



FINANCIAL REPORT CZECH NATIONAL BANK

1999

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CZECH NATIONAL BANK**

1999

March 2000

Josef Tošovský
Governor, Czech National Bank

REPORT OF INDEPENDENT AUDITORS

TO THE BANKING BOARD OF THE CZECH NATIONAL BANK

We have verified as to whether the financial information contained in the Financial Report (hereinafter “the Report”) of the Czech National Bank (hereinafter “the CNB”) was derived from and presents fairly the CNB’s accounting records. The CNB’s financial statements as at 31 December 1999 were compiled on the basis of these accounting records. This Report is not a part of the audit of the CNB’s financial statements.

In our opinion the financial information contained in this Report presents fairly, in all material respects, the CNB’s accounting records, on the basis of which the financial statements were verified.

The Auditor’s Report of the financial statements as at 31 December 1999, which is not a part of this Financial Report, is as follows:

“We have audited the accompanying balance sheet of the Czech National Bank (hereinafter the “CNB”) as at 31 December 1999, the related income statement and notes (hereinafter the “financial statements”) for the year then ended. These financial statements and underlying accounting records are the responsibility of the management of CNB. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Auditing Standards of the Chamber of Auditors of the Czech Republic and International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management of the CNB, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the accompanying financial statements present fairly, in all material respects, the assets, liabilities and equity of CNB as at 31 December 1999, and the results of its operations for the year then ended in accordance with the Act on Accounting and other relevant accounting legislation of the Czech Republic.”

29 March 2000

PricewaterhouseCoopers Audit, s.r.o.

Registered Auditing Company

Licence No. 21

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Zdeněk Mojžíšek

Auditor

Licence No. 1813

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Appendix 1 – CNB income and expenses (1998 and 1999)

Appendix 2 – CNB investment and inventories (1998 and 1999)

Appendix 3 – Assets and liabilities (quarterly data, *ad ultimo*)

I.

Introduction

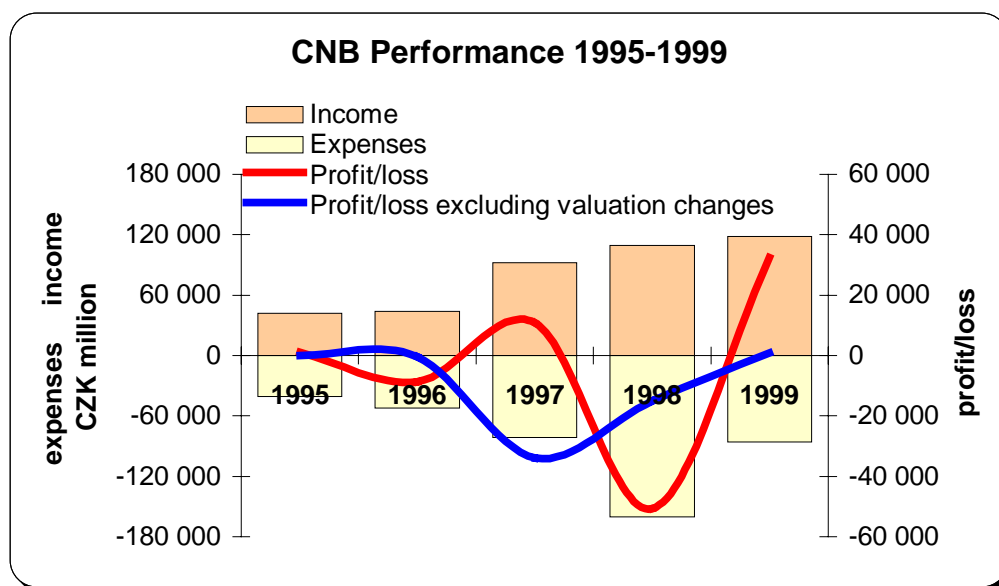
Pursuant to Act No. 6/1993 Coll. of the Czech National Council, the Czech National Bank shall submit the annual Financial Report to the appropriate body of the Parliament of the Czech Republic for approval, no later than three months after the end of the calendar year. The information in the Report is based on the 1999 financial statements and an analysis of economic performance. The accuracy of the annual financial statements has been verified by the auditor – PricewaterhouseCoopers Audit, s.r.o., in accordance with Act No. 6/1993 Coll.

In contrast to 1998, where losses were incurred, the CNB ended 1999 with a profit of CZK 32,378 million. In the distribution of these funds, exclusive priority was given to covering the 1998 losses.

During 1999, the Czech koruna weakened by 21% vis-à-vis the USD and by 3% vis-à-vis the EUR. As a result of this nominal decline, the koruna value of the CNB's international reserves was higher than at the beginning of the year (USD 12.9 billion as of 31 Dec. 1999). The decline in the value of the koruna was one of the main factors contributing to the 1999 profit. Given the extent of the international reserves and the floating exchange rate regime, the impact of exchange rate fluctuations is a very volatile feature of the bank's performance. Given the excess of foreign exchange assets over liabilities, exchange rate movements will continue to strongly influence the CNB's profit and loss account in future years as well.

The following chart shows the relationship between valuation changes and performance from 1995 to 1999.

CHART 1



II. Income and Expenses

II.1 Summary

The Czech National Bank's financial accounts for 1999 ended in a profit of CZK 32,378 million, income being CZK 118,325 million and expenses CZK 85,947 million. All in all, the results for 1999 were affected by the CNB's monetary policy measures and, in particular, by the exchange rate profits attained as a result of a rise in the koruna value of the CNB's international reserves. This increase in reserves was caused by depreciation of the koruna exchange rate. Valuation changes for 1999 amounted to CZK 31,517 million.

Overall sterilisation costs from repo operations with CNB bills fell against 1998. These expenses were offset by income from the management of CNB's international reserves.¹

At the end of 1999, an agreement was concluded between the CNB and the Czech Ministry of Finance on the transfer of a receivable from the National Bank of Slovakia (resulting from separation of the balance of the former State Bank of Czechoslovakia and division of the federal currency). In connection with this agreement, the CNB had taken on CZK 4,900 million. The obligation to create the full amount of the uncovered portion of the receivable was compensated in part by provisions and reserves, owing to a revision in the terms for the state guarantee created for the receivable, as well as guarantees issued and assets acquired as a part of banking sector consolidation.

Nonetheless, income had increased through the sale of the CNB's ownership interest in ČSOB (net income of CZK 14,807 million).

Table 1 gives a survey of income and expenses for 1999 grouped according to the specific budget items. (See Appendix 1 for a comparison of CNB income and expenses in 1998 and 1999).

Table 1 – CNB income and expenses (1999)

| | CZK million | | |
|-------------------------------------|----------------|---------------|---------------|
| | Income | Expenses | Balance |
| Monetary area | 118 263 | 83 143 | 35 120 |
| Monetary policy | 10 321 | 24 692 | -14 371 |
| International reserve management | 20 255 | 4 817 | 15 438 |
| Debt service | 845 | 1 496 | -651 |
| Valuation changes | 40 293 | 8 776 | 31 517 |
| Non-standard operations | 46 033 | 41 909 | 4 124 |
| Client operations | 516 | 1 453 | -937 |
| Currency circulation and management | 21 | 357 | -336 |
| Operations | 41 | 2 447 | -2 406 |
| Total | 118 325 | 85 947 | 32 378 |

Note: Some methodological changes have been made in the 1999 Report. Banking technology is now included in non-standard and client operations.

¹ The free liquidity of the banking sector is influenced by repo operations.

II.2 Monetary Area

In respect to the CNB's results, 97% of all expenses and almost the entire volume of the bank's income fall under the monetary area. These are mainly income and expenses connected to monetary policy measures, management of international reserves, consolidation of the banking sector and relations to the state budget. For budgetary purposes, this area is divided into six separate segments.

Although income and expenses for 1998 ended in a deficit, 1999 registered a positive balance of CZK 35,120 million, mainly as a result of CNB exchange rate profits.

| Year | INCOME (CZK million) | EXPENSES (CZK million) | BALANCE (CZK million) |
|------|-------------------------|---------------------------|--------------------------|
| 1998 | 109 595 | 157 874 | -48 279 |
| 1999 | 118 263 | 83 143 | 35 120 |

II.2.1. Implementing monetary policy

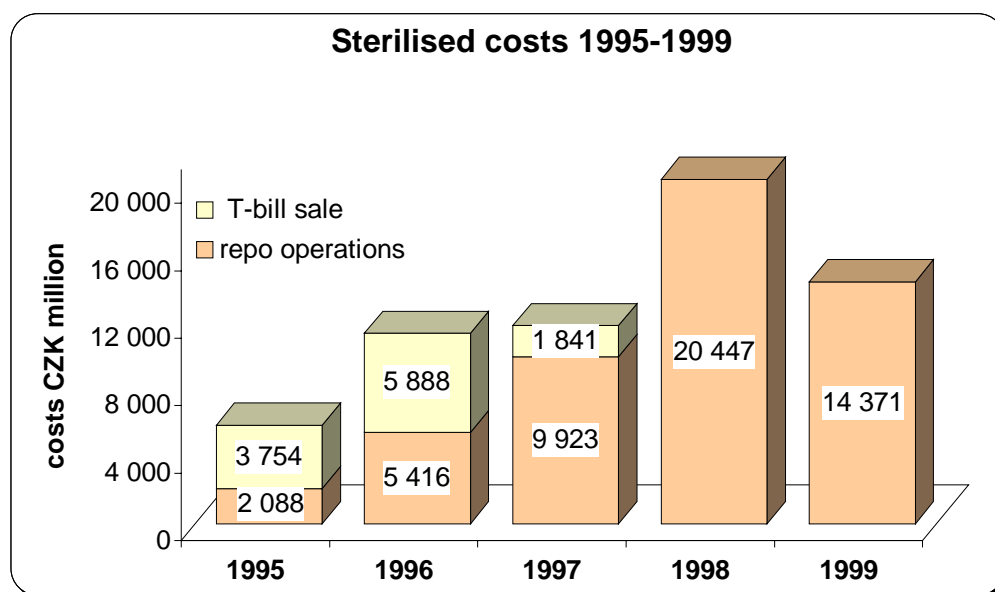
A loss of CZK 14,371 million had been recorded as of 31 Dec. 1999. In essence, this loss was caused by expenses relating to repo operations by which the CNB sterilises the free liquidity of commercial banks. Along with repo operations, commercial banks also took advantage of a new type of trading – deposit facilities (introduced 1 December 1998). Commercial banks are allowed to automatically deposit their surplus liquidity at the end of the day with the CNB in the form of a deposit at the discount rate. The purpose of introducing such a measure was to reduce the volatility of short-term interest rates and to restrict their movement to a band between the Lombard rate and the discount rate.

In 1999, an average of CZK 195,000 million was sterilised, which in comparison with 1998, is about a 46% increase. Reasons for the rise in the free liquidity of banks were related to the inflow of foreign capital and lowering of the minimum reserve requirement.

CNB key rates were significantly lowered during 1999. The two-week repo rate was gradually reduced from 9.5% p.a. at the beginning of the year to 5.25% p.a. as of 26 November 1999. In addition, the discount rate was lowered from 7.5% to 5% p.a., and the Lombard rate from 12.5% to 7.5% p.a.

The following chart gives a comparison of CNB sterilised costs.

CHART 2



II.2.2. Management of international reserves

This particular area primarily consists of the CNB's income and expenses for managing its international reserves. The determining factor for overall income is the volume of international reserves and their percentage yield.

The balance of income and expenses as of 31 December 1999 was CZK 15,438 million, which is an increase of CZK 865 million against 1998. A rise in the volume of the CNB's international reserves contributed most to this increase.

Expressed in USD, the CNB's international reserves rose from USD 12.6 billion (year-end 1998) to USD 12.9 billion at the end of 1999. The rate of return on international reserves had decreased as a result of interest rate fluctuation. The weighted average return on foreign exchange portfolios was 3.00% p.a., i.e. a decline of 1.39 percentage points in comparison to 1998.

II.2.3. Debt service

Debt service is primarily related to interest paid on loans received and on issued securities, as well as swap operations.

As of 31 December 1999, expenses (i.e. interest paid on loans received and issued securities in foreign currencies and on trading) exceeded income by CZK 651 million.²

II.2.4. Valuation changes

The volume of foreign exchange assets and liabilities is an important item for determining the level of valuation changes for the CNB. The exchange rate from the end of the previous year to the end of the current accounting period, i.e. 31 December, is also an important consideration.

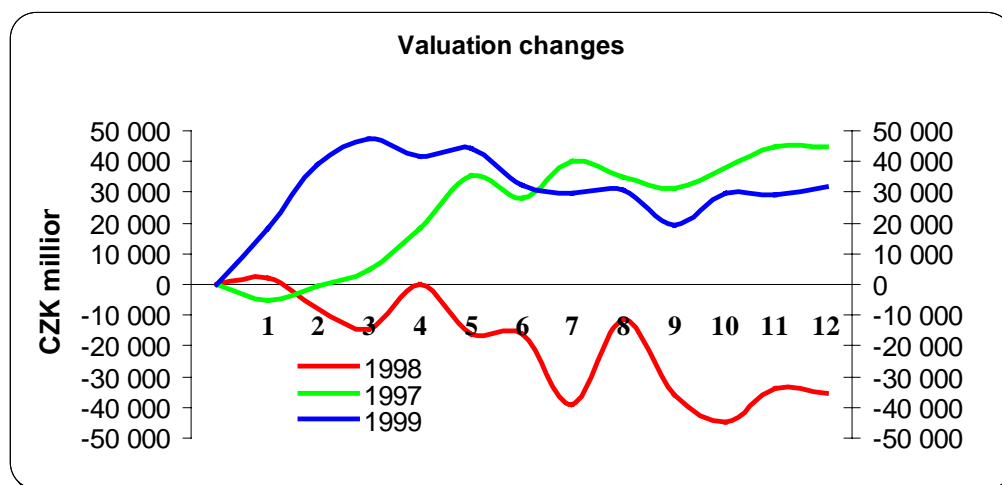
During the monitored period, the koruna exchange rate weakened vis-à-vis the EUR and the USD.³ The reason for this development stemmed from an increase in the koruna value of international reserves and, in turn, exchange rate profits from conversion of foreign exchange assets and liabilities. As a result, valuation changes amounted to CZK 31,517 million by 31 December 1999 – the reverse situation of 1998. Owing to appreciation of the koruna exchange rate, the koruna value of CNB international reserves declined in 1998, which meant an exchange rate loss of CZK 35,613 million.

Valuation changes for 1997, 1998 and 1999 are illustrated in the chart below.

² In 1998, there was a negative balance of CZK 621 million.

³ The foreign exchange activity of these currencies made up a substantial portion of the CNB's international reserves during the year.

CHART 3



II.2.5. Non-standard operations

As of 31 December 1999, the balance of income and expenses from non-standard operations amounted to CZK 4,124 million.

Income and expenses from non-standard operations are related in particular to the creation or dissolution of reserves and provisions that the CNB has created for covering the losses incurred from the banking sector's consolidation programme. A portion of the non-standard operations also include income from loans granted to Česká finanční, s.r.o. and income from redistribution loans (credits granted to Konsolidační banka Praha, s.p.ú. on permanent revolving stocks and to Investiční a poštovní banka, a.s. for covering government integrated projects and extensive housing construction – the loans were transferred to Konsolidační banka Praha, s.p.ú.).

In 1999, the total balance of income and expenses from non-standard operations was exceptionally affected by the sale of the ownership interest in ČSOB. The CNB acquired CZK 16,160 million from this transaction, and the expenses from the transfer of ownership interest, CZK 1,353 million, were covered by the income above. In addition, the receivables for the National Bank of Slovakia were resolved. This problematic situation had been caused by the division of the balance of the State Bank of Czechoslovakia and separation of the federal currency.⁴

In view of its obligation to support and maintain the stability of the banking sector and to monitor the security of deposits in the Czech Republic, the CNB assumed some of the assets and liabilities of a number of commercial banks or provided them with loans and

⁴ Pursuant to an agreement on the transfer of receivables, between the CNB and the Czech Ministry of Finance, the CNB shall transfer the receivables to the Government for the price of 1 Czech koruna. The agreement shall be valid on the day the agreement between the Czech Republic and the Slovak Republic on settlement of separation of the assets of the Czech and Slovak Federative Republic comes into effect. On the basis of the information above, the CNB created 100% provisions for the National Bank of Slovakia's receivable, while at the same time dissolving reserves created in the past. The overall impact on the CNB's performance was a loss of CZK 9,442 million.

guarantees. For covering the risk of losses incurred from the consolidation of the banking sector, the Czech Government resolved to issue a guarantee of CZK 22,500 million. The guarantee was issued on 19 March 1997 for a period of 10 years.

In past years, the Czech National Bank has also created reserves and provisions for covering part of the risk involved in the consolidation programme, which are, in turn, backed by a guarantee. As of 31 December 1998, provisions and reserves amounted to CZK 4,542 million (with a guarantee of CZK 17,958 million). Pursuant to the agreement with the Czech Government on the compensation of losses incurred from the transfer of the National Bank of Slovakia's receivable to the Government, the Czech Government confirmed, by the resolution of 12 January 2000, the obligation to cover the guarantee in its full amount. As a result, the CNB took full advantage of the guarantee on 31 December 1999 and reduced the formerly created reserves and provisions by CZK 4,542 million.

II.2.6. Client operations

CNB client operations include income and expenses for transactions with its clients. As of 31 December 1999, the balance of income and expenses amounted to -CZK 937 million.

Operations involving the Czech Government had a significant impact on the bank's performance, i.e. interest from deposits and current accounts of the Government at the CNB amounting to CZK 1.4 billion. In comparison to 1999, total interest paid had decreased, owing to a lower volume of deposits and a drop in interest rates – the discount rate in particular. Expenses from client operations were offset in part by fee collections from clearing, the short-term bond market and foreign payment transactions and interest on loans provided to state-owned institutions in the past.

II.3. Currency Circulation and Management

Expenses in this particular area are primarily related to the supply of new banknotes from the government press, Státní tiskárna cenin Praha, and coins from Bižuterie Česká mincovna Jablonec nad Nisou, as well as the contract on the basis of which Komerční banka, a.s. was granted the authority to manage and redistribute Czech cash reserves.

| Year | Income (CZK million) | Expenses (CZK million) | Balance (CZK million) |
|------|-------------------------|---------------------------|--------------------------|
| 1998 | 20 | 302 | -282 |
| 1999 | 21 | 357 | -336 |

The majority of the expenses consist of the actual expenses for banknotes and coins (coins are further divided into coins from ordinary metal, silver commemorative coins and gold coins). In 1999, expenses for the above-mentioned items were CZK 351 million. For 1999, CZK 5.7 million was paid out to Komerční banka, a.s. for managing Czech cash reserves. This is approximately the same amount as in 1998. In the other regions of the Czech Republic, this activity was managed by the CNB branch offices.

Income in the area of currency circulation and management mainly involved the sale of numismatic material (commemorative silver coins, golden ducats, gold Karel IV coins and banknotes and bills not in circulation) and the sale of trial strikes and silver coins for archive purposes.

II.4. Operations

CNB performance in the area of operations ended 1999 with an overall deficit of CZK 2,406 million.

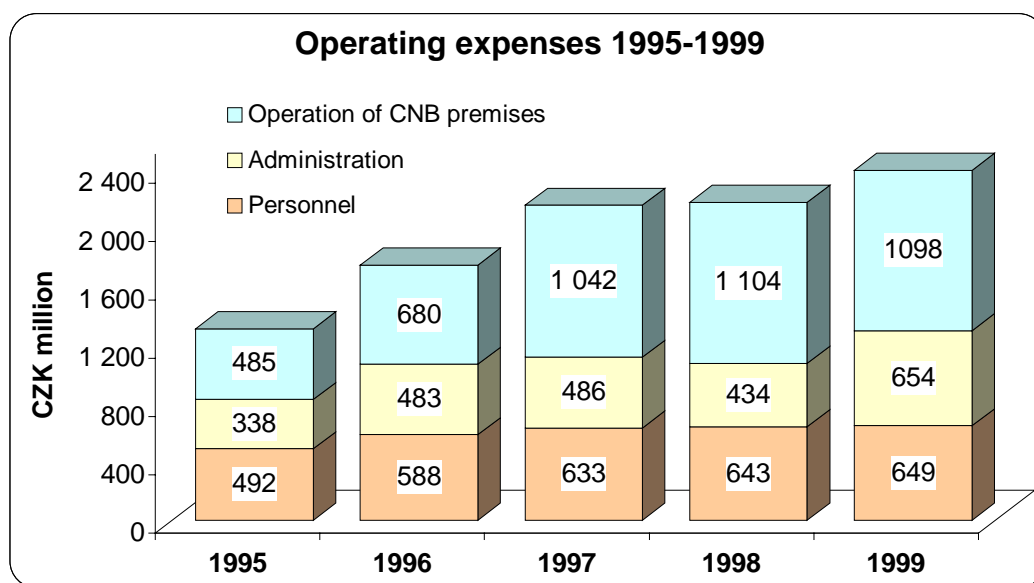
| Year | Income (CZK million) | Expenses (CZK million) | Balance (CZK million) |
|------|-------------------------|---------------------------|--------------------------|
| 1998 | 52 | 2,231 | -2,179 |
| 1999 | 41 | 2,447 | -2,406 |

The year-on-year increase in the deficit for the area of operations was 10.4% in comparison to 1998. This increase was connected to the privatisation of ČSOB, in which the CNB covered part of the National Property Fund's expenses for selling the shares. This increased the CNB's operating deficit by CZK 240 million. Excluding this extraordinary cost item, CNB operations for 1999 had developed similarly to that of 1998. Out of total CNB expenses, operating expenses in 1999 represented 2.8%. Income in this area was 0.03% of the CNB's total income.

Operating income and expenses were monitored in five basic groups according to the purpose of the funds.

Chart 4 below gives a comparison of important operating expenses from 1995 to 1999.

CHART 4



II.4.1 Personnel

Personnel expenses were CZK 649 million, of which CZK 456 million were expended for wages and other personal expenses. In addition, CZK 166 million was paid out for contributions to state health insurance, social security, the employment fund, liability insurance for damages and injuries at the workplace or illness from work and other necessary social expenses. Travel insurance, pension funds, life insurance and liability insurance for employees amounted to CZK 10 million, and employee education CZK 17 million.

As a result of changes in the personnel structure following the restructuring process and a reduction in the number of employees at the CNB during 1998 (mainly employees with below-average salaries were dismissed), statistics showed an average increase in nominal wages in 1999 of 6.85% against 1998. After making adjustments for the effects of structural changes, real nominal wages at the CNB remained on average at the same level, whereas average nominal monthly wages reached CZK 26,434. Overall personnel expenses remained virtually the same as last year (a rise of only 0.9%).

II.4.2. Administration activities

Expenses in this area amounted to CZK 654 million. This represents a month-on-month rise of CZK 220 million (50.7%) in comparison to 1998. The rise in expenses was mainly the result of costs for financial and legal advisory services related to selling the shares in ČSOB. Excluding this item, administration expenses were actually reduced by about CZK 20 million. Administration expenses comprised primarily costs directly relating to the CNB's organisational sections and units (including the CNB branches). This concerned in particular telecommunication charges, contracted services, utility expenses, travel expenses, materials, office supplies, marketing and advertising, taxes, fees and insurance.

An income of CZK 9 million was created in particular by sales in banking services and fees and penalties received for violation of contractual obligations in construction investment projects. Income for 1999 was the same as for 1998.

II.4.3. Operation of banking premises and facilities

Funds allocated for the operation of banking premises and facilities at the CNB were CZK 1,098 million, and represent 44.9% of the total operating expenses. Expenses in this area include property depreciation, repairs and maintenance, rental charges, fuel and energy consumption, transport, costs for small tangible assets, and packing materials. In comparison to 1998, expenses in this area fell by CZK 6 million. This reduction was caused in particular by a lower level of depreciation, especially for tangible assets.

Income in the amount of CZK 10 million includes sales for tangible assets, capitalisation of materials and rent received.

II.4.4. Operation of non-banking premises and facilities

From the standpoint of category type, expenses for the operation of non-banking premises and facilities were similar to those of banking premises. One difference was that it

related to non-operational buildings (e.g. recreation and sport facilities, accommodation facilities, flats, dining facilities, etc.). Expenses in this area were 0.03% of the CNB's total expenses. These expenses were, in addition, significantly offset by income in the amount of CZK 18 million. Income included sales from renting non-banking premises and payments for canteen food services.

II.4.5. Extraordinary income and expenses

Extraordinary expenses amounted to CZK 23 million. Almost half of these expenses were related to liquidation of unused banknote paper and dyes for manufacturing "federal currency" (CZK 11 million). Additional extraordinary expenses were related to settlement of the receivable for the National Bank of Slovakia and concerns the revaluation of the National Bank of Slovakia's deposited gold. The remaining extraordinary expenses stemmed from a number of smaller cases concerning the liquidation of retired assets and insurance matters.

Extraordinary income of CZK 4 million was created by reimbursements, refunds and overpayments.

III.

Assets and Liabilities

III.1. Summary

The CNB's balance sheet for 1999 fluctuated within a range of CZK 540–630 billion. From the beginning of 1999 to the end of the first third of July 1999, the balance gradually increased to CZK 628 billion as the koruna depreciated. As a result, the koruna value of receivables from abroad rose on the asset side, and profits increased on the liability side. In the following period, from the second third of July to 30 September 1999, the volume of receivables and liabilities vis-à-vis abroad was, on the contrary, reduced (especially due to a drop in repo operations). This development was reflected in a decline in the balance sheet, amounting to CZK 587 billion at the end of the monitored period. During the last quarter, there was a gradual increase in the overall balance resulting from a rise in the volume of international reserves. Hence, the balance sheet at the end of 1999 had reached CZK 622 billion.

In respect to the overall balance sheet, it should be noted that at the beginning of 1999, the CNB started recording issued CNB-bills together with redeemed CNB-bills as an adjusted balance, including repo operations and related interest rate adjustments. In this way, a substantial reduction in the balance sheet was recorded (a decrease of CZK 350 billion as of 31 December 1998).

See Appendix 3 for a survey of quarterly assets and liabilities.

III.2. Commentary on Selected Asset and Liability Items

III.2.1. Assets

In comparison to 31 December 1998, no significant changes had occurred in the share of items in the CNB's total balance sheet during the monitored period.

Receivables from abroad as of 31 December 1999 made up 77% of the total assets. This includes the total funds on nostro accounts and time deposits at correspondent banks abroad, funds in securities in foreign currency and in amounts converted to koruna. Funds deposited to reserve repos in freely convertible currencies are also recorded here.

Compared to the end of 1998, the CNB's international reserves in dollar terms rose by USD 0.28 billion. As of year-end 1999, these reserves amounted to USD 12.9 billion. There were a number of factors affecting the volume of reserves (in USD) during the year, thus, total reserves had changed over time. Intervention on the foreign exchange market during Q4 due to koruna appreciation was the most significant factor. Other factors included valuation changes connected to exchange rate movements between the USD and the EUR (a decisive volume of the CNB's international reserves are denominated in these currencies) and debt service payments. The koruna value of international reserves rose by CZK 85 billion against the end of 1998, which was attributable to growth in the volume of international reserves and overall weakening of the koruna vis-à-vis the USD in the period from 31 December 1998 to

31 December 1999.

In respect to international reserves, another important event had occurred at the turn of 1998/1999: redenomination of a part of the reserves in the former currencies of some EU countries into euros (mainly involving the Deutsche mark). In all, approximately EUR 7.1 billion of the reserves was redenominated, which is about two thirds of the CNB's international reserves.

Receivables from the International Monetary Fund consist of the Czech Republic's membership deposit in the IMF. Owing to an increase in the Czech Republic's membership share in February from SDR 589.6 million to SDR 819.3 million and the May exchange rate adjustment, the volume of claims expressed in koruna from the beginning of 1999 increased by about CZK 13.1 billion, reaching CZK 39.4 billion. Receivables from the IMF made up 6.3% of the total assets.

Receivables from clients record the status of credits granted to clients, with the exception of banks, and includes credits assumed from banks as a part of banking sector consolidation and credits of former banks. The volume of credits increased during the second third of July as a result of resolving the problems of Bohemia banka. Standard credits granted to Česká finanční, s.r.o., nevertheless, helped reduce the volume of receivables. Receivables from clients amounted to 6.4% of the overall volume of assets, i.e. CZK 39.9 billion.

Receivables from domestic banks mainly involve the central bank's function as an intermediary for refinancing commercial banks. These claims mainly include various kinds of credits provided to domestic financial institutions. Receivables from domestic banks make up 5% of the total assets. Since the beginning of 1999, receivables from domestic banks declined by about CZK 23 billion, mainly in connection with the security deposit at ČSOB, payment on the redistribution loan and reducing the receivables from Komerční banka, a.s. because of the redistribution of Czech cash reserves to CNB clients. As of 31 December 1999, the CNB's balance registered CZK 30.7 billion of receivables from domestic banks.

The entry "**other assets**" consists of the CNB's tangible and intangible assets, including settlements. Investment and inventories for 1999 are discussed in more detail in Chapter II.3.

III.2.2. Liabilities

As in the previous period, the entries, liabilities to domestic banks and currency in circulation, are decisive balance sheet items.

Liabilities to domestic banks include bank liabilities for deposits received from domestic banks, especially minimum reserve requirements, as well as liabilities from repo operations with CNB bills and other bank deposits. Liabilities to domestic banks were 44% of the total balance sheet. A large portion of this item involves repo operations with CNB bills and minimum reserve requirements. Credit provided to the CNB for repo operations amounted to approximately CZK 195 billion. Against 1998, liabilities from repo operations rose by CZK 45 billion. Short-term time deposits from banks also increased by CZK 24.7 billion and current accounts by CZK 1 billion. Minimum reserve requirements for banks stood at CZK 26.3 billion, which is a decline of CZK 60.3 billion in comparison to the end of 1998 (affected

by a cut in the MMR rate to 2%, as of 7 October 1999). Since June 1998, credit received has also been recorded under this balance sheet item in the amount of CZK 19.7 billion. By 31 December 1999, this amount had been gradually reduced to CZK 4.9 billion.

Currency in circulation represents the central bank's liabilities from issuing banknotes and coins for the cash supply of banks and the public. Currency in circulation amounted to ca. CZK 184 billion, which is CZK 38 billion more than at the end of 1998. This item makes up 29.6% of the total balance sheet.

Liabilities to the IMF consist of non-interest bearing bonds issued to the IMF by the CNB and deposits on IMF accounts 1 and 2 held at the CNB. IMF liabilities make up 6.3% of the total liabilities. Developments in 1999 are consistent with that of receivables from the IMF.

Deposits from clients include CNB liabilities for deposits accepted from entities other than the Government, government funds and banks. Deposits from clients make up 5.3% of all liabilities. As of 31 December 1999, CZK 33 billion was deposited on CNB accounts, which is approximately the same amount as at the end of 1998.

Bank reserves dropped by an absolute value of CZK 20.7 billion in connection to the dissolution of reserves for receivables from the NBS (provisions were also created, therefore the overall impact on the bank's performance was negative, i.e. -CZK 9.4 billion). A drop in reserves was also related to replenishing the volume of reserves for the consolidation programme. Total reserves amounted to CZK 33.6 billion, which amounts to 5.4% of the total CNB balance. See Chapter III.4 for a separate commentary on reserves and provisions.

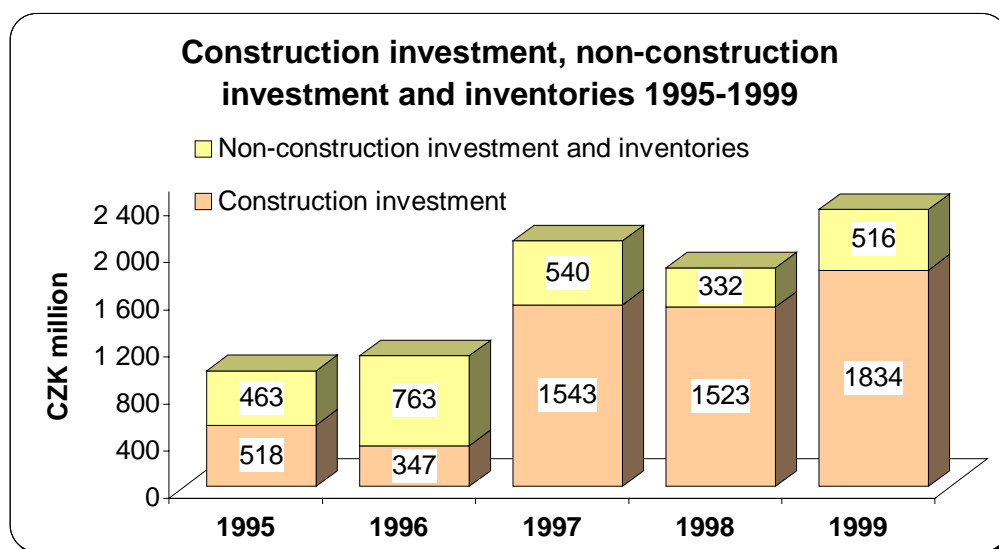
III.3. Investment and Inventories

In 1999, procurement expenses (investment and inventories) amounted to CZK 2,350 million, which is about 85% less than in 1998. A substantial volume of capital investment had been seen in 1998. Nevertheless, no financial funds were used for capital investment in 1999. When comparing totals in construction investment only, non-construction investment and inventories increased by 27% in 1999 against 1998. The primary reconstruction stage of the CNB headquarters in Prague 1 was the main cause of this increase. The following table and chart give a comparison of investment and inventories from 1995 to 1999. The chart does not include special capital investment, but instead, ownership interest related to the consolidation of the banking sector.

CZK million

| Investment and inventories (1995–1999) | | | | |
|---|--------------------------------|------------------------------------|---------------------------|---------------|
| Year | Construction investment | Non-construction Investment | Capital Investment | TOTAL |
| 1995 | 518 | 463 | 0 | 980 |
| 1996 | 347 | 763 | 0 | 1 110 |
| 1997 | 1 543 | 540 | 2 481 | 4 564 |
| 1998 | 1 523 | 332 | 13 333 | 15 188 |
| 1999 | 1 834 | 516 | 0 | 2 350 |

CHART 5



As is seen in the chart above, income from construction and non-construction investment and inventories has experienced similar development during the past three years, though the higher levels for these years are connected to the reconstruction of the CNB headquarters.

III.3.1. Construction investment

In 1999, CZK 1,834 million was invested in construction. Most of these funds were channelled into reconstruction of the CNB headquarters. The remaining funds were used for smaller repairs on branch offices and other CNB buildings, e.g. increasing the security of payment systems in Ústí nad Labem or improving of financial operations and repairing deposit boxes in Brno.

Of the total construction investment for 1999, CZK 1,817 million was spent on reconstruction of the CNB's headquarters. Most of this amount, CZK 1,320 million, consisted of funds for construction work and delivery. CZK 496 million was invested in project and design.

Construction was divided into nine construction sites, 36 operational groups and another 10 groups designated for other purposes. The "main building" and the "Commodity Exchange" were technically the most demanding, and from the standpoint of construction and materials, the most extensive part of the reconstruction process.

In 1999, the final phase of reconstruction had started. A significant part of the construction work, delivery and technical installation for all the building units, operational units and other deliveries had been completed. At the end of June 1999, the inspection process had begun, and the buildings were gradually turned back over to the CNB. By the end of 1999,

all the units of the CNB complex had been inspected and approved.

The office spaces, conference and meeting rooms as well as installation of operations in the “main building” have been completed. The computer network’s peripheral framework and the “demilitarisation zone” have also been installed. Preparations were being made in 1999 for the move back to the main headquarters. Integration of the security systems, the electronic security components, technical equipment and the fire alarm system had also been started. Flaws and defects connected to the inspection process were removed, and unfinished units were completed. Defects detected during the retrieval process were also repaired.

During the second half of the year, official inspection of the passageway connecting Na Příkopě and Senovážná Streets took place, and the rental spaces in the passageway were made available to the public.

The “Commodity Exchange” was completed, inspected and turned over to the bank. The educational complex, professional library, canteen and conference hall went through operational testing. The residential section and passageway were also completed. Defects during the retrieval process and damages caused by the water pipe accident on the mezzanine were also taken care of at this time.

III.3.2. Non-construction Investment and Inventories

During 1999, non-construction investment and inventories amounted to CZK 516 million, approximately 55% more than in 1998. Inventory purchases include tangible assets up to CZK 40,000, intangible assets up to CZK 60,000, or tangible and intangible assets with a life of less than one year. The year-on-year increase was attributable to the purchase of computer hardware and software for the newly renovated headquarters, as well as substantial investment in the Clearing Centre (ca. CZK 125 million), i.e. data security and on-line data transfer.

The majority of the funds were spent on computer hardware – CZK 145 million. Of this amount, CZK 63 million was used for updating the CNB’s system framework, CZK 44 million for on-line data transfer for the Clearing Centre and CZK 9 million for the “document services” project.

Investment in projects and application software from suppliers totalled CZK 110 million, and CZK 60 million for system software. CZK 69 million was invested in local and long-distance data communication equipment, including data communication security.

In addition, CZK 52 million was invested in office furnishings and equipment. CZK 11 million was invested in equipment for the security of safes and depositories, and another CZK 11 million for cash transport. Art objects and decorations were purchased for CZK 9 million. CZK 3 million was also spent on cash handling equipment.

The remaining CZK 46 million was used for materials such as inventory forms, packing material, office supplies, etc.

Effective Performance at the CNB

The use and allocation of resources at the CNB is regulated by a system of internal procedures. The aim of this system is to attain a maximum level of cost efficiency. The system consists of control mechanisms for verifying the requests and requirements of the departments at the CNB. These requests are also subject to the CNB's internal standards. The process is used for investment and non-investment expenses and is carried out at all levels of CNB management.

During 1999, the rules and regulations for the CNB's internal performance and for selecting business partners were prepared. More in-depth regulations were set up for the selection of business partners. Selection is based on various types of tenders, depending on the financial conditions of the particular case, and each tender is precisely defined and set up by the representatives of the selection committee with a clear description of the whole tender process. The aim is to increase the transparency and efficiency of all tenders.

III.4 Reserves, Provisions and Own Funds

III.4.1. Reserves and Provisions

As of 31 December 1999, total reserves and provisions at the CNB amounted to CZK 88,854 million, of which reserves CZK 33,602 million, and provisions 55,252 million. In comparison to the end of 1998, the net decrease in reserves was CZK 20,768 million and the net increase in provisions, CZK 31,695 million.

Provisions of CZK 25,810 million were created for the NBS receivable because of the division of the balance of the former State Bank of Czechoslovakia and separation of the federal currency (the receivable is 100% covered). Reserves and provisions for consolidation of the banking sector amounted to CZK 58,924 million. The structure of reserves and provisions is given in Table 2 below. The remaining portion of reserves and provisions are related to providing a redistribution loan, classified credits for CNB clients, foreign currency securities, providing guarantees and other debtors.

Table 2 – Structure of reserves and provisions for the consolidation programme

| | CZK million | | |
|-----------------------------|------------------|------------------|-------------------|
| | 31 December 1998 | 31 December 1999 | increase/decrease |
| Receivables from banks | 2 930 | 6 239 | 3 309 |
| Assets purchased from banks | 374 | 169 | -205 |
| Guarantees | 8 740 | 1 424 | -7 316 |
| Financial compensation | 20 540 | 19 717 | -823 |
| Česká finanční, s.r.o. | 28 030 | 31 375 | 3 345 |
| Total | 60 614 | 58 924 | -1 690 |

III.4.2. Own funds

As of 31 December 1999, the CNB registered a year-on-year negative balance in own funds (see Table 3 below for a comparison of 1998 and 1999).

Table 3 – Own funds

| | CZK million | | |
|--------------------------------|---------------------|---------------------|--------------------------|
| Funds | 31 Dec. 1998 | 31 Dec. 1999 | increase/decrease |
| Statutory fund | 1,400 | 1,400 | 0 |
| General reserve fund | 7,773 | 7,773 | 0 |
| Other reserves funds of profit | 159 | 159 | 0 |
| Other capital funds | 292 | 257 | -35 |
| Social fund | 9 | 14 | 5 |
| Remuneration fund | 2 | 0 | -2 |
| Total | 9 635 | 9 603 | -32 |

IV. Distribution of Profit

Pursuant to Section 47(2) of Act No. 6/1993 Coll., on the Czech National Bank, the Czech National Bank shall cover all necessary expenses connected to its activities from its income. The profit attained shall be used to replenish the reserve funds and other funds created of profit and for other uses in the amount budgeted. Any remaining profit shall be transferred to the state budget.

For 1999, the Czech National Bank recorded a profit of CZK 32,378 million. The Bank Board approved the distribution of this profit in the following manner (for 2000 accounting):

- CZK 32,347 million – for covering the 1998 losses
- CZK 31 million – contributions to the social fund for the year 2000

Covering the losses for 1998 was given priority status in the distribution of profit. Other losses from the previous period (CZK 18,393 million) shall be covered from the profit attained in future years.

V. State Budget Contributions

For 1999, no profits shall be transferred from the CNB to the state budget. In other words, all profits were used for the needs of the bank. This included covering, as much as possible, the 1998 losses and replenishing the social fund (in an amount stipulated in the collective agreement for 2000).

There were no available profit funds at the Czech National Bank for transferring to the state budget.

VI. Conclusion

The Czech National Bank attained a profit of CZK 32,378 million for 1999. This result does not allow for any transfer of funds to the state budget owing to the fact that all funds were needed for CNB expenditures, in particular for covering the 1998 losses.

In addition to the impact of valuation changes, performance was significantly affected by the CNB's monetary policy measures, the obligation to create the full amount of the uncovered portion of the receivable for the National Bank of Slovakia and other income from the sale of ownership interest in ČSOB.

As for the bank's internal performance, i.e. operating expenses and investment and inventories, the CNB had performed within the limits of the established budget.

Investment in the bank's own operations was about 27% higher than last year. Construction investment (reconstruction) and non-construction investment (substantial expenses for developing the Clearing Centre) were the main reasons for this increase.

The CNB's obligations to bank employees, pursuant to the collective agreement, have been met.

CNB INCOME AND EXPENSES (1998 and 1999)

CZK million

| Entry | Expenses | | | | Income | | | | Balance | | | |
|-------|----------|--------|----------|--------|----------|--------|----------|--------|----------|--------|----------|--------|
| | 1998 | | 1999 | | 1998 | | 1999 | | 1998 | | 1999 | |
| | budgeted | actual | budgeted | actual | budgeted | actual | budgeted | actual | budgeted | actual | budgeted | actual |

Group 1

| Monetary Area | | | | | | | | | | | | |
|------------------------------------|---|---------|---|--------|---|---------|---|---------|---|----------|---|----------|
| * Monetary policy measures | - | 47.342 | - | 24.692 | - | 27.019 | - | 10.321 | - | (20.323) | - | (14.371) |
| * International reserve management | - | 1.421 | - | 4.817 | - | 15.994 | - | 20.255 | - | 14.573 | - | 15.438 |
| * Debt service | - | 1.320 | - | 1.496 | - | 699 | - | 845 | - | (621) | - | (651) |
| * Valuation changes | - | 40.655 | - | 8.776 | - | 5.042 | - | 40.293 | - | (35.613) | - | 31.517 |
| * Non-standard operations | - | 64.053 | - | 41.909 | - | 60.407 | - | 46.033 | - | (3.646) | - | 4.124 |
| * Client operations | - | 3.083 | - | 1.453 | - | 434 | - | 516 | - | (2.649) | - | (937) |
| > Monetary area, total (Group 1) | - | 157.874 | - | 83.143 | - | 109.595 | - | 118.263 | - | (48.279) | - | 35.120 |

Group 2

| Currency Circulation and Management | | | | | | | | | | | | |
|--|-------|-------|-------|-------|----|----|----|----|---------|---------|---------|---------|
| > Currency circulation and management, total | 299 | 302 | 395 | 357 | 27 | 20 | 11 | 21 | (272) | (282) | (384) | (336) |
| Operations | | | | | | | | | | | | |
| * Personnel | 648 | 643 | 681 | 649 | 0 | 0 | 0 | 0 | (648) | (643) | (681) | (649) |
| * Management activities | 523 | 434 | 767 | 654 | 3 | 9 | 9 | 9 | (520) | (425) | (758) | (645) |
| * Operation of banking premises and facilities | 1.065 | 1.104 | 1.231 | 1.098 | 3 | 18 | 10 | 10 | (1.062) | (1.086) | (1.221) | (1.088) |
| * Operation of non-banking premises and facilities | 35 | 32 | 41 | 23 | 28 | 22 | 18 | 18 | (7) | (10) | (23) | (5) |
| * Extraordinary income/expenses | 21 | 18 | 11 | 23 | 0 | 3 | 4 | 4 | (21) | (15) | (7) | (19) |
| * Reserves | 165 | - | (191) | - | - | - | - | - | (165) | - | 191 | - |
| > Operations, total | 2.457 | 2.231 | 2.540 | 2.447 | 34 | 52 | 41 | 41 | (2.423) | (2.179) | (2.499) | (2.406) |
| > Group 2, total | 2.756 | 2.533 | 2.935 | 2.804 | 61 | 72 | 52 | 62 | (2.695) | (2.461) | (2.883) | (2.742) |

Total

| | | | | | | | | | | | | |
|-------------|--|---------|--|--------|--|---------|--|---------|--|----------|--|--------|
| | | 160.407 | | 85.947 | | 109.667 | | 118.325 | | | | |
| Profit/loss | | | | | | | | | | (50.740) | | 32.378 |

Note:

Income and expenses are not budgeted for Group 1. Only estimations of income and expenses are made for the calendar year and are updated at the end of each quarter according to actual monetary indicators.

A comma (,) represents a decimal point delimiter; a blank between figures or a point (.) within one number represent a thousand group delimiter.

CNB INVESTMENT AND INVENTORIES (1998 and 1999)

CZK million

| Investment and inventories | 1998 | | 1999 | |
|----------------------------|----------|--------|----------|--------|
| | budgeted | actual | budgeted | actual |

| Construction Investment | | | | |
|---|-------|-------|-------|-------|
| Project and design documentation | 359 | 307 | 504 | 498 |
| Construction work and supply | 1.373 | 1.216 | 1.343 | 1.336 |
| Purchase of land and construction sites | 0 | 0 | 3 | 1 |
| Construction investment, total | 1.732 | 1.523 | 1.850 | 1.834 |

| Non-construction Investment and Inventories | | | | |
|--|-----|-----|-------|-----|
| Transport | 0 | 0 | 21 | 11 |
| Office and electrical equipment | 5 | 3 | 5 | 1 |
| Cash handling equipment | 6 | 4 | 23 | 3 |
| Hardware | 139 | 60 | 290 | 145 |
| Software | 58 | 15 | 159 | 60 |
| Training programs | 0 | 0 | 0 | 0 |
| Training equipment | 3 | 1 | 4 | 3 |
| Investment in projects and application software from suppliers | 208 | 137 | 189 | 110 |
| Office furnishings and equipment | 79 | 28 | 86 | 52 |
| Local and long-distance data communication equipment | 129 | 9 | 142 | 69 |
| Weapons and security facilities | 0 | 0 | 3 | 0 |
| Security equipment for vaults and depositories | 5 | 2 | 16 | 11 |
| Treasury vaults and repositories, excluding interior equipment | 2 | 0 | 1 | 0 |
| Art work, decorations and antiques | 13 | 0 | 15 | 9 |
| Equipment for wireless telecommunications | 48 | 1 | 52 | 2 |
| Other | 78 | 73 | 49 | 40 |
| Non-construction investment, total | 773 | 332 | 1.056 | 516 |

| Capital Investment | | | | |
|---------------------------|--------|--------|---|---|
| In associates | 0 | 0 | 0 | 0 |
| In affiliates | 13.333 | 13.333 | 0 | 0 |
| Capital investment, total | 13.333 | 13.333 | 0 | 0 |

| | | | | |
|----------|-----|--|----|--|
| RESERVES | 134 | | 28 | |
|----------|-----|--|----|--|

| | | | | |
|---|---------------|---------------|--------------|--------------|
| TOTAL Investment and Inventories | 15.972 | 15.188 | 2.934 | 2.350 |
|---|---------------|---------------|--------------|--------------|

A comma (,) represents a decimal point delimiter; a blank between figures or a point (.) within one number represent a thousand group delimiter.

Assets and Liabilities (quarterly data, ad ultimo)

ASSETS

| Entry | as of 31 Dec. 1998 | | as of 31 Mar. 1999 | | as of 30 Jun. 1999 | | as of 30 Sep. 1998 | | as of 31 Dec. 1999 | |
|---------------------------------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|
| | CZK million | % | CZK million | % | CZK million | % | CZK million | % | CZK million | % |
| * Gold | 541,1 | 0,1 | 541,1 | 0,1 | 541,0 | 0,1 | 540,9 | 0,1 | 840,2 | 0,1 |
| * Receivables from the IMF | 26.319,9 | 4,9 | 36.573,8 | 6,2 | 39.404,6 | 6,4 | 39.404,6 | 6,7 | 39.404,6 | 6,3 |
| - in foreign currency | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| - in CZK | 26.319,9 | 4,9 | 36.573,8 | 6,2 | 39.404,6 | 6,4 | 39.404,6 | 6,7 | 39.404,6 | 6,3 |
| * Receivables from abroad | 402.412,2 | 74,2 | 445.385,8 | 75,0 | 464.978,3 | 75,4 | 443.425,4 | 75,5 | 478.223,7 | 76,9 |
| - in foreign currency | 402.412,2 | 74,2 | 445.385,8 | 75,0 | 464.978,3 | 75,4 | 443.425,4 | 75,5 | 478.223,7 | 76,9 |
| - in CZK | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| * Receivables from domestic banks | 53.822,4 | 9,9 | 51.475,7 | 8,7 | 50.264,3 | 8,2 | 35.447,9 | 6,0 | 30.739,3 | 4,9 |
| * Receivables from clients | 29.113,3 | 5,4 | 28.751,6 | 4,8 | 28.610,8 | 4,6 | 35.731,5 | 6,1 | 39.949,6 | 6,4 |
| * Domestic securities and shares | 17.177,9 | 3,2 | 17.177,9 | 2,9 | 17.177,9 | 2,8 | 15.824,7 | 2,7 | 15.824,7 | 2,5 |
| * Current result of state budget | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| * Other receivables from state budget | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| * Cash | 868,7 | 0,2 | 1.033,1 | 0,2 | 996,8 | 0,2 | 655,9 | 0,1 | 1.063,6 | 0,2 |
| * Other assets | 11.801,1 | 2,2 | 13.271,1 | 2,2 | 14.439,2 | 2,3 | 15.909,5 | 2,7 | 16.129,7 | 2,6 |
| Total | 542.056,6 | 100,0 | 594.210,1 | 100,0 | 616.412,9 | 100,0 | 586.940,4 | 100,0 | 622.175,4 | 100,0 |

LIABILITIES

| Entry | as of 31 Dec. 1998 | | as of 31 Mar. 1999 | | as of 30 Jun. 1999 | | as of 30 Sep. 1999 | | as of 31 Dec. 1999 | |
|---|--------------------|--------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|
| | CZK million | % | CZK million | % | CZK million | % | CZK million | % | CZK million | % |
| * Currency in circulation | 146.059,8 | 26,9 | 149.699,9 | 25,2 | 159.723,4 | 25,9 | 162.853,3 | 27,7 | 183.938,7 | 29,6 |
| * Liabilities to the IMF | 26.319,9 | 4,9 | 36.573,8 | 6,2 | 39.404,6 | 6,4 | 39.404,5 | 6,7 | 39.404,5 | 6,3 |
| - in foreign currency | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| - in CZK | 26.319,9 | 4,9 | 36.573,8 | 6,2 | 39.404,6 | 6,4 | 39.404,5 | 6,7 | 39.404,5 | 6,3 |
| * Liabilities to abroad, including securities | 11.382,7 | 2,1 | 13.877,2 | 2,3 | 26.154,9 | 4,2 | 15.299,5 | 2,6 | 30.544,9 | 4,9 |
| - in foreign currency | 10.952,1 | 2,0 | 13.455,7 | 2,3 | 25.724,8 | 4,2 | 14.868,9 | 2,5 | 30.128,8 | 4,8 |
| - in CZK | 430,6 | 0,1 | 421,5 | 0,1 | 430,1 | 0,1 | 430,6 | 0,1 | 416,1 | 0,1 |
| * Liabilities to domestic banks | 275.927,5 | 50,9 | 287.151,3 | 48,3 | 278.949,3 | 45,3 | 269.548,8 | 45,9 | 275.883,7 | 44,3 |
| of which: bank monetary reserve | 86.605,7 | 16,0 | 86.605,7 | 14,6 | 50.553,7 | 8,2 | 66.263,4 | 11,3 | 26.278,5 | 4,2 |
| * Deposits from clients | 31.811,8 | 5,9 | 26.316,2 | 4,4 | 26.533,8 | 4,3 | 27.035,9 | 4,6 | 33.122,9 | 5,3 |
| * Domestic securities issued | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| * Current result of state budget | 0,0 | 0,0 | 1.884,3 | 0,3 | 4.694,6 | 0,8 | 1.231,3 | 0,2 | 0,0 | 0,0 |
| * Other liabilities to the state budget | 28.370,5 | 5,2 | 16.383,8 | 2,8 | 15.552,4 | 2,5 | 15.043,8 | 2,6 | 27.069,2 | 4,4 |
| * Reserves | 54.369,7 | 10,0 | 54.369,7 | 9,1 | 54.369,7 | 8,8 | 48.469,0 | 8,3 | 33.602,3 | 5,4 |
| * Share capital | 1.400,0 | 0,3 | 1.400,0 | 0,2 | 1.400,0 | 0,2 | 1.400,0 | 0,2 | 1.400,0 | 0,2 |
| * Funds | 8.234,1 | 1,5 | 8.228,0 | 1,4 | 8.219,7 | 1,3 | 8.213,5 | 1,4 | 8.203,5 | 1,3 |
| * Retained profits/accumulated losses | 0,0 | 0,0 | (50.740,1) | - | (50.740,1) | - | (50.740,1) | - | (50.740,1) | - |
| * Profit/loss for accounting period | (50.740,1) | - | 38.794,9 | 6,5 | 42.565,9 | 6,9 | 43.425,1 | 7,4 | 32.378,4 | 5,2 |
| * Other liabilities | 8.920,7 | 1,6 | 10.271,1 | 1,7 | 9.584,7 | 1,6 | 5.755,8 | 1,0 | 7.367,4 | 1,2 |
| Total | 542.056,6 | 100,0 | 594.210,1 | 100,0 | 616.412,9 | 100,0 | 586.940,4 | 100,0 | 622.175,4 | 100,0 |

A comma (,) represents a decimal point delimiter; a blank between figures or a point (.) within one number represent a thousand group delimiter.