2003

INFLATION REPORT JANUARY/2003

CZECH NATIONAL BANK

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CONTENTS

CHARTS IN THE TEXT

ABBREVIATIONS USED

CNB	Czech National Bank
CPI	consumer price index
CSO	Czech Statistical Office
CZK	Czech koruna
EAGGF	European Agriculture Guidance and Guarantee Fund
EC	European Community
ECB	European Central Bank
ECOFIN	EU Council of Economics and Finance Ministers
EIB	European Investment Bank
EMU	Economic and Monetary Union
ERDF	European Regional Development Fund
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESF	European Social Fund
EU	European Union
EUR	euro
FDI	foreign direct investment
FIFG	Financial Instrument for Fisheries Guidance
FRA	forward rate agreement
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IRS	interest rate swap
L	a monetary aggregate (see Section III.1.1.)
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
M1	a monetary aggregate (see Section III.1.1.)
M2	a monetary aggregate (see Section III.1.1.)
MLSA	Ministry of Labour and Social Affairs
O/N	overnight
PRIBID 1W (1M, 1Y)	Prague Interbank Bid Rate, one-week (one-month, one-year)
PRIBOR	Prague Interbank Offered Rate
repo rate	repurchase agreement rate
SITC	Standard International Trade Classification
T-bills	treasury bills
USD	US dollar
VAT	value added tax

Boxes and annexes contained in past Inflation Reports

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002–2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
The Balassa–Samuelson effect	(Annex)	April 2002
The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002

FOREWORD

In 1998, the Czech National Bank switched to direct targeting of inflation. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the regular publishing of Inflation Reports. In these pivotal documents the central bank provides information on monetary and economic developments in the previous quarter and on the reasons for the Bank Board's monetary policy measures. The Inflation Report also acquaints readers with the view of the Czech National Bank regarding future inflation factors and with the updated inflation forecast. The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy transparent, comprehensible, predictable and therefore reliable. The Czech National Bank is convinced that reliable monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

This Inflation Report contains two annexes. Annex 1 consists of a document published by the CNB at the end of 2002: *The Czech Republic and the euro – Draft accession strategy.* One of the preconditions for rapid accession to the eurozone and sustainable macroeconomic development is the consolidation of public budgets. Annex 2 therefore analyses past developments and the immediate outlook in the fiscal area. This Inflation Report was approved by the CNB Bank Board on 6 February 2003.

An annex of statistical tables is available, together with this Report, on the enclosed CD and at http://www.cnb.cz/.

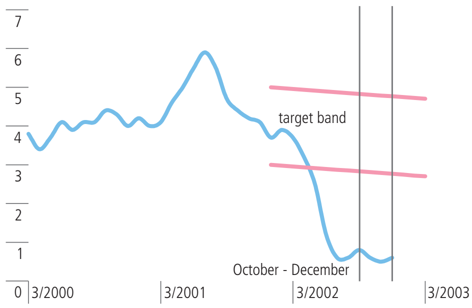
I. SUMMARY

TABLE I.1
INFLATION STABILISED IN 2002 Q4
(annual percentage figures unless otherwise indicated)

	9/02	10/02	11/02	12/02
Consumer price inflation	0.8	0.6	0.5	0.6
Industrial producer price inflation	-0.9	-0.9	-0.7	-0.7
Money supply growth (M2)	4.8	6.2	5.2	n.a.
3M PRIBOR[1]	2.99	2.82	2.77	2.63
Nominal CZK/EUR exchange rate[2]	30.30	30.91	30.89	31.49
State budget balance since January incl. SFAOs,[2] CZK bn	-21.4	-32.3	-41.7	-45.7
GDP growth at constant prices[3]	2.7[4]	-	-	-
Unemployment rate[2]	9.4	9.3	9.3	9.8

1) average for the month
2) end-of-month position
3) figure for the quarter ending with the given month
4) according to the CSO this is only a "tentative estimate"

CHART I.1
INFLATION REMAINED BELOW THE TARGET BAND IN 2002 Q4
(annual consumer price inflation; percentages)



As in previous quarters, inflation remained very low in 2002 Q4, fluctuating below the target band throughout the quarter (see Chart I.1). The correction to the CSO statistics on foreign trade and the CSO's ensuing tentative estimate suggest that annual GDP growth probably staged something of a recovery in Q3 relative to Q2. However, more accurate figures will not be available until March 2003. In 2002 Q4, important steps were taken in the area of the Czech Republic's integration into European structures and the consolidation of public finances, i.e. in areas that will have a major effect on domestic price and economic developments in the medium and longer term.

Annual consumer price inflation was flat in Q4, hovering at the record low levels achieved in July and August (0.6%) and even falling in November by another one tenth of a percentage point. As in the previous quarter, it was affected mainly by annual declines in food prices and import prices. The disinflationary import prices were attributable to an annual decline in prices of raw materials (especially energy-producing raw materials), the low inflation recorded by the Czech Republic's major trading partners, and to continuing (albeit weakening) year-on-year appreciation of the koruna's exchange rate. A further slackening of annual regulated price inflation – due in particular to a lowering of gas prices for households at the beginning of October – also played its part.

According to the CSO's tentative estimate, the annual growth rate of the Czech economy in Q3 was roughly the same as in Q1, i.e. faster than in Q2. The growth in Q3 was again attributable chiefly to a rise in domestic demand, and in particular household consumption. The contribution of government consumption was insignificant, and that of gross fixed capital formation was negative. The contribution of net exports was also negative, and more so than in the previous quarter. The economic growth in Q3 was also negatively affected by the continuing weak economic growth being recorded by the Czech Republic's major trading partners and by the strong exchange rate of the koruna. In contrast to the previous quarters, the negative factors also included the adverse impacts of the August floods. The floods affected GDP both directly (direct negative effects on production) and indirectly (a substantial drop in the number of foreign tourists). Preliminary information on the public finance results in 2002 indicates a lower deficit than the 7% of GDP that was originally officially expected and consequently a smaller-than-previously-expected fiscal contribution to economic growth.

The gap between the demand for, and supply of, labour continued to widen in both Q3 and Q4. This is evidenced by a further decline in the number of vacancies and by a rise in unemployment to a record high (9.8% in December 2002). The stronger position of employers fed through into a fall in the growth rate of average nominal wages in the business sector. However, the overall growth in average nominal wages was flat at the previous quarter's level, owing to a sizeable increase in wages in the non-business sector. Even in this situation, annual growth in average real wages picked up, thanks to the low inflation level. Growth in nominal unit wage costs slowed in Q3. The faster wage growth in the non-business sector is expected to continue in the period ahead, and its possible effect on wages in the economy remains a risk to future macroeconomic development.

In addition to the ongoing disclosure of the standard set of statistical information on the economy, there were several extraordinary events in Q4 with medium- to long-term significance for the Czech economy. In mid-December, the negotiations on the financial conditions of accession to the European Union were completed at a summit in Copenhagen. This brought the Czech Republic a step closer to joining this institution. On 27 December, the CNB also published and sent to the Government of the Czech Republic for comments a draft strategy for the Czech Republic's adoption of the euro, outlining a timetable for the steps necessary for further integration into European structures. This document, which was also posted on the CNB website, constitutes Annex 1 to this Report.

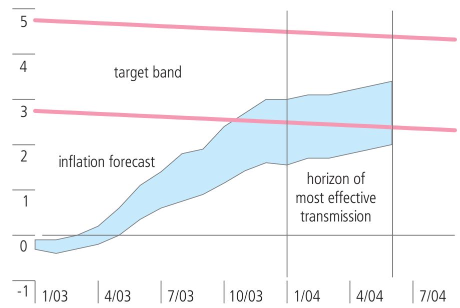
In addition to membership of the European Union and later of the eurozone, the price and economic developments in the Czech Republic in the medium and longer run will be significantly affected by public finances, and specifically by how successfully those finances are consolidated. The success of this consolidation will also determine the speed with which the single currency is introduced. In December, the Government approved a *Medium-term outlook for the state budget* and the Ministry of Finance presented its ideas on the reform of public finances for public discussion. Annex 2 to this Report, which estimates the effect of the expected fiscal consolidation on the Czech economy, is based on these two documents.

The monetary policy decision-making of the CNB Bank Board in 2002 Q4 was based on the inflation forecast discussed by the Board at its meeting on 31 October 2002 and published in the October Inflation Report. Owing to the monetary policy transmission lag, the Board's decision-making was focused on hitting the inflation target in approximately 2003 Q4 and 2004 Q1. The inflation forecast for this period was just above the lower boundary of the target band. A decline in interest rates at the end of 2002 and stability in 2003 were consistent with the starting assumptions of the forecast.

Based on this forecast and an assessment of additional risks and uncertainties, the Bank Board voted at its meeting at the end of October to reduce the monetary policy interest rates by 0.25 percentage points. In the remainder of 2002, the Bank Board made no further changes to interest rates, mainly because the risks pertaining to the inflation forecast were balanced: the upside risks (a weaker exchange rate of the koruna and higher growth in regulated prices and indirect taxes by comparison with the forecast) were approximately offset by the downside risks (slower economic growth and lower inflation in Germany, and a weaker dollar-euro exchange rate by comparison with the forecast), and also because of increased uncertainty regarding future economic development, associated in particular with the fiscal stimulus effect.

A new macroeconomic forecast for the next six quarters was published following the Bank Board meeting on 30 January 2003. The macroeconomic forecast continues to expect a gradual pick-up in domestic economic growth in 2003 and 2004 as a result of an assumed economic recovery abroad and a gradual easing of monetary conditions during the course of 2003. The inflation forecast for the beginning of 2003 decreases slightly, owing to the stronger-than-expected disinflationary effects of exogenous factors. For the horizon of most effective transmission, i.e. the end of 2003 and 2004 H1, the forecast is little changed relative to the CNB's October 2002 forecast. An absence of demand-pull inflationary pressures and a gradual unwinding of the disinflationary effects of the exogenous factors will remain the key factors with regard to inflation. Consistent with the macroeconomic forecast is a modest decline in interest rates at the start of 2003 and stability thereafter.

CHART I.2
THE FORECAST SUGGESTS INFLATION WILL RETURN TO THE LOWER BOUNDARY OF THE TARGET BAND AT THE HORIZON OF MOST EFFECTIVE TRANSMISSION
(annual consumer price inflation; percentages)



II. INFLATION DEVELOPMENTS

CHART II.1
CONSUMER PRICE INFLATION REACHED ITS LOWEST LEVEL SINCE THE START OF THE TRANSFORMATION
(percentages)

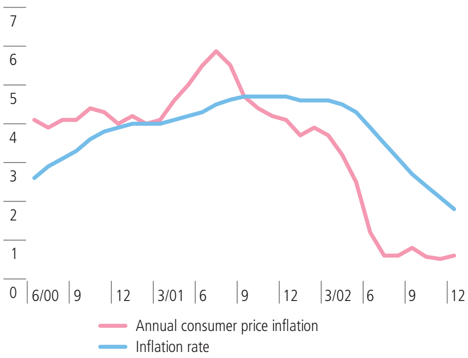
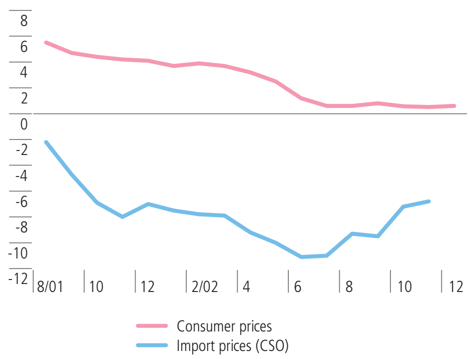


TABLE II.1
MOST OF THE CONSUMER BASKET CATEGORIES CONTRIBUTED TO THE LOW INFLATION OUTTURNS
(annual percentage changes)

	9/01	12/01	3/02	6/02	9/02	10/02	11/02	12/02
Food and non-alcoholic beverages	4.5	3.2	3.0	-4.1	-4.9	-4.9	-5.2	-5.4
Alcoholic beverages and tobacco	2.6	2.9	1.2	1.9	2.1	1.9	1.7	1.6
Clothing and footwear	-1.4	-1.2	-1.8	-2.2	-3.1	-3.4	-3.7	-4
Housing, water, electricity, gas and other fuels	10.7	10.4	7.9	6.2	5.2	4.5	4.5	4.5
Furnishings, household equipment and routine maintenance of the house	0.3	0.3	0.2	0.0	-0.3	-0.6	-0.6	-0.6
Health	4.3	4.1	4.8	5.2	4.3	3.8	4.2	4.1
Transport	-0.7	-3.3	-1.3	-3.7	-2.5	-1.5	-0.7	0.7
Communications	4.4	4.1	3.9	3.0	5.3	3.3	3.3	2.4
Recreation and culture	5.3	5.1	4.9	1.3	0.2	0.7	0.2	0
Education	3.3	3.3	3.4	3.3	3.7	4.2	4.2	4.2
Hotels, cafés and restaurants	3.1	3.2	4.0	3.9	3.1	2.9	2.7	2.6
Miscellaneous goods and services	5.0	5.4	4.8	3.8	3.6	3.2	3.1	2.9
Consumer prices	4.7	4.1	3.7	1.2	0.8	0.6	0.5	0.6

CHART II.2
THE MOSTLY FALLING IMPORT PRICES CONTRIBUTED SIGNIFICANTLY TO THE CONTINUING LOW INFLATION
(annual percentage changes)



Following a previous gradual decline, annual consumer price inflation stabilised below 1% in 2002 Q3 and Q4. In November, inflation reached its lowest level since the start of the transformation period (0.5%). It remained very low at the close of the year, recording an outturn of just 0.6% in December. Relative to the end of 2001, annual consumer price inflation fell by 3.5 percentage points during 2002. The inflation rate[1] also reached post-1990 historical lows in Q4 (1.8% in December).

As in the previous quarters of 2002, low growth (or an annual decline) in prices was recorded for the overwhelming majority of the consumer basket categories. Table II.1 shows that inflation was more markedly affected in Q4 by an increasing price decline in the food and non-alcoholic beverages category, which accounts for roughly one fifth of the consumer basket. Developments in the transport and education categories, where inflation rose in Q4, had a contrary effect.

The continuing low inflation in the Czech economy was again attributable to a combination of several factors on both the demand side and the supply side in Q4. Although consumer demand maintained its growth rate, no inflationary demand pressures were visible in the economy. The potential pro-inflationary effect of the rising consumer demand was depressed by strong competition on the retail market and the mostly falling prices of imports of final products for the consumer market. The decline in import prices (bolstered by continuing buoyant appreciation of the koruna's exchange rate)[2] curbed any rise in the producer and consumer prices of competing domestic products. Simultaneously, a persisting decline in the import prices of most energy-producing and non-energy-producing raw materials, again bolstered by the appreciation of the koruna's exchange rate, created room for a decline in producer prices. Although developments on the labour market indicated a slowdown in the growth rate of the personnel cost-output ratio, growth in nominal unit wage costs was nevertheless relatively high. In the given circumstances, however, this did not lead to any pick-up in inflation.

These factors chiefly affected market prices in the tradables category. In Q4, the external factors also fed through into regulated prices, since the adjustments made to regulated prices came in response to the long-term annual decline in import prices of energy-producing raw materials.

1 The inflation rate expressed as the increase in the average consumer price index (basic) for the last 12 months relative to the average for the previous 12 months.
2 In 2002 Q4, the nominal appreciation of the koruna-dollar rate was 16.5% and that of the koruna-euro rate 6.9% on average in year-on-year comparison.

Market prices, measured by annual net inflation,[3] continued falling throughout Q4. The negative net inflation outturns were only slightly higher than at the end of Q3 (during 2002 Q3 net inflation had moved within the range of -0.3% to -0.6%, whereas in Q4 the range was -0.1% to -0.2%). However, prices within the market prices category again recorded very mixed developments in the last quarter of 2002. The structure of the consumer price index confirms that the main factor underlying the different levels of inflation for different commodities in the Czech Republic was their degree of tradability. The extent to which the prices of each particular commodity were affected by the external competitive environment or by domestic factors was significant. One of the most important representatives of tradables in the Czech Republic is food prices,[4] which account for more than one quarter of the consumer basket.

It was mainly food prices that caused annual net inflation to lie below the level of the same period a year earlier throughout H2 and inflation to reach its lowest level since the start of transformation at the end of 2002. The annual decline in food prices increased by 0.5 percentage points in Q4, reaching -3.4% in December. This was mainly due to prices in the food and non-alcoholic beverages category, which in December recorded a further considerable annual decrease, of 5.4%. Although prices of alcoholic beverages and tobacco products rose again in Q4 in annual terms, the growth rate slowed to 1.6%.

The causes of the continuing annual disinflation in the food segment – described in detail in previous Inflation Reports – remain the same. As in previous quarters, the main factor was excess supply on the agricultural commodities market, which did not create conditions for any pick-up in inflation. The continuing limited opportunities for selling agricultural products in other countries prevented any reduction in surpluses on the domestic market. This factor was the main cause of a gradual slowdown in agricultural producer price inflation, which turned into a considerable annual decline in prices at the end of 2002 Q2. Moreover, the persisting fall in prices in some European countries, bolstered by the still relatively strong appreciation of the koruna's exchange rate, fostered a rise in imports of cheaper agricultural commodities and final food products for the consumer market. These factors affected prices in the agricultural-product processing and retailing chain, with import prices curtailing domestic price growth in this area.[5]

CHART II.3

THE SLIGHT RISE IN CONSUMER PRICES WAS DUE TO BOTH NET INFLATION AND REGULATED PRICES

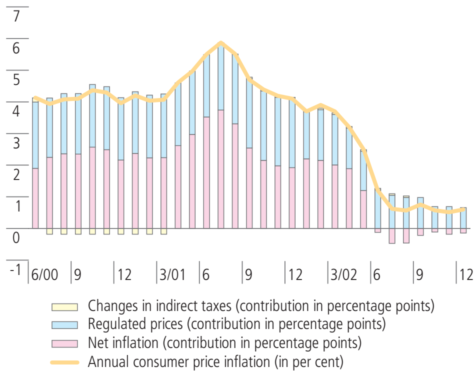


CHART II.4

IN THE MARKET PRICES CATEGORY, FOOD PRICES RECORDED THE LARGEST FALL
(annual percentage changes)

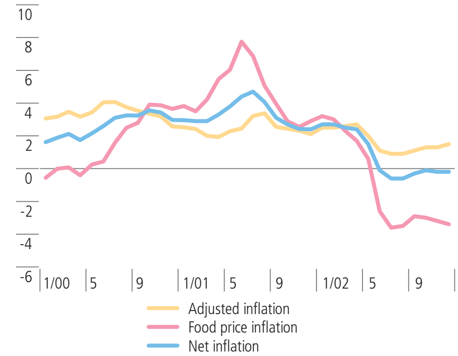
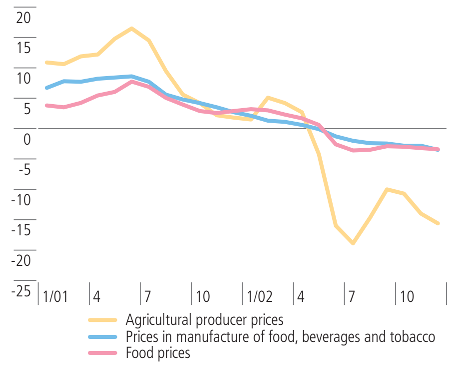


CHART II.5

PRICES OF FOOD PRODUCTS FELL THROUGHOUT THE PRODUCTION, PROCESSING AND RETAIL CHAIN
(annual percentage changes)



3 Net inflation = consumer price inflation adjusted for regulated prices and other administrative measures.
4 Food prices = prices of food and non-alcoholic beverages + prices of alcoholic beverages and tobacco (adjusted for administrative effects)
5 The aforementioned factors affected all the food sub-categories, most notably meat, where prices displayed the biggest annual decline in Q4 (11.9% in December). Large decreases were also recorded at the close of 2002 by prices in traditionally volatile categories such as temperate-zone fruit and vegetables, which in 2002 H1 had shown buoyant annual growth.

CHART II.6
PRICES OF NON-FOOD COMMODITIES RECORDED MIXED DEVELOPMENTS
(annual percentage changes)

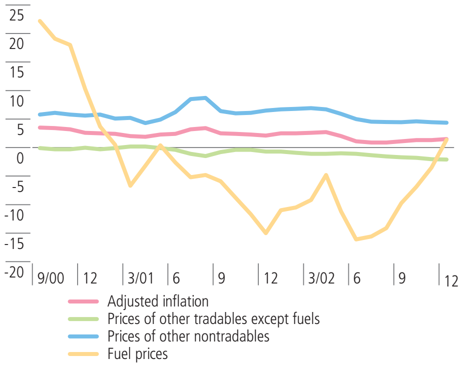


CHART II.7
FUEL PRICES RESPONDED TO THE CHANGE IN THE OIL PRICE TREND ON WORLD MARKETS
(annual percentage changes)

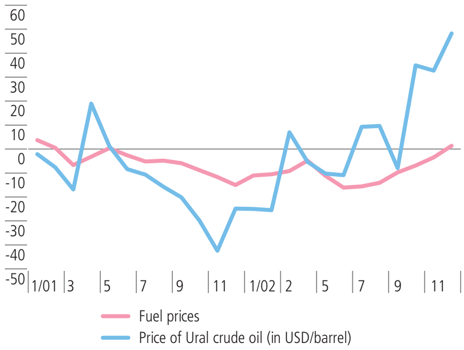


CHART II.8
FALLING PRICES OF IMPORTED NATURAL GAS FOSTERED A DECREASE IN REGULATED PRICE INFLATION
(annual percentage changes)

In 2002 Q4, prices also displayed an annual decline in the category of non-food tradables, which form part of adjusted inflation.[6] Prices of other tradables except fuels,[7] which are affected by foreign competition via imports, saw a continuing gradual deepening of their decline throughout Q4. In December, the annual decrease in this category was just over 2% (see Chart II.6). As with headline inflation, these were the lowest outturns recorded since the start of the transformation. Fuel prices, which are highly volatile, displayed a stronger response to oil price developments on world markets during Q4. The renewed sizeable growth in oil prices caused a gradual weakening of the annual decline in fuel prices, culminating in December in modest annual growth. Fuel prices had shown a 16.1% annual decrease in June and a 9.7% fall in September, whereas in December they recorded a rise of 1.4%.

In general, prices of nontradables – unlike most traded commodities – continued to rise in 2002 Q4. However, their development, which is determined chiefly by domestic factors, suggested a slowdown in annual growth. The growth eased in the category of other nontradables prices (services prices in particular), which are market prices, and in the case of regulated prices.

Other nontradables prices rose quite briskly again in Q4. Their annual growth rate remained above 4%. However, since the beginning of 2002 a fairly clear downward trend in annual growth (from 6.7% in January to 4.4% in December) has been visible in this group. The price growth stayed above 4% mainly thanks to prices in the education and health categories. In these categories, inflation was higher on average in 2002 than a year earlier. In Q4, however, inflation in the health category eased by comparison with the end of the previous quarter. In education, annual inflation picked up in October, but in the subsequent months of Q4 prices stagnated at the October level.

Annual regulated price inflation slowed more markedly in 2002 Q4, recording considerably lower outturns relative to the previous year. By comparison with the end of Q3, it fell by 1.6 percentage points to 3.3%, a slowdown of around 8 percentage points relative to 2001. The main factor underlying the continuing slackening of annual regulated price inflation during Q4 was the long-running fall in prices of imported natural gas, which in annual comparison reached double figures. As a result, the usual increase in gas prices for households was not undertaken in Q3 and, on the contrary, prices were lowered at the beginning of Q4. With effect from 1 October 2002, they were cut by 7.3% on average. Regulated prices also were favourably affected by the re-numbering of telephone lines (telephone districts were merged into larger units, meaning that many previously long-distance calls are now charged at local rates). Call charges declined by approximately 2%, although the effect of this on inflation was only around one sixth that of the reduction in gas prices. Other regulated price items recorded only small movements, with minimal impacts on inflation. No other administrative changes were made in Q4, nor was annual inflation affected in Q4 by any other past changes (the last changes having been made more than a year ago).

6 Adjusted inflation = prices of other tradables (including fuels) and prices of other nontradables
7 Food excluded.

An overall picture of the evolution of tradables and nontradables prices is provided by the long-term history of the basic indices since 1999 as depicted in Chart II.9. In particular, the trend displayed by the basic index of tradables prices over recent quarters confirms that the overwhelming majority of internal and external inflation factors have been acting downwards on inflation. At the end of 2002, this index was approaching its initial 1999 level. Slackening growth in the basic index, due mainly to the aforementioned external factors, is also visible in the case of nontradables.

Inflation in 2002 Q4 can also be assessed with regard to the CNB's previous forecasts. Given the lag in the transmission of monetary policy into prices, inflation in Q4 was most affected by the measures adopted between April and December 2001. By way of illustration, Table II.2 assesses the fulfilment of the July 2001 forecast. This forecast indicated that annual inflation would be 4.2% in December 2002, but in reality prices rose by only 0.6%. This deviation of the actual outturn from the forecast was due mainly to the unexpected disinflationary effect of factors which, from the point of view of the forecast, are predominantly exogenous – regulated prices and food prices. The disinflationary exogenous factors also included large inflows of foreign capital and expectations of continuing capital inflow in the years ahead. The appreciation of the exchange rate caused by these factors (the forecast assumed a stable exchange rate) decreased adjusted inflation (fuels excluded) in particular, and partly also food price inflation. The producer price developments recorded by the Czech Republic's major trading partners also had unexpectedly disinflationary effects, whereas the subsequent changes to the settings of the CNB's monetary policy instruments (the forecast was based on the technical assumption that these would remain unchanged) conversely had a slightly pro-inflationary effect compared to the assumptions contained in forecast. The differences in the evolution of endogenous factors and their elasticities from the July forecast had only a small effect on the non-fulfilment of this forecast.

As regards international comparisons, annual consumer price inflation in the Czech Republic in 2002 Q4 remained well below the inflation level in the eurozone. The annual Harmonised Index of Consumer Prices in the eurozone stayed just above 2% (2.1% in November), whereas in the Czech Republic it continued to show near-zero outturns (0.2% in November). As stated in the October Inflation Report, this difference between the Czech Republic and the eurozone was, in addition to specific factors (such as less regulation of agricultural producer prices), due mainly to appreciation of the exchange rate.

CHART II.9
PRICES OF NONTRADABLES HAVE LONG BEEN RISING FASTER THAN PRICES OF TRADABLES
(percentages; December 1999 = 100)

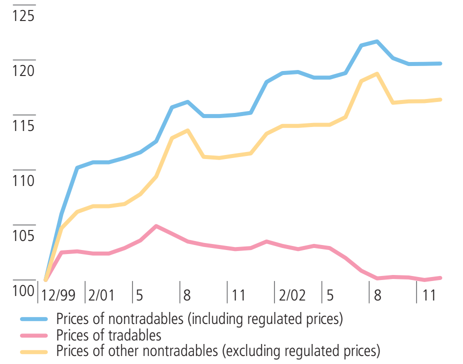
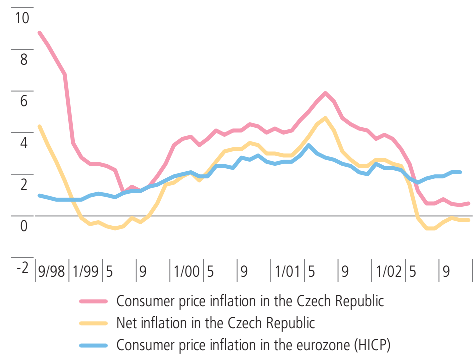


TABLE II.2
THE INFLATION OUTTURN WAS LOWER THAN FORECAST
(annual percentage changes; contributions in percentage points)

	JULY 2001 FORECAST	DECEMBER 2002 OUTTURN	DIFFERENCE
Annual consumer price inflation	4.20	0.60	-3.60
Breakdown into contributions:			
regulated prices	1.54	0.66	-0.88
indirect taxes	0.00	0.00	0.00
food prices	1.01	-0.93	-1.94
fuel prices	0.00	0.04	0.04
other consumer basket items	1.67	0.75	-0.92
rounding error	-0.02	0.08	0.10

CHART II.10
CONSUMER PRICE INFLATION WAS LOWER IN THE CZECH REPUBLIC THAN IN THE EUROZONE
(annual percentage changes)

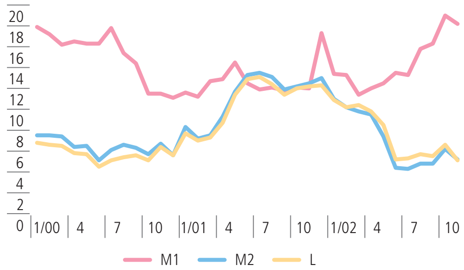


III. INFLATION FACTORS

III.1. MONETARY DEVELOPMENTS

III.1.1. Monetary aggregates

CHART III.1
ANNUAL GROWTH IN THE BROADER MONETARY AGGREGATES FLUCTUATED
(percentages)



Definition of monetary aggregates:
M1 = currency in circulation + CZK demand deposits
M2 = M1 + quasi money
L = M2 + T-bills + CNB bills in portfolios of domestic non-banks

Annual growth in the broader monetary aggregates fluctuated quite considerably in September–November 2002. By comparison with the previous three months, the average growth increased slightly. The inflow of money into the economy therefore rose modestly in this period, although not so much as to pose an inflationary risk.

The volatile annual growth in the broader monetary aggregates in September–November 2002 was fostered mainly by variations in net foreign assets and the volume of uncleared items between commercial banks and their clients. In October especially, these two factors bolstered the money supply growth. In contrast, in November they had a subduing effect, although this was partly offset by growth in net credit to the government due to the worsening performance of the state budget. Throughout the period September–November, lending (particularly in Czech korunas) counteracted the effect on the money supply of the fluctuations in net foreign assets and in uncleared items between commercial banks and their clients. However, it did not make a major contribution to the growth of the broader monetary aggregates in this period.

The long-running increase in annual M1 growth, fostered mainly by decreasing interest rates on time deposits, peaked in October 2002. Although annual M1 growth fell back slightly in November, it remained at a high level.

Monetary aggregate M2

TABLE III.1
THE ANNUALISED 6-MONTH M2 GROWTH SUGGESTS A DOWNWARD TENDENCY IN THE INFLOW OF MONEY INTO THE ECONOMY
(percentages)

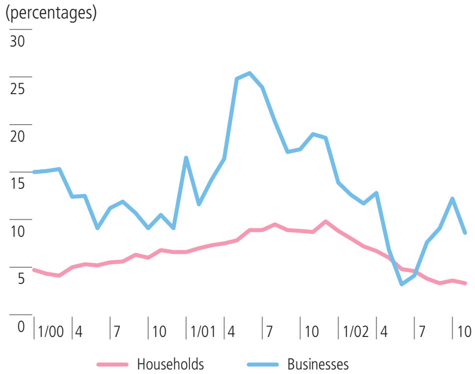
	1 MONTH	ANNUALISED FOR		1 YEAR
		3 MONTHS	6 MONTHS	
August	1.7	-0.3	4.5	4.8
September	0.4	9.6	3.5	4.8
October	1.4	14.8	3.7	6.2
November	0.0	7.0	3.3	5.2

Note: Seasonally adjusted according to deviations from the series smoothed by the centred moving average method (length 13)

The M2 instability in September–October 2002 was also reflected in the annualised annual M2 growth. It was particularly visible in the annualised three-month growth. The annualised six-month growth, which is showing a downward tendency, indicates rather more clearly the possibilities for further money supply growth.

Sector structure of M2

CHART III.2
THE FLUCTUATIONS IN THE INFLOW OF MONEY INTO THE ECONOMY RELATED PRIMARILY TO THE CORPORATE SECTOR
(percentages)



In September–November 2002, the volatile development of net foreign assets and uncleared items between commercial banks and the worsening state budget performance affected annual money supply growth primarily in the corporate sector. After rising in September and October, this growth fell back in the subsequent month in line with a fall in net foreign assets. Nevertheless, in September–November, the inflow of money into the corporate sector was higher overall than in the previous three months. Turning to the time structure of the money supply, the September–November period saw a continuation of the previous tendencies, determined mainly by the low level of interest rates. In line with these tendencies, the corporate sector recorded a rise in demand deposits in particular. Demand deposits accounted for 75% of the total money supply growth in businesses. The volume of corporate time deposits declined in this period.

In the case of businesses, the annual M2 growth in September–November 2002 fluctuated quite considerably, whereas in the household sector the fluctuations were only small. The average annual M2 growth fell by 1 percentage point relative to previous months. This fall marked the culmination of the decline in the annual M2 growth of households observed since the beginning of 2002. In September

2002, households recorded annual money supply growth of just 3.3%, i.e. one third of the December 2001 level and the lowest figure since the beginning of 1999. Following a slight rise in October 2002, the annual money supply growth of households fell back to 3.3%. The sluggish annual money supply growth recorded by households in September–November was accompanied by a decline in the money stock of households, due primarily to a reduction in the volume of time deposits. As in the corporate sector, demand deposits rose in the household sector, albeit at a substantially lower rate. Households' foreign currency deposits were flat in September–November.

Monetary aggregate M1

In October 2002, following seven months of uninterrupted growth, annual M1 growth reached 19.0%. This was the highest value since September 1994, when the buoyant annual M1 growth associated with the administrative process of splitting the currency in 1993 came to an end. Despite a slight decline in November (to 18.2%), annual M1 growth remained high. In contrast to 1993–1994, the current large increases in transactions money are due to the historically low level of interest rates, which is fostering growth both in demand deposits (which in November recorded an annual increase of 22.4%) and in currency in circulation (9.2%). Between August and November 2002, the share of currency in circulation in the money supply increased from 11.7% to 12.1%, one of the highest levels ever recorded. The annualised seasonally adjusted M1 growth suggests a probable downward tendency.

TABLE III.2
THE ANNUALISED M1 GROWTH SUGGESTS A DOWNWARD TENDENCY
(percentages)

	1 MONTH	ANNUALISED FOR 3 MONTHS	ANNUALISED FOR 6 MONTHS	1 YEAR
August	3.3	24.9	23.6	15.8
September	1.2	20.8	29.5	16.3
October	1.6	27.5	27.6	19.0
November	1.8	20.3	22.6	18.2

Note: Not seasonally adjusted because of the low significance of seasonal factors

Monetary aggregate L

Annual L growth in September–November 2002 showed similar fluctuations as M2. A decline in November caused the annual growth in these two aggregates to converge closely, following nine months of higher annual growth of L. This convergence is due to a long-running decline in the volume of T-bills held by non-banks, which are showing a preference for more liquid (mainly demand) deposits with banks. The annualised seasonally adjusted L growth for three and six months in November suggests continuing low growth going forward.

TABLE III.3
THE ANNUALISED SEASONALLY ADJUSTED L GROWTH SUGGESTS LOW GROWTH FOR THIS AGGREGATE IN THE FUTURE
(percentages)

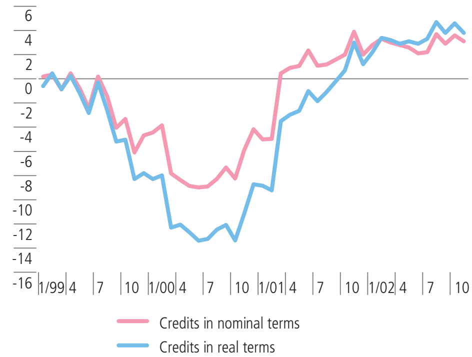
	1 MONTH	ANNUALISED FOR 3 MONTHS	ANNUALISED FOR 6 MONTHS	1 YEAR
August	1.7	-0.2	5.9	5.7
September	0.2	7.6	3.9	5.5
October	1.2	13.0	4.8	6.6
November	-0.4	3.9	1.8	5.1

Note: Seasonally adjusted according to deviations from the series smoothed by the centred moving average method (length 13)

III.1.2. Credits granted to businesses and households

The annual growth rate of lending adjusted for non-monetary effects remained at the 3.1% level in September–November 2002. The average annual increase in credits was 3.2% in nominal terms and 4.1% in real terms in the period under review. Nevertheless, the absolute volume of credits rose by CZK 12.4 billion, with koruna credits increasing by CZK 13.2 billion and foreign currency credits falling by CZK 0.8 billion.

CHART III.3
ANNUAL CREDIT GROWTH REMAINED AT THE LEVEL OF THE PREVIOUS PERIOD OF 2002
(percentages)



Credits granted to households continued to account for the biggest share of the rise in lending. Their growth helped to maintain household consumption at a relatively high level, although gross disposable income is the decisive factor as regards the financing of that consumption. The growth in credits granted to households continued to be fostered by low interest rates. In contrast, credits to non-financial corporations fell. This reflected their worsening financial situation; in 2002 Q1–Q3 they recorded slackening output and a decline in net operating profit. Non-financial corporations also used their own funds to finance their economic activities.

TABLE III.4
THE SEASONALLY ADJUSTED AND ANNUALISED 3-MONTH CREDIT GROWTH DECREASED
(percentages)

	1 MONTH	ANNUALISED FOR		1 YEAR
		3 MONTHS	6 MONTHS	
August	1.7	7.3	1.1	3.7
September	0.6	5.5	2.7	2.9
October	0.0	9.9	2.9	3.6
November	0.3	4.1	5.7	3.1

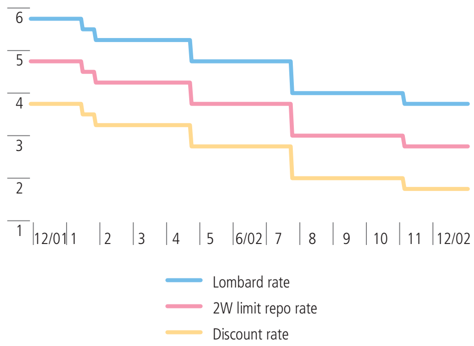
Note: Adjusted for exchange rate effects, write-offs, unlicensed banks, loan portfolio restructuring, the conversion of Konsolidační banka into the Czech Consolidation Agency (CCA) and the transfer of ČSOB's receivables to the CCA

Households' demand for consumer credit and mortgage loans remained strong in September–November 2002. Annual growth in credits granted to households stood at 26% in November. The absolute volume of these credits rose by CZK 11.2 billion in September–November, with mortgage loans rising by CZK 5.1 billion, consumer credit by CZK 4.6 billion and building savings loans by CZK 2.8 billion. Other loans decreased by CZK 1.3 billion. The share of mortgage loans in total household debt reached 30.3% in November 2002. For consumer credit the analogous figure was 34.7%, for building savings loans it was 25.9% and for other loans it was 9.1%.

The aforementioned developments in lending in September–November 2002 also affected the structure of credits by type. In the period under review, the share of operating credits continued declining (falling by 1 percentage point to 39.6%), while the share of investment credits remained flat at 29.4%. Rising shares were conversely recorded by mortgage loans (up by 0.6 percentage points to 9.4%), consumer credit (up by 0.6 percentage points to 6.8%) and building savings loans (up by 0.2 percentage points to 6.1%). Short-term and long-term credits increased in September–November.

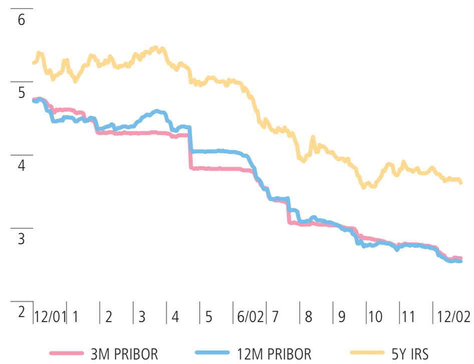
III.2. INTEREST RATES

CHART III.4
THE CNB LOWERED ITS KEY INTEREST RATES
(percentages)



Interest rates were affected in 2002 Q4 by a further reduction in the CNB's key rates. The CNB lowered all its key rates by 0.25 percentage points – the limit 2W repo rate to 2.75%, the Lombard rate to 3.75% and the discount rate to 1.75% – with effect from 1 November 2002. Money market participants had expected this change, so market interest rates declined before the changes had been announced. Interest rates with longer-term maturities were flat or moderately rising at the time, as they were being affected primarily by foreign factors. These included a rally on the stock markets, a reduction in key rates in the USA and speculation regarding a similar step in the eurozone (the ECB lowered its key rates on 6 December). In contrast, changes to the Standard & Poor's and Moody's ratings of the Czech Republic had virtually no effect. Thereafter, the downward trend continued in all segments of the financial market. The main factors acting downwards on interest rates were macroeconomic figures confirming the low-inflation environment of the domestic economy (including a favourable inflation outlook for the period ahead), slackening economic activity both in the Czech Republic and abroad, and the relatively strong exchange rate. At the end of December, interest rates fell to new historical lows in almost all segments of the financial market. Most market participants continued to expect the CNB to cut its key rates, especially if the ECB were to do likewise. In addition to the spot rates, this was indicated by the FRA rates.

CHART III.5
MARKET INTEREST RATES FOR THE MOST PART FELL
(percentages)

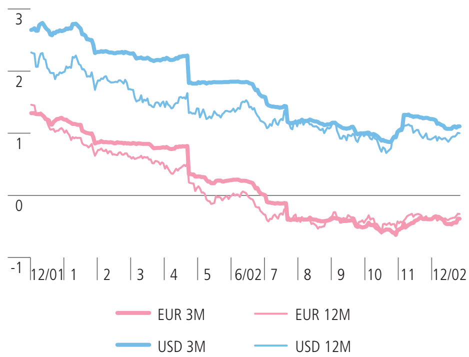


The fall in interest rates was accompanied by changes in the shapes and levels of the yield curves. During 2002 Q4, the PRIBOR yield curve gradually shifted to a lower level. Its slope was slightly negative to flat throughout the period. Compared to September, the average 1W PRIBOR fell by 0.25 percentage points to 2.76% and the 1Y PRIBOR by 0.35% to 2.60%. The spread between the two rates was -0.16 percentage points (compared to -0.06 percentage points in September).

The IRS yield curve also shifted to a lower yield level, although to a lesser extent than on the money market, particularly in its longer part. This meant that its positive slope increased slightly. The average 5Y-1Y spread was +1.07 percentage points and the 10Y-1Y spread was +1.84 percentage points. IRS interest rates generally fell by 0.1–0.3 percentage points depending on maturity.

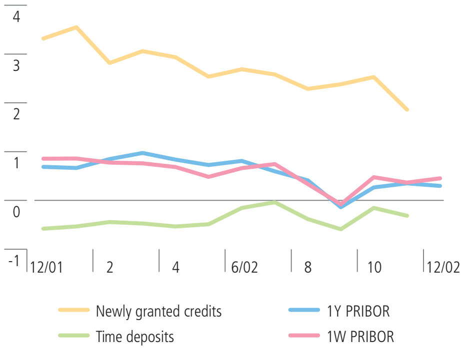
The interest rate differential (PRIBID/CZK-LIBOR/EUR,USD) was affected both by the changes in interest rates abroad and by the interest rate movements on the domestic interbank market. Key rates were changed in both major economies, so market rates did not remain flat either. The O/N rate in the USA was lowered by 0.50 percentage points to 1.25%. The repo rate in the eurozone was also reduced by 0.50 percentage points, to 2.75%. Interest rates on the domestic financial market declined fairly steadily, in contrast to those abroad. This affected the interest rate differential during the period under review. At all maturities, the differential vis-à-vis euro rates was negative (between -0.2 and -0.3 percentage points) at the end of 2002. The interest rate differential vis-à-vis dollar rates was 1.0–1.3 percentage points.

CHART III.6
THE INTEREST RATE DIFFERENTIAL WIDENED SOMEWHAT
(percentage points)



There were three auctions on the primary government bond market, with original maturities of 10Y, 5Y and 15Y and a total volume of CZK 22 billion. A maximum acceptable yield was not given, and demand was at least twice as high as supply in all the auctions. The average gross yields were 4.32%, 3.33% and 4.43%. Securities totalling CZK 4.5 billion were issued on the mortgage bond market. Issuing activity also continued on the primary koruna eurobond market, where the outstanding volume at the end of 2002 was CZK 103.2 billion.

CHART III.7
EX ANTE REAL INTEREST RATES SHOWED MIXED DEVELOPMENTS
(percentages)



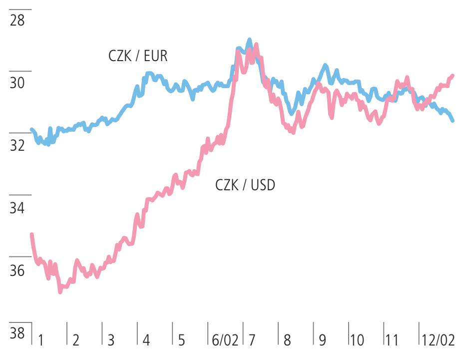
Client interest rates on credits and deposits also responded to the adjustments to key rates and to the changes in financial market rates. Client rates have been declining for over one year, reaching new historical lows almost every month. Interest rates on new credits stood at 4.2% in November, a decline of 1.7 percentage points since the start of the year. Time deposit rates stood at 2.1%. The interest rate margin between the overall credit and deposit rates remained almost unchanged in the last period, amounting to 4.1 percentage points in November.

In addition to the level of nominal rates, real interest rates[8] were affected by the way in which the price indices developed. The expected consumer price indices are higher and less stable than the expected industrial producer price indices, a fact that is reflected in the levels of the individual real rates. In November, real rates on newly granted credits were 1.9% and real rates on time deposits -0.3%.

III.2.1. The exchange rate

The koruna's exchange rate did not record any major fluctuations against the euro in 2002 Q4. In October and November it was stable, moving within the range of CZK 30.30–31.00 to the euro. In December, it started to depreciate slightly, reaching its weakest level since the August floods (CZK 31.60/EUR on 31 December). In the last three months of the year, the koruna depreciated against the euro by 3.5%. The koruna-dollar rate copied the dollar's depreciation against the euro and appreciated by 1.7% in quarter-on-quarter terms. In year-on-year comparison, the koruna's exchange rate was stronger against both the euro (by 4%) and the dollar (by 15.6%) in December.

CHART III.8
THE KORUNA WEAKENED SOMEWHAT IN Q4



The excessive appreciation of the koruna observed since 2001 H2 was halted in 2002 Q3 by the CNB's monetary-policy efforts (foreign exchange interventions and the lowering of interest rates). In Q4, the koruna was affected by factors which together resulted in a stable exchange rate, with a slight depreciation tendency at the close of 2002. The news of a successful referendum in Ireland (on 19 October), the

8 Ex ante real interest rates: nominal interest rates on credits are deflated by the industrial producer price indices expected by the CNB each month; nominal interest rates on deposits and PRIBOR rates are deflated by the consumer price indices expected by financial market participants each month.

CHART III.9
THE EFFECTIVE EXCHANGE RATES WEAKENED IN Q4
(Year 2000 = 100)

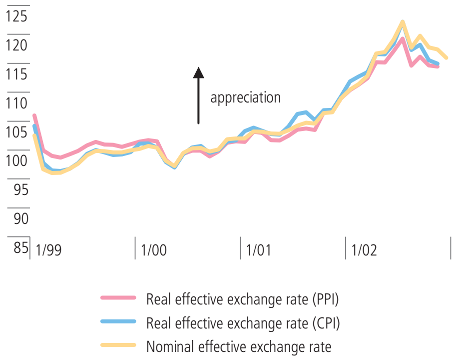
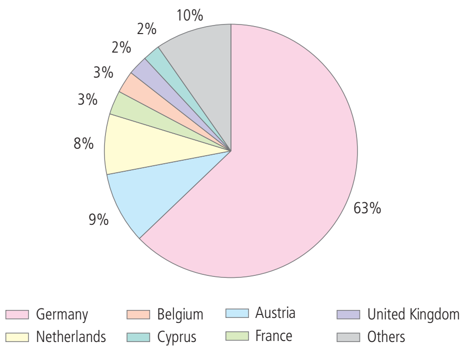


TABLE III.5
THE FINANCIAL ACCOUNT SURPLUS INCREASED
(in CZK billions; for Q1 - Q3)

	1999	2000	2001	2002
Financial account	46.3	82.3	86.6	308.8
Direct investment	151.7	143.5	118.8	231.3
- Czech abroad	-2.9	-1.0	-3.5	-4.4
- Foreign in Czech Republic	154.6	144.5	122.3	235.7
Portfolio investment	9.1	-44.2	19.0	17.0
- Czech abroad	-19.1	-52.9	-5.5	-23.7
- Foreign in Czech Republic	28.2	8.7	24.5	40.7
Financial derivates	0.0	-1.5	-0.9	-3.6
Other investment	-114.5	-15.5	-50.3	64.1
1. Long-term investment	-6.7	13.4	-3.1	19.5
- Credits granted abroad	-6.7	24.1	2.8	24.2
- Credits accepted from abroad	0.0	-10.7	-5.9	-4.7
2. Short-term investment	-107.8	-28.9	-47.2	44.6

CHART III.10
GERMANY DOMINATED THE INFLOW OF FOREIGN DIRECT INVESTMENT INTO THE CZECH REPUBLIC
(for 2002 Q1 - Q3)



upgraded Moody's rating (12 November) and the completed accession negotiations in Copenhagen (13 December) all fostered appreciation of the koruna's exchange rate. Conversely, the depreciation factors included the downgrading by Standard & Poor's (5 November), the postponement of the Telecom privatisation (3 December), statistical information signalling a widening of the trade deficit in October and November (these figures were revised in January 2003), and uncertainties over the extent and timing of the reform of public finances. Another factor ensuring a generally even exchange rate was the CNB's continuing resolve not to allow a further appreciation of the koruna. This was supported by falling interest rates and a different interest rate level in neighbouring Central and Eastern European countries.

The nominal effective exchange rate index[9] declined by 1.5% in December relative to October, but it was 6.4% higher than a year earlier. The real effective exchange rate indices copied the nominal effective rate.

III.2.2. Capital flows

The financial account ended 2002 Q1–Q3 in a surplus of CZK 308.8 billion (18.5% of GDP), the highest figure ever recorded. The record surplus was chiefly due to the sale of a considerable volume of property to non-residents by the state (around CZK 125 billion) and by the private sector (around CZK 50 billion) and to a decline in holdings of short-term assets abroad by the banking sector (around 100 billion). The inflow of capital was also attributable to inflow of capacity-creating foreign direct investment (around CZK 30 billion), the reinvested earnings of companies owned by non-residents (also around CZK 30 billion), purchases of domestic debt securities by non-residents (around CZK 50 billion) and the de-blocking of foreign assets by the government (around CZK 20 billion). In contrast, the financial account surplus was decreased by purchases of foreign, predominantly debt securities by residents (over CZK 20 billion), repayments of short-term liabilities abroad by the banking sector (almost CZK 30 billion) and a decline in the short-term liabilities of businesses (around CZK 10 billion). The inflow of capital was more than three times higher than in the same period a year earlier, but one-off and non-recurring capital flows are dominant in its structure.

The net inflow of direct investment in 2002 Q1–Q3 was the highest ever – CZK 231.3 billion, almost double the level in the same period a year earlier. The FDI inflow totalled CZK 235.7 billion, of which CZK 48.9 billion was in Q3. The relatively large FDI inflow in Q3 was mainly due to a sizeable volume of sales of low-value property (worth less than CZK 1 billion) registered by the Securities Centre (around CZK 27 billion). Reinvested earnings and inflow of capital into capacity-creating investment (each of around CZK 10 billion) remained approximately at the level of the previous two quarters. Turning to the territorial structure of the FDI, the biggest investors in 2002 were Germany and Austria. The outflow of FDI totalled CZK 4.3 billion in 2002 Q1–Q3. Although the outflow is showing a slight upward trend, it remains insignificant with regard to the overall capital flows.

In the area of portfolio investment, a net capital inflow of CZK 17.0 billion was recorded in the period under review. This constitutes a modest annual decline. The decisive factor as regards the capital inflow in this area was non-residents' interest in purchasing domestic debt securities, in particular government bonds. The value of domestic bonds held by non-residents rose by CZK 50.5 billion. Non-residents' domestic share holdings on the contrary fell slightly, by CZK 9.8 billion. However, Q3

9 Weighted by shares in foreign trade, including that of Russia.

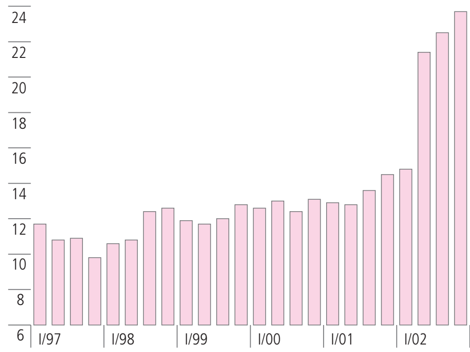
saw an upturn, albeit a small one, in purchases of domestic shares by non-residents (CZK 2.6 billion). Residents' interest in foreign securities recorded a year-on-year increase. The value of foreign securities held by residents rose by CZK 23.7 billion, with interest concentrated mainly on bonds.

Financial derivatives transactions led to an overall outflow of capital of CZK 3.6 billion during the course of 2002 Q1–Q3.

Other investment showed a net capital inflow of CZK 64 billion in the same period. The most important factor underlying the inflow was a reduction of CZK 71.1 billion in the international net creditor position of the banking sector, and in particular the aforementioned decline in the short-term assets of commercial banks (CZK 101.7 billion). The inflow of capital was to a lesser extent also attributable to the government sector (CZK 17.7 billion), and in particular to the de-blocking of Russian debt. The corporate sector showed a modest outflow of capital, of CZK 10.8 billion. However, this decline in liabilities was due to an operation associated with the aforementioned de-blocking of Russian debt. Adjusted for this effect, the corporate sector's debt vis-à-vis non-residents increased modestly in 2002 Q1–Q3, by around CZK 10 billion. In Q3, a sizeable rise in the inflow of other investment capital (CZK 42.6 billion) was recorded. The volume of the inflow was approximately double that in H1. This accelerated inflow was again chiefly attributable to a fall of CZK 40.9 billion in the short-term assets of commercial banks. However, this decline was in large part (around 70%) of a technical nature, caused by CNB interventions on the foreign exchange market to halt the appreciation of the koruna, which was not justified by fundamental factors.

The CNB's international reserves were not affected by foreign exchange operations in Q4. Unlike in the previous quarter, the change in the reserves was due solely to valuation changes and interest income. In dollar terms, the reserves rose by USD 1.2 billion to USD 23.7 billion. In koruna terms, they increased by CZK 24.9 billion in Q4, to CZK 714.8 billion. The key factor was the strengthening of the euro against both the US dollar and the Czech koruna. Relative to the beginning of the year, the reserves were up by USD 9.2 billion, or CZK 209.7 billion.

CHART III.11
THE INTERNATIONAL RESERVES ROSE IN 2002 Q4 THANKS MAINLY TO VALUATION CHANGES
(USD billions)



Box: The financial conditions of the Czech Republic's accession to the EU

The Copenhagen summit in December 2002 completed the accession negotiations between the European Union and the candidate countries and defined the basic financial conditions for the three years following entry into the EU. The payments structure was changed compared to previous proposals. "Entitlements", i.e. the income (primarily compensation) that the Czech Republic will receive without having to fulfil any particular conditions, acquired greater significance, to the detriment of income from EU funds tied, for example, to the submission of particular projects and the securing of a specific form of co-financing.

Income from European Union funds should increase markedly following accession compared to the current situation, where candidates can only draw on pre-accession funds (Phare, Ispa and Sapard). The objective of these funds is not only to provide direct assistance to candidate countries, but also to prepare the ground for successful project financing following accession. The drawing on pre-accession aid will peak in 2003 and 2004, as the project financing is usually spread over several years. At the same time, however, funds will start coming in from the structural funds (ERDF, ESF, EAGGF and FIFG) and from the cohesion fund under regimes identical to those in the Member States. These funds are to replace the pre-accession aid. In 2003–2006, around EUR 950 million is expected to be drawn from structural actions and EUR 432 million from the pre-accession aid funds.

Whereas financing from funds is conditional on having a sufficient quantity of projects, agricultural policy (excluding rural development) forms part of the entitlements. Aid for farmers has been spread over ten years, the minimum level having been set at 25% of the average of the European subsidies. The Czech Republic has negotiated itself the option of co-financing by the state, as well as a partial transfer of its funds for rural development, so that the amount of support in the first year of membership will be 55% of the EU average. In total, EUR 975 million will be earmarked for agriculture in the three years following accession. The entitlements also include compensation, which in the form of revenue to the state budget is intended to improve the Czech Republic's budget position vis-à-vis the EU. In addition, during the negotiations a transfer of EUR 100 million from the commitment appropriation to compensation in 2005–2006 (i.e. EUR 50 million per year) was successfully negotiated. A total of EUR 747 million in compensation has therefore been obtained for 2004–2006.

On the other hand, the Czech Republic will be obliged to make payments to the budget according to a key which is the same for all EU members. The contributions will be covered from traditional own sources (customs duties and agricultural fees), from VAT payments and according to gross national product. One special contribution is a payment for the United Kingdom, which constitutes a rebate for its higher payments into the budget at the start of the 1990s. Overall, EUR 2.5 billion will be paid into the EU budget over the first three years following accession. The original Czech request for a reduction in its payments in the first year in order to mitigate the post-accession shock was unsuccessful, but thanks to the budget compensation the Czech Republic's net position will be EUR 778 million, which is substantially more than under the original proposals prior to the Copenhagen summit. However, the increase in the volume of official financial flows from the EU into the Czech Republic will not have significant macroeconomic effects in the first years following accession, since the inflow will remain relatively low. Project implementation, however, will be conditional on the availability of co-financing from the state or public budgets, which will, of course, affect the fiscal stance of the Czech Republic.

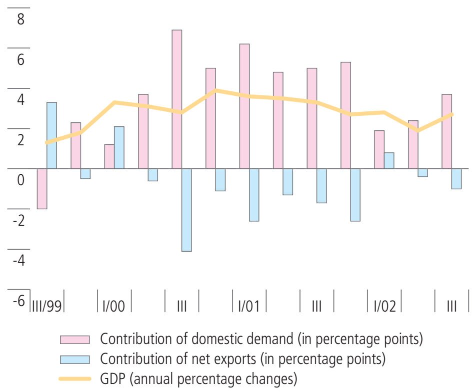
The financial flows associated with the Czech Republic's accession to the EU must also include payments associated with membership of international organisations such as the European Investment Bank (EIB). At the Copenhagen summit, the conditions were laid down under which the Czech Republic, following accession, will subscribe to the capital of the EIB in an amount of around EUR 1.2 billion, of which EUR 60.6 million is payable by 2009. Furthermore, the EIB's reserves need to be increased by roughly EUR 158 million by 2009. The Czech Republic must pay a total of EUR 218.6 million (around CZK 6.5 billion).

ESTIMATED NET POSITION OF THE CZECH REPUBLIC (1999 prices; EUR millions)				
PAYMENTS FROM EU BUDGET	2004	2005	2006	TOTAL
Pre-accession aid	181	153	98	432
Agriculture	100	392	483	975
Structural actions	169	355	427	950
Internal actions	44	76	102	222
Additional expenditure	7	9	9	25
Total compensation	300	270	177	747
Total allocated expenditure	**801**	**1 255**	**1 294**	**3 351**
PAYMENTS TO EU BUDGET				
Trad. own resources	-66	-105	-105	-276
VAT resource	-74	-116	-119	-309
GNP resource	-426	-653	-670	-1 750
UK rebate	-56	-88	-93	-238
Total own resources	-623	-963	-988	-2 573
Estimated net position	**178**	**293**	**307**	**778**

III.3. DEMAND AND OUTPUT

The evaluation of GDP growth in this part of the Inflation Report is based on new revised CSO figures published in January 2003 after the quarterly national accounts estimate for 2002 Q3 was released in December 2002. As part of the January revision, the CSO made an extensive change (of about CZK 40 billion) to exports of goods and consequently also revised the estimates of most demand-side components and of overall GDP. For this reason, the CSO figures allow us to assess GDP developments for the time being only from the point of view of the individual components of domestic demand (at an aggregated level) and net foreign demand. The revised figures on gross value added within individual industries have yet to be published.

CHART III.12
ECONOMIC GROWTH PICKED UP IN 2002 Q3



According to the preliminary CSO estimate, economic growth picked up slightly in 2002 Q3. Annual real GDP growth was 2.7%, which is 0.8 percentage points higher than in Q2 but below the previous year's level. In addition to external factors, the economic growth in Q3 was depressed by the August floods. This extraordinary factor affected GDP not only through its direct impacts on production, but also through its subsequent effects on incoming travel (a substantial drop in the number of foreign tourists) and probably also on value added in the insurance industry. The unfavourable external factors were again linked with the economic situation of the Czech Republic's major trading partners, which were still waiting for a more significant economic recovery. In addition, the continuing strong appreciation of the koruna again fostered growth in imports in 2002 Q3 and led to lower sales opportunities for exporters.

The developments in external demand from the point of view of domestic producers are most clearly documented by the figures on economic growth in the eurozone and the EU-15, to which the largest volumes of Czech exports are channelled.[10] According to the latest estimates for 2002 Q3, GDP in these regions rose by 0.3% and 0.4% respectively on the previous quarter, the same as in Q2. In year-on-year comparison, economic growth in the eurozone and EU-15 saw a very modest acceleration, to 0.8% and 0.9% respectively. With regard to structure, the growth increased in all the components of domestic and external demand except investment, which continued falling in annual terms. Particularly visible was a recovery in foreign trade, implying renewed growth in both imports and exports. The import growth rate, however, did not suggest any possibility of a pronounced improvement in the export conditions for Czech companies.

TABLE III.6
THE ECONOMIC SITUATION OF THE CZECH REPUBLIC'S MAJOR TRADING PARTNERS IS CREATING NO ROOM FOR FASTER CZECH EXPORT GROWTH
(annual percentage changes; 2002 Q3, seasonally adjusted)

	EUROZONE	EU-15
Gross domestic product	0.8	0.9
Final consumption expenditure of households and non-profit institutions	0.6	1.2
Government final consumption expenditure	2.4	2.5
Gross fixed capital formation	-3.0	-3.3
Domestic demand	0.3	0.7
Exports of goods and services	2.5	2.1
Imports of goods and services	1.2	1.4

Source: Eurostat

10 In 2003 Q3, the EU accounted for 67% of Czech exports.

CHART III.13
THE GROWTH IN DOMESTIC DEMAND WAS CHIEFLY ATTRIBUTABLE TO HOUSEHOLD CONSUMPTION
(annual percentage changes)

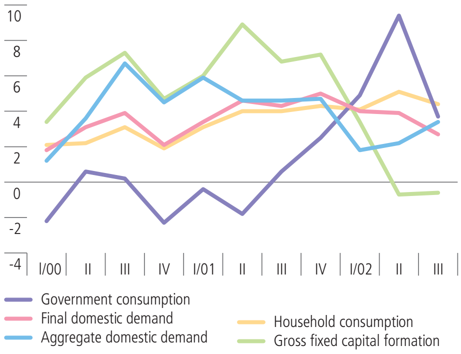


CHART III.14
INVESTMENT FELL IN YEAR-ON-YEAR TERMS, BUT THE RATE OF INVESTMENT CONTINUED TO FLUCTUATE AROUND 30%

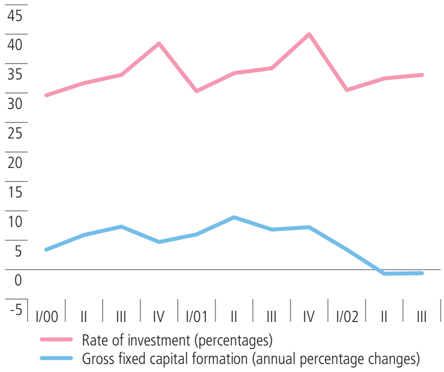
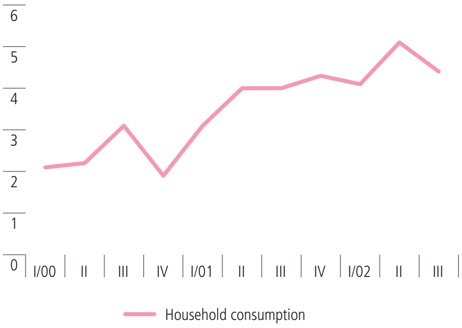


CHART III.15
HOUSEHOLD CONSUMPTION ROSE FOR THE 15TH CONSECUTIVE QUARTER
(annual percentage changes)



Overall, the GDP growth in 2002 Q3 was again attributable to increasing domestic demand, and in particular to private consumption. The contribution of the external sector to economic growth remained negative, and even more so than in Q2.

III.3.1. Domestic demand

Annual growth in aggregate domestic demand picked up in Q3 compared with Q2, to 3.4%, largely thanks to household consumption, which accounts for about 50% of aggregate domestic demand. The growth was also attributable to increasing government spending on final consumption and stockbuilding. Only gross fixed capital formation fell short of the level of the same period a year earlier (for the second consecutive quarter), hence its contribution to aggregate domestic demand growth was negative.

Investment demand

According to the revised CSO figures, gross fixed capital formation in the first three quarters of 2002 suggested a more marked moderation in investment activity compared to a year earlier (see Chart III.14). In Q3 alone, investment demand was down by 0.6%.[11] Amid GDP growth of 2.7%, the rate of investment[12] continued to move at a relatively high level of around 30%, but was slightly lower (by 1.1 percentage points) than a year earlier.

Investment demand in Q3 was, as in Q2, affected by a number of counteracting factors. These included in particular the lagged downward effect of the persisting weak external demand and economic growth in advanced market economies, which adversely affected the financial position and sales expectations of businesses. On the other hand, the continuing inflow of foreign capital in the form of foreign direct investment acted as an impulse for investment growth in some segments of the economy. The favourable conditions for mortgage lending, fostering growth in investment demand in the household sector, were another favourable factor.

Consumer demand

According to CSO figures, households' consumer spending rose for the fifteenth consecutive quarter in 2002 Q3. The buoyant annual growth, which has been moving around 4% since 2001 Q2, continued into 2002 Q3, when the final consumption expenditure of households rose by 4.4%. The constantly growing consumer spending of households was a major source of GDP growth in Q3. The real consumer spending of households is determined not only by the growth rate of their nominal disposable income (income net of taxes), but also by inflation and, last but not least, by the overall perception of present and future economic developments, which feeds back into households' propensity to consume or to save. According to a survey conducted in the household sector by Ecoma Plus, the consumption climate in the period under review was the best in five years. This finding was also supported by the continuing interest of households in borrowing to finance their consumer spending. The persisting increase in the household propensity to consume was probably also stimulated in Q3 by the extraordinarily favourable inflation, allowing households to make advantageous purchases.

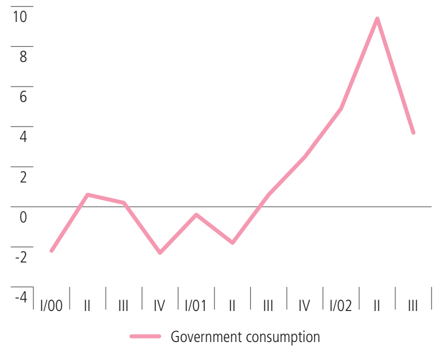
11 This change was chiefly due to methodological adjustments, which involved a change in the statements on investment in military destructive technology. This investment was excluded from gross fixed capital formation and included in government consumption. Had this methodological change been made in the comparable period of 2001, gross fixed capital formation would have been up by 4.6% in 2002 Q3.

12 i.e. the share of gross fixed investment in GDP.

Government demand

The buoyant annual growth (of 9.4%) in final consumption expenditure by the government at constant prices in 2002 Q2 was replaced by a pronounced slowdown in Q3, to 3.7%. This was largely due to lower drawing on some key expenditure items, in particular non-investment purchases and related expenditure. For this item, funds were drawn at only 59.4% of the budgeted amount in the first three quarters of 2002. Lower drawing on funds was also registered in transfers to local budgets (68.4% of the budgeted amount), subsidies to subsidised organisations (69.8%) and non-investment loans to businesses (29.4%). The expenditure in the first three quarters of 2002 also included a purchase of aircraft for the Czech armed forces (CZK 6.4 billion), which was, in line with the new CSO methodology, included in non-investment expenditure.

CHART III.16
GROWTH IN GOVERNMENT FINAL CONSUMPTION EXPENDITURE SLOWED SHARPLY IN 2002 Q3
(annual percentage changes)



III.3.2. Net external demand

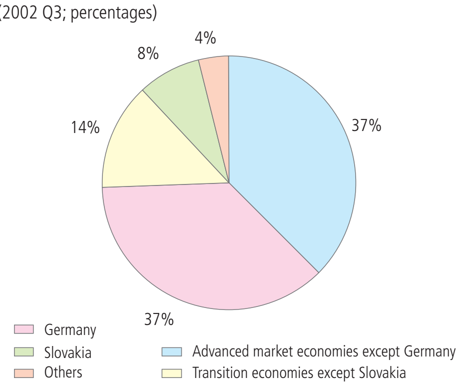
The contribution of net exports to economic growth was negative, and more so than in the previous quarter. The export growth rate was adversely affected by the persisting and exceedingly long-running weak external demand from the Czech Republic's major trading partners (Germany in particular) and the strong annual appreciation of the koruna's exchange rate. Exports and imports of goods and services in 2002 Q3 were also unfavourably affected by the direct and indirect impacts of the August floods. Despite these negative influences, real exports increased in Q3 (by 2.8% year-on-year), albeit more slowly than in Q2 (see Chart III.17).

CHART III.17
THE RELATIONSHIP BETWEEN EXPORT GROWTH AND IMPORT GROWTH DETERIORATED SOMEWHAT IN 2002 Q3
(annual percentage changes; constant prices)

The influence of the koruna's appreciation on exports is illustrated by the figures on the export structure at current prices. Whereas exports[13] to advanced market economies showed insignificant annual growth (of 0.4%), exports to transition economies fell by 6.1%. The decrease in exports to Germany (2%) was slower than the fall in exports to Slovakia (6.1%). As to the commodity structure, a positive upward trend was still visible in the share of higher-value-added products in total exports, despite the weakening exports of goods. This is evidenced in particular by a growing share of exports of mechanical and electrical engineering commodities in total exports and a falling share of exports of food, raw materials and semi-manufactures.

The floods also affected exports of services. Receipts from travel fell significantly, causing the services balance to worsen by CZK 12.3 billion and to shift from surplus to deficit (at constant prices).

CHART III.18
EXPORTS TO ADVANCED MARKET ECONOMIES CONTINUED TO DOMINATE
(2002 Q3; percentages)



Import growth also eased in 2002 Q3 (to 3.6%), although to a lesser extent than export growth. The lead of export growth over import growth thus increased slightly, to 0.8 percentage points. Like exports, imports at current prices also felt the downward effects of the koruna's appreciation. The main reasons for the modest worsening of the relationship between export growth and import growth on the import side were additional imports of goods after the floods (in particular the replacement of damaged stocks), the change in the structure of aggregate domestic demand and also the koruna's appreciation. The changes in the commodity structure of imports (at current prices) show that the above factors mainly affected imports for final consumption, which were up by 2.4% in 2002 Q3. Imports for investment fell for the third consecutive quarter in annual comparison. The major component of imports – imports for intermediate consumption[14] – also failed to reach the level

13 The figures on the territorial and commodity structure of exports and imports given below are at current prices and are the revised figures from January 2003.
14 These account for about 60% of total imports.

CHART III.19
THE SHARE OF NEGATIVE NET EXPORTS IN GDP DETERIORATED IN 2002 Q3
(percentages)

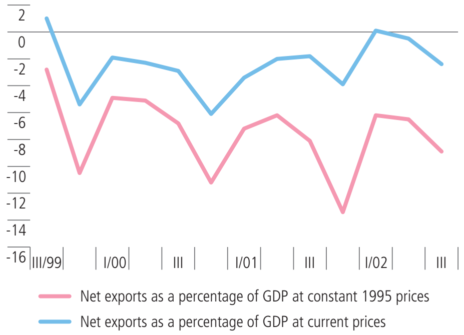
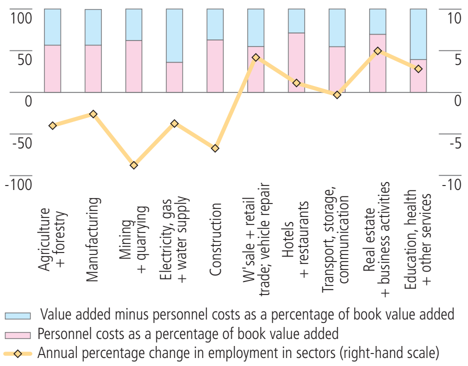


TABLE III.7
PROFITS INCREASED OVERALL IN 2002 Q1 - Q3, BUT STEADILY DETERIORATED
(annual percentage changes; CSO figures)

	2002 Q1 - Q3	
	BUSINESSES, TOTAL[1)]	OF WHICH: MANUFACTURING
Income, total	1.7	2.4
of which: extraordinary income	2.3	13.9
Output, total	1.4	0.4
Expenses, total	1.1	2.7
of which: cost of sales	1.9	2.1
personnel costs[2)]	5.9	4.5
depreciation	5.8	2.2
Book value added	0.5	-4.6
Equity capital	3.7	3.8
Net operating surplus	-13.7	-24.0
Profit before tax	15.1	-4.5

1) For non-financial institutions and corporations with 100 employees or more, all industries
2) Comprises wage and other personnel costs, remunerations to members of companies and co-operatives, social security costs and social costs

CHART III.20
IN NUMEROUS SECTORS, BUSINESSES RESPONDED TO UNFAVOURABLE PROFITS BY REDUCING EMPLOYMENT
(percentage; CSO figures)



of the same period a year earlier. Overall, the share of imports in GDP increased in year-on-year terms (primarily because of the changes in the structure of aggregate domestic demand).

The quicker growth of real imports than exports was the result of a marked year-on-year worsening on the services balance. The trade balance meanwhile improved. Net exports were down by CZK 3.7 billion to CZK -34.9 billion. As in 2002 Q2, this meant a negative contribution to GDP growth (of about 1 percentage point). The share of negative net exports in GDP was up by 0.7 percentage points on a year earlier, to -8.9%.

III.3.3. Financial performance of non-financial organisations and corporations[15]

During 2002, the aggregate financial results showed lower growth rates than a year earlier. This was particularly the case for the volume indicators – output, cost of sales, value added and total expenses, where growth rates were very low in the first three quarters of 2002. This was mostly due to the continuing weak external demand, which, together with the koruna's appreciation, affected both the output and expenses of corporations and subsequently also their profits. Compared to the previous year, pre-tax profits gradually decreased: from 29.2% annual growth in Q1 to a 19.2% decrease in Q3. In Q3 alone, the fall in the growth rate of gross profit (of CZK 5.8 billion from a year earlier) was attributable to most manufacturing industries and to the electricity and water supply sector. Of particular significance was a considerable year-on-year decrease (of 13.7%, i.e. almost CZK 22 billion) in the net operating surplus[16] for the first three quarters of 2002.

The gradually falling profitability was largely the result of the aforementioned output developments; the rise in expenses was moderate compared with 2001 (up by 3.2% in Q1, down by 0.3% in Q2 and very modest growth of 0.5% in Q3). Despite the fact that corporations reduced their workforces under these conditions, their personnel cost-output ratios increased. This testified to a lagged reaction by corporations to the changing conditions on the demand side. The corporations' efforts to tackle the problem of worsening profitability are confirmed by decreasing employment in numerous industries, as shown in Chart III.20.

15 Assessment based on the figures for non-financial organisations and corporations with 100 employees or more, all industries.
16 Net operating surplus = value added - write-offs and personnel costs.

The unfavourable effects of the weak external demand, combined with the persisting relatively strong appreciation of the koruna, were indicated in particular by the financial performance of manufacturing corporations, which account for a substantial share of exports. Compared to the same period of 2001, the first three quarters of 2002 saw decreases in profit, net operating surplus and value added and consequently a deterioration in all the efficiency indicators. However, a marked increase was registered for extraordinary income, probably thanks to insurance payouts for flood damage.

TABLE III.8
THE RATIOS IN MANUFACTURING DETERIORATED
(percentages and percentage points)

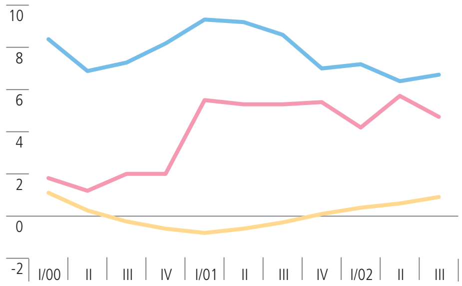
	2001 Q1 - Q3		2002 Q1 - Q3		Percentage point changes	
	Businesses total[1)]	Of which: manuf.	Businesses total[1)]	Of which: manuf.	Businesses total[1)]	Of which: manuf.
Profit-expenses ratio	4.58	5.09	5.21	4.74	0.63	-0.35
Profit-equity ratio	7.20	12.02	7.99	11.07	0.79	-0.95
Profit-output ratio	6.27	5.67	7.12	5.39	0.85	-0.28
Material costs-output ratio	69.26	74.33	69.55	75.61	0.29	1.28
Personnel costs-output ratio	15.44	12.78	16.11	13.30	0.67	0.52
Ratio of personnel costs to value added	50.23	49.79	52.91	54.52	2.68	4.73

1) For non-financial institutions and corporations with 100 employees or more, all industries

III.4 THE LABOUR MARKET

In 2002 Q3 and Q4, the main labour market indicators confirmed, as in the previous two quarters of 2002, a continuing gradual widening of the gap between the demand for, and supply of, labour. This trend was evidenced in particular by the unemployment figures – a falling number of vacancies and an increasing unemployment rate after seasonal adjustment. These trends passed through into short-term unemployment, which increased during the course of 2002.[17] The rise in unemployment strengthened the employers' hand in wage bargaining, leading to an overall drop in average nominal wage growth in the business sector. However, given the more substantial fall in inflation, average real wage growth accelerated. Annual average nominal wage growth in the non-business sector was much higher than in the business sector in Q2 and Q3, owing to a change in wage scales. Nominal unit wage costs rose fairly briskly in year-on-year terms in the first three quarters of 2002, although the growth was slower than a year earlier. The personnel cost-output ratios in different industries showed mixed developments.

CHART III.21
THE SITUATION ON THE LABOUR MARKET STEADILY DETERIORATED DURING 2002
(annual percentage changes and percentage point changes)

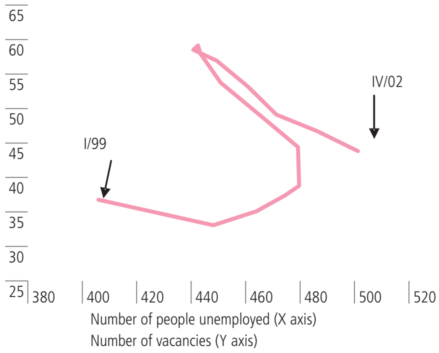


III.4.1. Employment and unemployment

According to Labour Force Survey (LFS) figures, the number of people employed in the national economy was 1.4% higher in 2002 Q3 than in the same period of 2001 (an increase of 64,800 persons in absolute terms). This increase, however, was largely attributable to a considerable rise in employment in the entrepreneurs category (of 8.5% year-on-year). By contrast, the growth in the number of employees (including members of production co-operatives), which better corresponds with registered unemployment, was insignificant in Q3 (0.1%). This suggests that many people responded to the low supply of vacancies by becoming self-employed.

The quarterly CSO business survey[18] generated similar results on employment in the employees category. According to these statistics, the number of employees decreased by 1.6% (preliminary figures) from a year earlier in 2002 Q3, falling in both the business sector (by 1.9%) and – unlike in Q2 – the non-business sector (by 0.3%). Broken down by sector, employment fell in most of the monitored industries. As in Q2, the biggest decrease (of 8.3% from a year earlier) was in mining and quarrying, which is experiencing a long-term fall in output. A fairly large drop in employment (of 5.8%) was also registered in construction. Manufacturing, which accounts for about 40% of total employment in the business sector, also saw a further decrease in employment (of 2.5%). An annual fall in employment was also recorded in a number of service industries (most notably financial intermediation and insurance). According to the LFS, the employment developments in 2002 Q3 were also mixed with respect to region.

CHART III.22
THE DECLINE IN VACANCIES CAUSED AN INCREASE IN UNEMPLOYMENT
(seasonally adjusted figures in thousands)



17 MLSA figures
18 Businesses with less than 20 employees in the business sector are not included. In insurance and financial intermediation, all employees are included.

CHART III.23
THE UNEMPLOYMENT RATE WAS HIGHER THAN A YEAR EARLIER
(percentages; MLSA figures)

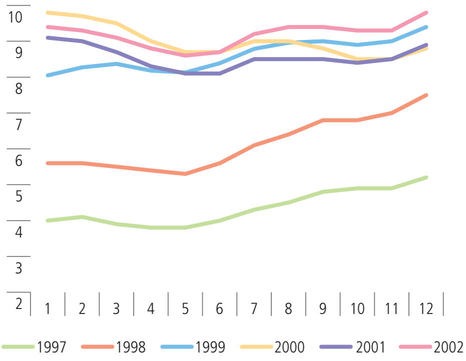


CHART III.24
THE NUMBER OF SHORT-TERM UNEMPLOYED INCREASED IN 2002 Q3 AND Q4
(quarter-on-quarter percentage changes)

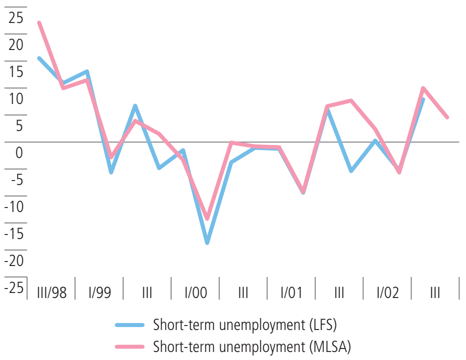
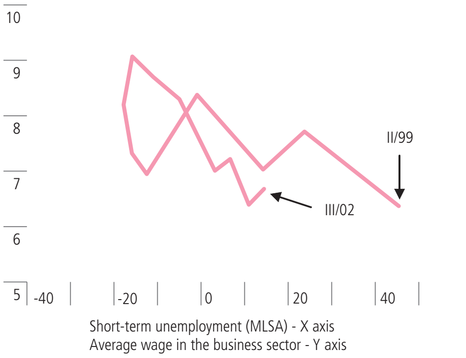


CHART III.25
THE LOWER WAGE GROWTH IN THE BUSINESS SECTOR CORRESPONDED TO THE SHORT-TERM UNEMPLOYMENT TREND
(annual percentage changes)



The overall and, in particular, structural changes in employment indicated a persisting gap between the demand for, and supply of, labour. As in the previous quarters of 2002, the primary factor underlying this situation on the labour market was weak external demand, reflecting very modest economic growth in Western European countries, uncertainties associated with recovery and continuing appreciation of the koruna's exchange rate. Moreover, employment growth was still being affected by the ongoing restructuring of the economy and rationalisation of manufacturing activities.

The decreasing demand for labour led to a fall in the number of vacancies. The supply of vacancies was below the levels of the same period of the previous year. According to the latest information for November and December, the supply of vacancies was around 11,000–13,000 lower than a year earlier, whereas in January 2002 it had been just 1,800 lower. The relationship between the number of job seekers and the number of vacancies also worsened. In December 2002, there were approximately 12.7 job applicants per vacancy. A year earlier the figure had been 3.8 applicants lower.

The decreasing supply of vacancies implied an unfavourable unemployment trend. According to MLSA figures, the number of unemployed people was more than 52,000 higher at the end of December 2002 than a year earlier. The seasonally adjusted unemployment rate showed a similar trend. The unemployment rate was 9.8% at the end of December, up by 0.9 percentage points on the same period of 2001. In December, the unemployment rate was 12% or more in 21 districts, most of them in northern Bohemia and northern Moravia. The large regional differences in unemployment were caused by structural problems related to low mobility of the labour force.

The increasing number of unemployed people manifested itself in growing short-term unemployment. According to MLSA[19] figures, the short-term unemployment rate (up to one year) rose by 0.3 percentage points to 6.2% in 2002 Q4. A previous increase in short-term unemployment in the second half of 2001 probably contributed to the higher long-term unemployment rate in 2002 Q3 and Q4.

III.4.2. Wages and productivity

In 2002 Q3, average nominal wage growth in monitored organisations was flat at the Q2 level (7.4% year-on-year). As in the previous two quarters, the average nominal wage rose more slowly than in the previous year. Compared to the whole of 2001, the average nominal wage growth in the first three quarters of 2002 was around 1 percentage point lower.

There were continuing sizeable differences in average wage growth between the business and non-business sectors, resulting mainly from high growth in the average wage in the non-business sector. The annual growth in average nominal wages in this sector – exceeding 11% in Q2 and Q3 – was due to a government-agreed increase in wage scales (in education, for example). In the business sector, annual average nominal wage growth showed a moderate pick-up in Q3 (of 0.3 percentage points compared to Q2, to 6.7%). This pick-up, however, did not interrupt the existing downward trend in average nominal wage growth in this sector, which was in line with the unemployment trend. The increased number of short-term unemployed people strengthened the employers' hand in wage bargaining and created conditions for lower wage growth pressures.

19 The MLSA's unemployment statistics are based on registered unemployment.

With inflation falling, average real wages grew faster in 2002 Q3, rising by 1.7 percentage points relative to Q2 in year-on-year comparison, to 6.7%. In the business sector, real wage growth increased by a full 2 percentage points. Average real wages in the non-business sector increased by 1.3 percentage points in Q3, on the back of a significant year-on-year rise of 6.6 percentage points in Q2 (following the aforementioned wage-scale increase).

The key factor with respect to inflation is the relationship between wage growth and productivity growth. Unemployment and wages usually respond to changes in economic activity with a lag. The year-on-year growth in whole-economy labour productivity picked up moderately in 2002 Q3 compared to the previous quarter, to 2.2%. By comparison with a year earlier, however, productivity increased more slowly.

According to nominal unit wage costs, growth in the personnel cost-output ratio at the macroeconomic level was more favourable in Q3 than in the previous quarter. Annual growth in nominal unit wage costs softened by 1 percentage point to 4.7% in 2002 Q3. The growth in nominal unit wage costs therefore indicated – despite some fluctuations – a downward trend in growth in the personnel cost-output ratio.

The relationship between wage growth and productivity growth varied across the individual sectors. For example, in industry (which covers around 40% of the employees in the monitored organisations) September saw renewed faster productivity growth than wage growth, following an August fall in productivity.[20] Overall, for the whole of 2002 Q3, labour productivity growth in industry was 2.9 percentage points higher than real wage growth, and unit wage costs recorded a year-on-year decrease. The wage growth in industry was therefore offset by rising labour productivity. By contrast, average real wages in construction again rose faster than productivity in Q3, although the growth rates were equal at the end of the quarter.

As in 2002 Q2, the buoyant growth in nominal unit wage costs at the macroeconomic level did not lead to higher inflation. Favourable import prices and the strongly competitive environment on the retail market have so far prevented the increased personnel cost-output ratio from passing through into producer prices. Simultaneously, the continuing fall in prices of imported inputs (see the sections *Other costs and prices* and *Producer prices*) created room to accommodate the still fast-growing personnel cost-output ratio.

III.5. OTHER COSTS AND PRICES

A turnaround in raw materials prices on world markets significantly affected the costs – and consequently prices – of some producers in 2002 Q4. Following a previous long-term slowdown, the renewed growth in prices of raw materials, most notably energy-producing raw materials and some metals, together with the still fairly strong annual appreciation of the koruna's exchange rate, helped to slow the annual decline in import prices. This change in trend for prices of imported inputs affected each price group differently. Most strongly affected were producer prices in industry, and particularly in oil-product-processing branches, where a considerable easing of the annual decline in prices was recorded. The annual decline in prices in other industrial branches weakened only slightly overall. Agricultural producer prices – and

20 Calculated in both industry and construction from the revised monthly figures determined by the CSO. Productivity is calculated from sales receipts.

TABLE III.9
AVERAGE REAL WAGE GROWTH PICKED UP SHARPLY IN 2002 Q3
(annual percentage changes)

	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2001	2002 Q1	2002 Q2	2002 Q3
Average wage in monitored organisations (nominal)	9.1	8.9	8.7	7.5	8.5	7.0	7.4	7.4
Average wage in monitored organisations (real)	4.8	3.7	3.1	3.1	3.6	3.2	5.0	6.7
Average wage in business sector (nominal)	9.1	8.7	8.3	7.0	8.2	7.2	6.4	6.7
Average wage in non-business sector (nominal)	9.6	10.0	10.9	9.5	10.0	6.5	11.7	11.3
Whole-economy labour productivity	2.7	2.7	3.0	2.5	2.7	2.6	1.1	2.2
Nominal unit wage costs	5.5	5.3	5.3	5.4	5.4	4.2	5.7	4.7

Source: CSO; CNB calculation

CHART III.26
IN 2002 Q3, WAGE GROWTH IN INDUSTRY DID NOT GENERATE WAGE-COST INFLATION PRESSURES
(annual percentage changes)

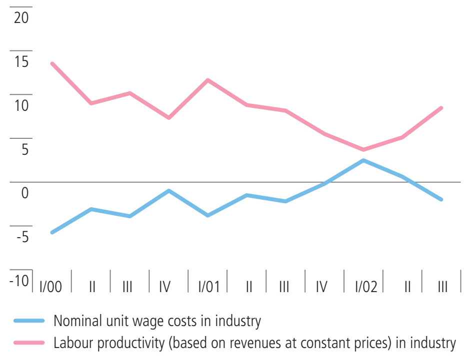
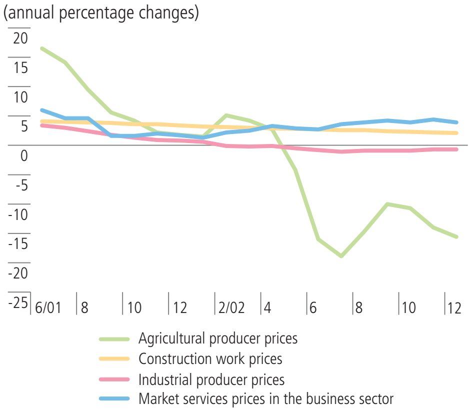


CHART III.27
PRODUCER PRICES CONTINUED TO CREATE CONDITIONS FOR LOW CONSUMER PRICE INFLATION
(annual percentage changes)



consequently food industry producer prices – again recorded the most significant decline. In construction and market services, where domestic effects dominated, prices again showed annual growth. Overall, producer prices in 2002 Q4 created conditions for continued low consumer price inflation.

A selective international comparison of industrial and agricultural prices confirmed the agreement in the basic longer-term trajectory in these price groups. The partial differences in the degree of price decline or growth between the Czech Republic and Germany registered in the selected price groups in 2002 Q4 (the deeper decline in agricultural producer prices overall in the Czech Republic than in Germany, and the still moderately falling industrial producer prices in the Czech Republic as against the renewed moderate growth in these prices in Germany) resulted from the disinflationary action of other specific factors in the Czech Republic (the appreciation of the koruna and so on).

CHART III.28
IN 2002 Q4, PRICES OF INDUSTRIAL RAW MATERIALS AND FOOD, AND IN PARTICULAR OIL, RECORDED AN UPTURN IN GROWTH ON WORLD MARKETS
(annual percentage changes)

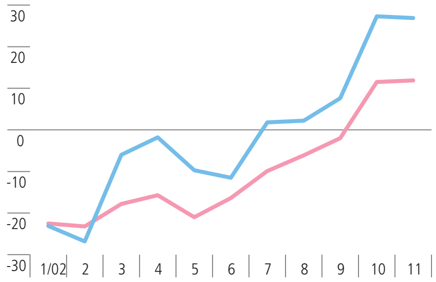
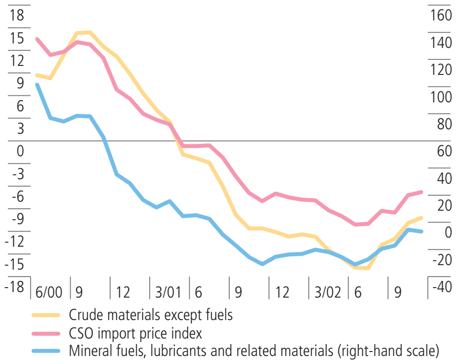


CHART III.29
THE YEAR-ON-YEAR DECLINE IN IMPORT PRICES SLOWED FURTHER IN 2002 Q4
(annual percentage changes)



III.5.1. Import prices

World prices of imported commodities, measured by the CSO index of world prices of industrial raw materials and food, signalled clearer changes in trends. The previous gradual slowdown in the annual decline in industrial raw materials and food prices turned into fairly significant growth during 2002 Q4. This important turnaround is evidenced by the development of the CSO annual index during the course of 2002: in July 2002, a sizeable decline of 9.9% had been recorded; in September this had slowed to -2%; and in October prices showed growth of 11.5%, which continued into November (11.9%).

The main reason for this change in the price trajectory on world markets was a sizeable pick-up in the growth of energy-producing raw materials prices. In particular, annual growth in oil prices in US dollars per barrel accelerated strongly, from 7.6% in September to 26.9% in November. Consequently, the annual decline in natural gas prices slowed sharply, from -18.6% in September to -3.8% in November. Prices of metals also started rising again (from -0.2% in September to 5.8% in November), and the pick-up in annual food price inflation continued (to 21.6% in November). Prices in other, lower-weight components of the raw materials price index showed very mixed developments, but overall they contributed to the rise in the annual price index for the monitored commodities.

TABLE III.10
THE SLOWDOWN IN THE DECLINE IN IMPORT PRICES WAS ACROSS-THE-BOARD IN NATURE
(annual percentage changes)

	1/02	2	3	4	5	6	7	8	9	10	11
Imports, total	-7.5	-7.8	-7.9	-9.2	-10.0	-11.1	-11.0	-9.3	-9.5	-7.2	-6.8
Food and live animals	-1.3	0.4	1.5	-0.6	-0.8	-2.4	-4.0	-4.9	-5.2	-4.8	-5.1
Beverages and tobacco	-1.4	-0.1	-2.3	-5.8	-7.5	-8.0	-10.3	-9.8	-10.0	-8.6	-7.7
Crude materials except fuels	-12.7	-12.4	-12.7	-14.5	-15.5	-16.8	-16.9	-13.8	-13.0	-10.9	-10.2
Mineral fuels and lubricants	-23.7	-23.4	-20.2	-21.9	-25.7	-31.1	-27.2	-19.6	-17.2	-5.5	-6.8
Animal and vegetable oils	-0.5	1.7	3.0	0.8	0.0	1.8	1.1	5.4	4.8	2.9	5.4
Chemicals and related products	-7.9	-8.5	-9.2	-10.0	-9.7	-10.0	-9.7	-8.8	-9.0	-8.5	-7.4
Manufactured goods	-7.3	-7.3	-8.0	-9.3	-9.9	-10.3	-10.6	-9.0	-9.9	-8.2	-6.9
Machinery and transport equipment	-4.7	-5.6	-6.6	-7.6	-8.1	-8.5	-9.2	-8.5	-9.0	-7.4	-7.2
Misc. manufactured articles	-2.5	-2.2	-2.0	-3.2	-3.3	-3.5	-4.0	-3.8	-5.1	-4.4	-4.1

Source: CSO

The change in trend for industrial raw materials and food prices on world markets in 2002 Q3 and Q4 (which came on the back of a relatively long period of significant annual decline) was the main cause of the turnaround in import prices. Another contributing factor was renewed growth in the industrial producer prices of the Czech Republic's major trading partners, who export part of their production (semi-manufactures and manufactures) to the Czech Republic. But because the second most important determinant of import prices, namely the koruna's exchange rate, was still appreciating fairly strongly in year-on-year comparison, import prices in Q4 remained lower than in the same period of the previous year. Together, though, these factors helped to slow the decline in import prices in Q4. In September 2002, a 9.5% annual decline in import prices had been recorded, whereas in November the figure was 2.7 percentage points lower, at 6.8%.

Reduced annual declines were recorded in almost all of the SITC import price categories. A particularly large decrease was recorded for fuels (from -17.2% in September to -6.8% in November). The decline in import prices of machinery and transport equipment also weakened, although it remained relatively steep (-7.2% in November). The year-on-year decline in prices also softened in most of the other, less important, sub-categories of the import price index.

III.5.2. Producer prices

Industrial producer prices

In conditions of a high import propensity in the Czech Republic and the mostly falling prices of imported inputs on the one hand, and the continuing strongly competitive environment both at home and abroad on the other hand, the annual decline in industrial producer prices continued into 2002 Q4. However, this decline slowed somewhat (from -0.9% in September to -0.7% in December), owing to the aforementioned reversal in the trend in raw materials prices and consequently in import prices in 2002 Q4. It is likely that the smaller decline in producer prices in a number of industrial sectors relative to the decline in import prices was partly due to the fact that export prices were still falling (albeit with less intensity than in the previous quarter). In the case of exporters, this partly offset the positive contributions of the reduced prices of imported inputs. A similar influence can be expected in some industrial sectors with an unbalanced relationship between wage growth and productivity growth. However, this problem is no longer of a general nature in industry.

The influence of the slowing decline in prices of raw materials on world markets was particularly visible in manufacturing, as this includes branches directly involved in processing oil products. Compared to September, the annual decline in producer prices in manufacturing as a whole slowed by 0.6% percentage points to -1.3% in December. However, significant changes were recorded in the manufacture of coke and refined petroleum products, as the previous significant annual decline in prices was replaced in December with an increase (of 13.5 percentage points compared to September, to 2.1% in December). The annual decline in producer prices in the chemical industry also slowed markedly. The price trend in other branches of manufacturing was unchanged overall in 2002 Q4. Producer prices in these branches remained slightly below the level of the previous year, with no major changes compared to the previous quarter (-1.3% in September, -1.5% in December). However, the individual industries showed mixed trends. Large annual declines in producer prices were recorded in Q4 in the manufacture of food, beverages and tobacco. This contrasts with industries with more sophisticated products, where prices decreased only very slightly or recorded weak growth.

The non-manufacturing industries continued to show mixed price trends. Following a short-lived increase in 2002 Q2, from August onwards producer prices in mining and quarrying recorded a modest annual decline (of 0.3% in December). Prices in the electricity, gas and water supply industry continued to rise, but thanks to electricity prices the growth slowed considerably compared to the previous two quarters (from 5.8% in September to 3.3% in December).

The overall change in the industrial producer price trend, caused by the changing situation in raw materials prices on world markets, was also indicated by the aforementioned trend in industrial producer prices in Germany and the EU. The partial differences in the growth rates of producer prices between the two countries reflected other factors specific to each economy (in the Czech Republic the continuing strong annual appreciation of the koruna, the indirect influence of strong competition on the retail market and so on.).

CHART III.30
THE CHANGE IN TREND RECORDED BY IMPORTED INPUT PRICES HELPED SLOW THE DECLINE IN INDUSTRIAL PRODUCER PRICES
(annual percentage changes)

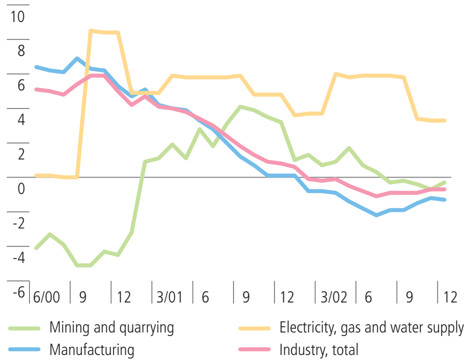


CHART III.31
THE BIGGEST CHANGE IN TREND WAS RECORDED BY PRICES IN OIL-PRODUCT-PROCESSING INDUSTRIES
(annual percentage changes)

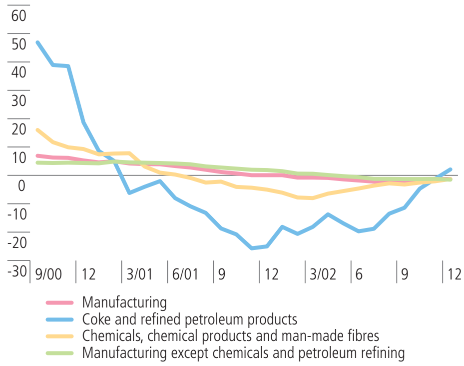


CHART III.32
INDUSTRIAL PRODUCER PRICES IN GERMANY ALSO SIGNALLED A CHANGE IN TREND
(annual percentage changes)

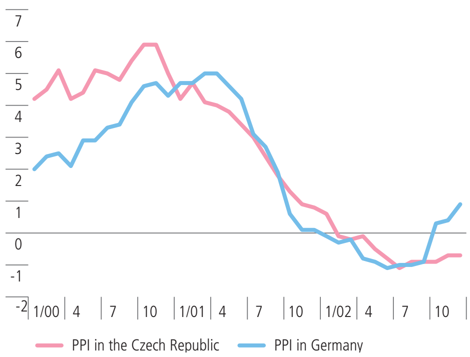


CHART III.33
PRICES OF AGRICULTURAL PRODUCERS AND IN RELATED MANUFACTURING BRANCHES RECORDED A YEAR-ON-YEAR DECLINE FOR THE THIRD CONSECUTIVE QUARTER
(percentages)

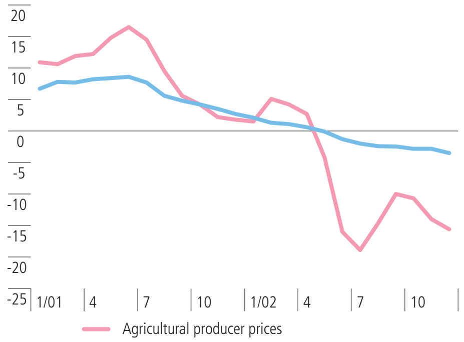


CHART III.34
GERMAN AGRICULTURAL PRODUCER PRICES RECORDED A SIMILAR TREND AS IN THE CZECH REPUBLIC
(annual percentage changes)

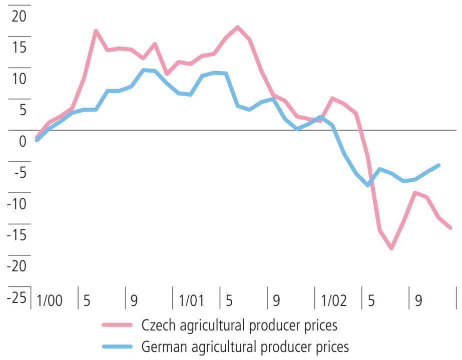
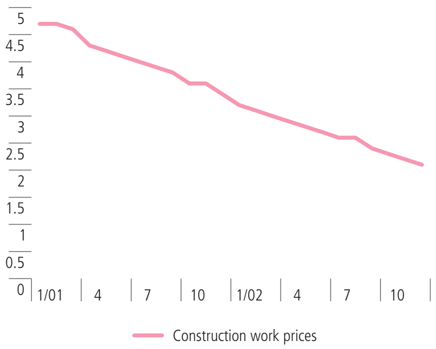


CHART III.35
THE LONG-RUNNING DOWNWARD TREND IN CONSTRUCTION WORK PRICE INFLATION CONTINUED INTO 2002 Q4
(annual percentage changes)



Agricultural producer prices

Agricultural producer prices again showed the biggest decrease of all in 2002 Q4. After having recorded their largest annual decrease since 1991 in July (-18.9%), the decline weakened somewhat in the months that followed (to around -10%). However, in November and December, it increased again (reaching -15.6% in December). The annual decline in prices remained very much across-the-board in nature – prices of both livestock and crop products went down. For example, the sharp decline in prices of crop products (of 12.6%) in December was the result of falls in prices of numerous commodities (most notably cereals, potatoes and fruit). The fact that the decline in prices was across-the-board in nature is confirmed by the livestock product price structure – most of the main commodities contributed to the considerable fall (of 17.5%) in December (only the prices of beef cattle and milk recorded growth).

As mentioned in previous Inflation Reports, the marked decline in agricultural producer prices below the level of the same period a year earlier was attributable to a combination of several long-term factors. On the demand side, these included in particular lower sales opportunities for agricultural products abroad, due in part to the negative impacts of the appreciation of the koruna on the competitiveness of domestic producers. The resulting surpluses of livestock and crop production on the domestic agricultural market helped to keep the price level of agricultural products at significantly lower level in year-on-year comparison. At the same time, the continuing decline in prices in some neighbouring countries (for example Germany), reinforced by the still fairly strong appreciation of the koruna's exchange rate, increased the opportunities for import arbitrage.

Turning to international comparisons, agricultural producer prices in the Czech Republic were still following broadly the same trajectory as those in Germany. This confirmed that they were being affected by the same factors (deteriorating sales opportunities on third markets, etc.). As in the case of industrial producer prices, however, the disinflationary pressures were stronger in the Czech Republic than in Germany, as the annual decline in agricultural producer prices in Germany in 2002 H2 was roughly half that in the Czech Republic. In addition to the aforementioned appreciation of the koruna, this was due to less regulation of domestic agricultural prices in the Czech Republic.

Construction work prices

Construction work prices, which are chiefly affected by domestic factors, recorded no significant changes in 2002 Q4. Compared to September, annual construction work price inflation recorded only a very modest decline in Q4 (of 0.3 percentage points to 2.1% in December), reaching its lowest level since 1991, when this index was first recorded. The long-running gradual downward trend in annual growth, seen since the beginning of 2001, was therefore confirmed. Probably the main underlying factor was a decline in demand for construction activity in an environment of stiff competition and relatively low utilisation of construction capacities.

Market services prices in the business sector

Market services prices in the business sector rose faster than construction work prices in 2002 Q4. In November, annual market services price inflation rose to 4.4%, but in December it fell back to the level recorded at the end of the previous quarter (3.9%). Market services prices are mainly affected by domestic factors. Annual inflation exceeding 4% was maintained in the segment of other business services. Higher inflation was recorded in particular in the areas of real estate and computer services. This was linked to rising demand for these services. Following a large fluctuation in November, growth in insurance prices returned to roughly the same level as at the end of the previous quarter (4.3%). Sewerage collection charges also maintained relatively high annual growth (6.9% in December). Only in the areas of national goods transport and financial intermediation did inflation remain at a low level.

CHART III.36
GROWTH IN MARKET SERVICES PRICES IN THE BUSINESS SECTOR REMAINED AT AROUND 4%
(annual percentage changes)

IV. THE INFLATION FORECAST AND ITS ASSUMPTIONS

IV.1. External assumptions of the inflation forecast

The overall message of the macroeconomic forecast is greatly affected by assumptions regarding the external environment. Prices of energy-producing raw materials, foreign producer price indices and the business cycle of the Czech Republic's major trading partners play a substantial role in this respect. As usual, the assumptions regarding the evolution of these variables are taken from the publication *Consensus Forecasts,* which summarises the predictions of foreign analytical teams.

In the area of prices of energy-producing raw materials, there are no changes from the last macroeconomic forecast. In 2003 Q1, the price of Ural crude oil is still expected to be roughly USD 27 per barrel. During 2003 the price is expected to decline gradually, falling below USD 23 per barrel in Q4. This price level is then fixed for the whole of 2004 (the *Consensus Forecasts* prediction is for 12 months only). No reassessment has been made to the scenario for natural gas prices either; stable gas prices are assumed for the whole forecast period.

By contrast, the estimates of economic growth abroad have again been reassessed. Compared to the October macroeconomic forecast, the assumption of annual real GDP growth in Germany has been decreased by around 0.5 percentage points to 0.9% in 2003. For 2004, a moderate recovery is expected, represented by GDP growth of 1.9%.

In line with the adjustment to the assumption regarding economic activity in Germany, a downward revision has also been made to the assumptions of industrial producer and consumer price inflation. Industrial producer prices in Germany are expected to increase by 0.8% and consumer prices by 1.2% in 2003. Given the assumed moderate recovery of the German economy in 2004, inflation is also expected to rise: by 0.5 percentage points in the case of industrial producer prices and by 0.2 percentage points in the case of consumer prices compared to 2003.

IV.2. Internal assumptions of the inflation forecast

The macroeconomic forecast is affected not only by assumptions regarding the external environment, but also by assumptions regarding the internal environment of the Czech economy and regarding the starting conditions of the forecast. These relate to the autonomous effect of fiscal policy, the trajectory of the equilibrium values of key macroeconomic variables, and the current position of the economy in the business cycle.

The public budget deficit, excluding privatisation proceeds and subsidies to transformation institutions, should reach 6%–7% of GDP in 2003. In 2004, the deficit is expected to reach 5.4%–7.4% of GDP, depending on the extent of the reform of public finances. Public finances therefore still present one of the biggest risks to economic growth.[21]

One of the key variables for the message of the macroeconomic forecast is the exchange rate. The forecast assumes that the exchange rate will remain stable in 2003 broadly at the 2002 H2 average. This is consistent with the balance of payments forecast. The koruna-dollar rate has been calculated on the basis of the assumptions regarding the

21 Prediction based on Czech Ministry of Finance figures. It should be borne in mind that preliminary information from the Ministry on the public finance results for 2002 indicates a much lower deficit than the 7% that was originally officially expected.

koruna-euro rate and the foreign consensus forecast of the euro-dollar rate, which foresees a modest appreciation of the euro against the dollar above parity.

The macroeconomic forecast also works with the following assumptions regarding the evolution of equilibrium macroeconomic variables. The growth rate of potential output is expected to gradually increase to 3.5% from its present values of around 3%. The growth rate of the equilibrium appreciation of the real exchange rate should fall rapidly. The one-year equilibrium real interest rates should remain stable at just above 1.5%.

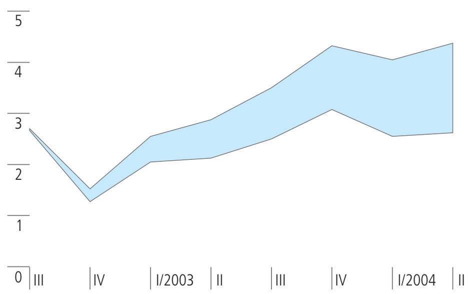
In line with the October 2002 macroeconomic forecast, the output gap has widened somewhat further and is now estimated at about -2%. This figure already takes into account the recent correction to the GDP growth estimate in 2002 Q3, without which the output gap would be wider. The widening of the output gap is attributable to economic developments abroad and the evolution of the monetary conditions in 2002 H1.

Turning to the initial monetary conditions, the extent to which they were eased in 2002 Q4 exceeded the expectations of the previous macroeconomic forecast. This easing is due to the evolution of their exchange-rate component – the estimated overvaluation of the real exchange rate decreased. By contrast, the interest-rate component of the monetary conditions was tightened as a result of a sharp fall in inflation expectations. The setting of the interest-rate component of the real monetary conditions thus shifted from easy to neutral.

IV.3. THE MESSAGE OF THE FORECAST

The macroeconomic forecast is signalling a slowdown in domestic demand growth and GDP growth at the end of 2002 and in 2003 Q1. During 2003, GDP growth will gradually pick up (see Chart IV.1). The GDP growth expected in 2003 – of just below 3% – is about 1 percentage point higher than in the October forecast. This reassessment is due to a higher growth rate of gross fixed capital formation, with growth expected for both private investment (of about 1%) and government investment. The increase in private investment growth ensues from the gradual easing of the exchange-rate component of the monetary conditions in 2002 H2. The rise in GDP growth in 2003 is also attributable to a positive contribution of net exports to GDP growth in this period. Compared to the previous year, however, household consumption growth is down. This is due to lower disposable income growth, resulting from a moderate decrease in wage growth and rising unemployment. However, also playing a role is the assumed gradual tightening of the interest-rate component of the monetary conditions, connected with the fall in inflation expectations. This is expected to peak in 2003 Q1. In general, the macroeconomic forecast assumes a stabilisation of the savings rate of households.

CHART IV.1
AFTER SLOWING AT THE END OF 2002, ECONOMIC GROWTH SHOULD START RISING STEADILY
(annual real GDP growth; percentages)



According to the forecast, GDP growth will pick up further in 2004, to about 3.5%. In response to the forecast-consistent gradual easing of both components of the monetary conditions during 2003 and to the economic recovery abroad, it is expected that gross fixed capital formation growth will rise, negative net exports will decrease further and household consumption growth will accelerate slightly. From 2003 H2 onwards, the output gap will gradually close, with output reaching potential at the end of 2004 or the start of 2005. In this period, government consumption will start counteracting the pick-up in economic growth, as the current macroeconomic forecast assumes that a reform of public finances will be launched in 2004. This implies a negative contribution of government consumption to GDP growth in this and the following periods.

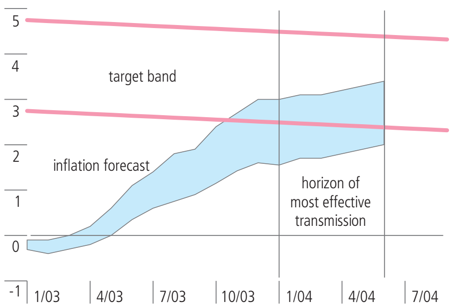
Compared to the October macroeconomic forecast, the inflation outlook for 2003 is little changed. The decrease in the inflation forecast for the start of 2003 is due to the faster-than-expected decline in food prices in 2002 Q4. For December 2003, however, annual consumer price inflation of 2.3% is still expected. Compared to the previous year there is a pick-up in inflation ensuing from a gradual unwinding of exogenous factors, particularly agricultural producer prices. In 2003, agricultural producer prices are expected to return gradually to their 2001 levels and foreign inflation is expected to pick up steadily. By contrast, the highly negative output gap will be a major anti-inflationary factor. Compared to the previous macroeconomic forecast, the expected size of the gap has been decreased in absolute terms. However, this revision is due to higher investment growth and bears little relation to inflation. As part of the preparation of the macroeconomic forecast, the weight of the output gap for nontradables price inflation was increased compared to the October prediction (based on a historical analysis). This led to a decline in adjusted inflation excluding fuels. However, this reduction is offset by a rise in fuel prices and so the prediction of total adjusted inflation for the end of 2003 is unchanged.

Owing to the gradual closing of the output gap from 2003 H2 onwards and the unwinding of the disinflationary effects of exogenous factors, most notably agricultural producer prices, the macroeconomic forecast indicates a modest pick-up in inflation in 2004. At the horizon of most effective transmission, i.e. roughly in 2004 H1, annual consumer price inflation will reach 2.5%. Inflation will thus be at the lower boundary of the inflation band.

CHART IV.2

THE FORECAST SUGGESTS INFLATION WILL RETURN TO THE LOWER BOUNDARY OF THE TARGET BAND AT THE HORIZON OF MOST EFFECTIVE TRANSMISSION

(annual consumer price inflation; percentages)

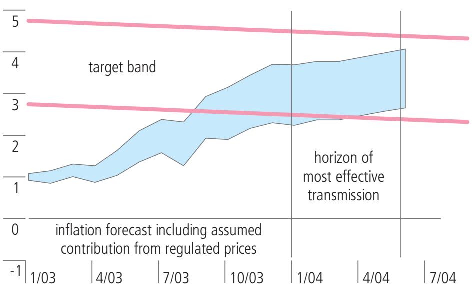


To sum up, the macroeconomic forecast expects a gradual pick-up in economic growth in 2003 and 2004, linked with an increase in inflation back to within the target band (see Chart IV.2). The pick-up in economic growth is associated with a forecast-consistent gradual easing of the monetary conditions during the course of 2003 and expectations of a gradual economic recovery abroad. Despite the economic recovery, inflation in 2003 and 2004 H1 will still be affected by an absence of demand-pull inflationary pressures and by a gradual unwinding of the disinflationary effects of exogenous factors. Consistent with the macroeconomic forecast is a modest decline in interest rates at the start of 2003 and stability thereafter.

CHART IV.3

HAD REGULATED PRICES BEEN RISING AT THE RATE ASSUMED WHEN THE INFLATION TARGET WAS SET, INFLATION WOULD HAVE RETURNED TO THE TARGET MUCH EARLIER

(annual consumer price inflation; percentages)



Box: Implications of the unexpectedly slow growth in regulated prices

One of the important internal factors of the inflation forecast is the evolution of regulated prices. In connection with the current forecast, it should be borne in mind that inflation is relatively low and will remain so throughout the forecast period. This is due, among other things, to the fact that regulated price inflation has long been, and will probably continue to be, much slower than was expected when the inflation target for the 2002–2005 period was set. Chart IV.3 shows that if regulated prices had been rising at the assumed rate, the extent of the current undershooting of the inflation target would have been 50% smaller. In this event, inflation would have returned to the target band in October 2003, i.e. six months earlier than suggested by the current forecast. Inflation would have been within the target band (just below its mid-point) throughout the period of most effective transmission of monetary policy. Non-fulfilment of the expected yearly contribution of regulated prices to headline inflation (1–1.5 percentage points) is one of the CNB's "escape clauses" from hitting the inflation target (see Annex 1 to the April 2001 Inflation Report).

IV.4. Expectations of economic agents

The future inflation outturns and interest rates expected by financial market participants decreased further to new historical lows. The respondents – financial market analysts, businesses and households – were responding primarily to the persisting low-inflation environment and to the fact that the domestic economy is not threatened by greater inflationary pressures in the near future. The expected inflation also reflected other factors, for instance the strong exchange rate and low external demand. Following a period of very low inflation (or even deflation), the price level should start rising in 2003 H2, primarily because of food, housing and nontradables prices. According to the analysts, there are also inflation risks associated with the potential conflict in Iraq and the related prospect of growth in oil prices.

The predicted interest rates and the shape of the money market yield curve indicated a modest reduction of the repo rate in the near future. Looking further ahead, however, the interest rate level is expected to increase again. The expectations of the financial market analysts broadly corresponded with the macroeconomic forecast described above and with the interest rate profile that is consistent with this forecast.

TABLE IV.1
THE INFLATION EXPECTATIONS OF ECONOMIC AGENTS DECREASED AT THE 12-MONTH HORIZON
(percentages)

	Consumer price index			1Y PRIBOR
	Financial market	Businesses	Households	Financial market
12/01	3.9	3.9	4.6	5.1
1/02	3.8			5.0
2/02	3.5			4.8
3/02	3.5	3.6	3.9	4.9
4/02	3.5			4.9
5/02	3.3			4.6
6/02	3.1	2.7	1.6	4.6
7/02	2.8			4.1
8/02	2.7			4.0
9/02	3.1	1.9	1.3	3.7
10/02	2.5			3.5
11/02	2.4			3.3
12/02	2.3			3.1

ANNEX 1

The Czech Republic and the Euro – Draft Accession Strategy

1. The negotiations on the Czech Republic's accession to the European Union are drawing to a close. As stated at the EU summit in Nice in 2000, the assumed time horizon for EU enlargement is the year 2004. According to the European Commission's *Regular Report* of October 2002, the Czech Republic has made considerable progress in fulfilling the political and economic criteria for EU accession. The negotiations on the financial conditions for accession were completed in December 2002 at the Copenhagen summit.

2. An integral part of the Czech Republic's accession to the EU is the obligation of subsequently joining the eurozone. Given the inevitable policy implementation lags, a credible timetable needs to be established for the Czech Republic's integration into European monetary structures. This timetable will then serve as the basis for each particular economic policy.

3. This document summarises the starting points for the Czech Republic's integration into European monetary structures and discusses the positive effects and potential risks associated with joining the eurozone. The Czech National Bank recommends that the Czech Republic join the eurozone as soon as economic conditions allow for doing so. At the same time it recommends that the process of structural reform and fiscal consolidation be accelerated.

1. The Starting Points for Joining the Eurozone

4. Economic and monetary union (EMU) was implemented in three stages on the basis of the Maastricht Treaty. During the first stage, starting in 1990, the liberalisation of capital flows was completed and a single internal market was created. The second stage, starting in 1994, focused on making progress on convergence of the Member States' economies. The third stage involved introducing the non-cash euro and launching the single monetary policy of the European Central Bank, which sets a single interest rate for the entire eurozone. The process of monetary integration was completed by the introduction of euro banknotes and coins into circulation in January 2002.

5. Economic integration within EMU is founded on the single currency and on co-ordination of economic policies. Fiscal policy is left partly to the discretion of the individual EMU Member States. The formation of excessive budget deficits is prevented by the *Treaty establishing the European Community* and the *Stability and Growth Pact* (see the Box).

BOX: Budget Deficits of the EU Member States

Article 104 of the *Treaty establishing the European Community* sets forth that Member States must avoid excessive government deficits. The decision on whether an excessive deficit exists is made by the European Council based on a report presented by the Commission. Where the existence of an excessive deficit is decided, the Council makes recommendations to the Member State concerned with a view to bringing that situation to an end. The recommendations of the Council are not made public unless the Member State fails to respond to the recommendations within the period laid down. In addition, under the *Stability and Growth Pact* financial sanctions may be imposed on eurozone Member States in the form of either a non-interest-bearing deposit requirement or – after two years of the decision to impose sanctions, unless the excessive deficit has in the view of the Council been corrected – a fine.

6. In 1999, eleven countries satisfied the conditions for adopting the single currency and consequently established the eurozone. They were joined by Greece in 2001. The United Kingdom and Denmark, which at the start of the Maastricht process insisted on an *opt-out clause,* are not currently part of the eurozone. Despite not having an opt-out clause, Sweden also remains outside the eurozone for the time being, for domestic political reasons, and will decide on its future course of action in a referendum.

7. When it joins the EU, the Czech Republic will automatically participate in the third stage of EMU. It will acquire the status of "Member State with a derogation" regarding the adoption of the euro, i.e. it will not be a member of the eurozone in this stage. Upon EU accession, the Czech National Bank will become a member of the European System of Central Banks (ESCB). After the Czech Republic adopts the euro, the CNB will become part of the *Eurosystem,* which consists of the ECB and the national central banks of the eurozone Member States.

8. Under the EU legislation, prior to adopting the euro the Czech Republic must be an EU Member State and must have fulfilled the Maastricht convergence criteria (see the Box), including compatibility between its legal rules and EU law on EMU. The European legislation does not explicitly stipulate a date for adopting the euro or for fulfilling the convergence criteria. Nonetheless, the Czech Republic will have to document periodically the progress of its economy towards fulfilment of the Maastricht criteria in the so-called *Convergence programme.*

BOX: The Convergence Criteria

The *criterion on price stability* requires that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best performing Member States in terms of price stability.

The *criterion on long-term interest rates* requires that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability.

The *criterion on the government budgetary position* means that a Member State has a ratio of planned or actual government deficit to GDP that does not exceed 3%, unless:

- either the ratio has declined substantially and continuously and reached a level that comes close to the reference value,

- or, alternatively, the excess of the reference value is only exceptional and temporary and the ratio remains close to the reference value.

The *criterion on government debt* means that a Member State has a ratio of government debt to GDP that does not exceed 60%, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The *criterion on exchange rate stability and participation in the Exchange Rate Mechanism* (at present the ERMII) means that a Member State's currency has respected the normal fluctuation margins provided for by the exchange rate mechanism for at least two years.

9. The convergence required for entering the eurozone is assessed according to the procedure laid down in the *Treaty establishing the European Community.* The final decision is subsequently made by a summit of EU Member States acting on the recommendation of the ECOFIN Council. Those Member States whose economic conditions are assessed as a potential threat to the maintenance of price stability in the eurozone will not join the monetary union and will retain the status of Member States with a derogation. These countries will thus have to wait before they can benefit from eurozone membership and will be at a comparative disadvantage relative to the new eurozone members.

10. The criterion on exchange rate stability requires two-year participation in the ERMII. The central parity and fluctuation band of the exchange rate regime within the ERMII will – after being agreed upon between the CNB and the government – be discussed with the ECB and the Commission and subsequently approved by the ECOFIN Council. Given that participation in the ERMII – unlike the irrevocable fixing of the exchange rate within a monetary union – does not in itself eliminate the risk of currency turbulence, it is regarded merely as the gateway into the eurozone. Staying in the ERMII for longer than the minimum required period is not deemed desirable.

2. The Positive Effects of, and Possible Barriers to, Eurozone Participation

Positive Effects

11. The Czech Republic's entry into the eurozone will represent the completion of the Czech economy's integration into European monetary structures. The Czech Republic will be able to participate fully in formulating and implementing the single European monetary and exchange rate policy, which aims to strengthen macroeconomic stability in Europe.

12. Membership of the eurozone should have positive impacts on *domestic economic policy,* since the key elements of the system are a requirement for balanced public budgets in the medium term and a requirement to undertake structural reforms supporting sustainable economic growth.

13. Fiscal policy implemented in accordance with the Stability and Growth Pact, coupled with a decline in the risk premium, will lead to stabilisation of *long-term interest rates* at a low level. Corporations and households will profit not only from the low interest rates, but also from access to the deeper, more liquid and more transparent eurozone capital markets.

14. The irrevocable fixing of the currency within EMU will increase the stability of the financial sector and reduce the risks of *monetary turbulence.* Sharp fluctuations in the exchange rate present a significant threat to a small open economy in an environment of liberalised capital flows.

15. The domestic enterprise sector in particular will profit from the elimination of *exchange rate risks vis-à-vis* the eurozone countries, which are the Czech Republic's most important trading partners. These benefits will show up as a decline in transaction and hedging costs and a reduction in investment uncertainty. The household sector will profit from greater *price transparency,* which stimulates competition.

16. These positive effects will foster a more stable environment for entrepreneurship, more efficient allocation of resources and subsequently higher economic growth. Eurozone membership will thus further speed up the real convergence of the Czech economy towards the EU average.

Possible Barriers

17. The Czech Republic's entry into the eurozone is associated not only with numerous advantages, but also with some risks, the intensity of which will change over time. These risks are connected primarily with the response of the economy to economic disturbances under the irrevocably fixed exchange rate within the eurozone. In the event of insufficient cyclical and structural alignment of the Czech economy and its financial sector with the eurozone economies, economic shocks may have unequal and asymmetric impacts in different regions. The cessation of an independent monetary policy able to respond flexibly to such shocks constitutes a challenge for fiscal policy and for the functionality of natural adjustment mechanisms, especially on the labour market. The barriers to fast entry into the eurozone may thus be as follows: (i) insufficient alignment of the Czech economy with the eurozone economies in the real and financial spheres, (ii) low fiscal policy flexibility, and (iii) an insufficiently flexible labour market.

Economic alignment

18. The characteristics of the Czech economy are gradually converging towards those of the EU Member States. Trade with the EU accounts for about two-thirds of the total foreign trade of the Czech economy, and the inflow of foreign direct investment from the EU accounts for as much as four-fifths of all the investment flowing into the Czech economy. Nevertheless, the cyclical development of the Czech economy is less aligned with the cyclical trend in the eurozone than is that of the average eurozone Member State. In the area of alignment of the real economy and financial sector structures, too, there is room for further improvement.

19. The sufficiency of economic alignment over time and in international comparison can be assessed, for example, by analysing the correlation of the economic cycle with the eurozone countries, by analysing the correlation of demand and supply shocks between the Czech economy and the eurozone economies, or by evaluating structural similarity on the basis of the shares of individual sectors in total value added or on the basis of a set of criteria relating to the Czech Republic's international trade and financial sector linkages with the eurozone countries.

Fiscal consolidation

20. The Czech Republic's large public budget deficits, together with the built-in trends towards a further structural widening of those deficits and inadequate conditions for the symmetrical functioning of automatic stabilisers, represent a serious barrier to effective fiscal stabilisation policy. The aim of fiscal consolidation must be not only to fulfil the Maastricht criteria, but also – in compliance with the Stability and Growth Pact – to achieve in the medium term a balanced public finance budget facilitating the effective action of automatic stabilisers and flexibility of discretionary expenditure. In the absence of an autonomous monetary policy, fiscal policy will – given the irrevocably fixed exchange rate within the eurozone – be the key instrument of macroeconomic stabilisation.

21. An insufficiently consolidated public finance system could have exceptionally adverse effects during the Czech Republic's participation in the ERMII and during the first few years after it joins the eurozone. During this period, the probability of the Czech economic cycle diverging from that elsewhere in the eurozone will be higher than in the later stage of integration. Moreover, given the unified nominal interest rates, the expected positive inflation differential between the Czech Republic and the eurozone average in this period will result in lower real interest rates, which could trigger excessive growth in domestic demand. Therefore, in the years immediately following the Czech Republic's entry into the eurozone, prudent fiscal policy will be a key condition for maintaining stable economic growth.

22. The appropriate methods for assessing progress in the area of consolidation of public finances include, for example, analysis of the sensitivity of built-in stabilisers by assessing the impacts of GDP fluctuations on the public budgets, analysis of the public budgets' room for manoeuvre for discretionary policy based on the budget structure or an international comparison of the public budget deficits and the cyclical position of the economy.

The labour market

23. Like the EU labour market, the Czech labour market is characterised by relatively low mobility and flexibility of the labour force. Moreover, for several years following accession, restrictions on the free movement of labour from new member states will have to be reckoned with. To strengthen the adjustment mechanisms on the labour market, steps must be taken to increase the flexibility of the labour market and real wages not only in the institutional area, but also in areas such as transport infrastructure and the housing market.

24. The degree of labour market flexibility can be assessed, for example, by evaluating the inter-regional mobility of the population, by analysing the variance in regional unemployment rates, by analysing wage flexibility or by evaluating the share of the long-term unemployed in the total number of people unemployed.

3. Draft Strategy for Eurozone Accession

25. Under the European legislation, the Czech Republic's entry into the eurozone is tied to its accession to the EU. From the procedural point of view, assuming that the Czech Republic enters the EU in 2004 and fulfils the Maastricht convergence criteria, the first possible year for joining the eurozone is 2007. Membership of the eurozone will enable the Czech Republic to participate fully in formulating and implementing the single European monetary and exchange rate policy and will strengthen the macroeconomic stability of the Czech economy. Participation in the eurozone will speed up the real convergence of the Czech economy towards the EU economies.

26. On the other hand, certain preconditions have to be fulfilled to ensure that the aforementioned positive effects really materialise and that the potential risks of eurozone membership are minimised. In the ERMII exchange rate regime and after the subsequent adoption of the euro, when the Czech Republic will give up its autonomous monetary policy, sufficient alignment of the Czech economy with the eurozone economies in the real and financial spheres, flexible fiscal policy and a well-functioning labour market will be of key importance for the smooth functioning of the economy. To achieve further progress in these areas, the Czech Republic needs to further deepen structural reforms directed at increasing the flexibility of the Czech economy and to consolidate its public finance system.

27. The evaluation of the positive effects and possible risks speaks in support of the Czech Republic's fast entry into the eurozone. However, the current outlook in the fiscal policy area is not fully consistent with this scenario. Accordingly, the aforementioned economic and political measures must be implemented in such a way as not to rule out the possibility of joining the eurozone sometime around 2007.

28. Until the monetary integration process has been completed, independent Czech monetary policy will continue to be implemented by means of the inflation targeting strategy. Continuing participation of the koruna in the ERMII is consistent with this strategy. The ERMII is regarded merely as the gateway to eurozone participation and not as an alternative to the existing monetary policy regime.

ANNEX 2

Fiscal consolidation and its effect on economic growth

In December 2002, the CNB published a document *The Czech Republic and the euro – Draft accession strategy* defining the starting points and basic economic policy measures for fostering greater economic integration after accession to the EU. The concluding part of this document speaks in support of the Czech Republic's fast entry into the eurozone, since the positive effects of this choice outweigh the potential risks. Joining the eurozone is conditional on fulfilment of the Maastricht criteria, including the criteria in the fiscal area. Sound fiscal development, aimed at achieving balanced public budgets, will create the necessary fiscal-policy room to implement stabilisation measures, helping the Czech Republic to reap the benefits and minimise the risks arising from membership of the monetary union.

However, the past developments and the immediate outlook for the public budgets in the Czech Republic are characterised by opposite trends, i.e. widening deficits, increasing debt and a loss of the stabilising function of fiscal policy. In the medium term, the widening public finance deficit may be accompanied by a loss of the growth trend and by dramatic signs of external imbalance. These trends are unsustainable in the long run, so consolidation of public budgets must be a fiscal policy priority. The obligations and requirements arising from the Czech Republic's accession to the European Union, and the subsequent preparations for adopting the single currency, thus represent only one, formal, aspect of the problem. The key argument is that consolidation of public finances is a necessary condition for sustainable macroeconomic growth and improved performance of the Czech economy.

For the central bank it is important to analyse the impacts of the consolidation process on the economy. The consolidation will pass through – via various transmission channels – into GDP and its components, into unemployment, inflation and the exchange rate, and into many other economic indicators at both the macroeconomic and microeconomic level. This in turn will require an appropriate monetary policy response. For this reason, a simulation analysis of fiscal development has been conducted at the CNB, focusing primarily on the period 2004–2006. This period was chosen for reasons of comparability with Ministry of Finance documents and bearing in mind the necessary degree of credibility of macroeconomic predictions and, last but not least, the economic and political consequences of the Czech Republic's accession to the EU.

The analyses show that the problem with the public budgets lies on the expenditure side, and in particular in the extremely high and ever-growing proportion of mandatory expenditures, which is expanding out of step with economic growth. On the revenue side, the possibilities for change are limited by the risk of a loss of tax competitiveness, since increasing the tax burden above the level in neighbouring countries could dissuade foreign investors from operating in the Czech Republic. The model analysis of the impacts of public finance consolidation takes this fact into account and concentrates on corrections to the expenditure side of the budgets. Although in reality numerous combinations of reform measures are possible, each having a different impact on the structure of public expenditure, for monetary-policy purposes it is sufficient to consider two marginal alternatives based on the fact that inefficient spending can be cut either selectively or across-the-board. These scenarios are not reform proposals in the area of public finances. They are merely points of reference intended as a starting point for modelling the impacts of different fiscal trajectories on macroeconomic growth with implications for monetary policy.

The scenario of an across-the-board reduction in expenditure is based on the principle of expenditure being reduced by the same proportion in all the budget chapters. To achieve the objective of balanced budgets in the medium run, it is vital that the nominal growth in expenditure is only slightly above the inflation level. This real expenditure stagnation is in essence divided equally between all the expenditure items.

In the scenario of a selective reduction in expenditure, two possibilities were analysed: that of making a large one-off correction in the selected expenditure items at the start of the period, and that of spreading this correction over the whole period. The second possibility also incorporated an assumed slowdown in the growth rate of transfers to households to the level of inflation, so as to simulate the need to intervene in the "mandatory" expenditures and to achieve, as an intermediate target, fulfilment of the Maastricht budget criteria at the end of the given period.

For comparison, the scenario of "inertia" in the public budgets was also analysed. This envisages that no major reforms will be implemented and that the present trends will continue into the future. On the expenditure side it is assumed that there will be no substantial change in structure and that the key expenditure items will grow at the same pace, equal to the growth in GDP. The main characteristic of the inertia scenario is that the public finance deficit will reach 8% of GDP and public debt 50% of GDP at the end of the period.

All the above scenarios were based on the Czech Ministry of Finance's outlook for public finances in 2003 as contained in the State Budget Bill. On the revenue side it was assumed that the tax quota would remain at the initial year's level for the whole period. For each scenario it was also assumed that the immediate savings in expenditure will be reinforced with reform measures in the pension area to foster sustainable development of public finances in the medium and long run.

The above scenarios formed the basis for a more detailed assessment of the impacts of public finance consolidation on Czech economic growth. In the first phase of the analysis, the direct demand impact of implementing each scenario was quantified using several approaches. The overall impact of consolidation quantified in this way was a short-term slowdown in growth (of about one percentage point).

In the second phase of the analysis, the monetary policy response to the changes in fiscal policy defined in each scenario was also estimated. The logic was as follows: a reduction in public budget expenditure leads to a decline in GDP growth, a subsequent reduction in interest rates, a depreciation of the koruna and an improvement in net exports. The extent of the monetary policy response under these conditions depends – via the risk premium – on the degree of fiscal consolidation. With a high growth rate of public budget indebtedness, an increase in public debt will probably lead to greater mistrust on the part of foreign investors and, in the parlance of uncovered interest parity, to a rise in the risk premium. By contrast, sound fiscal development will be reflected in a decrease in the risk premium and hence in lower interest rates.

These effects were quantified in two steps. The first step was based on the use of a small QPM model for reactive monetary policy. This allows us to show the consistent course of macroeconomic fundamentals such as inflation, GDP, the exchange rate and interest rates in relation to the fiscal consolidation scenario. In the second step, a control of the consistency of the previous simulations was performed using a HERMIN structural model. The inputs to this model were the individual fiscal consolidation scenarios together with the appropriate course of real interest rates and the exchange rate. The results of the model simulations show that despite a relatively large loss of growth in 2004 there is a rapid recovery thereafter, with GDP growth higher at the end of the period than in the case of the inertia scenario. This is achieved amid lower nominal (and real) interest rates, which thus promote growth in non-fiscal consumption and investment and gradually replace the missing fiscal expenditure.

The general conclusion of the analysis of the impact of public finance consolidation on the economy is that in the immediate future this process may be accompanied by a slowdown in growth. Overall, however, sounder public budgets will have a positive effect on economic performance in the medium run, as is clear from the model considerations incorporating reactive monetary policy. It turns out that timely consolidation incurs lower macroeconomic costs than deferred consolidation. With an appropriate monetary policy response from the central bank, the loss of output is only a short-term affair and is soon offset by higher economic growth.

Minutes of the CNB Bank Board Meetings

Minutes of the Board Meeting on 31 October 2002

Present at the meeting:

Zdeněk Tůma (Governor), Oldřich Dědek (Vice-Governor), Luděk Niedermayer (Vice-Governor),
Michaela Erbenová (Chief Executive Director), Jan Frait (Chief Executive Director),
Pavel Racocha (Chief Executive Director), Pavel Štěpánek (Chief Executive Director)

The Board opened the meeting with a presentation of the large October situational report, which contained the new forecast of inflation and other macroeconomic variables.

Year-on-year consumer price growth in September 2002 was slightly lower than the July prediction. Low regulated price growth, a substantial decline in food prices and the strong exchange rate contributed the most to low inflation developments. Demand-inflation pressures also remained weak. According to the analyses, the negative output gap slightly worsened again during the last quarter.

With respect to exogenous variables, fuel prices showed some pro-inflationary tendencies. However, there was also a downward shift in the economic growth forecast abroad. Following stagnant development this year, German economic growth in 2003 should experience moderate growth of 1.5%. This corresponded to modest price developments abroad, which would be transmitted to Czech inflation as well. After a rise in 2002 Q4, the price of oil in 2003 should slightly decline over time.

The updated forecast anticipated around 2% growth in the Czech economy this year and 1.1% to 2.6% in 2003. Domestic consumption would still be a catalyst for this growth. A strong fiscal impulse existed in 2002, and according to budget figures, should reach approximately 2% of GDP. Therefore, after eliminating the effect of fiscal policy, this meant that domestic demand would increase at a slow pace only. Low foreign demand and a strong exchange rate, which reduced the profits of Czech companies and undermined investor confidence, contributed to this development. Thus, a moderate slowdown in domestic demand could be expected in 2003, at which time the additional fiscal impulse would not be as significant and private investment would be recovering at a slow pace only. This assessment, however, was associated with a high level of uncertainty, because some public budget data were not available.

The inflation forecast assumed a slight rise in inflation for the remainder of 2002. In December of this year, year-on--year consumer price growth should reach about 1%. Due to the expected drop in electricity prices, inflation should experience a drop in January 2003. During the course of 2003, prices should then rise at a faster pace, mainly due to gradual fading of the effect of low import prices and agricultural producer prices. In addition, the growth rate of regulated prices would gradually increase, though it would still remain significantly lower than was expected when the inflation target was originally set. The baseline forecast scenario did not take into account any changes in indirect taxes. In December 2003, inflation would be in a range of 1.6% to 3.0%, i.e. at the lower boundary of the targeted band.

The decline in interest rates in 2002 Q4 and subsequent rate stability was consistent with the forecast based on information available at the time of its formation.

In the discussion to follow, the Board assessed the risks involved with the forecast. One view expressed that lowering the GDP forecast would not reflect so much the newly available information as much as it would a reassessment of current domestic demand development and the contribution of fiscal policy to its growth. Most board members agreed that the new GDP forecast provided an overly pessimistic view, and the real outcome could be expected to be more in the upper half of the forecast range. However, the level of uncertainty was high concerning the extent and timing of fiscal expansion and, in turn, domestic economic activity because of the low transparency of the public finance system, which currently had a negative impact on monetary policy decision-making.

With respect to the inflation forecast, the logic of inflation targeting justified any considerations on lowering interest rates. The given level of uncertainty, however, indicated that more discretion should be taken. In addition, some board members pointed to the potential risks of reducing interest rates. These risks included the development of bubbles, for example, in the area of household lending, which had been rising for some time now at a very rapid rate. Moreover, an added complication could be the relative lack of experience with rates below the Eurozone level. This uncertainty was increasing in strength, because the risks of future exchange rate development could be perceived as more balanced for strengthening and weakening the exchange rate in comparison with the recent past. A worsened growth outlook for the Czech economy could, in addition, support depreciation expectations. Nevertheless, the actual exchange rate value could still be seen as overvalued, and any further easing of monetary conditions through the exchange rate channel would help the economy.

The timing and intensity of recovery in Western Europe was still one of the sources of uncertainty. The forecasts would remain pessimistic for the near future and optimistic over the longer run. This, though, had been going on for two years, with constant delays in the recovery process. Therefore, one opinion expressed that it was risky to rely on anticipated external recovery as a positive stimulus for the domestic economy. In opposition though, another view stated that the expected growth of 1.5% in Germany for 2003 appeared to be a good estimate that was shared by a number of analyst groups.

Following the discussion of the October situational report, the Board decided by a majority vote to lower the CNB two--week repo rate by 0.25 percentage points to 2.75%, effective 1 November 2002. Four board members were in favour of this decision, and three members voted for leaving interest rates at their existing level. The discount and Lombard rates were also lowered by 0.25 percentage points to 1.75% and 3.75%, respectively.

MINUTES OF THE BOARD MEETING ON 28 NOVEMBER 2002

Present at the meeting:

Zdeněk Tůma (Governor), Oldřich Dědek (Vice-Governor), Luděk Niedermayer (Vice-Governor), Michaela Erbenová (Chief Executive Director), Jan Frait (Chief Executive Director), Pavel Racocha (Chief Executive Director), Pavel Štěpánek (Chief Executive Director)

The Board opened the meeting with a presentation of the 11th situational report. The main focus of the presentation was on assessing the importance of the new monetary-relevant data for the balance of risks relating to the October medium-term inflation forecast.

In October, prices in the main price groups were situated slightly below the prediction. Year-on-year CPI growth registered 0.6% in October. The difference in relation to the forecast was caused by a higher-than-expected decline in food prices. Year-on-year growth in industrial producer prices was slightly lower than the CNB's prediction. This was mainly the result of a lower-than-expected rise in the prices of electricity and selected energy raw materials. A year-on-year decline in agricultural producer prices of -10.6% had a strong anti-inflationary effect in October as well.

The year-on-year dynamics of M2 in September remained relatively low at 4.8%. Credit growth was almost entirely concentrated in the area of consumer loans and mortgages. Year-on-year industrial production growth of 9.2% (4.5% after adjusting for the higher number of working days) along with high sales dynamics for industrial production in September compensated for less favourable data from previous months. In the area of domestic demand, figures were released for retail trade turnover in September and sales of services for Q3. In September, the relatively high growth of retail sales in constant prices was affected to a large extent by the two extra business days and demand related to the August floods. The negative effects of the floods were apparent even in sales of services, which declined by -0.4% y-o-y. Weakening domestic and foreign demand was also reflected in the seasonally adjusted unemployment rate, which continued to rise. In the area of the exchange rate, the Czech koruna weakened at a gradual pace during October vis-à-vis the euro.

During the presentation of the situational report, special attention was given to interpreting the foreign trade figures for September and October. The balance of trade deficit in current and constant prices was significantly higher in both months than the CNB's prediction. In this respect, the specific factors behind the balance of trade deficit and their contribution to the overall worsening of the deficit were analysed. These included, in particular, the real exchange rate, foreign and domestic demand and any transient factors. It was mentioned that the relative contribution of these factors to substantial deterioration of the external imbalance was still difficult to identify in view of the short history of data affected by passing events and the possible combined effect of all of these factors.

For October and the first half of November, information in the area of the external environment did not significantly deviate from the assumptions in the October medium-term forecast. In November, Germany's economic growth estimate for 2002 was reduced slightly by 0.2 percentage points to 1.3%. The average October price of Ural oil remained approximately at the same level as the forecast for 2002 Q4. However, a tendency towards a sharp decline in oil prices of about 4 USD/barrel had been evident on world markets since the beginning of October.

In the discussion to follow, the board members identified the main economic areas that had undergone significant changes in order to assess a possible shift in the risks of the October inflation forecast.

One of the main points discussed was the worsening balance of trade deficit during recent months. It was said that a more pronounced decline in the balance of trade deficit in constant prices had so far occurred only in September and October. However, a worsening trend had been observed since the end of the second quarter. Although board members ascribed different levels of intensity to the specific factors of foreign trade, there was consensus on the fact that the recent sharp deterioration in the balance of trade deepened the conflict related to restoring the external and internal balance. The Czech Republic is a small, open economy with a floating exchange rate, and consequently, monetary policy decision-making must inevitably deal with keeping the balance of trade deficit at a financeable level.

The Board agreed that exchange rate expectations would shift in the direction of depreciation due to the worsening balance of trade, the likely decline in the balance of services of the balance of payments and postponement of some privatisation decisions.

The board members described the overall monetary and macroeconomic situation as a low-inflation environment. Under the assumption of achieving the inflation forecast, CPI inflation would stay below the lower band of the inflation target over the next several quarters. In this respect, one view expressed that there were several explanations for the restrained level of inflation pressures. Besides the restrictive influence of a strengthening real exchange rate and low foreign demand dynamics this year, it was also impossible to ignore the impact of the growth rate for regulated prices and indirect taxes, which was lower than initially expected when setting the inflation target. The sharp year-on-year decline in food prices – generally very volatile in nature and often not affected directly by monetary policy over the short run – also helped reduce inflation pressures. Another view pointed to the risk that inflation would move below the lower boundary of the targeted band for a longer period of time than predicted by the actual forecast due primarily to lower-than-expected price growth abroad.

Similarly as in last month's discussion of the situational report, this time the Board also identified as one of the most serious risks the uncertainty surrounding the size and timing of the demand effect of fiscal policy. Members, therefore, pointed to the higher likelihood that a part of the planned fiscal expenditures for this year would shift over to next year, according to available information. This uncertainty complicated the setting of monetary policy in two ways. First of all, the size of the expected demand impulse relating to public finance performance for next year was not known. Secondly, the main factors of economic growth this year would be difficult to quantify.

Following the discussion of the November situational report, the Board decided by a majority vote to leave the CNB two-week repo rate at its current level. Six members were in favour of this decision, and one member voted to reduce interest rates by 0.25 percentage points.

Minutes of the Board Meeting on 19 December 2002

Present at the meeting:

Zdeněk Tůma (Governor), Oldřich Dědek (Vice-Governor), Luděk Niedermayer (Vice-Governor),
Michaela Erbenová (Chief Executive Director), Jan Frait (Chief Executive Director),
Pavel Racocha (Chief Executive Director), Pavel Štěpánek (Chief Executive Director)

The Board discussed the December situational report assessing the new information released since the discussion of the November situational report. The current data on inflation were lower in comparison with the October forecast. Consumer prices in November rose year-on-year by 0.5%, which was 0.4 percentage points less than predicted by the forecast. A slight price decline in most segments of the consumer basket was the reason behind this development. Domestic demand had increased faster and foreign demand slower than the forecast's assumptions.

Foreign demand growth forecasts were adjusted downward by 0.6 percentage points. The cost factors of inflation were anti-inflationary in nature. Industrial and agricultural producer prices were declining. According to the newly available GDP figures, domestic demand was supported in particular by private consumption. Household demand rose at a rate of 5.3%, 1.1 percentage points more than the October forecast. Higher-than-expected domestic demand dynamics also contributed to a worsening external imbalance. The growth rate for the wider monetary aggregates increased to 6%–7%, and credit growth continued to recover.

The Board agreed that, in comparison to the October forecast, the newly available data increased the risks on both sides of the forecast and, in turn, the overall uncertainty related to future economic development. There was consensus among board members that global developments would shift the balance of risks in an anti-inflationary direction, because the foreign economic growth forecasts were adjusted downward. Foreign prices and foreign demand would help slow domestic inflation. One view expressed that even the adjusted global development forecasts anticipated a slight recovery as early as next year. It was also mentioned that a reduction in the monetary rates of neighbouring central banks was a reaction to information the CNB had already reflected in its interest rate decision-making.

The Board also discussed what the main sources of domestic economic growth had been in an environment of weakened foreign demand. It was repeatedly stated that the newly available GDP figures, including newly revised data for 2002 Q2, pointed to household consumption as being the main source of growth this year. The demand fiscal impulse was less significant than originally expected. In this respect, however, it was added that household consumption was supported to a certain degree by fiscal transfers and that it was not easy to clearly differentiate between these two sources of growth. Furthermore, it was expressed that estimates of the overall fiscal impulse were very difficult to form using the available data and that there was considerable uncertainty relating to the extent of fiscal expansion. Another view expressed that the fiscal impulse, whose impact had been expected this year, could be carried over to 2003. It was stated that slowed economic growth had not been caused by weakened foreign demand alone, but also by the supply side of the economy. It was further expressed that consumption of the population was supported more by temporary factors, and therefore, this growth must slow down over time.

The fact that low GDP growth was observed accompanied by strong domestic demand and more rigid supply was repeatedly indicated as an argument against lowering rates. A deteriorating current account deficit was commonly associated with strong domestic demand. An interest rate cut could cause the external imbalance to deteriorate even further. However, the domestic economy had been faced with external constraints and even raising the current account deficit had its limits. In addition, cutting rates was not an appropriate economic instrument for stimulating more rigid supply. It was repeatedly stated that the structure of domestic growth factors had inflationary tendencies.

The Board discussed whether or not the anti-inflationary risks could outweigh the pro-inflationary risks and whether a reduction in rates would be an appropriate monetary policy response. It was repeatedly expressed that the effects of easing monetary conditions caused this year by interest rate cuts and exchange rate developments would fully materialise during 2003.

At the close of the meeting, the Board decided unanimously to leave the CNB two-week repo rate unchanged at 2.75%.

INFLATION DEVELOPMENT

annual percentage changes

	1998											
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	13.1	13.4	13.4	13.1	13.0	12.0	10.4	9.4	8.8	8.2	7.5	6.8
Regulated prices	30.7	30.8	30.8	30.1	29.8	29.7	21.1	20.9	20.4	20.6	20.5	20.4
(contribution to consumer price inflation)	*6.36*	*6.38*	*6.38*	*6.26*	*6.20*	*6.11*	*5.00*	*4.91*	*4.79*	*4.81*	*4.78*	*4.73*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*	*0.73*
Net inflation	7.5	7.9	7.9	7.6	7.6	6.5	6.1	4.9	4.3	3.4	2.6	1.7
(contribution to consumer price inflation)	*6.00*	*6.31*	*6.32*	*6.08*	*6.07*	*5.19*	*4.66*	*3.73*	*3.31*	*2.64*	*1.96*	*1.32*
of which: prices of food, beverages and tobacco	6.0	6.8	7.2	7.2	7.5	5.8	5.4	3.8	3.1	1.9	0.4	-1.2
(contribution to consumer price inflation)	*1.97*	*2.22*	*2.40*	*2.44*	*2.88*	*1.96*	*1.75*	*1.21*	*1.00*	*0.60*	*0.14*	*-0.38*
adjusted inflation	8.5	8.6	8.4	7.9	7.7	6.9	6.6	5.6	5.1	4.5	4.0	3.7
(contribution to consumer price inflation)	*4.03*	*4.09*	*3.92*	*3.64*	*3.19*	*3.22*	*2.91*	*2.53*	*2.30*	*2.04*	*1.82*	*1.70*
Inflation rate (annual moving average)	8.9	9.5	10.0	10.5	11.1	11.5	11.6	11.5	11.4	11.2	11.0	10.7
	1999											
Consumer prices	3.5	2.8	2.5	2.5	2.4	2.2	1.1	1.4	1.2	1.4	1.9	2.5
Regulated prices	12.1	11.9	11.7	11.1	11.1	11.0	4.4	4.3	4.3	4.2	4.2	4.2
(contribution to consumer price inflation)	*2.97*	*2.90*	*2.87*	*2.75*	*2.74*	*2.72*	*1.13*	*1.12*	*1.12*	*1.08*	*1.08*	*1.09*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.32*	*0.32*	*0.32*	*0.32*	*0.32*	*0.32*
Net inflation	0.7	-0.1	-0.4	-0.3	-0.5	-0.6	-0.5	-0.1	-0.3	0.0	0.6	1.5
(contribution to consumer price inflation)	*0.54*	*-0.06*	*-0.33*	*-0.21*	*-0.37*	*-0.49*	*-0.36*	*-0.06*	*-0.21*	*0.02*	*0.47*	*1.14*
of which: prices of food, beverages and tobacco	-2.0	-3.1	-4.0	-4.3	-4.8	-5.0	-4.8	-4.1	-4.1	-3.6	-2.4	-0.7
(contribution to consumer price inflation)	*-0.61*	*-0.98*	*-1.25*	*-1.34*	*-1.48*	*-1.53*	*-1.44*	*-1.24*	*-1.24*	*-1.09*	*-0.71*	*-0.22*
adjusted inflation	2.6	2.1	2.1	2.5	2.5	2.3	2.5	2.7	2.3	2.5	2.6	3.0
(contribution to consumer price inflation)	*1.15*	*0.91*	*0.92*	*1.13*	*1.11*	*1.04*	*1.08*	*1.17*	*1.04*	*1.11*	*1.17*	*1.35*
Inflation rate (annual moving average)	9.8	8.9	8.0	7.1	6.3	5.5	4.7	4.1	3.4	2.9	2.5	2.1
	2000											
Consumer prices	3.4	3.7	3.8	3.4	3.7	4.1	3.9	4.1	4.1	4.4	4.3	4.0
Regulated prices	7.3	7.3	7.3	7.4	7.5	7.8	6.9	7.0	7.0	7.2	7.3	7.3
(contribution to consumer price inflation)	*1.94*	*1.95*	*1.96*	*1.98*	*1.99*	*2.09*	*1.87*	*1.90*	*1.91*	*1.98*	*1.99*	*1.97*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.32*	*0.32*	*0.32*	*0.14*	*0.14*	*0.14*	*-0.18*	*-0.18*	*-0.18*	*-0.18*	*-0.18*	*-0.18*
Net inflation	1.6	1.9	2.1	1.7	2.1	2.6	3.1	3.2	3.2	3.5	3.4	3.0
(contribution to consumer price inflation)	*1.19*	*1.38*	*1.55*	*1.27*	*1.57*	*1.90*	*2.25*	*2.36*	*2.35*	*2.57*	*2.49*	*2.16*
of which: prices of food, beverages and tobacco	-0.6	0.0	0.1	-0.4	0.2	0.4	1.6	2.5	2.8	3.9	3.9	3.6
(contribution to consumer price inflation)	*-0.16*	*0.00*	*0.02*	*-0.12*	*0.07*	*0.13*	*0.45*	*0.73*	*0.79*	*1.06*	*1.06*	*1.01*
adjusted inflation	3.1	3.2	3.5	3.2	3.4	4.0	4.1	3.8	3.5	3.4	3.2	2.6
(contribution to consumer price inflation)	*1.35*	*1.39*	*1.53*	*1.39*	*1.49*	*1.77*	*1.80*	*1.63*	*1.56*	*1.51*	*1.43*	*1.15*
Inflation rate (annual moving average)	2.1	2.2	2.3	2.4	2.5	2.6	2.9	3.1	3.3	3.6	3.8	3.9
	2001											
Consumer prices	4.2	4.0	4.1	4.6	5.0	5.5	5.9	5.5	4.7	4.4	4.2	4.1
Regulated prices	10.3	10.4	10.6	10.8	10.7	10.4	11.5	11.8	11.9	11.8	11.7	11.7
(contribution to consumer price inflation)	*1.95*	*1.98*	*2.01*	*1.98*	*2.00*	*1.97*	*2.12*	*2.19*	*2.19*	*2.19*	*2.16*	*2.17*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*-0.18*	*-0.18*	*-0.18*	*0.00*	*0.00*	*0.00*	*0.01*	*0.01*	*0.05*	*0.05*	*0.05*	*0.05*
Net inflation	3.0	2.9	2.9	3.3	3.8	4.4	4.7	4.1	3.1	2.7	2.4	2.4
(contribution to consumer price inflation)	*2.37*	*2.23*	*2.24*	*2.62*	*2.97*	*3.52*	*3.74*	*3.31*	*2.54*	*2.15*	*1.98*	*1.92*
of which: prices of food, beverages and tobacco	3.8	3.5	4.2	5.5	6.0	7.7	6.9	5.1	4.0	2.9	2.6	2.9
(contribution to consumer price inflation)	*1.09*	*1.02*	*1.25*	*1.62*	*1.78*	*2.24*	*2.11*	*1.70*	*1.28*	*0.97*	*0.87*	*0.80*
adjusted inflation	2.5	2.4	2.0	1.9	2.3	2.4	3.2	3.4	2.5	2.4	2.3	2.1
(contribution to consumer price inflation)	*1.28*	*1.21*	*0.99*	*1.00*	*1.18*	*1.27*	*1.63*	*1.62*	*1.26*	*1.17*	*1.11*	*1.12*
Inflation rate (annual moving average)	4.0	4.0	4.0	4.1	4.2	4.3	4.5	4.6	4.7	4.7	4.7	4.7
	2002											
Consumer prices	3.7	3.9	3.7	3.2	2.5	1.2	0.6	0.6	0.8	0.6	0.5	0.6
Regulated prices	7.6	8.1	8.0	6.5	6.3	6.3	5.3	5.0	4.9	3.4	3.4	3.3
(contribution to consumer price inflation)	*1.49*	*1.60*	*1.59*	*1.28*	*1.24*	*1.22*	*1.05*	*0.98*	*0.98*	*0.69*	*0.69*	*0.66*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	2.7	2.7	2.5	2.4	1.5	-0.1	-0.6	-0.6	-0.3	-0.1	-0.2	-0.2
(contribution to consumer price inflation)	*2.20*	*2.15*	*2.01*	*1.89*	*1.20*	*-0.12*	*-0.47*	*-0.46*	*-0.22*	*-0.11*	*-0.18*	*-0.15*
of which: prices of food, beverages and tobacco	3.2	3.0	2.3	1.7	0.6	-2.6	-3.6	-3.5	-2.9	-3.0	-3.2	-3.4
(contribution to consumer price inflation)	*0.88*	*0.82*	*0.65*	*0.47*	*0.16*	*-0.72*	*-0.97*	*-0.96*	*-0.79*	*-0.80*	*-0.87*	*-0.93*
adjusted inflation	2.5	2.5	2.6	2.7	2.0	1.1	0.9	0.9	1.1	1.3	1.3	1.5
(contribution to consumer price inflation)	*1.32*	*1.33*	*1.37*	*1.43*	*1.04*	*0.60*	*0.50*	*0.50*	*0.56*	*0.69*	*0.69*	*0.79*
Inflation rate (annual moving average)	4.6	4.6	4.6	4.5	4.3	3.9	3.5	3.1	2.7	2.4	2.1	1.8

CNB calculation based on CSO data

INFLATION DEVELOPMENT

monthly percentage changes

	1	2	3	4	5	6	7	8	9	10	11	12
						1998						
Consumer prices	4.0	0.6	0.1	0.3	0.1	0.3	1.9	-0.2	0.1	-0.2	-0.2	-0.2
Regulated prices	9.3	0.4	0.2	0.6	0.0	0.1	8.4	0.0	0.1	0.2	0.0	0.0
(contribution to consumer price inflation)	*2.13*	*0.09*	*0.03*	*0.13*	*0.01*	*0.03*	*2.07*	*0.01*	*0.03*	*0.04*	*0.00*	*0.01*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.73*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	1.5	0.7	0.1	0.2	0.1	0.4	-0.2	-0.3	0.1	-0.3	-0.3	-0.3
(contribution to consumer price inflation)	*1.14*	*0.54*	*0.10*	*0.16*	*0.07*	*0.28*	*-0.13*	*-0.23*	*0.07*	*-0.19*	*-0.25*	*-0.19*
of which: prices of food, beverages and tobacco	1.7	0.8	0.2	0.3	0.1	0.4	-1.4	-0.9	0.0	-0.6	-1.0	-0.9
(contribution to consumer price inflation)	*0.52*	*0.24*	*0.08*	*0.10*	*0.03*	*0.12*	*-0.42*	*-0.26*	*0.00*	*-0.16*	*-0.28*	*-0.26*
adjusted inflation	1.4	0.7	0.0	0.1	0.1	0.4	0.6	0.1	0.2	-0.1	0.1	0.2
(contribution to consumer price inflation)	*0.62*	*0.30*	*0.02*	*0.06*	*0.04*	*0.16*	*0.28*	*0.03*	*0.07*	*-0.03*	*0.03*	*0.07*
						1999						
Consumer prices	0.8	0.0	-0.2	0.3	-0.1	0.2	0.8	0.1	-0.1	0.0	0.2	0.5
Regulated prices	1.8	0.2	0.0	0.1	0.0	0.0	1.9	0.0	0.1	0.0	0.0	0.0
(contribution to consumer price inflation)	*0.46*	*0.04*	*0.01*	*0.02*	*0.01*	*0.01*	*0.49*	*0.00*	*0.02*	*0.00*	*0.01*	*0.01*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.32*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.5	-0.1	-0.2	0.4	-0.1	0.2	0.0	0.1	-0.1	0.0	0.3	0.6
(contribution to consumer price inflation)	*0.36*	*-0.07*	*-0.17*	*0.27*	*-0.08*	*0.16*	*-0.01*	*0.06*	*-0.08*	*0.03*	*0.20*	*0.47*
of which: prices of food, beverages and tobacco	0.9	-0.5	-0.7	0.0	-0.4	0.2	-1.2	-0.2	0.0	0.0	0.3	0.8
(contribution to consumer price inflation)	*0.25*	*-0.13*	*-0.19*	*0.00*	*-0.11*	*0.06*	*-0.35*	*-0.05*	*0.00*	*-0.01*	*0.09*	*0.22*
adjusted inflation	0.2	0.1	0.0	0.6	0.1	0.2	0.7	0.3	-0.1	0.1	0.2	0.6
(contribution to consumer price inflation)	*0.11*	*0.06*	*0.02*	*0.27*	*0.03*	*0.10*	*0.33*	*0.12*	*-0.07*	*0.04*	*0.10*	*0.25*
						2000						
Consumer prices	1.7	0.2	0.0	-0.1	0.2	0.6	0.6	0.2	0.0	0.3	0.1	0.2
Regulated prices	4.8	0.1	0.1	0.2	0.1	0.4	1.0	0.1	0.1	0.2	0.1	0.1
(contribution to consumer price inflation)	*1.29*	*0.04*	*0.02*	*0.05*	*0.02*	*0.10*	*0.27*	*0.02*	*0.03*	*0.06*	*0.03*	*0.01*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*-0.18*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.6	0.2	0.0	0.0	0.3	0.7	0.5	0.2	-0.1	0.3	0.1	0.2
(contribution to consumer price inflation)	*0.42*	*0.13*	*-0.01*	*-0.01*	*0.21*	*0.48*	*0.34*	*0.18*	*-0.08*	*0.26*	*0.10*	*0.14*
of which: prices of food, beverages and tobacco	1.0	0.1	-0.6	-0.5	0.3	0.4	-0.1	0.7	0.3	1.1	0.3	0.6
(contribution to consumer price inflation)	*0.30*	*0.03*	*-0.17*	*-0.14*	*0.07*	*0.11*	*-0.02*	*0.20*	*0.08*	*0.29*	*0.08*	*0.16*
adjusted inflation	0.3	0.2	0.3	0.3	0.3	0.8	0.8	0.0	-0.4	-0.1	0.0	0.0
(contribution to consumer price inflation)	*0.12*	*0.10*	*0.15*	*0.13*	*0.14*	*0.37*	*0.36*	*-0.02*	*-0.15*	*-0.04*	*0.02*	*-0.02*
						2001						
Consumer prices	1.9	0.0	0.1	0.4	0.6	1.0	1.0	-0.2	-0.7	0.0	-0.1	0.1
Regulated prices	7.7	0.3	0.2	0.3	0.0	0.1	2.1	0.3	0.2	0.1	0.0	0.0
(contribution to consumer price inflation)	*1.43*	*0.05*	*0.05*	*0.06*	*0.00*	*0.01*	*0.41*	*0.06*	*0.04*	*0.03*	*-0.01*	*0.01*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.01*	*0.00*	*0.05*	*0.00*	*0.00*	*0.00*
Net inflation	0.6	0.0	0.0	0.4	0.8	1.3	0.7	-0.3	-1.0	-0.1	-0.1	0.2
(contribution to consumer price inflation)	*0.45*	*0.01*	*-0.01*	*0.31*	*0.57*	*1.07*	*0.56*	*-0.21*	*-0.82*	*-0.10*	*-0.05*	*0.10*
of which: prices of food, beverages and tobacco	1.2	-0.2	0.1	0.7	0.8	2.0	-0.9	-1.0	-0.8	0.0	0.0	0.9
(contribution to consumer price inflation)	*0.33*	*-0.06*	*0.03*	*0.19*	*0.23*	*0.56*	*-0.24*	*-0.27*	*-0.21*	*0.00*	*-0.01*	*0.24*
adjusted inflation	0.2	0.1	-0.1	0.2	0.7	1.0	1.5	0.1	-1.2	-0.2	-0.1	-0.3
(contribution to consumer price inflation)	*0.12*	*0.07*	*-0.04*	*0.12*	*0.34*	*0.51*	*0.81*	*0.06*	*-0.62*	*-0.10*	*-0.03*	*-0.14*
						2002						
Consumer prices	1.5	0.2	-0.1	-0.1	-0.1	-0.3	0.5	-0.2	-0.5	-0.3	-0.2	0.2
Regulated prices	3.7	0.8	0.2	-1.1	-0.1	0.0	1.1	0.0	0.1	-1.3	0.0	-0.1
(contribution to consumer price inflation)	*0.75*	*0.16*	*0.04*	*-0.23*	*-0.03*	*0.00*	*0.23*	*-0.01*	*0.03*	*-0.26*	*0.00*	*-0.02*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.9	0.0	-0.2	0.2	-0.1	-0.3	0.3	-0.2	-0.7	0.0	-0.1	0.2
(contribution to consumer price inflation)	*0.74*	*-0.03*	*-0.14*	*0.20*	*-0.11*	*-0.24*	*0.20*	*-0.19*	*-0.58*	*0.01*	*-0.11*	*0.13*
of which: prices of food, beverages and tobacco	1.5	-0.4	-0.5	0.1	-0.3	-1.2	-1.9	-1.0	-0.1	0.0	-0.3	0.7
(contribution to consumer price inflation)	*0.41*	*-0.11*	*-0.14*	*0.01*	*-0.08*	*-0.32*	*-0.50*	*-0.25*	*-0.03*	*-0.01*	*-0.08*	*0.18*
adjusted inflation	0.6	0.2	0.0	0.3	-0.1	0.2	1.3	0.1	-1.0	0.0	-0.1	-0.1
(contribution to consumer price inflation)	*0.33*	*0.08*	*0.00*	*0.18*	*-0.04*	*0.08*	*0.70*	*0.07*	*-0.56*	*0.02*	*-0.03*	*-0.05*

CNB calculation based on CSO data

CONSUMER PRICES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 1998	1000.0	-4.9	-4.3	-4.2	-3.9	-3.8	-3.5	-1.7	-1.9	-1.8	-1.9	-2.2	-2.4	-3.0
Total - 1999	1000.0	-1.6	-1.6	-1.7	-1.5	-1.5	-1.4	-0.6	-0.5	-0.6	-0.5	-0.3	0.1	-1.0
Total - 2000	1000.0	1.8	2.0	2.0	1.9	2.1	2.7	3.3	3.5	3.5	3.8	3.9	4.1	2.9
Food and non-alcoholic beverages	197.6	1.8	1.9	1.1	0.4	0.7	1.3	1.1	1.7	2.1	3.5	3.8	4.6	2.0
Alcoholic beverages and tobacco	79.2	0.5	0.6	0.8	0.9	1.0	1.0	1.4	2.3	2.5	2.5	2.6	2.4	1.5
Clothing and footwear	56.9	-0.7	-1.7	-2.2	-2.1	-2.0	-2.0	-2.5	-2.9	-3.0	-2.8	-2.6	-2.7	-2.3
Housing, water, electricity, gas and other fuels	236.4	4.6	4.8	4.9	5.2	5.3	5.5	7.0	7.2	7.3	7.6	7.8	7.8	6.3
Furnishings, household equipment and routine maintenance of the house	67.9	-0.3	-0.4	-0.3	-0.3	-0.4	-0.6	-0.6	-0.7	-0.7	-0.9	-0.8	-0.7	-0.6
Health	14.3	1.8	2.2	2.6	2.8	3.1	3.5	3.7	3.9	4.1	4.0	3.9	4.1	3.3
Transport	101.4	0.8	1.4	4.0	3.6	4.8	8.4	8.8	8.0	8.6	8.4	8.0	6.9	6.0
Communications	22.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Recreation and culture	95.5	0.1	1.2	0.4	-0.3	-0.4	0.5	3.8	4.7	1.7	0.9	1.1	2.0	1.3
Education	4.5	0.2	0.9	1.0	1.0	1.0	1.3	1.3	1.3	3.3	3.3	3.3	3.4	1.8
Hotels, cafés and restaurants	74.2	0.6	0.9	0.9	1.1	1.3	1.3	1.4	1.5	2.0	2.4	2.5	2.6	1.5
Miscellaneous goods and services	49.5	2.1	2.3	2.4	2.4	2.5	2.6	2.6	2.7	2.7	2.9	3.1	3.1	2.6
Total - 2001	1000.0	6.1	6.1	6.2	6.6	7.2	8.3	9.4	9.2	8.4	8.4	8.3	8.4	7.7
Food and non-alcoholic beverages	197.6	6.0	5.5	5.5	6.4	7.5	10.5	9.2	7.7	6.7	6.6	6.5	7.9	7.2
Alcoholic beverages and tobacco	79.2	3.4	3.9	4.3	4.6	4.9	5.0	4.9	4.9	5.2	5.5	5.6	5.4	4.8
Clothing and footwear	56.9	-3.3	-4.0	-4.0	-3.8	-3.7	-3.7	-3.9	-4.4	-4.4	-4.1	-3.8	-3.9	-3.9
Housing, water, electricity, gas and other fuels	236.4	14.2	14.4	14.6	14.8	15.1	15.4	18.4	18.6	18.8	18.9	19.0	19.0	16.8
Furnishings, household equipment and routine maintenance of the house	67.9	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.2	-0.3	-0.4	-0.4
Health	14.3	4.7	4.9	5.1	5.3	5.4	5.7	6.5	7.5	8.6	8.9	8.3	8.4	6.6
Transport	101.4	4.9	4.8	4.7	5.8	7.5	8.7	8.2	7.6	7.8	6.5	5.3	3.4	6.3
Communications	22.5	7.2	7.1	7.1	7.0	6.8	6.7	6.6	6.5	6.0	5.9	5.8	5.7	6.5
Recreation and culture	95.5	2.7	3.4	2.9	2.3	3.3	7.0	13.7	15.3	7.1	6.5	6.8	7.2	6.5
Education	4.5	3.4	3.4	3.5	3.5	3.5	3.6	3.6	3.6	6.7	6.8	6.8	6.8	4.6
Hotels, cafés and restaurants	74.2	3.1	3.6	3.3	3.7	4.0	4.1	4.2	4.4	5.2	5.5	5.7	5.9	4.4
Miscellaneous goods and services	49.5	5.0	5.5	6.2	7.3	7.4	7.4	7.7	7.6	7.8	8.4	8.6	8.7	7.3
Total - 2002	1000.0	10.0	10.2	10.1	10.0	9.9	9.6	10.1	9.9	9.3	9.0	8.8	9.0	9.7
Food and non-alcoholic beverages	197.6	10.0	9.4	8.7	8.3	7.8	6.0	3.2	1.7	1.5	1.4	1.0	2.1	5.1
Alcoholic beverages and tobacco	79.2	5.8	5.8	5.6	6.8	7.0	7.0	7.1	7.3	7.4	7.5	7.4	7.1	6.8
Clothing and footwear	56.9	-4.7	-5.5	-5.7	-5.7	-5.7	-5.8	-6.4	-7.4	-7.4	-7.4	-7.4	-7.7	-6.4
Housing, water, electricity, gas and other fuels	236.4	23.5	23.6	23.7	22.6	22.6	22.6	24.9	25.0	25.0	24.2	24.3	24.3	23.9
Furnishings, household equipment and routine maintenance of the house	67.9	-0.4	-0.5	-0.3	-0.3	-0.3	-0.4	-0.5	-0.7	-0.7	-0.8	-0.9	-1.0	-0.6
Health	14.3	9.2	9.7	10.1	10.2	10.9	11.2	12.9	13.1	13.3	13.0	12.8	12.8	11.6
Transport	101.4	3.0	3.0	3.3	5.5	5.1	4.7	4.1	3.9	5.1	4.9	4.6	4.1	4.3
Communications	22.5	6.0	11.4	11.3	11.3	9.9	9.9	11.1	11.0	11.6	9.4	9.3	8.2	10.0
Recreation and culture	95.5	7.4	8.5	7.9	7.2	7.0	8.4	13.8	15.2	7.3	7.2	7.0	7.2	8.7
Education	4.5	6.9	7.0	7.0	7.0	7.0	7.0	7.0	7.0	10.7	11.3	11.3	11.3	8.4
Hotels, cafés and restaurants	74.2	6.4	7.0	7.4	7.9	8.0	8.2	8.4	8.4	8.5	8.6	8.6	8.7	8.0
Miscellaneous goods and services	49.5	11.0	11.2	11.3	11.6	11.6	11.5	11.5	11.4	11.7	11.9	12.0	11.9	11.6

Source: CSO

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2000	2001	2002			
		12	12	3	6	9	12
1. Food and non-alcoholic beverages	197.6	4.6	7.9	8.7	6.0	1.5	2.1
- tradables	197.6	4.6	7.9	8.7	6.0	1.5	2.1
2. Alcoholic beverages and tobacco	79.2	2.4	5.4	5.6	7.0	7.4	7.1
- tradables	79.2	2.4	5.4	5.6	7.0	7.4	7.1
3. Clothing and footwear	56.9	-2.7	-3.9	-5.7	-5.8	-7.4	-7.7
- nontradables	1.4	6.1	13.0	15.7	16.9	17.6	18.3
- tradables	55.5	-2.9	-4.3	-6.2	-6.4	-8.0	-8.4
4. Housing, water, electricity, gas and other fuels	236.4	7.8	19.0	23.7	22.6	25.0	24.3
- nontradables	226.1	8.1	19.7	24.6	23.5	26.0	25.2
- tradables	10.3	2.3	2.7	4.0	1.9	4.0	4.0
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.7	-0.4	-0.3	-0.4	-0.7	-1.0
- nontradables	2.9	4.3	7.5	8.8	9.3	9.8	9.9
- tradables	65.0	-0.9	-0.8	-0.7	-0.8	-1.2	-1.5
6. Health	14.3	4.1	8.4	10.1	11.2	13.3	12.8
- nontradables	11.0	4.9	10.1	12.1	13.4	16.0	15.4
- tradables	3.3	1.5	2.7	3.7	4.0	4.6	4.4
7. Transport	101.4	6.9	3.4	3.3	4.7	5.1	4.1
- nontradables	27.4	6.2	11.7	15.5	16.0	16.0	16.0
- tradables	74.0	7.2	0.3	-1.2	0.5	1.1	-0.3
8. Communications	22.5	1.5	5.7	11.3	9.9	11.6	8.2
- nontradables	21.0	2.7	8.5	14.8	13.5	15.6	12.4
- tradables	1.5	-16.4	-34.7	-39.3	-41.3	-45.6	-52.1
9. Recreation and culture	95.5	2.0	7.2	7.9	8.4	7.3	7.2
- nontradables	60.4	4.4	14.3	15.7	17.5	16.5	16.2
- tradables	35.1	-2.2	-5.0	-5.5	-7.3	-8.6	-8.3
10. Education	4.5	3.4	6.8	7.0	7.0	10.7	11.3
- nontradables	4.5	3.4	6.8	7.0	7.0	10.7	11.3
11. Hotels, cafés and restaurants	74.2	2.6	5.9	7.4	8.2	8.5	8.7
- nontradables	74.2	2.6	5.9	7.4	8.2	8.5	8.7
12. Miscellaneous goods and services	49.5	3.1	8.7	11.3	11.5	11.7	11.9
- nontradables	22.0	5.7	17.5	23.5	24.2	25.2	25.8
- tradables	27.5	1.1	1.7	1.6	1.4	0.9	0.8
Household consumer prices, total	1000.0	4.1	8.4	10.0	9.6	9.2	9.0
Tradables	549.1	2.5	2.9	2.8	2.0	0.3	0.2
- food	276.8	4.0	7.2	7.8	6.3	3.2	3.5
- others	272.3	1.0	-1.5	-2.3	-2.3	-2.7	-3.2
Nontradables	450.9	6.0	15.2	18.9	18.8	20.2	19.7
- others	271.2	4.7	11.5	14.0	14.8	16.1	16.4
- regulated	179.7	8.0	20.6	26.3	24.8	26.3	24.6

CNB calculation based on CSO data

INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS FOR 12 MONTHS AHEAD

annual percentage changes

	CPI		
	Financial market	Businesses	Households
12/98			
1/99			
2/99			
3/99			
4/99			
5/99	5.0		
6/99	4.7	4.3	3.6
7/99	4.8		
8/99	4.2		
9/99	3.9	3.9	2.1
10/99	4.1		
11/99	3.9		
12/99	4.2	3.9	3.1
1/00	4.0		
2/00	4.5		
3/00	4.5	4.3	4.1
4/00	4.2		
5/00	4.1		
6/00	4.4	4.8	4.1
7/00	4.6		
8/00	4.5		
9/00	4.7	5.0	4.6
10/00	4.6		
11/00	4.8		
12/00	5.0	4.7	4.1
1/01	4.5		
2/01	4.3		
3/01	4.2	4.2	4.0
4/01	4.0		
5/01	4.3		
6/01	4.6	4.8	5.1
7/01	4.6		
8/01	4.7		
9/01	4.8	4.8	4.9
10/01	4.4		
11/01	4.0		
12/01	3.9	3.9	4.6
1/02	3.8		
2/02	3.5		
3/02	3.5	3.6	3.9
4/02	3.5		
5/02	3.3		
6/02	3.1	2.7	1.6
7/02	2.8		
8/02	2.7		
9/02	3.1	1.9	1.3
10/02	2.5		
11/02	2.4		
12/02	2.3	2.3	2.6

Source: CNB statistical survey

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	1998	1999	2000	2001	2002
	12	12	12	12	11
Belgium	0.7	2.1	3.0	2.0	1.1
Denmark	1.1	3.1	2.3	2.1	2.8
Finland	0.8	2.2	2.9	2.3	1.7
France	0.3	1.4	1.7	1.4	2.1
Ireland	2.2	3.9	4.6	4.4	4.7
Italy	1.7	2.1	2.8	2.2	2.9
Luxembourg	0.4	2.3	4.3	0.9	2.7
Germany	0.2	1.4	2.3	1.5	1.0
Netherlands	1.5	1.9	2.9	5.1	3.4
Portugal	2.8	1.7	3.8	3.9	4.1
Austria	0.5	1.7	1.8	1.8	1.7
Greece	2.7	2.3	3.7	3.5	3.9
Spain	1.4	2.8	4.0	2.5	3.9
Sweden	0.0	1.2	1.3	3.2	1.4
United Kingdom	1.6	1.2	0.9	1.0	1.6
European Union	1.0	1.7	2.3	1.9	2.1
Czech Republic	5.8	2.5	4.0	3.9	0.2

Source: Eurostat

MONETARY SURVEY

position at month-end in CZK billions

		1998	1999	2000	2001	2002
		12	12	12	12	11
Total assets		1241.4	1337.5	1412.3	1596.0	1646.6
Net foreign assets		425.3	570.4	673.1	800.6	912.6
- assets		761.4	940.2	998.8	1088.4	1134.2
- liabilities		336.1	369.8	325.7	287.8	221.6
Net domestic assets		816.1	767.1	739.2	795.4	734.0
Domestic credits		1079.8	1058.5	1068.8	1011.9	912.7
Net credit to the government sector		33.1	57.5	104.9	236.5	193.9
- net credit to government		42.4	67.7	103.8	246.2	210.4
- net credit to NPF		-9.3	-10.2	1.1	-9.7	-16.5
Client credits of commercial banks and CNB		1046.7	1001.0	963.9	775.4	718.8
CZK credits		847.0	824.6	819.7	661.2	624.5
- businesses		743.3	715.7	699.1	524.2	455.1
- households		103.7	108.9	120.6	137.0	169.4
Foreign currency credits		199.7	176.4	144.2	114.2	94.3
- businesses		196.2	173.0	141.9	111.9	93.1
- households		3.5	3.4	2.3	2.3	1.2
Other net items		-263.7	-291.4	-329.6	-216.5	-178.7
Liabilities						
M2	2)	1241.4	1337.5	1412.3	1596.0	1646.6
M1	1)	404.0	447.8	497.7	583.6	669.8
Currency in circulation		127.2	157.9	171.8	180.4	198.6
CZK demand deposits		276.8	289.9	325.9	403.2	471.2
- households		144.1	162.6	195.0	230.2	283.5
- businesses		129.4	124.4	128.0	169.2	185.5
- insurance companies		3.3	2.9	2.9	3.8	2.2
Quasi money		837.4	889.7	914.6	1012.4	976.8
CZK time deposits		672.5	653.1	645.0	742.2	747.7
- households		550.4	537.6	549.8	596.6	574.1
- businesses		90.0	78.9	78.9	120.8	138.9
- insurance companies		32.1	36.6	16.3	24.8	34.7
Deposit bills of exchange and other bonds	5)	26.5	91.3	114.0	112.8	85.7
Foreign currency deposits		138.4	145.3	155.6	157.4	143.4
- households		73.6	80.8	83.7	91.5	80.0
- businesses		64.8	64.5	71.9	65.9	63.4
Monetary aggregate L	3)	1285.5	1386.3	1463.5	1643.9	1697.9
Annual percentage changes						
M1		-3.6	10.8	11.1	17.3	18.2
M2		5.4	7.7	5.6	13.0	5.2
L		7.1	7.8	5.6	12.3	5.1
Client credits of commercial banks and CNB		-4.7	-4.4	-3.7	-19.6	-9.2
Client deposits with banks	4)	2.8	0.1	3.5	15.7	5.2

1) M1 = Currency in circulation + CZK demand deposits

2) M2 = M1 + quasi money

3) L = M2 + T-bills and CNB bills in the portfolios of domestic non-bank institutions

4) CZK deposits + foreign currency deposits

5) In 1998 - 2000 including certificates of deposit

CREDIT SUPPLY

	1998	1999	2000	2001	2002
	12	12	12	12	11
Non-adjusted credits					
Total credits, CZK and foreign currency					
absolute volumes in CZK billions	1046.7	1001.0	963.9	775.4	718.8
annual percentage changes	-4.7	-4.4	-3.7	-19.6	-9.2
CZK credits					
absolute volumes in CZK billions	847.0	824.6	819.7	661.2	624.5
annual percentage changes	-6.0	-2.6	-0.6	-19.3	-6.7
Foreign currency credits					
absolute volumes in CZK billions	199.7	176.4	144.2	114.2	94.3
annual percentage changes	1.0	-11.7	-18.3	-20.8	-22.6
Adjusted credits 1)					
Total credits, CZK and foreign currency					
absolute volumes in CZK billions	1017.5	969.9	929.5	947.9	981.0
annual percentage changes	0.7	-4.7	-4.2	2.0	3.1
CZK credits					
absolute volumes in CZK billions	808.7	797.8	787.7	826.6	874.2
annual percentage changes	-1.7	-1.3	-1.3	4.9	5.7
Foreign currency credits					
absolute volumes in CZK billions	208.8	172.1	141.8	121.3	106.8
annual percentage changes	11.1	-17.6	-17.6	-14.5	-14.1

1) Adjusted for exchange rate effects, write-offs, banks with licences revoked and loan portfolio restructuring

CREDIT BREAKDOWN BY TIME, SECTOR AND TYPE

percentages of the total

	1998	1999	2000	2001	2002
	12	12	12	12	11
Time structure					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Short-term	42.1	39.0	36.6	37.5	34.0
Medium-term	22.8	24.2	22.2	26.0	31.1
Long-term	35.1	36.8	41.2	36.5	34.9
Sector structure					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Businesses	89.8	88.8	87.2	82.0	76.3
Households	10.2	11.2	12.8	18.0	23.7
Type structure 1)					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Operating	54.1	52.0	49.3	42.6	39.6
Investment (incl. general housing construction)	31.0	31.1	30.8	35.2	29.4
Mortgage	2.2	2.8	4.1	6.7	9.4
Consumer	1.7	2.9	3.3	3.6	6.8
For privatisation	1.4	2.3	2.0	0.4	0.2
For temporary fund shortage	8.3	7.4	9.1	9.8	7.8
For securities purchase	1.3	1.5	1.4	1.7	0.5
Building savings loans					6.1
Others					0.2

1) Owing to new methodology introduced on 1 January 2002, the figures on type structure are not comparable with the previous period's figures

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	1998	1999	2000	2001	2002
	12	12	12	12	12
1. AVERAGE PRIBOR 1)					
- 1 day	10.84	5.21	5.23	4.63	2.75
- 7 day	10.56	5.32	5.29	4.79	2.76
- 14 day	10.54	5.40	5.29	4.78	2.76
- 1 month	10.46	5.59	5.32	4.77	2.73
- 2 month	10.27	5.58	5.36	4.72	2.67
- 3 month	10.08	5.58	5.42	4.69	2.63
- 6 month	9.56	5.64	5.60	4.62	2.60
- 9 month	9.38	5.72	5.78	4.61	2.60
- 12 month	9.31	5.84	5.90	4.62	2.60
2. AVERAGE PRIBID 1)					
- 1 day	10.48	5.05	5.11	4.53	2.65
- 7 day	10.30	5.16	5.18	4.69	2.67
- 14 day	10.27	5.23	5.19	4.69	2.67
- 1 month	10.18	5.42	5.22	4.68	2.64
- 2 month	9.99	5.40	5.26	4.62	2.57
- 3 month	9.79	5.41	5.31	4.59	2.54
- 6 month	9.26	5.46	5.49	4.52	2.51
- 9 month	9.08	5.54	5.67	4.52	2.51
- 12 month	9.02	5.67	5.79	4.52	2.51

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

FRA RATES

percentages; monthly averages

	1998	1999	2000	2001	2002
	12	12	12	12	12
3 * 6	9.02	5.57	5.68	4.49	2.52
3 * 9	8.99	5.70	5.85	4.53	2.54
6 * 9	8.79	5.75	5.93	4.53	2.52
6 * 12	8.79	5.94	6.10	4.52	2.58
9 * 12	8.62	6.04	6.19	4.54	2.61
12 * 24	9.03	.	.	.	
9*12 - 3*6 spread	-0.40	0.47	0.51	0.05	0.10
6*12 - 3*9 spread	0.20	0.24	0.25	-0.02	0.04

IRS RATES

percentages; monthly averages

	1998	1999	2000	2001	2002
	12	12	12	12	12
1Y	9.52	5.92	5.94	4.64	2.63
2Y	9.13	6.54	6.40	4.72	2.85
3Y	9.06	6.95	6.72	4.89	3.18
4Y	8.99	7.16	6.96	5.05	3.46
5Y	8.93	7.26	7.15	5.19	3.70
6Y	8.73	7.29	7.29	5.32	3.91
7Y	8.71	7.28	7.38	5.43	4.08
8Y	8.67	7.27	7.42	5.52	4.23
9Y	8.63	7.27	7.43	5.60	4.36
10Y	8.61	7.27	7.43	5.66	4.47
15Y	.	.	.	5.85	4.77
5Y - 1Y spread	-0.60	1.34	1.21	0.56	1.07
10Y - 1Y spread	-0.92	1.35	1.49	1.02	1.84

NOMINAL AND REAL INTEREST RATES (ex post approach)

percentages

	Nominal rates				Real rates based on CPI				Real rates based on PPI		
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		new client credits
	1W	1Y	new credits	time deposits	1W	1Y	new credits	time deposits	1W	1Y	
1/98	15.3	16.7	15.7	11.1	2.0	3.2	2.3	-1.8	8.7	10.0	9.0
2/98	14.9	16.4	15.7	11.1	1.3	2.6	2.1	-2.0	7.8	9.2	8.6
3/98	15.0	16.1	16.1	11.1	1.4	2.4	2.4	-2.1	7.9	9.0	9.0
4/98	15.1	15.9	16.2	11.0	1.7	2.5	2.7	-1.9	8.4	9.1	9.4
5/98	15.2	15.6	15.8	10.7	2.0	2.3	2.4	-2.0	8.5	8.9	9.0
6/98	15.3	15.8	16.0	11.0	2.9	3.4	3.5	-0.9	9.1	9.7	9.8
7/98	14.8	14.0	15.3	10.9	4.0	3.2	4.4	0.4	9.2	8.3	9.6
8/98	14.4	13.5	14.8	10.7	4.5	3.8	4.9	1.2	9.8	8.9	10.2
9/98	14.0	13.4	14.6	10.5	4.8	4.2	5.3	1.6	9.9	9.3	10.5
10/98	13.4	12.6	14.3	10.3	4.8	4.1	5.6	1.9	9.8	9.0	10.6
11/98	12.0	10.5	12.9	9.5	4.2	2.8	5.0	1.8	8.9	7.5	9.8
12/98	10.6	9.3	11.9	8.7	3.5	2.4	4.7	1.8	8.2	7.0	9.5
1/99	9.2	8.1	10.7	8.2	5.5	4.5	7.0	4.5	8.3	7.3	9.9
2/99	8.2	8.2	10.3	6.6	5.2	5.3	7.3	3.7	8.3	8.3	10.4
3/99	7.8	7.6	9.7	6.1	5.1	4.9	7.1	3.5	7.8	7.6	9.7
4/99	7.4	7.0	9.4	5.8	4.8	4.4	6.8	3.2	7.2	6.8	9.2
5/99	7.0	7.0	8.9	5.6	4.5	4.5	6.4	3.1	6.6	6.6	8.5
6/99	6.9	7.1	9.1	5.3	4.6	4.8	6.8	3.1	6.5	6.7	8.7
7/99	6.6	6.9	8.2	5.2	5.4	5.7	7.1	4.0	6.1	6.4	7.7
8/99	6.4	6.8	8.0	5.0	4.9	5.3	6.5	3.6	5.1	5.5	6.7
9/99	6.1	6.7	8.0	4.9	4.9	5.5	6.8	3.7	4.9	5.5	6.8
10/99	5.8	6.4	7.7	4.8	4.4	4.9	6.2	3.4	3.9	4.5	5.8
11/99	5.5	6.0	7.7	4.8	3.6	4.1	5.7	2.8	3.1	3.6	5.2
12/99	5.3	5.8	6.7	4.7	2.8	3.3	4.1	2.2	1.9	2.4	3.2
1/00	5.3	5.9	7.3	4.6	1.8	2.4	3.8	1.2	1.1	1.7	3.0
2/00	5.3	6.0	7.0	4.5	1.5	2.2	3.2	0.7	0.8	1.4	2.4
3/00	5.3	5.7	7.1	4.5	1.4	1.8	3.2	0.6	0.2	0.6	1.9
4/00	5.3	5.5	7.1	4.4	1.8	2.1	3.6	1.0	1.0	1.3	2.8
5/00	5.3	5.5	7.1	4.3	1.5	1.8	3.2	0.6	0.9	1.1	2.5
6/00	5.3	5.7	6.8	4.2	1.1	1.5	2.6	0.1	0.2	0.6	1.6
7/00	5.3	5.8	6.5	4.2	1.3	1.8	2.5	0.3	0.3	0.7	1.5
8/00	5.3	5.7	6.7	4.2	1.1	1.6	2.5	0.1	0.5	0.9	1.8
9/00	5.3	5.7	6.8	4.2	1.1	1.5	2.6	0.1	-0.1	0.3	1.4
10/00	5.3	5.8	6.6	4.0	0.9	1.3	2.1	-0.3	-0.6	-0.1	0.7
11/00	5.3	5.9	6.7	4.0	0.9	1.5	2.3	-0.3	-0.6	0.0	0.7
12/00	5.3	5.9	6.8	3.9	1.2	1.8	2.7	-0.1	0.3	0.9	1.7
1/01	5.3	5.6	6.3	3.9	1.0	1.3	2.0	-0.3	1.0	1.3	2.0
2/01	5.2	5.3	6.2	3.9	1.2	1.3	2.1	-0.1	0.5	0.6	1.4
3/01	5.0	5.1	6.2	3.7	0.9	0.9	2.0	-0.3	0.9	0.9	2.0
4/01	5.0	5.0	6.2	3.7	0.4	0.4	1.5	-0.9	1.0	0.9	2.1
5/01	5.0	5.1	6.3	3.7	0.0	0.0	1.2	-1.2	1.2	1.2	2.4
6/01	5.0	5.3	6.3	3.7	-0.4	-0.2	0.7	-1.7	1.6	1.8	2.8
7/01	5.1	5.6	6.4	3.7	-0.8	-0.2	0.5	-2.1	2.0	2.6	3.3
8/01	5.3	6.0	6.6	3.7	-0.2	0.5	1.0	-1.7	2.8	3.5	4.1
9/01	5.3	5.7	6.6	3.7	0.6	0.9	1.8	-0.9	3.4	3.8	4.7
10/01	5.3	5.3	6.6	3.7	0.9	0.9	2.1	-0.7	3.9	4.0	5.3
11/01	5.3	4.9	6.3	3.6	1.0	0.7	2.0	-0.5	4.3	4.0	5.4
12/01	4.8	4.6	5.9	3.3	0.7	0.5	1.7	-0.8	4.0	3.8	5.1
1/02	4.7	4.5	5.7	3.2	1.0	0.8	2.0	-0.4	4.1	3.9	5.1
2/02	4.3	4.4	5.1	3.0	0.4	0.5	1.1	-0.8	4.4	4.5	5.2
3/02	4.3	4.5	5.3	3.0	0.6	0.8	1.6	-0.7	4.5	4.7	5.5
4/02	4.2	4.4	5.1	2.9	1.0	1.1	1.8	-0.2	4.3	4.5	5.2
5/02	3.8	4.1	4.9	2.8	1.3	1.5	2.3	0.3	4.3	4.6	5.4
6/02	3.8	3.9	5.0	2.9	2.6	2.7	3.8	1.7	4.6	4.8	5.9
7/02	3.6	3.4	4.5	2.8	3.0	2.8	3.9	2.2	4.7	4.6	5.7
8/02	3.0	3.1	4.4	2.3	2.4	2.5	3.8	1.7	4.0	4.1	5.4
9/02	3.0	3.0	4.5	2.5	2.2	2.1	3.7	1.7	4.0	3.9	5.5
10/02	3.0	2.8	4.6	2.3	2.4	2.2	4.0	1.7	3.9	3.7	5.5
11/02	2.8	2.8	4.2	2.1	2.3	2.2	3.7	1.6	3.5	3.5	4.9
12/02	2.8	2.6			2.2	2.0			3.5	3.3	

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

The average rates on credits in December 1999 were affected mainly by the settlement of medium-term loan receivables for which the interest rate was taken into account in the purchase price. These receivables are incorporated into the interest-rate statistics with a zero interest rate.

REAL INTEREST RATES (ex ante approach)

percentages

	Real rates expected by financial markets				Real rates expected by businesses				Real rates expected by households			
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		client rates	
	1W	1Y	new credits	time deposits	1W	1Y	new credits	time deposits	1W	1Y	new credits	time deposits
12/98												
1/99												
2/99												
3/99												
4/99												
5/99	1.9	1.9	3.7	0.6								
6/99	2.1	2.3	4.2	0.6	2.5	2.7	4.6	1.0	3.2	3.4	5.3	1.7
7/99	1.7	2.0	3.3	0.3								
8/99	2.1	2.5	3.7	0.8								
9/99	2.1	2.7	4.0	1.0	2.1	2.7	4.0	1.0	3.9	4.5	5.8	2.8
10/99	1.7	2.2	3.4	0.7								
11/99	1.6	2.1	3.7	0.8								
12/99	1.1	1.6	2.4	0.5	1.4	1.9	2.7	0.8	2.2	2.7	3.5	1.6
1/00	1.3	1.8	3.2	0.6								
2/00	0.8	1.4	2.4	0.0								
3/00	0.8	1.2	2.5	0.0	1.0	1.3	2.7	0.2	1.1	1.5	2.9	0.4
4/00	1.0	1.3	2.8	0.2								
5/00	1.1	1.4	2.8	0.2								
6/00	0.8	1.2	2.3	-0.1	0.5	0.9	1.9	-0.5	1.1	1.5	2.6	0.1
7/00	0.7	1.1	1.9	-0.4								
8/00	0.7	1.2	2.1	-0.3								
9/00	0.6	1.0	2.0	-0.5	0.3	0.7	1.8	-0.8	0.7	1.1	2.1	-0.4
10/00	0.7	1.1	1.9	-0.5								
11/00	0.5	1.0	1.8	-0.8								
12/00	0.3	0.9	1.7	-1.1	0.6	1.1	2.0	-0.8	1.1	1.7	2.6	-0.2
1/01	0.7	1.1	1.8	-0.6								
2/01	0.9	1.0	1.8	-0.4								
3/01	0.8	0.8	1.9	-0.4	0.8	0.8	1.9	-0.4	1.0	1.0	2.1	-0.2
4/01	1.0	0.9	2.1	-0.3								
5/01	0.7	0.7	1.9	-0.6								
6/01	0.4	0.7	1.6	-0.8	0.2	0.5	1.4	-1.0	-0.1	0.2	1.1	-1.3
7/01	0.5	1.0	1.7	-0.8								
8/01	0.6	1.2	1.8	-0.9								
9/01	0.5	0.8	1.7	-1.0	0.5	0.8	1.7	-1.0	0.4	0.7	1.6	-1.1
10/01	0.9	0.9	2.1	-0.7								
11/01	1.2	0.9	2.2	-0.4								
12/01	0.9	0.7	1.9	-0.6	0.9	0.7	1.9	-0.6	0.2	0.0	1.2	-1.2
1/02	0.9	0.7	1.9	-0.5								
2/02	0.8	0.8	1.5	-0.4								
3/02	0.8	1.0	1.8	-0.5	0.7	0.9	1.7	-0.6	0.4	0.6	1.4	-0.9
4/02	0.7	0.8	1.5	-0.5								
5/02	0.5	0.7	1.5	-0.5								
6/02	0.7	0.8	1.9	-0.2	1.1	1.2	2.3	0.2	2.1	2.3	3.4	1.3
7/02	0.7	0.6	1.7	0.0								
8/02	0.3	0.4	1.7	-0.4								
9/02	-0.1	-0.1	1.4	-0.6	1.1	1.0	2.6	0.6	1.7	1.6	3.2	1.2
10/02	0.5	0.3	2.0	-0.2								
11/02	0.4	0.3	1.8	-0.3								
12/02	0.5	0.3			0.5	0.3			0.2	0.0		

Note: real rates = nominal rates deflated by inflation expected by selected economic sectors according to the CNB statistical survey
The average rates on credits in December 1999 were affected mainly by the settlement of medium-term loan receivables for which the interest rate was taken into account in the purchase price. These receivables are incorporated into the interest-rate statistics with a zero interest rate.

COMMERCIAL BANK INTEREST RATES

percentages

	1998 12	1999 12	2000 12	2001 12	2002 11
Newly drawn credits					
in CZK	10.8	6.7	6.8	5.9	4.2
- short-term	11.6	6.7	6.5	5.6	3.7
- medium-term	7.4	5.1	8.0	7.5	5.9
- long-term	11.7	10.2	8.1	7.1	6.1
in foreign currency	5.4	6.1	6.4	4.8	3.9
- short-term	5.3	6.2	6.2	4.5	3.6
- medium-term	5.9	5.3	6.4	4.9	4.8
- long-term	5.6	6.0	7.2	5.5	4.8
Credits					
in CZK	10.5	7.7	6.9	7.0	5.8
- short-term	10.6	7.4	6.6	6.2	4.6
- medium-term	10.7	8.3	7.8	7.7	6.3
- long-term	10.3	7.6	6.8	7.4	6.2
in foreign currency	6.4	6.6	7.2	5.2	4.9
- short-term	6.9	7.7	8.0	4.5	4.5
- medium-term	5.6	5.4	6.3	4.9	4.7
- long-term	6.0	5.9	6.7	5.7	5.1
Deposits					
in CZK	6.7	3.7	3.0	2.6	1.7
- demand	1.9	1.6	1.5	1.4	1.1
- time	8.7	4.7	3.9	3.3	2.1
- short-term	9.2	4.8	4.0	3.4	1.8
- medium-term	10.9	5.6	3.9	3.1	2.1
- long-term	4.2	3.6	3.5	3.2	3.2
in foreign currency	2.3	2.7	3.2	1.5	1.4
- demand	1.1	0.9	1.1	0.6	0.5
- time	3.2	4.0	4.6	2.1	2.0
- short-term	3.1	3.9	4.6	2.1	1.9
- medium-term	3.3	4.2	4.2	2.5	3.6
- long-term	3.5	4.7	5.1	3.5	2.4

BALANCE OF PAYMENTS 1)

in CZK millions

	1998	1999	2000	2001	2002 2)4)
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
A. Current account	**-40 492.0**	**-50 596.4**	**-104 877.1**	**-99 833.7**	**-50 870.0**
Balance of trade 3)	-84 002.8	-65 830.8	-120 825.0	-116 685.0	-36 328.0
exports	834 227.0	908 756.0	1 121 099.0	1 269 634.0	277 643.0
imports	918 229.8	974 586.8	1 241 924.0	1 386 319.0	313 971.0
Services	61 935.7	41 501.3	54 559.8	57 984.9	5 817.4
credit	246 703.2	243 851.0	264 806.2	269 689.6	60 607.5
transport	44 829.3	53 520.3	53 734.3	57 492.3	12 289.2
travel	124 902.0	109 142.0	115 071.0	118 133.0	25 893.4
others	76 971.9	81 188.7	96 000.9	94 064.3	22 424.9
debit	184 767.5	202 349.7	210 246.4	211 704.7	54 790.1
transport	22 794.0	27 071.4	27 543.0	30 570.5	6 437.1
travel	61 121.0	51 760.0	49 370.0	52 802.0	15 903.4
others	100 852.5	123 518.3	133 333.4	128 332.2	32 449.6
Income	-35 078.0	-46 673.6	-52 978.4	-58 904.3	-24 197.6
credit	55 042.4	64 298.3	75 439.1	82 482.6	18 427.5
debit	90 120.4	110 971.9	128 417.5	141 386.9	42 625.1
Current transfers	16 653.1	20 406.7	14 366.5	17 770.7	3 838.2
credit	34 558.9	45 394.4	36 594.6	36 404.9	8 408.4
debit	17 905.8	24 987.7	22 228.1	18 634.2	4 570.2
B. Capital account	**65.8**	**-73.2**	**-198.2**	**-330.7**	**-143.6**
credit	454.6	637.3	223.4	90.4	37.9
debit	388.8	710.5	421.6	421.1	181.5
Total A + B	*-40 426.2*	*-50 669.6*	*-105 075.3*	*-100 164.4*	*-51 013.6*
C. Financial account	**94 324.5**	**106 564.4**	**148 046.6**	**153 310.4**	**91 679.1**
Direct investment	115 866.3	215 703.9	190 767.4	183 343.8	47 264.7
abroad	-4 102.2	-3 107.6	-1 653.7	-3 657.5	-1 594.4
equity capital and reinvested earnings	-2 538.8	-2 585.3	-1 245.9	-3 508.6	-1 149.1
other capital	-1 563.4	-522.3	-407.8	-148.9	-445.3
in the Czech Republic	119 968.5	218 811.5	192 421.1	187 001.3	48 859.1
equity capital and reinvested earnings	87 762.8	192 615.5	171 777.2	183 839.8	46 633.1
other capital	32 205.7	26 196.0	20 643.9	3 161.5	2 226.0
Portfolio investment	34 508.2	-48 268.9	-68 172.9	34 857.3	1 322.3
assets	-755.1	-65 608.0	-86 631.8	4 405.6	-9 385.1
equity securities	3 855.7	-48 965.2	-44 181.0	9 447.8	-632.0
debt securities	-4 610.8	-16 642.8	-42 450.8	-5 042.2	-8 753.1
liabilities	35 263.3	17 339.1	18 458.9	30 451.7	10 707.4
equity securities	34 846.2	4 394.2	23 810.9	23 203.6	2 579.4
debt securities	417.1	12 944.9	-5 352.0	7 248.1	8 128.0
Financial derivatives	0.0	0.0	-1 402.8	-3 220.3	502.4
assets			-4 501.6	-9 407.6	-3 967.6
liabilities			3 098.8	6 187.3	4 470.0
Other investment	-56 050.0	-60 870.6	26 854.9	-61 670.4	42 589.7
assets	-46 628.7	-91 273.9	35 832.1	-48 850.5	45 870.0
long-term	-24 280.2	-23 884.0	21 322.2	1 349.8	3 170.2
CNB					
commercial banks	-26 952.8	-25 858.5	14 362.2	-4 125.8	3 122.2
government	630.3	977.5	2 937.0	6 928.9	328.6
other sectors	2 042.3	997.0	4 023.0	-1 453.3	-280.6
short-term	-22 348.5	-67 389.9	14 509.9	-50 200.3	42 699.8
commercial banks	-21 641.6	-63 804.7	22 001.9	-45 523.2	40 893.6
government				-87.1	-803.8
other sectors	-706.9	-3 585.2	-7 492.0	-4 590.0	2 610.0
liabilities	-9 421.3	30 403.3	-8 977.2	-12 819.9	-3 280.3
long-term	-39 840.7	-1 286.1	-26 212.5	1 921.7	4 531.5
CNB	-216.4	-2 083.5	-22.8	-22.0	-10.0
commercial banks	-14 399.2	-7 109.5	-31 523.7	-7 222.2	-733.0
government	-11 765.4	-6 384.3	-1 837.6	-5 000.8	-689.8
other sectors	-13 459.7	14 291.2	7 171.6	14 166.7	5 964.3
short-term	30 419.4	31 689.4	17 235.3	-14 741.6	-7 811.8
CNB	-6.0	84.9	-17.0	59.7	20.2
commercial banks	24 445.9	36 615.6	-3 812.5	-35 688.6	-12 226.2
government	-216.5	-103.2			
other sectors	6 196.0	-4 907.9	21 064.8	20 887.3	4 394.2
Total A + B + C	*53 898.3*	*55 894.8*	*42 971.3*	*53 146.0*	*40 665.5*
D. Net errors and omissions, valuation changes	**8 716.7**	**1 241.9**	**-11 378.5**	**14 007.0**	**-3 385.5**
Total A + B + C + D	*62 615.0*	*57 136.7*	*31 592.8*	*67 153.0*	*37 280.0*
E. Change in reserves (- increase)	**-62 615.0**	**-57 136.7**	**-31 592.8**	**-67 153.0**	**-37 280.0**

1) Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993
2) Preliminary data
3) In accordance with customs statistics methodology in force since 1 July 2000
4) The Q3 figures do not take into account the CSO's adjustment to the trade balance data on 16 January 2003. This adjustment will be made on the publication date for the 2002 Q4 figures

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	1998 31 Dec.	1999 31 Dec.	2000 31 Dec.	2001 31 Dec.	2002 30 Sep. 1)
ASSETS	1 087 507.3	1 347 954.9	1 448 400.7	1 536 670.9	1 508 297.8
Direct investment abroad	24 003.5	25 114.9	27 899.3	30 174.0	31 855.0
- equity capital	21 901.2	22 415.9	24 797.5	27 075.0	28 650.0
- other capital	2 102.3	2 699.0	3 101.8	3 099.0	3 205.0
Portfolio investment	35 872.4	104 345.3	180 431.3	185 138.6	213 666.3
- equity securities	13 415.5	66 318.2	92 222.9	68 675.5	79 823.3
- debt securities	22 456.9	38 027.1	88 208.4	116 463.1	133 843.0
Financial derivatives 2)			6 347.2	15 754.8	31 936.3
Other investment	650 948.4	757 065.5	736 903.7	781 145.7	539 930.5
Long-term	287 328.8	323 131.1	315 625.5	310 133.9	184 735.7
- CNB 3)	26 122.4		329.1	307.3	279.1
- commercial banks	64 041.6	89 900.1	75 537.9	79 663.7	68 300.0
- government 4)	176 213.4	210 221.3	220 777.8	210 694.9	100 611.6
- other sectors	20 951.4	23 009.7	18 980.7	19 468.0	15 545.0
Short-term	363 619.6	433 934.4	421 278.2	471 011.8	355 194.8
- CNB 5)	0.1		52.9	51.2	50.5
- commercial banks	272 219.5	336 117.2	314 115.3	359 638.5	232 896.8
of which: gold and foreign exchange 6) 7)	175 753.2	218 995.8	228 961.7	257 138.5	173 396.5
- government				87.1	1 837.5
- other sectors	91 400.0	97 817.2	107 110.0	111 235.0	120 410.0
CNB reserves 8)	376 683.0	461 429.2	496 819.2	524 457.8	690 909.7
- gold 6)	369.1	677.0	4 640.4	4 469.9	4 386.7
- SDR			7.7	31.0	105.3
- reserve position in the IMF			116.0	5 478.3	7 025.5
- foreign exchange	376 313.9	460 752.2	491 001.2	514 188.0	650 399.3
- other reserve assets			1 053.9	290.6	28 992.9
LIABILITIES	1 204 984.0	1 458 893.3	1 640 270.0	1 784 507.6	1 884 437.5
Direct investment in the Czech Republic	429 167.8	631 505.3	818 411.6	970 450.9	1 106 003.2
- equity capital	364 816.5	538 379.3	702 217.8	857 595.9	997 168.2
- other capital	64 351.3	93 126.0	116 193.8	112 855.0	108 835.0
Portfolio investment	166 128.1	165 579.2	164 592.0	180 346.2	211 866.7
- equity securities	113 247.2	98 011.8	115 670.6	128 740.1	131 071.0
- debt securities	52 880.9	67 567.4	48 921.4	51 606.1	80 795.7
Financial derivatives 2)			5 307.9	11 495.2	24 117.8
Other investment	609 688.1	661 808.8	651 958.5	622 215.3	542 449.8
Long-term	358 510.5	379 172.2	352 323.4	339 013.2	314 197.8
- CNB	1 883.3	197.1	180.4	133.4	107.9
- commercial banks	124 286.3	118 368.9	84 607.4	73 688.6	63 606.0
- government	23 814.8	20 852.9	19 699.2	9 476.2	7 108.9
- other sectors	208 526.1	239 753.3	247 836.4	255 715.0	243 375.0
Short-term	251 177.6	282 636.6	299 635.1	283 202.1	228 252.0
- CNB	39.5	25.8	8.8	68.5	38.3
- commercial banks	193 373.0	229 988.7	226 176.2	190 487.6	150 333.7
- government	103.2				
- other sectors	57 661.9	52 622.1	73 450.1	92 646.0	77 880.0
NET INVESTMENT POSITION	-117 476.7	-110 938.4	-191 869.3	-247 836.7	-376 139.7

1) Preliminary data
2) Financial derivatives (from banks position) have been recorded since 31 March 2000
3) At the end of 1999 the receivable from the National Bank of Slovakia was transferred from the non-resident position to the resident position
4) Including foreign currency shares in international non-monetary organisations (The World Bank, EBRD, IBEC, IIB)
5) Since 31 March 2000, this item has included gold not recorded in CNB reserves
6) Gold valued at USD 42.22 per Troy ounce (until 31 December 1999) and at market price (since 31 March 2000)
7) Foreign currency - convertible currencies
8) In compliance with IMF requirements, CNB reserves have been recorded with a more detailed breakdown (since 31 March 2000)

EXTERNAL DEBT

in CZK millions

	1998	1999	2000	2001	2002
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	30 Sep. 1)
DEBT IN CONVERTIBLE CURRENCIES	717 923.6	813 576.5	808 122.8	786 676.4	732 080.5
of which:					
Long-term	446 484.3	497 872.1	464 323.8	461 217.5	464 735.2
By debtor					
- CNB	10 952.2	12 527.6	180.4	133.4	107.9
- commercial banks	133 376.5	128 703.3	95 737.1	88 401.4	86 786.7
- government	32 953.5	32 303.5	29 753.5	30 839.2	46 015.0
- other sectors	269 202.1	324 337.7	338 652.8	341 843.5	331 825.6
By creditor					
- foreign banks	248 712.0	257 410.0	228 709.6	235 115.5	223 664.0
- government institutions	4 409.6	4 239.2	3 405.7	2 373.6	1 740.9
- multilateral institutions	49 036.3	58 202.2	67 521.2	70 879.0	64 068.3
- suppliers and direct investors	72 624.6	93 831.4	99 560.2	95 664.0	88 995.0
- other investors	71 701.8	84 189.3	65 127.1	57 185.4	86 267.0
Short-term	271 439.3	315 704.4	343 799.0	325 458.9	267 345.3
By debtor					
- CNB	39.5	25.8	8.8	68.5	38.3
- commercial banks	193 373.0	230 000.5	226 246.1	192 438.4	150 963.0
- government	22.0	7.0	2 115.0	465.0	749.0
- other sectors	78 004.8	85 671.1	115 429.1	132 487.0	115 595.0
By creditor					
- foreign banks	175 604.1	201 808.8	203 333.8	195 166.4	143 120.2
- suppliers and direct investors	67 446.7	81 794.6	106 988.6	93 127.0	88 745.0
- other investors	28 388.5	32 101.0	33 476.6	37 165.5	35 480.1
DEBT IN NON-CONVERTIBLE CURRENCIES	8 996.7	8 925.7	8 950.9		
of which:					
- long-term	8 893.5	8 925.7	8 950.9		
- short-term	103.2				
TOTAL EXTERNAL DEBT	726 920.3	822 502.2	817 073.7	786 676.4	732 080.5
of which:					
- long-term	455 377.8	506 797.8	473 274.7	461 217.5	464 735.2
- short-term	271 542.5	315 704.4	343 799.0	325 458.9	267 345.3

1) Preliminary data

EXCHANGE RATES

A. NOMINAL RATE

in CZK; foreign exchange market rates

	1998	1999	2000	2001	2002
	1-12	1-12	1-12	1-12	1-12
CZK EXCHANGE RATE AGAINST SELECTED CURRENCIES					
- annual/quarterly averages					
1 EUR	.	36.88	35.61	34.08	30.81
1 USD	32.27	34.60	38.59	38.04	32.74
100 SKK	91.61	83.64	83.64	78.68	72.22
	12	12	12	12	12
- monthly averages					
1 EUR	.	36.05	34.82	32.59	31.19
1 USD	30.06	35.63	38.94	36.48	30.65
100 SKK	83.04	84.70	80.07	75.61	74.67
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	31 Dec.
- last day of the month					
1 EUR	.	36.13	35.09	31.98	31.60
1 USD	29.86	35.98	37.81	36.26	30.14
100 SKK	80.97	85.08	79.70	74.81	75.18

B. NOMINAL EFFECTIVE RATE

	1998	1999	2000	2001	2002
CZK nominal effective exchange rate (percentages) (2000=100)					
weights - foreign trade turnover	96.0	98.5	100.0	104.3	116.4
weights - foreign trade turnover SITC 5-8	98.9	98.6	100.0	104.4	116.1

Drawing on CSO statistics on the geographical and commodity structure of foreign trade for 2000, 23 countries which account for around 90% of the Czech Republic's foreig trade were selected. The weights were processed in two alternatives:

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

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

C. REAL EFFECTIVE RATE

	1998	1999	2000	2001	2002
CZK real effective exchange rate (percentages) (2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	99.5	100.6	100.0	103.9	114.4
weights - foreign trade turnover SITC 5-8	99.9	99.5	100.0	104.4	115.1
b) consumer prices					
weights - foreign trade turnover	99.0	98.8	100.0	105.2	116.1
weights - foreign trade turnover SITC 5-8	99.4	98.2	100.0	105.8	117.0

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

Table 17

PUBLIC FINANCES

in CZK billions

	1998	1999	2000	2001	2002
	1-12	1-12	1-12	1-12	1-12
STATE BUDGET					
TOTAL REVENUE	537.4	567.3	586.2	626.2	705.0
Tax revenue	509.6	540.1	559.5	598.3	627.4
Taxes on income, profits and capital gains	87.4	86.4	87.0	147.4	159.0
Domestic taxes on goods and services	187.2	211.4	216.8	187.0	186.9
- value-added taxes	119.4	138.3	145.9	121.3	118.1
- excises	67.8	73.1	70.9	65.7	68.9
Taxes on international trade and transactions	13.6	12.1	13.6	10.0	9.8
Taxes on property	6.3	6.8	6.0	6.4	7.9
Social and health security contributions and payroll taxes	203.9	210.9	222.2	242.3	258.5
Non-tax and capital incomes and received subsidies	27.8	27.2	26.7	27.9	77.7
TOTAL EXPENDITURE	566.7	596.9	632.3	693.9	750.8
Current expenditure	516.2	537.9	571.4	642.5	697.3
Capital expenditure	50.5	59.0	60.9	51.4	53.5
Public budgets (balance in IMF GFS methodology)	-28.2	-11.1	-62.0	-52.3	
state budget	-29.3	-29.6	-46.1	-67.7	-45.7
local budget	1.5	18.5	-2.5	-11.2	
state financial assets	3.7	-5.2	-5.7	.	
state funds	0.9	-0.6	2.6	11.2	
Land Fund	0.1	-0.3	-0.5	-0.1	
National Property Fund	-5.1	2.9	-11.5	13.2	
health insurance companies	0.7	2.5	2.1	1.4	
others	-0.7	0.7	-0.4	0.9	

CAPITAL MARKET

A. STOCK MARKET INDICES

last day of the month in points

	1998	1999	2000	2001	2002
	12	12	12	12	12
BCPP					
PX 50	394.2	489.7	478.5	394.6	460.7
PX-D	.	1296.7	1366.0	1065.6	1166.4
PX-GLOB	478.3	587.9	570.6	492.9	576.8
RM-SYSTÉM					
PK-30	564.5	713.2	724.8	593.0	672.5

B. TRADE VOLUMES

in CZK millions

	1998	1999	2000	2001	2002
	12	12	12	12	12
BCPP					
Monthly trade volumes	92 553.0	99 604.0	73 240.5	142 803.6	109 264.8
of which:					
a) shares	18 873.1	13 974.5	11 113.9	12 819.3	17 089.3
b) units	224.3	394.2	61.3	4.3	0.0
c) bonds	73 455.6	85 235.3	62 065.3	129 980.0	92 175.5
RM-SYSTÉM					
Monthly trade volumes	20 836.9	22 014.7	4 861.7	2 162.5	4 412.1
of which:					
a) shares	16 573.5	20 642.3	4 190.1	1 841.0	298.4
b) units	570.3	176.8	25.9	212.2	1.0
c) bonds	3 693.1	1 195.6	645.7	109.3	4 112.7

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
			1998		
23 January			19.0		
20 March	15.00				
17 July	14.50				
30 July				7.5	
14 August	14.00	11.5	16.0		
25 September	13.50				
27 October	12.50	10.0	15.0		
13 November	11.50				
4 December	10.50				
23 December	9.50	7.5	12.5		
			1999		
18 January	8.75				
28 January				5.0	
29 January	8.00				
12 March	7.50	6.0	10.0		
9 April	7.20				
4 May	6.90				
25 June	6.50				
30 July	6.25				
3 September	6.00	5.5	8.0		
5 October	5.75				
7 October				**2.0**	**2.0**
27 October	5.50	5.0	7.5		
26 November	5.25				
			2000		
	No changes made				
			2001		
23 February	5.00	4.0	6.0		
27 July	5.25	4.25	6.25		
30 November	4.75	3.75	5.75		
			2002		
22 January	4.50	3.50	5.50		
1 February	4.25	3.25	5.25		
26 April	3.75	2.75	4.75		
26 July	3.00	2.00	4.00		
1 November	**2.75**	**1.75**	**3.75**		

MACROECONOMIC AGGREGATES

in CZK millions; annual percentage changes; constant 1995 prices

	1998	1999	2000	2001	2002
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
GROSS DOMESTIC PRODUCT					
- in CZK millions	1 414 422	1 421 043	1 467 285	1 515 076	388 559
- percentages		0.5	3.3	3.3	1.5
FINAL CONSUMPTION					
- in CZK millions	1 023 403	1 042 354	1 058 969	1 090 812	291 926
- percentages		1.9	1.6	3.0	5.0
of which:					
Households					
- in CZK millions	751 235	765 638	783 454	813 726	220 624
- percentages		1.9	2.3	3.9	5.3
Government					
- in CZK millions	260 293	266 199	263 628	264 500	67 896
- percentages		2.3	-1.0	0.3	3.7
Non-profit institutions					
- in CZK millions	11 875	10 517	11 887	12 586	3 406
- percentages		-11.4	13.0	5.9	5.4
GROSS CAPITAL FORMATION					
- in CZK millions	481 383	467 412	511 229	556 941	149 054
- percentages		-2.9	9.4	8.9	9.8
of which:					
Fixed capital					
- in CZK millions	467 862	463 128	487 874	523 243	132 188
- percentages		-1.0	5.3	7.2	0.9
Changes in inventories					
- in CZK millions	13 019	3 880	22 990	33 316	16 767
Acquisitions less disposals of valuables					
- in CZK millions	502	404	365	382	99
- percentages		-19.5	-9.7	4.7	2.1
TRADE BALANCE					
- in CZK millions	-90 364	-88 723	-102 913	-132 677	-52 421
of which:					
Exports of goods					
- in CZK millions	747 211	809 783	971 784	1 113 902	261 091
- percentages		8.4	20.0	14.6	1.1
Exports of services					
- in CZK millions	215 396	211 548	223 676	228 658	52 538
- percentages		-1.8	5.7	2.2	-17.9
Imports of goods					
- in CZK millions	875 929	920 348	1 106 476	1 276 002	310 823
- percentages		5.1	20.2	15.3	3.9
Imports of services					
- in CZK millions	177 042	189 706	191 897	199 235	55 227
- percentages		7.2	1.2	3.8	1.6
FINAL DOMESTIC DEMAND					
- in CZK millions	1 491 265	1 505 482	1 546 843	1 614 055	424 114
- percentages		1.0	2.7	4.3	3.7
AGGREGATE DOMESTIC DEMAND					
- in CZK millions	1 504 786	1 509 766	1 570 198	1 647 753	440 980
- percentages		0.3	4.0	4.9	6.5
GROSS DOMESTIC PRODUCT AT CURRENT PRICES					
- in CZK millions	1 839 088	1 902 293	1 984 833	2 157 828	564 660
- percentages		3.4	4.3	8.7	2.9

Source: CSO

Note on the estimated impact on GDP of the corrections made to the foreign trade figures:
The correction made to the 2002 H2 figures on goods exports and imports has affected the estimated evolution of several macroeconomic indicators.
At constant prices, the expected adjustment will increase GDP growth from 1.5% to 2.7%; household expenditure growth will fall from 5.3% to 4.4%;
the 0.9% growth in gross fixed capital formation will switch to a 0.6% decline; change in inventories will fall by CZK 8.8 bn to CZK 8 bn; and
the trade deficit will decrease by CZK 17.5 bn to CZK -34.9 bn.
The usual revision to this estimate will be published together with the GDP estimate for 2002 Q4.

LABOUR MARKET

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR

annual percentage changes

	1998	1999	2000	2001	2002
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
Current income	.	3.9	4.8	6.7	4.0
of which:					
- gross operating surplus and mixed income	.	5.2	3.0	10.2	1.9
- compensation of employees	.	3.8	4.9	7.1	5.7
- property income	.	-15.8	-7.0	2.6	-5.3
- social benefits other than social transfers in kind	.	8.6	9.6	6.0	9.0
- other current transfers	.	20.5	10.2	-4.7	-8.7
Current expenditure	.	5.3	4.8	7.1	6.2
of which:					
- property income	.	-11.9	-8.4	1.9	10.7
- current taxes on income, wealth, etc.	.	2.5	3.8	4.7	15.7
- social contributions	.	4.9	5.9	9.8	0.5
- other current transfers	.	20.3	5.6	-0.2	20.9
Gross disposable income	.	3.3	4.8	6.5	3.1
Change in net equity of households in pension funds reserves	.	-20.0	24.6	47.2	16.7
Individual consumption expenditure	.	5.7	5.3	7.7	4.1
Gross saving	.	-18.7	0.6	-4.4	-9.6
Gross savings rate	.	8.33	8.00	7.19	5.47
(gross saving/gross disposable income - ratio in per cent)					

B. AVERAGE WAGES

annual percentage changes

	1998	1999	2000	2001	2002
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
Overall nominal wage	9.4	8.2	6.6	8.5	7.4
Business sector	11.0	7.1	7.8	8.2	6.7
Non-business sector	3.9	13.1	2.8	10.0	11.3
Overall real wage	-1.2	6.0	2.6	3.6	6.7
Business sector	0.3	4.9	3.8	3.3	6.0
Non-business sector	-6.1	10.8	-1.1	5.1	10.5

C. UNEMPLOYMENT

end of period

	1998	1999	2000	2001	2002
	12	12	12	12	12
Registered job applicants (thousands)	386.9	487.6	457.4	461.9	514.4
Unemployment rate (percentages)	7.5	9.4	8.8	8.9	9.8

Source: CSO

PRODUCER PRICES

percentage changes

	1998	1999	2000	2001	2002
INDUSTRIAL PRODUCER PRICES					
a) previous month = 100	0.2	0.3	0.4	0.1	-0.1
b) same period of last year = 100	4.9	1.0	4.9	2.9	-0.5
c) average for 2000 = 100	.	.	0.0	2.8	2.3
d) December 1999 = 100	.	.	3.4	6.3	5.8
CONSTRUCTION WORK PRICES					
a) previous month = 100	0.6	0.3	0.4	0.3	0.2
b) same period of last year = 100	9.4	4.8	4.0	4.1	2.6
c) average for 2000 = 100	.	.	0.0	4.1	6.9
d) December 1999 = 100	.	.	2.3	6.5	9.3
AGRICULTURAL PRODUCER PRICES					
b) same period of last year = 100	2.3	-11.7	9.2	8.4	-9.5
of which:					
crop products					
b) same period of last year = 100	-5.4	-15.0	12.6	9.3	-4.6
livestock products					
b) same period of last year = 100	5.7	-10.5	8.0	8.0	-12.1
MARKET SERVICES PRICES (excluding interest rates)					
a) previous month = 100	0.6	0.3	0.4	0.1	0.3
b) same period of last year = 100	8.8	4.1	3.4	3.9	3.2
c) average for 2000 = 100	.	.	0.0	4.0	7.3
d) December 1999 = 100	.	.	0.6	4.6	8.0

Source: CSO

RATIOS OF KEY INDICATORS TO GDP

percentage ratios

	1998	1999	2000	2001
State budget balance	-1.6	-1.6	-2.3	-3.1
Public budgets balance	-1.5	-0.6	-3.1	-2.4
Public debt	13.8	15.1	17.7	24.0
Debt in convertible currencies	39.0	42.8	40.7	36.5
Trade balance 1)	-4.4	-3.4	-6.1	-5.4
Current account balance	-2.2	-2.7	-5.3	-4.6
M2	67.5	70.3	71.2	74.0

Note: ratio = indicator/GDP at current prices

1) Source: CSO

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