2004

INFLATION REPORT APRIL/2004

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

CCA	Czech Consolidation Agency
CNB	Czech National Bank
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
EIB	European Investment Bank
EU	European Union
EUR	euro
FDI	foreign direct investment
FRA	forward rate agreement
GDP	gross domestic product
HICP	Harmonised index of consumer prices
IPI	Industrial production index
IRS	interest rate swap
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.)
MLSO	Ministry of Labour and Social Affairs
O/N	overnight
PPI	producer price index
PRIBID 1W	Prague Interbank Bid Rate, one-week
(1M, 1Y)	(one-month, one-year)
PRIBOR	Prague Interbank Offered Rate
repo rate	repurchase agreement rate
USD	US dollar
VAT	value added tax

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 the current position of the economy in the business cycle and its future development. 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 was approved by the CNB Bank Board on 6 May 2004. The Annex to the Report comprises a document published on 11 March 2004 in which the Czech National Bank declared its inflation target for the period starting January 2006.

An annex of statistical tables is available, together with this Report, on the enclosed CD and at http://www.cnb.cz/. Unless stated otherwise, the sources of the data presented in this Inflation Report are the CZSO or the CNB.

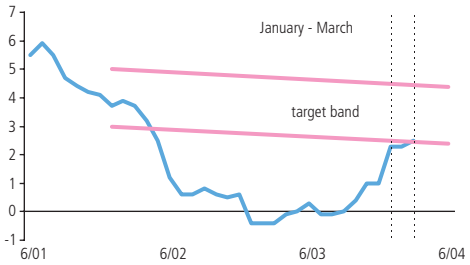
I. SUMMARY

Table I.1
INFLATION INCREASED FURTHER IN 2004 Q1
(annual percentage figures unless otherwise indicated)

	12/03	1/04	2/04	3/04
Consumer price inflation	1.0	2.3	2.3	2.5
Industrial producer price inflation	0.9	1.6	1.5	2.1
Money supply growth (M2)	7.0	6.9	7.2	x
3M PRIBOR[a)]	2.1	2.1	2.1	2.1
Nominal CZK/EUR exchange rate[b)]	32.31	32.72	32.86	32.98
State budget balance since January incl. SFAOs[b)] CZK bn	-109.1	7.3	-2.9	-7.8
GDP growth at constant prices[c)]	3.1			x
Unemployment rate[b)]	10.3	10.8	10.9	10.7

a) average for the month
b) end-of-month position
c) figure for the quarter ending with the given month

Chart I.1
INFLATION REACHED THE LOWER BOUNDARY OF THE TARGET BAND IN 2004 Q1
(annual consumer price inflation; percentages)



After having previously edged up from low figures to near the CNB's target band, inflation reached in keeping with the CNB's expectations the lower boundary of this band in 2004 Q1 (see Chart I.1). The Czech economy grew rather more slowly in 2003 Q4 than in the previous quarter. However, the growth rate was roughly double that in 2002 Q4. The persisting gap between the demand for, and supply of, labour, which widened further at the end of 2003 and in 2004 Q1, remained a key factor affecting unemployment and wages.

In 2004 Q1, consumer prices recorded annual growth rates of 2.3% in both January and February and 2.5% in March. Prices were strongly affected by changes to indirect taxes. These changes fed through into growth in regulated prices – whose contribution to inflation in this period was the largest – and on into prices of fuel and nontradable other commodities. As a result of forward buying by retailers of tobacco products and spirits, these changes did not affect food prices in Q1. However, food prices nonetheless contributed significantly to the rise in consumer prices in this period, owing to pass-through of rapid growth in agricultural producer prices caused by the adverse weather in 2003.

As in 2003 Q3, the annual growth rate of the Czech economy in 2003 Q4 was just above the three per cent level. The annual growth for 2003 as a whole was just below this level, owing to slower growth in H1, and was 50% higher than in the previous year. The economic growth in 2003 was fostered by buoyant growth in domestic demand, which was again dominated by household consumption and, unlike in 2002, also by accelerating gross fixed capital formation, driven chiefly by government investment expenditure. The significant growth contribution of government consumption in 2002 was conversely much lower in 2003 Q4 and roughly zero for the year as a whole. The external sector continued to act negatively in Q4, its effect doubling by comparison with Q3. The negative growth contribution on a full-year basis remained roughly at the 2002 level.

Developments on the labour market in 2004 Q1 were in line with the previous year's trend. The growing excess supply of labour was both cyclical and structural (skills, regional and sectoral discrepancies). The result was a pick-up in the year-on-year decline in employment and an increase in unemployment. The widening gap on the labour market also prevented excessive growth in wages in the business sector.

The main features of the balance of payments in both Q4 and 2003 as a whole were a growing current account deficit and decreasing net capital inflow. This was one of the important factors underlying a year-on-year depreciation of the koruna's exchange rate against the euro, which continued into 2004 Q1. On the other hand, though, the koruna appreciated strongly year on year against the dollar, mainly as a result of the latter's continuing depreciation against the euro.

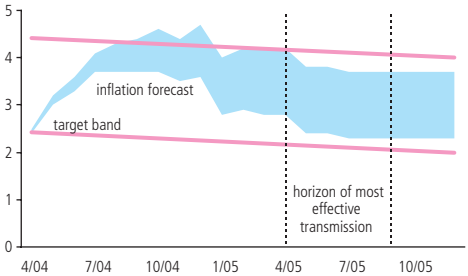
The monetary policy decision-making of the CNB Bank Board in 2004 Q1 was based on the inflation forecast discussed by the Board at its meeting on 29 January 2004 and published in the January Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in the first half of 2005. According to the forecast, inflation should be in the lower half of the target band in this period. Consistent with this macroeconomic forecast was interest rate stability in 2004 H1 and a gradual rise in rates thereafter at a two-year horizon. Based on this forecast and an assessment of the additional risks and uncertainties regarding its fulfilment, the Bank Board left monetary policy rates unchanged throughout the past quarter.

A fundamental monetary policy measure from the long-term perspective was the announcement of the CNB's inflation target for the period starting January 2006. The target has been set at 3%. The CNB will endeavour to ensure that the actual inflation outturn does not differ by more than one percentage point in either direction from this target. The inflation target will be in force until the Czech Republic joins the euro area. The document announcing the inflation target on 11 March 2004 can be found in the Annex to this Report.

As usual, section IV of this Inflation Report presents the CNB's new macroeconomic forecast. To sum up, the forecast is for a pick-up in economic growth to around 4% in 2004 and 2005. This will result in a gradual closure of the negative output gap during 2004 and a switch to positive figures in 2005. Unlike in 2003, the main growth factor will not be household consumption, but private investment and net exports.

The closing of the output gap will be reflected in a gradual resurgence of demand-pull inflationary pressures. Their impact on inflation will show up in 2005, after the effect of external factors – in the form of changes to indirect taxes – has unwound. The aggregate action of the demand effects and the counteracting import prices will cause inflation to be near the centre of the inflation target in 2005 H2. Consistent with the forecast is a gradual rise in interest rates at the two-year horizon.

Chart I.2
THE INFLATION FORECAST IS AT THE CENTRE OF THE TARGET BAND AT THE HORIZON OF MOST EFFECTIVE TRANSMISSION
(annual consumer price inflation; percentages)



II. INFLATION DEVELOPMENTS

II.1 PAST INFLATION DEVELOPMENTS

Annual consumer price inflation increased further in 2004 Q1. The rise in inflation at the start of 2004 was sharper than that recorded in the previous quarter. After having risen from zero per cent in September to 1% in December 2003, consumer price inflation increased by a further 1.5 percentage points to 2.5% in March. The inflation rate[1] rose to 0.8% in March.

The development of consumer price inflation confirmed a continuing attenuation of disinflationary tendencies. At the start of 2004 this was linked chiefly with extraordinary factors. The further increase in annual consumer price inflation was caused primarily by a continuing pick-up in agricultural producer price inflation, due in turn to adverse weather in 2003, and by changes made to excise duty and VAT rates[2] under the reform of public finances. However, the impact of the tax changes on consumer price inflation was not across the board in nature; it only concerned a limited number of items in the consumer basket. Another significant contributor to the rise in annual inflation was the January changes to prices of regulated items, which chiefly affected inflation in the category of "Housing, water, electricity, gas and other fuels".

The evolution of prices of imported production inputs also suggested continuing external cost pressures for growth in prices. The upswing in prices of imported inputs ongoing since mid-2003 fed through gradually – with a lag – into industrial producer prices. This process, however, was still not across the board in nature and (with some exceptions) had no major effect on producer price inflation. Consequently, its pass-through into consumer prices was as yet imperceptible (again with some exceptions). Only in the case of oil was there direct pass-through of the price changes on world markets into industrial producer prices in oil-processing industries and subsequently into fuel prices, just as in previous quarters.

Conditions on the demand side and on the retail market continued to prevent any greater pass-through of the re-emergent external cost pressures into producer prices and on into consumer prices. Consumer demand rose fairly briskly in 2003 H2, but the economy remained below potential output. At the same time, competition on the retail market remained strong. For many commodities, consumer price inflation was curbed by still falling import prices of consumer products, which had yet to be strongly affected by the depreciation of the koruna-euro exchange rate. On the supply side, producers responded to the tough competitive environment by rationalising employment and boosting productivity in order to cut their personnel costs relative to output. Some space for offsetting the rise in prices of imported inputs was also created by more favourable export prices, fostered by a depreciation of the koruna-euro exchange rate.[3]

These factors chiefly affected market prices in the category of non-food tradable commodities (except fuels), which are determined primarily by foreign competition via import prices. Overall, prices in this category continued to display an annual decline in 2004 Q1. However, the decline did not deepen and, on the contrary, eased to 2% in March. This slowdown in price growth was also due in part to the regrading of some commodities to the basic VAT rate.

Chart II.1
CONSUMER PRICE INFLATION INCREASED FURTHER IN 2004 Q1
(percentages)

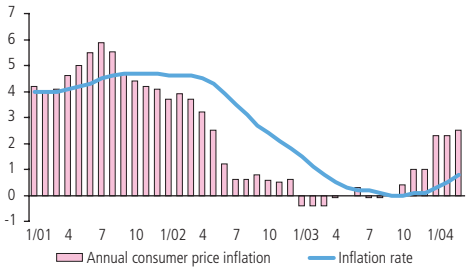


Table II.1
THE NUMBER OF CATEGORIES IN THE CONSUMER BASKET WITH RISING PRICES INCREASED
(annual percentage changes)

	9/03	10/03	11/03	12/03	1/04	2/04	3/04
Food and non-alcoholic beverages	-0.4	0.8	3.4	3.5	4.2	4.2	4.6
Alcoholic beverages and tobacco	0.5	0.2	0.6	0.7	0.8	0.8	0.9
Clothing and footwear	-5.4	-5.1	-4.9	-4.6	-4.8	-4.8	-4.4
Housing, water, electricity, gas and other fuels	1.6	1.9	1.9	1.9	4.2	4.2	4.2
Furnishings, household equipment and routine maintenance of the house	-2.0	-2.0	-2.1	-2.0	-2.0	-2.1	-2.0
Health	3.7	3.5	3.1	3.2	2.5	2.5	2.3
Transport	-0.8	-0.9	-0.9	-0.5	1.1	0.6	0.9
Communications	-3.9	-1.9	-1.8	-0.9	15.1	13.0	13.1
Recreation and culture	-1.1	-0.8	-0.7	-1.0	-1.0	-0.8	-0.8
Education	0.3	0.6	0.6	0.6	0.8	1.1	0.9
Hotels and restaurants	1.7	1.7	1.9	1.9	2.4	2.4	2.7
Miscellaneous goods and services	2.9	3.1	2.9	2.9	3.0	3.2	3.6
Consumer prices	0.0	0.4	1.0	1.0	2.3	2.3	2.5

Chart II.2
THERE WAS FASTER GROWTH IN CONSUMER PRICES IN THE CATEGORIES OF BOTH MARKET AND REGULATED PRICES

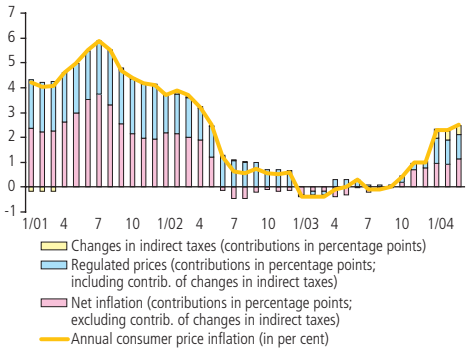
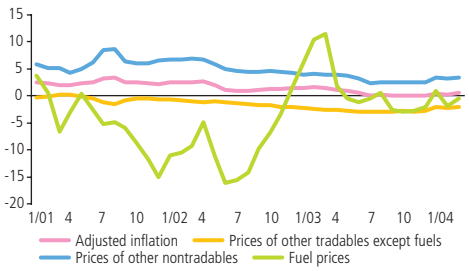


Chart II.3
WITHIN THE MARKET PRICES CATEGORY, PRICES OF NON-FOOD TRADABLE COMMODITIES AND FUELS DECLINED
(annual percentage changes)



1 The inflation rate expressed as the increase in the average consumer price index (basic) for the 12 last months relative to the average for the previous 12 months.

2 These chiefly involved moving certain commodities from the 5% rate to the basic 22% rate.

3 The terms of trade moved in the range of 101.7%–102.4% between October 2003 and January 2004 in year-on-year comparison.

In most other market price categories, prices continued to rise. The further increase in food price inflation[4] in early 2004 (to 3.2% in March) was linked primarily with continuing growth in prices in the agricultural-commodity production and processing chain, triggered by the adverse weather in the Czech Republic and neighbouring European countries in 2003 (for details see Section III.5 *Other costs and producer prices*). The pick-up in agricultural commodity prices and subsequently in food prices was also fostered by the annual depreciation of the koruna-euro exchange rate, which fed through into domestic prices via import prices.

The year-on-year growth in food prices at the start of 2004 was also fostered by an increase in excise duties on alcohol and tobacco. Their upward effect on inflation in the category of "Alcoholic beverages and tobacco" (to 0.9% in March), however, was lower than expected, as there was no rise in prices of tobacco products following the increase in excise duty in 2004 Q1. This was due to the sale of stocks of tobacco products from the previous year's production. However, prices of "Food and non-alcoholic beverages" showed very brisk growth. The further pick-up in their growth rate, to 4.6% in March, was linked primarily with prices of bakery products, potatoes and vegetables, i.e. commodities for which there had been an annual rise in input prices or a fall in supply due to lower yields in 2003. Prices of temperate-zone fruit also increased significantly.

In the case of other nontradable commodities (primarily services), the tax change was evidently the main cause of a further pick-up in price growth (from 2.4% in December 2003 to 3.5% in March; see Chart II.3). Housing-related services and unregulated telephone call charges (mobile phones) were moved to the basic VAT rate. The actual evolution of prices of other nontradable commodities, however, indicated a sharper increase in prices than had been forecasted after the change in the tax rate. It cannot be ruled out that this was a result of higher inflation expectations of providers of services included in the consumer basket, based on an expected rise in costs associated with the increase in VAT on other services[5] (car and property rental, advisory services, accountancy, etc.).

Fuel prices remained sensitive to oil price movements on world markets. In January and February oil prices recorded, due to the higher 2003 year comparative base, a year-on-year decline, and their impact on koruna prices of imports was moreover bolstered by a persisting year-on-year appreciation of the koruna-dollar exchange rate (see Chart III.33). As a result, fuel prices recorded a deep year-on-year decline in this period. The increase in excise duties on petrol and diesel merely attenuated this decline (to -1.9% in February net of the tax changes). Despite an upturn in oil prices in March, the year-on-year fall in fuel prices continued at the end of Q1.

On aggregate, the evolution of market prices in 2004 Q1 suggested no extraordinary price trend changes linked with the tax changes. The growth in net inflation – an indicator of market prices – was not high (1.4% year on year in March). Within net inflation, food prices showed faster growth, but the rise in prices of non-food commodities[6] did not even reach the 1% level. Regulated prices rose more sharply at the start of 2004 (to 4.7% in March). The biggest contributors to their faster growth

Chart II.4
THE ANNUAL PICK-UP IN FOOD PRICE INFLATION WAS DUE PRIMARILY TO AN ACCELERATION IN AGRICULTURAL PRODUCER PRICE INFLATION
(annual percentage changes)

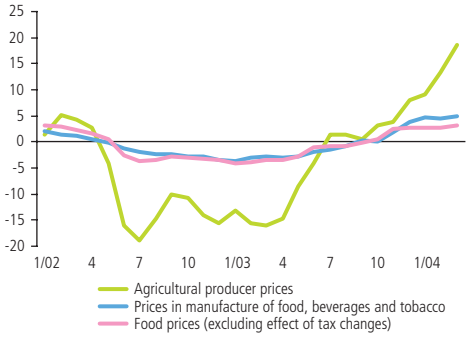


Chart II.5
ANNUAL GROWTH IN MARKET PRICES WAS MODERATE OVERALL, EVEN AFTER THE CHANGE TO EXCISE DUTY AND VAT RATES
(percentages)

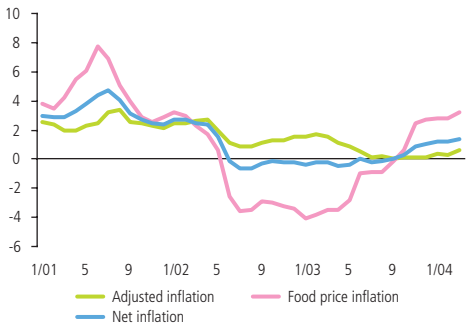
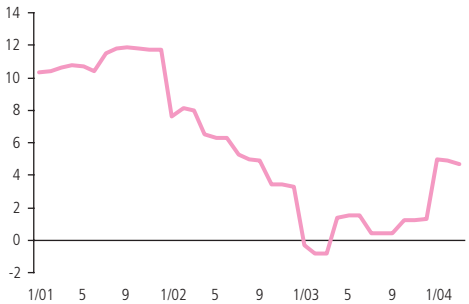


Chart II.6
REGULATED PRICES RECORDED LARGER GROWTH, OWING TO THE TAX CHANGES AND THE CHANGES TO PRICES OF REGULATED ITEMS
(annual percentage changes)

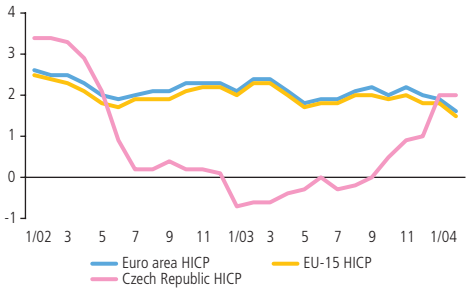


4 Food prices = prices of food and non-alcoholic beverages + prices of alcoholic beverages and tobacco (adjusted for administrative effects). Their share (constant weight) in the consumer basket is 27.7%.

5 i.e. services not included in the consumer basket.

6 Measured by adjusted inflation, which comprises prices of non-food items of the consumer basket excluding regulated prices and administrative measures, i.e. fuel prices, other tradables prices and other nontradables prices.

Chart II.7
ANNUAL CONSUMER PRICE INFLATION IN THE CZECH REPUBLIC ROSE ABOVE THE LEVEL OF THE EU COUNTRIES AND THE EURO AREA AT THE START OF 2004
(percentages)



were a year-on-year increase in regulated telephone call charges (of 15% in March), resulting from their regrading to the basic VAT rate, and the January changes to prices of the regulated items: electricity for households (of 3.5%), water supply and sewerage collection charges (of around 4%) and gas (of 7.8%). According to the CNB's calculations, the primary effect of the tax changes (i.e. their impact on prices in the amount stipulated by law) accounted for more than one-quarter of the annual inflation recorded in 2004 Q1. Secondary effects of the tax changes were visible in the category of other nontradable commodities and fuels.

By international comparison, annual consumer price inflation in the Czech Republic as measured by the Harmonised Index of Consumer Prices (HICP) was slightly above the HICP in the EU in 2004 Q1. According to the latest data, the HICP in the Czech Republic rose by 2% year on year in February, while in the EU the figure was 1.5%.

II.2 FULFILMENT OF THE INFLATION TARGET

Actual inflation in 2004 Q1 was broadly at the lower boundary of the target band (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Table II.2
HEADLINE INFLATION IN 2004 Q1 WAS IN LINE WITH THE OCTOBER 2002 FORECAST
(annual percentage changes,contribution to total difference in percentage points)

	October 2002 forecast	March 2004 outturn	Contribution to total difference in perc. points
Annual consumer price inflation	2.5	2.5	0.0
Breakdown into contributions:			
regulated prices	2.9	4.7	0.3
indirect taxes	0.0	0.4	0.4
food prices	2.0	3.2	0.3
fuel prices, excluding changes to indirect taxes	-3.0	-5.4	-0.1
adjusted inflation excluding fuels	2.7	0.9	-0.9

Changes to interest rates pass through into inflation most strongly with a lag of roughly 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2004 Q1, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around July 2002 to March 2003. For simplicity, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in October 2002, i.e. approximately in the middle of the aforementioned period, with inflation in March 2004 (see Table II.2).

The October 2002 inflation forecast had indicated a negative output gap, with anti-inflationary effects, throughout 2003. Conversely, import prices and agricultural producer prices were expected to have an upward effect on inflation. Overall, the October forecast was for inflation to return inside the target band in 2004 (see the October 2002 Inflation Report). The consumer price inflation outturn in March 2004 (2.5%) matched this projection but differed in structure from the forecast. Food prices and regulated prices rose more quickly than forecasted in October 2002, and the contribution of indirect taxes was higher, too. Conversely, adjusted inflation including fuel prices was lower.

Table II.3
THE DIFFERENT-THAN-FORECASTED STRUCTURE OF THE MARCH INFLATION WAS PARTLY DUE TO ANTI-INFLATIONARY EXTERNAL FACTORS

		IV/2002	I/2003	II/2003	III/2003	IV/2003	I/2004
GDP in Germany	prediction	1.1	1.3	1.6	1.6	1.6	1.8
(annual perc. changes)	outturn	0.4	0.5	0.1	-0.3	-0.3	x
CPI in Germany	prediction	1.5	1.0	1.1	1.5	1.6	1.7
(annual perc. changes)	outturn	1.1	1.1	0.9	1.0	1.1	1.0
1Y EURIBOR	prediction	3.3	3.3	3.4	3.6	3.7	3.7
(percentages)	outturn	3.0	2.5	2.2	2.2	2.4	2.1
EUR/USD exchange rate	prediction	0.99	1.00	1.01	1.01	1.02	1.02
(levels)	outturn	1.00	1.07	1.14	1.13	1.19	1.25
Oil prices	prediction	27.0	26.3	25.0	23.7	22.8	22.8
(USD/barrel)	outturn	26.0	30.1	24.1	27.2	27.5	29.8

The difference in the structure of the inflation outturn from the October forecast can be put down to unexpectedly disinflationary exogenous factors lying partly or completely outside the purview of the CNB's monetary policy (weak external demand, low inflation abroad and the euro's appreciated exchange rate against the dollar), higher-than-expected sensitivity of domestic prices to the negative output gap, and higher-than-expected growth in regulated prices (see Table II.3).

Tab. II.4
EASIER MONETARY CONDITIONS LED TO FASTER CLOSURE OF THE OUTPUT GAP

		IV/2002	I/2003	II/2003	III/2003	IV/2003	I/2004
3M PRIBOR	prediction	2.5	2.4	2.5	2.5	2.6	2.6
(percentages)	outturn	2.7	2.5	2.4	2.1	2.1	2.1
CZK/EUR exchange rate	prediction	30.0	30.0	30.0	29.8	29.6	29.5
(levels)	outturn	30.9	31.6	31.5	32.2	32.1	32.9
GDP	prediction	1.9	0.8	1.0	2.6	2.5	4.1
(real. annual perc. changes)	outturn	1.5	2.5	2.6	3.4	3.1	x
Output gap	prediction	-2	-2.4	-2.5	-2.5	-2.2	-1.8
(percentages of GDP)	outturn*	-1.9	-1.4	-1.8	-1.7	-1.7	-1.5

*estimate based on the CNB's April 2004 forecast

Consistent with the October forecast was a decline in interest rates at the end of 2002 and then flat rates in 2003. In reality, the decline in interest rates was sharper, as monetary policy rates were lowered by 1 percentage point in four steps in the period from October 2002 onwards. This notwithstanding, thanks to the greater-than-expected decline in inflation, real interest rates were higher than forecasted during 2003, hence the interest rate component of the monetary conditions was more restrictive than forecasted. However, the deviation of the actual interest rate component from the forecast was more than offset by the easier effect of the exchange rate component.

Overall, then, the monetary conditions were easier by comparison with the October forecast. This resulted in higher-than-forecasted economic growth and faster-than-forecasted closure of the output gap (see Table II.4). The anti-inflationary pressure from the output gap was therefore weaker. The easier-than-forecasted monetary conditions thus acted towards higher-than-forecasted inflation.

Acting in the opposite direction overall, i.e. towards lower-than-forecasted inflation, were the settings of certain parameters that were not estimated accurately in the October forecast, i.e. parameters that were revised in the CNB's modelling system in the period since October 2002. The most significant of the revisions was an upscaling of the sensitivity of certain segments of the consumer basket to the negative output gap. The higher real sensitivity of consumer prices to the negative output gap than that forecasted in the October forecast acted towards lower-than-forecasted adjusted inflation excluding fuels.

The inflation forecast is the primary source material for the Bank Board's decisions. Also of key importance for its decision-making is an assessment of the possible risks associated with this forecast by the board members. At the Board's meetings during the final two quarters of 2002 (see the relevant minutes), the risks were perceived initially as being slightly anti-inflationary and later as being balanced. In 2003 Q1, a moderately inflationary perception of the risks prevailed. Among the downside risks, particular emphasis was put on the risk of a longer-lasting stagnation of external demand, the risk of lower external inflation and the risk of lower growth in food prices and regulated prices. The upside risks mentioned included the risk of higher growth in oil prices, the risk of a reversal in the exchange rate trend and the risk of a higher fiscal-policy demand stimulus.

Subsequent developments bore out the majority of the risks identified, with the downside risks materialising to a greater extent than the upside risks. This notwithstanding, we can say – with the benefit of hindsight – that the Bank Board's decisions based on the aforementioned perception of the individual forecasts' risks contributed to the fulfilment of the inflation target.

III. INFLATION FACTORS

III.1 MONETARY DEVELOPMENTS

III.1.1 Money

Annual M2 growth increased to 7.2% in the period of December 2003 – February 2004, thus confirming the long-term tendency of higher money growth ongoing since mid-2003. The money growth was affected in particular by the improving financial condition of corporations and by expectations of economic growth. Corporations invested their temporary liquidity especially in nonmarketable securities. Another important factor was households' precautionary motive for holding money.

Within M2, the monetary aggregate M1 maintained a buoyant growth rate. Its annual growth in February 2004 was 15.6%, although this was the lowest figure in a year. The growth was supported by low interest rates, which are giving rise to a long-term upward tendency in demand deposits at the expense of time deposits of corporations and households. The slackening M1 growth was consistent with the slowing growth in the consumption expenditure of households in 2003 Q4.

The decline in quasi money of corporations and households has been slowing since mid-2003. The same trend has been recorded for time deposits (which constitute 40.6% of M2), despite a fall of 1.9% in February 2004. The gradually slowing decline in time deposits was linked with growth in saving by households in building saving schemes, due in turn to higher returns and a change to the terms and conditions as from 2004. Corporations' demand for nonmarketable securities (which constitute 6.4% of M2) remained robust. This chiefly concerns deposit bills of exchange, which for corporations are a better investment vehicle for temporary liquidity than current accounts. Deposit bills of exchange are used mainly by corporations with large current account balances. These bills have maturities of up to one year and a fixed interest rate derived from the cost of money on the financial market.

TABLE III.1
THE ANNUAL M2 GROWTH MANIFESTED ITSELF IN AN INCREASE IN QUASI MONEY AMID PERSISTING HIGH DEMAND FOR NARROW MONEY
(quarterly figures are averages, percentages)

	Outstanding amount as a percentage of M2*	I/03	II/03	III/03	IV/03	1/04	2/04
M1	45.2	19.1	18.0	17.0	16.6	17.5	15.6
Currency in circulation	12.7	11.0	14.1	15.0	12.8	12.3	11.0
Demand deposits	32.5	22.8	19.7	17.8	18.1	19.7	17.6
M2-M1 (quasi money)	54.8	-5.8	-5.8	-2.2	-2.5	-0.4	1.1
Time and savings deposits	40.6	-4.2	-6.4	-5.9	-5.2	-3.1	-1.9
Dep. bills of exch. and other bonds	6.4	-17.7	-12.2	10.2	9.4	26.7	38.4
Foreign currency deposits	7.8	-5.7	1.4	10.9	4.8	-2.3	-4.7
M2	100.0	3.2	3.1	5.4	5.3	6.9	7.2

Note *: As at end of last month available.

CHART III.1
THE GROWTH RATES OF M1 AND HOUSEHOLD CONSUMPTION EXPENDITURE DID NOT INCREASE ANY FURTHER IN 2003 Q4
(annual percentage changes)

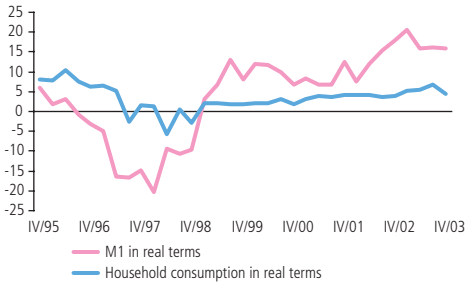


CHART III.2
ANNUAL GROWTH IN LOANS FELL SOMEWHAT
(percentages)

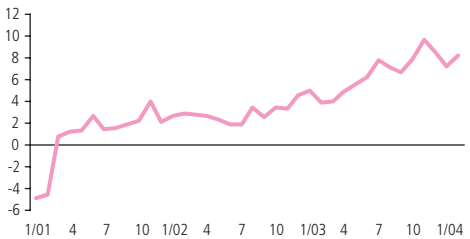
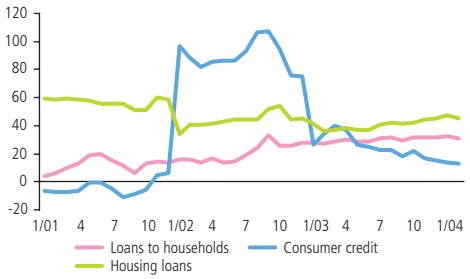


CHART III.3
THE GROWTH RATE OF LOANS TO HOUSEHOLDS DID NOT INCREASE ANY FURTHER
(annual percentage changes)



III.1.2 Credit

The growth rate of loans adjusted for non-monetary effects eased somewhat in December 2003 – February 2004, to 8.2%. Households and corporations both contributed to this fall.

Annual growth in loans to households slackened by 0.3 percentage point to 31% in the period under review. Household demand for debt financing nonetheless remained robust. Despite higher unemployment and a rise in inflation at the start of 2004, it continued to be supported by household demand for investment in housing, the low level of real interest rates and the supply of new loan products. Except in February 2004 housing loans recorded rising annual growth, reaching 45.1% at the end of the period under review. The increase was mostly due to mortgage loans, which, in addition to households' investment in real estate, may be affecting their consumption expenditure. This can occur in the case of purchases of older properties by original owners of apartments and by recipients of bank loans secured by real estate, provision of which is under preparation (American mortgages).

Annual growth of consumer credit (including bank overdrafts and loans for temporary shortages of funds) slowed further. Having fallen from 39.6% in 2003 Q1 to 15.4% in 2003 Q4, it continued down to 13.3% in February 2004 (credit growth in 2002 had been affected by a methodical change to the statistical reporting for one of the selected banks). Disposable income, as well as loans from non-banking institutions were used increasingly to finance consumption expenditure. The consumer credit trend in 2003 Q4 was in line with the lower growth in household consumption.

Households' level of debt with banks increased by 3.2 percentage points in 2003, reaching 17.5% of their disposable income. Housing loans had the largest share, accounting for 11% of disposable income. The figure for consumer credit was 5.4%. The debt had yet to present major problems as regards households' ability to repay loans. The ratio of loans to deposits of households had been roughly one-third over the last two years. Deposits are still the key financial assets of households and can be used to repay loans in the event of unexpected fluctuations in current income. Households' interest expenditure as a percentage of disposable income was flat at 1.9% in 2003, owing to the low level of interest rates. Conversely, the share of net interest expenditure rose, although only to 0.8%. Underlying this was a fall in interest income affected by the slope of the yield curve, reflecting the longer maturities of households' loans (around 90% of such loans have maturity of more than 1 year) relative to deposits. The high growth rate of loans in 2003 was accompanied by a fall in the share of classified loans of households in the total loans of this sector, to 9.2%.

After having recorded a steadily slowing decline in 2003, loans to non-financial corporations recorded a decrease of 0.3% between December 2003 and February 2004. This was linked with the better financial condition of non-financial corporations and expectations of economic growth. However, the upturn in effective demand for credit, i.e. demand associated with quality loan projects, remains subdued. Loans extended to foreign-controlled non-financial corporations were down by 10.1% from a year earlier, while lending to domestic non-financial corporations was up by 3.8%. The low demand for credit among foreign-controlled non-financial corporations was linked with their low investment activity and the evolution of external demand. Turning to the time structure of loans to non-financial corporations, short-term and medium-term loans recorded the largest growth. After having recorded a rise at the end of 2003, long-term loans fell back in January and February 2004. A gradual halt in the decline in loans to non-financial corporations was particularly visible for operating (short-term) loans. The ratio of investment (long-term) loans to short-term loans did not increase significantly.

The time structure of total loans (inclusive of households and other economic sectors) showed mixed developments. Between December 2003 and February 2004 the proportion of short-term and medium-term loans decreased in favour of long-term loans. This trend was partially apparent for households and was influenced by a change to the statistical reporting of standard and bridging building society loans as from January 2004. The statistical reporting of the receivables of one selected economic agent was also revised.

III.2 DEVELOPMENT ON THE FINANCIAL MARKETS

III.2.1 Interest rates

Interest rates were affected by several domestic and foreign factors in 2004 Q1. The CNB's key rates remained unchanged in this period, the 2W repo rate at 2%, the Lombard rate at 3% and the discount rate at 1% with effect from 1 August 2003. Rates on the money market were flat, while interest rates with longer maturities were more volatile and falling for most of the period under review. This was due to sentiment in the developed markets; domestic factors affected interest rates only exceptionally. At the beginning of the year, the world financial markets were still expecting an increase in key interest rates to come fairly soon. As time went on, however, these expectations moved further into the future, mainly because of the insufficient economic recovery. In addition, the international political situation deteriorated. Medium-term and long-term interest rates therefore fell by up to 0.4 percentage point. PRIBOR spot quotations and FRA forward quotations at the end of March indicated expectations of stability in the immediate future and an increase in rates in the longer term.

Chart III.4
THE LEVEL OF HOUSEHOLD DEBT INCREASED IN 2003
(percentages of gross disposable income)

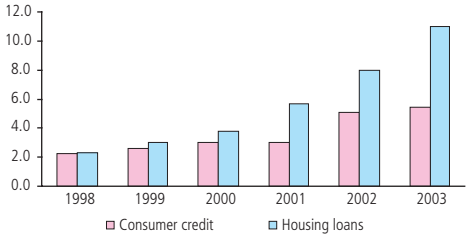


Chart III.5
INTEREST EXPENDITURE AS A PERCENTAGE OF GROSS DISPOSABLE INCOME WAS FLAT IN 2003
(percentages of disposable income)

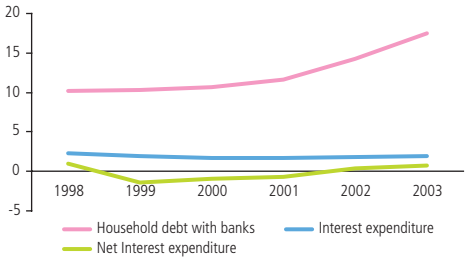


Table III.2
THE ANNUAL DECLINE IN LOANS TO NON-FINANCIAL CORPORATIONS HALTED
(percentages)

	I/03	II/03	III/03	IV/03	1/04	2/04
Loans to non-financial corporations	-12.4	-8.0	-4.5	-1.3	-3.0	-0.3
Loans up to 1 year	-19.8	-10.2	-5.7	-4.3	-0.6	2.5
Loans over 1 year and up to 5 years	-13.5	-13.6	-9.8	-2.2	-3.0	2.1
Loans over 5 years	-0.4	-0.4	1.3	3.3	-6.2	-5.4

Chart III.6
THE RATIO OF MEDIUM-TERM AND LONG-TERM LOANS TO NON-FINANCIAL CORPORATIONS TO SHORT-TERM LOANS HAD YET TO INCREASE
(percentages)

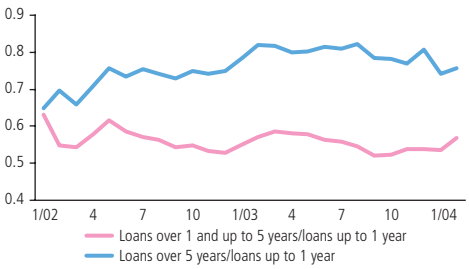


Chart III.7
THE CNB LEFT KEY RATES UNCHANGED
(percentages)

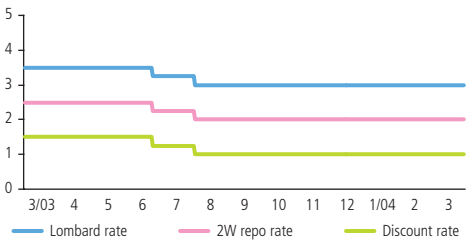


Chart III.8
MARKET INTEREST RATES MOSTLY FELL
(percentages)

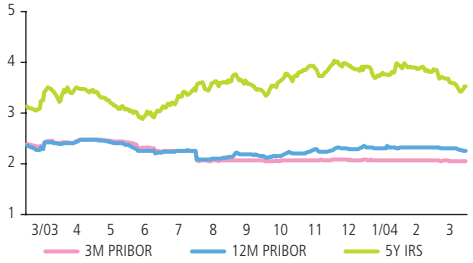
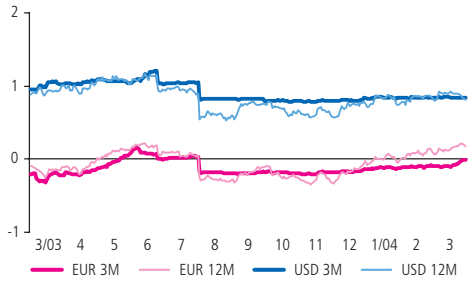


Chart III.9
THE INTEREST RATE DIFFERENTIAL WIDENED SOMEWHAT
(percentage points)



EX ANTE REAL INTEREST RATES SHOWED MIXED DEVELOPMENTS
(percentages)

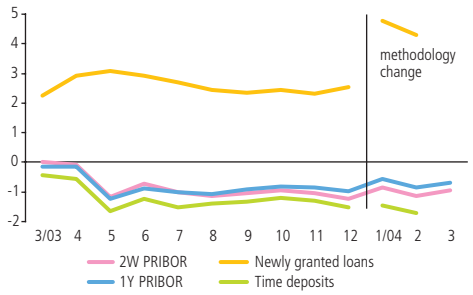
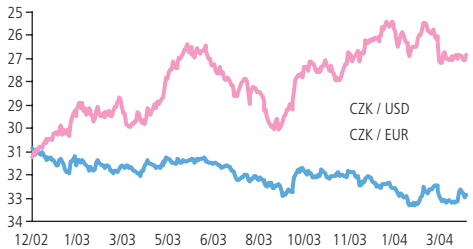


Chart III.11
THE KORUNA'S EXCHANGE RATE AGAINST THE EURO WAS VOLATILE IN 2004 Q1



The PRIBOR yield curve remained almost unchanged, keeping its slightly positive slope. The spread between the 1Y PRIBOR and the 2W PRIBOR was unchanged at 0.28 percentage point. The IRS yield curve moved to a higher yield level, but the shift was not sizeable. The largest changes were in the central part of the curve. In March, the average 5Y-1Y spread was 1.32 percentage points and the 10Y-1Y spread 2.14 percentage points.

The interest rate differential (PRIBID/CZK-LIBOR/EUR,USD) was affected mainly by interest rate developments abroad, since interest rates on the domestic interbank market were almost unchanged. Key rates also remained unchanged in both the most important economies. In the euro area the repo rate was 2.0%, while in the USA the O/N rate was 1.0%. However, market interest rates were generally falling, so the interest rate differential widened somewhat. At the end of March, the differential vis-à-vis euro rates was -0.1 to 0.2 percentage point depending on maturity and vis-à-vis dollar rates 0.8 percentage point.

Six auctions were held on the primary government bond market, with original maturities ranging from 3Y to 15Y and a total volume of CZK 37.6 billion. The Ministry of Finance changed its previous practice: the auctions are now held in smaller volumes. At the same time, reverse auctions of soon-to-mature government bonds started to be organised in order to support the liquidity of other issues. Despite investor interest, the Ministry of Finance did not accept the yields bid and the auctions ended unsuccessfully. The mortgage bond market saw securities issues amounting to CZK 6.7 billion. Issuing activity also continued on the primary koruna eurobond market, where the outstanding volume at the end of March 2004 was CZK 149.6 billion.

There was a change in methodology for client interest rates at the beginning of 2004. Newly drawn loans were replaced by newly granted loans, the deciding date for which is the date of conclusion of the loan agreement. This better reflects the demand for loans at any given interest rate. Interest rates on new deposits started to be monitored in the same way. This approach is in line with ECB methodology. Nominal interest rates on new loans were 5.0% and rates on new time deposits 1.4% in February.

Real interest rates[7] were affected not only by the level of nominal rates, but also by how the price indices developed. Expected consumer price indices are customarily higher than expected industrial producer price indices. This fact is reflected in the levels of the individual real interest rates. Real rates on new loans were 4.3% in February, while real rates on time deposits were -1.7%.

III.2.2 The exchange rate

The average exchange rate of the koruna against the euro in 2004 Q1 was CZK 32.85/EUR, which represents a year-on-year depreciation of almost 4%. The continuing year-on-year depreciation of the koruna reflected a slightly widening current account deficit and also lower capital inflow, due in turn mainly to a sizeable decline in sales of property to non-residents.

The exchange rate of the koruna against the euro saw relatively large swings in Q1. At the start of January, the exchange rate continued to depreciate slightly by comparison with the December average. This depreciation was probably associated with higher demand for

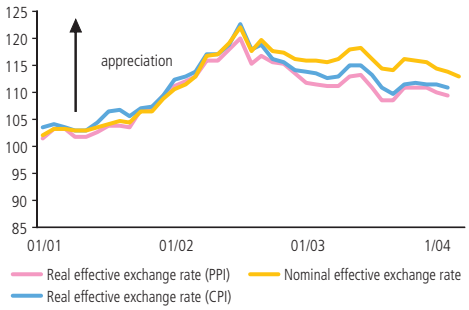
7 Ex ante real interest rates: nominal interest rates on loans are deflated by the industrial producer price indices expected by the CNB each month; nominal interest rates on deposits and PRIBOR rates are deflated by the consumer price indices expected by financial market participants each month.

foreign currency reflecting the widening of the trade deficit at the close of 2003. The koruna depreciated as far as CZK 33.3. At the end of January and at the beginning of February, however, it rebounded to around CZK 32.5, probably because of interest from foreign investors (investment funds) in adding selected domestic shares to their investment portfolios. However, when the purchases subsided, the koruna again showed a tendency to return to figures just above CZK 33/EUR. The next major impulse for a change in the koruna's exchange rate was the publication of favourable trade balance figures for February towards the end of March. The year-on-year improvement in the trade balance, or the divergence from analysts' expectations, was approximately CZK 5 billion and was reflected in a gradual appreciation of 70 hellers, to CZK 32.5. At the end of March, the exchange rate was again approaching the CZK 33 level.

The koruna's exchange rate against the dollar reached CZK 26.28/USD in Q1, a year-on-year appreciation of approximately 12%. This was due to the dollar's depreciation on world markets. The exchange rate was strongly affected by the koruna's movements against the euro. However, particularly in the second half of the quarter it also reflected the general trend towards modest appreciation of the dollar on world markets. As a result, the koruna depreciated relatively fast, from around CZK 25.4/USD to CZK 26.8/USD between mid-January and the end of that month. Over the next two weeks it appreciated again, reaching CZK 25.4/USD. However, over the following two weeks it weakened again to around CZK 27/USD and remained at this level during March.

The nominal effective exchange rate index depreciated slightly in 2004 Q1 (by 1.8% year on year). Most of all this reflected the evolution of the koruna's exchange rate against the euro. In January and February, the year-on-year depreciation of the koruna's real effective exchange rate based on both the CPI and the PPI also continued. Throughout 2003, the effective exchange rate reflected the lower inflation in the Czech Republic than abroad, which brought about a more sizeable weakening of the real effective exchange rate. Over the course of 2004 Q1, the rising domestic inflation caused the real and nominal effective exchange rates to converge again.

Chart III.12
THE NOMINAL EFFECTIVE EXCHANGE RATE DEPRECIATED IN Q1
(Year 2000 = 100)



III.2.3 Capital flows

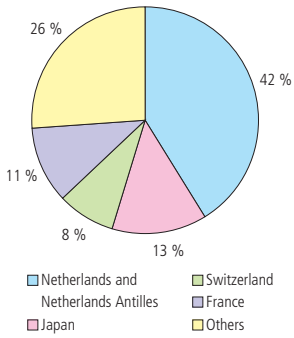
The net inflow of foreign capital in 2003 amounted to CZK 163.9 billion, i.e. approximately 6.8% of GDP. In year-on-year terms this constituted a decline of around one-half. The year-on-year decline in surplus was due mainly to a sizeable year-on-year fall in sales of property to non-residents[8]; other forms of capital developed more favourably (recording either a growing surplus or a shrinking deficit). However, the overall structure of the capital inflow changed. Banking capital, short-term in particular, became the largest component of the total capital inflow, accounting for around 50% of the net inflow. Foreign direct investment played a smaller role than in the past. In addition to the aforementioned virtual cessation of sales of property to non-residents, this was due to transactions in ownership interests in Český Telecom and its subsidiary Eurotel, which reduced the net inflow of direct investment by CZK 50 billion but at the same time led to an increase in holdings of domestic shares by non-residents and an upturn in drawings on foreign credit sources by the corporate sector in almost the same amount. Non-residents' interest in domestic portfolio investment and drawings on loans by the public and the corporate sector contributed to the capital inflow to a significantly lesser extent. The overall inflow of capital was depressed by residents' interest in foreign debt securities.

Table III.3
THE FINANCIAL ACCOUNT SURPLUS RECORDED A LARGE YEAR-ON-YEAR DECREASE IN 2003
(CZK billions)

	2000	2001	2002	2003
Financial account	148.0	172.8	347.8	163.9
Direct investment	190.8	208.3	270.9	66.4
- Czech abroad	-1.7	-6.3	-6.8	-6.5
- Foreign in Czech Republic	192.5	214.6	277.7	72.9
Portfolio investment	-68.2	34.9	-46.7	-37.7
- Czech abroad	-86.6	4.4	-75.6	-85.9
- Foreign in Czech Republic	18.4	30.5	28.9	48.2
Financial derivatives	-1.4	-3.3	-4.3	3.8
Other investment	26.8	-67.1	127.9	131.4
1. Long-term investment	-4.9	-3.0	31.6	22.4
- Credit granted abroad	21.3	1.3	28.7	1.1
- Credit accepted from abroad	-26.2	-4.3	2.9	21.3
2. Short-term investment	31.7	-64.1	96.3	109.0

8 In 2002, sales of property had amounted to CZK 176 billion (of which state property accounted for CZK 125 billion). In 2003, the figure was only around CZK 3 billion.

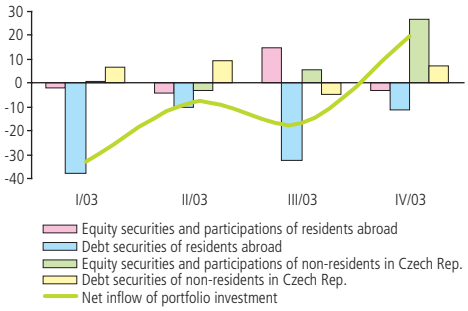
Chart III.13
GEOGRAPHICAL STRUCTURE OF THE FDI INFLOW IN 2003



The net inflow of direct investment in 2003 amounted to CZK 66.4 billion, i.e. 2.8 % of GDP (compared to CZK 270.9 billion in 2002). The inflow of foreign direct investment totalled CZK 72.9 billion and was made up mainly of reinvested earnings of firms with foreign capital. Sales of property to non-residents, which had been exceptionally significant in the preceding five years, almost stopped in 2003. Private sales practically dried up, and the state sold property worth CZK 3 billion to non-residents. However, the inflow of capital from abroad into capacity-building investments reached CZK 51.9 billion and rose slightly year on year.

The total inflow of foreign direct investment capital from abroad, however, was affected by two transactions in ownership interests in Český Telecom. The first was the sale by Telsource of a CZK 22.2 billion minority stake in Český Telecom on foreign stock markets, which brought about a decrease in direct investment and an increase in portfolio investment. The second transaction was the purchase of a minority stake in the Eurotel subsidiary from its foreign owner Atlantic West by the parent firm Český Telecom for CZK 28.1 billion. The purchase was financed mainly by a foreign loan. As regards its sectoral structure, the inflow of capital was channelled primarily into industry, wholesale and retail trade and real estate. The biggest investor (with a share of around 40%) was the Netherlands and the Netherlands Antilles. Significant inflows of capital also came from Japan, France and Switzerland. At CZK 6.5 billion, Czech direct investment abroad remained roughly at the level of the previous two years.

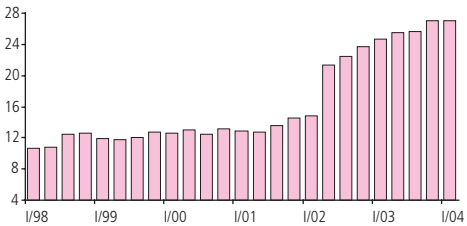
Chart III.14
THE NET OUTFLOW OF PORTFOLIO INVESTMENT DECREASED DURING 2003



The net outflow of portfolio investment in 2003 was CZK 37.7 billion, which represented a year-on-year decline of around CZK 9 billion. However, this decline was caused by the aforementioned one-off transaction in Český Telecom shares worth CZK 22.2 billion. The portfolio investment deficit was due exclusively to residents' interest in foreign debt securities, holdings of which rose by more than CZK 90 billion. These were primarily investments by banks and funds in long-term bonds. Geographically speaking, preference was given to investment in the bonds of EU countries, in particular Germany, France, Luxembourg and Italy, as well as the bonds of international institutions. Conversely, holdings of American bonds fell quite sharply. Residents' holdings of foreign shares decreased somewhat. The ongoing uncertainties regarding the economic recovery in the developed nations were reflected in a lack of interest in foreign equity securities. Investment by non-residents in domestic securities remained less significant. Leaving aside the aforementioned one-off purchase of Český Telecom shares, non-residents' share holdings were below CZK 10 billion and the volume of bonds approximately doubled.

Financial derivatives transactions remained insignificant in 2003, generating a CZK 3.9 billion rise in the financial account surplus.

Chart III.15
THE INTERNATIONAL RESERVES WERE UNCHANGED IN DOLLAR TERMS IN 2004 Q1
(USD billions)



Other investment recorded a net capital inflow of CZK 131.4 billion (approximately the same as in 2002). This was attributable mainly to short-term financial transactions of the banking sector (approximately CZK 80 billion). At the beginning of the year these took the form of a decline in banks' short-term assets, absorbed in the period of huge sales of property to non-residents. In the second half of the year they involved growth in the short-term liabilities of the banking sector. The business sector did not resume drawing on foreign credit until the end of the period under review. The total volume of loans adjusted for the aforementioned loan for the purchase of the stake in Eurotel, however, did not exceed CZK 10 billion. The government sector drew almost the same volume of funds from abroad as in 2002 (CZK 18.2 billion). However, in contrast to 2002, there was no significant deblocking of foreign debt; the funds mostly consisted of drawings on loans.

In 2004 Q1, international reserves were affected exclusively by capital and interest income and valuation changes. The CNB did not intervene on the foreign exchange market. In koruna

terms international reserves rose in the course of 2004 Q1 from CZK 691.5 billion to CZK 724.9 billion. In dollar terms their value remained unchanged (USD 27.0 billion).

III.3 DEMAND AND OUTPUT

By the CZSO's estimate, the growth of the Czech economy slackened somewhat in 2003 Q4 (to 3.1% year on year). Nonetheless, GDP growth was higher than in 2003 H1 and in 2003 as a whole (2.9%). The economy grew for the fifth consecutive year, but the output gap remained negative.[9]

As in the previous quarters of 2003, the GDP growth in Q4 was underpinned by rising domestic demand, and in particular households' expenditure on final consumption. The main factors underlying the relatively rapid growth of household consumption were a continuing rise in households' disposable income and probably also expectations of inflation upturn in 2004 linked with the upcoming indirect tax changes. The GDP growth was also attributable to increasing investment demand, driven primarily by investment by general government. Again, however, the external sector did not contribute to the GDP growth at the end of 2003. On the contrary, owing to a widening of the net export deficit in Q4 the negative contribution of the external sector to GDP growth increased further (see Chart III.16). A year-on-year weakening of the weighted exchange rate of the koruna, a modest improvement in conditions in the external demand area and some other effects led to a further pick-up in the already comparatively robust growth of goods exports in Q4. Imports rose faster, however, due to the evolution of domestic demand (investment and consumer in particular).

On the supply side, the GDP growth in 2003 Q4 was due mainly to the services sector. Gross value added also continued to grow in industry. As in Q3, this growth was accompanied by a decreasing number of workers and increasing productivity. For the second consecutive quarter, construction also contributed to GDP growth, amid ongoing growth in productivity and a modest rise in workforce.

CHART III.16
THE LONG-RUNNING GROWTH OF THE CZECH ECONOMY CONTINUED FOR THE FIFTH CONSECUTIVE YEAR

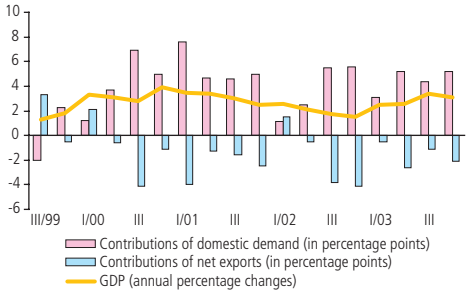


TABLE III.4
IMPORT GROWTH RECOVERY IN EU COUNTRIES AND EURO AREA INDICATED MODERATE IMPROVEMENT FOR CZECH EXPORT REALIZATION
(annual percentage changes; seasonally adjusted; source: Eurostat)

	Euro area		EU-15	
	2003 Q3	2003 Q4	2003 Q3	2003 Q4
Gross domestic product	0.3	0.6	0.5	0.9
Final consumption expenditure of households and non-profit institutions	0.9	0.6	1.3	1.0
Government final consumption expenditure	1.9	2.2	1.8	2.2
Gross fixed capital formation	-1.0	-0.7	-0.5	-0.1
Domestic demand	0.7	1.1	1.0	1.3
Exports of goods and services	-0.3	0.3	-0.3	0.9
Imports of goods and services	1.0	1.8	0.8	2.0

III.3.1 Domestic demand

Domestic demand remained the main engine of economic growth in 2003 Q4. Growth in final domestic demand slowed (to 4% year on year), owing to the development of its main component – household consumption. The growth rate of households' expenditure on final consumption slackened from the extraordinary values achieved in 2003 Q3[10]. This change was not, however, fully offset by a counteracting further rise in investment and expenditure on final government consumption. Nonetheless, both household consumption and final domestic demand grew quite fast at the end of 2003. Aggregate domestic demand growth picked up (to 4.5%) owing to smaller stock decrease in 2003 Q4 than a year earlier.

TABLE III.5
IN 2003 Q4 AND IN 2003 AS A WHOLE, THE GROWTH IN DOMESTIC DEMAND AND GDP WAS DRIVEN BY CONSUMER AND INVESTMENT DEMAND
(annual percentage changes)

	2002	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2003
Gross domestic product	2.0	2.5	2.6	3.4	3.1	2.9
Aggregate demand (domestic demand and exports)	3.1	3.8	4.7	5.9	6.5	5.2
Total domestic demand a)	3.4	2.9	4.9	4.0	4.5	4.1
Final domestic demand b)	3.2	3.2	4.0	4.4	4.0	3.9
of which:						
Household consumption	3.9	5.3	5.5	6.7	4.6	5.5
Government consumption	5.7	-0.1	1.3	-2.9	1.6	0.0
Non-profit institutions serving households	6.8	4.6	2.5	1.6	1.1	2.4
Gross fixed capital formation	0.6	1.5	3.1	4.7	4.8	3.7
Imports of goods and services	4.3	5.0	6.9	8.6	9.5	7.6
Exports of goods and services	2.8	4.8	4.4	8.5	9.0	6.7
Net exports of goods and services (balance, CZK billions)	-163.5	-27.5	-36.4	-49.6	-74.7	-188.2
Net exports as a percentage of GDP (percentages)	-10.6	-7.3	-8.9	-12.4	-18.8	-11.9

a) including changes in inventories; b) excluding changes in inventories

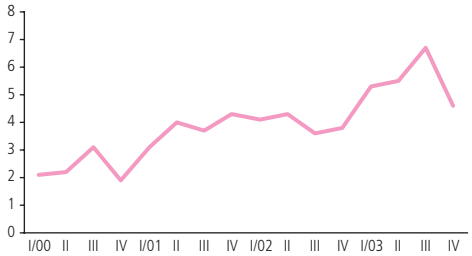
Consumer demand

The growth rate of household expenditure on final consumption eased somewhat in 2003 Q4, to 4.6%. Despite this, household consumption was still one of the most dynamic components of domestic demand.

9 The output gap (= the production gap) is the difference between actual GDP (as published by the CZSO) and potential output. The level of potential output is the GDP level at which there are no upward pressures on costs (wages in particular) and hence no upward pressures on prices. It is independent of the phase of the business cycle in which the economy finds itself. Information on the nature and size of the output gap is used in setting economic policies, including monetary policy.

10 For details see the January 2004 Inflation Report.

Chart III.17
ANNUAL HOUSEHOLD CONSUMPTION GROWTH EASED, BUT REMAINED FAIRLY BUOYANT
(percentages)



The rising consumption expenditure of households in Q4 was due to more sluggish growth in their disposable income compared to the previous quarter (by 1.1 percentage points, or CZK 3.4 billion). The main sources of household income – wages and salaries and social benefits – were higher than a year earlier, but the decrease in income ensuing from lower growth in gross operating surplus[11] and, above all, a decline in non-life insurance claims was higher.[12] Nevertheless, households' nominal expenditure on consumption continued to grow faster than their income (5.6% and 4.2% respectively in nominal terms). Households were continuing to save a smaller proportion of their disposable income and concurrently were drawing on consumer credit.

For the second consecutive quarter the gross savings rate was thus at a historically low level – below 5% (4.85% in Q4). The evolution of consumer credit indicated continuing drawing on such loans, albeit at a lower rate than in the previous quarter (see Section III.1.2 *Credit*). Consumption expenditure of households growing faster than their disposable income also in 2003 Q4 was probably due to the expectations of inflation pick-up in 2004 in connection with the upcoming indirect tax changes.

An overall higher propensity to consume by households in 2003 was also suggested by rising sales in almost all the main categories of goods compared to 2002. This was particularly apparent for non-food products; food sales rose more slowly.

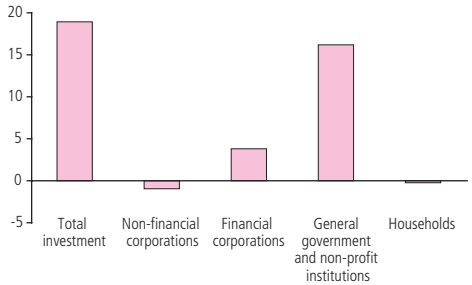
Chart III.18
GROWTH IN GOVERNMENT FINAL CONSUMPTION EXPENDITURE WAS MODEST AT THE END OF 2003
(annual percentage changes)

Government demand

Government final consumption expenditure saw only modest growth in 2003 Q4 (of 1.6% year on year) and its contribution to GDP growth was insignificant compared to household consumption. For 2003 as a whole, government sector expenditure was flat at the previous year's level.

The individual state budget expenditure items channelled into government consumption recorded mixed developments in both Q4 and 2003 as a whole. Non-investment transfers to local public budgets recorded the largest increase (of 65% year on year at current prices), due to the completion of public administration reforms and the transfer of the responsibilities of the former district authorities to municipalities and regions. Non-investment transfers to state funds grew as well, although by a smaller absolute amount. The increase in expenditure was also attributable to extraordinary payments of about CZK 23 billion not originally included in the state budget (most notably payment of a commitment arising from the arbitration dispute with CME and repayment of flood-related loans from the EIB); nevertheless, these expenditure items did not affect domestic demand. This increase was offset on the other hand by savings in expenditure on compensation of employees in the government sector and by much lower coverage of the Czech Consolidation Agency's losses by comparison with the previous year.

Chart III.19
INVESTMENT BY THE GOVERNMENT CONTRIBUTED MOST TO THE ALMOST 4% INCREASE IN INVESTMENT IN 2003
(annual changes in CZK billions; constant prices)



Investment demand

Following a period of very modest growth in 2002, investment growth gradually picked up pace in 2003. Gross fixed capital formation was up by 4.8% on a year earlier in 2003 Q4 (and 3.7% in 2003 as a whole). This growth was, however, mostly due to investment by

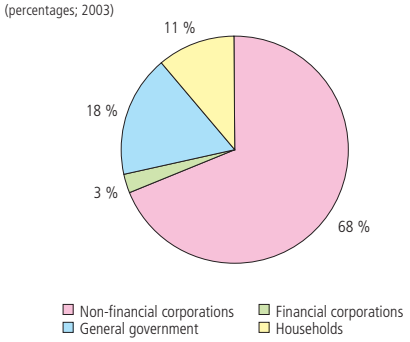
11 Operating surplus and mixed income are the result of economic activity of small entrepreneurs in production and services. In 2003 Q4 they accounted for roughly 17% of households' current income.

12 Down by 58.4%, or CZK 4.2 billion, year on year due to base effects (claims paid by insurance companies for damage caused by the 2002 floods).

general government, as the sector of non-financial corporations still showed no signs of a sustained recovery in investment activity. Government investment accounted for about two-thirds of the total year-on-year increase in investment in 2003 Q4 and for more than four-fifths of that in 2003 as a whole.[13] Investment by financial corporations also showed marked growth, but its effect on total investment and GDP growth was relatively lower in comparison with government investment.

With the exception of Q3, investment by non-financial corporations saw a modest annual decline during 2003 (of 0.3% in both Q4 and 2003 as a whole). Entrepreneurs' investment decisions were apparently still being strongly affected by uncertainties regarding future developments, especially with respect to external demand. The continuing relatively weak economic growth of the Czech Republic's major trading partners (most notably the EU) was not yet creating any optimistic expectations. The decreasing lending to non-financial corporations in 2003 despite the relatively low interest rate level suggested that the approval of projects submitted for lending was, to a certain extent, also dependent on uncertainties regarding future demand. This factor probably also affected the use of internal funds for investment financing, which recorded more substantial growth in 2003. Acting in the opposite direction on investment in 2003 was a modest rise in the inflow of capital into capacity-building investments.

Chart III.20
ALTHOUGH INVESTMENT BY NON-FINANCIAL CORPORATIONS FELL SOMEWHAT, IT REMAINED THE BIGGEST CONTRIBUTOR TO TOTAL INVESTMENT
(percentages; 2003)



The household sector recorded renewed annual investment growth in 2003 H2 (to 5.1% in Q4). Household investment demand was supported by the historically low level of nominal mortgage rates, the uncertainties surrounding rent deregulation, and the expected effects of the Czech Republic's accession to the European Union on prices on the real estate market. However, in 2003 as a whole, household investment did not reach the previous year's level.

III.3.2 Net external demand

Following a marked improvement in Q3, net exports of goods and services again developed unfavourably at the end of the year. Export growth increased further (to 9% year on year), but imports grew even faster (9.5%). As a result, negative net exports were CZK 8 billion higher in Q4 than a year earlier. Their negative contribution to GDP growth was almost twice that in the previous quarter (Chart III.16).

Chart III.21
WITH IMPORTS RISING FASTER THAN EXPORTS, NEGATIVE NET EXPORTS INCREASED IN 2003 Q4 YEAR ON YEAR
(annual percentage changes; constant prices)

The year-on-year deterioration in net exports was entirely due to a widening of the trade deficit (by CZK 9.8 billion), since the services deficit narrowed slightly (by CZK 1.6 billion) owing to base effects. The widening of net export deficit in 2003 Q4 primarily reflected faster aggregate domestic demand growth and a related increase in imports of goods. The koruna exchange rate recorded a modest depreciation for the second consecutive quarter[14], but this had no significant effect on imports. Import analyses suggest that the relationship between imports and the exchange rate is less pronounced and that imports are more dependent on the components of domestic demand (consumer and investment demand in particular). The causes of domestic producers' lower flexibility in responding to domestic demand growth in these components can be seen chiefly in the structural changes that have occurred on the supply side (for example the adverse effects of Asian competition in the textile industry and greater specialisation in the area of technological equipment).

13 Government investment rose by 15.3% in 2003 Q4 and by 20.7% in 2003 as a whole.

14 In 2003 Q4, the weighted exchange rate of the koruna (USD, EUR) showed a year-on-year depreciation of 0.67%, owing to the development of the koruna-euro rate (a weakening of 3.97%). By contrast, the koruna-dollar rate appreciated by 12.52% year on year.

CHART III.22
MACHINERY AND TRANSPORT EQUIPMENT AGAIN ACCOUNTED FOR THE BULK OF TOTAL EXPORTS
(2003 Q4; percentages)

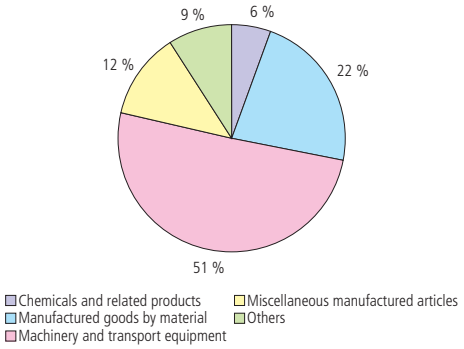


CHART III.23
SERVICES AND INDUSTRY MADE THE BIGGEST CONTRIBUTIONS TO THE GDP GROWTH IN 2003 Q4
(annual percentage changes; selected contributions in percentage points)

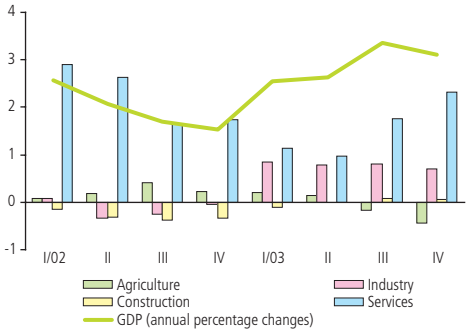
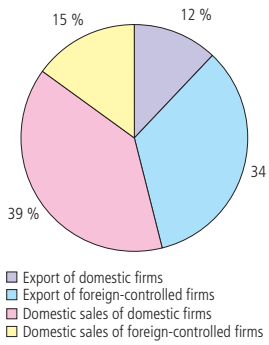


CHART III.24
IN 2003 EXPORTS OF INDUSTRIAL PRODUCTION WERE CHIEFLY DUE TO FOREIGN-OWNED FIRMS
(shares in total industrial sales - domestic and external - at constant prices)



As for the structure of goods imports, the most rapid growth in Q4 was again recorded for imports for investment and final consumption (12.7% and 12% respectively).[15] Growth of imports for intermediate consumption, which account for more than half of total imports, was more sluggish (10.6%). The high level of these imports is to a large extent due to the increasing proportion of production collaborations in the Czech economy.

Goods exports showed greater sensitivity than imports to the koruna exchange rate, particularly in the case of the koruna-euro rate given that most Czech exports go to EU countries. The favourable development of exports during 2003 – despite the weak external demand – was underpinned also by the fact that exports are to a large extent realised by foreign-owned companies. Their sales are better secured, thanks to extensive distribution networks abroad. Exports to advanced market economies still prevailed. In 2003 Q4, the growth rate of exports to these countries was much higher than that to transition economies (13.6% and 8.2% respectively at current prices). Very rapid growth was recorded for exports to the Czech Republic's main trading partners – Germany and Slovakia. As for the commodity structure, exports of mechanical and electrical engineering commodities prevailed.

III.3.3 Gross domestic product

On the supply side of the economy, the 3.1% GDP growth in 2003 Q4 was mostly attributable to the services sector. Its share in GDP at basic prices exceeded the 60% level in both 2003 Q4 and 2003 as a whole. Gross value added also continued rising in industry and construction. Agriculture was the only sector to record an annual decrease in value added, doing so for the second consecutive quarter.

The gross value added growth in services has been accelerating since 2003 Q2 and reached 4.2% in Q4. All the monitored branches contributed to the year-on-year increase, although their contributions varied considerably. In Q4, the largest contributors were wholesale and retail trade, repair of vehicles and consumer goods, and transport, storage, postal services and telecommunications, which accounted for about half the annual growth in value added in services. Its structural development thus showed a close relationship with consumer demand.

The gross value added growth in industry was more sluggish than that in services. As in the previous three quarters of 2003, its growth rate at the year end was above 2%. The relatively stable gross value added growth in industry during 2003 was supported in particular by the opening of new production facilities for vehicle components, plastics and electrical equipment, by the entry of more foreign investors, by continuing structural changes in industry, and by robust growth in export production. Corporations whose production has been developed with the help of foreign capital made a major contribution to the buoyant growth in exports. In 2003 as a whole, their sales accounted for almost half of the total sales in industry, while almost 70% of their sales came from exports. Overall, direct export sales of industrial enterprises increased by 8.8% (at constant prices) in 2003. The growth in industrial production and gross value added in 2003 as a whole was accompanied by a substantial rise in productivity and a fall in personnel costs.

From the structural perspective, the highest growth rates in industrial production (IPI) in 2003 were recorded for rubber and plastic products, transport equipment, and coke and refined petroleum products. Turning to the main product groupings, manufacture of

15 At current prices. In 2003 Q4, goods imports and exports at current prices grew by 11.3% and 12.6% respectively.

intermediate goods and capital goods recorded the fastest growth (6% and 7.6% respectively). Production of non-durable consumer goods grew more slowly and production of durable consumer goods experienced a year-on-year decline in 2003.

A second consecutive quarter of growth in value added in construction (of 1.8% year on year in 2003 Q4) reflected sizeable growth in construction output accompanied by dynamic growth in productivity. The construction work growth was due chiefly to work in the housing and infrastructure areas.

III.3.4 Financial performance of non-financial organisations and corporations[16]

The financial performance of non-financial organisations and corporations in 2003 Q4 recorded a continuation of the favourable trend ongoing since 2003 Q2. In 2003 as a whole, corporations' output grew faster than their expenses. Net operating surplus was more than 20% higher than a year earlier and pre-tax profit was up by 15.3%. Book value added per employee saw marked growth. These results were achieved amid improved profitability indicators – most notably the profit-expenses and profit-equity ratios. Overall, the material cost-output ratio and personnel cost-output ratio decreased and profit margin increased. The decline in the personnel cost-output ratio was achieved amid growth in productivity, which was partly the result of a reduction in the number of employees. Under these circumstances, the total wage volume grew much more slowly than the average wage. In industry, the material cost-output ratio also decreased year on year in 2003, although the developments in Q3 and Q4 again indicated a pick-up in growth.

As regards ownership structure, foreign-controlled corporations continued to achieve the best financial performance. From the sectoral point of view, the highest increases in net operating surplus were recorded in communications, construction, wholesale and retail trade and hotel and restaurant services. Within manufacturing, the financial performance of corporations showed mixed developments, but branches recording growth in net operating surplus prevailed. A favourable trend in the financial performance of non-financial organisations and corporations in 2003 was also indicated by positive changes in the structure of the corporations. While the number of corporations was broadly unchanged, the number of profit-making corporations increased and the number of loss-making corporations decreased (to 3.5% of the total number of monitored corporations).

Taking into consideration the evolution of industrial producer prices, the financial performance of non-financial organisations and corporations in 2003 suggests that the corporate sector was coping with certain unfavourable phenomena in the economic environment – most notably the still weak external demand and the gradual recovery of external input growth. It is likely that the favourable terms of trade also helped.

III.4 THE LABOUR MARKET

At the end of 2003 and in 2004 Q1, the gap between the demand for, and supply of, labour widened further. A further annual decline in employment in the employees category and growth in the number of registered unemployed and the unemployment rate chiefly indicated a rationalisation of production activities, consistent with the position of the economy below its potential. A concurrent rise in the seasonally adjusted unemployment rate and an annual increase in registered vacancies at the same time suggested rising

TABLE III.6
GROSS PROFITS RECORDED A LARGE YEAR-ON-YEAR INCREASE IN 2003
(percentages)

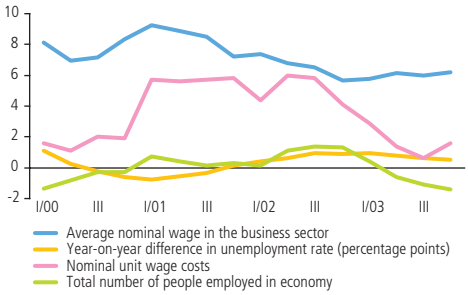
	2003	
	Organisations, total	Industry
Income, total	5.6	2.7
Output, total	7.3	6.2
Expenses, total	5.2	2.2
of which: cost of sales	6.9	5.8
personnel costs a)	5.1	4.6
depreciation	1.8	3.8
Book value added	8.2	7.1
Pre-tax profit	15.3	12.0
Net operating surplus	23.0	15.4

a) Comprises wage and other personnel costs, remunerations to members of companies and co-operatives, social security costs and social costs

TABLE III.7
THE PERSONNEL COST-OUTPUT RATIO SHOWED A YEAR-ON-YEAR DECLINE DURING 2003
(percentages; percentage points; CZK thousands)

	2003		Change in perc. points. against 2002	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	5.02	5.66	0.44	0.49
Profit-equity ratio	10.86	11.83	1.24	0.53
Profit-sales ratio	5.36	6.01	0.32	0.30
Material cost-output ratio	69.78	73.93	-0.40	-0.30
Personnel cost-output ratio	15.94	12.95	-0.33	-0.19
Ratio of wage costs to value added	37.06	34.59	-1.70	-1.67
	CZK thousands per month		annual percentage changes	
Book value added per employee	46.60	49.30	11.00	11.30

CHART III.25
DEVELOPMENTS ON THE LABOUR MARKET INDICATED A CONTINUING WIDENING OF THE IMBALANCE ON THIS MARKET
(annual percentage changes and percentage point changes)



16 Assessment based on figures for non-financial organisations and corporations with 100 employees or more, all branches.

structural unemployment, reflecting the skills gap between supply and demand on the labour market. The falling employment was a major contributing factor to relatively rapid whole-economy productivity growth in 2003 Q3 and Q4. These effects helped reduce the personnel cost-output ratio. Year-on-year growth in nominal unit wage costs slowed significantly and, despite a modest increase at the end of the year, was below the 2002 level. This was mostly attributable to industry and construction.

III.4.1 Employment and unemployment

During 2003 and at the beginning of 2004, the gap between the supply of, and demand for, labour on the labour market widened. This imbalance was both quantitative, in the form of aggregate excess labour supply, and structural, with demand being particularly out of step with supply with regard to skills, regions and sectors. The result was both a rise in the unemployment rate and a decrease in employment.

According to Labour Force Survey (LFS) figures, employment in the national economy has been gradually decreasing since 2003 Q2. In 2003 Q4 alone, the year-on-year decline in employment increased further to -1.4%, which meant a fall of 66,800 in the number of people employed. Employment continued to decrease most in the employees category[17] (by 2.1% year on year in Q4), and especially in manufacturing owing to the strongly competitive environment. Employment decreased in services as well, but the causes of this were probably different in nature than in industry.[18] The reduced absorption capacity of the tertiary sector was in turn negatively reflected in the overall development of unemployment.[19] By contrast, employment growth in construction reflected an increase in demand for construction work. Overall, however, the majority of industries had falling employment at the end of 2003.

The main causes of the falling employment remain the same –corporations' efforts to cut costs, increase labour productivity and thereby strengthen their competitiveness in conditions of a negative output gap. The main factor underlying this trend was the still none-too-high economic growth being recorded by the Czech Republic's major trading partners. In other words, the Czech economy grew faster, but not fast enough for cyclical effects to prevail over the rationalisation and restructuring on the labour market.

The structural gap between the demand for, and supply of, labour was indicated chiefly by a cessation of the year-on-year fall in the number of vacancies, which had lasted more than two years. Since January, the numbers of vacancies have been increasing moderately (up by 1,100 in March), a fact confirmed by the seasonally adjusted data. The renewal of annual growth in vacancies and the concurrent rise in the number of people unemployed pointed above all to a skills gap between the supply of, and demand for, labour. The structural problems led to an increase in long-term unemployment, which reached an all-time high in 2004 Q1 (4.3%).

The result of the widening gap between the supply of, and demand for, jobs overall was a further rise in the number of registered unemployed at the start of 2004 (of 31,600 year on year in March). As of the end of March, there were on average 13.2 unemployed persons

Chart III.26
THE DECLINE IN TOTAL EMPLOYMENT WAS CAUSED BY FALLING EMPLOYMENT IN THE EMPLOYEES CATEGORY
(annual percentage changes)

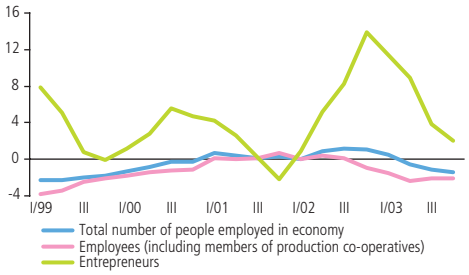


Chart III.27
CONCURRENT GROWTH IN THE NUMBER OF UNEMPLOYED PEOPLE AND VACANCIES SIGNALLED AN INCREASE IN STRUCTURAL UNEMPLOYMENT
(seasonally adjusted numbers in thousands)

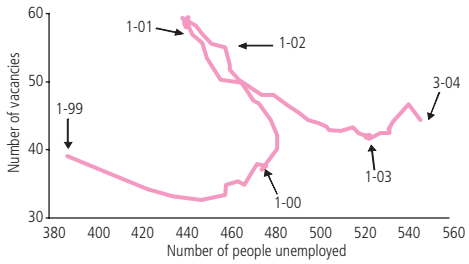
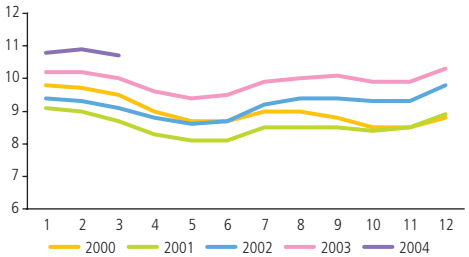


Chart III.28
THE UNEMPLOYMENT RATE IN FEBRUARY AND MARCH 2004 WAS THE HIGHEST SINCE 1990
(percentages; source: MLSA)



17 Including members of production co-operatives.

18 It was probably due to uncertainties associated with the impacts of the tax changes in effect from 2004 on the financial performance of businesses in the services sector.

19 As a result, the share of people employed in the tertiary sector was the same in 2004 Q4 as in Q3, at 56.2%; the figures for the secondary sector and primary sector were 39.3% and 4.5% respectively.

per vacancy, and the rate of registered unemployment increased to 10.7%. Since the start of 2004 the unemployment rate has also been increasing in year-on-year comparison (by 0.7 percentage points in March), whereas in 2003 the opposite trend was recorded.

By international comparison, however, the unemployment rate (i.e. the general unemployment rate according to LFS data based on ILO methodology) was still slightly below the EU level. In 2003, it was 7.8%, compared to 8% in the EU countries. In comparison with the ten candidate countries joining the EU in May, the Czech Republic is among those countries with a lower general unemployment rate.

Table III.8
BUT BY INTERNATIONAL COMPARISON THE UNEMPLOYMENT RATE WAS LOWER THAN IN EU COUNTRIES
(percentages; ILO methodology; source: CZSO, Eurostat)

	2000	2001	2002	2003
EU (15 countries)	7.8	7.4	7.7	8.0
Czech Republic	8.7	8.0	7.3	7.8
Slovakia	18.7	19.4	18.7	17.1
Hungary	6.3	5.6	5.6	5.8
Poland	16.4	18.5	19.8	19.2
Slovenia	6.6	5.8	6.1	6.5
Cyprus	5.2	4.4	3.9	4.4
Malta	7.0	6.7	7.5	8.2
Estonia	12.5	11.8	9.5	10.1
Lithuania	15.7	16.1	13.6	12.7
Latvia	13.7	12.9	12.6	10.5

III.4.2 Wages and productivity

Growth in the average nominal wage picked up pace in the monitored organisations in 2003 Q4, but the annual growth rate (7%) showed no sizeable departure from the level in 2003. In year-on-year comparison, average nominal wages grew rather more slowly in 2003 than in 2002 (see Table III.9).

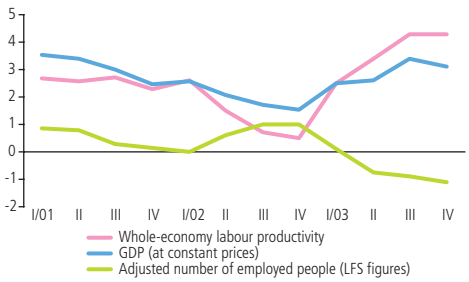
Table III.9
AVERAGE NOMINAL WAGE GROWTH PICKED UP PACE SOMEWHAT IN 2003 Q4, BUT WAGES ROSE MORE SLOWLY OVERALL IN 2003 THAN IN THE PREVIOUS YEAR
(annual percentage changes)

	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2002	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2003
Average wage in monitored organisations										
nominal	7.1	7.7	7.4	6.7	7.2	7.3	6.8	6.3	7.0	6.8
real	3.2	5.3	6.7	6.1	5.3	7.7	6.7	6.4	6.2	6.7
Average wage in business sector										
nominal	7.4	6.8	6.5	5.7	6.5	5.8	6.1	6.0	6.2	6.0
real	3.5	4.4	5.8	5.1	4.7	6.2	6.0	6.1	5.4	5.9
Average wage in non-business sector										
nominal	6.0	11.2	11.3	10.3	9.8	14.5	9.0	7.5	9.3	9.8
real	2.2	8.7	10.5	9.7	7.8	15.0	8.9	7.6	8.4	9.7
Whole-economy labour productivity	2.6	1.5	0.7	0.5	1.3	2.5	3.4	4.3	4.3	3.6
Nominal unit wage costs	4.4	6.0	5.8	4.1	5.0	2.9	1.4	0.6	1.6	1.6

The modest slowdown in average nominal wage growth in 2003 was attributable to the business sector. During 2003 as a whole, the average nominal wage growth in this sector was around 6%. The stabilisation or moderation of wage growth in the business sector can be seen primarily as a consequence of increasing excess labour supply for the reasons specified in detail in section III.4.1. The very weak pick-up in annual average nominal wage growth in 2003 Q4 compared to Q3 was associated with businesses' improving financial results, which allowed bonuses to be paid.

Although average nominal wage growth in the business sector both in 2003 Q4 and in 2003 as a whole was relatively buoyant and, given the low inflation, average real wage growth was also relatively fast (see Table III.9), wages were not a source of potential across-the-board inflationary pressures. This was evidenced by faster productivity growth than average real wage growth in industry and construction. For example, the 5.9% annual average real wage growth in industry in 2003 was accompanied by 9.7% growth in productivity.[20] Roughly the same difference was recorded in Q4. In construction, productivity rose by almost 14.7%[21] in Q4 and wages again grew much more slowly. Under these circumstances, nominal unit wage costs in both industry and construction continued falling in 2003 Q4 year on year, although the decline was more moderate than in Q3.

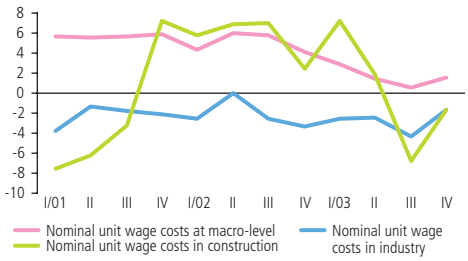
Chart III.29
THE FALL IN EMPLOYMENT IN 2003 Q4 HELPED TO MAINTAIN LABOUR PRODUCTIVITY GROWTH AT THE PREVIOUS QUARTER'S LEVEL
(annual percentage changes)



In the non-business sector, average nominal and real wages grew significantly faster than in the business sector in 2003. This was due primarily to a substantial change in wage scales in education and health care in January. Their growth rate in Q4 and in 2003 as a whole was more than 3 percentage points higher than in the business sector. In 2003 as a whole, average nominal wages in this sector rose by almost 10%, just as in 2002.

Indicators of wage-cost and demand-pull inflationary pressures at the macroeconomic level, however, suggested that a generally positive personnel cost-GDP ratio in the business sector prevailed, especially in industry and construction, both in Q4 and in 2003 as a whole. Whole-economy productivity grew comparatively quickly in 2003 Q3 and Q4 (by 4.3% year on year), thanks mainly to the continuing process of employment rationalisation, the relatively stable economic output and the commissioning of new facilities by foreign investors.

Chart III.30
NOMINAL UNIT WAGE COSTS AT MACRO-LEVEL ROSE MORE SLOWLY IN 2003 Q4 AND IN 2003 AS WHOLE THAN IN THE PREVIOUS YEAR
(annual percentage changes)



20 i.e. sales productivity at constant prices.

21 At 2000 constant prices.

Chart III.31
AGRICULTURAL PRODUCER PRICES AND ELECTRICITY, GAS AND WATER SUPPLY PRICES ROSE MORE QUICKLY AT THE START OF 2004
(annual percentage changes)

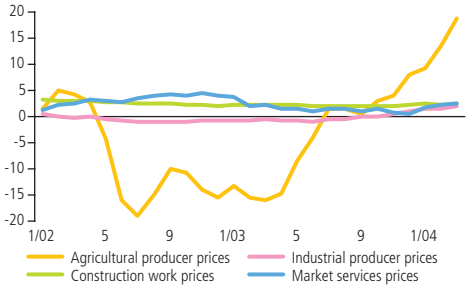


Chart III.32
THE SLOWING GROWTH OF RAW MATERIALS AND FOOD PRICES ON WORLD MARKETS IN 2004 Q1 WAS DUE CHIEFLY TO ENERGY-PRODUCING MATERIALS PRICES
(annual percentage changes)

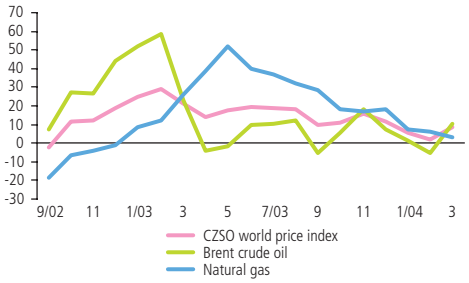


Chart III.33
THE IMPACTS OF ENERGY-PRODUCING MATERIALS WORLD PRICES ON IMPORT PRICES WERE LARGELY CORRECTED BY THE KORUNA-DOLLAR EXCHANGE RATE
(annual percentage changes)

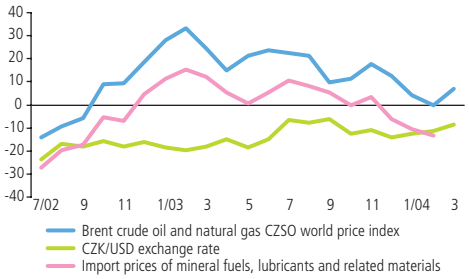


Table III.10
IMPORT PRICES FELL SLIGHTLY OVERALL, BUT THE INDIVIDUAL CATEGORIES AGAIN SHOWED MIXED DEVELOPMENTS
(annual percentage changes)

	9/03	10/03	11/03	12/03	1/04	2/04
Imports, total	1.6	0.3	0.5	-0.3	-0.3	-0.2
Food and live animals	-0.6	0.2	1.1	2.6	1.2	3.8
Beverages and tobacco	3.6	4.5	5.4	3.5	2.8	3.6
Crude materials except fuels	5.7	4.4	4.8	3.9	4.2	5.5
Mineral fuels and related products	5.2	0.0	3.4	-6.1	-10.7	-13.5
Animal and vegetable oils	2.5	-0.4	-1.3	-2.7	-2.0	-0.4
Chemicals and related products	0.8	0.5	0.4	0.2	1.0	1.9
Manufactured goods classified by material	4.0	2.9	2.6	2.4	3.5	3.7
Machinery and transport equipment	-0.1	-1.3	-1.4	-1.2	-0.6	-0.4
Miscellaneous manufactured articles	-0.3	-0.9	-0.9	-1.0	-0.5	-0.1

The pick-up in whole-economy labour productivity in the course of 2003 in turn fostered a substantial slackening of growth in nominal unit wage costs at the macroeconomic level to much lower levels than in 2002. They were also positively affected by slower annual growth in the volume of wages in the economy.

III.5 OTHER COSTS AND PRODUCER PRICES

Other cost indicators and producer prices developed very differentially in 2004 Q1. Import prices continued to show mixed developments. The upswing in prices of imported inputs ongoing since mid-2003 fed through gradually – with a lag – into industrial producer prices. This process, however, was still not across the board in nature and (with some exceptions) was not significant. A fall in prices of imported mineral fuels at the end of 2003 and the start of 2004 for the time being only affected producer prices in the manufacture of refined petroleum products. Another marked change was a further rise in agricultural producer prices, which in turn fostered a pick-up in producer price inflation in the food industry. Also significant were price changes in the electricity, gas and water supply industry, which involved all products included in this industry. Construction work and market services price inflation accelerated, but was still not high in annual terms.

III.5.1 Import prices

Given the high import propensity of the Czech economy, import prices are an important inflation factor. Their growth rate and direction are determined chiefly by raw materials prices on world markets, foreign producer prices and the koruna's exchange rate. A modest decline in import prices at the end of 2003 and the start of 2004 (of 0.2% in March year on year) was largely due to the development of raw materials prices on world markets and the koruna-dollar exchange rate.

A decline in the growth of raw materials and food prices on world markets at the start of 2004 – from above 10% throughout 2003[22] to 5.5%[23] – was mostly the result of a marked change in prices of energy-producing materials, which are the most important segment of the CZSO's annual world price index with respect to weight.[24] After having recorded a roughly 10% increase in 2003 Q4, oil prices rose by just 1.9% on average in 2004 Q1. The rise in natural gas prices also slowed considerably. Prices of the other commodities included in the CZSO's world price index continued to show very mixed developments, but metal and wood prices were the only ones to record a continuing upward trend in growth (to 33.4% year on year in Q1 for metals).

As in previous quarters, the impacts of raw materials and food prices on world markets on koruna import prices were quite strongly corrected by the koruna's exchange rate (Chart III.33). This effect was more pronounced for the koruna-dollar rate, which again recorded an annual appreciation in 2004 Q1 (of around 10% on average). Its "moderating" (anti-inflationary) effect was particularly apparent for energy-producing and other raw materials, where payments for imports are made mostly in dollars. As a result, koruna prices of imports of raw materials grew more slowly than prices on world markets, and oil import prices fell in December in year-on-year terms, whereas world markets still recorded a 7.4% rise. By contrast, the koruna-euro rate, which has been depreciating since mid-2003, led to stronger growth for some import prices.

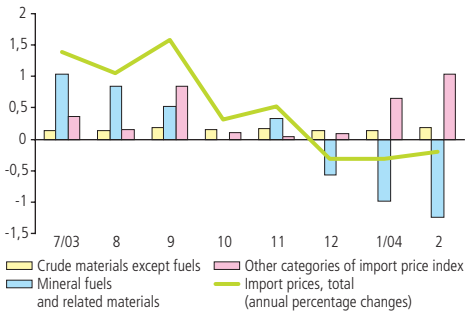
22 Annual growth of less than 10% (9.5%) was recorded only in September. Measured by the CZSO's annual world price index.

23 i.e. the average value for 2004 Q1.

24 Their constant weight in the world price index is 69.39% (of which 37.29% for oil prices).

The differential evolution of raw materials prices on world markets and the koruna-dollar and koruna-euro rates thus fed through with various intensities into the individual items included in the CZSO's import price index. In December 2003 and the first two months of 2004 the effect of the falling import prices of raw materials prevailed, and so the CZSO's import price index was again negative (see Table III.10).[25] Prices in the other groups of the CZSO's import price index (i.e. excluding mineral fuels) showed very mixed developments. Their structure, however, revealed a gradual upturn in the annual growth of prices of imported production inputs ongoing since mid-2003. This was fostered not only by the gradual depreciation of the koruna-euro rate since 2003 H2 and an increase in prices of some raw materials on world markets, but also by the upswing in industrial producer price inflation recorded by the Czech Republic's major trading partners (Germany in particular) in 2003.

Chart III.34
THE ANNUAL FALL IN IMPORT PRICES WAS FOSTERED BY IMPORT PRICES OF MINERAL FUELS
(percentages, percentage points)

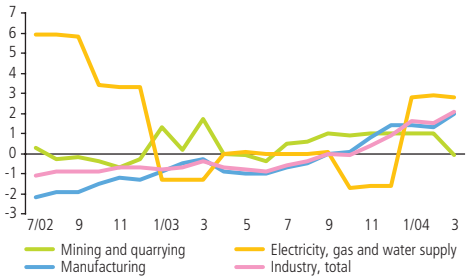


III.5.2 Producer prices

Industrial producer prices

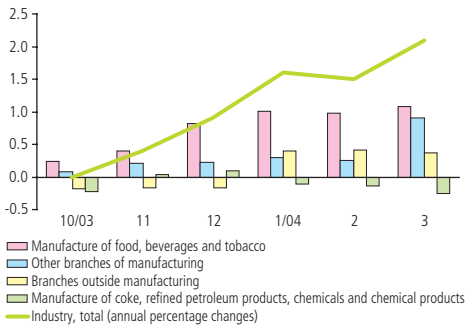
In 2004 Q1, a continuing moderate rise in the hitherto very weak growth in industrial producer prices suggested slackening disinflation in this price segment and a shift to more stable annual growth. Underlying this change in trend was a combination of factors, both external and domestic, in particular lagged pass-through of the pick-up in import price growth in 2003 H2, rising prices of agricultural primary production inputs and the koruna-euro exchange rate. These effects fed through variously into producer prices in the individual industrial branches, as in some branches producer prices were still falling year on year. On aggregate, the modest annual growth in industrial producer prices at the end of 2003 (0.9%) picked up pace in Q1 to 2.1% (in March).

Chart III.35
THE STEADY PICK-UP IN ANNUAL INDUSTRIAL PRODUCER PRICE INFLATION CONTINUED INTO 2004 Q1
(percentages)



As in the previous quarter, the pick-up in annual industrial producer price inflation in 2004 Q1 was to a large extent (about one half) due to a sizeable rise in producer prices in the food industry (to 5% in March; see Chart III.36). The main cause of the pick-up in inflation in this industry was a continuing acceleration in growth of agricultural commodity prices, which in turn was primarily a reaction to lower crop yields in 2003 for the reasons specified in detail in the section *Agricultural producer prices*. The strengthening of producers' bargaining position in relation to retailers also had some effect on the upturn in producer price inflation in the food industry.

Chart III.36
THE PICK-UP IN ANNUAL INDUSTRIAL PRODUCER PRICE INFLATION WAS DUE PRIMARILY TO PRICES IN THE FOOD INDUSTRY
(percentages, contributions in percentage points)



The rise in industrial producer price inflation at the start of 2004 was also greatly supported by changes to producer prices in the electricity, gas and water supply industry. Producer prices in the manufacture of metals and metal products increased as well (to 5.6% in March) on the back of a very rapid rise in metal prices on world markets. By contrast, producer prices in the manufacture of coke and refined petroleum products remained quite volatile owing to their close link to oil prices on world markets and the koruna-dollar exchange rate. In 2004 Q1 alone, producer prices in this industry fell quite sharply year on year (by 9.2% in March) amid a modest rise in dollar prices of oil and a year-on-year appreciation of the koruna-dollar exchange rate. In the chemical industry, which as a rule reacts with a lag to changes in oil prices and producer prices in the manufacture of coke and refined petroleum products, producer prices recorded a modest annual rise at the start of the year (1.5% in March).

25 The weight of energy-producing materials in the CZSO's import price index is 67.3843 per mille.

On aggregate, industrial producer price inflation in 2003 Q4 and in the first two months of 2004 – with some exceptions (the food industry, metal manufacture and to some extent power generation) – for the time being suggested no pronounced across-the-board cost pressures on consumer price inflation for the immediate future.

Chart III.37
THE UPSWING IN ANNUAL AGRICULTURAL PRODUCER PRICE INFLATION CONTINUED INTO 2004 Q1
(annual percentage changes)

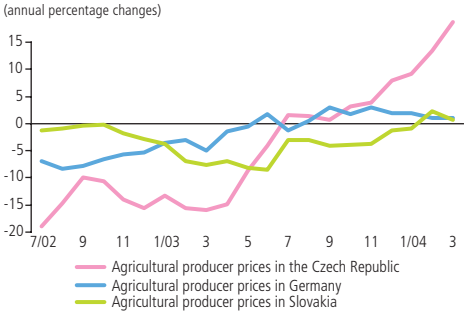


Chart III.38
THE PICK-UP IN ANNUAL AGRICULTURAL PRODUCER PRICE INFLATION WAS DUE CHIEFLY TO CROP PRODUCTS
(annual percentage changes)

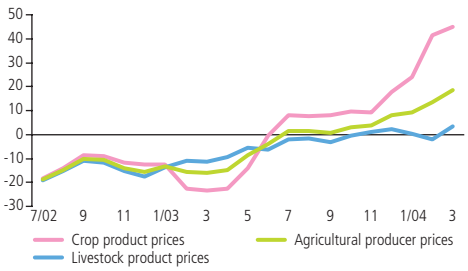
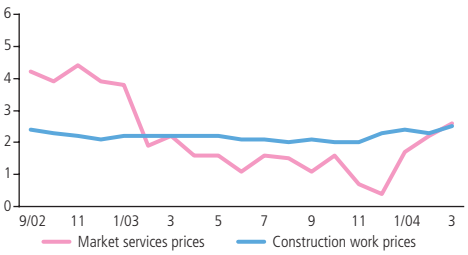


Chart III.39
CONSTRUCTION WORK AND MARKET SERVICES PRICE INFLATION REMAINED SUBDUED IN 2004 Q1
(annual percentage changes)



Agricultural producer prices

Unlike industrial producer prices, agricultural producer prices showed very rapid growth at the start of 2004 (18.7% year on year in March). The continuing upturn in their growth was due almost exclusively to crop products, particularly cereals and potatoes[26]. As mentioned in the previous Inflation Report, the main factor underlying the sizeable increase in crop production prices was a change in the relationship between supply and demand on the agricultural commodities market due to the adverse weather in 2003. The lack of rainfall impacted negatively on yields of cereals, oil plants and potatoes in particular. According to a CZSO estimate, cereal production in 2003 was about 16% lower than a year earlier.

The grain harvest was also low in other European countries in 2003 for the same reasons. This opened up room for domestic producers to increase their exports of cereals. This room was utilised, since the year-on-year depreciation of the koruna-euro exchange rate at the same time created favourable sales conditions. On the other hand, exports of domestic grain production at higher prices than at home led to a further fall in supply on the domestic market. The result was a widening gap between supply and demand on the domestic agricultural market and escalating pressures on domestic prices. In general, crop prices thus indicated a continuing build-up of upward cost pressures on prices in manufacturing and consequently prices of food on the retail market (for more details see the section *Industrial producer prices*).

Livestock product prices rose more slowly than crop product prices (by 3.3% in March). Their evolution in 2003 Q4 and at the start of 2004 signalled a gradual upturn in price growth following quite a long-running period of annual decline.

Other producer prices

Prices of construction work and market services in 2004 Q1 did not veer far from the 2003 trend. Annual construction work price inflation picked up pace slightly in Q1 (to 2.5%). Market services price inflation increased at the start of 2004 from the very low level recorded in December 2003 (0.4%) to above 2%. This increase (to 2.6% in March) was mostly due to prices of business services. Prices also rose in insurance and national goods transport, although their annual growth was very moderate. Only in the communications services category did prices in Q1 overall slightly decrease year on year. On aggregate, the growth in prices in the other categories of the production sector was still subdued at the start of 2004 and presented no significant risk to consumer price inflation.

26 In March, prices of cereals and potatoes rose by 35.9% and 116.4% year on year respectively.

IV. THE MACROECONOMIC FORECAST AND ITS ASSUMPTIONS

IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

To set the assumptions regarding the external environment, the CNB has as usual drawn on the publication Consensus Forecast, which brings together the forecasts of a whole range of foreign analytical teams. The outlook for GDP growth in the EU countries was revised downwards in the latest issue of this publication. By contrast, the growth expected in the candidate countries was increased somewhat. The growth outlook in Germany, which proxies in the forecast for developments abroad, was downscaled compared to the previous forecast from 1.8% to 1.6%. The outlook for consumer price inflation remains unchanged at 1.2%, whereas industrial producer price inflation was decreased from the 0.8% used in the last forecast to the current 0.5%. In 2005, GDP growth in Germany should reach 1.7% amid unchanged consumer price growth of 1.2% and slightly higher producer price inflation of around 1.2%.

Oil prices on world markets during 2004 Q1 deviated upwards by 17% from the assumption used in the previous forecast. This is also reflected in a shift in the Consensus Forecast. The forecast assumes a Ural crude oil price of around USD 28 a barrel in the coming quarter and a gradual decline to USD 26 a barrel at the start of 2005.

Table IV.1
EXTERNAL ASSUMPTIONS OF THE FORECAST

	I/04	II/04	III/04	IV/04	I/05	II/05	III/05	IV/05
Ural crude oil prices (USD/barrel)	29.8	28.4	27.1	26.5	26.1	26.1	26.1	26.1
Natural gas prices (by import structure, USD/1000m³)	126.9	132.90	134.5	134.4	133.7	132.78	132.1	131.6
GDP in Germany (annual, in per cent)	1.1	1.6	1.8	2.0	1.5	1.7	1.8	1.8
Producer price inflation in Germany (annual, in per cent)	0.0	0.7	0.6	0.7	1.1	1.0	1.3	1.4
Consumer price inflation in Germany (annual, in per cent)	1.0	1.2	1.3	1.3	1.1	1.2	1.2	1.2
Nominal USD/EUR exchange rate	1.249	1.226	1.246	1.247	1.248	1.243	1.223	1.208
1Y EURIBOR	2.1	2.0	2.0	2.1	2.3	2.5	2.6	2.8

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions regarding the domestic economy are an important input for the forecast. Besides the expected effect of fiscal policy on the economy, these include assumptions regarding the equilibrium values of key macroeconomic variables. These assumptions allow us *inter alia* to assess the starting conditions of the forecast, i.e. the current position of the economy in the business cycle and the current setting of monetary conditions.
In the forecast, the effect of fiscal policy is derived from assumptions regarding the evolution of the public budget deficit, excluding net lending and subsidies to transformation institutions. By comparison with the previous forecast, the deficit expected for 2004 has been lowered from 5.1% to 4.7% of GDP. This reduction reflects the public budget results in 2003, when the deficit was 4.5% of GDP, and the expected pick-up in economic growth in 2004. A further modest decrease in the deficit to about 4.5% of GDP is expected in 2005. Based on these assumptions, the forecast is for a slightly positive contribution of fiscal policy to GDP growth in 2004 and a neutral effect in 2005.

Assumptions regarding the equilibrium values of key macroeconomic variables are one of the important starting points of the forecast. These variables are: potential output, equilibrium real interest rates and the equilibrium real exchange rate. As no information has appeared calling for a reassessment of the main economic trends since the last forecast, the forecast for 2004–2005 assumes, as in January 2004, a growth rate of potential output of around 2.5%, one-year equilibrium real interest rates of around 1.5% and an appreciation of the equilibrium real exchange rate at a pace of about 3% at present, gradually falling to 2% at the end of 2006.

The above assumptions regarding the equilibrium values of the three key variables together with the data on current economic growth allow us *inter alia* to derive the starting conditions of the forecast, i.e. in particular an estimate of the current setting of the monetary conditions (see the *Box*) and an estimate of the current position of the economy in the business cycle.

BOX
Monetary conditions

The term "monetary conditions" is very often used in connection with the evaluation of the monetary policy settings. The monetary conditions represent the combined effect of interest rates (the interest rate component of the monetary conditions) and the exchange rate (the exchange rate component) on the economy. These are the key variables through which monetary policy can affect economic activity and, through it, inflation. In a period of easy monetary conditions monetary policy has been set in such a way as to support economic growth. If, conversely, monetary policy suppresses growth, we speak of a period of tight monetary conditions. Finally, in the case of neutral monetary policy settings, the monetary conditions are also termed neutral. The components of the monetary conditions do not necessarily affect the economy in the same direction. The interest rate component may, for example, be evaluated as relaxed and the exchange rate component as tight, or vice versa.

The interest rate component plays the primary role in determining the monetary conditions. The exchange rate component – together with numerous other effects – adjusts to interest rates: low interest rates in a given period tend to lead to disinterest in the koruna and a weaker exchange rate, whereas high interest rates have the opposite effect.

The interest rate component of the monetary conditions is made up not of short-term interest rates, which are subject to direct control by the CNB, but of long-term rates. Most firms, households and economic agents work with long-term interest rates (one-year and longer) when making decisions about their level of consumption and investment. High interest rates generally increase the attractiveness of deferring consumption and investment and of depositing any free funds in the interim on a koruna account to increase their value. This leads to weaker domestic demand, slower economic growth and a fall in inflation. By contrast, if interest rates are low it is generally better to realise one's consumption and investment plans in the given period, be it using one's own money or borrowed funds. The result is upward pressure on economic growth and inflation.

The exchange rate component of the monetary conditions represents the relative price of domestic and foreign goods, services and investment. An appreciation of the exchange rate, i.e. an increase in the relative price of domestic goods, services and investment compared to those abroad naturally leads to a shift in interest from domestic to foreign supply. The result is a decrease in domestic economic growth and downward pressure on prices of domestic goods. A depreciation of the exchange rate has opposite effects. Both main channels (interest rate and exchange rate) through which monetary policy affects economic activity are thus derived from changes in long-term rates.

It may seem at first glance that in their decisions on whether to consume and invest now or in the future, economic agents take into account observed nominal interest rates, i.e. the rates themselves. In reality, however, they usually simultaneously consider – at least in rough outline – expected price developments, since the future real value of deposited or borrowed money can be appreciably decreased or increased by inflation in the economy. The comparative advantage of consuming or investing now as opposed to deferring such activity to the future is therefore expressed by real interest rates, i.e. interest rates adjusted for expected changes in the price level. Likewise, the comparative advantage of investing in koruna assets as opposed to

investing in foreign currency assets is expressed by the real exchange rate, i.e. the exchange rate adjusted for expected changes in the price level in the domestic and external economy.

So, from the economic point of view, what is important is the settings of both components of monetary conditions not in nominal, but in real terms relative to their long-term equilibrium values. If real interest rates are above their long-term level, economic agents tend to reduce their current consumption and investment and the interest rate component of the monetary conditions is assessed as tight. On the other hand, a lower level of real interest rates relative to their long-term level means an easing of the interest rate component of the monetary conditions. In the construction of the CNB forecast, the interest rate component of the monetary conditions is computed as a weighted average of three real interest rates: the one-year real PRIBOR, the real rate on newly granted loans and the one-year real interest rate in the euro area.

If the real exchange rate of the koruna against the relevant foreign currency is lower (stronger) than its long-term level, the exchange rate component of the monetary conditions is evaluated as tight. On the other hand, a real exchange rate higher (weaker) than its long-term level means an easy exchange rate component of the monetary conditions. In the CNB forecast, the exchange rate component of the monetary conditions is expressed by the koruna-euro exchange rate computed as the average for the given quarter.

In the calculation of the overall monetary conditions, the interest rate component accounts for two-thirds of the total and the exchange rate component for one-third. These weights reflect the belief that interest rates play the larger role in influencing future economic growth.

At present the monetary conditions can be viewed as easy. Turning to the structure of the monetary conditions, domestic real interest rates are assessed as neutral and the real exchange rate as easy, in line with the last forecast. The higher-than-expected average depreciation of the nominal exchange rate during 2004 Q1 nonetheless meant a greater-than-forecasted easing of the real exchange rate. The assessment of the monetary conditions is also based on the view of their past evolution. During 2003 there was a gradual easing of the exchange rate component. As a result, the output gap stopped widening. Based on expectations of a faster GDP growth, the negative output gap estimate for 2004 Q1 was revised slightly – towards a somewhat narrower gap (-1.5%).

The aforementioned assessment of the starting conditions of the forecast can be verified by looking at the actual economic developments described in the preceding sections of this Report. The developments in 2004 Q1 indicated a continuing low-inflation environment characteristic of an economy operating below its potential. Some disinflationary pressures are still apparent, especially in demand-sensitive segments of the consumer basket.

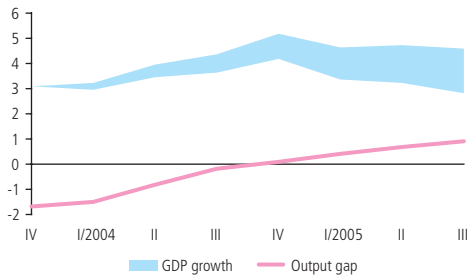
The growth in economic activity in 2003 H2 was due chiefly to household consumption. The latter's acceleration was fostered by the easy interest rate component of the monetary conditions during 2002 and rapid growth in real disposable income. The easy interest rate component is confirmed by a fall in the savings rate in a situation of dynamic growth in households' real income. The modest slowdown in household consumption growth in 2003 Q4, however, to a large extent confirmed the hypothesis that the unusually fast growth of this component of GDP in 2003 Q3 had been caused

in part by the one-off effect of changes in the VAT Act. Also, the actual evolution of consumer credit and M1 suggests a slackening of household consumption relative to the previous year, which can be viewed as confirmation of a switch of the interest rate component from easy to neutral at the start of 2003.

Private-sector investment activity verged on stagnation in the course of 2003. The possible explanations include a deterioration in corporations' financial condition at the start of 2003 in response to the appreciation shock during 2002, and the weak external demand and pessimistic expectations regarding future developments. The current structural evolution of the money stock may be a sign of an improvement in corporations' financial condition, which would tally with the steady easing of the monetary conditions during 2003. The easing of the exchange rate component of the monetary conditions in particular is also the likely cause of the upturn in export growth and slight decrease in the propensity to import over the course of last year.

IV.3 THE MESSAGE OF THE FORECAST

Chart IV.1
ACCORDING TO THE FORECAST, THE CLOSURE OF THE OUTPUT GAP WILL LEAD TO A PICK-UP IN GDP GROWTH IN 2004 H2
(percentages)



The greater easing of the monetary conditions than expected in the last forecast underlies a shift in the output gap forecast towards its closing in 2004 H2. The prediction of growth in potential output has been retained and the expected growth in GDP has also been upscaled. According to the forecast, GDP growth will be approximately 4% in 2004 and 3.9% in 2005.

The pick-up in economic growth is generated by an improvement in net exports and growth in investment, which will replace household consumption in 2004 in the position of primary economic growth factor. This will also be the case in 2005, when we predict an investment growth rate of 7%, thanks also to the fact that rising inflation expectations will lead to a gradual autonomous easing of the interest rate component of the monetary conditions. In line with the upswing in investment activity, the forecast is for an initial halt in the decline, and then a gradual rise, in lending by the banking sector to non-financial corporations.

On the other hand, the growth rate of household consumption will gradually ease during 2004, owing to falling growth in real disposable income, a transitory rise in unemployment and also to the tightening of real interest rates that occurred in the course of 2003. The falling growth in real disposable income stems from higher inflation than in 2003 coupled with a flat growth rate of aggregate nominal wages around 5%. In both 2004 and 2005, growth in households' consumption spending of around 4% is expected.

The economic recovery in 2004 and 2005 will be accompanied by a slowdown in the decline in net exports. As in the case of investment activity, this change stems from the easy exchange rate and the gradual onset of an economy recovery abroad. The easy exchange rate will lead to a fall in the import propensity of domestic demand, whereas exports will react more to external developments. If we express foreign trade in current prices, the forecast is consistent with an improvement in the output and trade balance in 2004 and 2005.

The forecast is for gradual moderate appreciation of the nominal exchange rate for the entire prediction horizon. The nominal exchange rate trend ensues from the predicted evolution of the interest rate differential and risk premium. Together with lower inflation abroad by comparison with the last forecast, the moderate appreciation of the nominal exchange rate generates a lower import price forecast. Although import price inflation

initially stays positive, it falls comparatively quickly, and negative growth rates are expected for this indicator by the end of 2004.

The aforementioned evolution of real economic activity, imported inflation and exogenous factors determine the future inflation profile. The inflation pressures implied by the closure of the output gap and its switch to positive figures will start to emerge at the end of 2004. This represents a change in both timing and intensity from the last forecast.

Inflation will furthermore be strongly affected in 2004 by changes to indirect taxes linked not only with accession to the EU, but also with the government's reform of public finances. Since the preparation of the last forecast there have been numerous changes that lead to an increase in the primary and secondary effects of these changes. The total estimated contribution of the tax changes is approximately 1.2 percentage points, as against the 0.9 percentage point predicted in January. In addition to the tax changes, inflation will be affected by a transitory rise in food price inflation in response to the development of agricultural producer prices. The growth in food prices should peak during the summer months of 2004.

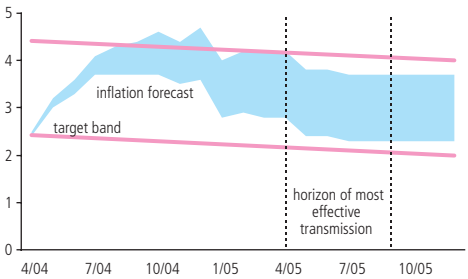
Owing to the rising demand and the secondary impacts of the tax changes, adjusted inflation excluding fuels will reach figures of around 2.7% by the end of 2004, an increase of approximately 1 percentage point by comparison with the last forecast. Headline consumer price inflation should be somewhere around 4.2% at the end of 2004.

Over the course of 2005, the effect of the changes to indirect taxes and the short-lived rise in food price inflation will gradually unwind. Rising demand-pull inflation will thus take over the role of primary inflation factor. Its inflationary action will be depressed by falling import prices. Headline inflation will thus fluctuate around 3% in 2005 H2, i.e. near the centre of the inflation target.

To sum up, the forecast is for a pick-up in economic growth to around 4% in both years. Underlying this there will be gradual closing of the negative output gap during 2004 and a switch to positive figures in 2005. The attainment of the economy's level of potential output will be reflected in a resurgence of demand-pull inflationary pressures. Their impact on inflation will show up in 2005, by which time the effect of external factors – in the form of changes to indirect taxes – will have unwound. The aggregate action of the demand effects and the counteracting import prices will cause inflation to be near the centre of the inflation target in 2005 H2. Consistent with the forecast is a gradual rise in interest rates at the two-year horizon. Like previous forecasts, this forecast assumes that monetary policy will not respond to the direct effects of the changes to indirect taxes included in the forecast, but will anticipate the secondary effects.

During the construction of the forecast, a number of risks and uncertainties are identified. The most important of these are embodied in alternative scenarios. Within the current forecast, two alternative scenarios were constructed. The first of these quantifies the uncertainty associated with the size of the secondary effects of the changes to indirect taxes, arising through gradual pass-through of the primary effects via inflation expectations and wages. As in the past, the baseline scenario considers relatively a low pass-through of these effects. The alternative scenario either further reduces the pass-through to zero or conversely increases it to double. While neither of the two alternatives changes the message of the forecast for economic growth and inflation, deviations are seen when one compares the consistent interest rate paths. By comparison with the baseline scenario, the first alternative leads to a lower interest rate path and the second to a higher path. A second uncertainty concerns the possibility

Chart IV.2
THE INFLATION FORECAST IS AT THE CENTRE OF THE TARGET BAND AT THE HORIZON OF MOST EFFECTIVE TRANSMISSION
(annual consumer price inflation; percentages)



of an only temporary easing of the exchange rate component of the monetary conditions arising from an observed shift in the nominal rate to around CZK 33/EUR. The alternative scenario considers a faster appreciation in the future, which results in a rapid decrease in the extent of the easing of the real exchange rate. The result is more gradual closure of the output gap, weaker demand-pull inflationary pressures and hence lower pressures for a monetary-policy tightening.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

Table IV.2
THE INFLATION EXPECTATIONS OF ECONOMIC AGENTS SHOWED MIXED DEVELOPMENTS
(percentages)

	12/02	12/03	1/04	2/04	3/04
Consumer price index					
1Y horizon:					
Financial market	2.3	3.3	2.9	3.2	3.0
Corporations	2.3	2.9			3.3
Households	2.3	4.2			4.9
3Y horizon:					
Financial market	2.8	2.8	2.9	2.8	2.8
Corporations	2.2	2.8			3.1
Households	1.9	4.6			4.9
1Y PRIBOR					
1Y horizon:					
Financial market	3.1	3.1	3.0	3.0	3.1

The inflation outturns expected by financial market participants decreased slightly. Nevertheless, at the nearest horizon the analysts still expected rising inflation, due mainly to the VAT changes and growth in food prices. Uncertainty prevailed regarding rent deregulation, and oil prices remained one of the external risk factors. In 2005, owing to the predicted closure of the output gap, the first demand pressures should emerge. Despite this, the overall rise in prices should not be at all dramatic. The inflation expectations of corporations and households rose, probably in connection with accession to the EU and the changes to VAT.

The CNB also monitors inflation expectations at the medium-term horizon. The expected figures lay in a narrower range. The main factor is the speed and intensity of the recovery of the global economy. As mentioned in the document on the post-2006 inflation target in the Annex, the long-term inflation expectations of the financial market are consistent with the target of 3% set for the period starting January 2006.

Expected interest rates showed only minimal changes in the period under review. In the immediate future interest rate stability was still expected, but in the longer term rates were expected to rise moderately. The first increase in the CNB's key rates was expected by the financial market approximately in 2004 H2. The interest rate path was thus at a lower level than that consistent with the CNB forecast described above.

ANNEX

THE CNB'S INFLATION TARGET FROM JANUARY 2006

The current inflation target of the Czech National Bank (CNB) is defined up until December 2005. In line with the *CNB Monetary Strategy* document, the CNB is now setting its inflation target for the period starting January 2006. This means that, sufficiently in advance, a framework is created for monetary policy decision-making with impacts on inflation from the start of 2006, and long-term inflation expectations are anchored.

The CNB hereby announces that the inflation target for the period starting January 2006 is year-on-year consumer price index (CPI) change of 3%. The CNB will at the same time endeavour to ensure that the actual inflation outturn does not differ by more than one percentage point in either direction from this target. The inflation target will be in force continuously until the Czech Republic joins the euro area, when the implementation of monetary policy directed at maintaining price stability will pass on to the European Central Bank (ECB).

This target has been set in line with the general principles of the CNB's monetary policy strategy, defined in the *CNB Monetary Strategy* document of April 1999 and updated or supplemented by later documents on the announcement of the inflation targets for 2001 and 2002–2005 and by *The Czech Republic's Euro-area Accession Strategy*. The declared inflation target does not institute any acceleration of targeted inflation and follows smoothly on the end of the previous steadily descending target band. Given the low-inflation environment, the target is set in horizontal form.

The inflation target is at the same time a good starting point for future fulfilment of the convergence criteria, corresponds to the long-term inflation expectations of the financial markets, and also conforms to the limitations stemming from statistical overvaluation in measuring inflation. The target takes into account also the zero nominal interest rate bound and the potential downward inflexibility of wages.

The inflation target has been set slightly above the price stability level declared by the ECB for the euro area in terms of the year-on-year change in the harmonised index of consumer prices (HICP), which is "below but close to 2%". This small inflation differential reflects the long-term real convergence of the Czech economy towards the euro area average, which will continue for some time after the Czech Republic's accession to the euro area.

The CNB continues to regard its inflation targets as medium-term targets from which actual inflation may deviate temporarily. Such a deviation comes into consideration especially if the economy is hit by an "exogenous shock". If such a shock deflects expected inflation from the target, the CNB does not respond to the primary impacts of the shock. It will apply an exemption ("escape clause") from the obligation to hit the inflation target and accept the deviation of the inflation forecast from the target caused in this way. There can be a whole range of shocks which create room for applying such escape clauses. They include, for example, major deviations in world prices of energy raw materials or major deviations in agricultural producer prices. A specific type of exogenous shocks is administrative measures that have strong price impacts, in particular major changes in the structure or rates of indirect taxes and major changes in the segment of regulated prices.

MINUTES OF THE CNB BANK BOARD MEETINGS

MINUTES OF THE BOARD MEETING ON 29 JANUARY 2004

Present at the meeting: Zdeněk Tůma (Governor), Oldřich Dědek (Vice-Governor), Luděk Niedermayer (Vice-Governor), Jan Frait (Chief Executive Director), Pavel Racocha (Chief Executive Director)

The Board opened the meeting with a presentation of the January situational report, containing the new forecast for inflation and other key macroeconomic variables in 2004 and 2005.

Consumer prices in December 2003 increased 1% year-on-year. This rise in inflation was higher than predicted by the CNB's October forecast. Excessive price growth in relation to the forecast was seen especially in food and regulated prices. On the other hand, adjusted inflation registered lower-than-expected growth. Despite certain growth acceleration, though, food price development during the last quarter of 2003 did not generate any substantial deviation from the medium-term link between food prices and the cyclical position of the economy on the one hand and cost factors on the other. Since formation of the October macroeconomic forecast, there had also been higher-than-expected household consumption growth. This higher growth was triggered by the interest rate settings for monetary conditions in the past, rapid growth of real disposable incomes in 2003 and the effect of non-systematic factors in the form of anticipated tax legislation changes.

In the horizon of the most effective transmission, inflation was within the targeted band, similar to the situation with the October macroeconomic forecast. With the exception of import prices, all factors in 2004 would contribute to inflation growth. In comparison with the previous forecast, the import price forecast was lowered, despite the fact that German inflation was higher than predicted in the 10th situational report and that the nominal exchange rate depreciated. The main reasons behind this decline in import prices were exchange rate appreciation vis-à-vis the dollar and a deviation in actual development from the forecast at the end of 2003. The expected development for the output gap was a systematic factor contributing in particular to higher inflation. Looser real monetary conditions and faster foreign recovery were the main reasons why current output converged to the potential of the economy at a faster rate. The dynamics of household consumption within the cycle corresponded to the components of real incomes. Employment followed the economic cycle with a certain time lag, while real wages were in line with the past anti-cyclical development. In the previous period, nominal wage rigidity contributed significantly to this development. The impact of rising unemployment would not be reflected in wage restraint until some time in 2004.

Regulated prices would have a large impact on how fast inflation returned back to the target and on the observed deviation compared with the previous forecast. However by mid-2005, the share of regulated prices in total inflation would decline to 0.5 percentage points. In addition, food prices would contribute to the observed difference in the inflation forecast for 2004 despite primary factors, such as import prices and agricultural producer prices, behaving in a similar manner or with less intensity. On the contrary, adjusted inflation in 2004, excluding fuel, was situated below the previous prediction. This was related to the development of import prices. However, the output gap would not close up at a faster pace until 2005.

The current level of nominal interest rates in Q1 as well as a gradual rise in these rates during the following period was consistent with the forecast.

Two alternative scenarios were worked up for the forecast. The first scenario quantified the effect of the shift in catering and accommodation services from the lowered VAT category to the base VAT category by the Czech Republic's EU entry date. In contrast to the baseline scenario, this scenario was characterised by a higher level of total inflation starting in Q2 2004 and a slight slowdown in economic activity at the end of 2004/beginning of 2005. Considering that monetary policy reacts only to the secondary effects of tax corrections, this alternative in comparison with the baseline scenario would not put more pressure on tightening monetary policy until the middle of this year. The second scenario would map out the risks associated with the observed appreciation of the euro vis-à-vis the US dollar. This scenario, depending on the assumed reaction of the ECB to euro appreciation, would help ease inflation pressures and lead to lower nominal interest rates in the Czech Republic.

Following the presentation of the January situational report, the Board discussed the new forecast and the risks associated therein. There was agreement that, in principle, current and expected macroeconomic development in the Czech Republic were reflected well in the inflation forecast. For this reason, the discussion was primarily focused on the risks associated with the forecast.

When assessing the overall balance of inflation risks, most of the board members observed risks skewed in a pro-inflationary direction. Other members considered the forecast risks to be more or less balanced. One of the main risks was identified as the estimate of the impact tax changes had on inflation expectations, wage development and overall demand, which was also influenced by the income effect. The extent of compensation that could accompany these tax-harmonising changes would also be significant. Expected economic growth and a closing output gap could, in this respect, have more of an inflationary effect than in the past. However, it was said that future CPI inflation adjusted for the direct effect of tax changes still indicated the continuation of a low-inflation environment.

The Board considered the current interest rate settings to be eased, especially in relation to expected price development. In this respect, it was pointed out that interest rates were lowered to 2% at a time when there was a threat of deflation and significantly reduced demand in the global economy. Since this time, the basic risks of external development had substantially declined. Czech economic performance was satisfactory. Corporate sector polls showed improvements in using capacity, and the majority of indicators at the macro- and micro-level confirmed the positive tendency in the real economy. The European economy was slowly recovering from a slump, but had maintained around two per cent inflation. The United States, on the other hand, registered dynamic economic growth with low inflation. This occurred in an environment of very low interest rates and sharp depreciation of the dollar against the euro.

The only anti-inflationary risk that board members discussed in any detail was the scenario quantifying the more substantial weakening of the USD and its impact on a slowdown in European economic growth. There was consensus that this alternative forecast scenario from a qualitative standpoint correctly captured the impact of the depreciated dollar on the Czech economy. However, from a quantitative standpoint, the board members attached different weights to this particular risk.

At the close of the meeting and following the discussion on the situational report, the Board decided unanimously to leave the CNB two-week repo rate unchanged at 2%.

MINUTES OF THE BOARD MEETING ON 26 FEBRUARY 2004

Present at the meeting: Zdeněk Tůma (Governor), Oldřich Dědek (Vice-Governor), Luděk Niedermayer (Vice-Governor), 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 February situational report assessing the new information and risks associated with the January forecast.

Consumer prices rose in January at a slightly faster pace than predicted in the January forecast. This was especially due to regulated prices and the influence indirect tax changes had on them. Adjusted inflation was also slightly higher than the forecast. Food prices, however, rose at a slower pace, and net inflation fluctuated near the forecast level. Industrial and agricultural producer prices in January were higher than the prediction for Q1 2004.

There were no real discernible quantitative shifts in the external environment against the assumptions of the January forecast. In Germany, the estimate of CPI inflation was slightly reduced. The higher forecast for oil prices on world markets was, in principle, offset by a stronger CZK exchange rate vis-à-vis the dollar. The dollar exchange rate vis-à-vis the euro substantially weakened against the forecast assumptions.

The December figures on the real economy indicated favourable developments in industrial production, construction and retail sales. M2 growth accelerated, and relatively rapid lending growth continued. According to preliminary data, the 2003 public budget deficit was substantially lower than the Ministry of Finance expected. The trade deficit for 2003 corresponded to the forecast. However, the current account for the balance of payments ended with a higher deficit, reflecting, in particular, the impact of reinvested profit in the balance of incomes. Developments on the labour market in January were in line with the forecast.

Following the presentation of the situational report, the Board turned to a discussion of the current distribution of risks associated with the January forecast. Overall, the risks were perceived to be slightly pro-inflationary in nature. Some board members considered the risks to be more or less balanced in the horizon of the most effective transmission.

Similar to the January situational report, a considerable amount of attention was devoted this time to the planned tax corrections. It was mentioned that the ambiguous situation surrounding the changes in indirect taxes increased overall uncertainty, which could unfavourably affect rising inflation expectations, and in the end, even future inflation. However, it was argued that, from the budgetary standpoint, the overall financial effect of changes was essentially clear. In the medium run, this would mean neutral operations as far as income was concerned. Fiscal development was discussed even in context with a lower-than-expected public budget deficit in 2003. It was repeatedly stated that there was a risk of using a more favourable starting position for relaxing the originally assumed speed and scope of fiscal consolidation. In the same way, some expenditure measures compensating for changes in VAT could generate an additional deficit tendency for the medium term.

The dynamics of credit formation was indicated by some board members as another possible inflation risk. On the other end of the scale, however, attention was focused on global economic development and the situation on the labour market. From the standpoint of external economic development, the Board agreed that acceleration of economic growth in the Czech Republic was strongly tied to recovery abroad. Any delay in this recovery presented a downside risk, especially if this development were combined with a decline in FDI inflow to the Czech Republic. During the discussion on the labour market, it was said that real wage development this year would be mostly moderate according to a number of indicators, and it could offset to a certain extent the accelerated dynamics from the previous year. The Board also discussed the long-term trends on the labour market leading to the premise that the structural level of unemployment in the Czech economy could rise, and as a consequence, present a serious problem for macroeconomic development.

The Board also discussed in detail the issue of the external imbalance in relation to publishing figures on the balance of payments. The current account deficit for 2003 exceeded 7% of GDP. It was stated that the deficit would be cut in half after accounting for the effect of reinvested profit, which was automatically financed in the balance of payments as FDI. It was also pointed out that, despite this fact, the overall current account deficit was still rather high and the supply side of the economy, strengthened in the past by foreign investments, should try to at least partially offset these deficit pressures with a favourable trade balance.

At the close of the meeting and following the discussion on the situational report, the Board decided unanimously to leave the CNB two-week repo rate unchanged at 2%.

MINUTES OF THE BOARD MEETING ON 25 MARCH 2004

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 March situational report assessing the new information and risks associated with the inflation forecast from January of this year.

Year-on-year consumer price growth in February was in line with the forecast. The 0.2% increase against January was influenced among other things by a time lag in the effect of excise tax corrections on cigarette and alcohol prices, because these goods had still been largely supplied using old inventories. Industrial producer prices experienced faster growth for the supply of water, electricity and heat. In agriculture, this growth was concentrated in the area of crop production.

The January figures pointed to the stability of favourable industrial production development. The figures confirmed that GDP growth was expected to remain at around 3%. In spite of this, the number of unemployed was on the rise, reflecting the deepening structural problems on the labour market. The expected slowdown in the growth of household consumption expenditures was taking place. Due to a rise in government investment, gross fixed capital creation increased in Q4 by almost 5%.

In the external environment, the estimates of this year's economic growth in Germany were being gradually lowered, and the new inflation forecasts would also shift downwards. The effect of higher global oil and natural gas prices on the price level in the Czech Republic had been offset thus far by a stronger Czech koruna vis-à-vis the dollar.

The situational report indicated the rise in agricultural production prices as a current risk to the short-term inflation forecast. The assessment of the impact of indirect tax changes was marked by uncertainty. According to the draft bill passed by Parliament, the primary impact of these taxes on inflation as of 1 May was for the most part non-existent. However, one risk was the secondary effects conditional on inflation expectations and to what extent the changes in VAT rates would be reflected in prices.

Following the presentation of the situational report, the Board discussed the significance of the new information and figures for monetary decision-making. There was consensus among the members that the new information did not justify a change in the economic and monetary outlook.

A similar conclusion was also valid for the assessment of risks. The Board discussed the inflation risks originating from the growth of agricultural producer prices and the risks associated with high global oil prices. The notions on indirect tax changes had become more and more clear. However, the change in regulated rent was still uncertain. The appreciated koruna exchange rate vis-à-vis the dollar and economic development in the EU continued to have an anti-inflationary effect. As a reminder, however, it was mentioned that economic growth in the USA and China was a substantial incentive for the global economy.

The Board considered inflation expectations to be the most significant uncertainty at present. Expectations were now formed, in particular, by judgements made about the results of the specific steps of public finance reform and EU accession. In this respect, the media's influence on the general public in forming inflation expectations and its possible one-sided effect were discussed. It was expressed that, after the effects of tax changes died out, inflationary pressures would lessen and inflation expectations should decline.

Based on the figures for Q4, GDP growth was perceived to be relatively satisfactory. Some doubts about the sustainability of this growth, however, were expressed in view of slow growth in private business investments, household savings, a slowdown in foreign direct investment inflow and the structural imbalance between supply and demand on the labour market. Uncertainties concerning upcoming economic developments, especially unemployment, wages and prices, were reflected in the current lag in household consumption growth. One view expressed that delayed consumption could also be related to the planned reduction in the base VAT rate, which would make more costly long-term consumption items less expensive.

At the close of the meeting and following the discussion on the situational report, the Board decided unanimously to leave the CNB two-week repo rate unchanged at 2%.

INFLATION DEVELOPMENT

annual percentage changes

	1	2	3	4	5	6	7	8	9	10	11	12
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
2003												
Consumer prices	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0
Regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
(contribution to consumer price inflation)	*-0.07*	*-0.15*	*-0.16*	*0.29*	*0.31*	*0.32*	*0.08*	*0.09*	*0.08*	*0.24*	*0.24*	*0.27*
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	-0.4	-0.2	-0.2	-0.5	-0.4	0.0	-0.2	-0.1	0.0	0.3	0.9	1.0
(contribution to consumer price inflation)	*-0.32*	*-0.17*	*-0.15*	*-0.38*	*-0.30*	*-0.01*	*-0.19*	*-0.10*	*-0.01*	*0.20*	*0.70*	*0.77*
of which: prices of food. beverages and tobacco	-4.1	-3.8	-3.5	-3.5	-2.8	-1.0	-0.9	-0.9	-0.1	0.6	2.5	2.7
(contribution to consumer price inflation)	*-1.06*	*-1.06*	*-0.97*	*-0.94*	*-0.76*	*-0.28*	*-0.22*	*-0.22*	*-0.04*	*0.16*	*0.66*	*0.70*
adjusted inflation	1.5	1.7	1.5	1.1	0.9	0.5	0.1	0.2	0.0	0.1	0.1	0.1
(contribution to consumer price inflation)	*0.74*	*0.89*	*0.82*	*0.56*	*0.46*	*0.27*	*0.04*	*0.12*	*0.02*	*0.04*	*0.04*	*0.06*
Inflation rate (annual moving average)	1.5	1.1	0.8	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.1
2004												
Consumer prices	2.3	2.3	2.5									
Regulated prices	5.0	4.9	4.7									
(contribution to consumer price inflation)	*1.01*	*0.99*	*0.96*									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.35*	*0.35*	*0.35*									
Net inflation	1.2	1.2	1.4									
(contribution to consumer price inflation)	*0.96*	*0.92*	*1.15*									
of which: prices of food. beverages and tobacco	2.8	2.8	3.2									
(contribution to consumer price inflation)	*0.75*	*0.75*	*0.83*									
adjusted inflation	0.4	0.3	0.6									
(contribution to consumer price inflation)	*0.21*	*0.17*	*0.32*									
Inflation rate (annual moving average)	0.3	0.5	0.8									

CNB calculation based on CZSO data

INFLATION DEVELOPMENT

monthly percentage changes

	1	2	3	4	5	6	7	8	9	10	11	12
	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
	2003											
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	0.03	0.06	0.03	0.23	-0.01	0.01	0.00	0.00	0.01	-0.09	0.00	0.00
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	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	0.55	0.14	-0.13	-0.03	-0.04	0.05	0.03	-0.11	-0.49	0.22	0.39	0.20
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	0.22	-0.05	-0.05	0.04	0.10	0.16	-0.44	-0.25	0.16	0.18	0.42	0.22
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	0.33	0.18	-0.07	-0.06	-0.14	-0.11	0.47	0.15	-0.65	0.03	-0.03	-0.02
	2004											
Consumer prices	1.8	0.2	0.1									
Regulated prices	3.7	0.2	0.0									
(contribution to consumer price inflation)	0.76	0.04	0.01									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.00	0.00									
Net inflation	0.9	0.1	0.1									
(contribution to consumer price inflation)	0.74	0.09	0.10									
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1									
(contribution to consumer price inflation)	0.26	-0.05	0.02									
adjusted inflation	0.9	0.3	0.1									
(contribution to consumer price inflation)	0.48	0.14	0.08									

CNB calculation based on CZSO data

CONSUMER PRICES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	Months												Average since start of year
		1	2	3	4	5	6	7	8	9	10	11	12	
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
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
Total - 2003	1000.0	9.6	9.8	9.7	9.9	9.9	9.9	10.0	9.8	9.3	9.4	9.9	10.1	9.8
Food and non-alcoholic beverages	197.6	3.1	2.8	2.5	2.7	3.2	4.2	1.7	0.3	1.1	2.2	4.4	5.7	2.8
Alcoholic beverages and tobacco	79.2	7.6	7.7	7.7	7.7	7.9	7.6	7.7	7.7	7.9	7.7	8.0	7.8	7.8
Clothing and footwear	56.9	-9.1	-10.0	-10.4	-10.1	-10.1	-10.4	-11.5	-12.6	-12.4	-12.1	-11.9	-11.9	-11.0
Housing, water, electricity, gas and other fuels	236.4	24.9	25.3	25.4	26.5	26.6	26.6	26.9	27.0	27.0	26.6	26.6	26.6	26.3
Furnishings, household equipment and routine maintenance of the house	67.9	-1.1	-1.2	-1.4	-1.6	-1.8	-2.1	-2.3	-2.6	-2.7	-2.8	-3.0	-3.0	-2.1
Health	14.3	13.7	14.2	14.8	15.4	16.3	16.4	17.4	17.5	17.5	16.9	16.3	16.4	16.1
Transport	101.4	4.7	5.2	5.8	5.5	4.5	3.8	3.5	3.8	4.3	4.0	3.7	3.6	4.4
Communications	22.5	7.9	8.9	8.8	9.0	7.5	7.4	7.4	7.4	7.3	7.3	7.3	7.2	7.8
Recreation and culture	95.5	8.5	9.6	8.5	7.7	7.1	7.0	12.5	14.3	6.1	6.3	6.2	6.1	8.3
Education	4.5	11.3	11.4	11.5	11.5	11.5	11.6	11.6	11.6	11.0	12.0	12.0	12.0	11.6
Hotels, cafés and restaurants	74.2	9.2	9.4	9.4	9.5	9.6	9.6	9.9	10.0	10.3	10.5	10.7	10.8	9.9
Miscellaneous goods and services	49.5	14.0	14.6	14.7	14.7	14.6	14.6	14.5	14.7	14.9	15.4	15.3	15.2	14.8
Total - 2004	1000.0	12.1	12.3	12.4										12.3
Food and non-alcoholic beverages	197.6	7.4	7.1	7.2										7.2
Alcoholic beverages and tobacco	79.2	8.5	8.6	8.7										8.6
Clothing and footwear	56.9	-13.5	-14.3	-14.3										-14.0
Housing, water, electricity, gas and other fuels	236.4	30.1	30.5	30.7										30.4
Furnishings, household equipment and routine maintenance of the house	67.9	-3.1	-3.3	-3.4										-3.3
Health	14.3	16.5	17.0	17.4										17.0
Transport	101.4	5.8	5.8	6.8										6.1
Communications	22.5	24.2	23.1	23.0										23.4
Recreation and culture	95.5	7.4	8.7	7.6										7.9
Education	4.5	12.2	12.6	12.5										12.4
Hotels, cafés and restaurants	74.2	11.8	12.0	12.4										12.1
Miscellaneous goods and services	49.5	17.4	18.3	18.8										18.2

Source: CZSO

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2000	2001	2002	2003				2004
		12	12	12	3	6	9	12	3
1. Food and non-alcoholic beverages	197.6	4.6	7.9	2.1	2.5	4.2	1.1	5.7	7.2
- tradables	197.6	4.6	7.9	2.1	2.5	4.2	1.1	5.7	7.2
2. Alcoholic beverages and tobacco	79.2	2.4	5.4	7.1	7.7	7.6	7.9	7.8	8.7
- tradables	79.2	2.4	5.4	7.1	7.7	7.6	7.9	7.8	8.7
3. Clothing and footwear	56.9	-2.7	-3.9	-7.7	-10.4	-10.4	-12.4	-11.9	-14.3
- nontradables	1.4	6.1	13.0	18.3	19.2	20.0	20.9	21.1	25.6
- tradables	55.5	-2.9	-4.3	-8.4	-11.2	-11.2	-13.2	-12.7	-15.3
4. Housing, water, electricity, gas and other fuels	236.4	7.8	19.0	24.3	25.4	26.6	27.0	26.6	30.7
- nontradables	226.1	8.1	19.7	25.2	26.3	27.6	28.0	27.5	31.6
- tradables	10.3	2.3	2.7	4.0	5.3	4.0	4.5	5.9	10.9
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.7	-0.4	-1.0	-1.4	-2.1	-2.7	-3.0	-3.4
- nontradables	2.9	4.3	7.5	9.9	10.8	11.2	11.8	12.3	14.0
- tradables	65.0	-0.9	-0.8	-1.5	-1.9	-2.7	-3.4	-3.7	-4.2
6. Health	14.3	4.1	8.4	12.8	14.8	16.4	17.5	16.4	17.4
- nontradables	11.0	4.9	10.1	15.4	17.9	19.9	21.2	19.9	21.1
- tradables	3.3	1.5	2.7	4.4	4.9	5.1	5.4	5.1	5.3
7. Transport	101.4	6.9	3.4	4.1	5.8	3.8	4.3	3.6	6.8
- nontradables	27.4	6.2	11.7	16.0	17.2	17.6	18.1	18.4	22.2
- tradables	74.0	7.2	0.3	-0.3	1.6	-1.3	-0.8	-1.9	1.1
8. Communications	22.5	1.5	5.7	8.2	8.8	7.4	7.3	7.2	23.0
- nontradables	21.0	2.7	8.5	12.4	13.2	12.0	12.0	12.1	17.8
- tradables	1.5	-16.4	-34.7	-52.1	-54.6	-58.3	-59.8	-62.3	96.8
9. Recreation and culture	95.5	2.0	7.2	7.2	8.5	7.0	6.1	6.1	7.6
- nontradables	60.4	4.4	14.3	16.2	18.8	17.7	16.6	16.7	19.0
- tradables	35.1	-2.2	-5.0	-8.3	-9.2	-11.4	-12.1	-12.1	-12.0
10. Education	4.5	3.4	6.8	11.3	11.5	11.6	11.0	12.0	12.5
- nontradables	4.5	3.4	6.8	11.3	11.5	11.6	11.0	12.0	12.5
11. Hotels, cafés and restaurants	74.2	2.6	5.9	8.7	9.4	9.6	10.3	10.8	12.4
- nontradables	74.2	2.6	5.9	8.7	9.4	9.6	10.3	10.8	12.4
12. Miscellaneous goods and services	49.5	3.1	8.7	11.9	14.7	14.6	14.9	15.2	18.8
- nontradables	22.0	5.7	17.5	25.8	32.9	33.9	34.8	36.4	43.7
- tradables	27.5	1.1	1.7	0.8	0.2	-0.8	-1.0	-1.7	-1.1
Household consumer prices, total	1000.0	4.1	8.4	9.0	9.7	9.9	9.3	10.1	12.4
Tradables	549.1	2.5	2.9	0.2	0.3	0.2	-1.2	0.3	1.6
- food	276.8	4.0	7.2	3.5	4.0	5.2	3.0	6.3	7.6
- others	272.3	1.0	-1.5	-3.2	-3.5	-4.9	-5.5	-5.8	-4.5
Nontradables	450.9	6.0	15.2	19.7	21.2	21.8	22.1	22.0	25.5
- others	271.2	4.7	11.5	16.4	18.5	18.6	19.0	19.4	22.7
- regulated	179.7	8.0	20.6	24.6	25.3	26.7	26.8	26.0	29.8

CNB calculation based on CZSO data

INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS FOR 12 MONTHS AHEAD

annual percentage changes

	CPI		
	Financial market	Businesses	Households
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	4.7	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	2.4	1.3
10/02	2.5		
11/02	2.4		
12/02	2.3	2.3	2.3
1/03	2.5		
2/03	2.4		
3/03	2.5	2.1	4.3
4/03	2.6		
5/03	3.7		
6/03	3.2	2.6	1.7
7/03	3.3		
8/03	3.2		
9/03	3.1	2.6	3.1
10/03	3.0		
11/03	3.1		
12/03	3.3	2.9	4.2
1/04	2.9		
2/04	3.2		
3/04	3.0	3.3	4.9

Source: CNB statistical survey

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2000	2001	2002	2003	2004
	12	12	12	12	3
Belgium	3.0	2.0	1.3	1.7	1.0
Denmark	2.3	2.1	2.6	1.2	0.4
Finland	2.9	2.3	1.7	1.2	-0.4
France	1.7	1.4	2.2	2.4	1.9
Ireland	4.6	4.4	4.6	2.9	1.8
Italy	2.8	2.2	3.0	2.5	2.3
Luxembourg	4.3	0.9	2.8	2.4	2.0
Germany	2.1	1.4	1.1	1.1	1.1
Netherlands	2.9	5.1	3.2	1.6	1.2
Portugal	3.8	3.9	4.0	2.3	2.2
Austria	1.8	1.8	1.7	1.3	1.5
Greece	3.7	3.5	3.5	3.1	2.9
Spain	4.0	2.5	4.0	2.7	2.2
Sweden	1.3	3.2	1.7	1.8	0.4
United Kingdom	0.9	1.0	1.7	1.3	1.1
European Union	2.2	1.9	2.2	1.8	1.5
Czech Republic	4.0	3.9	0.1	1.0	2.1

Source: Eurostat

MONETARY SURVEY

position at month-end in CZK billions

		2000	2001	2002	2003	2004
		12	12	12	12	2
Total assets		1412.3	1596.0	1647.3	1763.3	1761.7
Net foreign assets		673.1	800.6	912.9	822.0	849.8
- assets		998.8	1088.4	1187.7	1084.0	1062.4
- liabilities		325.7	287.8	274.8	262.0	212.6
Net domestic assets		739.2	795.4	734.4	941.3	911.9
Domestic credits		1068.8	1011.9	911.1	1080.2	1090.9
Net credit to the government sector		104.9	236.5	189.9	294.7	302.5
- net credit to government		103.8	246.2	207.4	306.6	313.8
- net credit to NPF		1.1	-9.7	-17.5	-11.9	-11.3
Client credits of commercial banks and CNB		963.9	775.4	721.2	785.5	788.4
CZK credits		819.7	661.2	620.0	689.3	690.2
- businesses		699.1	524.2	442.5	454.6	449.9
- households		120.6	137.0	177.5	234.7	240.3
Foreign currency credits		144.2	114.2	101.2	96.2	98.2
- businesses		141.9	111.9	99.9	95.3	97.2
- households		2.3	2.3	1.3	0.9	1.0
Other net items		-329.6	-216.5	-176.7	-138.9	-179.0
Liabilities						
M2	2)	1412.3	1596.0	1647.3	1763.3	1761.7
M1	1)	497.7	583.6	692.3	809.5	796.6
Currency in circulation		171.8	180.4	197.8	221.4	223.8
CZK demand deposits		325.9	403.2	494.5	588.1	572.8
- households		195.0	230.2	270.9	327.2	350.6
- businesses		128.0	169.2	221.1	253.7	213.2
- insurance companies		2.9	3.8	2.5	7.2	9.0
Quasi money		914.6	1012.4	955.0	953.8	965.1
CZK time deposits		645.0	742.2	729.6	715.6	715.2
- households		549.8	596.6	568.0	558.7	560.6
- businesses		78.9	120.8	125.7	120.8	119.4
- insurance companies		16.3	24.8	35.9	36.1	35.2
Deposit bills of exchange and other bonds	5)	114.0	112.8	79.6	95.5	112.4
Foreign currency deposits		155.6	157.4	145.8	142.7	137.5
- households		83.7	91.5	79.4	73.0	73.1
- businesses		71.9	65.9	66.4	69.7	64.4
Monetary aggregate L	3)	1463.5	1643.9	1696.0	1787.0	1790.2
Annual percentage changes						
M1		11.1	17.3	18.6	16.9	15.6
M2		5.6	13.0	3.2	7.0	7.2
L		5.6	12.3	3.2	5.4	6.4
Client credits of commercial banks and CNB		-3.7	-19.6	-7.0	8.9	8.6
Client deposits with banks	4)	3.5	15.7	5.2	5.6	4.8

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-banking institutions
4) CZK deposits + foreign currency deposits
5) In 1998 - 2000 including certificates of deposit

CREDIT SUPPLY

	2000	2001	2002	2003	2004
	12	12	12	12	2
Non-adjusted credits					
Total credits, CZK and foreign currency					
absolute volumes in CZK billions	963.9	775.4	721.2	785.5	788.4
annual percentage changes	-3.7	-19.6	-7.0	8.9	8.6
CZK credits					
absolute volumes in CZK billions	819.7	661.2	620.0	689.3	690.2
annual percentage changes	-0.6	-19.3	-6.2	11.2	9.2
Foreign currency credits					
absolute volumes in CZK billions	144.2	114.2	101.2	96.2	98.2
annual percentage changes	-18.3	-20.8	-11.4	-4.9	5.0
Adjusted credits 1)					
Total credits, CZK and foreign currency					
absolute volumes in CZK billions	913.6	932.8	974.9	1057.6	1061.3
annual percentage changes	-4.3	2.1	4.5	8.5	8.2
CZK credits					
absolute volumes in CZK billions	771.8	811.5	861.2	948.0	949.2
annual percentage changes	-1.4	5.1	6.1	10.1	8.5
Foreign currency credits					
absolute volumes in CZK billions	141.8	121.3	113.7	109.6	112.1
annual percentage changes	-17.6	-14.5	-6.3	-3.6	6.0

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

	2000	2001	2002	2003	2004
	12	12	12	12	2
Time structure					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Short-term	36.6	37.5	34.3	30.9	29.7
Medium-term	22.2	26.0	30.9	31.4	27.7
Long-term	41.2	36.5	34.8	37.7	42.6
Sector structure					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Businesses	87.2	82.0	75.2	70.0	69.4
Households	12.8	18.0	24.8	30.0	30.6
Type structure 1)					
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0
Operating	49.3	42.6	40.9	39.2	40.7
Investment (incl, general housing construction)	30.8	35.2	29.5	25.4	25.1
Mortgage	4.1	6.7	9.6	13.2	14.1
Consumer	3.3	3.6	7.3	7.9	7.7
For privatisation	2.0	0.4	0.2	0.1	0.1
For temporary fund shortage	9.1	9.8	5.5	0.9	1.0
For securities purchase	1.4	1.7	0.4	0.7	0.7
Building savings loans			6.4	8.1	8.2
Others			0.2	4.5	2.4

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

	2000	2001	2002	2003	2004
	12	12	12	12	3
1. AVERAGE PRIBOR 1)					
- 1 day	5.23	4.63	2.75	1.98	2.00
- 7 day	5.29	4.79	2.76	2.02	2.01
- 14 day	5.29	4.78	2.76	2.03	2.02
- 1 month	5.32	4.77	2.73	2.04	2.03
- 2 month	5.36	4.72	2.67	2.06	2.04
- 3 month	5.42	4.69	2.63	2.08	2.05
- 6 month	5.60	4.62	2.60	2.13	2.12
- 9 month	5.78	4.61	2.60	2.22	2.21
- 12 month	5.90	4.62	2.60	2.30	2.30
2. AVERAGE PRIBID 1)					
- 1 day	5.11	4.53	2.65	1.88	1.90
- 7 day	5.18	4.69	2.67	1.92	1.91
- 14 day	5.19	4.69	2.67	1.93	1.92
- 1 month	5.22	4.68	2.64	1.94	1.93
- 2 month	5.26	4.62	2.57	1.96	1.94
- 3 month	5.31	4.59	2.54	1.98	1.95
- 6 month	5.49	4.52	2.51	2.03	2.02
- 9 month	5.67	4.52	2.51	2.12	2.11
- 12 month	5.79	4.52	2.51	2.20	2.20

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

FRA RATES

percentages; monthly averages

	2000	2001	2002	2003	2004
	12	12	12	12	3
3 * 6	5.68	4.49	2.52	2.23	2.21
3 * 9	5.85	4.53	2.54	2.36	2.29
6 * 9	5.93	4.53	2.52	2.47	2.37
6 * 12	6.10	4.52	2.58	2.64	2.48
9 * 12	6.19	4.54	2.61	2.77	2.58
12 * 24	.	.			
9*12 - 3*6 spread	0.51	0.05	0.10	0.55	0.37
6*12 - 3*9 spread	0.25	-0.02	0.04	0.28	0.19

IRS RATES

percentages; monthly averages

	2000	2001	2002	2003	2004
	12	12	12	12	3
1Y	5.94	4.64	2.63	2.41	2.32
2Y	6.40	4.72	2.85	2.98	2.74
3Y	6.72	4.89	3.18	3.38	3.09
4Y	6.96	5.05	3.46	3.69	3.39
5Y	7.15	5.19	3.70	3.93	3.64
6Y	7.29	5.32	3.91	4.13	3.86
7Y	7.38	5.43	4.08	4.29	4.05
8Y	7.42	5.52	4.23	4.43	4.21
9Y	7.43	5.60	4.36	4.54	4.34
10Y	7.43	5.66	4.47	4.64	4.46
15Y	.	5.85	4.77	4.97	4.86
5Y - 1Y spread	1.21	0.56	1.07	1.52	1.32
10Y - 1Y spread	1.49	1.02	1.84	2.23	2.14

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
	2W	1Y	new credits	time deposits	2W	1Y	new credits	time deposits	2W	1Y	credits
1/00	5.3	5.9	7.3	4.6	1.9	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	1.1	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	1.6	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	1.0	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	5.0	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	5.2	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	3.5	3.4	4.5	2.8	2.9	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	4.2	2.2	2.1	2.0	3.6	1.6	3.5	3.3	4.9
1/03	2.7	2.6	4.1	2.1	3.2	3.0	4.5	2.5	3.6	3.5	5.0
2/03	2.5	2.4	3.9	1.9	2.9	2.8	4.3	2.3	3.2	3.2	4.6
3/03	2.5	2.4	3.9	1.9	2.9	2.8	4.3	2.3	2.9	2.8	4.3
4/03	2.5	2.4	3.9	1.9	2.6	2.5	4.0	2.0	3.2	3.2	4.7
5/03	2.5	2.4	4.0	1.9	2.5	2.4	4.0	1.9	3.3	3.3	4.8
6/03	2.5	2.3	3.8	1.9	2.2	2.0	3.5	1.6	3.4	3.2	4.8
7/03	2.3	2.2	3.5	1.8	2.4	2.3	3.6	1.9	2.9	2.9	4.2
8/03	2.0	2.1	3.3	1.7	2.1	2.2	3.4	1.8	2.4	2.5	3.7
9/03	2.0	2.2	3.6	1.7	2.0	2.2	3.6	1.7	2.0	2.2	3.6
10/03	2.0	2.2	3.7	1.7	1.6	1.8	3.3	1.3	2.1	2.3	3.8
11/03	2.0	2.2	3.5	1.7	1.0	1.2	2.5	0.7	1.6	1.8	3.1
12/03	2.0	2.3	3.7	1.7	1.0	1.3	2.6	0.7	1.1	1.4	2.7
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	1.5	-0.5	0.4	0.7	2.2
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	1.6	-0.5	0.5	0.8	2.4
3/04	2.0	2.3			-0.5	-0.2			-0.1	0.2	

Note: real rates = nominal rates deflated by annual index (CPI/PPI) in given month
Starting from January 2004, methodology for new credits and time deposits was changed. Newly drawn credits were replaced by newly granted credits.

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	
	2W	1Y	new credits	time deposits	2W	1Y	new credits	time deposits	2W	1Y	new credits	time deposits
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	1.1	1.3	2.8	0.2								
5/00	1.1	1.4	2.8	0.2								
6/00	0.9	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	0.8	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	0.8	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	-0.3
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	2.2	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	1.9	-0.1	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1
1/03	0.2	0.1	1.6	-0.4								
2/03	0.1	0.0	1.4	-0.5								
3/03	0.0	-0.1	1.3	-0.6	0.4	0.3	1.7	-0.2	-1.7	-1.9	-0.4	-2.3
4/03	-0.1	-0.2	1.3	-0.7								
5/03	-1.2	-1.2	0.3	-1.7								
6/03	-0.7	-0.9	0.6	-1.3	-0.1	-0.3	1.2	-0.7	0.8	0.6	2.1	0.2
7/03	-1.0	-1.0	0.2	-1.5								
8/03	-1.1	-1.1	0.1	-1.4								
9/03	-1.0	-0.9	0.5	-1.4	-0.6	-0.4	1.0	-0.9	-1.0	-0.9	0.5	-1.4
10/03	-0.9	-0.8	0.6	-1.3								
11/03	-1.0	-0.8	0.4	-1.3								
12/03	-1.2	-1.0	0.4	-1.5	-0.8	-0.6	0.7	-1.1	-2.1	-1.8	-0.5	-2.4
1/04	-0.9	-0.6	2.5	-1.4								
2/04	-1.1	-0.8	1.8	-1.7								
3/04	-1.0	-0.7			-1.2	-1.0			-2.7	-2.5		

Note: real rates = nominal rates deflated by inflation expected by selected economic sectors according to the CNB statistical survey
Starting from January 2004, methodology for new credits and time deposits was changed. Newly drawn credits were replaced by newly granted credits.

KORUNA INTEREST RATES (stock of business)

%

	2000	2001	2002	2003	2004
	12	12	12	12	3
Koruna interest rates on loans provided by banks to residents:					
Households and Non-profit institutions serving households (S.14+S.15) - total		8.74	8.77	8.24	8.22
- maturity up to 1 year		8.20	10.35	11.21	12.04
- maturity over 1year up to 5 years		10.55	10.80	10.17	11.91
- maturity over 5 years		8.02	7.35	6.65	6.61
- for consumption - total			13.83	13.83	14.95
- maturity up to 1 year			13.05	14.26	15.31
- maturity over 1year up to 5 years			14.48	13.86	15.15
- maturity over 5 years			12.55	13.21	13.71
- for purchase of housing real estates - total			7.11	6.31	6.30
- maturity up to 1 year			7.67	6.24	5.19
- maturity over 1year up to 5 years			7.90	7.05	7.26
- maturity over 5 let			6.88	6.09	6.20
- other - total			6.99	7.80	7.26
- maturity up to 1 year			6.64	8.49	7.53
- maturity over 1year up to 5 years			6.34	8.02	7.47
- maturity over 5 years			7.61	7.02	6.95
Non-financial corporations (S.11) - total		6.84	5.19	4.53	4.28
- maturity up to 1 year		6.32	4.34	4.08	3.68
- maturity over 1year up to 5 years		6.93	5.47	4.64	4.36
- maturity over 5 years		7.52	6.34	5.14	5.21
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total		2.63	1.72	1.30	1.32
- one-day		1.42	0.94	0.50	0.48
- with agreed maturity - total		3.11	2.26	2.02	2.01
- with agreed maturity up to 2 years			1.68	0.96	0.98
- with agreed maturity over 2 years			3.04	2.90	2.85
- with notice - total			1.81	1.26	1.53
- with notice up to 3 months			1.93	1.67	1.86
- with notice over 3 months			1.73	0.98	1.29
- repo operations					
Non-financial corporations (S.11) - total		1.96	1.25	0.85	1.05
- one-day		1.00	0.94	0.64	0.58
- with agreed maturity - total		3.62	2.16	1.50	1.63
- with agreed maturity up to 2 years			2.15	1.49	1.62
- with agreed maturity over 2 years			3.47	3.04	4.13
- with notice - total			1.64	1.17	1.10
- with notice up to 3 months			1.60	1.14	1.09
- with notice over 3 months			2.26	1.32	1.21
- repo operations			2.42	0.75	1.98

BALANCE OF PAYMENTS 1)

in CZK millions

	1999	2000	2001	2002	2003 2)
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
A. Current account	**-50 596.4**	**-104 877.1**	**-124 478.3**	**-136 378.1**	**-157 217.9**
Balance of trade 3)	-65 830.8	-120 825.0	-116 685.0	-71 323.0	-69 392.0
exports	908 756.0	1 121 099.0	1 269 634.0	1 254 394.0	1 371 810.0
imports	974 586.8	1 241 924.0	1 386 319.0	1 325 717.0	1 441 202.0
Services	41 501.3	54 559.8	57 984.9	21 850.8	13 236.7
credit	243 851.0	264 806.2	269 689.6	231 131.1	219 151.1
transport	53 520.3	53 734.3	57 492.3	56 560.5	60 556.3
travel	109 142.0	115 071.0	118 133.0	96 289.2	100 310.1
others	81 188.7	96 000.9	94 064.3	78 281.4	58 284.7
debit	202 349.7	210 246.4	211 704.7	209 280.3	205 914.4
transport	27 071.4	27 543.0	30 570.5	29 332.8	33 725.7
travel	51 760.0	49 370.0	52 802.0	51 549.3	54 419.2
others	123 518.3	133 333.4	128 332.2	128 398.2	117 769.5
Income	-46 673.6	-52 978.4	-83 548.9	-115 615.0	-116 644.7
credit	64 298.3	75 439.1	84 892.3	66 790.1	74 410.3
debit	110 971.9	128 417.5	168 441.2	182 405.1	191 055.0
Current transfers	20 406.7	14 366.5	17 770.7	28 709.1	15 582.1
credit	45 394.4	36 594.6	36 404.9	46 709.0	46 773.7
debit	24 987.7	22 228.1	18 634.2	17 999.9	31 191.6
B. Capital account	**-73.2**	**-198.2**	**-330.7**	**-119.4**	**-82.2**
credit	637.3	223.4	90.4	221.0	198.2
debit	710.5	421.6	421.1	340.4	280.4
Total A + B	*-50 669.6*	*-105 075.3*	*-124 809.0*	*-136 497.5*	*-157 300.1*
C. Financial account	**106 564.4**	**148 046.6**	**172 849.9**	**347 827.4**	**163 854.2**
Direct investment	215 703.9	190 767.4	208 296.1	270 930.2	66 353.0
abroad	-3 107.6	-1 653.7	-6 289.2	-6 759.3	-6 546.5
equity capital and reinvested earnings	-2 585.3	-1 245.9	-5 848.5	-5 376.8	-324.1
other capital	-522.3	-407.8	-440.7	-1 382.5	-6 222.4
in the Czech Republic	218 811.5	192 421.1	214 585.3	277 689.5	72 899.5
equity capital and reinvested earnings	192 615.5	171 777.2	185 981.4	270 061.0	66 811.9
other capital	26 196.0	20 643.9	28 603.9	7 628.5	6 087.6
Portfolio investment	-48 268.9	-68 172.9	34 857.3	-46 748.7	-37 715.0
assets	-65 608.0	-86 631.8	4 405.6	-75 602.1	-85 888.6
equity securities	-48 965.2	-44 181.0	9 447.8	-7 807.9	5 630.5
debt securities	-16 642.8	-42 450.8	-5 042.2	-67 794.2	-91 519.1
liabilities	17 339.1	18 458.9	30 451.7	28 853.4	48 173.6
equity securities	4 394.2	23 810.9	23 203.6	-9 035.7	30 133.5
debt securities	12 944.9	-5 352.0	7 248.1	37 889.1	18 040.1
Financial derivatives	0.0	-1 402.8	-3 220.3	-4 281.7	3 860.1
assets		-4 501.6	-9 407.6	-15 458.4	7 083.7
liabilities		3 098.8	6 187.3	11 176.7	-3 223.6
Other investment	-60 870.6	26 854.9	-67 083.2	127 927.6	131 356.1
assets	-91 273.9	35 832.1	-46 144.5	133 121.8	67 045.4
long-term	-23 884.0	21 322.2	1 325.8	28 711.4	1 115.4
CNB					
commercial banks	-25 858.5	14 362.2	-4 125.8	5 271.7	-999.9
government	977.5	2 937.0	6 928.9	25 333.6	5 688.4
other sectors	997.0	4 023.0	-1 477.3	-1 893.9	-3 573.1
short-term	-67 389.9	14 509.9	-47 470.3	104 410.4	65 930.0
commercial banks	-63 804.7	22 001.9	-45 523.2	122 163.8	44 971.2
government			-87.1	-2 237.4	2 193.8
other sectors	-3 585.2	-7 492.0	-1 860.0	-15 516.0	18 765.0
liabilities	30 403.3	-8 977.2	-20 938.7	-5 194.2	64 310.7
long-term	-1 286.1	-26 212.5	-4 262.6	2 853.8	21 349.6
CNB	-2 083.5	-22.8	-22.0	-20.2	-20.4
commercial banks	-7 109.5	-31 523.7	-7 222.2	-8 059.2	-1 663.8
government	-6 384.3	-1 837.6	-5 000.8	-1 517.2	10 304.7
other sectors	14 291.2	7 171.6	7 982.4	12 450.4	12 729.1
short-term	31 689.4	17 235.3	-16 676.1	-8 048.0	42 961.1
CNB	84.9	-17.0	59.7	-24.3	-21.4
commercial banks	36 615.6	-3 812.5	-35 688.6	-3 871.2	37 899.4
government	-103.2				
other sectors	-4 907.9	21 064.8	18 952.8	-4 152.5	5 083.1
Total A + B + C	*55 894.8*	*42 971.3*	*48 040.9*	*211 329.9*	*6 554.1*
D. Net errors and omissions. valuation changes	**1 241.9**	**-11 378.5**	**19 112.1**	**5 615.1**	**6 349.3**
Total A + B + C + D	*57 136.7*	*31 592.8*	*67 153.0*	*216 945.0*	*12 903.4*
E. Change in reserves (- increase)	**-57 136.7**	**-31 592.8**	**-67 153.0**	**-216 945.0**	**-12 903.4**

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

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	1999	2000	2001	2002	2003
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	31 Dec. 1)
ASSETS	1 347 954.9	1 448 400.7	1 544 963.0	1 579 922.9	1 527 647.8
Direct investment abroad	25 114.9	27 899.3	41 176.1	44 397.1	49 040.0
- equity capital	22 415.9	24 797.5	37 633.6	39 472.1	38 005.0
- other capital	2 699.0	3 101.8	3 542.5	4 925.0	11 035.0
Portfolio investment	104 345.3	180 431.3	185 138.6	274 344.7	343 854.4
- equity securities	66 318.2	92 222.9	68 675.5	86 464.7	47 337.7
- debt securities	38 027.1	88 208.4	116 463.1	187 880.0	296 516.7
Financial derivatives 2)		6 347.2	15 754.8	31 213.2	24 129.5
Other investment	757 065.5	736 903.7	778 435.7	515 356.2	419 109.0
Long-term	323 131.1	315 625.5	310 133.9	179 639.6	157 598.6
- CNB 3)		329.1	307.3	280.9	468.4
- commercial banks	89 900.1	75 537.9	79 663.7	67 966.9	66 121.3
- government 4)	210 221.3	220 777.8	210 694.9	97 156.8	79 483.9
- other sectors	23 009.7	18 980.7	19 468.0	14 235.0	11 525.0
Short-term	433 934.4	421 278.2	468 301.8	335 716.6	261 510.4
- CNB 5)		52.9	51.2	376.7	98.8
- commercial banks	336 117.2	314 115.3	359 638.5	213 815.4	161 140.9
of which: gold and foreign exchange 6) 7)	218 995.8	228 961.7	257 138.5	163 032.9	115 875.5
- government			87.1	2 324.5	130.7
- other sectors	97 817.2	107 110.0	108 525.0	119 200.0	100 140.0
CNB reserves 8)	461 429.2	496 819.2	524 457.8	714 611.7	691 514.9
- gold 6)	677.0	4 640.4	4 469.9	4 653.8	4 784.3
- SDR		7.7	31.0	137.1	238.7
- reserve position in the IMF		116.0	5 478.3	7 081.5	11 949.9
- foreign exchange	460 752.2	491 001.2	514 188.0	686 516.1	674 451.8
- other reserve assets		1 053.9	290.6	16 223.2	90.2
LIABILITIES	1 458 893.3	1 640 270.0	1 789 030.7	1 977 177.7	2 143 363.3
Direct investment in the Czech Republic	631 505.3	818 411.6	982 335.0	1 165 529.1	1 219 263.4
- equity capital	538 379.3	702 217.8	837 537.3	1 013 102.9	1 063 633.4
- other capital	93 126.0	116 193.8	144 797.7	152 426.2	155 630.0
Portfolio investment	165 579.2	164 592.0	180 346.2	201 120.0	248 782.8
- equity securities	98 011.8	115 670.6	128 740.1	128 097.7	165 951.0
- debt securities	67 567.4	48 921.4	51 606.1	73 022.3	82 831.8
Financial derivatives 2)		5 307.9	11 495.2	22 671.9	19 448.3
Other investment	661 808.8	651 958.5	614 854.3	587 856.7	655 868.8
Long-term	379 172.2	352 323.4	332 593.2	326 321.3	355 276.9
- CNB	197.1	180.4	133.4	114.5	96.1
- commercial banks	118 368.9	84 607.4	73 688.6	63 541.0	61 454.0
- government	20 852.9	19 699.2	9 476.2	9 475.8	22 456.0
- other sectors	239 753.3	247 836.4	249 295.0	253 190.0	271 270.8
Short-term	282 636.6	299 635.1	282 261.1	261 535.4	300 591.9
- CNB	25.8	8.8	68.5	44.2	22.8
- commercial banks	229 988.7	226 176.2	190 487.6	176 196.2	208 534.1
- government					
- other sectors	52 622.1	73 450.1	91 705.0	85 295.0	92 035.0
NET INVESTMENT POSITION	-110 938.4	-191 869.3	-244 067.7	-397 254.8	-615 715.5

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

	1999	2000	2001	2002	2003
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	31 Dec. 1)
DEBT IN CONVERTIBLE CURRENCIES	813 576.5	808 122.8	811 258.1	813 305.2	894 330.6
of which:					
Long-term	497 872.1	464 323.8	465 687.8	498 833.8	538 585.7
By debtor					
- CNB	12 527.6	180.4	133.4	114.5	96.1
- commercial banks	128 703.3	95 737.1	88 401.4	80 063.7	76 674.1
- government	32 303.5	29 753.5	30 839.2	47 701.3	69 029.9
- other sectors	324 337.7	338 652.8	346 313.8	370 954.3	392 785.6
By creditor					
- foreign banks	257 410.0	228 709.6	229 305.5	230 589.8	246 533.0
- government institutions	4 239.2	3 405.7	2 373.6	1 747.2	
- multilateral institutions	58 202.2	67 521.2	70 879.0	69 894.7	83 779.6
- suppliers and direct investors	93 831.4	99 560.2	105 944.3	118 829.4	116 880.0
- other investors	84 189.3	65 127.1	57 185.4	77 772.7	91 393.1
Short-term	315 704.4	343 799.0	345 570.3	314 471.4	355 744.9
By debtor					
- CNB	25.8	8.8	68.5	44.2	22.8
- commercial banks	230 000.5	226 246.1	192 438.4	177 474.4	210 017.1
- government	7.0	2 115.0	465.0	761.0	710.0
- other sectors	85 671.1	115 429.1	152 598.4	136 191.8	144 995.0
By creditor					
- foreign banks	201 808.8	203 333.8	192 126.4	168 200.7	219 391.2
- suppliers and direct investors	81 794.6	106 988.6	116 278.4	112 256.8	101 210.0
- other investors	32 101.0	33 476.6	37 165.5	34 013.9	35 143.7
DEBT IN NON-CONVERTIBLE CURRENCIES	8 925.7	8 950.9	0.0	0.0	0.0
of which:					
- long-term	8 925.7	8 950.9			
- short-term					
TOTAL EXTERNAL DEBT	822 502.2	817 073.7	811 258.1	813 305.2	894 330.6
of which:					
- long-term	506 797.8	473 274.7	465 687.8	498 833.8	538 585.7
- short-term	315 704.4	343 799.0	345 570.3	314 471.4	355 744.9

1) Preliminary data

EXCHANGE RATES

A. NOMINAL RATE

in CZK; foreign exchange market rates

	2000	2001	2002	2003	2004
	1-12	1-12	1-12	1-12	1-3
CZK EXCHANGE RATE AGAINST SELECTED CURRENCIES					
- annual/quarterly averages					
1 EUR	35.61	34.08	30.81	31.84	32.86
1 USD	38.59	38.04	32.74	28.23	26.30
100 SKK	83.64	78.68	72.22	76.75	81.03
	12	12	12	12	3
- monthly averages					
1 EUR	34.82	32.59	31.19	32.31	32.98
1 USD	38.94	36.48	30.65	26.32	26.90
100 SKK	80.07	75.61	74.67	78.57	81.65
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	30 Mar.
- last day of the month					
1 EUR	35.09	31.98	31.60	32.41	32.84
1 USD	37.81	36.26	30.14	25.65	26.86
100 SKK	79.70	74.81	75.18	78.71	81.87

B. NOMINAL EFFECTIVE RATE

	2000	2001	2002	2003	2004
					3
CZK nominal effective exchange rate (percentages) (2000=100)					
weights - foreign trade turnover	100.0	104.3	116.5	116.0	112.8
weights - foreign trade turnover SITC 5-8	100.0	104.4	116.1	115.6	111.9

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2000, 23 countries which account for around 90% of the Czech Republic's foreign 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

	2000	2001	2002	2003	2004
					2
CZK real effective exchange rate (percentages) (2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	100.0	104.0	114.9	111.2	109.4
weights - foreign trade turnover SITC 5-8	100.0	104.6	115.6	112.0	110.2
b) consumer prices					
weights - foreign trade turnover	100.0	105.5	116.7	112.6	111.0
weights - foreign trade turnover SITC 5-8	100.0	106.2	117.5	113.4	111.6

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

PUBLIC FINANCES

in CZK billions

	2000	2001	2002	2003	2004
	1-12	1-12	1-12	1-12	1-3
STATE BUDGET					
TOTAL REVENUE	586.2	626.2	705.0	699.7	186.8
Tax revenue	559.5	598.3	627.4	667.5	173.3
Taxes on income, profits and capital gains	87.0	147.4	159.0	172.9	41.8
Domestic taxes on goods and services	216.8	187.0	186.9	198.4	55.4
- value-added taxes	145.9	121.3	118.1	125.6	34.4
- excises	70.9	65.7	68.9	72.9	21.0
Taxes on international trade and transactions	13.6	10.0	9.8	10.2	2.5
Taxes on property	6.0	6.4	7.9	8.8	2.2
Social and health security contributions and payroll taxes	222.2	242.3	258.5	272.4	70.0
Non-tax and capital incomes and received subsidies	26.7	27.9	77.7	32.2	13.5
TOTAL EXPENDITURE	632.3	693.9	750.8	808.7	194.6
Current expenditure	571.4	642.5	697.3	745.4	188.2
Capital expenditure	60.9	51.4	53.5	63.3	6.5
Public budgets (balance in IMF GFS methodology)	-62.0	-52.3	-11.8	-134.2	
state budget	-46.1	-67.7	-45.7	-109.1	-7.8
local budget	-2.5	-11.2	-4.3	-5.5	
state financial assets	-5.7	.	.	.	
state funds	2.6	11.2	12.3	7.4	
Land Fund	-0.5	-0.1	-0.5	-0.7	
National Property Fund	-11.5	13.2	28.4	-27.0	
health insurance companies	2.1	1.4	-1.2	-0.3	
others	-0.4	0.9	-0.8	1.0	

CAPITAL MARKET

A. STOCK MARKET INDICES

last day of the month in points

	2000	2001	2002	2003	2004
	12	12	12	12	3
BCPP					
PX 50	478.5	394.6	460.7	659.1	823.8
PX-D	1366.0	1065.6	1166.4	1642.7	2056.8
PX-GLOB	570.6	492.9	576.8	816.9	1001.2
RM-SYSTÉM					
PK-30	724.8	593.0	672.5	947.5	1168.7

B. TRADE VOLUMES

in CZK millions

	2000	2001	2002	2003	2004
	12	12	12	12	3
BCPP					
Monthly trade volumes	73 240.5	142 803.6	109 264.8	98 640.0	131 198.9
of which:					
a) shares	11 113.9	12 819.3	17 089.3	28 296.0	48 441.2
b) units	61.3	4.3	0.0	0.0	0.0
c) bonds	62 065.3	129 980.0	92 175.5	70 344.0	82 757.7
RM-SYSTÉM					
Monthly trade volumes	4 861.7	2 162.5	4 412.1	1 103.0	323.0
of which:					
a) shares	4 190.1	1 841.0	298.4	1 082.5	298.1
b) units	25.9	212.2	1.0	3.7	1.1
c) bonds	645.7	109.3	4 112.7	16.8	23.8

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
	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		
	2003				
31 January	2.50	1.50	3.50		
26 June	2.25	1.25	3.25		
1 August	**2.00**	**1.00**	**3.00**		

MACROECONOMIC AGGREGATES

in CZK millions; annual percentage changes; constant 1995 prices

	1999	2000	2001	2002	2003
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
GROSS DOMESTIC PRODUCT					
- in CZK millions	1 421 043	1 467 285	1 512 626	1 542 221	1 587 182
- percentages	0.5	3.3	3.1	2.0	2.9
FINAL CONSUMPTION					
- in CZK millions	1 042 354	1 058 969	1 102 058	1 150 738	1 197 491
- percentages	1.9	1.6	4.1	4.4	4.1
of which:					
Households					
- in CZK millions	765 638	783 454	813 026	845 111	891 523
- percentages	1.9	2.3	3.8	3.9	5.5
Government					
- in CZK millions	266 199	263 628	277 719	293 540	293 594
- percentages	2.3	-1.0	5.3	5.7	0.0
Non-profit institutions					
- in CZK millions	10 517	11 887	11 313	12 087	12 374
- percentages	-11.4	13.0	-4.8	6.8	2.4
GROSS CAPITAL FORMATION					
- in CZK millions	467 412	511 229	547 829	554 934	577 852
- percentages	-2.9	9.4	7.2	1.3	4.1
of which:					
Fixed capital					
- in CZK millions	463 128	487 874	514 934	518 193	537 129
- percentages	-1.0	5.3	5.5	0.6	3.7
Changes in inventories					
- in CZK millions	3 880	22 990	32 513	36 351	40 324
Acquisitions less disposals of valuables					
- in CZK millions	404	365	382	390	399
- percentages	-19.5	-9.7	4.7	2.1	2.3
TRADE BALANCE					
- in CZK millions	-88 723	-102 913	-137 261	-163 451	-188 161
of which:					
Exports of goods					
- in CZK millions	809 783	971 784	1 109 242	1 174 839	1 279 124
- percentages	8.4	20.0	14.1	5.9	8.9
Exports of services					
- in CZK millions	211 548	223 676	228 169	199 596	186 950
- percentages	-1.8	5.7	2.0	-12.5	-6.3
Imports of goods					
- in CZK millions	920 348	1 106 476	1 275 437	1 329 758	1 451 503
- percentages	5.1	20.2	15.3	4.3	9.2
Imports of services					
- in CZK millions	189 706	191 897	199 235	208 128	202 732
- percentages	7.2	1.2	3.8	4.5	-2.6
FINAL DOMESTIC DEMAND					
- in CZK millions	1 505 482	1 546 843	1 616 992	1 668 931	1 734 620
- percentages	1.0	2.7	4.5	3.2	3.9
AGGREGATE DOMESTIC DEMAND					
- in CZK millions	1 509 766	1 570 198	1 649 887	1 705 672	1 775 343
- percentages	0.3	4.0	5.1	3.4	4.1
GROSS DOMESTIC PRODUCT AT CURRENT PRICES					
- in CZK millions	1 902 293	1 984 833	2 175 238	2 275 609	2 410 123
- percentages	3.4	4.3	9.6	4.6	5.9

Source: CZSO

LABOUR MARKET

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR

annual percentage changes

	1999	2000	2001	2002	2003
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
Current income	3.9	4.8	5.6	5.2	5.6
of which:					
- gross operating surplus and mixed income	5.2	3.0	6.6	1.4	7.7
- compensation of employees	3.8	4.9	7.1	6.4	5.9
- property income	-15.8	-7.0	-0.4	-8.9	3.5
- social benefits other than social transfers in kind	8.6	9.6	5.9	7.5	3.8
- other current transfers	20.5	10.2	-10.7	15.6	1.2
Current expenditure	5.3	4.8	6.6	8.1	6.7
of which:					
- property income	-11.9	-8.4	1.9	12.5	12.0
- current taxes on income. wealth. etc.	2.5	3.8	4.7	13.9	4.3
- social contributions	4.9	5.9	8.9	5.9	6.2
- other current transfers	20.3	5.6	-0.2	9.1	11.4
Gross disposable income	3.3	4.8	5.1	3.9	5.0
Change in net equity of households in pension funds reserves	-20.0	24.6	47.2	5.8	13.9
Individual consumption expenditure	5.7	5.3	7.6	3.8	5.6
Gross saving	-18.7	0.6	-20.7	4.9	-2.8
Gross savings rate	8.33	8.00	6.04	6.10	5.64
(gross saving/gross disposable income - ratio in per cent)					

B. AVERAGE WAGES

annual percentage changes

	1999	2000	2001	2002	2003
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
Overall nominal wage	7.5	5.9	8.1	7.0	6.4
Business sector	6.2	6.9	7.7	6.3	5.5
Non-business sector	12.7	2.6	9.6	9.8	9.8
Overall real wage	5.3	1.9	3.2	5.1	6.3
Business sector	4.0	2.9	2.9	4.4	5.4
Non-business sector	10.4	-1.3	4.7	7.9	9.7

C. UNEMPLOYMENT

end of period

	1999	2000	2001	2002	2003
	12	12	12	12	12
Registered job applicants (thousands)	487.6	457.4	461.9	514.4	542.4
Unemployment rate (percentages)	9.4	8.8	8.9	9.8	10.3

Source: CZSO

PRODUCER PRICES

percentage changes

	2000	2001	2002	2003	2004
					3
INDUSTRIAL PRODUCER PRICES					
a) previous month = 100	0.4	0.1	-0.1	0.1	0.8
b) same period of last year = 100	4.9	2.9	-0.5	-0.3	2.1
c) average for 2000 = 100	0.0	2.8	2.3	1.9	4.7
d) December 1999 = 100	3.4	6.3	5.8	5.4	8.3
CONSTRUCTION WORK PRICES					
a) previous month = 100	0.4	0.3	0.2	0.2	0.4
b) same period of last year = 100	4.0	4.1	2.7	2.2	2.5
c) average for 2000 = 100	0.0	4.1	6.9	9.2	11.3
d) December 1999 = 100	2.3	6.5	9.3	11.7	13.9
AGRICULTURAL PRODUCER PRICES					
b) same period of last year = 100	9.2	8.4	-9.5	-2.9	18.7
of which:					
crop products					
b) same period of last year = 100	12.6	9.3	-4.6	-1.0	45.0
livestock products					
b) same period of last year = 100	8.0	8.0	-12.1	-4.0	3.3
MARKET SERVICES PRICES (excluding interest rates)					
a) previous month = 100	0.4	0.1	0.3	0.0	0.8
b) same period of last year = 100	3.4	3.9	3.2	1.6	2.6
c) average for 2000 = 100	0.0	4.0	7.3	9.0	11.9
d) December 1999 = 100	0.6	4.6	8.0	9.7	12.6

Source: CZSO

RATIOS OF KEY INDICATORS TO GDP

percentage ratios

	1999	2000	2001	2002	3003
State budget balance	-1.6	-2.3	-3.1	-2.0	-4.5
Public budgets balance	-0.6	-3.1	-2.4	-0.5	-5.6
Public debt	15.1	17.7	23.8	24.8	28.7
Debt in convertible currencies	42.8	40.7	37.3	35.7	37.1
Trade balance 1)	-3.4	-6.1	-5.4	-3.1	-2.9
Current account balance	-2.7	-5.3	-5.7	-6.0	-6.5
M2	70.3	71.2	73.4	72.4	73.2

Note: ratio = indicator/GDP at current prices
1) Source: CZSO

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