INFLATION REPORT / APRIL

2005

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

CCA	Czech Consolidation Agency
CMKOS	Czech–Moravian Confederation of Trade Unions
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
EURIBOR	Euro Interbank Offered Rate
FDI	foreign direct investment
Fed	Federal Reserve System (the central banking system in the USA)
FOMC	Federal Open Market Committee
FRA	forward rate agreement
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Organisation
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.)
O/N	overnight
PPI	producer price index
PRIBID	Prague Interbank Bid Rate
PRIBOR	Prague Interbank Offered Rate
(1W, 1M, 1Y)	(one-week, one-month, one-year)
repo rate	repurchase agreement rate
USD	US dollar
VAT	value added tax
WTI	West Texas Intermediate crude oil

In 1998, the Czech National Bank switched to direct inflation targeting. 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 publishing of regular 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 5 May 2005. The annex to this Inflation Report is a Czech National Bank press release on the reform of the Stability and Growth Pact.

Unless stated otherwise, the sources of the data contained in this Inflation Report are the CZSO or the CNB. All the Inflation Reports published to date are available on the CNB website at http://www.cnb.cz.

Chart I.1
Inflation fluctuated just below the lower boundary of the target band in 2005 Q1
(annual consumer price inflation; percentages)

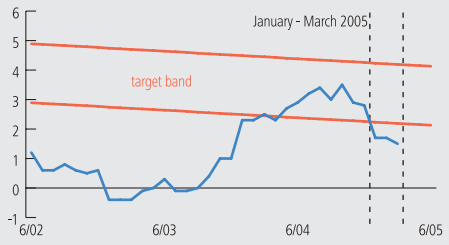


Table I.1
Inflation fell in 2005 Q1
(annual percentage changes unless otherwise indicated)

	12/04	01/05	02/05	03/05
Consumer price inflation	2.8	1.7	1.7	1.5
Industrial producer price inflation	7.7	7.2	7.1	6.4
Money supply growth (M2)	4.4	4.2	4.7	x
3M PRIBOR[a] (in per cent)	2.6	2.5	2.3	2.1
Nominal CZK/EUR exchange rate[a] (level)	30.65	30.31	29.96	29.78
State budget balance since January incl. SFAOs[b] (CZK bn)	-93.7	3.5	-2.6	8.2
GDP growth at constant prices[c]	4.3			x
Unemployment rate[b] (in per cent)	10.3	10.7	10.6	10.3

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

The slowdown in annual consumer price inflation during 2005 Q1 took inflation below the lower boundary of the target band (see Chart I.1). The growth rate of the Czech economy in 2004 Q4, as in 2004 as a whole, rose modestly. The situation on the labour market further improved during 2004 Q4 and 2005 Q1. The decline in interest rates, especially at longer maturities, continued into Q1 this year. The koruna's exchange rate appreciated further in this period.

Inflation fluctuated below the 2% level in 2005 Q1 and was more than one percentage point lower than in the previous quarter. All the main price categories contributed to this substantial slowdown. The falling food prices reflect a substantial year-on-year decline in prices of agricultural products of vegetable origin. The growth contribution of adjusted inflation and changes to indirect taxes was roughly half that in the previous quarter, and in the case of regulated prices it was down by a quarter. The impact of high prices of energy-producing materials and metals on world markets on domestic prices continued to be cushioned by appreciation of the koruna's exchange rate against the dollar.

The growth rate of the Czech economy picked up further in 2004 Q4 even by comparison with the higher revised growth rates in previous quarters. The robust growth recorded the previous year thus continued. The external sector accounted for more than three-quarters of the growth of the Czech economy, as a result of a growing lead of annual growth in goods and services exports over growth in imports. Among other things, entry into the EU has contributed to high foreign trade dynamics. To a lesser extent, the economic growth was also attributable to fixed investment and household consumption, although their contributions gradually diminished as the year progressed. The negative contribution of government consumption to Czech economic growth seen throughout 2004 increased further in Q4.

The labour market situation further improved in 2004 Q4 and 2005 Q1 thanks to the pick-up in Czech economic growth and continuing foreign direct investment inflows. This manifested itself in renewed growth in employment in 2004 Q4 and in a rise in the number of vacancies and a slight decline in unemployment in 2005 Q1. Wage growth slowed again in 2004 Q4 relative to the previous quarter. Wages grew at roughly the same rate in the business and non-business sectors.

On the money market in 2005 Q1 there was a continuing fall in interest rates, particularly at longer maturities. This decline reflected the two monetary policy rate cuts in Q1 and the expected evolution of these rates in the remainder of the year. The main trend on the foreign exchange market in Q1 was a continuing appreciation of the koruna-euro exchange rate and, in the final two months of Q1, the koruna-dollar exchange rate as well.

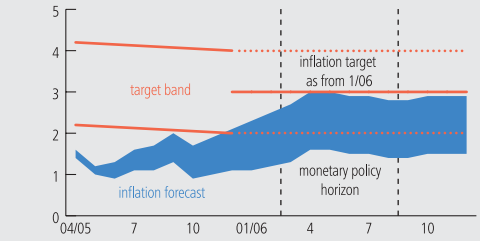
The monetary policy decision-making of the CNB Bank Board in 2005 Q1 was based on the inflation forecast discussed by the Board at its meeting on 27 January 2005 and published in the January Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in the first half of 2006. According to the forecast, inflation in this period should be slightly below the point inflation target. Consistent with the forecast was a slight decline in interest rates in 2005 H1, with growth in rates deferred to 2006 H1.

At its meeting at the end of January, the Bank Board decided by a majority of the votes cast to lower the monetary policy interest rates by 0.25 percentage point with effect from 28 January 2005. A number of arguments were made at the January meeting in favour of lowering interest rates: the GDP time series revision for 2003, the more

restrictive impact of fiscal policy in 2004, considerable exchange rate appreciation, and lower external demand. In the months that followed, the risks developed in the anti-inflationary direction, so at its meeting at the end of March, the Board decided unanimously to lower monetary policy rates by a further 0.25 percentage point with effect from 1 April 2005.

As usual, section IV of this Inflation Report describes the CNB's new forecast. The April forecast does not deviate significantly from previous forecasts, as it predicts continuing relatively high economic growth based on exports and investment. Nevertheless, the closure of the output gap is deferred to 2006 H2. Underlying this is a downward revision of foreign demand, tighter initial monetary conditions and the slower unwinding of anti-inflationary demand pressures observed in the past. The revision of the estimate of future demand pressures, proxied by the output gap, together with a revision of the import price trend leads to a downscaling of the inflation forecast over the entire forecast horizon. At the monetary policy horizon, the forecast is thus below the CNB's point inflation target. Consistent with the April forecast and its assumptions is a decline in interest rates in the near future and their subsequent stability.

Chart I.2
The inflation forecast is below the point inflation target at the monetary policy horizon
(annual consumer price inflation; percentages)



Several alternative scenarios were drawn up together with the baseline scenario. As in January, the CNB analysed the sensitivity of the forecast to fiscal policy developments. It also considered alternative scenarios of lower external growth and lower pass-through of the exchange rate into prices. The sensitivity analysis is delimited by two extreme scenarios. The first assumes that this year's fiscal impulse will be distributed over two years and generates the need for slightly easier monetary policy this year. The second assumes a higher fiscal impulse this year and a slightly negative fiscal impulse next year. This scenario results in the need for slightly tighter monetary policy than in the baseline scenario. The alternative scenario of lower external growth leads to slower closure of the output gap and appreciation pressures on the exchange rate, which monetary policy faces with easier monetary policy. The alternative scenario of lower pass-through of the exchange rate into prices produces the opposite message.

The annex to this Inflation Report is a Czech National Bank press release on the reform of the Stability and Growth Pact approved by the European Council on 22–23 March this year. The Bank Board noted with concern that the changes will significantly weaken the Pact, particularly with regard to its transparency, the enforcement of its objectives and the principle of equal treatment. The changes may also endanger the stable and non-inflationary trend in the European Union.

II.1 PAST INFLATION DEVELOPMENTS

The gradual and long-running rise in annual inflation – which had started at the beginning of 2003 – peaked in October 2004. In November inflation started declining, recording its largest fall (of 1.1 percentage point) between December 2004 and January 2005. After stagnating in February, inflation dropped only moderately in March, recording an annual outturn of 1.5%. The inflation rate also fell, to stand at 2.6%[1] in March.

The slowdown in annual consumer price inflation during 2005 Q1 was seen in all the main components of inflation. Underlying this trend were various factors of both external and domestic origin. The effects of the external factors and year-on-year appreciation of the koruna exchange rate were observed primarily in prices of tradable non-food commodities. Slower food price growth was closely linked with a significant fall in inflation in the agricultural producer segment. The reduction in consumer price inflation was also due to smaller changes to prices of regulated items at the beginning of 2005 compared to the same period of the previous year.

The relatively wide spectrum of consumer basket categories that contributed to the reduction in consumer price inflation in 2005 Q1 suggested that the still quite rapidly rising prices of energy-producing materials and metals on world markets – with the exception of fuels – were still not passing through into consumer prices at the beginning of 2005. Their effects on import prices of raw materials continued to be significantly dampened by year-on-year appreciation of the koruna-dollar rate. Import prices were declining year on year overall by the beginning of 2005, although the developments within the individual categories were mixed. The number of import categories with falling prices prevailed, but prices of imported raw materials continued to rise year on year. The continuing high overall growth in producer prices in industry was also not across the board in nature. Only in industrial branches engaged directly in processing the aforementioned raw materials and semi-manufactures made from them, as well as the chemical industry and manufacture of metal products, did prices rise quickly. In most other branches, the secondary effect of the higher import prices of energy-producing materials and metals was insignificant. Prices in these branches recorded either modest year-on-year growth or a fall (especially in the case of products with a higher degree of processing).

Developments on the demand side had yet to create conditions for growth in prices. Economic growth was relatively buoyant in 2004, but the economy remained below potential output. Consumer demand fell in year-on-year terms during 2004, and its growth was low at the end of 2004. Competition on the retail market remained strong, bolstered by the entry of new retailers. Higher inflation was also counteracted by strong foreign competition, indicated chiefly by mostly falling prices of imports for final consumption. Corporations responded to the strong competition by rationalising their production activities. This was reflected, among other things, in a declining personnel cost-output ratio in industry. As in previous quarters, the positive terms of trade also gave exporters some leeway to offset the rising prices of imported inputs.

Overall, anti-inflationary factors prevailed in the economy at the beginning of 2005. This was evidenced by the prevailing number of consumer basket categories showing either slower price growth or a greater price decline at the end of the first quarter. Only two

CHART II.1
Annual inflation declined further in 2005 Q1
(percentages)

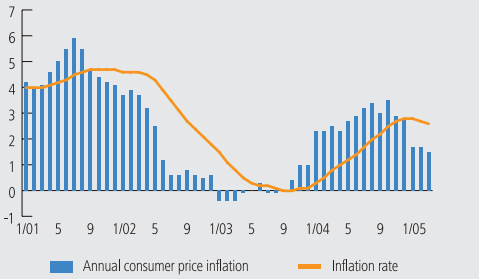
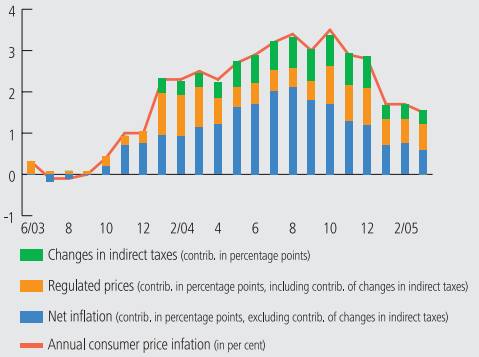


TABLE II.1
Most of the consumer basket categories recorded either slower growth or a faster decline in prices in 2005 Q1
(annual percentage changes)

	9/04	10/04	11/04	12/04	1/05	2/05	3/05
Consumer prices	3.0	3.5	2.9	2.8	1.7	1.7	1.5
Food and non-alcoholic beverages	3.6	2.4	0.4	0.9	-0.5	-0.2	-0.4
Alcoholic beverages and tobacco	4.1	4.2	3.8	3.5	3.8	3.9	3.7
Clothing and footwear	-3.9	-3.1	-3.1	-3.1	-4.3	-4.6	-4.8
Housing, water, electricity, gas and other fuels	2.8	4.4	4.4	4.4	3.5	3.4	3.4
Furnishings, household equipment and routine maintenance of the house	-1.8	-1.9	-1.9	-2.0	-2.2	-2.2	-2.2
Health	3.6	3.5	3.7	3.6	7.7	7.8	7.9
Transport	2.0	2.9	2.8	1.4	-1.8	-2.0	-2.5
Communication	11.5	13.0	12.9	12.9	-2.6	-2.4	-2.4
Recreation and culture	2.6	2.0	1.7	1.7	2.2	2.5	2.3
Education	6.2	5.4	5.4	5.4	2.4	2.7	2.9
Hotels and restaurants	7.7	8.0	7.9	7.9	7.7	8.0	7.8
Miscellaneous goods and services	4.6	4.1	4.3	4.4	2.5	2.2	1.8

CHART II.2
Market prices and regulated prices contributed to the fall in annual consumer price inflation in 2005 Q1



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

of the twelve categories recorded an annual rise in prices (health, and recreation and culture); in both cases the increase was only slight.

The above factors chiefly affected market prices as measured by net inflation[2], whose growth moderated by 0.8 percentage point compared to the end of 2004, to 0.7%. Slowing growth in prices was recorded for food and non-food commodities, and in both cases annual inflation was by now below 1%.

The contribution of non-food commodities[3] to the slowdown in consumer price inflation was greater than that of food. Their annual decline to 0.9% in Q1 was linked primarily with prices of tradable commodities. Prices of these commodities have long been falling, and in 2005 Q1 the decline deepened significantly (to -3.8%). The main cause was probably annual appreciation of the koruna-euro rate, since prices of tradable commodities are affected by foreign competition via prices of consumer products imported into the domestic market. When analysing movements in prices of tradable commodities one should also take into account the fact that prices of many consumer products were falling year on year on foreign markets. Prices of consumer products in the domestic consumer market declined year on year particularly in the categories of clothing and footwear, recreation and culture, and consumer electronics.

Conversely, prices of nontradable market commodities – affected mostly by factors of domestic origin – continued to show high growth by comparison with the other items of the consumer basket (5.1% in March). Relatively fast growth was recorded mainly in the health, education, recreation and housing categories. After having stagnated in November and December 2004, however, annual growth in nontradable market commodities prices also eased slightly in Q1 (see Chart II.3).

The further moderation of annual food price inflation[4] in 2005 Q1 (to 0.4%) indicated a continuation of the trend visible since September last year. The causes of this remain the same – a continuing sizeable year-on-year decline in agricultural producer prices in crop production, which, with a short lag, passed through into producer prices in the food industry and subsequently into food prices on the consumer market. Most of the other commodities in the food price index did not experience any major changes in price trend. Their growth remained moderate, fluctuating around the level reached in the previous quarter.

The biggest change was recorded by fuel prices. A gradual deepening of the year-on-year fuel price decline during 2005 Q1 (to -1.2% in March), following a period of high growth exceeding 10%, chiefly reflected volatile oil prices on world markets. However, as in the previous quarter, the annual growth of fuel prices was much lower than the growth recorded by oil prices on world markets. There were several reasons for this sizeable difference. In addition to sharp year-on-year appreciation of the koruna-dollar exchange rate, they included demand-side factors and growing competition between fuel sellers, which impacted on their profit margins.

Chart II.3
The slower growth in market prices was largely due to tradable commodities
(annual percentage changes, including indirect tax changes)

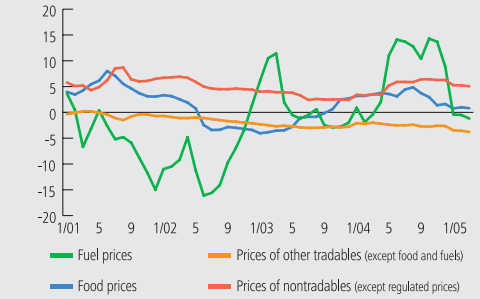


Chart II.4
Annual food price inflation slowed in 2005 Q1
(annual percentage changes)

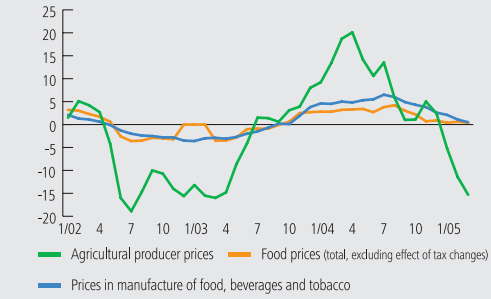
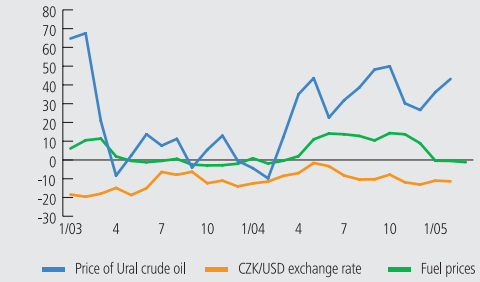


Chart II.5
The impact of the fast-rising oil prices on consumer prices was strongly dampened by the koruna-dollar exchange rate
(annual percentage changes)



[2] Net inflation is defined as growth in the consumer price index net of regulated prices and adjusted for other administrative measures.

[3] i.e. other tradable commodities (except food and fuels) and other nontradable commodities (except regulated prices).

[4] Consolidated category of food and non-alcoholic beverages and alcoholic beverages and tobacco.

Chart II.6
Inflation in the Czech Republic was lower than in the EU Member States at the start of 2005
(annual percentage changes)

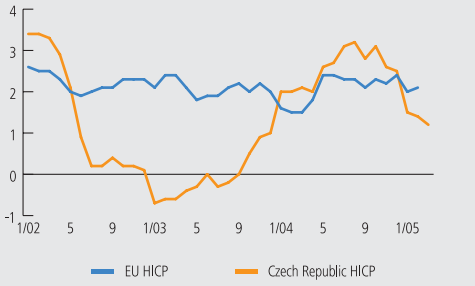


Table II.2
Headline inflation in 2005 Q1 was lower than forecasted in October 2003
(annual percentage changes; contributions in percentage points)

	October 2003 forecast	2005 Q1 outturn	Contribution to total difference in p.p.[a)]
Annual consumer price inflation	2.2	1.6	-0.6
Breakdown into contributions:			
regulated prices	3.2	2.9	-0.1
indirect taxes	0.2	0.3	0.1
food prices, excluding effects of indirect taxes	1.8	0.4	-0.4
fuel prices, excluding effects of indirect taxes	-2.6	1.9	0.1
adjusted inflation excluding fuels, excluding effects of indirect taxes	1.8	1.0	-0.4

[a)] owing to rounding, the sum of the contributions need not be equal to the total difference

Chart II.7
Inflation during 2004 was, conversely, higher than forecasted in October 2003
(annual percentage changes)

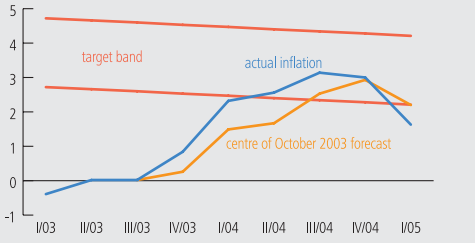


Table II.3
External factors had the opposite effect on the fulfilment of the October 2003 forecast

		IV/2003	I/2004	II/2004	III/2004	IV/2004	I/2005
GDP in Germany	prediction	0.3	1.0	1.5	1.9	2.0	2.0
(annual perc. changes)	outturn	0.2	1.5	1.9	1.2	1.5	x
CPI in Germany	prediction	1.0	0.5	0.8	1.0	1.3	1.4
(annual perc. changes)	outturn	1.2	1.1	1.8	1.9	2.0	1.7
1Y EURIBOR	prediction	2.2	2.3	2.4	2.6	2.8	2.9
(percentages)	outturn	2.4	2.1	2.3	2.3	2.3	2.3
USD/EUR exchange rate	prediction	1.11	1.11	1.12	1.13	1.14	1.16
(levels)	outturn	1.19	1.25	1.20	1.22	1.30	1.31
Oil prices	prediction	25.0	24.2	23.5	23.2	23.1	23.2
(USD/barrel)	outturn	27.5	29.8	32.2	38.0	37.3	42.8

Growth in regulated prices in 2005 Q1 also fell by comparison with the end of the previous quarter (by 1.5 percentage points year on year, to 2.9%). This fall was due to a smaller increase in regulated prices in January 2005 than a year earlier. The most significant changes during 2005 Q1 were an increase of 4.9% in electricity prices, rises in the prices of some regulated items in the health category, and increases in heat prices and waste collection charges.

Turning to international comparisons, annual consumer price inflation in the Czech Republic was above the inflation level in the EU countries during 2004. At the close of 2004, however, the HICP figures in the Czech Republic and the EU converged, and at the start of 2005 inflation in the Czech Republic was lower than in the EU. According to the latest figures for March, the annual HICP in the Czech Republic fell to 1.2%. The HICP in the EU Member States was 2.1% in February.

II.2 FULFILMENT OF THE INFLATION TARGET

Actual inflation was below the CNB's target band in 2005 Q1 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through into inflation most strongly with a lag of around 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2005 Q1, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around July 2003 to March 2004. For simplicity, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in October 2003, i.e. approximately in the middle of the aforementioned period, with inflation in 2005 Q1 (see Table II.2).

The October 2003 forecast had predicted easy monetary policy, primarily via an easy exchange rate component of the monetary conditions. The interest rate component was expected to have a roughly neutral effect. The effect of the easy monetary policy on the closure of the output gap was expected to be diminished by a reduction of the fiscal impulse connected with the expected public finance reform. The predicted return of inflation from its near-zero values in summer 2003 to the lower boundary of the inflation target in 2005 Q1 was expected to be aided, in addition to the closing output gap, by changes to indirect taxes and rising food prices. Actual consumer price inflation in 2005 Q1 was lower than forecasted in October 2003 (by 0.6 percentage point), but during 2004 it was conversely higher (see Chart II.7). A closer look at the inflation structure reveals that growth in food prices and adjusted inflation excluding fuels in 2005 Q1 was considerably lower than the forecast. By contrast, fuel prices grew faster than forecasted in October 2003.

The lower consumer price inflation in 2005 Q1 than forecasted in October 2003 can be put down mainly to factors lying partly or completely outside the purview of the CNB's monetary policy. These factors include in particular, relative to the forecast, lower agricultural producer prices, a stronger exchange rate of the koruna, lower external demand in 2004 H2 and 2005 Q1, and a weakening dollar-euro rate. These factors were counteracted by higher oil prices, lower foreign interest rates and higher foreign inflation (see Table II.3).

Consistent with the October forecast were interest rates just below 2% and a slight rise in rates starting in the second half of 2004. In reality, interest rates were above this trajectory until the end of 2004. In the key period as regards the most recent consumer price developments i.e. in 2003 H2 and 2004 Q1, interest rates were slightly higher than forecasted in both nominal and real terms. Although the forecast for the exchange rate was almost fulfilled, we now view the impact of the exchange rate component of the monetary conditions as having been tighter, owing to a reduction of the estimated rate of equilibrium appreciation. Overall, the monetary conditions were slightly tighter by comparison with the October forecast, but they remained easy in their effect on the economy.

The current assessment of the fulfilment of the October forecast is partly dependent on a change in the CNB's view of the functioning of the economy since the October forecast was prepared. Since October 2003, two closely interlinked changes have been made to the forecasting system. The first change, mentioned above, reduced the rate of equilibrium appreciation of the koruna's exchange rate in 2003. The second change consisted in rejecting the October forecast's assumption of a lower effect of the exchange rate component of the monetary conditions on the output gap. Had these changes been incorporated into the October forecast, they would – given their opposite natures – have acted neutrally on the output gap, albeit towards higher inflation in 2005 Q1. Given the lower rate of equilibrium appreciation, the forecast would have implied a weaker exchange rate of the koruna and thus higher growth in import prices.

In December 2004, the CZSO published a revision to the national accounts for 2001-2003 which significantly altered the Czech economic growth figure for 2003. This did not lead to any change to the modelling system, but it was reflected in an estimate of a narrower output gap in both 2003 and 2004.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the October forecast was drawn up can be summed up as follows.

Despite rather tighter monetary conditions in the key period (July 2003–March 2004) and broad fulfilment of the assumptions regarding external demand, the output gap in 2003 and 2004 was revised towards greater closure as a result of a revision of the GDP figures by the CZSO (see Table II.4).

However, the narrower output gap did not lead to higher growth in adjusted inflation excluding fuels. This fact can be put down to a disinflationary external environment and imperfections in the CNB's forecasting system. These imperfections chiefly concerned the estimates for food prices and the exchange rate.

The inflation forecast is the primary source material for the Bank Board's decisions. Also of key importance is an assessment of the possible risks associated with this forecast by the board members. At the Board's meetings during 2003 Q3 (see the relevant minutes) the risks were seen as broadly symmetrical. In 2003 Q4 and 2004 Q1 they were perceived as slightly inflationary. The slightly tighter setting of interest rates ensuing from this perception also contributed to the lower-than-forecasted inflation in 2005 Q1.

Table II.4

The revision of the GDP figures led to a revision of the output gap towards greater closure

		IV/2003	I/2004	II/2004	III/2004	IV/2004	I/2005
3M PRIBOR	prediction	1.8	1.7	1.8	2.0	2.3	2.6
(percentages)	outturn	2.1	2.1	2.2	2.6	2.6	2.3
CZK/EUR exchange rate	prediction	32.0	32.0	32.0	32.0	31.9	31.7
(levels)	outturn	32.1	32.9	32.0	31.6	31.1	30.0
GDP	prediction	3.2	3.0	3.2	2.5	2.7	3.2
(real, annual perc. changes)	outturn	4.0	3.8	4.0	4.0	4.3	x
Output gap	prediction	-1.7	-1.7	-1.6	-1.3	-0.9	-0.6
(percentages of GDP)	outturn*	-1.7	-1.5	-1.2	-1.0	-0.9	-0.7

* estimate based on the CNB's April 2005 forecast

III.1 THE EXTERNAL ENVIRONMENT

Chart III.1
Oil prices reached record highs in March 2005
(USD/barrel)

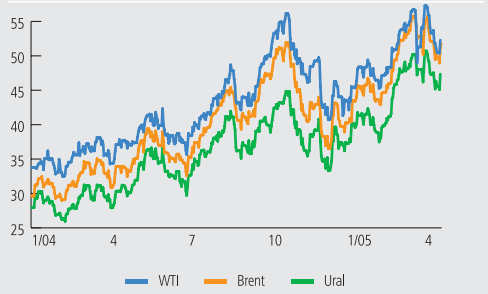
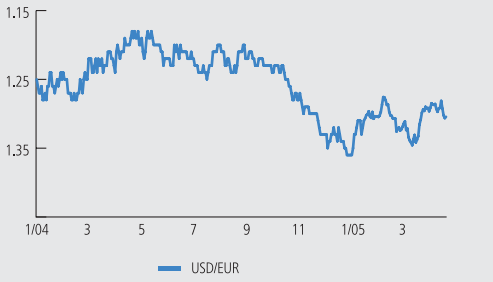


Chart III.2
The dollar recorded large swings in 2005 Q1



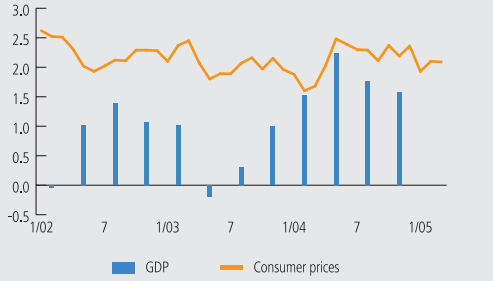
The substantial difference in GDP growth between the euro area and the USA persisted in 2004, with the US economy growing at more than double the pace of the euro area. Against this, given the evolution of its output and exchange rate, the US economy recorded higher inflation. The economic situation in Q4 was also characterised by a substantial difference in output growth (of more than 2 percentage points), with no tendency towards any narrowing of this difference. Following a short-lived fall, oil prices returned to record highs (of over USD 57 per barrel of WTI crude oil) and strongly affected economic developments throughout this period. The dollar also weakened to a record low against the euro during Q4.

Economic growth in the USA rose in 2004 by comparison with the previous year (from 3% to 4.4%). The buoyant growth was facilitated by very easy monetary and fiscal policy (a budget deficit of 3.6% of GDP). This led to a high rate of growth of domestic demand. At the same time, the continuing worsening of the USA's external imbalance manifested itself in a greatly weakened dollar exchange rate and a further increase in the nation's net export deficit. The annual output growth rate gradually declined during the individual quarters of 2004 (from 5% in Q1 to 3.9% in Q4), but remained above the long-term average and above the rate of growth of potential output. Thanks to this, the unemployment rate fell to 5.4% in February and 5.2% in March this year. In order to prevent a build-up of inflationary pressures in the economy, the Fed responded by raising its key interest rate by 25 basis points at each FOCM meeting. The rate thus gradually increased from 1% in June 2004 to 2.75% at the FOCM meeting on 22 March. Annual inflation fell to 2.9% in January and February 2005, from an average of 3.4% in 2004 Q4, thanks chiefly to a temporary fall in energy prices. However, in March, thanks to a further rise in energy prices, inflation picked up to 3.2%.

Real GDP growth in the euro area stood at 2.0% last year, a considerable improvement on the figure of 0.4% recorded the previous year. Although the rate of growth of the external sector was high and satisfactory, household consumption increased by only 1.2% amid general uncertainty ensuing from high and unabating unemployment, planned pension reforms and an unfavourable demographic trend.

Annual output growth fell from 1.8% in Q3 to 1.6% in 2004 Q4. Household expenditure growth increased, but owing to a stronger euro and a global growth slowdown, export growth went down and investment failed to maintain the growth rate it had recorded in the previous period. The rate of growth of prices declined concurrently with output. Inflation fell from 2.4% in December to 1.9% in January and 2.1% in February and March. This decline in prices against the end of 2004 was due to appreciation of the euro and lower prices of agricultural products and energy. The favourable inflation trend was supported by very subdued growth in wages, which rose by 2.2% year on year in Q4 in nominal terms, i.e. 0.2 percentage point less than in Q3. The unemployment rate in early 2005 was meanwhile virtually unchanged from 2004 Q4, fluctuating around 8.8% of the labour force.

Chart III.3
Economic growth in the euro area fell again in 2004 Q4
(annual percentage changes)

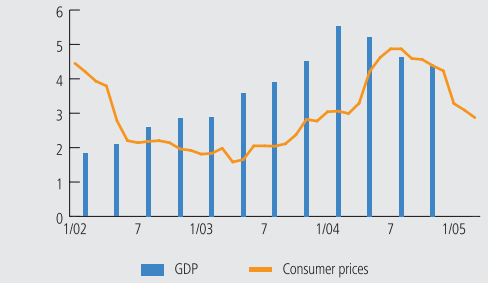


The German economy grew by 1.6% in 2004. Although the growth rate was below the euro area average, it was a significant improvement on the previous year, when the German economy actually shrank slightly (by 0.1%). The upturn was due primarily to export growth. By contrast, domestic demand rose only negligibly. However, the growth weakened significantly in Q4, with GDP rising by only 0.6% year on year, as against 1.2% in Q3. Despite an improvement in net exports, this negative development was caused by worsening domestic demand, which moved from growth of 1.7% in Q3 to a negative

growth figure of -0.1% in Q4. Annual consumer price inflation at the beginning of this year was below the 2% level and also below the euro area average. The unemployment rate, which was roughly 0.8 percentage point above the euro area level, went up slightly (to 9.7% in February) and in absolute terms reached the level of 4 million people under ILO methodology.

In 2004, all the countries of the Central European region – the Czech Republic, Hungary, Poland and Slovakia – saw a pick-up in economic growth compared to the previous year (of more than one percentage point on average). At the same time, consumer price inflation has fallen substantially in all these countries since the beginning of 2005, owing to the unwinding of accession-related administrative effects, strengthening national currencies and falling food prices.

Chart III.4
GDP rose much faster in the "new" EU Member States than in the euro area
(annual percentage changes)



GDP in Hungary rose by 4% last year, up from 3% in 2003. Household consumption and gross capital formation recorded the most buoyant growth. The output growth rate in Q4 was 3.9%, the same as in Q3, and a very slight fall was recorded in H2 compared to H1. In Q4 there was also a minor change in the structure of aggregate demand – despite an appreciating forint, net exports increased markedly, whereas household expenditure slowed amid low growth in real wages. Despite the relatively buoyant output growth, the unemployment rate increased, reaching 6.8% in March 2005 and rising by 0.6 percentage point over the four quarters. Annual consumer price inflation fell very sharply – from 7% in February 2004 and 5.5% in December to 3.3% in March this year. Responding to this significant decline in inflation and to appreciation pressures, the Hungarian central bank has reduced its monetary policy rates in three steps from 9.5% to 7.75% since the beginning of the year.

Poland recorded economic growth of 5.3% in 2004, up from 3.8% a year earlier. This result was due in equal measure to investment growth, exports and household consumption. However, the growth rate gradually fell over the course of the year, from 6.9% in Q1 to 3.9% in Q4, owing to weakening domestic demand. The current account deficit simultaneously declined, as did consumer price inflation (from 4.4% in December to 3.2% in March). Poland's unemployment rate, which is the highest in the EU (18.7% in March 2005), declined by 1 percentage point over one year. The monetary policy rate, which the central bank had left unchanged since August 2004, was lowered by 0.5 percentage point to 6% on 4 April.

The highest real growth in the region last year was recorded by Slovakia. This was due to daring and radical reforms. Output rose by 5.5%, up from just 4% a year earlier. The main factors of the high growth were household consumption (which rose by 3.5%) and gross capital formation (which increased by 13%), whose strong growth was driven primarily by high FDI inflow. The high growth, together with social policy reforms, generated a decline in the unemployment rate, which fell by more than 2 percentage points to 16.7% in March 2005. This was accompanied by a fall in the unemployment rate of 0.2 percentage point between December 2004 and March 2005 and by a dramatic decline in consumer price inflation, from 5.8% to 2.3%, in the same period. This was due to an unwinding of administrative effects combined with appreciation of the Slovak koruna. At the end of February, the Slovak central bank decreased its key monetary policy rate by one percentage point to 3%.

Chart III.5
The CNB lowered key interest rates
(percentages)

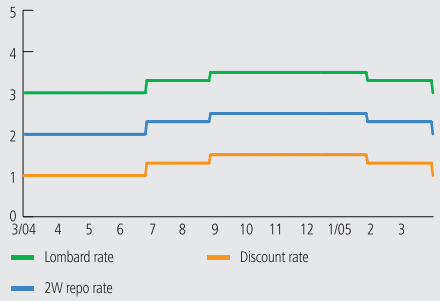


Chart III.6
Market interest rates declined
(percentages)

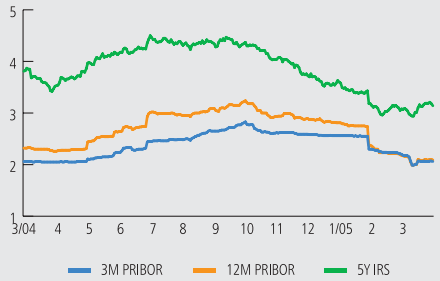
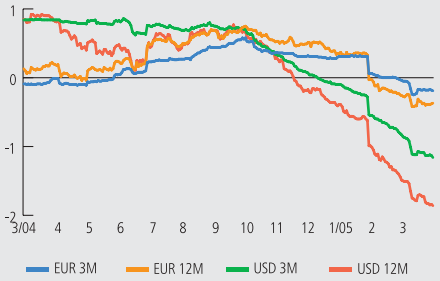


Chart III.7
The interest rate differentials fell to negative values
(percentage points)



III.2 INTEREST RATES AND THE EXCHANGE RATE

The settings of the real monetary conditions in 2005 Q1 can be characterised as neutral. The interest rate component was fairly easy, but the exchange rate was moderately tight owing to appreciation of the nominal exchange rate.[5] The evolution of the interest rate and exchange rate components of the monetary conditions in 2005 Q1 is described in more detail below.

III.2.1 The interest rate component of the monetary conditions

Interest rates continued to fall gradually at almost all maturities in 2005 Q1. The main reason for this was a decrease in the CNB's key rates and subsequent comments from the CNB's Bank Board meetings. The key rates were cut in two steps (at the end of January and March), each time by 0.25 percentage point. Effective 1 April 2005, the 2W repo rate was set at 2%, the Lombard rate at 3% and the discount rate at 1%.

Other factors underlying the fall in interest rates included an appreciating koruna, the inflation figures and the absence of demand-pull inflationary pressures in the Czech economy. The decline on the money market reached as much as 0.7 percentage point. Medium-term and long-term interest rates did not fall so unequivocally, being affected to a large extent by exchange rate movements on advanced foreign markets. Moreover, in mid-March there was an outflow of investment from the Central European region, which besides temporarily increasing interest rates also brought about a weakening of national currencies and fall in stock prices. PRIBOR spot quotations and FRA forward quotations at the end of March 2005 indicated expectations of interest rate stability for at least the next several months.

The PRIBOR yield curve gradually shifted to a lower level, while its slope changed from positive to negative. The spread between the 1Y PRIBOR and the 2W PRIBOR was -0.12 percentage point in March. The IRS yield curve also moved to a lower level, but its slope remained positive. In March, the average 5Y–1Y spread was 0.97 percentage point and the 10Y–1Y spread 1.64 percentage points.

The interest rate differential (PRIBID/CZK-LIBOR/EUR,USD) was affected by changes in key rates and movements in interbank market rates. Key rates in the two most important economies developed differently. The Fed continued raising rates (O/N rate: 2.75%), whereas the ECB kept its rates unchanged (repo rate: 2.0%). The interest rate differential decreased further, with the differential vis-à-vis euro and dollar rates turning negative at all maturities.

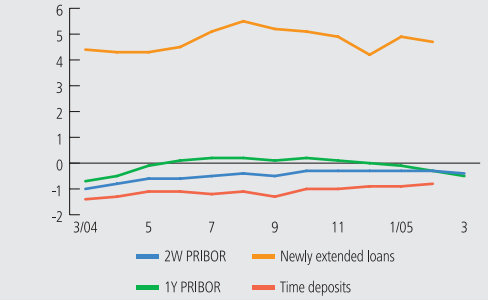
Primary auctions of government bonds took place under new rules. The competitive part was separated from the non-competitive part, and for the first time non-residents were allowed to take part. Four auctions were held during Q1, with original maturities ranging from 3Y to 15Y and a total volume of CZK 16.3 billion. The Ministry of Finance also issued a second eurobond with a maturity of 15Y. The volume is EUR 1 billion and the issue is hedged against exchange rate risk.

[5] However, the simultaneous effect of monetary policy on economic activity and inflation also depends on the settings of the monetary conditions in previous quarters. The accumulated setting of the monetary conditions is assessed as easy. This accumulated easy monetary policy setting in turn co-determines the starting conditions of the forecast

The decline in interest rates on the financial market was also partly reflected in client interest rates. Nominal interest rates on new loans fell slightly, to 6.0% in February. Rates on new time deposits declined to 1.7%.

Real interest rates[6] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices are traditionally 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 4.7% in February, while real rates on time deposits were -0.8%.

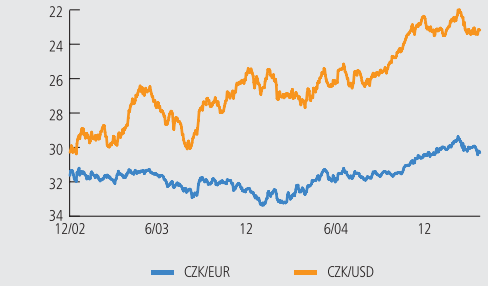
CHART III.8
Ex ante real interest rates were mostly flat
(percentages)



III.2.2 The exchange rate

The average exchange rate of the koruna against the euro in 2005 Q1 was CZK 30.02/EUR, which represents a year-on-year appreciation of 8.6%. The main causes of the strengthening of the koruna were foreign investors' positive sentiment about the Central European region and, to a lesser extent, the favourable trade balance, which reduced demand for foreign currency on the market in real terms. In Q1, the appreciation trend moderated, mainly due to developments in March, when the koruna depreciated by more than 2%. A similar trend (a strengthening of currencies partly corrected in March) was visible in other Central European countries (Hungary, Poland and Slovakia). The correction at the end of 2005 Q1 was probably due to a change in the short-term expectations of foreign investors, linked to some extent with a change in the interest rate differential of the koruna vis-à-vis the main world currencies (a decline in koruna rates, flat euro rates and an increase in dollar rates).

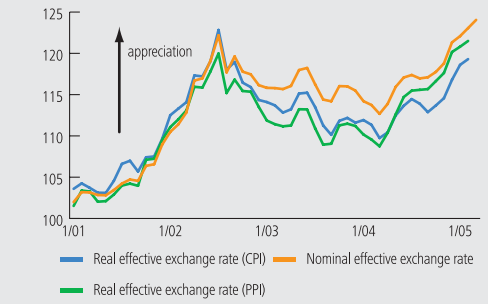
CHART III.9
The koruna appreciated against both the euro and the dollar in 2005 Q1



The average exchange rate of the koruna against the dollar in 2005 Q1 was CZK 22.8/USD, a year-on-year appreciation of almost 13%. In addition to the koruna's appreciation, this was due to a weakening of the dollar on world markets associated with growth in the USA's external imbalance (current account deficit). However, owing to rising dollar rates the dollar stopped weakening on world markets in 2005 Q1 and even appreciated slightly against the euro compared to December 2004.

The nominal effective exchange rate of the koruna appreciated by about 10.1% year on year in March 2005, mainly because of the koruna's appreciation against the dollar and the euro. The extent of the strengthening of the effective exchange rate was partly moderated by the koruna's exchange rate against the zloty and the Slovak koruna. Owing to the exchange rate developments at the end of 2004 and at the beginning of 2005 and a concurrent decline in consumer prices in the Czech Republic, the year-on-year appreciation of the real effective exchange rate deflated by the CPI (10.9% in February 2005) accelerated sharply, even though the exchange rate had still been weakening in year-on-year terms in 2004 H1. The real effective exchange rate deflated by the PPI appreciated rather more moderately year on year in 2004 (by 7.2% in February), chiefly as a result of relatively high annual growth in domestic industrial producer prices.

CHART III.10
The nominal effective exchange rate recorded faster year-on-year growth in 2005 Q1
(Year 2000 = 100)



[6] Ex ante real interest rates: nominal interest rates on loans are deflated by the industrial producer price indices forecasted 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.

III.3 THE BALANCE OF PAYMENTS

The current account deficit recorded a slight year-on-year decrease, due to a fairly marked reduction in the trade deficit in 2004. The improved balance of trade resulted primarily from an increase in the competitiveness of Czech engineering production on EU markets. The financing structure of the current account deficit improved as well. Foreign direct investment regained the key role after a one-year gap. The most significant year-on-year change in the balance of payments was a turnaround in portfolio investment flows.

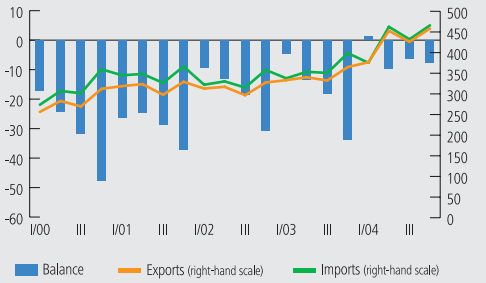
TABLE III.1
The current account deficit fell due to a decrease in the trade deficit
(CZK billions)

	2001	2002	2003	2004
A. Current account	-124.5	-136.4	-157.2	-143.5
Trade balance	-116.7	-71.3	-69.4	-22.3
Services	58.0	21.9	13.2	12.5
Income	-83.5	-115.6	-116.6	-139.5
Transfers	17.8	28.7	15.6	6.1
B. Capital account	-0.3	-0.1	-0.1	-14.0
C. Financial account	172.9	347.8	163.9	180.9
Direct investment	208.3	270.9	66.4	100.7
Portfolio investment	34.9	-46.7	-37.7	62.2
Financial derivatives	-3.2	-4.3	3.9	-1.5
Other investment	-67.1	127.9	131.3	19.6
D. Errors and omissions	19.1	5.7	6.3	-16.8
Change in reserves (- = increase in reserves)	-67.2	-217.0	-12.9	-6.8

III.3.1 The current account

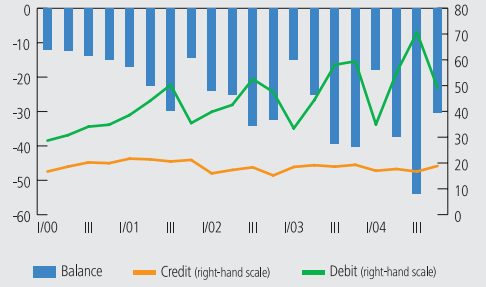
In 2004, the current account deficit amounted to CZK 143.3 billion (5.2% of GDP), a year-on-year decline of CZK 13.7 billion (1.1 percentage point). This decline chiefly reflected a large decrease in the trade deficit (of CZK 47.1 billion), which, however, was largely offset by a worse income balance. A slight year-on-year worsening was also observed for current transfers, although this was partly due only to a shift of part of the income (some EU subsidies) to the capital account. The current account thus continued to reflect the medium-term growth tendency of outflow of earnings in the form of dividends paid to non-residents. However, this tendency was more than offset by structural changes on the supply side having a positive effect on export performance.

CHART III.11
The trade deficit narrowed significantly further year on year in 2004 Q4
(CZK billions)



The trade deficit amounted to just CZK 22.3 billion in 2004, down by CZK 47.1 billion from a year earlier as mentioned above. The best year-on-year improvement in the trade balance was recorded in Q4 (CZK 26.1 billion). Alongside the decline in the deficit, export growth remained high (25% year on year), although a slight downward tendency has been visible since Q3. The trade balance was greatly affected by broadly favourable price developments (an annual terms of trade improvement of 2% in 2004), a recovery in external demand growth, most notably in Germany, and above all by continuing progressive changes on the supply side and the transfer of production (chiefly of mechanical and electrical engineering commodities) from other countries to the Czech Republic. The Czech Republic's accession to the EU was another positive factor behind the rising foreign trade turnover, although its direct impact on the trade balance was neutral overall. As regards the goods structure, the only category to record a major year-on-year improvement was that of machinery and transport equipment (up by CZK 63 billion). The other categories saw a moderate worsening of their balances. From the geographical perspective, the trade balance improvement was due to an increase in the trade surplus with the EU (25), which grew by CZK 71.4 billion to CZK 225.8 billion. The trade balance with Asia (China in particular) worsened by CZK 29.4 billion to CZK 191.1 billion.

CHART III.12
The income deficit decreased year on year in 2004 Q4
(CZK billions)



The surplus on services was virtually unchanged in year-on-year terms and amounted to CZK 12.5 billion. In Q4, the surplus was only CZK 1.3 billion, mainly because of growing expenditure on other services. In 2004, moderate annual growth in surplus was visible above all in transport and, to a lesser extent, in travel. However, the improvement was eliminated by growth in the deficit on other services (primarily financial and some business services).

The income deficit increased by CZK 22.9 billion year on year, to CZK 139.5 billion. In Q4 it amounted to CZK 30.4 billion. The growth in the overall deficit resulted mainly from a growing outflow of dividends abroad. A rise in compensation of foreign employees and a fall in compensation of domestic employees abroad were also minor factors behind the higher deficit.

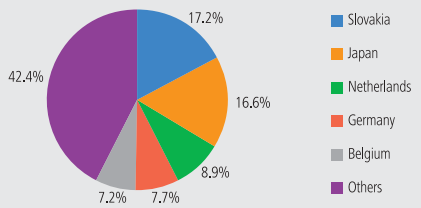
Current transfers ended in a surplus of CZK 6.1 billion, down by CZK 9.5 billion from a year earlier. In Q4, the current transfers surplus was a mere CZK 0.7 billion. The year-on-year decrease in the surplus was affected by the termination of flood-related reinsurance payments and new expenditure associated with EU membership (amid simultaneous recording of some revenues from EU funds under the capital account). Private transfers meanwhile showed a year-on-year decrease.

III.3.2 The financial account

The financial account ended 2004 in a surplus of CZK 180.9 billion (6.6% of GDP), a rise of around one-tenth on the same period of 2003. The net inflow of capital was due mostly to foreign direct investment and portfolio investment and, to a lesser extent, to borrowing by the corporate sector. The net capital inflow was moderated by outflow of capital through the banking sector. The most significant change in the balance of payments was a turnaround in portfolio investment flows from outflow to inflow. This year-on-year change amounted to around CZK 100 billion.

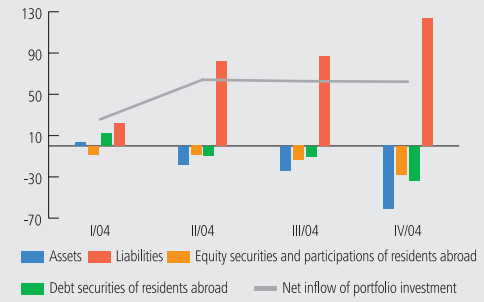
The net inflow of direct investment in the period under review was CZK 100.7 billion, a year-on-year increase in inflow of roughly one-half on 2003. The inflow of foreign direct investment (including reinvested earnings) was CZK 114.7 billion, which represents a year-on-year rise of more than CZK 40 billion. However, the relatively large year-on-year increase in FDI was due solely to a one-off decrease at the end of 2003 associated with ownership changes in Telecom (the exit of a minority foreign shareholder and a rise in a Telecom's shareholding in its subsidiary Eurotel). This reduced the net direct investment inflow in 2003 by around CZK 50 billion. Adjusted for this one-off effect, the FDI inflow decreased slightly. Reinvested earnings of non-residents (CZK 60.8 billion) remained the biggest contributor to FDI in 2004. The capital inflow from abroad (CZK 53.9 billion, including loans) was channelled primarily into industry (about 40%), real estate (about 25%) and trade (about 20%). The biggest investors were Slovakia, Japan, the Netherlands, Germany and Belgium. The inflow of direct investment in Q4 was lower than in previous quarters, amounting to just CZK 12.5 billion. The cause was a decline in FDI inflow and a one-off increase in outflow connected with power company ČEZ's acquisition in Bulgaria. Due to this investment of about CZK 9 billion, Czech direct investment abroad reached a historical high of CZK 14 billion.

Chart III.13
Slovakia became the largest foreign investor



The net inflow of portfolio investment was CZK 62.2 billion, contrasting with the outflow of CZK 37.7 billion recorded in the same period of 2003. The year-on-year change of around CZK 100 billion was due mainly to a fall in residents' interest in foreign debt securities (probably thanks to a rise in the attractiveness of domestic investments) and to the first government bond issue on foreign markets. Portfolio investment by residents on foreign markets reached CZK 61.1 billion, representing an annual reduction in outflow of about one-quarter. Interest in shares slightly prevailed. Total holdings of foreign securities by non-residents are dominated by holdings of bonds (about 80%), particularly from E15 countries (Germany, the Netherlands and Luxembourg). The inflow of portfolio investment from abroad reached a record CZK 123.3 billion, more than three times the inflow in 2003. Interest in bonds – government bonds in particular – was much greater than that in shares. The year-on-year increase in the inflow of portfolio investment was strongly affected by the aforementioned government bond issue on foreign markets. In Q4, as in Q3, there was a very slight net capital outflow of CZK 0.4 billion, due mostly to residents' renewed interest in investing abroad.

Chart III.14
The net inflow of portfolio investment was unchanged in Q4
(CZK billions)



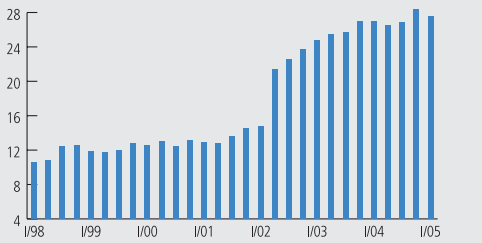
Financial derivatives transactions generated a CZK 1.6 billion decline in the financial account surplus.

In the area of other investment there was a net inflow of capital of CZK 19.6 billion, despite an outflow of almost CZK 74 billion having been recorded in the middle of last year. The net inflow of other investment was affected by a government accounting operation (a reduction in foreign long-term government assets) connected with the planned de-blocking of foreign assets (dating from prior to 1989) in 2005, amounting to about CZK 19 billion. The neutral effect of what is so far the only accounting operation was ensured by an outflow of the same amount recorded on the liabilities side of the capital account. Adjusted for this operation, other investment was approximately balanced. The government sector recorded a net inflow of other capital of CZK 32.2 billion (after adjustment for the aforementioned accounting operation connected with the de-blocking of foreign assets of around CZK 13 billion). The capital inflow was associated primarily with the de-blocking of long-term assets in Russia and drawing on EIB loans. The business sector saw a net capital inflow of CZK 37.3 billion. The capital inflow into the corporate sector was associated mainly with a rise in corporations' short-term import liabilities and with a long-term loan drawn by power company ČEZ for planned foreign acquisitions. The net outflow of capital through the banking sector was CZK 50.5 billion, even though the outflow had reached CZK 93 billion at the end of Q3. This was exclusively outflow of short-term capital.

The preliminary monthly balance of payments data for January and February 2005 mostly suggest a continuation of the previous trends. The trade surplus is up by around CZK 4 billion year on year. The much better current transfers result is due to the Slovak government's repayment to Československá obchodní banka of a liability dating from the division of Czechoslovakia. The year-on-year changes in the financial account are due in particular to a turnaround in portfolio investment (the replacement of last year's inflow by an outflow) connected with the decline in domestic interest rates at the beginning of 2005 and falling holdings of domestic shares by non-residents.

In 2005 Q1, the CNB's international reserves were again primarily affected by valuation changes. The CNB also continued selling off part of the income on the reserves (around CZK 0.1 billion). In 2004 Q1, the reserves were virtually unchanged in koruna terms, at CZK 636.2 billion. In dollar terms they decreased by USD 0.9 billion to USD 27.5 billion.

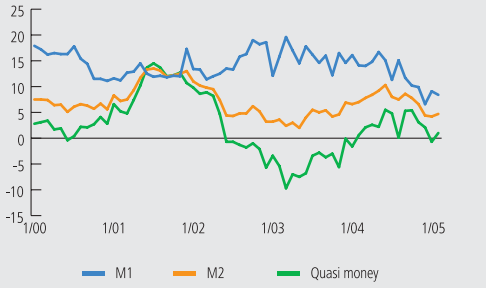
CHART III.15
The international reserves decreased in dollar terms in 2005 Q1
(USD billions)



III.4 MONEY AND CREDIT

The slowdown in money growth recorded in the second half of last year came to a halt in February 2005. The lower M2 growth was due in particular to a tightening of the exchange rate component of the monetary conditions, associated with lower growth in corporate deposits. The share of M1 in M2 was relatively high, confirming the fairly easy interest rate component of the monetary conditions. The money developments continued to indicate higher growth in investment than in consumption. The favourable financing conditions also encouraged demand by non-financial corporations for investment loans, although corporations increasingly also took out short-term loans to finance their operating needs. Growth in loans to households remained buoyant, with mortgage loans still predominating. Their growth stabilised in 2004, owing, among other things, to flat real estate prices. The slight upswing in consumer credit recorded at the end of last year stopped in the first two months of this year, indicating subdued growth in household consumption in the near future.

CHART III.16
The slowdown in monetary aggregate growth recorded in 2004 Q4 halted in February 2005
(annual percentage changes)



III.4.1 Money

M2 growth continued to slow in 2004 Q4. In February 2005, the decline in growth stopped at 4.7% (see Chart III.16). The slowdown in M2 growth was linked above all to lower growth in corporate deposits due to the tighter exchange rate component of the monetary conditions. The fairly easy interest rate component of monetary conditions, by contrast, continued to foster a relatively high share of M1 in M2 (52.2%). Increased holdings of highly liquid money persisted, owing to the low interest rate level.

The growth rate of M1 slowed to 8.8% in 2004 Q4 and to 8.4% in February 2005 (the latest available figure) (see Table III.2). Overnight deposits and currency in circulation grew less significantly, particularly in the case of households. The share of new overnight deposits of households in total new deposits, however, remained at the high level of around 60%. Non-monetary financial institutions transferred part of their funds from overnight deposits to deposits with agreed maturity under quasi money.

Growth of quasi money stagnated at 3.5% in 2004 Q4 and declined further to 1% in February 2005. This chiefly reflected lower growth in deposit bills of exchange of non-financial corporations. Conversely, the growth of household deposits redeemable at notice of up to 3 months accelerated. They accounted for around 30% of new household deposits, while the share of new deposits with agreed maturity was only about 10%. Deposits with agreed maturity of non-monetary financial institutions continued to show a modest recovery in 2004 Q4. Deposits of these institutions are highly volatile and, moreover, their share of M2 is only about 4%. Consequently, they are of no significance as an indicator of GDP growth, unlike deposits of households and non-financial corporations.

Turning to the sector structure of M2 deposits, the slackening M2 growth has, since the middle of last year, been accompanied by lower demand of non-financial corporations for deposit bills of exchange (see Chart III.18). Corporations probably used their temporarily free funds more for financing increased economic activity. The lower creation of new deposits by non-financial corporations was linked with a tightening of the exchange rate component of the monetary conditions. Deposits of non-monetary financial institutions (particularly foreign-controlled private insurance corporations and pension funds) continued to decline in 2004, owing to heightened demand for medium-term and long-term government bonds. This increased the contribution of these institutions to government financing.

As regards its counterparts, the M2 growth in 2004 continued to be supported most of all by growth in loans provided to corporations and households (adjusted for reclassifications, exchange rate variations and other revaluations; see Chart III.19). The year-on-year flow of this adjusted M2 was CZK 113.2 billion; the analogous flow for loans was CZK 144.1 billion. Within the other counterparts of M2, conversely, a negative year-on-year flow was recorded for net credit to government. The repayment of a loan provided in the past to the CCA for the financing of transfers of bad debt partly contributed to the decline in net credit to government in 2004. However, this decline was partly offset by an increase in net foreign assets in 2004 H1. Their growth, however, stagnated in 2004 H2 (owing, among other things, to a larger outflow of dividends abroad). In addition, the M2 growth was depressed by a rise in capital, reserves and other net items, including unsettled items between clients and monetary financial institutions.

CHART III.17

The share of M1 in M2 remained relatively high

(percentages)

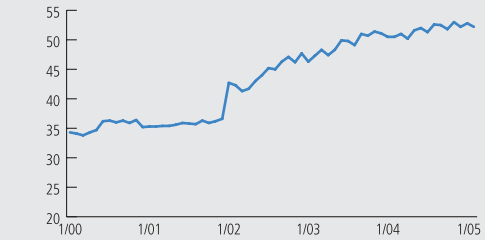


TABLE III.2

The slowdown in M1 and quasi money growth continued

(quarterly averages and end-of-month stocks; percentages)

	II/04	III/04	IV/04	1/05	2/05	Outstanding amount as % of M2 2/05
M1	15.6	12.7	8.8	9.1	8.4	52.2
Currency in circulation	8.9	7.7	6.7	7.2	7.7	13.1
Overnight deposits	18.0	14.4	9.6	9.7	8.6	39.2
M2-M1 (quasi money)	3.2	3.3	3.5	-0.7	1.0	47.8
Deposits with agreed maturity	4.1	3.7	3.5	-2.8	0.0	36.7
Dep. bills of exch. and other bonds	47.6	29.1	21.6	-5.9	-5.7	6.0
Deposits redeemable at notice	-3.5	-1.1	4.2	8.3	8.8	10.8
Repurchase agreements	95.6	75.7	-10.8	-33.9	-55.5	0.3
M2	9.2	8.0	6.2	4.2	4.7	100.0

CHART III.18

Within M2 deposits, declines were recorded for deposits of non-financial corporations and non-monetary financial institutions

(annual percentage changes)

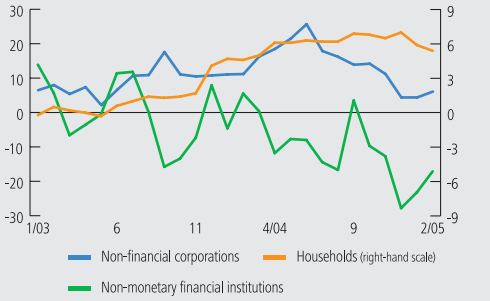
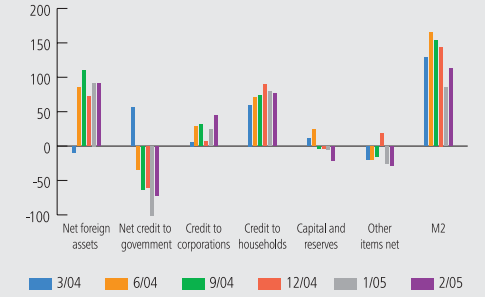


CHART III.19

The lower M2 growth was fostered by all counterparts except credit to corporations and households

(adjusted for reclassifications, exchange rate variations and other revaluations; annual flows in CZK billions)



III.4.2 Credit

The upward trend in growth in loans provided to corporations and households continued into 2004 Q4 (to 12.9%). A similar pattern was also observed in February 2005. The growth in loans continued to be bolstered by the fairly easy component of the monetary conditions. Loans to non-financial corporations and households increased, with the latter continuing to account for most of the rise in lending[7].

Table III.3

Year-on-year growth in lending to non-financial corporations increased further

(quarterly averages and end-of-month stocks; annual percentage changes)

	II/04	III/04	IV/04	1/05	2/05
Loans up to 1 year	2.5	0.3	2.3	-0.2	4.0
Loans over 1 year and up to 5 years	1.5	12.9	17.1	16.9	10.3
Loans over 5 years	3.0	7.2	9.1	13.7	14.0
Loans to non-financial corporations, total	2.4	5.6	8.0	8.4	8.8

The pick-up in growth of loans to non-financial corporations (to 8%) was in line with the solid investment growth in 2004 Q4 (see Table III.3). This is confirmed by the demand of corporations for long-term investment loans, although short-term loans also increased in the period under review. Loans to both domestic and foreign corporations rose, but in January and February 2005 the rate of growth was higher for loans to foreign-controlled corporations (11.2%, as against 8% for domestic corporations in February 2005).

New loans to non-financial corporations of greater than CZK 30 million, provided mostly to large corporations (approximately 42%), again made up a significant proportion of the total in 2004 Q4 and in the first two months of 2005. This was also in line with their investment and export activity. However, this proportion has been decreasing since mid-2004, while the share of new bank overdrafts (45%) has conversely been rising. This implies that non-financial corporations are taking out long-term loans connected with growing investment, but at the same time they are increasing their demand for short-term bank overdrafts in order to finance their operating needs. The share of new loans of up to CZK 30 million, provided mostly to small and medium-sized enterprises, remained lower in 2004 Q4 and in January and February 2005 than at the beginning of last year (around 13%).

Table III.4

Growth in total external funds slowed, despite a rise in loans from banks in 2004 Q4

(non-financial corporations with 100 employees or more; annual percentage changes)

	I/04	II/04	III/04	IV/04	Outstanding amount as % of total liabilities IV/04
Equity	4.2	4.9	6.1	7.4	53.1
External funds (liabilities - equity)	2.0	5.0	5.0	2.8	46.9
Reserves	4.6	-0.8	-0.9	1.3	3.7
Bonds and bills	24.6	3.9	4.9	2.1	4.9
Credit and loans	0.6	7.2	7.9	-1.6	12.6
Other liabilities	-1.4	4.9	4.4	5.5	25.7
Liabilities	3.1	5.0	5.6	5.2	100.0

Growth in the total financial funds of non-financial corporations recorded a slight year-on-year slowdown in 2004 Q4, even though loans from monetary financial institutions picked up. This was consistent with the more moderate, although relatively high, investment growth. External funds of corporations – most notably loans obtained from abroad – recorded lower growth[8]. Conversely, growth in internal funds rose slightly, owing to the increasing profitability of non-financial corporations. In 2004 as a whole, however, growth in total financial funds accelerated. The significance of loans in the financing of corporations' economic activities rose concurrently (see the box *The structure of lending* in the January 2005 Inflation Report). This showed up in a halt to the decline in the share of loans to non-financial corporations in GDP, even though from a historical perspective this indicator is currently relatively low (about 20%). The costs associated with corporate financing remained relatively low. Their share of GDP dropped to 1.2% in 2004.

Corporate financing conditions remained favourable in 2004 Q4. This situation continued into January and February 2005. Interest rates on the new loans that account for most of the new loans provided to non-financial corporations – i.e. bank overdrafts and loans

[7] The share of loans to households in year-on-year growth in total loans was 9.8 percentage points. The equivalent share for loans to non-financial institutions was 4.8 percentage points and for loans to non-monetary financial institutions 0.6 percentage point.

[8] The decline in the inflow of foreign loans to non-financial corporations in 2004 Q4 was partly due to the high base of the previous year, when a foreign loan of around CZK 29 billion was provided to Telecom. The inflow of foreign loans to corporations was flat at CZK 44.5 billion in 2004 as a whole.

of greater than CZK 30 million with floating rates and rate fixation of up to one year - mostly fell, albeit less so than the 1Y PRIBOR from which they are derived. The interest rate spread between these interest rates continued to increase slightly, affected by the expected phase of the business cycle.

Annual growth in loans to households went up slightly (to 32.7%) in 2004 Q4 and was flat in January and February 2005 (see Table III.5). The high growth in loans was supported by the fairly easy interest rate component of the monetary conditions and the supply of loans from banks. Mortgage loans again accounted for a major part of the growth (17.4 percentage points). However, the growth rate of housing loans, including mortgage loans, has stabilised since May last year, primarily due to flat prices of residential real estate following the Czech Republic's accession to the EU[9]. This has been visible in a decline in new housing loans as a percentage of new loans to households since approximately the middle of last year.

Consumer credit growth recovered slightly in 2004 Q4. However, this trend did not continue into February 2005. Consequently, consumer credit to households only briefly offset the slowdown in gross real disposable income growth, amid stagnating or slowing household consumption growth in real terms. The lower growth in consumer credit in January and February 2005 conversely indicated continuing moderate growth in household consumption in the immediate future.

TABLE III.5

Growth of loans to households remained high and stabilised in 2004 and early 2005

(quarterly averages and end-of-month stocks; annual percentage changes)

	II/04	III/04	IV/04	1/05	2/05
Housing loans	39.0	35.4	34.8	34.6	31.4
Consumer credit	18.7	22.0	23.4	25.1	23.8
Other loans	22.0	32.3	39.1	37.3	35.8
Loans to households, total	31.9	31.9	32.7	32.7	30.2

III.5 DEMAND AND OUTPUT

The long period of relatively stable economic growth, visible since the start of 2003, continued into 2004 Q4. According to the CZSO's estimates[10], annual GDP growth was 0.3 percentage point higher than in Q3, at 4.3%. In 2004 as a whole, annual GDP growth was 4%. According to the CNB's estimates, economic output was still below the potential output level, but the output gap was by now only slightly negative.[11]

The relatively rapid economic growth was driven by the increasing export performance of the economy, associated primarily with FDI inflows and the Czech Republic's EU accession. Thanks to the continuing fast growth of exports, accompanied by a much slower rise in imports in Q4, the external sector – for the first time in ten quarters – made a large contribution to GDP growth (of more than three-quarters). On the supply side of the economy, this trend was mostly attributable to industry, with its fast-growing exports. The biggest improvement in the trade balance was recorded in the machinery and transport equipment category.

Within domestic demand, the relatively buoyant economic growth was supported above all by investment demand. Investment growth slackened slightly in Q4, but was still high. Investment decision-making was again affected by high export growth, the favourable external demand outlook (supported by high growth in new orders from abroad), growth of own funds and easy monetary conditions. Other major contributing factors to the total investment growth included foreign direct investment and the persisting high

CHART III.20

Economic growth fluctuated around 4% throughout 2004

(annual percentage changes)

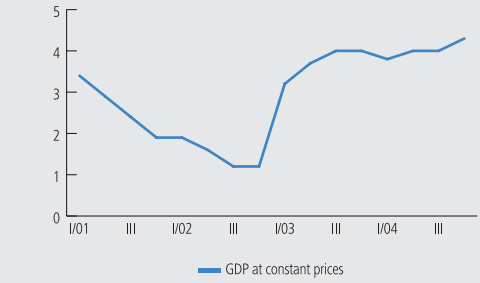


TABLE III.6

The external sector and investment demand contributed most to the GDP growth in 2004 Q4

(annual percentage changes; constant prices)

	2003	I/04	II/04	III/04	IV/04	2004
Gross domestic product	3.1	3.8	4.0	4.0	4.3	4.0
Aggregate demand (domestic demand and exports)	5.3	7.2	14.2	11.4	10.3	10.8
Total domestic demand[a)]	4.6	4.6	4.5	3.1	1.0	3.3
Final consumption expenditure	5.1	1.8	1.4	0.2	-0.6	0.7
of which:						
Household consumption	4.9	3.3	2.5	2.0	1.9	2.4
Government consumption	2.2	-1.8	-1.0	-3.8	-5.8	-3.2
Non-profit institutions serving households	3.2	15.8	10.1	11.8	7.0	11.1
Gross fixed capital formation	7.4	9.9	9.4	9.6	7.5	9.1
Imports of goods and services	9.5	11.3	27.0	19.9	15.8	18.5
Exports of goods and services	6.2	10.6	27.4	23.0	22.2	20.9
Net exports of goods and services (CZK billions)	-215.3	-47.3	-64.7	-58.9	-66.7	-237.7

a) including changes in inventories

[9] The assessment of loans provided to households with regard to financial stability is dealt with in the Financial Stability Report for 2004.

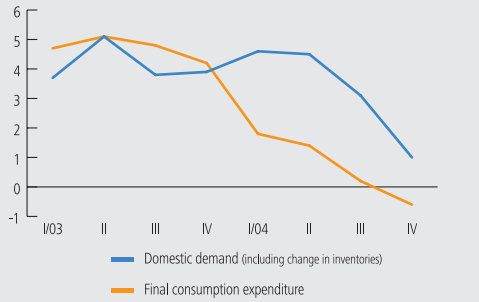
[10] Together with the 2004 Q4 estimate, the CZSO revised the GDP growth estimate for the previous quarters of 2004.

[11] For details see the box *Use of the output gap indicator at the CNB* in the October 2003 Inflation Report.

supply of housing investment, which continued to meet with demand in the household sector. The impact of consumer demand on GDP growth in Q4 and in 2004 as a whole was not as great as in previous years. In Q4, as in Q3, government expenditure on final consumption made no contribution to GDP growth.

III.5.1 Domestic demand

Chart III.21
All the main components of domestic demand contributed to the sharp slowdown in domestic demand
(annual percentage changes)

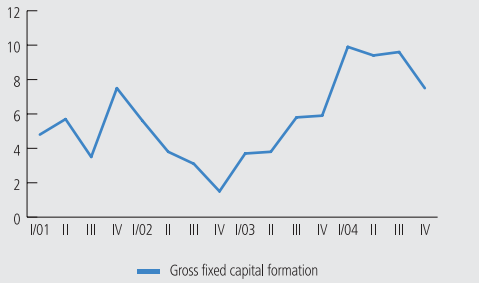


Total domestic demand growth eased further in 2004 Q4. This slowdown was more pronounced than in the previous quarter and was attributable to all the main components of domestic demand. As a result, real domestic demand growth was modest in 2004 Q4, at 1%. The falling aggregate domestic demand growth was largely due to gross fixed capital formation, government expenditure on final consumption and inventories (the end of 2004 saw the usual decline in inventories, although the decrease was larger than in 2003 Q4). Households' expenditure on final consumption also recorded sluggish growth, but its effect on the downturn in total demand growth was less than that of the above components of domestic demand. Government expenditure on final consumption continued to fall in year-on-year terms at the end of 2004.

Investment demand

Investment demand growth eased somewhat in 2004 Q4, but remained high. According to the CZSO's estimate, annual growth in gross fixed capital formation was 7.5% and the rate of investment[12] was 28%. The continuing high level of investment activity in the economy was confirmed not only by the investment demand indicators in most monitored sectors[13], but also by continuing two-digit growth in industrial production of investment products, fast-growing construction output (up by 4.7% year on year) and a still sizeable rise in investment imports. At the same time, however, changes in the growth rates of the above indicators (particularly slower investment import growth) suggested some changes in investment structure compared to the previous quarter.

Chart III.22
Investment growth eased somewhat at the end of 2004, but was still high
(annual percentage changes)



These changes were mostly associated with investment by the government and non-financial corporations. The most pronounced change was probably in government sector investment, as capital expenditure in state and local budgets recorded marked growth in Q4 (up by 21.7%, or CZK 74.5 billion, year on year) after having shown a year-on-year decline in 2004 Q3. Given this growth rate, we can assume that its contribution to total investment growth in Q4 was significant and was satisfied mostly from domestic sources (with construction work predominating).

By contrast, investment growth in non-financial corporations, which account for about two-thirds of total investment, probably decreased in 2004 Q4. This change was suggested by much slower growth in the volume of investment in large businesses[14] in Q4 (from 15.1% in 2004 Q3 to 5.8% in Q4) and more sluggish growth of investment imports. In terms of structure, investment grew only in foreign-controlled corporations, whereas in domestic public and private corporations it was lower than in the same period a year earlier. As regards the individual industries, however, investment rose in all of them except transport.

[12] i.e. the share of gross fixed capital formation in GDP at current prices.

[13] Since revised data on the investment structure have not yet been published by the CZSO, the analysis of trends in this area is based on partial indicators.

[14] Corporations with 100 employees or more.

The persisting rise in household investment was supported by a continuing rapid expansion of housing construction. This was evidenced primarily by a large year-on-year rise in the number of housing starts and completions in Q4 and continuing strong annual growth in housing loans (for details see section III.4 *Money and credit*).

Consumer demand

The gradual downward trend in consumer demand growth, visible since 2003 Q3, continued into 2004 Q4. According to the CZSO's latest estimate, the annual rise in the real final consumption expenditure of households was quite low in 2004 Q4, at 1.9%. As in the previous three quarters of 2004, the weakening consumer demand of households was primarily due to declining growth in their real disposable income, which is the key factor for household consumption growth.

The slower growth of households' real disposable income in 2004 than in 2003 was mainly the result of the higher annual consumer price inflation in 2004[15], since nominal disposable income growth was higher than a year earlier (up by 0.8 percentage point to 4.2%). This gross disposable income growth was largely due to wages and salaries, the largest component of current household income by volume, which recorded balanced growth overall in 2004 (5% year on year). Growth in income from social benefits was slower, remaining below 3% except in Q2[16]. Other household incomes showed mixed developments during 2004 and their contribution to the total growth of households' disposable income was less significant.

Households' nominal gross disposable income grew faster in 2004 as a whole than in 2003, but the rate of growth eased gradually to 3.2% in Q4. By contrast, inflation was rising until Q3. As a result, the real growth in households' disposable income gradually decreased to 1% in Q4 (see Chart III.24). However, at the end of 2004, as in the previous three quarters of 2004, households' real expenditure grew faster (1.9%) than their real disposable income (by 0.9 percentage point). In this situation, households saved less of their income than in the same period of 2003 and financed part of their increasing consumption expenditure by borrowing. This was evidenced by an annual decline of about 6% in gross saving and a slight upturn in annual growth of consumer credit obtained from banks compared to the previous quarter (for details see section III.4 *Money and credit*).

Government demand

According to the CZSO's estimate, government expenditure on final consumption fell by 5.8% year on year in real terms in 2004 Q4. This was a deeper decline than in the previous three quarters, due mostly to a decrease in current expenditure by the organisational units of the state. At current prices, final government consumption rose by about 2%.

The assessment of government demand is based on an analysis of data on the state budget performance, which cover a substantial part of the developments in the

CHART III.23
Growth in the real consumption expenditure of households slowed further
(annual percentage changes)

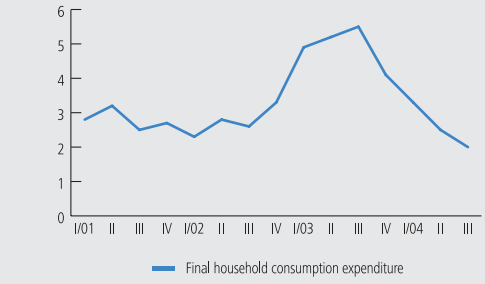


CHART III.24
Higher annual inflation greatly reduced the purchasing power of households' income in 2004
(annual percentage changes)

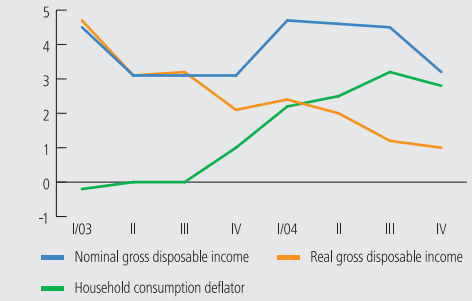
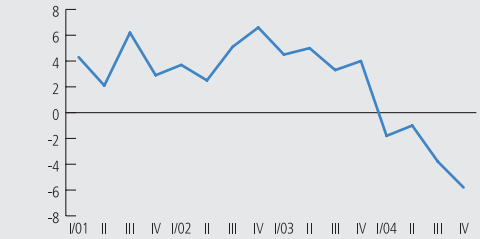


CHART III.25
The annual decline in government final consumption expenditure deepened in 2004 Q4
(percentages)



[15] In 2003 consumer price inflation measured by the household consumption deflator had recorded an annual rise of just 0.2%, whereas in 2004 the figure was 2.7%.

[16] In 2004 Q2, social benefits recorded an annual rise of 9.4% due to one-off compensations for tax changes.

government sector. Fiscal developments in 2004 Q4 were characterised by a high year-on-year increase in nominal expenditure (of almost 21%), whereas income rose at half that pace (10.5%). The result was a state budget deficit exceeding CZK 53 billion, a large shortfall compared to the 2003 Q4 deficit of CZK 27 billion.

This extraordinary growth on the expenditure side of the budget was due mostly to a transfer of CZK 24.7 billion to reserve funds, which was made possible by the implementation of new budgetary rules. These funds were not really consumed in the economy, but under the methodology used to monitor the state budget performance they did appear on the expenditure side. The budget expenditure growth also reflected a year-on-year rise in the nominal remuneration of public employees (of about 11%) and a sizeable increase in transfers to regional budgets, which, however, do not directly affect government sector demand. The revenue side of the state budget saw a continued upward trend for indirect tax collection in the last quarter of 2004, with VAT and excise duty revenues up by 17% and 15% respectively in nominal terms. It is evident that, adjusted for the aforementioned methodological effect[17], the government sector again made no contribution to the demand growth in the economy in 2004 Q4. This view is consistent with figures published by the CZSO.

III.5.2 Net external demand

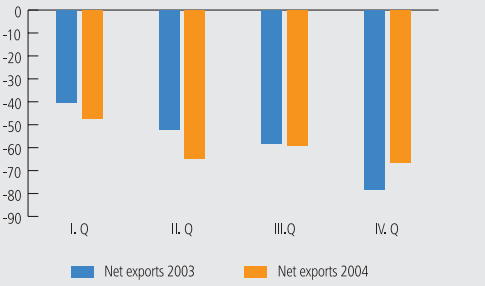
The continuing fast growth of exports of goods and services[18] again attested to the strong export performance of the Czech economy in 2004 Q4. Export growth rates exceeded 20% for the third consecutive quarter. In Q4, this growth was slightly lower than in Q3, but remained high (22.2% year on year). Given the high import intensity of Czech GDP, imports also rose rapidly. At the end of 2004, import growth slackened as well, although much more so than export growth (to 15.8% year on year). As a result, the lead of export growth over import growth increased to 6.3 percentage points (see Chart III.26). After ten quarters, the unfavourable trend of a year-on-year widening of the net export deficit thus reversed in 2004 Q4. Negative net exports decreased by CZK 11.3 billion to CZK -66.7 billion, and their contribution to GDP growth was positive.

The year-on-year improvement in net exports was, however, due solely to a very favourable trade balance, which, to a lesser extent, had already been apparent in the previous quarter. The trade deficit narrowed by CZK 21.4 billion in 2004 Q4, whereas the services deficit increased for the third consecutive quarter (by CZK 6.8 billion in Q4). The fall in the net export deficit thus reflected continuing rapid growth in the export performance of the Czech economy and the related large increase in goods exports (23.6%). New export-oriented production facilities, including the shift of production from advanced market economies to the Czech Republic, and EU accession continued to have a positive effect.

The moderation of import growth in 2004 Q4, which also helped improve net exports, was largely attributable to lower growth in investment imports. Annual growth in goods imports was, however, still quite strong overall (15.1%) and, as in the previous two quarters, was due to fast-growing imports for final and intermediate consumption (primarily collaboration imports). The growth rate of investment imports also remained high (at almost 8% year on year at current prices), after the moderation recorded in Q4.

Chart III.26
The lead of export growth over import growth widened considerably in 2004 Q4
(annual percentage changes; constant prices)

Chart III.27
Negative net exports fell year on year for the first time in ten quarters
(CZK billions; constant prices)



[17] i.e. the inclusion of additions to reserve funds in public expenditure in 2004.

[18] At constant 1995 prices.

III.5.3 Output

On the supply side, the relatively brisk GDP growth in 2004 Q4 was mostly attributable to industry (roughly 70%). The strong annual value added growth in Q4 (8.6%), and in 2004 as a whole, confirmed a continuation of the previous years' positive trends. These trends were due to various factors and manifested themselves chiefly in an upturn in foreign trading by domestic corporations. The rapid growth in industrial production (IPI) and value added in 2004 was generated mainly by the launching of new production facilities (particularly for vehicle component production), high domestic investment demand growth, a continuing boom on the steel and iron market, a continuing upturn in new orders in the electrical engineering industry and the overall recovery of the world economy, which created favourable sales conditions for Czech products abroad.

Exports were the fastest growing item of sales of industrial corporations – total sales from industrial activity increased by 9.8% (at constant prices) in 2004, while real sales from direct exports grew by 17%. Exports accounted for almost one-half of industrial sales and were mostly realised by foreign-controlled corporations. The fastest growing items were exports of higher-value-added products, particularly machinery and equipment, electrical and optical equipment and rubber and plastic products. Manufacture of basic metals and fabricated metal products also showed very quick growth. Under these circumstances, the major structural changes in industry continued. Besides the developing branches, these changes also affected branches facing the problem of weakening demand for their products (owing to strong foreign competition in the textiles industry etc.). The demand-side changes were also confirmed by structural developments in industrial production by use, where the strongest increases were recorded for investment products and intermediate products.

Although services again made the largest contribution to GDP in 2004 Q4 (about 70%), their contribution to GDP growth was much lower than that of industry. Gross value added growth within the services sector was, however, very mixed. As Chart III.28 shows, the higher GDP within the services sector was attributable to financial intermediation and other business services, wholesale and retail trade and transport. Gross value added growth in the trade sector continued to be accompanied by structural changes, as the share of large shops (supermarkets etc.) in the total number of sales outlets was increasing. By contrast, gross value added in other services and hotels and restaurants (accommodation, services) recorded a marked year-on-year decline. Above-average annual value added growth (of 25%) was recorded in agriculture, forestry and fishing. Given its low weight in the total GDP volume, its contribution to GDP growth was three-quarters of a percentage point. On the other hand, construction made no contribution to GDP growth for the third consecutive quarter, as gross value added fell short of the level of the same period a year earlier.

III.5.4 Financial performance of non-financial corporations[19]

The latest figures on the financial performance of large non-financial corporations for 2004 confirmed persisting favourable trends in output, profit and profitability indicators in the last quarter of 2004, as had been signalled by the results for the first three quarters of the year.[20] The favourable financial results were linked with the continuing economic

CHART III.28
Industry was the biggest contributor to the 4.3% GDP growth recorded in 2004 Q4
(contributions in percentage points; selected branches)

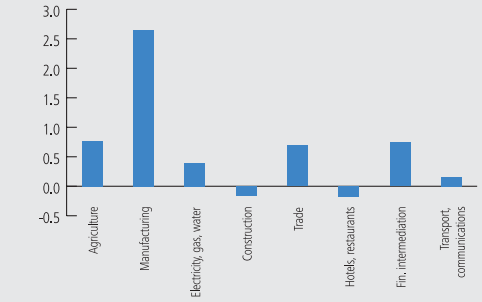


CHART III.29
Almost half the production in industry was exported in 2004
(shares in total industrial sales - domestic and external - at constant prices)

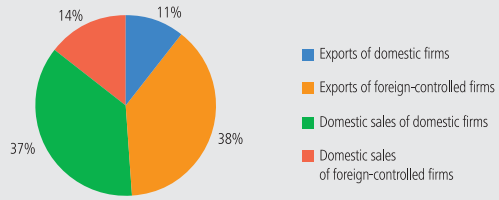
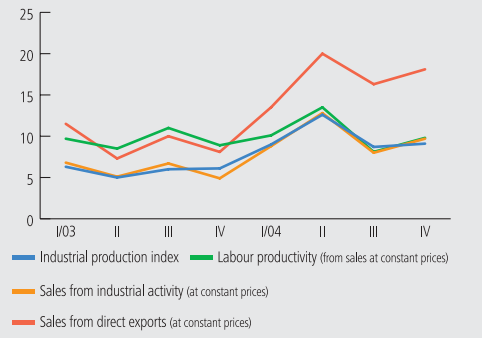


CHART III.30
The rapid growth in production in industry was achieved amid high productivity growth
(annual percentage changes)



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

[20] Large corporations account for about one-half of the main output and balance-sheet indicators of the non-financial corporations sector.

TABLE III.7

Earnings were up significantly in 2004 compared to 2003

(annual percentage changes)

	2004	
	Organisations, total	Industry
Income, total	12.1	14.2
Output, total	13.5	14.7
Expenses, total	11.0	12.9
of which: cost of sales	14.5	15.1
personnel costs[a]	7.3	6.7
depreciation	3.3	5.0
Book value added	11.2	13.8
Pre-tax profit	33.5	36.1
Net operating surplus	27.1	32.9

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

TABLE III.8

A higher material cost-output ratio year on year was partly offset by a falling personnel cost-output ratio

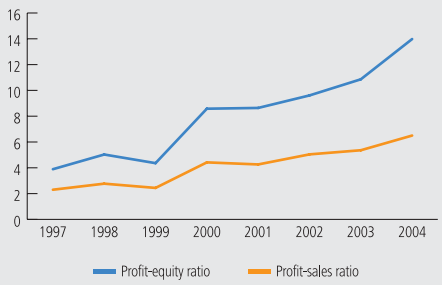
(percentages; percentage points; CZK thousands)

	2004		Change in perc. points against 2003	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	6.24	7.23	1.05	1.23
Profit-equity ratio	13.98	15.42	2.74	2.95
Profit-sales ratio	6.50	7.51	0.96	1.17
Sales-assets ratio	1.14	1.09	0.09	0.08
Material cost-output ratio	70.75	74.10	0.59	0.21
Personnel cost-output ratio	14.85	11.74	-0.94	-0.89
Ratio of wage costs to value added	50.80	45.35	-1.90	-3.02
	CZK thousands per month		annual percentage changes	
Book value added per employee	51.30	56.77	11.40	14.86

CHART III.31

Fast-growing earnings in 2004 generated a higher profit-equity ratio

(percentages)



growth, accompanied by high export growth, confirming the ability of Czech firms to compete on foreign markets.

A large annual pre-tax profit increase of 33.5% (within which net operating surplus grew by 27.1%)[21] was achieved amid 12.1% growth in income. Expenses grew more slowly overall (by 11% year on year), but the structural developments again confirmed faster growth of cost of sales[22] and a year-on-year rise in the material cost-output ratio connected with stronger growth in prices of imported inputs. This effect was offset by a falling personnel cost-output ratio.

Table III.8 shows that the aggregate profit-expenses and profit-output ratios also developed favourably. The year-on-year rise in the profit-expenses ratio indicated that the fast-growing prices of imported energy-producing and non-energy-producing materials (see section III.7 *Import prices and producer prices*) had only a minor effect on the financial results of large corporations. When analysing the impact of the high growth in prices of external inputs on corporate financial performance, one should, however, consider whether, and to what extent, corporations reflected the higher costs in their prices. According to CZSO data, producer prices reacted more strongly to the external cost shock in branches with a high proportion of imported energy-producing materials and metals. Consequently, prices grew more markedly in the small number of industries at the first stages of the "product vertical" (see section III.7 *Import prices and producer prices*). The year-on-year increase in profit margins in these industries in 2004 suggested that the price changes fully offset the higher growth in external input prices and that this increase in margins was made possible by favourable demand-side conditions.

Structural analyses also showed that the high year-on-year profit growth in 2004 was associated to a lesser extent with capital expansion in the form of investment. To a larger extent, the profit creation was attributable to better use of capital, as evidenced by a higher profit-equity ratio and, within it, a large increase in the overall sales-assets ratio in particular. The profit-sales ratio also saw a slight increase.

The favourable financial performance in 2004 was reflected in a rise in the proportion of profitable corporations (to about 80%) and a fall in corporations reporting negative capital and corporations owing wages. Corporate differentiation by financial results also decreased. Operating surplus increased significantly year on year in all monitored corporation types by form of ownership[23], although greater differences persisted in profit-equity ratios. Throughout 2004, output and value added grew fastest in foreign-controlled corporations. In 2004, these corporations accounted for 45% of the total output and 51.1% of the earnings of the corporations monitored.

III.6 THE LABOUR MARKET

The labour market developments at the end of 2004 and the start of 2005 confirmed a gradual narrowing of the gap between the supply of, and demand for, labour. The further easing of labour market conditions was fostered mainly by the continuing GDP

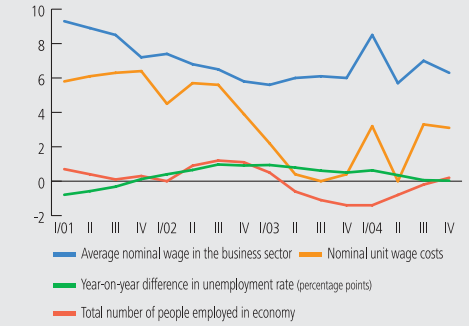
[21] Profit on a corporation's core business.

[22] Cost of sales accounts for about 70% of the value of output.

[23] Foreign-controlled corporations, national private corporations and public non-financial corporations.

growth and FDI inflows. These factors generated a renewed rise in the number of employed people and a modest fall in unemployment. The turnabout on the labour market was also indicated by a gradually rising number of new jobs. Faster growth in the number of employed people and a corresponding fall in unemployment were again prevented by structural unemployment, as indicated primarily by a persisting relatively high share of long-term unemployment. Average nominal and real wage growth was slower than in 2004 Q3, and whole-economy labour productivity growth stabilised at a higher level. Nominal unit wage cost growth did not depart from the pattern of the previous quarters of 2004 and again differed across the individual sectors. In industry, these costs recorded a year-on-year decrease. Overall, the evolution of the personnel cost-output ratio throughout 2004 did not suggest any build-up of across-the-board upward pressures on prices.

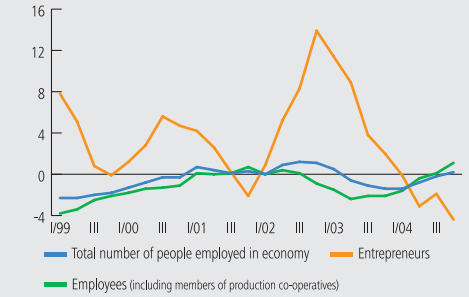
CHART III.32
The steady improvement on the labour market continued
(annual percentage changes and percentage point changes)



III.6.1 Employment and unemployment

An improving situation on the labour market was signalled by the main employment and unemployment indicators throughout 2004. The fall in employment moderated and in Q4 switched to modest annual growth (of 0.2%, or 7,700 persons, according to LFS figures). However, this positive change was visible solely in the employees category[24], where employment started growing in the second half of 2004 (to 1.1% in Q4) after a long-running decline. Conversely, the number of entrepreneurs gradually decreased. The likely factors underlying this decrease were changes to the tax laws in 2004 and a simultaneously improving supply of steady employment opportunities on the labour market[25]. The easing labour market conditions were also indicated by a larger rise in the number of vacancies (labour offices registered 11,000 more vacancies at the end of March than a year earlier).

CHART III.33
Employment in the employees category rose further in 2004 Q4
(annual percentage changes)



The renewed rise in employment and higher job creation were largely due to the continuing relatively stable growth of the Czech economy, supported by rising domestic and external demand. The upturn in demand for labour was also fostered by continuing inflow of FDI, as evidenced by relatively high year-on-year growth in the number of employees in large foreign-controlled corporations[26] in 2004. Table III.9 shows that employment increased in all the main sectors of the Czech economy at the end of 2004. Particularly important was the recovery in employment growth in industry, even though this was quite mixed across the individual branches – as it was in the services sector. Labour demand increased primarily in branches experiencing rising external demand for their products. This was counteracted in some industries by strong competition exerting downward pressure on wage costs (for example in the textile and clothing industry due to Asian competition).

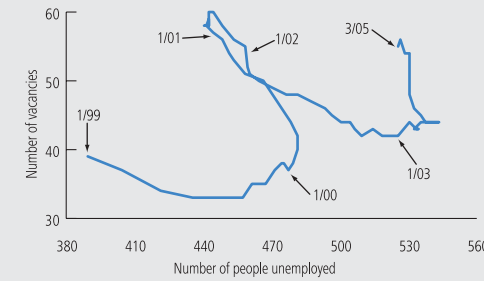
TABLE III.9
Labour demand increased in all the main sectors of the economy in 2004 Q4
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4
Industry, total	-1.5	-0.8	-0.3	0.4
of which:				
Manufacturing	-2.5	-1.8	-0.9	0.6
Construction	-7.4	-2.7	1.7	4.8
Services	0.1	1.0	0.9	2.5

Source: LFS (including members of production co-operatives)

The growing supply of vacancies fostered a turnabout in the unemployment indicators at the start of 2005. According to the latest data, the number of registered unemployed was down by more than 19,000 year on year at the end of March, whereas in September 2003 it had still been increasing. The same trend has been recorded in recent months for the seasonally adjusted registered unemployment rate. According to the latest data for March 2005, the registered unemployment rate decreased by 0.4 percentage point year

CHART III.34
According to Beveridge curve the rise in vacancies was not accompanied by a corresponding fall in the number of people unemployed
(seasonally adjusted numbers in thousands)



[24] Including members of production co-operatives.

[25] In an economic recovery phase some entrepreneurs move to more steady employment. The LFS monitors employment in terms of sole or principal employment.

[26] i.e. corporations with 100 employees or more.

CHART III.35
A greater fall in unemployment continued to be prevented by structural unemployment, as indicated by the persisting high share of long-term unemployment
(source: LFS)

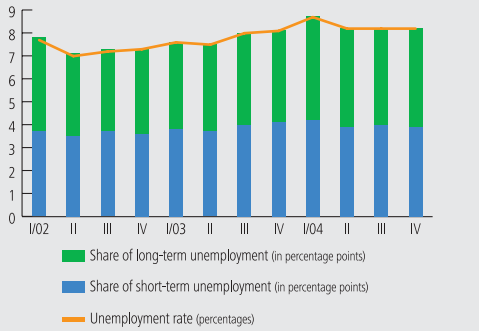
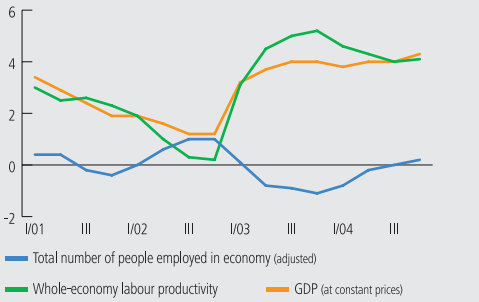


TABLE III.10
Average nominal wage growth slowed again at the end of 2004 Q4, but the figure for 2004 as a whole was the same as in 2003
(annual percentage changes)

	I/03	II/03	III/03	IV/03	2003	I/04	II/04	III/04	IV/04	2004
Average wage in monitored organisations										
nominal	7.2	6.8	6.3	6.9	6.6	8.7	4.2	7.3	6.3	6.6
real	7.6	6.7	6.4	6.1	6.5	6.3	1.6	4.0	3.1	3.7
Average wage in business sector										
nominal	5.6	6.0	6.1	6.0	5.9	8.5	5.7	7.0	6.3	6.9
real	6.0	5.9	6.2	5.2	5.8	6.1	3.0	3.7	3.1	4.0
Average wage in non-business sector										
nominal	13.9	9.2	7.5	9.7	9.5	9.6	-0.5	8.3	6.4	5.7
real	14.4	9.1	7.6	8.8	9.4	7.1	-3.0	4.9	3.2	2.8
Whole-economy labour productivity	3.1	4.5	5.0	5.2	4.4	4.6	4.3	4.0	4.1	4.2
Nominal unit wage costs	2.2	0.4	0.0	0.4	0.8	3.2	0.0	3.3	3.1	2.3

CHART III.36
Annual growth in whole-economy labour productivity stabilised above 4% in 2004
(annual percentage changes)



on year, to 10.3%. Under the new methodology[27] it was down by almost 1 percentage point, at 9.4%.

A larger decrease in unemployment continued to be prevented by high structural unemployment, as indicated for numerous quarters by relatively high long-term unemployment (more than one year), reflecting skills and regional gaps between the supply of, and demand for, labour. According to the latest LFS figures for 2004 Q4, the share of the long-term unemployed in the total number of people unemployed was 52.2%. Chart III.35 clearly illustrates the consequences of the low flexibility of the Czech labour market.

III.6.2 Wages and productivity

Average nominal and real wage growth slowed again in 2004 Q4 compared to the previous quarter (to 6.3% and 3.1% respectively year on year). This slowdown took place in both the business and non-business sectors. The changes in wage growth recorded at the end of 2004 thus completed the picture of a quite volatile average wage trend overall during the year.

In aggregate, however, the average nominal wage growth rate in monitored organisations in 2004 was the same as in 2003 (6.6% year on year). But this conclusion does not apply to average real wages or to wages in the two monitored sectors. Real wages grew much more slowly in 2004 than in 2003, because of the considerably higher annual consumer price inflation in 2004 than in 2003. The different wage trends in the business and non-business sectors in 2004 compared to the previous year also resulted from other factors mentioned below.

In the business sector, annual average nominal wage growth rose by 1 percentage point in 2004 (to 6.9%). This pick-up was largely a result of favourable domestic and external demand, labour productivity growth and the improving performance of most corporations in industry. By contrast, average nominal wage growth in the non-business sector was down by almost 4 percentage points in 2004 (to 5.7%), following sizeable increases in 2003. The higher volatility and overall lower average wage growth in this sector in 2004 were due to changes in the volume of bonus monthly wages (known as the "thirteenth" and "fourteenth" paycheques).

Whole-economy labour productivity growth was above the 4% level throughout 2004 (4.1% in Q4), thanks to the relatively rapid GDP growth accompanied by the only modest employment recovery in the economy. This growth was mostly attributable to the business sector in industry, where annual productivity growth exceeded 10% in 2004 as a whole (9.8% in Q4).[28] The robust productivity growth in industry was largely the result of the launching of new production facilities and a large increase in export production.

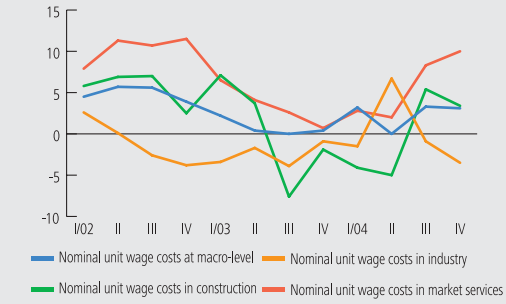
The most important factor as regards inflation, though, was how wages developed in relation to productivity indicators. Given the broadly subdued wage growth coupled with the relatively rapid growth in whole-economy productivity, the personnel cost-output ratio was not high in 2004. The causes of the year-on-year growth in nominal unit wage costs (Table III.10) must be sought primarily in the non-business sector and some

[27] The methodological definition of this indicator was published in the October 2004 Inflation Report.

[28] Calculated from sales at constant prices.

services. In industry, which is most exposed to the external competitive environment, productivity growth throughout 2004 was faster than average real wage growth, and nominal unit wage costs decreased year on year (by 3.5% in Q4). In construction, the nominal unit wage cost growth in 2004 H2 was short-term in nature, being linked with increased invoicing in Q2 prior to the introduction of new VAT rates. This assumption was confirmed by renewed growth in productivity and another drop in nominal unit wage costs in this sector at the beginning of 2005.

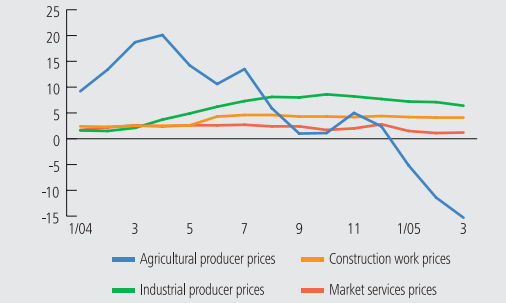
CHART III.37
Annual growth in nominal unit wage costs at the macro-level fluctuated mostly around the 3% level in 2004
(annual percentage changes; selected branches)



III.7 IMPORT PRICES AND PRODUCER PRICES

Unlike in the previous quarters of 2004, import prices and domestic producer prices at the start of 2005 signalled falling cost-push inflationary pressures. Import price growth eased markedly at the end of 2004 and turned into an annual decline at the start of 2005. This was largely due to year-on-year appreciation of the koruna's exchange rate, which substantially cushioned the impacts of the still rapidly rising world prices of key raw materials on import prices. The stronger exchange rate at the same time helped to accelerate the year-on-year fall in prices of imported products with a higher degree of processing and slow the rise in import prices of intermediate products. The slower rise in import prices created conditions for an easing of annual industrial producer price inflation. Prices of products with a higher degree of processing mostly decreased in year-on-year terms. Thanks to the good harvest in 2004 and other factors, agricultural producer prices were falling year on year by the start of 2005 and inflation in the related food industry slowed. By contrast, energy price inflation (electricity, coal) picked up further.

CHART III.38
Producer price inflation moderated in all the main sectors of the economy in 2005 Q1
(annual percentage changes)



III.7.1 Import prices

The rapid moderation of annual import price growth at the end of 2004, which switched to an annual decline at the start of 2005, represented a change in trend. After a slight reduction of 0.4% in January, the decline in import prices deepened further in February (to -1.1%), according to the latest CZSO figures.

However, this decline was not due primarily to prices of imported key commodities, but rather to an increasing fall in import prices of higher-value-added products – machinery and transport equipment and miscellaneous manufactured articles. The cause of the import price reduction in these categories lies primarily in the decreasing prices of these commodities in our main trading partner nations combined with year-on-year appreciation of the koruna-euro and koruna-dollar exchange rates. The decline in import prices at the start of 2005 was also partly attributable to chemicals and related products, food and vegetable oils, whose prices had been increasing throughout 2004.

TABLE III.11
After a prolonged period of annual growth, import prices fell slightly at the start of 2005
(annual percentage changes)

	7/04	8/04	9/04	10/04	11/04	12/04	1/05	2/05
Imports, total	2.5	2.2	2.2	3.3	2.1	0.1	-0.4	-1.1
Food and live animals	4.2	1.8	1.7	1.9	0.7	-1.2	-0.1	-0.5
Beverages and tobacco	6.2	5.4	5.9	5.1	3.6	4.3	4.3	2.3
Crude materials except fuels	13.2	11.6	11.3	9.7	6.3	3.4	3.3	3.3
Mineral fuels and related products	10.7	11.9	15.4	23.5	17.3	14.1	18.0	19.3
Animal and vegetable oils	6.3	4.5	3.5	3.7	4.6	0.6	-3.3	-5.7
Chemicals and related products	2.0	2.4	1.9	2.6	2.6	0.6	-1.0	-2.2
Manufactured goods classified by material	5.0	4.7	4.6	5.5	4.4	2.5	1.4	0.5
Machinery and transport equipment	-1.5	-2.1	-2.3	-2.1	-2.6	-4.2	-5.3	-5.7
Miscellaneous manufactured articles	-0.1	-0.4	-0.6	-0.4	-0.8	-2.6	-4.4	-6.0

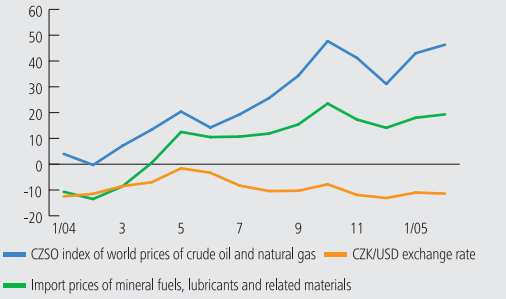
Conversely, import prices of raw materials showed mixed developments at the end of 2004 and the start of 2005. Annual growth in raw materials and food prices on world markets picked up again at the start of 2005[29]. This, however, was due mostly to a pick-up in oil and natural gas price growth[30]. By contrast, the substantial year-on-year

[29] The CZSO's annual world price index increased from 24.8% in December 2004 to 35.7% in February 2005.

[30] Annual growth of world natural gas prices rose from 26.2% in December 2004 to 41.4% in February 2005. Oil price growth increased from 26.2% to 51.2% year on year in the same period.

growth in prices of metals fell by about one half (from 21.5% in December to 11.1% in February). Prices of other raw materials and food continued falling year on year.

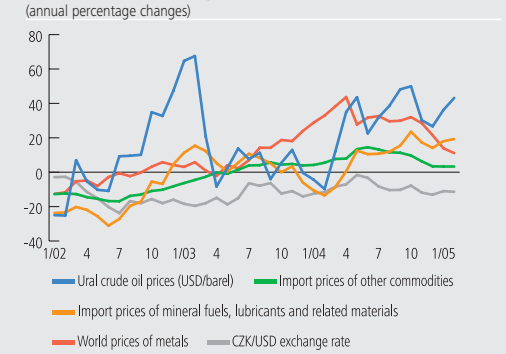
CHART III.39
The impacts of the fast-rising world prices of raw materials on import prices continued to be corrected by the koruna-dollar exchange rate
(annual percentage changes)



As in previous quarters, the impacts of world prices on domestic prices were strongly corrected by the koruna's exchange rate[31]. Oil and natural gas price growth was as much as 10 percentage points higher in early 2005 than in late 2004, but this increase was almost fully offset by year-on-year appreciation of the koruna-dollar exchange rate. Import prices of mineral fuels, lubricants and related materials thus grew at roughly the same rate at the start of 2005 as in the last two months of 2004 thanks to the "dampening" exchange rate (see Table III.11). The change in the overall import price trend was, however, aided by prices of non-energy-producing raw materials, whose year-on-year growth slackened by almost one half compared to November 2004 (to 3.3% in February) thanks to weaker growth in metal prices on world markets and the year-on-year appreciation of the koruna-dollar exchange rate.

Owing to the year-on-year appreciation of the koruna and the weaker growth in some commodity prices abroad, the number of import categories with annually falling prices increased to five out of nine. Higher inflation was recorded only in the mineral fuels category, as the growth in prices of other raw materials eased considerably. Growth in prices of imported manufactured goods also slowed sharply, after having risen quite quickly during 2004.

CHART 1(BOX)
The high growth in world commodity prices was significantly offset by year-on-year appreciation of the koruna-dollar exchange rate
(annual percentage changes)



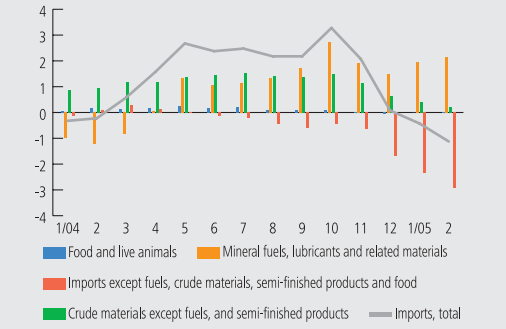
BOX
The transmission of external cost shocks into domestic prices in 2003-2005

The history of the current external cost shock is associated with year-on-year growth in prices of energy-producing materials and metals on world markets, which emerged in mid-2002 and, with some fluctuations, gradually accelerated to high figures in 2004. World commodity prices are, via import prices, an important inflation factor in the Czech Republic, owing to the high openness of the Czech economy and the high import intensity of GDP.

However, the contribution of the rising oil, gas and metal price growth to the upturn in import price inflation was less intense, since it was significantly dampened by year-on-year appreciation of the koruna-dollar exchange rate (Chart 1). As a result, the year-on-year rise in prices of imported inputs was not high in 2003, and a more pronounced acceleration was recorded only during 2004 due to a more marked pick-up in prices of these commodities on world markets. The annual growth in prices of imported energy-producing and non-energy-producing materials reached quite high levels in 2004 and was a key factor underlying the pick-up in total import price inflation (Chart 2). At the start of 2005, total import growth decreased year on year, but commodities prices continued rising.

Greater impacts of the increasing prices of external inputs on producer prices were apparent in 2004. The high prices of imported energy-producing materials and metals most strongly affected industrial producer prices (PPI) and prices of materials and products consumed in the construction industry. Within industry, their effect was most pronounced in branches involved in primary oil and metal processing. Chart 3 shows that

CHART 2(BOX)
High growth in import prices of energy-producing materials and metals was the key factor of the total import price growth
(annual percentage changes; contributions in percentage points)



[31] The koruna-dollar exchange rate appreciated year on year by 9.67% in 2004 Q3, 10.92% in 2004 Q4 and 12.46% in 2005 Q1. The koruna-euro annual appreciation was lower, at 1.83%, 2.96% and 8.41% respectively.

price increases in these manufacturing branches were the main reason for the high PPI growth in 2004, which fluctuated above 7% in the second half of the year.

The evolution of producer prices at the individual stages of the product vertical in oil-based branches indicated that the transmission of the increased prices of external cost inputs was very fast. Its gradual slowdown at subsequent stages of the product vertical towards products with a higher degree of processing can be explained by a falling proportion of oil intermediate products in the total product. The high annual growth in producer prices in branches involved in primary oil product processing – manufacture of coke and refined petroleum products – was almost the same as that of oil prices on world markets and fully covered the rise in prices of imported inputs, since profit margins in this industry rose year on year. In the chemical industry, prices rose more slowly. The relatively low inflation in the branches of this industry which lie at the end of the product vertical, whose output includes final products, was probably also affected by the strongly competitive environment on the consumer market.

In branches whose production depends heavily on metal inputs, annual producer price inflation also decreased in the product vertical towards products with a higher degree of processing. Compared with oil-based industries, however, the transmission process was rather slower and the producer prices of some products with a high degree of processing even showed annual decreases. The slower transmission in metal-based branches was due to different needs for basic material inputs, the length of technological processing and, in some branches, the demand situation.

The high price growth in primary industries reflected the robust demand for these products. By contrast, falling year-on-year prices of transport equipment and some other products with a high degree of processing suggested that both the Czech market and the markets of other European countries are currently saturated with such products. In the manufacture of machinery and equipment, a pick-up in investment demand allowed the increased input costs to be reflected in prices.

The evolution of producer prices in 2004 shows that the transmission of large external cost shocks is quite quick. The speed and intensity of transmission, however, is also dependent on other factors, in particular the koruna's exchange rate, the type of products produced (share of input material, length of technological processing), the level of demand, and competition on the market. In 2004, the impact of external cost pressures was also softened by increasing productivity and subdued wage growth. Producer prices at the last stages of the product vertical were furthermore affected by conditions on the consumer market, in particular increasing foreign competition.

CHART 3(BOX)
Fast-rising prices of external inputs were the main cause of the high industrial producer price inflation
(annual percentage changes; contributions in percentage points)

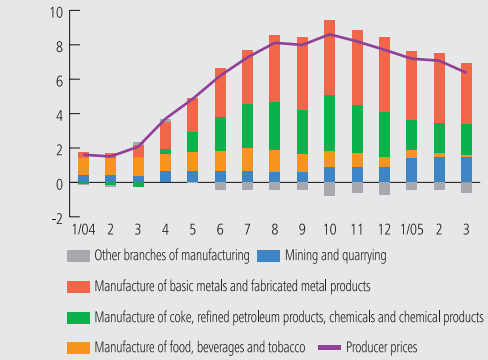


CHART 4(BOX)
The intensity of transmission of the high oil prices into product prices in the product vertical gradually decreased
(annual percentage changes)

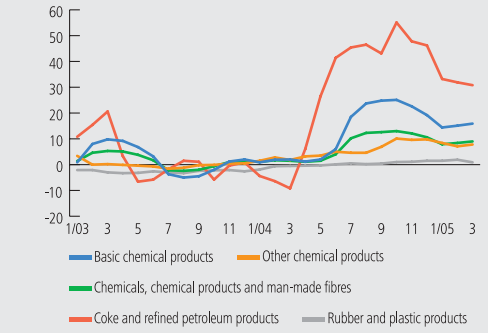
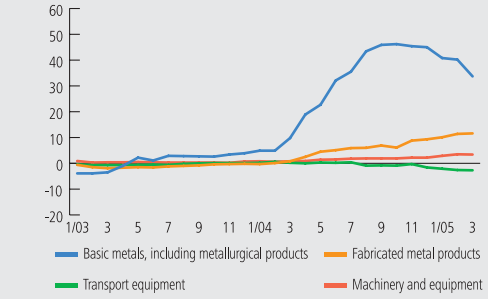


CHART 5(BOX)
The transmission of the high metals prices in the product vertical also gradually diminished
(annual percentage changes)



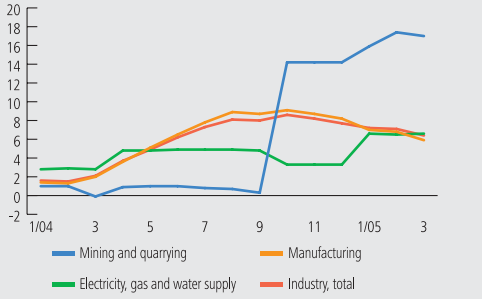
III.7.2 Producer prices

Industrial producer prices

The gradual slowdown in the relatively pronounced year-on-year growth in industrial producer prices, which started in 2004 Q4, continued into 2005 Q1. Compared to December 2004, industrial producer price inflation fell by 1.3 percentage points to 6.4% in March. This slowdown was attributable to several industries.

As in most of 2004, about one-half of the annual increase in industrial producer prices at the start of 2005 was due to buoyant growth in prices of metals and metal products (of 24.2% year on year in March). The sharper fall in annual growth of

Chart III.40
Industrial producer price inflation eased further at the start of 2005, but was still high
(percentages)



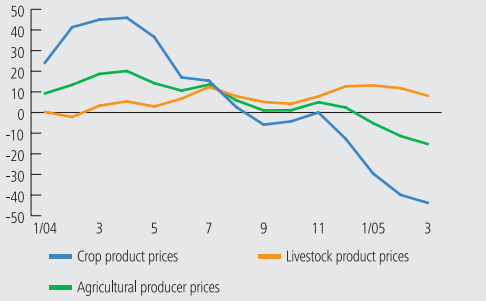
world prices of metals and subsequently in import prices at the end of 2004 and in early 2005 had yet to pass through into producer prices in metal-processing industries. Consequently, their contribution to industrial producer price inflation decreased only slightly (see Chart 3 Box).

The lower industrial producer price inflation in 2005 Q1 was also due to industries involved in processing energy-producing materials – manufacture of coke and refined petroleum products and manufacture of chemicals, chemical products and man-made fibres (to 30.7% and 9.0% respectively year on year in March). The declining inflation in these industries resulted from slower growth in import prices of mineral fuels in the last two months of 2004. Food producer prices also grew more slowly at the beginning of 2005 (0.5% year on year in March). The continuing moderation of inflation in this industry reflected the lagged pass-through of falling prices of agricultural commodities of vegetable origin (for details see the section *Agricultural producer prices*).

Conversely, non-manufacturing industries recorded a pick-up in inflation. In particular, inflation in mining and quarrying continued rising (to 17% in March), mainly because of rising coal prices. Prices also grew in the electricity, gas and water supply industry, owing to growth in prices of electricity for the corporate sector (to 6.6% year on year in March).

Although industrial producer price inflation was still quite high at the start of 2005, the growth was not across the board in nature. The faster price growth was concentrated in just a few sectors with a relatively high share of input raw materials in the price of the final product. In industries with a higher proportion of sophisticated products, the effect of the increasing prices of the aforementioned external inputs did not pass through into producer prices. Some industries[32] saw a deepening disinflation trend at the start of 2005. Companies partly offset the unfavourable effects of the rising prices of imported inputs by reducing their wage cost-output ratios. The persisting positive terms of trade acted in the same direction.

Chart III.41
Underlying the decline in agricultural producer prices were contrary movements in crop and livestock product prices
(annual percentage changes)



Agricultural producer prices

At the end of 2004 and the beginning of 2005, agricultural producer prices recorded a continuing downward trend in growth. This trend, which culminated in a decline in prices, has been apparent, with some volatility, since mid-2004. By the end of 2004 agricultural producer price inflation was already quite low, and by 2005 Q1 prices were falling (-15.3% in March).

This was primarily due to crop products, whose prices showed a much stronger year-on-year decline between December 2004 and March 2005 to the lowest level since 1992 (-43.8% in March). This extraordinary development reflected the good harvest in 2004 (particularly for cereals), which changed the supply-demand relationship in the agricultural commodity market. No less important from the point of view of domestic inflation, however, was the pronounced year-on-year appreciation of the koruna-euro exchange rate since November 2004, which reduced the level of EU intervention prices and at the same time made food imports to the domestic market cheaper. It is likely that

[32] Manufacture of machinery and transport equipment and manufacture of electrical and optical equipment.

this factor contributed to the substantial fall in prices of vegetables and potatoes at the start of 2005. The deepening annual price decline in crop production was also partly affected by a different price index structure, which has been changing from month to month (after EU accession some crops recorded marked annual growth in the autumn months, but were not included in the index at the start of 2005).

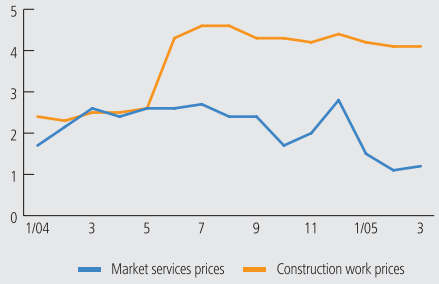
By contrast, prices of the higher-weight livestock products continued to record fast year-on-year growth at the beginning of 2005, although this did slow somewhat compared to the end of 2004 (to 8.1%). As mentioned in the January Inflation Report, the reasons for the continuing rapid growth of livestock product prices can be seen particularly in improved opportunities to export these products to EU countries at better prices (cattle, milk). Growth in prices abroad – due to excess demand – thus indirectly generated growth in domestic prices, and did so to a larger extent than in previous years.

Other producer prices

Construction work prices showed no major changes at the beginning of 2005 compared to the previous quarter. Their year-on-year growth merely slowed somewhat, again fluctuating just above 4% (4.1% in March according to preliminary estimates). The continuing upturn in construction work price inflation was largely due to the relatively strong recovery in investment demand in the economy. Prices of materials and products consumed in the construction industry grew as well. The rapid growth of these prices (7.7% in March year on year) reflected, in addition to demand side factors, the lagged pass-through of rising prices of metals on world markets into prices of products used in the construction industry (steel structures).

At the start of 2005, inflation also slowed in the category of market services for the business sector. Chart III.42 shows that the slowdown here was more pronounced than in construction and that prices of market services saw only modest growth in March (1.2% year on year). This trend was apparent in most of the services included in this price index, but the biggest inflation declines were recorded in insurance and business services. Prices in telecommunication services fell year on year in March 2005. The main factor of the inflation slowdown was probably stronger competition, reflecting the very high number of providers of the services included in the index of market services for the business sector.

Chart III.42
Inflation slowed in both construction and market services at the start of 2005
(annual percentage changes)



IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB draws on the publication Consensus Forecasts, which brings together the forecasts of a whole range of foreign analytical teams. Recent information in this publication suggests that the impact of the external environment on the Czech economy going forward can be assessed as less favourable to growth compared to the January forecast.

Table IV.1
The price of Ural crude oil is expected to fall

	II/05	III/05	IV/05	I/06	II/06	III/06	IV/06	I/07
Ural crude oil prices (USD/barrel)	45.6	42.3	40.6	39.6	39.5	39.5	39.5	39.5
Natural gas prices (by import structure, USD/1000m^3)	187.17	196.4	199.6	199.9	199.3	198.8	198.5	198.2
GDP in Germany (annual, in per cent)	0.8	1.0	1.1	1.3	1.4	1.5	1.5	1.6
Producer price inflation in Germany (annual, in per cent)	3.1	1.9	1.0	0.4	1.0	1.9	2.3	2.2
Consumer price inflation in Germany (annual, in per cent)	1.5	1.3	1.2	1.2	1.1	1.2	1.3	1.4
Nominal USD/EUR exchange rate	1.308	1.321	1.323	1.326	1.328	1.324	1.320	1.319
1 Y EURIBOR	2.3	2.3	2.4	2.5	2.6	2.6	2.7	2.7

The CNB's forecasting system uses data on the German economy to proxy for developments in the Czech Republic's major trading partner nations. By comparison with January, the April Consensus Forecasts prediction for GDP growth in Germany this year has been revised from 1.3% to 0.9%. The outlook for 2006 remains unchanged, however, at 1.4%. The expectations regarding consumer price inflation in 2005 are still at 1.4%. The forecast for CPI growth in Germany in 2006 is about 1.2%, compared to 1.5% in the previous forecast. By contrast, the outlook for German industrial producer price inflation in 2005 has increased significantly, by 0.9 percentage point to 2.5%, due to rising oil prices. In 2006, PPI inflation should reach approximately 1.4%, down by 0.2 percentage point compared to the January assumptions.

Given the recent developments on world markets, the current forecast assumes a Ural crude oil price of USD 46 a barrel in 2005 Q2 and then a gradual decline to USD 40 a barrel in the remainder of the year. In 2006, oil prices are expected to be stable at roughly this level. The impact of the higher oil prices will be magnified only slightly by a modest revision of the outlook for the dollar-euro exchange rate towards a stronger dollar. The outlook for foreign interest rates is unchanged from the assumptions of the January forecast, with just a slow rise in nominal 1Y EURIBOR rates still expected.

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to projections regarding the external environment, assumptions about the domestic economy are an important input to the forecast. These include an estimate of the effect of fiscal policy. The public budget results for 2004 – and in particular the extraordinary savings (additions to reserve funds) in the state budget due to changes in the budgetary rules – suggest a more restrictive fiscal policy effect last year than previously expected. As a result, the estimate for the future evolution of public budgets has also changed to a great extent. By comparison with the January forecast, the estimate for the public budget deficit (under the national accounts methodology) has been reduced from 4.7% to 4.0% of GDP in 2005, and the outlook for 2006 is for a further moderate fall below 4%. Given the 2004 developments, the expected public budget deficits imply quite a sizeable easy fiscal policy effect in 2005. According to current estimates, fiscal policy should have a neutral effect on economic activity in 2006. The estimated evolution of public finances is, however, still connected with a number of significant uncertainties.

Assumptions regarding the equilibrium values of key macroeconomic variables are another important factor for the message of the forecast. This is because the starting conditions of the forecast, i.e. the current position of the economy in the business cycle and the current settings of the monetary conditions, are determined as the difference between current and equilibrium values. The evolution of the equilibrium values then provides a framework for the fundamental orientation of the forecast. The variables that frame the forecast in this way include equilibrium real interest rates, the equilibrium real exchange rate and potential output (i.e. the non-accelerating inflation level of output).

The determination of the starting conditions is based on a number of auxiliary indicators and on analyses of information on economic activity, inflation, interest rates and the exchange rate. These analyses are based, in turn, on the linkages between these variables as perceived by the CNB's forecasting system.

Since the preparation of the January forecast, no information has emerged leading to a revision of the evolution of equilibrium real interest rates and the equilibrium real exchange rate. As in the previous forecast, the one-year real equilibrium interest rate is set at 1.4%. As in January, the equilibrium real exchange rate is expected to strengthen at a rate of just under 3%. It will, however, gradually fall towards 2% in 2007. Compared to the January forecast, the estimate for growth in potential output (i.e. the non-accelerating inflation level of output) has been revised upwards to about 3.5%. The reason is the higher economic growth observed in the past, which was not accompanied by inflationary pressures.

The information published since the preparation of the January forecast is not inconsistent with the message of previous CNB forecasts. The new data on real economic activity indicate that the gradual closure of the output gap, which started in early 2004, is continuing. Underlying this trend are the easy monetary conditions in 2003 and 2004 and the modest economic recovery abroad last year. By contrast, the closure of the output gap was subdued by restrictive fiscal policy. Compared to the previous forecast, however, a modest revision has been made to the size of the initial output gap, which was slightly more open in 2005 Q1 than forecasted in January, despite the higher-than-expected GDP growth in 2004. This shift reflects the observed absence of significant demand-pull inflationary pressures, the more restrictive fiscal policy last year, and the less pro-growth effect of external demand.

The individual components of GDP also followed the trends of previous quarters. Domestic export growth – responding to the easy real exchange rate, the slight pick-up in external demand and the launch of export-oriented facilities – remained the major source of economic growth. Despite a modest slowdown, demand for fixed investment – linked to a large extent with exports – also maintained a high growth rate. The slowdown in private consumption growth, due mainly to a decline in real disposable income growth, continued into Q4, as did the fall in government consumption.

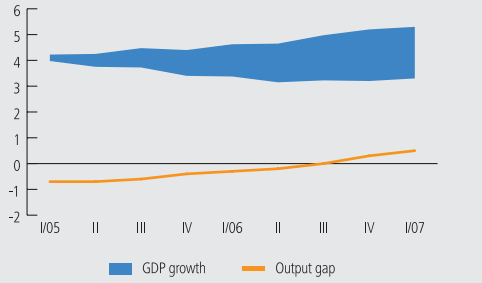
Consumer price inflation in 2005 Q1 was characterised by weakening cost-push inflationary pressures. The main role was played by import prices, which were affected by the koruna's appreciation against both the euro and the dollar. The persisting negative output gap acted simultaneously in a disinflationary direction. The combined effect of these two factors led to a decline in adjusted inflation excluding fuels. The expectations of the January forecast regarding food price inflation[33] also failed to materialise, as food prices remained flat year on year in Q1. This was one of the reasons for the aforementioned revision of the initial output gap towards greater openness.

Overall, the present real monetary conditions can be characterised as neutral. The moderately easy interest rate component of the monetary conditions has remained relatively stable recently. By contrast, the previously easy exchange rate component of the monetary conditions has become – for the first time in almost two years – moderately tight, owing to the latest evolution of the nominal exchange rate, characterised by fairly strong appreciation.

[33] Consolidated category of food and non-alcoholic beverages and alcoholic beverages and tobacco.

IV.3 THE MESSAGE OF THE FORECAST

CHART IV.1
The output gap will close in the second half of 2006
(annual percentage growth)



The starting conditions of the forecast, characterised by neutral real monetary conditions, combined with the downward revision of expected economic growth abroad, mean that the current forecast defers the date of closure of the output gap. According to the forecast, the crossing of the potential output level and the gradual emergence of demand-pull inflationary pressures should not happen until 2006 H2. Nonetheless, real GDP growth can be expected to stay relatively high this year and the next, at roughly 4%.

The current forecast sticks to the previous assumptions that the continuing growth in real economic activity will be driven primarily by exports and investment. Owing to a tight real exchange rate and sluggish external demand growth, exports will see a modest decline in growth this year compared to 2004 (to 10%). Despite this, exports will maintain quite a high growth rate this year thanks to structural changes. In 2006, as a result of an easy exchange rate, export growth will rise again.

Corporate investment activity will remain very closely linked to export growth. The latest exchange rate developments and the expected export slowdown are reflected in slightly lower investment growth in 2005 compared to the assumptions of the January forecast. However, the slowdown in investment activity will not be very significant thanks to good corporate financial results and persisting growth in lending. Growth in public budget capital expenditure will act in the same direction. Its positive contribution to investment growth will be one of the manifestations of the easy effect of fiscal policy on the economy in 2005. The positive fiscal impulse will also pass through directly into government consumption, whose growth will temporarily move into positive figures this year.

TABLE IV.2
The positive trends on the labour market will continue
(annual percentage changes)

	2005	2006
Real disposable income of households (annual growth in per cent)	4.0	3.2
Unemployment rate (in per cent)	9.8	9.4
Labour productivity (annual growth in per cent)	3.7	3.9
Current account deficit (ratio to GDP in per cent)	-3.7	-3.1
M2 (annual growth in per cent)	4.5	6.8

Households' real consumption will be determined above all by expected developments on the labour market. Here, the forecast assumes continuing growth in the number of employees in 2005 and 2006 (of about 1%), reflecting the positive effect of real economic activity. Wages will not depart from the trend of annual average nominal wage growth of about 7%, driven mostly by the corporate sector. Thanks to the more favourable trends on the labour market, and given the low expected inflation, households' real disposable income will thus rise in both years at a rate of around 3%–4%, slightly higher than assumed in the January forecast. In 2005, the forecast is for real household consumption growth of 3.5%, i.e. 0.5 percentage point higher than in the January forecast. In 2006, household consumption growth will increase further (by about 1 percentage point) compared to this year, thanks to easy real interest rates.

TABLE IV.3
Household consumption will grow faster
(annual percentage changes)

	2005	2006
Gross domestic product	4.1	4.2
Total domestic demand	4.6	5.0
of which:		
Household consumption	3.5	4.3
Government consumption	1.9	-1.9
Gross fixed capital formation	8.5	9.0
Imports of goods and services	10.1	12.6
Exports of goods and services	10.0	13.1
Net exports of goods and services in CZK billions	-263.2	-288.0

Growth in exports of goods and services at constant prices will, on the one hand, be affected by the expected decline in export growth; on the other hand, the domestic demand recovery, generated by the upswing in private consumption growth and the ongoing relatively high gross investment growth, will – owing to the exchange rate trend – result in import growth keeping pace with export growth. This will, abstracting from terms of trade development, lead to a renewed widening of the net export deficit at constant prices. At current prices, however, positive changes on the supply side of the economy and demand factors leading to growth in the export performance of the economy will be supported by continuing favourable terms of trade. This will be reflected in a gradual widening of the trade surplus and a reduction of the current account deficit as a percentage of GDP in the years ahead.

According to the forecast, the nominal exchange rate will stop appreciating and remain broadly stable in the next two years. This expected trend results from the forecast-consistent movement of the interest rate differential. The exchange rate will be the main factor affecting import prices. Owing to the koruna's appreciation at the end of 2004 and the start of 2005, import prices will have a more disinflationary effect this year than expected in the January forecast, whereas in 2006 the effect will be more inflationary. The box *The effect of the exchange rate on inflation* describes in detail the transmission of an exchange rate shock into the economy.

BOX
The effect of the exchange rate on inflation

The exchange rate is one of the macroeconomic fundamentals which significantly affect consumer price inflation. In a small and relatively open economy such as the Czech Republic, two channels through which the exchange rate affects inflation can in principle be monitored.

The first is the "direct channel", whereby the exchange rate affects, with a relatively small lag, prices of imported goods, i.e. goods intended directly for the consumer market as well as raw materials and semi-manufactures intended for production of consumer goods of domestic origin. The exchange rate affects not only prices of imported goods, but also – indirectly via import arbitrage – prices of domestic goods which are under competitive pressure from imported goods.

The second channel is the "indirect channel", whereby the change in the exchange rate, all other things being equal, affects the change in the real exchange rate. This, in turn, affects the economy via aggregate demand and a changed output gap (see the box in the October 2003 Inflation Report). However, by comparison with the direct exchange rate channel, the pass-through of the exchange rate change into the real exchange rate via impacts on economic activity and subsequently on inflation, is relatively slow.

Under its monetary policy regime of inflation targeting and a freely floating exchange rate, the CNB does not directly regulate the exchange rate. However, since changes in the exchange rate also affect inflation, the CNB conducts detailed analyses of the exchange rate, and each CNB macroeconomic forecast also contains the internally consistent outlook for the exchange rate. On the one hand, the exchange rate forecast affects future inflation and thus also monetary policy, which is aimed at keeping inflation near the inflation target. On the other hand, the exchange rate is in turn affected by monetary policy (via the difference between domestic and foreign interest rates).

The CNB's forecasting system enables it to analyse the impacts of deviations of the exchange rate from the baseline outlook contained in the forecast. This can be illustrated using the example of an appreciation of 1 koruna against the euro (i.e. a change of approximately 3% at the current exchange rate) against the starting assumptions of the baseline scenario in the first quarter of the forecast, with the euro-dollar exchange rate remaining unchanged (i.e. with simultaneous appreciation of the koruna-dollar rate). This simulation, which, however, does not constitute a full forecast, is illustrated in Charts 1 and 2. Inflation would start deviating downwards from the baseline scenario, and monetary policy, all other things being equal, would have to respond to this situation with lower interest rates than in the baseline scenario.

Chart 1 (Box)
Exchange rate shock - initial appreciation (of 1 CZK/EUR); effect on import prices
(change against baseline scenario of April forecast in percentage points)

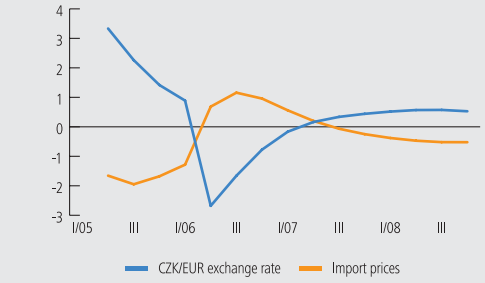
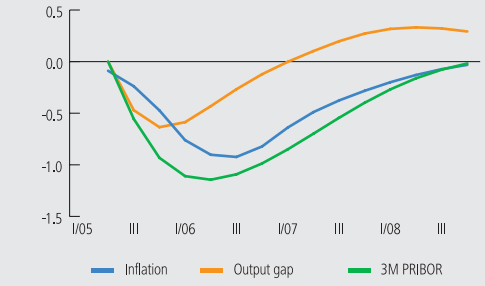


Chart 2 (Box)
Exchange rate shock - effect on output gap, nominal interest rates and inflation
(change against baseline scenario of April forecast in percentage points)



Overall, the inflation outlook in this illustrative example would decrease by around 0.8% at the one-year horizon compared to the baseline scenario. The model monetary policy response to the change towards a lower annual inflation path would be to lower interest rates by around 1%. At the same time, the lower nominal interest rates would cause the exchange rate to depreciate and would ease the monetary conditions tightened by the original exchange rate shock. At the horizon of approximately 18 months, the exchange rate would gradually return to the outlook contained in the baseline scenario of the forecast. Interest rates and inflation would follow it with a lag, at the horizon of two to three years.

Chart IV.2

The inflation forecast is below the point inflation target at the monetary policy horizon

(annual consumer price inflation; percentages)

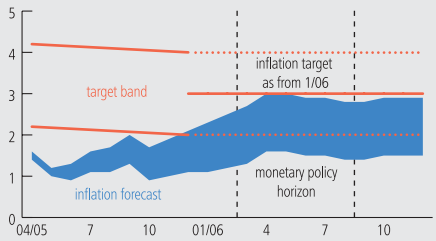


Table IV.4

Growth of inflation in 2006 will be driven by the gradual emergence of demand-pull inflationary pressures

(annual percentage growth)

	II/05	III/05	IV/05	I/06	II/06	III/06	IV/06	I/07
Annual consumer price inflation	1.2	1.5	1.4	1.9	2.3	2.2	2.2	2.0
Breakdown into contributions:								
regulated prices	3.7	5.1	3.6	2.3	2.4	2.3	2.2	1.5
indirect taxes (contributions in p.p.)	0.2	0.3	0.3	0.6	0.8	0.5	0.4	0.4
food prices, excluding effects of indirect taxes	-0.4	-0.6	0.2	0.3	1.1	1.2	1.1	0.5
fuel prices, excluding effects of indirect taxes	0.0	-0.2	1.0	9.7	2.6	0.4	-1.1	-1.9
adjusted inflation excluding fuels, excluding effects of indirect taxes	0.8	0.6	0.5	0.8	1.2	1.7	2.1	2.5

The expected inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other exogenous factors. The deferred emergence of future demand-pull pressures together with the downward shift in import price expectations leads to a downscaling of the inflation forecast over the entire forecast horizon. At the monetary policy horizon (April to September 2006) the inflation forecast is below the CNB's point inflation target.

Compared to the January forecast, the forecast for adjusted inflation excluding fuels has shifted downwards. Moreover, the forecast for food prices is falling, especially at the short-term horizon. This is due to a higher decline in agricultural producer prices thanks to the extraordinarily good harvest in 2004. The forecast is for headline inflation of around 1.6% at the end of 2005, compared to the 2.3% forecasted in January. In 2006, the forecast then expects the disinflationary effect of import prices to unwind and demand-pull inflationary pressures to arise. These, however, will emerge later and will be weaker than forecasted in January. Therefore, the forecast is below the CNB's point inflation target at the monetary policy horizon, and remains at low levels at the end of 2006. The return of inflation to the CNB's target is thus deferred to 2007. A modest shift in the estimate for regulated prices and tax adjustments has a negligible effect on the change in the message of the forecast.

The expected rise in excise duties on cigarettes had already been incorporated into previous forecasts. The forecast expects the first step of this increase to occur in June 2005 and the second step in January 2006. The assumption that these changes will have fairly limited secondary effects remains unchanged.

Consistent with the April forecast and its assumptions is a decline in interest rates in the near future and their subsequent stability. Compared to the previous forecast, the implied interest rate trajectory is thus lower over the entire forecast horizon.

Alternative scenarios were prepared within the framework of the April forecast. These consider a different fiscal policy effect, the risk of lower external growth and the risk of lower pass-through of the exchange rate into consumer prices.

The fiscal alternative reflects the uncertainty arising from the transfer of undrawn funds from the budget to reserve funds last year. Two versions of the alternative scenario have been drawn up. The first assumes lower drawing on reserve funds this year. This results in a still positive, but lower, contribution of fiscal policy to growth this year than in the baseline scenario, and, conversely, a higher contribution in 2006. By comparison with the baseline scenario this leads to slower closure of the output gap and the need for slightly easier monetary policy. In 2006, the output gap closes faster than in the baseline scenario and interest rates return to the baseline scenario.

The second version of the alternative scenario is exactly the opposite, reckoning with higher drawing on reserve funds and thus accelerating the pace of closure of the output gap this year. This generates the need for slightly tighter monetary policy. In 2006, the contribution of fiscal policy is revised downwards and the output gap gradually approaches the baseline scenario, as do interest rates. In this alternative, the different fiscal policy contributions this year and the next thus impact more on the forecast for real economic activity than on inflation.

The alternative scenario of lower external growth describes the risk of a further slackening of external demand compared to the reference scenario taken from Consensus Forecasts. It envisages a decline in real economic growth in Germany of 1 percentage point. The lower external demand has an anti-inflationary effect, with slower closure of the domestic output gap as a result of lower real exports. By comparison with the baseline scenario this alternative generates a need for easier monetary policy, due, among other things, to lower foreign interest rates.

The baseline scenario works with full pass-through of the observed appreciation of the nominal exchange rate via import prices into inflation through the linkages contained in the CNB's core forecasting model. However, some analyses suggest a possibility of lower pass-through of the observed decline in import prices into domestic inflation. In the alternative scenario, the sensitivity of import prices to the exchange rate is thus temporarily decreased. Higher inflation, and hence also higher inflation expectations, cause inflation to converge towards the target and lead to a slightly tighter setting of interest rates than in the baseline scenario.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The inflation outturns expected by financial market participants decreased slightly. The analysts expect inflation to decline further and fluctuate below the lower boundary of the CNB's inflation target band at least until the middle of this year. The anti-inflationary factors include the koruna's exchange rate and strong competition; demand in the economy is not exerting upward pressure on prices thus far, either. A slight pick-up in inflation is expected in the second half of the year, mainly because of administrative measures (excise duty on tobacco, a rise in regulated rents). Oil prices also present a risk. However, annual inflation should remain below the 3% level. The inflation expectations of corporations also declined. Conversely, a rise was recorded for households, but their expectations are traditionally more volatile.

The CNB also monitors inflation expectations at the three-year horizon. These are subject to smaller fluctuations, because they are not influenced by short-term factors. The inflation expectations of the financial market and corporations at this horizon are slightly below the CNB's target, while households' expectations are currently higher.

Expected interest rates decreased markedly in the period under review. Expectations regarding the CNB's key interest rates at the short-term horizon were broadly in line with the interest rates consistent with the CNB's forecast described above. At the longer horizon, the interest rates expected by financial market analysts were higher than forecasted by the CNB.

Table IV.5

The inflation expectations of economic agents were slightly below the CNB's target

(percentages)

	12/03	12/04	1/05	2/05	3/05
Consumer price index					
1Y horizon:					
Financial market	3.3	2.8	2.8	2.6	2.6
Corporations	2.9	3.2			2.7
Households	4.2	1.5			3.8
3Y horizon:					
Financial market	2.8	2.8	2.7	2.7	2.6
Corporations	2.8	2.7			2.8
Households	4.6	1.8			4.2
1Y PRIBOR					
1Y horizon:					
Financial market	3.1	3.4	3.3	2.7	2.6

THE CZECH NATIONAL BANK'S POSITION ON THE REVISION OF THE STABILITY AND GROWTH PACT

At its meeting on 24 March 2005, the CNB Bank Board discussed the reform of the Stability and Growth Pact approved by the European Council on 22–23 March 2005. The Bank Board noted with concern that the changes will significantly weaken the Pact, particularly with regard to its transparency, the enforcement of its objectives and the principle of equal treatment. The changes may also endanger the stable and non-inflationary trend in the European Union.

It is the primary responsibility and task of any government to be aware of the macroeconomic importance of sound public budgets. In this respect, the Pact's rules merely create a framework for co-ordinating fiscal policy at the European level. They are, however, crucial for the successful functioning of the Economic and Monetary Union.

Despite some reservations regarding the relaxation of the definition and enforcement of the Pact's objectives (the consideration of numerous factors when setting the medium-term fiscal policy objective, the granting of some exceptions as regards exceeding the 3% deficit limit, the possibility of extending the deadlines for correcting excessive deficits, etc.) the CNB welcomes the strengthening of the preventive part of the Pact, which is directed at responsible fiscal policy in good times. This may contribute to a strengthening of fiscal discipline at the European level.

The Czech National Bank does not share the view that the revision of the Pact might result in earlier introduction of the euro by the Czech Republic as a consequence of the softening of fiscal targets. Compliance with the Maastricht criteria in the fiscal area is a necessary but not sufficient condition for smooth introduction of the euro. The decision to introduce the euro should be a result of an overall examination of the economic conditions, including an evaluation of the public budgets' capacity to behave responsibly in the future and to contribute to economic stability. With regard to the Czech Republic's own interests and to future fulfilment of the Pact's objectives, the consolidation of Czech public finances should continue.

The Czech National Bank will keep monitoring and carefully analysing the issues associated with the fiscal rules and the observance thereof in the European Union.

MINUTES OF THE BOARD MEETING ON 27 JANUARY 2005

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

The Board opened the meeting with a presentation of the 1st Situational Report for January 2005, which contained the new macroeconomic forecast.

The main changes in comparison to the October forecast consisted in a downward reassessment of future demand pressures and lower inflation expectations during the whole forecast period. More substantial demand pressures according to the forecast were postponed until 2006. Expectations of more moderate GDP growth and a somewhat wider output gap were associated with this. In view of this development, there was a downward shift in the implied interest rate trajectory in comparison to the previous forecast. During the period of monetary transmission, inflation would be slightly below the midpoint of the inflation target band. The slight reduction in interest rates in Q1 2005 was consistent with the January forecast, and their gradual increase was postponed until the first half of 2006.

Behind these changes were domestic as well as foreign effects. Not only was the influence of the koruna's nominal and real appreciation from the end of 2004 on the domestic economic growth and inflation taken into consideration, but also anticipated weaker foreign growth and more moderate import price development.

Certain downward reassessment of the assumptions relating to the dynamics of domestic economic growth had occurred. This reassessment was caused by the revision of GDP time series for 2003 and the more restrictive impact of fiscal policy in 2004 contrary to expectations. In addition to this, the CNB forecast expected somewhat lower real export and investment dynamics compared to 2004. The economy was still in a stage of relatively fast growth, however, due to the above mentioned reasons, the growth outlook was slightly reduced.

The January forecast expected CPI inflation growth ranging from 1.6% to 3.0% in December 2005 and in June 2006 between 2.0% and 3.4%. The GDP forecast for 2004 was adjusted to 3.5% to 3.7%. The current 2005 forecast was expecting GDP growth ranging between 3.2% and 4.4% and for 2006 from 3.0% to 5.0%.

After the presentation of the 1st Situational Report, the Board discussed the risks of the January forecast. Board members agreed that the upcoming period would be one of lower demand pressures, inflation and economic growth. There was also agreement regarding the influence of declining foreign prosperity on the Czech economy, though full agreement on the intensity of all these processes and consequently on the appropriate monetary policy reaction had not been reached.

Board members agreed that, from the monetary policy point of view, the predictability of public finance development was declining. Unexpectedly good results for the 2004 state budget led to the restrictive influence of fiscal policy on economic growth, which was not possible to fully predict in the CNB forecast. For 2005, this uncertainty would grow even more due to a wide range of hard-to-predict factors. One of the greatest risks was the uncertainty of how the Government would deal with the state budget savings transferred to reserve funds. The Board agreed that these reserves should not be disbursed to supplementary budget expenditures in 2005, because this could cause excessive fiscal expansion.

The Board also generally agreed that exchange rate development at the end of 2004 and during January 2005 was not a major deviation from the trajectory of the equilibrium exchange rate, but signalled a risk of a more substantial inflation decline, and thereby was a danger to reaching the inflation target within the forecast horizon. The severity of this risk was perceived by the board members in different ways.

During the monetary meeting, an opinion prevailed that the January forecast brought forth a number of arguments leading towards a possible cut in interest rates. The following four factors were indicated as being the strongest: the GDP time series revision for 2003, the more restrictive impact of fiscal policy in 2004, considerable exchange rate strengthening, and lower foreign demand.

There was also an opinion that the observed intensity of the disinflationary effects in the context of the overall favourable growth performance of the economy only justified postponement of an interest rate increase. This opinion was also underlined by an argument that lowering rates would be difficult to communicate and could worsen the predictability of monetary policy.

However, an argument dominated the discussion that monetary policy should react precisely when it recognised the need to lower rates, and not with a delay, when it could then take on a passive role. This applies in spite of the fact that a rate cut was accompanied under the current assumptions by an understanding that they would be increased at a later time.

When considering the risks, the possible impact of lowering interest rates on financial stability was also taken into account, especially in relation to the yet unsaturated household loan and mortgage market. There was consensus in this respect that lowering the interest rates would not lead to fluctuating financial stability.

At the close of the meeting, the Board decided to lower the CNB two-week repo rate by 0.25 percentage points to 2.25%. The repo rate cut was also reflected in a reduction in the Lombard rate to 3.25% and the discount rate to 1.25%. Four members were in favour of this rate change, effective 28 January 2005, and two members voted for leaving rates unchanged.

MINUTES OF THE BOARD MEETING ON 24 FEBRUARY 2005

Present at the meeting:
Zdeněk Tůma (Governor), Luděk Niedermayer (Vice-Governor), Miroslav Singer (Vice-Governor), Michaela Erbenová (Chief Executive Director), Jan Frait (Chief Executive Director), Robert Holman (Chief Executive Director), Pavel Řežábek (Chief Executive Director)

The Board opened the meeting with a presentation of the February situational report. The presentation concentrated on evaluation of the risks of the January macroeconomic forecast. The risks changed over time according to the gradual assessment of the new information, which was not available at the time the forecast was formulated. Assessment of the new information showed that, in relation to the January forecast, the risks shifted in an anti-inflationary direction.

There were a number of factors behind this anti-inflationary shift. January inflation reached 1.7%, which was a lower figure than used in the January forecast. The development of adjusted inflation, excluding fuel, could be assessed similarly. Furthermore, the exchange rate component of monetary conditions was tightened. Cost factors were not sending inflation signals to the economy. The latest figures on import and producer prices were slightly lower compared to the January forecast. Newly available information on business cycle indicators, such as industrial production, construction and retail sales, were in line with Q4 2004 GDP growth at around 3.5%.

Following the presentation of the situational report, the Board discussed the risks associated with fulfilling of the January forecast as well as related macroeconomic issues. It was said repeatedly that the newly available data confirmed the positioning of the January forecast and that the January interest rate cut was an adequate monetary policy reaction, even though it was somewhat unexpected at the time of the decision. The Board agreed that the Czech economy was henceforth low-inflationary in nature and that, in the monetary policy horizon, there were no apparent demand inflation pressures. According to the available information, the existence of a more significant inflation impulse could not be assumed even for factors that, according to the assumptions of previous forecasts, were sending inflation impulses, for example food prices.

The Board further discussed the distribution of risks in relation to the January forecast. It was repeatedly said that risks were accumulating on the anti-inflationary side. In this respect, there were opinions that it was not yet clear whether this was the beginning of a new trend or whether this was due to the influence of cost and exogenous factors, which could only be temporary in nature. It was also said that it was difficult to predict in the current situation fiscal policy's contribution to aggregate demand during the next few years. On the other hand, it was repeatedly mentioned that risks were significantly accumulating on the anti-inflationary side of the forecast, and that there was no need to hold off a rate change in order to confirm this development.

In this respect, the board members concentrated on the issue of interest rate stability. The following two views were presented during the discussion. It was said that interest rate stability was beneficial to the economy and that interest rates should be changed only if there was enough convincing evidence in favour. It was, however, mentioned that monetary policy should react with an interest rate change every time relevant information was available to indicate a significant change in inflation pressures. Should there be a correction in the ongoing trend at a later stage, it would be possible to change rates in the opposite direction. In this respect, there was an opinion that real interest rates, and not nominal interest rates, should be assessed, and therefore, decreasing nominal rates in the current situation of declining inflation, as well as the accumulation of risks on the anti-inflationary side, was an adequate monetary policy reaction.

The Board then discussed the settings of monetary conditions. It was said that the strengthening Czech koruna tightened exogenously monetary conditions. In this respect, it was stated that the Czech economy had to adjust to this kind of monetary tightening in 2002, and it was possible to assume that, in the current situation of robust growth, the adaptability of the Czech economy would be better than back in 2002. It was also pointed out that a significant decline in the yield curve was noted over the past month, which had eased monetary conditions. It was also said that a more significant interest rate cut could, in the current situation of economic growth, increase the risks of financial instability in the future, and even these remote risks needed to be accounted for when making decisions. On the contrary, it was mentioned that monetary tightening could occur even as a result of declining inflation expectations and that an interest rate cut could mean only sustaining monetary conditions, and not easing them.

The Board also discussed the supply and demand shocks in the economy. It was stated that the current inflation development was caused to certain extent by the supply shocks in the economy and also international development, which was pushing the global price level very low. There were opinions that it was not suitable in such situation to react to a slowdown in inflation by lowering rates and thereby sending an additional demand impulse to the economy. Such a reaction would have been suitable provided that declining inflation was the cause of the drop in demand. It was also mentioned that undershooting the target in this situation would not decrease monetary policy's credibility. In reaction, it was said that monetary policy's primary objective should always be to reach the inflation target.

At the close of the meeting, the Board decided by a majority vote to leave the CNB two-week repo rate unchanged at 2.25%. Four members voted in favour of this decision, and three members voted for cutting rates by 0.25 of a percentage point.

MINUTES OF THE BOARD MEETING ON 31 MARCH 2005

Present at the meeting:
Zdeněk Tůma (Governor), Luděk Niedermayer (Vice-Governor), Miroslav Singer (Vice-Governor), Michaela Erbenová (Chief Executive Director), Jan Frait (Chief Executive Director), Robert Holman (Chief Executive Director), Pavel Řežábek (Chief Executive Director)

The meeting opened with a presentation of the March situational report, which concentrated on assessment of new information and its implications for the risks associated with the fulfilment of the January macroeconomic forecast. The new information indicated that, in relation to the January forecast, the risks were shifting in an anti-inflationary direction.

At 1.7%, February inflation was slightly lower than predicted in the January forecast. Downward deviations of the reality from the forecast were recorded for food prices and adjusted inflation excluding fuels. Regulated prices deviated upwards from the forecast.

Year-on-year GDP growth was higher in 2004 Q4 compared to the January forecast. Favourable net exports accounted for the bulk of the deviation. Conversely, household consumption growth was more sluggish than predicted in the January forecast, and the year-on-year decline in government consumption was greater than expected. Growth in gross fixed capital formation was also lower. Investment nonetheless maintained a solid rate of growth. The leading growth indicators signal continuing economic recovery.

The Board followed the presentation of the situational report with a discussion. The board members agreed that the new information did not signal any major change in the assessment of the economy by comparison with the previous monetary policy meeting. It had been confirmed that the risks of the January forecast were accumulating on the anti-inflationary side. These anti-inflationary risks included in particular the development of the exchange rate, which was continuing to deviate towards appreciation from the assumptions of the January forecast. They also included the evolution of food prices, owing to the development of agricultural producer prices and the competition in the agricultural and food product markets. In the remainder of this year, the contribution of regulated prices to inflation would probably be smaller than forecasted. Long-term inflation expectations were also at a relatively low level. An upside risk was the evolution of prices of oil and other selected commodities, although this had so far been largely offset by the exchange rate. An improvement in labour market indicators and employment growth was expected; this could boost the rate of growth of private consumption via an improvement in household income. So far, however, the change was too small to present a significant inflationary risk.

The Board turned its attention to assessing the GDP growth figures for 2004 Q4 and the revised figures for previous quarters. The effect of the new figures on inflation could not be interpreted unequivocally. Economic growth had been higher than forecasted without generating inflationary pressures. This could signify a wider-than-forecasted negative output gap due to higher than expected growth in potential output. The estimate of potential GDP growth was thus viewed as a major uncertainty of the forecast. The structural view of GDP growth simultaneously indicated that the growth last year had been driven primarily by net exports and investment, whose direct impact on consumer price inflation is smaller. Growth in consumption, i.e. the component of GDP that has a direct influence on consumer prices, had been lower than forecasted. The persisting low inflation hence did not necessarily reflect solely an absence of demand pressures, but might also be due to the aforementioned structural effects.

The Board then discussed the settings of the monetary conditions. It was said that the appropriate response to the new information confirming the persistence of anti-inflationary risks was a reduction of interest rates. Such action would be consistent with the logic of the inflation targeting regime and with the current inflation target. A decrease in interest rates could boost demand slightly, ease the exchange rate pressure on the corporate sector somewhat, and reduce the risk of continued stronger appreciation. The opinion was also expressed that should new information further accentuate the disinflationary risks, which would thereafter probably be reflected in the April forecast, it would be possible to consider reducing interest rates by more than 0.25 of a percentage point.

However, it was also pointed out that the interest rate component of the monetary conditions was already easy and interest rates were stimulating for the economy. That could imply an increase in risks in the financial stability area going forward, especially given the accelerating growth in lending and developments in the property market. It was also said that it was not appropriate to try to fully offset past exchange rate swings with a movement in interest rates, nor was this even possible given the different lags in the effect of the exchange rate and interest rates on the economy. Such an approach would be backward-looking and would mean excessive central bank interest rate policy activism. Another argument in favour of caution as regards lowering interest rates was that the low current and expected inflation reflected not only demand factors, but also structural ones, and monetary policy had limited options for countering these anti-inflationary pressures. In the event of continuing exchange rate appreciation and disinflationary cost factors, it was likely that inflation would remain relatively low in the longer term despite a monetary policy response.

In this context, the Board discussed the parallels and differences between the current exchange rate and economic situation and that in 2001–2002. It pointed out that the current rate of appreciation of the exchange rate vis-à-vis its equilibrium level was lower than at the end of 2001 and in the first half of 2002, and that the corporate and financial sectors were in a different situation. The impact of the exchange rate on the economy therefore should not be as significant as during the previous appreciation episode.

After discussing the situational report, the Board decided unanimously to lower the CNB two-week repo rate by 0.25 percentage point to 2%, effective from 1st April 2005. At the same time it decided to reduce the discount rate and Lombard rate by the same amount, to 1% and 3% respectively. All seven members voted in favour of this decision.

ANNEX OF STATISTICAL TABLES

Table 1a

INFLATION DEVELOPMENT

annual percentage changes

2001	1	2	3	4	5	6	7	8	9	10	11	12
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	2.3	2.7	2.9	3.2	3.4	3.0	3.5	2.9	2.8
Regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4
(contribution to consumer price inflation)	1.01	0.99	0.96	0.63	0.49	0.49	0.49	0.47	0.46	0.90	0.89	0.89
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.35	0.35	0.39	0.61	0.68	0.72	0.73	0.76	0.76	0.76	0.76
Net inflation	1.2	1.2	1.4	1.5	2.0	2.1	2.5	2.6	2.3	2.1	1.6	1.5
(contribution to consumer price inflation)	0.96	0.92	1.15	1.21	1.63	1.71	2.02	2.11	1.81	1.71	1.28	1.20
of which: prices of food, beverages and tobacco	2.8	2.8	3.2	3.3	3.4	2.7	3.8	4.2	3.0	2.2	0.7	0.9
(contribution to consumer price inflation)	0.75	0.75	0.83	0.86	0.89	0.71	1.00	1.10	0.78	0.59	0.18	0.25
adjusted inflation	0.4	0.3	0.6	0.6	1.4	1.9	1.9	1.9	1.9	2.1	2.1	1.8
(contribution to consumer price inflation)	0.21	0.17	0.32	0.35	0.74	1.00	1.02	1.02	1.03	1.12	1.10	0.96
Inflation rate (annual moving average)	0.3	0.5	0.8	1.0	1.2	1.4	1.7	2.0	2.2	2.5	2.7	2.8
2005												
Consumer prices	1.7	1.7	1.5									
Regulated prices	2.9	2.9	2.9									
(contribution to consumer price inflation)	0.61	0.60	0.61									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.35	0.35									
Net inflation	0.9	0.9	0.7									
(contribution to consumer price inflation)	0.72	0.75	0.59									
of which: prices of food, beverages and tobacco	0.4	0.6	0.4									
(contribution to consumer price inflation)	0.11	0.17	0.12									
adjusted inflation	1.1	1.1	0.9									
(contribution to consumer price inflation)	0.61	0.59	0.47									
Inflation rate (annual moving average)	2.8	2.7	2.6									

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												monthly percentage changes
2001	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
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	0.0	0.4	0.2	0.4	0.0	-0.8	0.5	-0.1	0.1
Regulated prices	3.7	0.2	0.0	-0.5	-0.7	0.0	0.0	-0.1	0.0	1.6	0.0	0.0
(contribution to consumer price inflation)	0.76	0.04	0.01	-0.10	-0.15	0.00	0.00	-0.03	0.01	0.34	-0.01	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.00	0.00	0.04	0.23	0.07	0.04	0.01	0.03	0.00	0.00	0.00
Net inflation	0.9	0.1	0.1	0.0	0.5	0.1	0.4	0.0	-1.0	0.2	0.0	0.2
(contribution to consumer price inflation)	0.74	0.09	0.10	0.03	0.37	0.12	0.33	-0.01	-0.78	0.12	-0.04	0.12
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1	0.3	0.5	-0.1	-0.6	-0.6	-0.6	0.0	0.0	1.1
(c ontribution to consumer price inflation)	0.26	-0.05	0.02	0.07	0.14	-0.03	-0.15	-0.15	-0.16	-0.01	0.01	0.28
adjusted inflation	0.9	0.3	0.1	-0.1	0.4	0.3	0.9	0.3	-1.2	0.2	-0.1	-0.3
(contribution to consumer price inflation)	0.48	0.14	0.08	-0.04	0.23	0.14	0.48	0.14	-0.63	0.13	-0.05	-0.16
2005												
Consumer prices	0.7	0.2	-0.1									
Regulated prices	2.2	0.2	0.1									
(contribution to consumer price inflation)	0.48	0.04	0.01									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	-0.06	0.00	0.00									
Net inflation	0.3	0.2	-0.1									
(contribution to consumer price inflation)	0.26	0.13	-0.06									
of which: prices of food, beverages and tobacco	0.5	0.0	-0.1									
(contribution to consumer price inflation)	0.12	0.01	-0.02									
adjusted inflation	0.3	0.2	-0.1									
(contribution to consumer price inflation)	0.14	0.11	-0.04									

CNB calculation based on CZSO data

Table 2

CONSUMER PRICES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 2001	1,000.0	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
Total - 2002	1,000.0	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	1,000.0	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	1,000.0	12.1	12.3	12.4	12.4	12.9	13.1	13.5	13.5	12.6	13.2	13.1	13.2	12.9
Food and non-alcoholic beverages	197.6	7.4	7.1	7.2	7.5	7.1	7.1	6.3	5.4	4.7	4.7	4.8	6.6	6.3
Alcoholic beverages and tobacco	79.2	8.5	8.6	8.7	9.4	11.2	11.8	12.2	12.4	12.3	12.2	12.1	11.6	10.9
Clothing and footwear	56.9	-13.5	-14.3	-14.3	-14.2	-14.1	-14.1	-15.3	-16.1	-15.8	-14.8	-14.6	-14.6	-14.6
Housing, water, electricity, gas and other fuels	236.4	30.1	30.5	30.7	30.2	29.7	29.8	30.2	30.3	30.5	32.2	32.2	32.2	30.7
Furnishings, household equipment and routine maintenance of the house	67.9	-3.1	-3.3	-3.4	-3.4	-3.9	-3.9	-4.2	-4.4	-4.5	-4.6	-4.8	-4.9	-4.0
Health	14.3	16.5	17.0	17.4	17.9	20.3	20.7	20.9	21.2	21.7	21.0	20.6	20.6	19.7
Transport	101.4	5.8	5.8	6.8	6.8	8.2	7.6	7.3	7.2	6.4	7.0	6.6	5.0	6.7
Communications	22.5	24.2	23.1	23.0	22.9	21.5	21.4	21.3	19.7	19.6	21.2	21.1	21.0	21.7
Recreation and culture	95.5	7.4	8.7	7.6	7.0	7.5	9.1	14.9	17.0	8.9	8.4	8.0	7.9	9.4
Education	4.5	12.2	12.6	12.5	12.5	12.9	12.8	12.8	12.8	17.9	18.1	18.1	18.1	14.4
Hotels, cafés and restaurants	74.2	11.8	12.0	12.4	12.6	17.1	17.5	17.7	17.8	18.8	19.3	19.5	19.6	16.3
Miscellaneous goods and services	49.5	17.4	18.3	18.8	18.7	19.9	20.3	20.4	20.3	20.2	20.1	20.3	20.3	19.6
Total - 2005	1,000.0	14.0	14.2	14.1										14.1
Food and non-alcoholic beverages	197.6	6.9	6.9	6.8										6.9
Alcoholic beverages and tobacco	79.2	12.6	12.8	12.7										12.7
Clothing and footwear	56.9	-17.2	-18.2	-18.4										-17.9
Housing, water, electricity, gas and other fuels	236.4	34.7	34.9	35.1										34.9
Furnishings, household equipment and routine maintenance of the house	67.9	-5.2	-5.4	-5.5										-5.4
Health	14.3	25.5	26.1	26.7										26.1
Transport	101.4	3.9	3.7	4.1										3.9
Communications	22.5	21.0	20.1	20.1										20.4
Recreation and culture	95.5	9.8	11.4	10.1										10.4
Education	4.5	14.9	15.6	15.8										15.4
Hotels, cafés and restaurants	74.2	20.4	21.0	21.2										20.9
Miscellaneous goods and services	49.5	20.3	20.9	20.9										20.7

Source: CZSO

Table 3

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2000 12	2001 12	2002 12	2003 12	2004 6	2004 9	2004 12	2005 3
1. Food and non-alcoholic beverages	197.6	4.6	7.9	2.1	5.7	7.1	4.7	6.6	6.8
- tradables	197.6	4.6	7.9	2.1	5.7	7.1	4.7	6.6	6.8
2. Alcoholic beverages and tobacco	79.2	2.4	5.4	7.1	7.8	11.8	12.3	11.6	12.7
- tradables	79.2	2.4	5.4	7.1	7.8	11.8	12.3	11.6	12.7
3. Clothing and footwear	56.9	-2.7	-3.9	-7.7	-11.9	-14.1	-15.8	-14.6	-18.4
- nontradables	1.4	6.1	13.0	18.3	21.1	34.4	34.9	35.9	36.9
- tradables	55.5	-2.9	-4.3	-8.4	-12.7	-15.3	-17.1	-15.9	-19.8
4. Housing, water, electricity, gas and other fuels	236.4	7.8	19.0	24.3	26.6	29.8	30.5	32.2	35.1
- nontradables	226.1	8.1	19.7	25.2	27.5	30.8	31.4	33.2	36.2
- tradables	10.3	2.3	2.7	4.0	5.9	8.5	11.3	10.7	11.9
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.7	-0.4	-1.0	-3.0	-3.9	-4.5	-4.9	-5.5
- nontradables	2.9	4.3	7.5	9.9	12.3	16.2	16.2	16.8	15.7
- tradables	65.0	-0.9	-0.8	-1.5	-3.7	-4.8	-5.4	-5.9	-6.5
6. Health	14.3	4.1	8.4	12.8	16.4	20.7	21.7	20.6	26.7
- nontradables	11.0	4.9	10.1	15.4	19.9	25.3	26.7	25.2	33.2
- tradables	3.3	1.5	2.7	4.4	5.1	5.7	5.5	5.6	5.7
7. Transport	101.4	6.9	3.4	4.1	3.6	7.6	6.4	5.0	4.1
- nontradables	27.4	6.2	11.7	16.0	18.4	22.7	22.9	23.0	24.4
- tradables	74.0	7.2	0.3	-0.3	-1.9	2.0	0.3	-1.6	-3.4
8. Communications	22.5	1.5	5.7	8.2	7.2	21.4	19.6	21.0	20.1
- nontradables	21.0	2.7	8.5	2.1	2.3	16.6	14.9	16.6	15.8
- tradables	1.5	-16.4	-34.7	95.9	77.5	89.8	86.7	83.6	82.0
9. Recreation and culture	95.5	2.0	7.2	7.2	6.1	9.1	8.9	7.9	10.1
- nontradables	60.4	4.4	14.3	16.2	16.7	22.4	22.7	21.2	25.0
- tradables	35.1	-2.2	-5.0	-8.3	-12.1	-13.7	-14.8	-15.0	-15.5
10. Education	4.5	3.4	6.8	11.3	12.0	12.8	17.9	18.1	15.8
- nontradables	4.5	3.4	6.8	11.3	12.0	12.8	17.9	18.1	15.8
11. Hotels, cafés and restaurants	74.2	2.6	5.9	8.7	10.8	17.5	18.8	19.6	21.2
- nontradables	74.2	2.6	5.9	8.7	10.8	17.5	18.8	19.6	21.2
12. Miscellaneous goods and services	49.5	3.1	8.7	11.9	15.2	20.3	20.2	20.3	20.9
- nontradables	22.0	5.7	17.5	25.8	36.4	47.7	48.1	48.4	50.3
- tradables	27.5	1.1	1.7	0.8	-1.7	-1.5	-2.0	-2.2	-2.6
Household consumer prices, total	1,000.0	4.1	8.4	9.0	10.1	13.1	12.6	13.2	14.1
Tradables	549.1	2.5	2.9	0.6	0.7	1.9	0.6	0.9	0.4
- food	276.8	4.0	7.2	3.5	6.3	8.4	6.9	8.0	8.5
- others	272.3	1.0	-1.5	-2.4	-5.0	-4.8	-5.8	-6.3	-7.8
Nontradables	450.9	6.0	15.2	19.2	21.6	26.7	27.3	28.2	30.8
- others	271.2	4.7	11.5	16.5	19.4	25.7	26.7	26.9	28.9
- regulated	179.7	8.0	20.6	23.2	24.9	28.3	28.2	30.3	33.7

CNB calculation based on CZSO data

Table 4

INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS FOR 12 MONTHS AHEAD annual percentage changes

	CPI		
	Financial market	Businesses	Households
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
4/04	2.8	—	—
5/04	2.6	—	—
6/04	2.7	3.1	4.9
7/04	2.8	—	—
8/04	2.8	—	—
9/04	3.0	3.1	1.7
10/04	2.8	—	—
11/04	2.8	—	—
12/04	2.8	3.2	1.5
1/05	2.8	—	—
2/05	2.6	—	—
3/05	2.6	2.7	3.8

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES annual percentage changes

	2001 12	2002 12	2003 12	2004 12	2005 3
Belgium	2.0	1.3	1.7	1.9	2.8
Denmark	2.1	2.6	1.2	1.0	1.3
Finland	2.3	1.7	1.2	0.1	0.9
France	1.4	2.2	2.4	2.3	2.1
Ireland	4.4	4.6	2.9	2.4	1.9
Italy	2.2	3.0	2.5	2.4	2.1
Luxembourg	0.9	2.8	2.4	3.5	3.5
Germany	1.4	1.1	1.1	2.2	1.7
Netherlands	5.1	3.2	1.6	1.2	1.5
Portugal	3.9	4.0	2.3	2.6	2.3
Austria	1.8	1.7	1.3	2.5	2.5
Greece	3.5	3.5	3.1	3.1	2.9
Spain	2.5	4.0	2.7	3.3	3.4
Sweden	3.2	1.7	1.8	0.9	0.5
United Kingdom	1.0	1.7	1.3	1.6	1.9
European Union	1.9	2.2	1.8	2.2	2.0
Czech Republic	3.9	0.1	1.0	2.5	1.2

Source: Eurostat

Table 6

MONETARY SURVEY

position at month-end in CZK billions

	2001 12	2002 12	2003 12	2004 12	2005 2
Total assets	1,596.0	1,651.8	1,766.1	1,844.1	1,844.3
Net external assets (NEAs)	800.6	926.1	821.5	863.3	863.4
NEAs of CNB	__	715.6	687.5	634.1	622.3
NEAs of OMFIs	__	210.5	134.0	229.3	241.1
Net domestic assets	795.4	725.8	944.5	980.8	980.9
Domestic loans	1,011.9	940.0	1,145.6	1,147.0	1,181.5
Net credit to government (NCG) (including securities)	__	215.8	354.0	257.5	272.7
NCG to central government (including securities)	__	260.4	408.7	312.4	336.2
NCG to other government (including securities)	__	-44.6	-54.8	-54.9	-63.5
Loans to corporations and households (excluding securities)	775.4	724.2	791.6	889.4	908.7
Loans to corporations (excluding securities)	636.1	542.7	554.1	574.2	588.2
Loans to households (excluding securities)	139.3	181.5	237.5	315.2	320.6
Other net items (including securities and capital)	-216.5	-214.3	-201.1	-166.2	-200.6
Capital and reserves	__	-462.8	-398.7	-346.9	-408.0
Holdings of securities	__	18.5	16.6	18.8	19.0
Issued securities	__	-48.6	-51.6	-75.0	-79.6
Others	__	278.5	232.6	236.9	268.1
Liabilities					
Monetary aggregate M2	1,596.0	1,651.8	1,766.1	1,844.1	1,844.3
Monetary aggregate M1	583.6	787.7	902.8	962.3	963.3
Currency in circulation	180.4	197.8	221.4	236.8	240.8
Overnight deposits	__	589.9	681.4	725.6	722.5
Overnight deposits - households	__	315.6	372.1	410.8	430.6
Overnight deposits - corporations	__	274.3	309.3	314.7	291.9
M2-M1 (quasi money)	1,012.4	864.1	863.3	881.8	880.9
Deposits with agreed maturity	__	651.2	666.4	675.4	676.3
Deposits with agreed maturity - households	__	448.6	439.8	458.6	454.5
Deposits with agreed maturity - corporations	__	202.5	226.6	216.7	221.8
Deposits redeemable at notice	__	194.3	185.6	198.8	199.2
Deposits redeemable at notice - households	__	190.7	182.3	194.6	195.0
Deposits redeemable at notice - corporations	__	3.6	3.2	4.2	4.2
Repurchase agreements	__	18.6	11.3	7.6	5.5
Annual percentage changes					
M1	17.3	35.0	14.6	6.6	8.4
M2	13.0	3.5	6.9	4.4	4.7
Loans to corporations and households	-19.6	-6.6	9.3	12.4	15.2
M2-M1 (deposits)	10.7	-14.6	-0.1	2.1	1.0
Annual percentage growth rates					
M1	__	__	15.5	8.3	9.4
M2	__	__	8.1	5.8	5.8
Loans to corporations and households	__	__	11.8	15.3	17.3
M2-M1 (deposits)	__	__	1.2	3.3	2.1

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2001 12	2002 12	2003 12	2004 12	2005 3
1. AVERAGE PRIBOR [1]					
- 1 day	4.63	2.75	1.98	2.49	2.21
- 7 day	4.79	2.76	2.02	2.51	2.22
- 14 day	4.78	2.76	2.03	2.51	2.21
- 1 month	4.77	2.73	2.04	2.53	2.17
- 2 month	4.72	2.67	2.06	2.55	2.11
- 3 month	4.69	2.63	2.08	2.57	2.08
- 6 month	4.62	2.60	2.13	2.67	2.08
- 9 month	4.61	2.60	2.22	2.76	2.08
- 12 month	4.62	2.60	2.30	2.85	2.09
2. AVERAGE PRIBID [1]					
- 1 day	4.53	2.65	1.88	2.39	2.11
- 7 day	4.69	2.67	1.92	2.41	2.12
- 14 day	4.69	2.67	1.93	2.41	2.11
- 1 month	4.68	2.64	1.94	2.43	2.07
- 2 month	4.62	2.57	1.96	2.45	2.01
- 3 month	4.59	2.54	1.98	2.47	1.98
- 6 month	4.52	2.51	2.03	2.57	1.98
- 9 month	4.52	2.51	2.12	2.66	1.98
- 12 month	4.52	2.51	2.20	2.75	1.99

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

Table 8

FRA RATES

percentages; monthly averages

	2001 12	2002 12	2003 12	2004 12	2005 3
3 * 6	4.49	2.52	2.23	2.74	2.04
3 * 9	4.53	2.54	2.36	2.81	2.06
6 * 9	4.53	2.52	2.47	2.85	2.07
6 * 12	4.52	2.58	2.64	2.92	2.12
9 * 12	4.54	2.61	2.77	2.97	2.17
9*12 - 3*6 spread	0.05	0.10	0.55	0.24	0.12
6*12 - 3*9 spread	-0.02	0.04	0.28	0.12	0.06

IRS RATES

percentages; monthly averages

	2001 12	2002 12	2003 12	2004 12	2005 3
1Y	4.64	2.63	2.41	2.82	2.12
2Y	4.72	2.85	2.98	3.06	2.37
3Y	4.89	3.18	3.38	3.27	2.63
4Y	5.05	3.46	3.69	3.45	2.87
5Y	5.19	3.70	3.93	3.62	3.09
6Y	5.32	3.91	4.13	3.77	3.27
7Y	5.43	4.08	4.29	3.89	3.42
8Y	5.52	4.23	4.43	4.00	3.55
9Y	5.60	4.36	4.54	4.09	3.67
10Y	5.66	4.47	4.64	4.17	3.76
15Y	5.85	4.77	4.97	4.40	4.04
20Y	—	—	5.11	4.54	4.19
5Y - 1Y spread	0.56	1.07	1.52	0.80	0.97
10Y - 1Y spread	1.02	1.84	2.23	1.35	1.64

Table 9

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 loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	loans
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	2.2	3.2	3.0	4.5	2.6	3.6	3.5	5.0
2/03	2.5	2.4	3.9	2.1	2.9	2.8	4.3	2.5	3.2	3.2	4.6
3/03	2.5	2.4	3.9	2.0	2.9	2.8	4.3	2.5	2.9	2.8	4.3
4/03	2.5	2.4	3.9	2.0	2.6	2.5	4.0	2.1	3.2	3.2	4.7
5/03	2.5	2.4	4.0	2.0	2.5	2.4	4.0	2.0	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	1.7	2.4	2.3	3.6	1.8	2.9	2.9	4.2
8/03	2.0	2.1	3.3	1.8	2.1	2.2	3.4	1.9	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	1.8	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	3.1	-0.9	0.4	0.7	3.9
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5
3/04	2.0	2.3	5.1	1.6	-0.5	-0.2	2.6	-0.9	-0.1	0.2	3.0
4/04	2.0	2.3	5.4	1.5	-0.3	-0.0	3.0	-0.8	-1.6	-1.4	1.6
5/04	2.0	2.5	5.4	1.5	-0.7	-0.2	2.6	-1.2	-2.7	-2.3	0.5
6/04	2.1	2.8	5.3	1.5	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8
7/04	2.3	3.0	5.7	1.6	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5
8/04	2.3	3.0	6.0	1.6	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9
9/04	2.5	3.1	5.9	1.7	-0.5	0.1	2.9	-1.3	-5.1	-4.5	-1.9
10/04	2.5	3.0	6.0	1.7	-1.0	-0.4	2.4	-1.7	-5.6	-5.1	-2.4
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1
3/05	2.2	2.1	__	__	0.7	0.6	__	__	-3.9	-4.0	__

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

Starting from January 2004, the methodology for new loans and time deposits was changed. Newly drawn credits were replaced by newly extended loans.

Table 10

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 loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
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	-0.3	—	—	—	—	—	—	—	—
2/03	0.1	0.0	1.4	-0.3	—	—	—	—	—	—	—	—
3/03	0.0	-0.1	1.3	-0.4	0.4	0.3	1.7	-0.1	-1.7	-1.9	-0.4	-2.2
4/03	-0.1	-0.2	1.3	-0.6	—	—	—	—	—	—	—	—
5/03	-1.2	-1.2	0.3	-1.6	—	—	—	—	—	—	—	—
6/03	-0.7	-0.9	0.6	-1.2	-0.1	-0.3	1.2	-0.6	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	-1.3	-0.6	-0.4	1.0	-0.8	-1.0	-0.9	0.5	-1.3
10/03	-0.9	-0.8	0.6	-1.2	—	—	—	—	—	—	—	—
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	-1.2	-0.8	1.8	-1.7	—	—	—	—	—	—	—	—
3/04	-1.0	-0.7	2.1	-1.4	-1.2	-1.0	1.8	-1.7	-2.8	-2.5	0.2	-3.2
4/04	-0.8	-0.5	2.5	-1.3	—	—	—	—	—	—	—	—
5/04	-0.6	-0.1	2.7	-1.1	—	—	—	—	—	—	—	—
6/04	-0.6	0.1	2.6	-1.1	-1.0	-0.3	2.2	-1.5	-2.7	-2.0	0.4	-3.2
7/04	-0.5	0.2	2.8	-1.2	—	—	—	—	—	—	—	—
8/04	-0.5	0.2	3.1	-1.1	—	—	—	—	—	—	—	—
9/04	-0.5	0.1	2.9	-1.3	-0.6	0.0	2.8	-1.4	0.8	1.4	4.2	-0.0
10/04	-0.3	0.2	3.1	-1.0	—	—	—	—	—	—	—	—
11/04	-0.3	0.1	3.2	-1.0	—	—	—	—	—	—	—	—
12/04	-0.3	0.0	3.2	-0.9	-0.7	-0.3	2.8	-1.3	1.0	1.3	4.5	0.3
1/05	-0.3	-0.1	3.3	-0.9	—	—	—	—	—	—	—	—
2/05	-0.3	-0.3	3.3	-0.8	—	—	—	—	—	—	—	—
3/05	-0.4	-0.5	—	—	-0.5	-0.6	—	—	-1.5	-1.6	—	—

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

Table 11

KORUNA INTEREST RATES (stock of business)					percentages
	2001 12	2002 12	2003 12	2004 12	2005 2
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	7.96	7.81
- maturity up to 1 year	8.20	10.35	11.21	12.81	13.32
- maturity over 1 year and up to 5 years	10.55	10.80	10.17	12.40	11.86
- maturity over 5 years	8.02	7.35	6.65	6.39	6.32
for consumption - total	__	13.83	13.83	14.89	14.63
- maturity up to 1 year	__	13.05	14.26	15.48	16.08
- maturity over 1 year and up to 5 years	__	14.48	13.86	15.17	14.54
- maturity over 5 years	__	12.55	13.21	13.45	13.38
for house purchase - total	__	7.11	6.31	5.93	5.85
- maturity up to 1 year	__	7.67	6.24	4.48	4.39
- maturity over 1 year and up to 5 years	__	7.90	7.05	6.57	6.53
- maturity over 5 years	__	6.88	6.09	5.89	5.82
other - total	__	6.99	7.80	7.50	7.31
- maturity up to 1 year	__	6.64	8.49	8.96	9.20
- maturity over 1 year and up to 5 years	__	6.34	8.02	7.63	7.10
- maturity over 5 years	__	7.61	7.02	6.58	6.44
Non-financial corporations (S.11) - total	6.84	5.19	4.53	4.75	4.62
- maturity up to 1 year	6.32	4.34	4.08	4.35	4.20
- maturity over 1 year and up to 5 years	6.93	5.47	4.64	4.68	4.61
- maturity over 5 years	7.52	6.34	5.14	5.39	5.24
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	1.41	1.35
overnight	1.42	0.94	0.50	0.52	0.50
with agreed maturity - total	3.11	2.26	2.02	2.13	2.06
- with agreed maturity up to 2 years	__	1.68	0.96	1.37	1.26
- with agreed maturity over 2 years	__	3.04	2.90	2.69	2.66
redeemable at notice - total	__	1.81	1.26	1.63	1.63
- redeemable at notice up to 3 months	__	1.93	1.67	2.14	2.15
- redeemable at notice over 3 months	__	1.73	0.98	1.12	1.07
Non-financial corporations (S.11) - total	1.96	1.25	0.85	1.21	1.19
overnight	1.00	0.94	0.64	0.68	0.69
with agreed maturity - total	3.62	2.16	1.50	2.08	1.89
- with agreed maturity up to 2 years	__	2.15	1.49	2.05	1.86
- with agreed maturity over 2 years	__	3.47	3.04	3.12	2.95
redeemable at notice - total	__	1.64	1.17	1.60	1.43
- redeemable at notice up to 3 months	__	1.60	1.14	1.49	1.33
- redeemable at notice over 3 months	__	2.26	1.32	2.26	2.03

Table 12

BALANCE OF PAYMENTS[1)]

in CZK millions

	2000 Q1-4	2001 Q1-4	2002 Q1-4	2003 Q1-4	2004[2)] Q1-4
A. Current account	**-104,877.1**	**-124,478.3**	**-136,378.1**	**-160,614.6**	**-143,259.0**
Balance of trade [3)]	-120,825.0	-116,685.0	-71,323.0	-69,793.0	-22,325.0
exports	1,121,099.0	1,269,634.0	1,254,394.0	1,370,930.0	1,713,694.0
imports	1,241,924.0	1,386,319.0	1,325,717.0	1,440,723.0	1,736,019.0
Services	54,559.8	57,984.9	21,850.8	13,236.7	12,472.5
credit	264,806.2	269,689.6	231,131.1	219,151.1	248,433.1
transport	53,734.3	57,492.3	56,560.5	60,556.3	72,308.9
travel	115,071.0	118,133.0	96,289.2	100,310.1	107,129.8
others	96,000.9	94,064.3	78,281.4	58,284.7	68,994.4
debit	210,246.4	211,704.7	209,280.3	205,914.4	235,960.6
transport	27,543.0	30,570.5	29,332.8	33,725.7	38,603.0
travel	49,370.0	52,802.0	51,549.3	54,419.2	58,362.8
others	133,333.4	128,332.2	128,398.2	117,769.5	138,994.8
Income	-52,978.4	-83,548.9	-115,615.0	-119,858.4	-139,535.9
credit	75,439.1	84,892.3	66,790.1	75,508.3	70,209.1
debit	128,417.5	168,441.2	182,405.1	195,366.7	209,745.0
Current transfers	14,366.5	17,770.7	28,709.1	15,800.1	6,129.4
credit	36,594.6	36,404.9	46,709.0	46,976.7	46,045.3
debit	22,228.1	18,634.2	17,999.9	31,176.6	39,915.9
B. Capital account	**-198.2**	**-330.7**	**-119.4**	**-82.2**	**-14,017.0**
credit	223.4	90.4	221.0	198.2	5,608.2
debit	421.6	421.1	340.4	280.4	19,625.2
Total A + B	-105,075.3	-124,809.0	-136,497.5	-160,696.8	-157,276.0
C. Financial account	**148,046.6**	**172,849.9**	**347,827.4**	**157,093.5**	**180,923.0**
Direct investment	190,767.4	208,296.1	270,930.2	53,500.3	100,673.6
abroad	-1,653.7	-6,289.2	-6,759.3	-5,815.7	-14,038.9
equity capital and reinvested earnings	-1,245.9	-5,848.5	-5,376.8	-3,124.6	-12,732.3
other capital	-407.8	-440.7	-1,382.5	-2,691.1	-1,306.6
in the Czech Republic	192,421.1	214,585.3	277,689.5	59,316.0	114,712.5
equity capital and reinvested earnings	171,777.2	185,981.4	270,061.0	59,350.4	104,432.3
other capital	20,643.9	28,603.9	7,628.5	-34.4	10,280.2
Portfolio investment	-68,172.9	34,857.3	-46,748.7	-35,719.1	62,209.2
assets	-86,631.8	4,405.6	-75,602.1	-83,892.7	-61,068.5
equity securities	-44,181.0	9,447.8	-7,807.9	,5,630.5	-27,280.4
debt securities	-42,450.8	-5,042.2	-67,794.2	-89,523.2	-33,788.1
liabilities	18,458.9	30,451.7	28,853.4	48,173.6	123,277.7
equity securities	23,810.9	23,203.6	-9,035.7	30,133.5	19,558.6
debt securities	-5,352.0	7,248.1	37,889.1	18,040.1	103,719.1
Financial derivatives	-1,402.8	-3,220.3	-4,281.7	3,860.1	-1,539.7
assets	-4,501.6	-9,407.6	-15,458.4	7,083.7	-13,902.7
liabilities	3,098.8	6,187.3	11,176.7	-3,223.6	12,363.0
Other investment	26,854.9	-67,083.2	127,927.6	135,452.2	19,579.9
assets	35,832.1	-46,144.5	133,121.8	67,071.3	-35,983.8
long-term	21,322.2	1,325.8	28,711.4	1,141.3	20,516.9
CNB	—	—	—	—	-184.9
commercial banks	14,362.2	-4,125.8	5,271.7	-999.9	587.7
government	2,937.0	6,928.9	25,333.6	5,714.3	22,790.7
other sectors	4,023.0	-1,477.3	-1,893.9	-3,573.1	-2,676.6
short-term	14,509.9	-47,470.3	104,410.4	65,930.0	-56,500.7
commercial banks	22,001.9	-45,523.2	122,163.8	44,971.2	-34,807.6
government	—	-87.1	-2,237.4	2,193.8	92.9
other sectors	-7,492.0	-1,860.0	-15,516.0	18,765.0	-21,786.0
liabilities	-8,977.2	-20,938.7	-5,194.2	68,380.9	55,563.7
long-term	-26,212.5	-4,262.6	2,853.8	26,361.6	29,813.4
CNB	-22.8	-22.0	-20.2	-20.4	-20.5
commercial banks	-31,523.7	-7,222.2	-8,059.2	-5,038.0	-1,410.8
government	-1,837.6	-5,000.8	-1,517.2	10,304.7	9,264.7
other sectors	7,171.6	7,982.4	12,450.4	21,115.3	21,980.0
short-term	17,235.3	-16,676.1	-8,048.0	42,019.3	25,750.3
CNB	-17.0	59.7	-24.3	-21.4	843.7
commercial banks	-3,812.5	-35,688.6	-3,871.2	37,899.4	-14,766.2
government	—	—	—	—	—
other sectors	21,064.8	18,952.8	-4,152.5	4,141.3	39,672.8
Total A + B + C	42,971.3	48,040.9	211,329.9	-3,603.3	23,647.0
D. Net errors and omissions, valuation changes	**-11,378.5**	**19,112.1**	**5,615.1**	**16,506.7**	**-16,864.8**
Total A + B + C + D	31,592.8	67,153.0	216,945.0	12,903.4	6,782.2
E. Change in reserves (- increase)	**-31,592.8**	**-67,153.0**	**-216,945.0**	**-12,903.4**	**-6,782.2**

[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

Table 13

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	2000 31 Dec.	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004 31 Dec. [1]
ASSETS	1,448,400.7	1,544,963.0	1,579,922.9	1,537,284.6	1,535,040.8
Direct investment abroad	27,899.3	41,176.1	44,397.1	58,581.5	68,450.0
- equity capital	24,797.5	37,633.6	39,472.1	50,965.5	60,050.0
- other capital	3,101.8	3,542.5	4,925.0	7,616.0	8,400.0
Portfolio investment	180,431.3	185,138.6	274,344.7	343,968.7	369,425.6
- equity securities	92,222.9	68,675.5	86,464.7	47,337.7	73,309.3
- debt securities	88,208.4	116,463.1	187,880.0	296,631.0	296,116.3
Financial derivatives	6,347.2	15,754.8	31,213.2	24,129.5	38,032.2
Other investment	736,903.7	778,435.7	515,356.2	419,090.0	422,891.5
Long-term	315,625.5	310,133.9	179,639.6	157,598.6	118,694.3
- CNB	329.1	307.3	280.9	468.4	600.0
- commercial banks	75,537.9	79,663.7	67,966.9	66,121.3	58,055.5
- government	220,777.8	210,694.9	97,156.8	79,483.9	48,918.8
- other sectors	18,980.7	19,468.0	14,235.0	11,525.0	11,120.0
Short-term	421,278.2	468,301.8	335,716.6	261,491.4	304,197.2
- CNB	52.9	51.2	376.7	98.8	71.7
- commercial banks	314,115.3	359,638.5	213,815.4	161,150.2	185,146.0
of which: gold and foreign exchange	228,961.7	257,138.6	163,032.9	115,884.8	128,118.7
- government	—	87.1	2,324.5	102.4	9.5
- other sectors	107,110.0	108,525.0	119,200.0	100,140.0	118,970.0
CNB reserves	496,819.2	524,457.8	714,611.7	691,514.9	636,241.5
- gold	4,640.4	4,469.9	4,653.8	4,784.3	4,253.9
- SDR	7.7	31.0	137.1	238.7	118.0
- reserve position in the IMF	116.0	5,478.3	7,081.5	11,949.9	9,137.5
- foreign exchange	491,001.2	514,188.0	686,516.1	674,451.8	622,606.4
- other reserve assets	1,053.9	290.6	16,223.2	90.2	125.7
LIABILITIES	1,640,270.0	1,789,030.7	1,977,177.7	2,064,768.3	2,360,031.1
Direct investment in the Czech Republic	818,411.6	982,335.0	1,165,529.1	1,161,783.6	1,261,710.9
- equity capital	702,217.8	837,537.3	1,013,102.9	1,009,391.8	1,106,150.9
- other capital	116,193.8	144,797.7	152,426.2	152,391.8	155,560.0
Portfolio investment	164,592.0	180,346.2	201,120.0	223,620.4	381,019.4
- equity securities	115,670.6	128,740.1	128,097.7	140,788.6	208,872.1
- debt securities	48,921.4	51,606.1	73,022.3	82,831.8	172,147.3
Financial derivatives	5,307.9	11,495.2	22,671.9	19,448.3	31,811.3
Other investment	651,958.5	614,854.3	587,856.7	659,916.0	685,489.5
Long-term	352,323.4	332,593.2	326,321.3	360,279.2	372,377.2
- CNB	180.4	133.4	114.5	96.1	70.2
- commercial banks	84,607.4	73,688.6	63,541.0	58,056.3	52,020.9
- government	19,699.2	9,476.2	9,475.8	22,456.0	32,065.4
- other sectors	247,836.4	249,295.0	253,190.0	279,670.8	288,220.7
Short-term	299,635.1	282,261.1	261,535.4	299,636.8	313,112.3
- CNB	8.8	68.5	44.2	22.8	866.5
- commercial banks	226,176.2	190,487.6	176,196.2	208,534.0	185,565.8
- government	—	—	—	—	—
- other sectors	73,450.1	91,705.0	85,295.0	91,080.0	126,680.0
NET INVESTMENT POSITION	-191,869.3	-244,067.7	-397,254.8	-527,483.7	-824,990.3

[1] Preliminary data

Table 14

EXTERNAL DEBT

in CZK millions

	2000 31 Dec.	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004 31 Dec.
DEBT IN CONVERTIBLE CURRENCIES	808,122.8	811,258.1	813,305.2	895,139.6	1,013,196.8
of which:					
Long-term	464,323.8	465,687.8	498,833.8	535,995.9	631,667.2
By debtor					
- CNB	180.4	133.4	114.5	96.1	70.2
- commercial banks	95,737.1	88,401.4	80,063.7	73,276.4	64,346.6
- government	29,753.5	30,839.2	47,701.3	69,029.9	147,729.1
- other sectors	338,652.8	346,313.8	370,954.3	393,593.5	419,521.3
By creditor					
- foreign banks	228,709.6	229,305.5	230,589.8	251,535.3	263,931.4
- government institutions	3,405.7	2,373.6	1,747.2	—	—
- multilateral institutions	67,521.2	70,879.0	69,894.7	83,779.6	84,862.4
- suppliers and direct investors	99,560.2	105,944.3	118,829.4	109,287.9	108,720.0
- other investors	65,127.1	57,185.4	77,772.7	91,393.1	174,153.4
Short-term	343,799.0	345,570.3	314,471.4	359,143.7	381,529.6
By debtor					
- CNB	8.8	68.5	44.2	22.8	866.5
- commercial banks	226,246.1	192,438.4	177,474.4	210,017.0	189,036.5
- government	2,115.0	465.0	761.0	710.0	3,334.6
- other sectors	115,429.1	152,598.4	136,191.8	148,393.9	188,292.0
By creditor					
- foreign banks	203,333.8	192,126.4	168,200.7	218,436.1	208,032.3
- multilateral institutions	—	—	—	—	861.3
- suppliers and direct investors	106,988.6	116,278.4	112,256.8	105,563.9	130,000.0
- other investors	33,476.6	37,165.5	34,013.9	35,143.7	42,636.0
DEBT IN NON-CONVERTIBLE CURRENCIES	8,950.9	—	—	—	—
of which:					
- long-term	8,950.9	—	—	—	—
- short-term	—	—	—	—	—
TOTAL EXTERNAL DEBT	817,073.7	811,258.1	813,305.2	895,139.6	1,013,196.8
of which:					
- long-term	473,274.7	465,687.8	498,833.8	535,995.9	631,667.2
- short-term	343,799.0	345,570.3	314,471.4	359,143.7	381,529.6
Total long-term debt	473,274.7	465,687.8	498,833.8	535,995.9	631,667.2
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	245,389.0	203,102.3	207,325.2	222,120.9	275,002.1
- liabilities of entities with majority private capital	227,885.7	262,585.5	291,508.6	313,875.0	356,665.1

[1] Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2001	2002	2003	2004	2005
	1 - 12	1 - 12	1 - 12	1 - 12	1 - 3
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	34.08	30.81	31.84	31.90	30.01
1 USD	38.04	32.74	28.23	25.70	22.90
100 SKK	78.68	72.22	76.75	79.69	78.35
	12	12	12	12	3
- monthly averages					
1 EUR	32.59	31.19	32.31	30.65	29.78
1 USD	36.48	30.65	26.32	22.87	22.59
100 SKK	75.61	74.67	78.57	78.81	77.78
	31 Dec.	31 Dec.	31 Dec.	31 Dec.	31 Mar.
- last day of the month					
1 EUR	31.98	31.60	32.41	30.47	29.95
1 USD	36.26	30.14	25.65	22.37	23.10
100 SKK	74.81	75.18	78.71	78.63	77.44

B. NOMINAL EFFECTIVE RATE	2001	2002	2003	2004	2005
					3
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	104.3	116.5	116.0	116.3	124.1
weights - foreign trade turnover SITC 5-8	104.4	116.1	115.6	115.5	123.3

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	2001	2002	2003	2004	2005
					2
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	104.3	115.2	111.3	114.0	121.5
weights - foreign trade turnover SITC 5-8	104.9	115.9	112.0	115.4	123.5
b) consumer prices					
weights - foreign trade turnover	105.5	116.7	112.9	113.0	119.3
weights - foreign trade turnover SITC 5-8	106.2	117.5	113.7	114.1	121.0

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

Table 16

PUBLIC FINANCES					in CZK billions
	2001 1- 12	2002 1- 12	2003 1- 12	2004 1- 12	2005 1- 3
STATE BUDGET					
TOTAL REVENUE	626.2	705.0	699.7	769.2	206.8
Tax revenue	598.3	627.4	667.5	716.7	176.3
Taxes on income, profits and capital gains	147.4	159.0	172.9	180.7	42.7
Domestic taxes on goods and services	187.0	186.9	198.4	223.2	56.5
- value-added taxes	121.3	118.1	125.6	140.4	29.4
- excises	65.7	68.9	72.9	82.8	27.1
Taxes on property	6.4	7.9	8.8	10.4	2.0
Social and health security contributions and payroll taxes	242.3	258.5	272.4	293.3	73.6
Non-tax and capital incomes and received subsidies	27.9	77.7	32.2	52.5	30.5
TOTAL EXPENDITURE	693.9	750.8	808.7	862.9	198.6
Current expenditure	642.5	697.3	745.4	796.8	192.5
Capital expenditure	51.4	53.5	63.3	66.1	6.1
Public budgets (balance in IMF GFS methodology)	-52.3	-11.8	-130.2	-107.2	—
state budget	-67.7	-45.7	-109.1	-93.7	8.2
local budget	-11.2	-4.3	-2.9	-7.0	—
state financial assets	—	—	—	—	—
state funds	11.2	12.3	7.1	-6.1	—
Land Fund	-0.1	-0.5	-0.7	-0.2	—
National Property Fund	13.2	28.4	-27.0	-4.3	—
health insurance companies	1.4	-1.2	0.1	-0.4	—
others	0.9	-0.8	2.3	4.5	—

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2001	2002	2003	2004	2005
	12	12	12	12	3
BCPP					
PX 50	394.6	460.7	659.1	1,032.0	1,168.4
PX-D	1,065.6	1,166.4	1,642.7	2,551.1	2,816.4
PX-GLOB	492.9	576.8	816.9	1,232.7	1,382.3
RM-SYSTEM					
PK-30	593.0	672.5	947.5	1,443.5	1,680.7

in CZK millions

B. TRADE VOLUMES	2001	2002	2003	2004	2005
	12	12	12	12	3
BCPP					
Monthly trade volumes	142,803.6	109,264.8	98,640.0	90,610.5	186,043.1
of which:					
a) shares	12,819.3	17,089.3	28,296.0	46,210.3	122,712.9
b) units	4.3	0.0	0.0	0.0	0.0
c) bonds	129,980.0	92,175.5	70,344.0	44,400.2	63,330.2
RM-SYSTEM					
Monthly trade volumes	2,162.5	4,412.1	1,103.0	335.8	446.6
of which:					
a) shares	1,841.0	298.4	1,082.5	332.7	419.1
b) units	212.2	1.0	3.7	3.1	4.7
c) bonds	109.3	4,112.7	16.8	0.0	22.8

Table 18

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	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
2005					
28 January	2.25	1.25	3.25	—	—

Table 19

MACROECONOMIC AGGREGATES					in CZK millions; annual percentage changes; constant 1995 prices
	2000 Q1-4	2001 Q1-4	2002 Q1-4	2003 Q1-4	2004 Q1-4
GROSS DOMESTIC PRODUCT					
- in CZK millions	1,576,298	1,617,894	1,641,996	1,703,024	1,771,973
- percentages	3.9	2.6	1.5	3.7	4.0
FINAL CONSUMPTION					
- in CZK millions	1,180,391	1,215,582	1,255,918	1,314,720	1,323,285
- percentages	2.1	3.0	3.3	4.7	0.7
of which:					
Households					
- in CZK millions	828,009	851,305	874,649	917,619	939,419
- percentages	2.9	2.8	2.7	4.9	2.4
Government					
- in CZK millions	342,498	355,593	371,673	387,305	374,851
- percentages	0.2	3.8	4.5	4.2	-3.2
Non-profit institutions					
- in CZK millions	10,026	8,793	9,506	9,834	10,924
- percentages	-0.2	-12.3	8.1	3.5	11.1
GROSS CAPITAL FORMATION					
- in CZK millions	502,489	534,349	552,819	568,314	619,680
- percentages	9.2	6.3	3.5	2.8	9.0
of which:					
Fixed capital					
- in CZK millions	481,636	507,629	524,964	550,391	600,320
- percentages	4.9	5.4	3.4	4.8	9.1
Changes in inventories					
- in CZK millions	20,688	26,627	27,731	17,824	19,257
Acquisitions less disposals of valuables					
- in CZK millions	165	93	124	99	103
- percentages	143.5	-43.8	33.0	-19.6	3.8
FOREIGN TRADE					
of which:					
Exports of goods					
- in CZK millions	969,070	1,109,034	1,175,324	1,290,442	1,577,743
- percentages	19.6	14.4	6.0	9.8	22.3
Exports of services					
- in CZK millions	195,044	192,798	162,181	152,396	171,247
- percentages	4.8	-1.2	-15.9	-6.0	12.4
Imports of goods					
- in CZK millions	1,085,433	1,244,593	1,302,315	1,418,104	1,682,641
- percentages	20.0	14.7	4.6	8.9	18.7
Imports of services					
- in CZK millions	194,949	201,328	214,620	218,726	257,180
- percentages	-1.6	3.3	6.6	1.9	17.6
FINAL DOMESTIC DEMAND					
- in CZK millions	1,662,027	1,723,211	1,780,882	1,865,111	1,923,605
- percentages	2.9	3.7	3.3	4.7	3.1
AGGREGATE DOMESTIC DEMAND					
- in CZK millions	1,682,880	1,749,931	1,808,737	1,883,034	1,942,965
- percentages	4.1	4.0	3.4	4.1	3.2
GROSS DOMESTIC PRODUCT AT CURRENT PRICES					
- in CZK millions	2,150,058	2,315,255	2,414,669	2,550,754	2,751,075
- percentages	5.3	7.7	4.3	5.6	7.9

Source: CZSO

Table 20

LABOUR MARKET

annual percentage changes

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	2000 Q1-4	2001 Q1-4	2002 Q1-4	2003 Q1-4	2004 Q1-4
Current income	5.0	5.7	6.4	4.8	4.9
of which:					
- gross operating surplus and mixed income	7.2	8.3	2.4	4.6	4.9
- compensation of employees	3.8	6.8	8.5	5.8	5.5
- property income	-11.5	0.8	-0.9	-7.9	10.8
- social benefits other than social transfers in kind	9.6	4.6	8.0	3.5	3.9
- other current transfers	13.7	-9.0	4.1	9.9	-3.4
Current expenditure	7.2	6.6	8.4	7.8	6.5
of which:					
- property income	-5.7	1.7	15.1	6.0	12.6
- current taxes on income, wealth, etc.	7.1	5.9	8.2	10.2	6.0
- social contributions	8.2	6.8	8.9	6.6	8.0
- other current transfers	6.9	8.5	4.7	10.8	-1.1
Gross disposable income	4.1	5.3	5.6	3.4	4.2
Change in net equity of households in pension funds reserves	24.6	23.9	22.6	16.1	15.6
Individual consumption expenditure	6.0	6.4	3.5	5.1	5.2
Gross saving	-11.7	-4.7	31.8	-11.2	-4.6
Gross savings rate	8.77	7.93	9.90	8.51	7.79
(gross saving/gross disposable income - ratio in per cent)					

annual percentage changes

B. AVERAGE WAGES	2000 Q1-4	2001 Q1-4	2002 Q1-4	2003 Q1-4	2004 Q1-4
Whole-economy nominal wage	5.9	8.1	7.0	6.4	6.2
Business sector	6.9	7.7	6.3	5.5	6.3
Non-business sector	2.6	9.6	9.8	9.8	5.7
Whole-economy real wage	1.9	3.2	5.1	6.3	3.3
Business sector	2.9	2.9	4.4	5.4	3.4
Non-business sector	-1.3	4.7	7.9	9.7	2.8

Note: including data for the Ministry of Defence and the Ministry of the Interior and an estimate for intelligence services not included in the survey.

end of period

C. UNEMPLOYMENT	2000 12	2001 12	2002 12	2003 12	2004 12
Registered job applicants (thousands)	457.4	461.9	514.4	542.4	541.7
Unemployment rate (percentages)	8.8	8.9	9.8	10.3	10.3

Source: CZSO

Table 21

PRODUCER PRICES

percentage changes

	2001	2002	2003	2004	2005 3
INDUSTRIAL PRODUCER PRICES					
a) previous month = 100	0.1	-0.1	0.1	0.6	0.2
b) same period of last year = 100	2.9	-0.5	-0.3	5.7	6.4
c) average for 2000 = 100	2.8	2.3	1.9	7.7	11.4
d) December 1999 = 100	6.3	5.8	5.4	11.4	15.2
CONSTRUCTION WORK PRICES					
a) previous month = 100	0.3	0.2	0.2	0.4	0.2
b) same period of last year = 100	4.1	2.7	2.2	3.7	4.1
c) average for 2000 = 100	4.1	6.9	9.2	13.3	15.9
d) December 1999 = 100	6.5	9.3	11.7	15.8	18.6
AGRICULTURAL PRODUCER PRICES					
b) same period of last year = 100	8.4	-9.5	-2.9	8.1	-15.3
of which:					
crop products					
b) same period of last year = 100	9.3	-4.6	-1.0	11.6	-43.8
livestock products					
b) same period of last year = 100	8.0	-12.1	-4.0	6.1	7.9
MARKET SERVICES PRICES (excluding interest rates)					
a) previous month = 100	0.1	0.3	0.0	0.2	0.9
b) same period of last year = 100	3.9	3.2	1.6	2.3	1.2
c) average for 2000 = 100	4.0	7.3	9.0	11.5	13.2
d) December 1999 = 100	4.6	8.0	9.7	12.2	13.9

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP

percentage ratios

	2000	2001	2002	2003	2004
State budget balance	-2.1	-2.9	-1.9	-4.3	-3.4
Public budgets balance	-2.9	-2.3	-0.5	-5.1	-3.9
Public debt	16.1	18.0	19.0	22.3	24.5
Debt in convertible currencies	37.6	35.0	33.7	35.1	36.8
Trade balance [1]	-5.6	-5.0	-3.0	-2.7	-0.8
Current account balance	-4.9	-5.4	-5.6	-6.3	-5.2
M2	65.7	68.9	68.4	69.2	67.0

Note: ratio = indicator/GDP at current prices

[1] Source: CZSO

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