 30 million and EUR 10 million, even though transactions worth CZK 15–20 billion on average are settled every day.

The single treasury accounts system increases the amount of available liquidity that can be used to finance a state budget deficit during the year. The long-term nature of these resources meanwhile allows for effective planning of government bond issues. This lowers the refinancing risk of the state and generates budgetary savings by reducing debt servicing costs.

— SUPPORT FOR STATE DEBT FINANCING

In the area of state debt management, the CNB carries out primary sales of both short-term and long-term government bonds for the Ministry of Finance and acts as administrator of the issues. In 2017, the CNB organised 29 auctions of T-bills, with sales totalling almost CZK 410 billion. The CNB also executed 58 auctions of government bonds, with sales amounting to CZK 197.6 billion. As administrator, the CNB made coupon payments for government bonds and payments of principal on three maturing issues.

The CNB also organised coupon payments and repayments of principal for issues of government saving bonds.

— ECONOMIC AND FINANCIAL RESEARCH

Economic and financial research at the CNB helps create an analytical and knowledge base for monetary and macroprudential policy-making and the development of the central bank's human capital.

At the start of 2017, the CNB reorganised its research by abolishing the Economic Research Department and establishing two new research divisions: an Economic Research Division in the Monetary Department and a Financial Research Unit in the Financial Stability Department. In parallel, the CNB's overall research capacity was increased. This organisational change was aimed at strengthening the link between economic and financial research and the central bank's core activities while maintaining the professional quality of research publications. In September 2017, the Bank Board approved a new model for the organisation of research projects. The model should enhance the emphasis on research applicability, strengthen the motivation of the CNB's staff outside research divisions to participate in research projects and reduce the projects' administrative demands.

CNB experts published 14 internationally reviewed articles in the Working Paper Series and two articles in the Research and Policy Notes series in 2017. These articles cover a wide range of subjects, from empirical analyses of the real economy, through macroeconomic modelling, to financial stability. The CNB also published two issues of the Economic Research Bulletin presenting the research results in a comprehensible manner. The May issue was devoted to international trade and external relations, while the November issue featured papers on the effects of monetary policy.

The CNB held its traditional Research Open Day in May. The speakers at the event included Macedonian central bank governor Dimitar Bogov as guest of honour. In June, a conference on the interplay between monetary policy and fiscal policy was held at the CNB in partnership with the International Journal of Central Banking.

Two CNB economists won prestigious awards for their research in 2017. Dominika Kolcunová received the Karel Engliš Prize, presented by the Czech Economic Society, for her paper on estimating the effective lower bound for the CNB's policy rate. Lukáš Pfeifer won the Young Economist of the Year competition for the František Vencovský Prize organised by the University of Finance and Administration. His award-winning paper dealt with the impact of credit booms and economic policy on labour productivity.

Details on research publications, seminars and conferences, and other research activities can be found in the *Economic research* section of the CNB website.



— EUROPEAN AND INTERNATIONAL COOPERATION

— EUROPEAN CENTRAL BANK, EUROPEAN SYSTEM OF CENTRAL BANKS AND EUROPEAN SYSTEMIC RISK BOARD

As the CNB is a member of the European System of Central Banks, its Governor and Vice-Governor attend – usually four times a year – the meetings of the General Council of the European Central Bank (ECB), where the governors of the central banks of all the EU countries are represented. In 2017, the ECB General Council discussed macroeconomic, fiscal, monetary and financial developments around the world, in the EU and in the euro area. The meetings also dealt with, among other things, an assessment of compliance with the prohibition of monetary financing by central banks, Brexit, the cyber resilience of the financial sector and the potential impacts of the introduction of central bank digital currencies on monetary policy. At the March meeting, the CNB Governor presented the macroeconomic situation in the Czech Republic. His speech concentrated mainly on CNB monetary policy, including the use of the exchange rate commitment, and indicated that the use of this instrument was coming to an end. The CNB ended the commitment on 6 April 2017.

CNB representatives were involved in the work of the ESCB's 13 committees and numerous sub-committees and working groups. The CNB processed a total of 82 documents in the written consultations of the ECB General Council on draft EU and Member State legislation and ECB documents. It made comments in seven cases. The CNB commented on the ECB's Annual Report for 2016, the draft minutes of the 87th meeting of the ECB Governing Council and the ECB's draft opinion on the proposal for a directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures. It also sent comments on the ECB's draft opinions on legislative proposals of EU Member States, specifically an Italian legislative act on measures to support liquidity, preventive recapitalisation

THE CNB IN 2017

and other urgent measures concerning the Italian banking sector. The CNB also expressed its opinion on a draft Irish law on flood insurance, a draft Slovenian law whose main objective is to remedy the unconstitutional nature of some provisions of the Banking Act, and a draft Austrian law concerning changes to financial market supervision.

The CNB Governor and a Vice-Governor also attended the meetings of the General Board of the European Systemic Risk Board (ESRB), which dealt with the assessment of risks to the EU financial market and the development of a macroprudential policy framework. In 2017, the ESRB worked on extending the application of macroprudential instruments to insurance companies and investment funds and dealt with risks associated with the property market, among other things. In this context, it adopted a recommendation on closing real estate data gaps. A key topic from the CNB's perspective was the preparation of the ESRB's opinion on the EU's legislative proposals regarding structural capital buffers in the banking sector. The CNB was also actively involved in discussing the concept of sovereign bond-backed securities of euro area countries (SBBS) and changes in the institutional set-up of the ESRB. The CNB was also compliant with the information duty to the ESRB arising from the recommendation on funding of credit institutions, the recommendation on guidance for setting countercyclical buffer rates and the recommendation on the assessment of cross-border effects of national macroprudential policy and voluntary reciprocity for measures adopted by macroprudential authorities of other EU countries.

— RELATIONS WITH EU COUNCIL, EU COMMITTEE

With a few exceptions, such as the EU Council's Economic and Financial Committee, CNB representatives do not take part directly in the meetings of the EU Council and its working and advisory bodies. The CNB therefore actively participates in preparing and coordinating the Czech Republic's positions for relevant negotiations primarily through the EU Committee at both the government level and the working level. The main topics discussed were the future course of European integration, the deepening of the Economic and Monetary Union and the completion of the banking union. The talks about the Economic and Monetary Union are continuing in connection with the European Commission's White Paper on the Future of Europe, published in March, and the December package of proposals for deepening the Economic and Monetary Union, which includes, among other things, a proposal to convert the European Stability Mechanism into a European Monetary Fund. Negotiations about the package of legislative proposals for completing the banking union continued in 2017 in line with the June 2016 Council Conclusions on a roadmap to complete the Banking Union. The negotiations primarily concerned the common backstop for the Single Resolution Fund and the proposal to create a European Deposit Insurance Scheme. In addition, the CNB was involved in the discussions about reducing the level of non-performing loans in EU banking sectors, the preparation of the EU's common positions for negotiations in the International Monetary Fund (IMF) and initiatives in the sustainable finance area. The CNB also took part in the debates about the revision of the legislative framework for the European System of Financial Supervision and the topic of sovereign bond-backed securities. Discussions were also held about the capital markets union and issues related to the negotiations on, and expected impacts of, Brexit.

— INTERNATIONAL MONETARY FUND

The CNB Governor, who represents the Czech Republic on the IMF Board of Governors, attended the yearly spring and annual meetings of the IMF and World Bank in Washington, D.C. He also took part in a meeting of the International Monetary and Financial Committee (IMFC), in which member countries of the IMF Executive Board are represented. The Central European and Eastern European constituency, of which the Czech Republic is a member, is represented by Michaela Erbenová in the Executive Board from 1 November 2016 until 31 October 2018.

After the ratification of the 2010 quota and governance reforms was completed, work on the fifteenth general review of quotas was started in 2017. The review should be completed in 2019. In this context, the first discussions were held on the sufficiency of the IMF's resources and the distribution of the quotas among its members. The discussions also concerned the method for setting individual quotas. Given the identified need to maintain the current level of funds, a number of new bilateral loan agreements between the IMF and the existing creditors were signed in 2017. They replaced the previous loans, whose validity had expired. The CNB Governor signed the third loan agreement with the IMF on 13 October 2017. However, the IMF may draw funds from the CNB's international reserves up to the agreed amount of EUR 1.5 billion only after a law on a state guarantee for the CNB for the loan provided has been passed. In 2017, the CNB continued to be involved as a creditor in assistance provided to IMF member countries experiencing balance of payments difficulties.

The main topics discussed with the direct or indirect involvement of the CNB also included the strengthening of collaboration between the IMF and regional financial arrangements and the IMF's role in governance reforms. Discussions were also held about a revision of the IMF's lending instruments, including the introduction of a new non-financial monitoring instrument, the role of macroprudential policies in relation to capital flows and IMF supervision in the micro-finance area. The Executive Board approved new programmes for a number of countries, including the approval "in principle" of a new programme for Greece. This means that the payment of funds was postponed and made conditional on sustainability of Greece's debt and satisfactory implementation of reforms.

An IMF Article IV mission to the Czech Republic took place in May. From the CNB's perspective, the key issues were the discussion about monetary policy, including the then recent discontinuation of the use of the exchange rate as a monetary policy instrument, and the inflation outlook. The situation in the domestic banking sector and the situation in the financial stability area were also discussed. The IMF's final report supported the April decision to end the exchange rate commitment and recommended a gradual increase in rates based on economic conditions.

— 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) and the meeting of the Central Bank Governors' Club of Central Asia, Black Sea Region and Balkan Countries. The CNB was also represented at the regular meetings of vice-governors and at meetings of the Basel Consultative Group, which is part of the Basel Committee on Banking Supervision. Vice-Governor Mojmír Hampl was elected Co-Chair of the Regional Consultative Group for Europe of the Financial Stability Board (FSB) and co-chaired its meetings together with a representative of the Italian central bank. He also attended the FSB Plenary Meeting on 6 October 2017 as an observer. In addition, the CNB was represented at the meetings of a number of OECD working bodies, particularly the Economic Policy Committee and the Committee on Financial Markets. A CNB representative also attended the annual meeting of the European Bank for Reconstruction and Development on 9–11 May 2017.

— FOREIGN TECHNICAL ASSISTANCE

The CNB organised 15 events in 2017 to provide technical assistance to its foreign partners. Seven seminars were attended by 122 experts from 33 central banks, and five consultations took place for 40 participants from four central banks and supervisory authorities (from Myanmar, Brazil, Jordan and Vietnam). The CNB also provided expert assistance in the form of consultations and lectures abroad, specifically in Albania and Mongolia, and, as part of IMF missions, also in Belarus.



Since the renovation in 2017, the corridor connecting the Neo-Renaissance Commodity Exchange and its functionalist extension has been housing a gallery of paintings of prominent personalities in Czechoslovak economic and political life during the First Republic. It contains portraits of the finance ministers

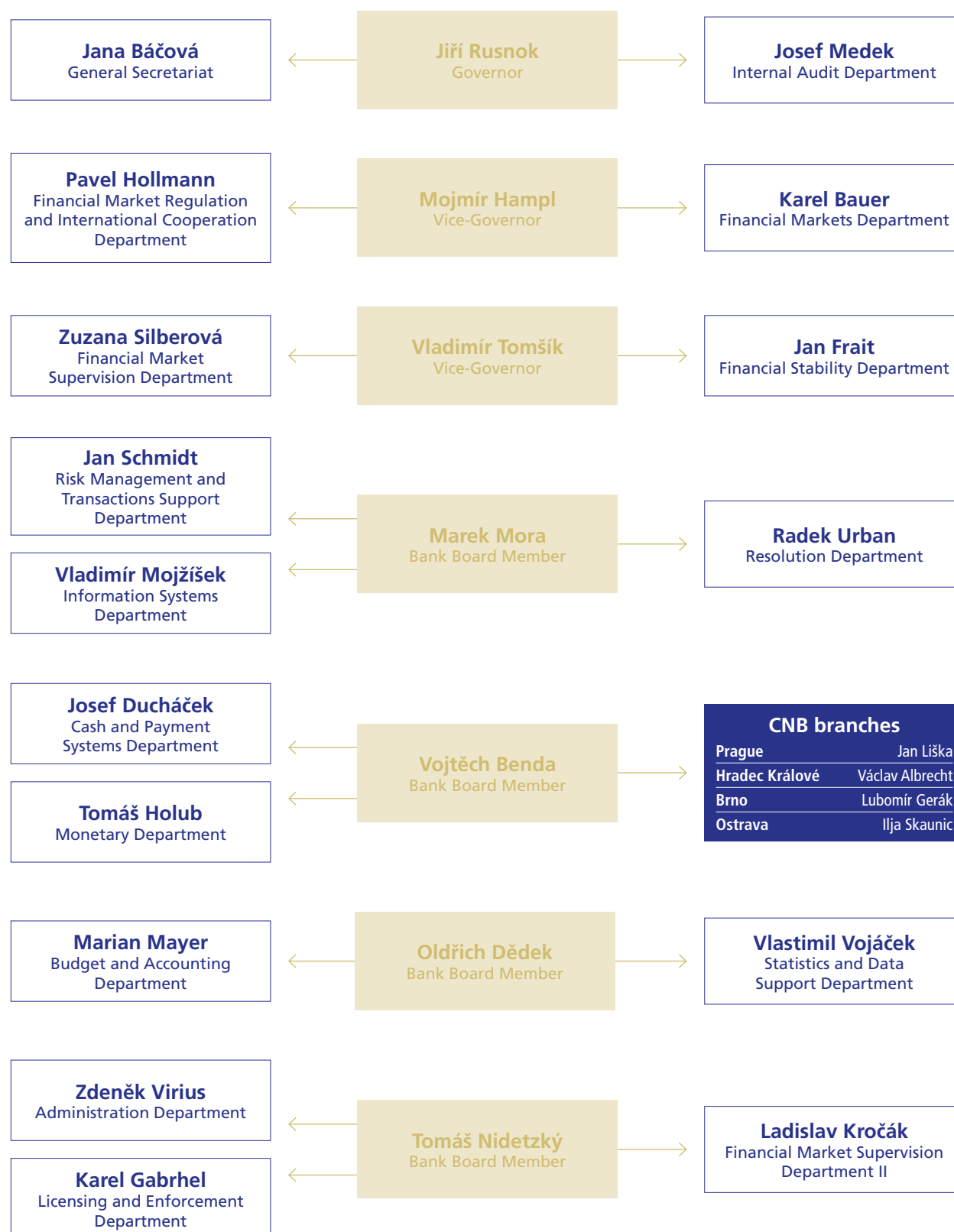
Karel Trapl and Bohdan Bečka and agricultural credit union representatives such as Ferdinand Klindera, Jan Sedlák and Jan František Kroiher. A row of wooden display cabinets containing old books on economics and other subjects completes the space and emphasises its links with the special library.

The background of the slide is a photograph of a library interior. On the left, there are tall wooden bookshelves filled with books. Some of the book spines are visible, with titles in Cyrillic script such as "ОТТОУ СЛОВНИК НАУЧНИ" and "ОТ СЛ". To the right of the bookshelves is a large, ornate mirror with a decorative frame. The mirror reflects the bookshelves and the text of the slide. The overall lighting is soft, and the colors are muted, giving it a classic, academic feel.

III. MANAGEMENT AND ORGANISATION

Management and organisation

— ORGANISATIONAL CHART AS OF 31 DECEMBER 2017



The CNB's organisational structure consists of a headquarters in Prague and four branches in Prague, Hradec Králové, Brno and Ostrava. In addition, the CNB is represented in České Budějovice, Plzeň and Ústí nad Labem by regional offices of its headquarters, where selected units of the Cash and Payment Systems Department, the Licensing and Enforcement Department and the Financial Market Supervision Department II operate (see the CNB website: *About the CNB > CNB offices in the Czech Republic*).

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.

— BANK BOARD

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 as of 31 December 2017).



— 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 the individual areas of 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.

MANAGEMENT AND ORGANISATION

— HEADQUARTERS

Departments (subdivided into divisions) are the organisational units of CNB headquarters. 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, project teams and the Assets and Liabilities Management Committee – are used to implement Bank Board decisions and perform activities that cover the areas of competence of more than one organisational unit and that depend on close and efficient cooperation between them.

Several organisational changes were made at the CNB's headquarters at the decision of the Bank Board. The Monetary Department and the Financial Stability Department took over the work of the abolished Economic Research Department on 1 January 2017. On the same date, the EU and International Organisations Division was subsumed into the Financial Market Regulation and International Cooperation Department. The Human Resources Department was abolished on 31 January 2017. A large part of its work, such as human resources management, wage administration and social policy, was transferred to a newly established Human Resources Division within the General Secretariat on 1 February 2017. The remaining activities of the Human Resources Department were transferred to the Budget and Accounting Department and the Administration Department. The former now performs duties relating to staff loans and travel insurance of CNB staff on business trips and the latter is responsible for the areas of health care for CNB staff and recreational, cultural and sports activities at the CNB.

Supervision Department II was renamed Financial Market Supervision Department II on 1 March 2017 and its activities were simultaneously divided into a Consumer Credit Supervision Division, a Payment Services and Currency Exchange Supervision Division, a Capital Market Supervision Division, a Retail Distribution Supervision Division and a Retail Distribution On-Site Supervision Division. The Bank Board also decided that the Financial Market Supervision Department and Financial Market Supervision Department II will oversee compliance with the duties set forth in the Consumer Protection Act and the Act on Certain Measures against Money Laundering and Terrorist Financing by the entities they supervise under sector-specific laws. Supervision of management companies and investment funds was merged in Financial Market Supervision Division II.

In addition, the Bank Board decided to transfer, as of 8 March 2017, activities related to the General Board of the European Systemic Risk Board (ESRB) from the Financial Market Regulation and International Cooperation Department to the Financial Stability Department, thereby concentrating all ESRB-related work in one unit both procedurally and as regards expertise. Besides being authorised to publish provisions relating to the countercyclical capital buffer and the systemic risk buffer, this unit is now also authorised to publish provisions of a general nature regarding macroprudential and systemic risk.

At the end of 2017, the Bank Board decided to elevate the Financial Stability Department to multi-divisional department status as of 1 January 2018. This decision reflects the increasing importance of financial stability and macroprudential policy in the central bank's activities.

— 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, maintaining accounts under the Act on Budgetary Rules and the accounts of other CNB clients falling within their fields of competence, and making payments for their clients..

— HUMAN RESOURCES

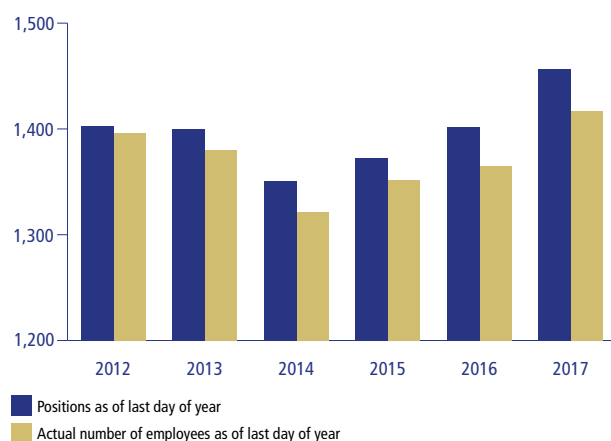
In the area of human resources management, the CNB has long focused on developing its employees and recruiting new ones. The exceptional quality of the work environment at the CNB, together with the CNB's unique duties, fosters long-term stability of the existing workforce and high interest in working at the CNB. This is evidenced by the fact that the CNB has since 2004 regularly ranked in the top three of the "Top 100 IDEAL Employers" list in the "Business" category in the Czech Republic organised by Universum.

— NUMBER OF POSITIONS AND EMPLOYEES

The number of job positions at the CNB was 1,457 at the end of 2017, an increase of 3.9% compared to 2016. This growth was due mainly to the strengthening of human resources to safeguard the CNB's critical activities, particularly following the entry into effect of the new Consumer Credit Act, which entrusted the CNB with supervision of the entire consumer credit market, including non-bank companies, as from December 2016.

The rise in the number of positions was followed by growth in staff numbers. The CNB had 1,417 employees at the end of 2017, 3.8% more than at the end of 2016. The difference between the number positions and the number of employees was due, among other things, to numerous ongoing and at the end of 2017 still uncompleted selection procedures. In line with its long-term staffing stabilisation strategy, the CNB is succeeding in keeping staff turnover low. The total staff turnover rate was just 7.2% in 2017. The average length of employment at the CNB decreased slightly year on year to 13.4 years.

Number of employees and number of positions (in %)



— RECRUITMENT AND SELECTION

The CNB is required by law to perform a number of specific and demanding tasks. To do so flawlessly, it is vital for the CNB to seek and recruit highly qualified staff who perform their duties responsibly and are motivated to consistently deliver high performance.

MANAGEMENT AND ORGANISATION

The CNB uses a range of traditional and modern means to advertise vacancies. It advertises unoccupied jobs both internally on the CNB intranet and externally on the CNB website, on internet job sites and via the CNB's official Facebook and LinkedIn pages. The recruitment of new staff at the CNB usually involves several rounds, in which the necessary qualifications and expertise and personal attributes of applicants for jobs at the CNB are tested.

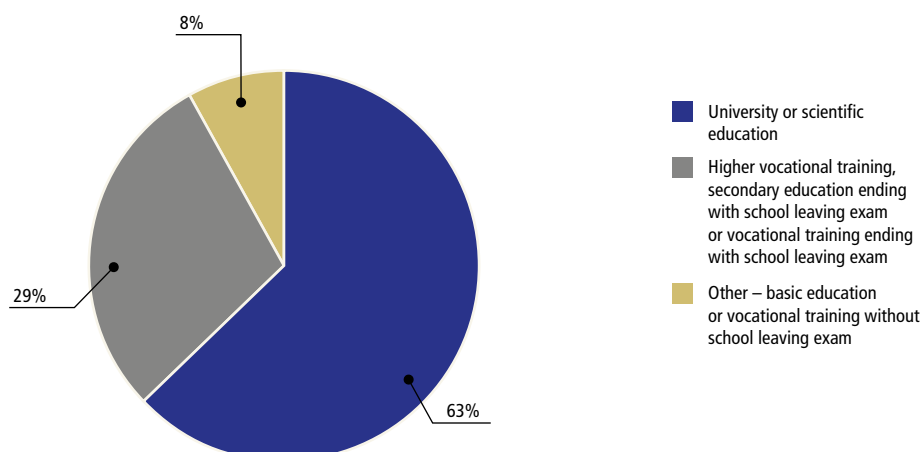
— EDUCATION, AGE AND GENDER STRUCTURE

The CNB consistently abides by the principle of equal opportunities for all job applicants and employees when managing human resources. This approach creates a balanced age, gender and skills structure at the CNB in the long term.

The structure of employees by education level was the same in 2017 as it was in 2016 and is shown in the following chart. This skills distribution, dominated by highly educated employees, reflects the expertise required by the CNB.

Employee structure by highest level of education attained
as of 31 December 2017

(shares in %)

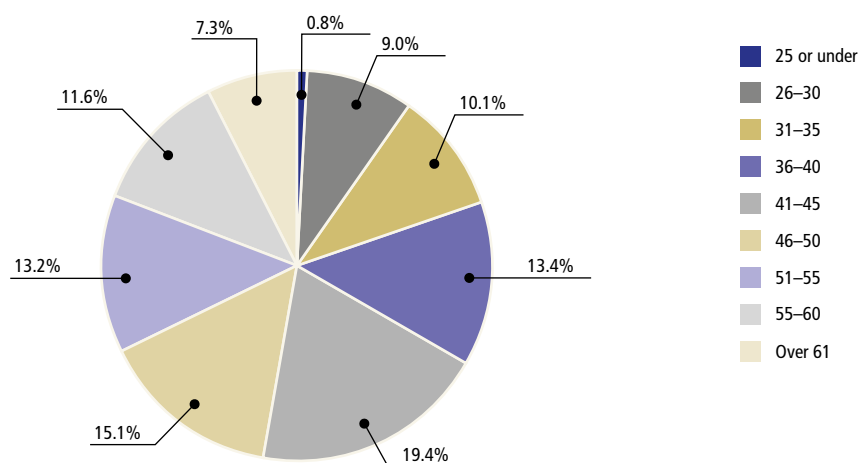


The CNB has an even staff age distribution. Employees aged 41–45 account for the largest share (19%). Its stable staff structure enables the CNB to create work teams with the optimal composition and thereby minimise the risks arising from generational turnover.

The average age of the CNB's employees decreased slightly year on year (by around four months) to 45 years in 2017.

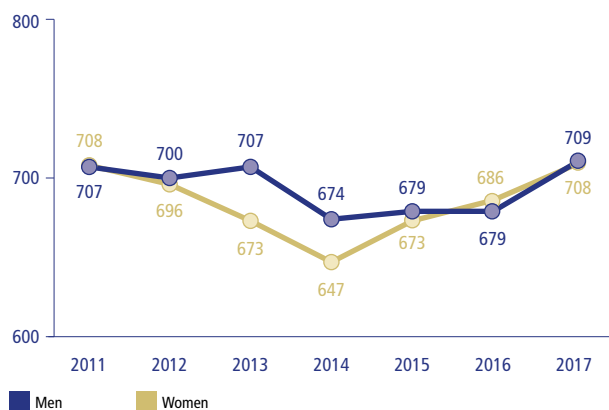
Age structure of employees as of 31 December 2017

(shares in %)



As in previous years, the CNB maintained balanced shares of men and women in the total workforce in 2017.

Numbers of men and women employed at the CNB



— INCENTIVE SYSTEM

Together with staff assessments, the wage system forms the basis for raising the quality and performance of employees. Regular feedback provided by managers within working teams is another integral part of the incentive system. In 2018, the CNB is switching from an annual assessment system to a system where employees are assessed at the end of every half-year. In this system, managers – the salary administrators of their divisions and departments – are motivated to streamline all activities and optimise all processes on an ongoing basis.

Personnel expenses (wage costs, including temporary sick leave payments, obligatory insurance contributions and other social expenses, training expenses and employee benefits) amounted to CZK 1,485 million in 2017, up by about 5.8% on a year earlier. Under the Act on the CNB, the bank has been publishing information on the wages of all Bank Board members since 2004.

MANAGEMENT AND ORGANISATION

Salaries of Bank Board members in 2017

(in CZK)

	Gross salary ¹⁾	Net salary ²⁾
Jiří Rusnok	5,475,513	3,931,381
Mojmír Hampl	4,366,745	3,164,213
Vladimír Tomšík	4,338,728	3,086,350
Lubomír Lízal ³⁾	837,583	566,484
Marek Mora ⁴⁾	3,307,659	2,363,134
Pavel Řežábek ³⁾	1,002,568	685,521
Oldřich Dědek ⁴⁾	3,312,847	2,366,877
Vojtěch Benda	3,661,658	2,655,492
Tomáš Nidetzký	3,664,027	2,657,202

1) The gross salary comprises the basic wage, performance-related bonuses and compensation for salary pursuant to the Labour Code.

2) The net salary is the gross salary net of state health insurance contributions, social security contributions, state employment policy contributions, income tax and solidarity tax and tax discounts for the taxpayer and tax discounts for dependent children for those Bank Board members who applied for the discounts.

3) Lubomír Lízal and Pavel Řežábek terminated their employment at the CNB as of 31 March 2017.

4) Marek Mora and Oldřich Dědek were appointed members of the Bank Board with effect from 13 February 2017.

— PROFESSIONAL DEVELOPMENT OF CNB STAFF

Staff training is one of the priorities of personnel work and encompasses a wide range of activities, from internal training organised at the CNB, through training provided by domestic external organisations, including university studies and language tuition, to training provided in other countries. The direct costs of professional development of CNB staff (tuition fees excluding transport and accommodation costs) amounted to CZK 18.9 million in 2017.

The CNB provides a wide range of internal training opportunities for its employees, focusing particularly on developing and deepening the expert knowledge and soft skills of CNB staff. A significant part consists of training of new employees in the form of expert seminars within the CNB aiming to deepen their expertise.

International seminars and workshops are a key element of professional development. Attendance at such events is necessary for CNB experts mainly because it gives them an opportunity to exchange information and knowledge with colleagues from other central banks. The most frequent topics of these training events are financial stability, economic modelling and financial markets. Organisers include the International Monetary Fund, the Joint Vienna Institute, the Financial Stability Institute and the Study Center Gerzensee. Employees of CNB supervisory units also continued to take advantage of seminars organised by the authorities responsible for supervising the individual sectors of the financial market in the EU (EBA, ESMA and EIOPA) in 2017.

The CNB organised 12 international training events for 153 experts from other EU central banks in 2017. It was also again involved in organising supervisory training events under the European Supervisor Education initiative.





Following the September 2017 renovation, the CNB special library moved to a former apartment in the Hypšman extension. The generous two-level space was refurbished to give library users enhanced comfort. The library collection was laid out more efficiently and logically, and zones were created in the library to provide a quiet environment for studying. Users can use their own mobile electronic

devices. A self-service kiosk was set up close to the loans desk where users can do quick searches in the catalogue, check their library accounts and so on. Another benefit is the separation of the library space from the CNB Congress Centre, as it prevents any clashes between events organised at the Congress Centre and the day-to-day running of the library.



IV. PUBLIC RELATIONS

Public relations

— COMMUNICATIONS

As in previous years, the CNB's communications with the public focused mainly on monetary policy. This is one of the core activities stemming from its legal duty to maintain price stability. In line with this, the most important communication topic last year was the exit from the exchange rate commitment in April 2017.



The CNB has long nurtured an identity as a unique, independent, prestigious and erudite institution that builds its image on expertise, transparency, credibility, stability and tradition. These values and attributes were the key communication pillars in the period after the exchange rate commitment was introduced in November 2013. Their application in the configuration of communication processes and tools contributed to a smooth and positively viewed exit from the exchange rate commitment, which subsequently made it possible to start increasing interest rates from near-zero levels. Governor Jiří Rusnok won the prestigious award "Central Bank Governor of the Year for Central and Eastern Europe 2017" for the smooth exit from the exchange rate commitment, including its careful preparation and effective communication (see also the section *Monetary policy and economic developments*).

The CNB Vlog was one of the most frequently used communication tools last year. Through 20 video interviews, central bank representatives provided the public with information about topical issues directly, without any need to use the media. These videos were published on the CNB website and YouTube. Shorter versions containing the key ideas and information about the topics concerned were shared on the CNB's official Facebook and Twitter profiles. During 2017, this video format became a popular source of information for the media, which often shared or quoted from the videos. To shorten the communication path to experts and the general public as much as possible, the CNB continued to broadcast online its press conferences following the Bank Board's monetary policy meetings and its quarterly meetings with analysts. In addition, central bank representatives last year made another two visits to Czech regions, where they held round-table debates with senior representatives of local firms. These meetings took place in Ústí nad Labem and Zlín last year.



The CNB continued to work with the *Money on the Run (Peníze na útěku)* microsite to support financial education. The site offers easy-to-understand advice and guidance to the public on how to create and manage a personal and family budget. A further upgrade of the highly rated *Czech Money (České peníze)* app, which focuses on the security features of Czech banknotes, widened the range of users to include owners of mobile devices running on iOS 11 or higher.

As in previous years, the CNB organised its now traditional competition for secondary school pupils for the best essay on a selected topic. Another two academic round tables were held in the CNB's Ostrava and Hradec Králové branches, where Bank Board members debated with university students from the relevant regions about topical issues relating to the central bank.

The CNB was also involved in the Economics Olympics. This event, organised by the Institute of Economic Education, was held under the official auspices of CNB Vice-Governor Mojmír Hampl. As part of the competition, the CNB presented the "CNB Award" for the best essay on a given topic, written by the Olympics' ten finalists. These essays were judged by the CNB's experts and published on its website, where the public could also vote on the best one.

The CNB continued to communicate with the public using its official Twitter, Facebook, YouTube and LinkedIn profiles. It handled 1,923 phone queries, 4,898 electronic submissions and 942 written submissions as part of its communication with the public in 2017.

— PROVISION OF INFORMATION UNDER ACT NO. 106/1999 COLL., ON FREEDOM OF INFORMATION

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 internet, primarily at www.cnb.cz, or to applicants on the basis of applications. The following text gives details on applications for information under the Act in 2017.

1. Number of applications for information under the Act: 79
2. Number of decisions refusing an application: 15
3. Number of appeals submitted against decisions: 8
4. Court judgements relating to the CNB in the area of provision of information:
 - Judgement of the Municipal Court in Prague of 23 March 2017, ref. no. 6A 36/2014-33 – the court dismissed the action against the decision of the CNB Bank Board dismissing the complainant's appeal against the CNB decision partly refusing an application for the provision of a preliminary measure which the CNB had imposed on WPB Capital, spořitelní družstvo on 15 March 2013.
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
 - Both the complaints contested the obliged entity's action in dealing with the application consisting in a similar objection that in its reply the obliged entity had not provided the complainants with all the requested information it should have provided by law. Both the complaints were dealt with in the same manner under the procedure laid down in Article 16a(5) of the Act, and a decision partly refusing the application was issued in both cases.

PUBLIC RELATIONS

7. Other information relating to application of the Act:
- The number of applications received increased from 51 in 2016 to 79 in 2017. This was the highest number of applications for the provision of information that the CNB has ever dealt with in a single calendar year.
 - The applications pertained to a broad range of information. The queries concerned statistics, monetary policy, the balance of payments, international reserves and the circulation of banknotes and coins. A significant proportion of the applications consisted of queries relating to the CNB's supervisory work in all financial market segments, including queries about licensing and enforcement activities.

— CONGRESS CENTRE

The Congress Centre, located in the listed building of the former Commodity Exchange, was extended to include the premises vacated by the CNB's special library. The library moved to the Hypšman extension, which is an integral part of the CNB's headquarters. As in previous years, the Congress Centre was used as a venue for meetings between the CNB's top management and analysts and journalists, representatives of other central banks and financial market and trade union representatives. The CNB's specialised units hold conferences, lectures, presentations, seminars, committee and working group meetings of the European Central Bank (ECB), quarterly insurance intermediaries' examinations and various training sessions there. Thanks to its flexible spaces and modern technology, the Congress Centre is one of Prague's most popular venues. External partners organise about 50 professional and social events there every year. The Congress Centre's clients include public and private institutions – both domestic and foreign – from various fields of activity.

More information is available in the *Congress Centre* section of the CNB website.

— SPECIAL LIBRARY

The primary mission of the CNB's special library is to provide CNB staff and outside specialists with lending, advisory, reference, bibliographic 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 economics and banking, law and computer technology and to some extent in other areas as well. The library provides access to more than 80,000 publications and 700 periodicals, a large number of research reports and annual reports, and other publications.

In 2017, the library acquired a new Verbis library information system using the Portaro search engine on the basis of a public tender. Besides a more user-friendly search engine, the system offers a whole range of new features to users, including the option of creating user accounts via a web interface. The library is located on the first floor of the Hypšman extension, Senovážné náměstí 29, Prague 1. It is open Monday to Thursday from 9 a.m. to 5 p.m. and Friday from 9 a.m. to 3 p.m. Information about the library, including the electronic catalogue and contacts, is available in the *CNB special library* section of the CNB website.



— EXHIBITION

The CNB's *People and Money* exhibition is a publicly accessible exhibition that aims to present the history of money and monetary developments in the Czech lands to the general public. The permanent exhibition is located at the CNB's Prague headquarters (in a former strong room) and also at the CNB's Brno branch, where its content is focused on the specificities of this subject in Moravia. In 2017, the exhibition in Prague was augmented with a *Genius with a Lion* section featuring the history of the CNB symbol and a *Beauty in Simplicity* exhibition dedicated to Jiří Hrcuba, an important Czech glass engraver and medal maker and the designer of the CZK 5 coin. An exhibition on the life and work of Jiří Hrcuba has also been installed at the Brno branch, where a model of his studio is also shown.

— ARCHIVE

The CNB Archive cares for the archive documents produced by the CNB and its legal predecessors. It currently contains 65 archive collections totalling 6,102 linear metres and offering a unique view of the political, economic, social and cultural history of the Czech lands and Central Europe. The CNB Archive's research room is open to the public all year round subject to prior consultation. Anyone interested in obtaining information from, or studying in, the CNB Archive should visit the *About the CNB > Archive of the CNB* section of the CNB website or e-mail archiv@cnb.cz.



The staircase and the lounge of the special library are other highly interesting places in the Commodity Exchange extension. The staircase with abstract white stained glass, which was Hybšman's favourite feature, connects the entrance to the extension with the special library, the offices and the top-floor

apartment. The wood-panelled oval lounge of the special library, which overlooks the courtyard between the CNB building and Slovanský dům, is a perfect venue for meetings of all kinds.



V.

FINANCIAL REPORT

Financial Report



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INDEPENDENT AUDITOR'S REPORT

To the Bank Board of the Czech National Bank

Having its registered office at: Na Příkopě 28, 115 03 Prague 1

Opinion

We have audited the accompanying financial statements of the Czech National Bank prepared on the basis of accounting regulations applicable in the Czech Republic, which comprise the balance sheet as at 31 December 2017, and the income statement and statement of changes in equity for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the assets and liabilities of the Czech National Bank as at 31 December 2017, and of its expenses and income and its profit or loss for the year then ended in accordance with accounting regulations applicable in the Czech Republic.

Basis for Opinion

We conducted our audit in accordance with the Act on Auditors and Auditing Standards of the Chamber of Auditors of the Czech Republic, which are International Standards on Auditing (ISAs), as amended by the related application guidelines. Our responsibilities under this law and regulation are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Czech National Bank in accordance with the Act on Auditors and the Code of Ethics adopted by the Chamber of Auditors of the Czech Republic and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information in the Annual Report

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than the financial statements and auditor's report thereon. The Bank Board of the Czech National Bank is responsible for the other information.

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law or regulation, in particular, whether the other information complies with law or regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law or regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Czech National Bank obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

Responsibilities of the Bank Board of the Czech National Bank for the Financial Statements

The Bank Board of the Czech National Bank is responsible for the preparation and fair presentation of the financial statements in accordance with accounting regulations applicable in the Czech Republic and for such internal control as the Bank Board of the Czech National Bank determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/cz/about to learn more about our global network of member firms.



In preparing the financial statements, the Bank Board of the Czech National Bank is responsible for assessing the Czech National Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Bank Board of the Czech National Bank either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the above law or regulation, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Czech National Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Bank Board of the Czech National Bank.
- Conclude on the appropriateness of the Bank Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Czech National Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Czech National Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Bank Board of the Czech National Bank regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

In Prague on 22 March 2018

Audit firm:

Deloitte Audit s.r.o.
registration no. 079

Statutory auditor:

Diana Rádl Rogerová
registration no. 2045

— FINANCIAL STATEMENTS

BALANCE SHEET		31 December 2017 CZK million	31 December 2016 CZK million
1.	Gold	602	630
2.	Receivables from the International Monetary Fund	81,008	89,557
3.	Receivables from abroad, including securities	3,120,494	2,167,721
3.1.	Deposits at foreign banks and financial institutions	1,323,050	614,180
3.2.	Securities	1,764,109	1,515,053
3.3.	Other receivables from abroad	33,335	38,488
4.	Receivables from domestic banks	0	0
5.	Fixed assets	3,308	3,449
5.1.	Tangible fixed assets	3,228	3,421
5.2.	Intangible fixed assets	80	28
6.	Other assets	6,729	6,836
6.1.	Other financial assets	4,302	4,696
6.2.	Other	2,427	2,140
TOTAL ASSETS		3,212,141	2,268,193
1.	Notes and coins in circulation	593,854	556,689
2.	Liabilities to the International Monetary Fund	81,282	88,714
3.	Liabilities abroad	140,992	66,307
3.1.	Loans from foreign banks	27,248	15,351
3.2.	Other liabilities abroad	113,744	50,956
4.	Liabilities to domestic banks	2,294,920	1,291,306
4.1.	Loans received	1,758,566	541,506
4.2.	Bank monetary reserves	92,721	201,561
4.3.	Other liabilities to banks	443,633	548,239
5.	Liabilities to the state and other public institutions	269,895	182,585
6.	Provisions	245	294
7.	Share capital	1,400	1,400
8.	Funds	60,081	14,161
9.	Revaluation reserve	-2,044	4,400
10.	Accumulated losses from previous periods	0	-549
11.	Net loss / profit for the period	-243,243	46,469
12.	Other liabilities	14,759	16,417
TOTAL LIABILITIES AND EQUITY		3,212,141	2,268,193

OFF-BALANCE SHEET		31 December 2017 CZK million	31 December 2016 CZK million
1.	Guarantees issued	1,049	157,272
2.	Issued loan commitments	0	40,530
3.	Receivables from spot, term and futures transactions	398,115	468,645
4.	Liabilities from spot, term and futures transactions	397,498	471,518
5.	Guarantees received	64,616	224,515
6.	Collateral received	40,602	45,034

INCOME STATEMENT		31 December 2017 CZK million	31 December 2016 CZK million
1.	Interest income and similar income	14,457	8,585
1.1.	Interest from fixed income securities	13,864	8,401
1.2.	Other	593	184
2.	Interest expense and similar expense	-13,843	-4,182
3.	Income from shares and other interests	6,764	4,873
4.	Fee and commission income	613	427
5.	Fee and commission expense	-176	-142
6.	Gains less losses from financial operations	-249,789	39,298
6.1.	Net foreign exchange gains / losses and foreign exchange spread	-270,365	23,978
6.2.	Other	20,576	15,320
7.	Other operating income	1,367	1,044
7.1.	Income from money issue	848	273
7.2.	Other	519	771
8.	Other operating expense	-579	-1,444
8.1.	Expenses for production of notes and coins	-453	-486
8.2.	Other	-126	-958
9.	Administration expense	-1,819	-1,747
9.1.	Personnel expenses	-1,494	-1,407
9.1.1.	Wages and salaries	-1,056	-991
9.1.2.	Social and health security	-352	-328
9.1.3.	Training and employee benefits	-86	-88
9.2.	Other administration expenses	-325	-340
10.	Depreciation and amortisation of fixed assets	-238	-243
11.	Reversal of provisions for receivables and guarantees, income from receivables already written off	6	6
12.	Write offs, additions and utilisation of provisions for receivables and guarantees	-6	-6
13.	Net loss / profit for the period	-243,243	46,469

FINANCIAL REPORT

The full version of the CNB's financial statements as of 31 December 2017, including the notes thereto, is available in the *About the CNB > Performance > Financial statements* section of the CNB website and, in the case of the printed version of this Annual Report, on CD-ROM, if attached.

The income and expense structure used in the following text provides information according to the purpose of the bank's expenditure. By contrast, the standard financial statements give an overview of income and expenses with regard to type.

The CNB's income and expenses in 2017 (in CZK millions)

	Expenses	Income	Net	Y-o-y change
Monetary area	318,983	77,048	-241,935	-290,419
Monetary policy-making	4,030	1	-4,029	-3,416
International reserves management	40,155	72,191	32,036 ¹⁾	6,837
Valuation changes	274,777	3,796	-270,981	-293,845
Client operations	21	1,013	992	-407
Other operations	0	47	47	412
Currency issuance and management	453	864	411	568
Operations	2,185	466	-1,719	139
Total	321,621	78,378	-243,243	-289,712

Note: Operations include all personnel expenses, depreciation and amortisation, purchased services, energy consumption, etc.

1) All debt securities are included in the realisable portfolio. In accordance with accounting standards, their regular revaluation to market value is therefore reflected in the revaluation reserve balance sheet item (included in equity). If the unrealised loss from bond revaluation, which totalled CZK 6,050 million in 2017, was directly reflected in the income statement, the overall balance of income and expenses from international reserves management would decrease to CZK 25,986 million.

The primary objective of the CNB's work is to maintain price stability. In accordance with this objective, the bank sets monetary policy and takes decisions regardless of the impact on its financial performance. The year 2017 was a good example of the fulfilment of this key principle of the central bank.

The main monetary policy event was the decision to discontinue the CNB's exchange rate commitment in early April, which became the first step towards a gradual return of the overall monetary conditions to normal. Since the commitment was ended, the koruna exchange rate has been moving solely according to supply and demand on the foreign exchange market. The CNB subsequently increased the two-week repo rate and the Lombard rate in August and November 2017. This was the first adjustment to interest rates since November 2012, when the repo rate had been cut to technical zero. Additionally, the August decision was the first increase in domestic interest rates since February 2008 and, together with their November adjustment, represented a further step towards the gradual normalisation of monetary policy.

The tightening of monetary conditions implemented through policy rates increased the expenses of the CNB's open market operations. The lifting of interest rates from technical zero and the growth in sterilisation liabilities while the exchange rate commitment was in place significantly increased the CNB's sterilisation costs.

The renewed process of convergence towards more advanced economies is being accompanied by appreciation of the koruna. An earlier return of Czech versus ECB monetary policy to normal is also fostering a stronger koruna. In 2017, the koruna appreciated against all currencies in which the CNB's international reserves are allocated. The resulting exchange rate loss of CZK 271 billion stemmed mainly from unrealised exchange losses and gains arising as a result of exchange rate movements on foreign currency assets and liabilities held in the balance sheet until the end of the calendar year. The koruna recorded the strongest year-on-year appreciation against the US dollar and the Japanese yen. However, the largest foreign exchange losses were incurred against the euro, in which the bulk of the CNB's reserves are invested.

The CNB made intervention purchases until early April 2017. The approaching end of the CNB's "hard" commitment (the CNB had undertaken not to end the exchange rate commitment before the second quarter of 2017) led to a sharp capital inflow in the first three months of the year. This was due to speculation on a subsequent strengthening of the koruna and to hedging against exchange rate risk by domestic exporters. The size of the CNB's interventions to keep the koruna above the exchange rate floor therefore increased sharply. Overall, the CNB made intervention purchases totalling EUR 42.5 billion (around CZK 1,149 billion) in 2017.

The income on international reserves management was due mainly to the equity portfolios with net income of CZK 29.8 billion, which benefited from growing stock markets and from dividends. The bond portfolios, in which the largest proportion of the CNB's international reserves is deposited, contributed net income of CZK 9.6 billion, representing a year-on-year drop of 8%. This was due primarily to a decline in the market value of bonds at the end of the year, which resulted in capital losses. The realised part of these losses (CZK 0.2 billion) was directly reflected in the CNB's bottom line. Unrealised capital losses, recorded at CZK 6.1 billion during the calendar year, were left in the bank's balance sheet as a valuation change. The returns on the bond portfolios thus came solely from the interest rate component. As regards money market instruments, interest income was negative as a whole due to persisting negative interest rates on the euro and Swedish krona markets.

The bulk of the income in the area of client operations was due to conversions of funds on client accounts. The largest conversions are executed on the accounts of the Ministry of Finance on drawdown of EU funds or conversely on payment of the Czech Republic's contributions to the EU budget.

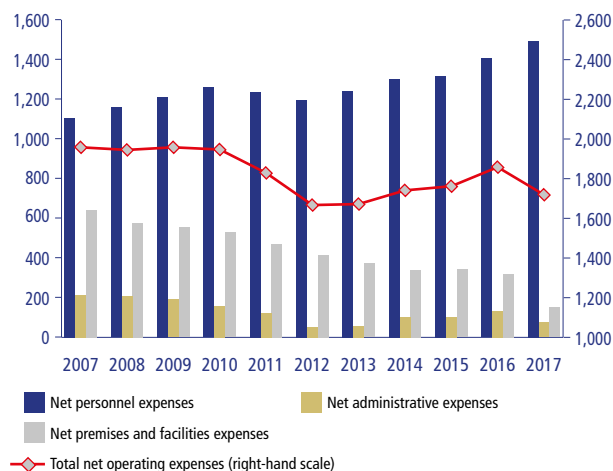
The CNB made a profit in the area of currency issuance and management. This was due mainly to extraordinary income (CZK 0.6 billion) recorded after the termination of the exchange of invalid CZK 50 banknotes and to sales of numismatic material, i.e. silver and gold commemorative coins and base metal coins for sets. Conversely, lower supplies of new banknotes and coins meant a year-on-year drop in the bank's costs.

In the area of operations, the CNB made a net loss of CZK 1.7 billion, down by 7.5% year on year. This result cannot be regarded as a saving, although the CNB always aims to use funds efficiently. The year-on-year change was due to two factors. The first actually occurred in 2016, when the CNB paid non-recurring costs to settle international arbitration proceedings. This increased the comparison base for last year. The second factor was the sale of the central bank's loss-making guesthouse in 2017. Given their financial size, the above cases had a significant one-off effect on operating profit.

FINANCIAL REPORT

The CNB's net operating expenses 2008-2017

(in CZK millions)

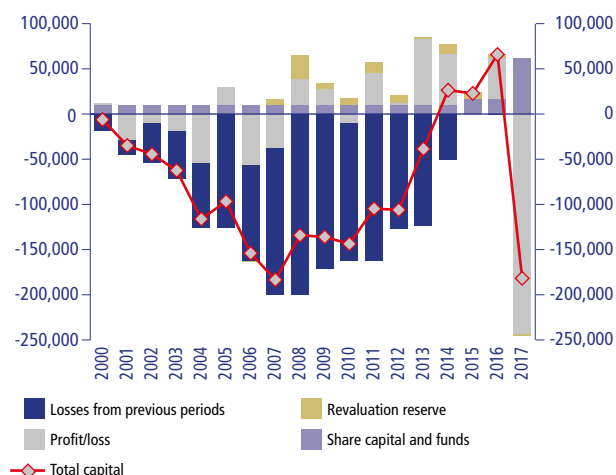


In accordance with the CNB's financial management principles, the Bank Board decided to use the reserve fund (CZK 60.1 billion) to cover its 2017 accounting loss (CZK 243.2 billion). The rest will remain in the balance sheet as accumulated losses from previous accounting periods. The CNB's capital thus attained a negative value of CZK 183.8 billion. Although the CNB has long recorded negative capital, this has not prevented it from fulfilling its statutory mandate in the area of maintaining price stability and performing its other tasks. The fulfilment of all the objectives of the CNB's activities will therefore be similar as in the past.

More comprehensive information about the CNB's performance in 2017 is available in the *About the CNB > Performance > Financial Reports* section of the CNB website.

The CNB's capital 2000-2017

(in CZK millions)



Abbreviations

ABO	Automated Banking Operations
AML	Anti-Money Laundering Directive
AnaCredit	Analytical Credit Datasets
AUD	Australian dollar
BIS	Bank for International Settlements
BRRD	Bank Recovery and Resolution Directive
CAD	Canadian dollar
CERTIS	Czech Express Real Time Interbank Gross Settlement System
CNB	Czech National Bank
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
CZK	Czech koruna
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN Council	EU Council in the composition of the ministers of economy and finance
EIOPA	European Insurance and Occupational Pensions Authority
ERM II	Exchange Rate Mechanism II
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	euro
FSB	Financial Stability Board
FSC	Financial Stability Committee
FTSE 100	benchmark index for the UK stock market
G20	group of the 20 most important economies in the world
GBP	British pound
GDP	gross domestic product
IDD	Insurance Distribution Directive
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commissions
IR	Inflation Report

JPY	Japanese yen
LHS	left-hand scale
LTV	loan-to-value
MBS	mortgage-backed securities
MiFID II	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MREL	minimum requirement for own funds and eligible liabilities
MSCI Euro	benchmark index for the European stock market
Nikkei 225	benchmark index for the Japanese stock market
PRIIPs	packaged retail investment products
PSD2	Payment Services Directive
RHS	right-hand scale
RIAD	system for administering reference data on institutions
S&P 500	benchmark index for the US stock market
S&P ASX 200	benchmark index for the Australian stock market
S&P TSX	benchmark index for the Canadian stock market
SBBS	sovereign bond-backed securities of euro area countries
SDAT	the CNB's data collection system
SDR	special drawing rights
SEK	Swedish krona
SKD	Short-Term Bond System
Solvency II	directive on the taking-up and pursuit of the business of insurance and reinsurance
SRB	Single Resolution Board
USD	US dollar

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